External Audit Report 2015/16

London Borough of Lambeth

26 September 2016

Contents

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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. Public Sector Audit Appointments 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 Neil Thomas, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (on 0207 694 8981, or by email to andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Section one

Introduction

This document summarises:

- **The key issues identified during our audit of the financial statements for the year ended 31 March 2016 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 London Borough of Lambeth ('the Authority') in relation to the Authority's 2015/16 financial statements and those of the Local Government Pension Scheme it administers ('the Fund'); and
- The work to support our 2015/16 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 2015/16*, presented to you in March 2016, set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July and August 2016.

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 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 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 2015/16 financial statements of the Authority and the Fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

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

Headlines

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.

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Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007. 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 2016.
Adjustments	There were a total of three adjustments impacting the primary statements. The impact of these adjustments is to: — Decrease in total reserves and net assets of the Authority of £4.3 million; — Decrease in the surplus on provision of services for the year by £4.0 million; — We have included a full list of significant audit adjustments in Appendix two. All of these were adjusted by the Authority We have raised a number of recommendations in relation to the matters highlighted above, which are summarised in Appendix one. The key recommendation relates to review and follow up of cash reconciliations, as we identified a £10.7m audit misstatement which could have been avoided through more effective oversight of reconciliations.
Key financial statements audit risks	We identified the following key financial statements audit risks in our 15/16 External audit plan issued in March 2016. — Land and building valuations — Pension Fund liability — Minimum Revenue provision We have worked with officers throughout the year to discuss these key risks and our detail findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas.
Accounts production and audit process	We received complete draft accounts in accordance with the DCLG deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. The Authority has good processes in place for the production of the accounts and good quality supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. We will debrief with the Closedown team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particular we would like to thank Authority Officers who were available throughout the audit visit to answer our queries.

Headlines (cont.)

VFM conclusion and risk areas	We identified the following VFM risks in our External audit plan 2015/16 issued in March 2016. — Securing financial resilience: We considered whether the Authority has robust financial systems and processes in place to manage its financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future. We carried out our work in discussion and agreement with officers. — Securing economy, efficiency and effectiveness: We considered the Authority is prioritising its resources in the light of continued financial constraints, considering the views of external assessors and the views of internal audit. We also completed specific follow up testing on the external assessor reports. We have worked with officers throughout the year to discuss these VFM risks and our detailed findings are reported in section 4 of this report. The VFM conclusion for 2014/15 was qualified, and this was finalised in September 2016. While progress has been made regarding the VFM risks, more progress is required throughout 2016/17 before we can conclude with an unqualified VFM conclusion. Therefore for 2015/16, we have concluded that the Authority has not made proper arrangements to secure economy, efficiency and effectiveness in its use of resources, although we note that progress has been made. We therefore anticipate issuing a qualified VFM conclusion by 30 September 2016.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Final review of the financial statements; — WGA completion; and — Subsequent events. 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 Section 151 Officer on 23 September 2016. We draw your 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 confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements. We will not be certifying our audit as complete as result of the objections we have received to the accounts, these are discussed in section 3.

Proposed opinion and audit differences

Our audit has identified a total of 3 audit adjustments above AMPT.

The impact of these adjustments is to:

- **Decrease the surplus on the provision of services for the year by £4 million; and**
- **Decrease the net worth of the Authority as at 31 March 2016 by £4.3m**

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Corporate Committee on 29th September 2016.

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 three for more information on materiality) level for this year's audit was set at £15million for the Council. Audit differences below £750,000 for the Council are not considered significant.

Our audit identified a total of 3 significant audit differences for the Council, which we set out in Appendix two. These have been corrected. There only remains one adjusted amount which is not material.

All other non material and presentational recommendations for the Council have been adjusted.

The tables on the right illustrate the total impact of audit differences on the surplus for the year and balance sheet as at 31 March 2016.

The net impact on the net worth of the Council as a result of audit adjustments is to decrease the balance as at 31 March 2016 by £4.3million.

