



External Audit Report 2015/16