Movements on the general fund 2015/16 (£000)

£m	Pre-audit	Post-audit	*See app 2*
(Surplus) on the provision of services	(105,431)	(101,395)	*[4,036]*

Balance sheet as at 31 March 2016 (£000)

£m	Pre-audit	Post-audit	*Ref (App.2)*
Property, plant and equipment	3,596,362	3,591,711	*(4,651)*
Current assets	430,992	420,847	*(10,145)*
Current liabilities	(237,343)	(223,835)	*13,508*
Long term liabilities	(1,134,675)	(1,137,662)	*(2,987)*
Net worth	**2,664,208**	**2,659,942**	***(4,266)***
Other usable reserves	(282,799)	(282,799)	*0*
Unusable reserves	(2,381,410)	(2,377,143)	*(4,267)*
Total reserves	**(2,664,208)**	**(2,659,942)**	***(4,266)***

Proposed opinion and audit differences (cont.)

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 2016.

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

Pension fund audit

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

For the audit of the Fund we used a materiality level of £20.5 million. Audit differences below £1m are not considered significant.

Subject to all matters being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Corporate Committee on 29th September 2016.

We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code. The Fund has addressed these.

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.

Annual report

We have reviewed the Authority's annual report and can confirm it is not inconsistent with the financial information contained in the audited financial statements.

Pension fund annual report

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

— It complies with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008; and

— 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.

We will need to complete additional work in respect of subsequent events to cover the period between signing our opinions on the Statement of Accounts and the *Pension Fund Annual Report.*

Significant audit risks

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 2015/16, presented to you in March 2016, we identified the significant risks affecting the Authority's 2015/16 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.

Land and buildings valuations - Authority

Risk: in 2014/15 the Authority reported Property, Plant and Equipment of £3.1bn related to land and buildings, including Council dwellings. Local authorities exercise judgement in determining the fair value of the assets held and the methods used to ensure the carrying values recorded each year reflect those fair values. Given the material nature of the balance and judgement involved in determining the carrying amounts of assets we consider this to be an area of significant audit risk for 2015/16. The total net book value for 2015/16 is £3.6bn.

The authority engaged external valuers. Wilks Head & Eve valued Other Land and Buildings and Council dwellings, and the District Valuer valued schools.

We assessed the expertise of the valuers, considering their professional experience, qualifications and independence. We did not identify any issues from this review and determined that the valuers are appropriate to undertake the valuation;

- We reviewed the instructions provided by the Authority to the valuers to confirm they were complete and accurate. We also checked whether the instructions were in line with the Code. This review did not identify any issues and we are satisfied that the instructions provided to the valuers were appropriate.
- We reconciled the fixed asset register, to the valuation and to the financial statements, to ensure the completeness of the valuation undertaken by the valuers. We are satisfied the valuer was provided a complete list in line with the Authority's revaluation methodology and that the complete valuation was reflected in the financial statements.
- We reviewed the valuation provided by the Authority's valuers and assessed whether it was reflected accurately in the Fixed Asset Register and financial statements. We also ensured we were satisfied that the valuation was in line with the Authority's accounting policy and that appropriate coverage was provided over the Authority's estate. This testing did not identify any issues.
- We reviewed the revaluation basis and considered its appropriateness, drawing on national benchmarks. We also engaged our property team experts to undertake an assessment of the revaluation. This testing did not identify any issues.
- We reviewed the floor plans and GIA information that was sent to the valuers to ensure they were accurate. This testing did not identify any issues.
- We considered the basis upon which impairments to land and buildings were calculated and considered the underlying assumptions supporting these assessments. This testing did not identify any issues.

Significant audit risks (cont.)

Pension fund liability – Authority

Risk: In 2014/15 the Authority reported a pension liability of £767 million. The liability is calculated by the Authority's external actuary using figures provided by the Authority. Given the material value and the inherent judgement involved in determining the liabilities we consider this to be an area of significant audit risk. In 2015/16 the pension liability is £699 million.

The authority engaged the actuary firms Hymans Robertson for the Lambeth Pension fund and Barnett Waddington for the London Pension Fund Authority.

- We assessed the expertise of the actuaries, considering their professional experience, qualifications and independence. We did not identify any issues from this review;
- We reviewed the source data provided by the Authority to the actuaries to confirm it was complete and accurate. This review did not identify any issues and we are satisfied that the instructions provided to the actuaries were appropriate.
- We reviewed the actuarial assumptions provided by the actuaries using KPMG internal expertise in addition to external reports on IAS 19 approach to assumptions. We found the assumptions to be reasonable.
- We reviewed the judgements and valuation of the scheme liabilities to ensure that all disclosures are within expectations and incorporate redundancies and transfers. We also tested contributions. Our testing did not identify issues in the current year. We recommended the amendment of a prior year adjustment relating to the transfer of Lambeth Living.

Minimum revenue provision - Authority

Risk: The Council has identified what they believe is an error in their calculation of MRP relating to previous years. The 2015/16 charge for non-PFI General Fund is £2m and for PFI General Fund is £1.9m.

The authority engaged Capita to review and quantify the error.

- We assessed the expertise of Capita, considering their professional experience, qualifications and independence. We did not identify any issues from this review.
- We reviewed the calculations for MRP for the current year and forecast for future years and the approach to prior period adjustments (none made) to ensure they were in line with the Capita recommendations and statutory guidance. No issues were identified.
- We consulted our technical team to assess the final MRP approach and we concluded that the approach is reasonable. We recommended that the Authority obtain legal advice for their approach in line with the approach from other Authorities.

Significant audit risks

In our *External Audit Plan 2015/16* 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.

Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our External Audit Plan 2015/16 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.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because 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.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

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.

There are no matters arising from this work that we need to bring to your attention.

Opening balances

Per ISA 510, as we were conducting an initial audit engagement we performed additional audit procedures including a review of the predecessor audit file, ISA 260 report, the accounting policies and specific audit procedures to obtain evidence about the opening balances. This was required to obtain sufficient appropriate audit evidence about whether:

- opening balances contain misstatements that materially affect the current period's financial statements, and
- appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

No issues were noted.

Other areas of focus

In our External Audit Plan 2015/16, presented to you in March 2016, we identified additional 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.

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

Payroll

Focus: The Authority's employee costs are £299m million a year, including those for schools.

We tested controls in the system to ensure that amounts paid out are materially correct and complete.

We performed analytical review procedures to gain assurance over the total amount paid in the year.

We agreed staff costs to payslips.

We also reviewed pay related disclosures such as Exit Packages and Members Allowances.

Our testing did not identify any issues for Payroll but we did identify errors with the Exit Packages disclosure note.

Non pay expenditure

Focus: The Authority spends £834 million of expenditure in the cost of services on non pay each year.

We reviewed processes in place and completed data analytics to provide assurance that the amounts paid out are reasonable and have followed the Authority's procedures.

We tested a sample of transactions to underlying support. We did not identify any material issues.

Business rates

Focus: The Authority collects £122 million a year.

We reviewed and tested the processes in place, including over the appeals provision, to ensure the estimate is reasonable.

We performed analytical procedures to gain assurance of the total amount collected. Lambeth self identified a variation in the NNDR provision for appeals. In addition to this adjustment, we did not identify any material issues.

Housing Revenue Account and Housing Benefit

Focus: The Housing benefit subsidy and the HRA repairs and maintenance expenditure.

We reviewed and tested the processes in place and did not identify any material issues. We will undertake further testing on the Housing Benefit subsidy as part of our Grant testing later in the year.

Significant audit risks - pension fund

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus for the pension fund, details of these are recorded here.

In our *External Audit Plan 2015/16*, presented to you in March 2016, we identified the significant risks affecting the Authority's Pension Fund's 2015/16 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 Pension Fund.

Pension investments and liabilities – Pension fund

Risk: The Pension Fund held over £1.1bn of investments at 31 March 2015. Investment liabilities in March 2015 were £13m. Given the materiality and judgement involved investment and related liabilities are an area of audit focus. At 31 March 2016 investment assets had increased to £1.13bn and investment liabilities had increased to £16m.

We reviewed and tested investment values through obtaining confirmations from the Fund Managers and Custodians as well as reviewing the ISAE 3402 reports. No issues were identified. We tested the journal entries to ensure all entries were accurately recorded. We reviewed and tested the investment liability process and entries to ensure they were accurately recorded.

Contributions receivable and investment income – Pension Fund

Risk: Contributions received in at March 2015 was £55m and investment income was £32m. In March 2016 these balance remained relatively consistent at £55m and £32m. Given the materiality and the complexity of the calculations of contributions these are an area of audit focus. We reviewed the contributions process and tested the contributions and investment income to ensure accuracy. We performed analytical review for assurance over the total contributions received in year. We performed detailed testing to supporting documentation

Cash deposits – Pension Fund

Risk Cash deposits were £25m at 31 March 2015. Due to materiality this area is an audit focus. In March 2016 cash deposits were £13m. We reviewed year end bank reconciliations. We reviewed bank confirmations and bank statements. We also reviewed the cash included in the Fund Manager statements.

Benefits payable – Pension Fund

Risk: Benefits payable in March 2015 were £48m. Given the complexities surrounding the calculation of both benefits in retirement and ill health this is a key area of focus. In March 2016 the benefits were £51m. We reviewed the processes to ensure that benefits are calculated correctly. We performed analytical review procedures to gain assurance of the total benefits paid. We performed detailed testing on a sample of benefits paid during the year through agreeing to supporting documentation.

Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:

Assessment of subjective areas			
Asset/liability class	**15/16**	**Balance (£m)**	**KPMG comment**
Provisions	3	£25 million *(PY: £18 million)*	We consider the level of judgment over the provisions balance to be balanced. The balance has remained materiality consistent year on year.
Grants receipts in advance - capital	3	£37 million *(PY: £41 million)*	We consider the related disclosures to be proportionate. The main accruals are consistent with the prior year and in line with our expectations.
Creditors	3	£261 million *(PY: £273 million)*	We have considered deferred income and accruals. We consider the approach appropriate..
Business rate appeals provisions	3	£8.4 million *(PY: £6.5 million)*	We consider the approach appropriate. As the next business rates revaluation will come into affect on 1 April 2017 this may lead to an increase in appeals in the future.
Property, Plant and Equipment (valuations / asset lives)	3	£3.6 billion *(PY: £3.1 billion)*	This is split across the different asset classes including Council Dwellings. This year the Schools were valued by the District Valuer and the remaining valuations of other asset classes and Council Dwellings were undertaken by Wilks Head & Eve. We consider the disclosure to be proportionate.
Pensions liabilities	3	£599 million *(PY: £767million)*	We reviewed these disclosures and consider them to be appropriate.

Accounts production and audit process

Officers dealt efficiently with audit queries and the audit process could be 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	The Authority has worked to strengthen its financial reporting process. There is scope to improve this further and we have set out our recommendations in Appendix one. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June 2016.
Quality of supporting working papers	Our *Accounts Audit Protocol*, set out our working paper requirements for the audit. The quality of working papers provided met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced delays, specifically where the staff who prepared the working papers were not available during the audit.
Pension Fund Audit	The audit of the Fund was completed alongside the main audit. There are no specific matters to bring to your attention relating to this.

Completion

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.

We have received objections to the accounts which means we will not be able to certify our audit as complete until these objections have been resolved.

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 Lambeth Council and Lambeth Pension Fund for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Lambeth Council and Lambeth 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 four 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 Head of Finance for presentation to the Council. 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 are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

Objections to the accounts

We have received objections from six electors in relation to the 2015/16 statement of accounts. These relate to 15 different aspects of the financial statement and record matters which may require further review. The nature of these objections can be summarised as relating to:

— The nature and management of contracts which have been entered into by the Authority during the year;

— The payments which have been made to contractors by the Authority during the year; and

— The valuation of assets within the financial statements.

We have considered whether any of these objections prevent us from issuing our financial statements audit opinion or our value for money conclusion and do not believe that, as presented or raised, they prevent us finalising those two aspects of our work. We will need to complete further work before we can issue our audit certificate.

VFM Conclusion

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

While we note that progress has been made since the 2014/15 audit, we have concluded that the Authority has not made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Background

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

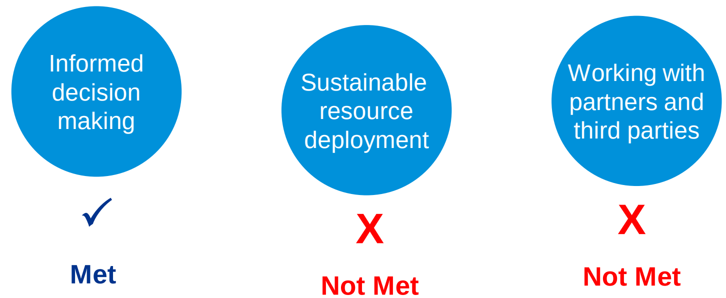
These sub-criteria provide a focus to our VFM work at the Authority.

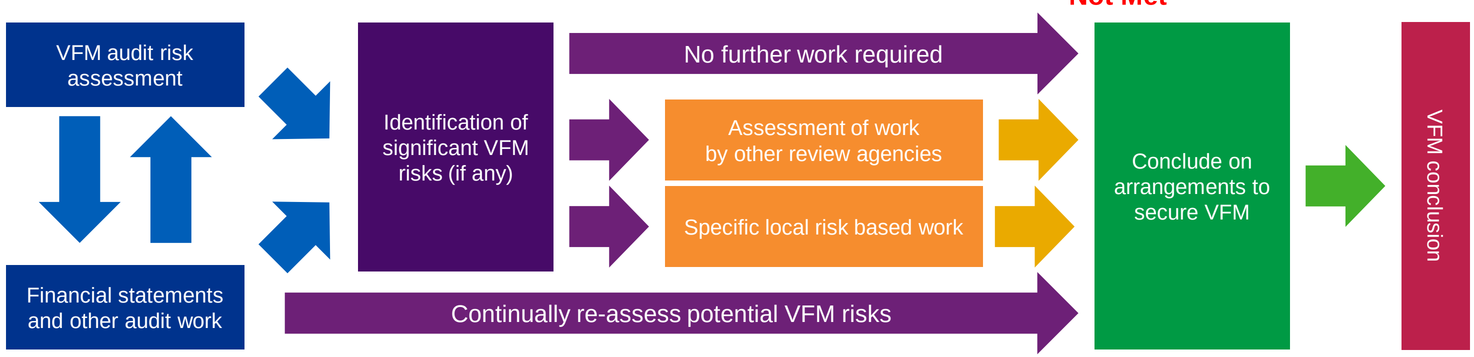
Conclusion

We have concluded that the Authority has not made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Overall criterion

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.





Specific VFM Risks

We have identified a number of specific VFM risks.

Risk 1: Decision making is robust and informed and good progress has been made on governance.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* we have:

- Assessed the Authority's key business risks which are relevant to our VFM conclusion;
- Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- Considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas.

Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion. We concluded that we did not need to carry out additional work for these risks as there was sufficient relevant work that had completed by the Authority, inspectorates and review agencies in relation to these risk areas.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Risk 1	**Arrangements in place to secure financial resilience** This is relevant to the informed decision making sub-criteria of the VFM conclusion.	In 2014/15 weaknesses in internal controls and non compliance with policies were highlighted which could have an impact on financial resilience. To assess if the authority has robust systems and processes in place to effectively manage financial risks and opportunities and to secure a stable financial position, we reviewed the Financial Management Strategy and budget reports up until 2019, in addition to relevant Council minutes. The Council has previous had reservations expressed around its control environment thought it's Head of Internal Audit Opinion. Similar reservation this year indicate the there are areas within the Authority where further work is required to deliver the desired level of control. We conclude that the decision making is robust and informed and supported by financial reporting processes. However, more work needs to be undertaken to implement the proposed changes and to deliver the savings.

Specific VFM Risks (cont.)

We have identified a number of specific VFM risks.

Risk 2: we cannot conclude that the authority has secured economy, efficiency and effectiveness.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Risk 2	**Securing economy, efficiency and effectiveness.** We considered the Authority is prioritising its resources in the light of continued financial constraints, considering the views of external assessors and the views of internal audit. We also completed specific follow up testing on the external assessor reports. This is relevant to the sustainable resource deployment, working with partners and third parties sub-criteria of the VFM conclusion.	In 2014/15 the Authority received inspection reports from both Ofsted (for Children's Services) and the HMI Probation which included adverse findings relating to Youth Offending Work. Following another inspection of Children's Services in July 2016, Ofsted has concluded that although improvement has been made, not all improvement measures are in place and it is too soon to conclude that all recommendations have been addressed effectively. We note that additional senior management capacity since May 2016 has enabled senior management to make improvements to their processes and systems. Ofsted inspected Adult Services in October 2015 and the outcome across all areas was "good". There has not yet been another inspection by HMI Probation so it is too early to conclude that all recommendations have yet been addressed. We note that a quality assurance framework has been set up to address the recommendations and that a recruitment campaign has taken place to reduce dependency on agency staff. Progress is being monitored quarterly.. The Council's own review of the effectiveness of its governance and internal control arrangements has improved following review of the internal audit reports and the Annual Governance Statement. However, the Head of Internal audit has confirmed that significant weaknesses remain in governance, risk management and systems of internal control. We therefore acknowledge that progress has been made to address these adverse findings, and weaknesses in the control environment. However, all recommendations and weaknesses have not yet been fully addressed and therefore we will be continuing to monitor progress over 2016/17.

KPMG

Appendices

Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We have had initial discussions regarding these recommendations and they are agreed in principle. The specific management responses will be agreed over the next 2-3 weeks.

We will formally follow up these recommendations next year.

All our recommendation have been accepted in principal and management responses will be provided in due course, we will therefore update this section of our report to present these alongside our annual audit letter to the Authority.

Priority rating for recommendations					
1	***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.	2	***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.	3	***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.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	1	**Cash reconciliations** We identified that while reconciliations were being performed, the unreconciled differences had not been cleared or followed up. This resulted in the identification of a £10.7 million unreconciled difference. **Recommendation** Ensure that all bank accounts are reconciled, the unreconciled difference is cleared on a timely basis and there is oversight and follow up of any issues.	
2	1	**AIM System** The AIM system automatically posts cash payments or receipts (from the cash book) to the general ledger, and operates alongside the cash management system (Oracle reconciliation tool). We noted a failure of this automated process in the year which has resulted in a £10.7m unreconciled balance. **Recommendation** We recommend management investigate the root cause of this system failure and take necessary steps to resolve as a matter of urgency.	

Key issues and recommendations

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
3	3	**High level review of changes** We identified some areas where changes were made or developments were taking place and these updates were not included in the first draft of the accounts. This relates to updates in capital commitments, sale of fixed assets, leases and short and long term liabilities,. **Recommendation** We recommend that high risk areas where changes or updates are taking place are highlighted and re-reviewed prior to finalising the accounts.	
4	3	**Exit packages** There was an error in the exit packages note as a result of the duplication of information from payroll and finance. This resulted in an overstatement within the note. **Recommendation** We recommend that the final figures are reviewed by both Finance as well as Payroll to ensure any errors are identified.	
5	3	**Floor Plans** We were unable to easily obtain floor measurements from the asset management teams. **Recommendation** We recommend that these measurements are recorded and maintained by a central asset management team to ensure there is a reliable record for valuations.	

Key issues and recommendations

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
6	3	**Regular review of fixed asset register** We identified through our testing 68 assets which had not been revalued since 2008. Of which that one asset had not been removed from the Register despite being at nil value and no longer owned by the Council. In addition, an adjustment of £4.6m was made for council properties which should have been removed due to transfer of economic benefits agreed in 2012,. **Recommendation** We recommend the Fixed Asset Register is reviewed regularly to ensure transfers and disposals are correctly recorded and to ensure all assets are revalued which should be.	
7	3	**Regular review of aged creditors** We reviewed the aged creditors, and while there were no issues identified, we noted that an aged creditors report is not regularly produced or reviewed **Recommendation** We recommend that an aged creditors report is regularly produced and reviewed to ensure that all aged creditors are monitored and cleared in a timely manner.	

PY issues and recommendations

No.	Risk	Issue and recommendation	Update at September 2016
1	1	**PY - Property valuations** The Council has recorded a revaluation loss of £60m on its holding of schools. This was not consistent with the movement in general market and build cost data. Officers had not determined and challenged the reasons for this loss. The rolling valuation programme is currently organised around a previous directorate structure. The re-allocation of assets in future periods to match asset profile to new organisational structure could lead to a risk that some material assets could be overlooked for five yearly revaluation.. **Recommendation** Whilst the valuation of properties is carried out by an external valuer, the Council should review, understand and challenge the outcome of their work before incorporating the results into the financial statements. Re-design the rolling programme so that not dependent on organisational structures.	
2	2	**Review of journals** Our test of journals identified a number of journals which were correcting errors in past journals. The position was the same last year. **Recommendation** Consider the design and effectiveness of arrangements for the review and approval of journals.	

PY issues and recommendations

No.	Risk	Issue and recommendation	Update at September 2016
3	2	**Management of sundry debtor arrears** The Council has significant arrears of sundry debtors. For some of the sample selections, officers found it difficult to locate evidence to support the original debt or comment on the status of recovery action. **Recommendation** Evaluate processes around the management of sundry debtors including: - Administrative arrangements for filing and retention of support for invoices and credit notes raised; - Identification and processing of write-offs on a timely basis; and - Management of recovery action.	
4	2	**Reconciliation of control accounts** We identified one instance where payroll processed and paid by the Council on behalf of an academy school for July 2014, had not been invoiced by the date of our audit visit. As a result, a debit balance of £0.6m was carried forward on a control account at year end. We also identified instances where we were not able to readily explain how the balance on a certain bank control accounts reconciled to the banks records. **Recommendation** Review and enhance arrangements which ensure all balance sheet control accounts are reconciled on a monthly basis and any actions identified by the reconciliation process are closed on a timely basis.	

Audit differences

This appendix sets out the significant audit differences identified during the audit for the year ended 31 March 2016.

We are reporting all audit differences over £750,000.

All of these have been adjusted.

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 Corporate 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.

Corrected audit differences – the Council (none for the Pension Fund)

The following table sets out the corrected material audit differences identified by our audit of Lambeth Council's financial statements for the year ended 31 March 2016.

Impact (£000)						
No.	**Income and expenditure statement**	**Movement in reserves statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1	Dr re measurement of net defined benefit liability £16,119	Cr Total unusable reserves £16,119				A prior year adjustment was made for the transfer of the Lambeth Living pension fund liability. This was deemed technically incorrect and was therefore reversed. This amount should not have been restated in prior year since it relates to a transfer in 2015/16.
	£16,119	**£16,119**	**-**	**-**	**-**	**Total impact of corrected material adjustments since draft 1.**

Audit differences (cont.)

This appendix sets out the audit differences.

The financial statements have been amended for all of the errors identified through the audit process.

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

There is only one uncorrected audit difference which relates to the Council. This relates to the £557k remaining reconciling difference on the General account. The Council has reconciled and adjusted for the £10.1m reconciling difference, which only leaves this immaterial balance. The Council are continuing to investigate this remaining difference in 2016/17.

Corrected audit differences

We have highlighted the misstatements impacting the primary statements on the previous slide.

The remainder of the corrected misstatements are summarised below:

- A misstatement relating to an unreconciled difference on the General Account of £10.7m, of which £10.1m has been reconciled and now adjusted by reducing cash and short term creditors. £557k remaining uncorrected.
- A misstatement resulting in a reduction in PPE (£4,650k) due to remove an asset where the economic benefit has been transferred, although the legal status timing differed. We note the NBV results in loss on disposal (£4,036k).
- The overstatement of the Exit Packages note by £2,774,652 due to duplication of information;
- Four instances of incorrect figures in the Officers Remuneration note (material by nature rather than amount);
- An overstatement of £1.5m in the Capital Commitments note due to an update which had not been included;
- An understatement of £9.6m due to renewed leases which had been thought to be expired and an overstatement in leases of £18.6m due to International House not being removed following the purchase.

Our audit identified a small number of presentational misstatements in the notes to the financial statements. These have been discussed with management and the financial statements have been amended for all of them.

A number of minor amendments focused on presentational errors or improvements for both the Council and the Pension Fund. These have all been amended. The Finance Department are committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Materiality and reporting of audit differences

For 2015/16 our materiality is £15 million for the Authority's accounts. For the Pension Fund it is £20.5 million.

We have reported all audit differences over £750K for the Authority's accounts and £1 million for the Pension Fund, to the Corporate Committee.

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.

Materiality for the Authority's accounts was set at £15 million which equates to around 1.32 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Corporate 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 Corporate 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 £750,000 for the Authority.

Where management has corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Corporate 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 £20.5 million which is approximately 1.8 percent of gross assets.

We design our procedures to detect errors at a lower level of precision, set at £1 million for 2015/16.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice.

Requirements

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

"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."

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 A*udit 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 Corporate 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.

Declaration of independence and objectivity (cont.)

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.

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.

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 Lambeth Council and Lambeth Pension Fund for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and Lambeth Council and Lambeth 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.

Audit Fees

Our fee for the audit was £207,841 plus VAT in 2015/16. This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in March 2016. Our fee for certification grant claims and returns is £ 35,376 plus VAT in 2015/16).

We have not completed any other non-audit work for the Authority during 2015/16.

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The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG LLP is multi-disciplinary practice authorised and regulated by the Solicitors Regulation Authority. For full details of our professional regulation please refer to ‘Regulatory Information’ at www.kpmg.com/uk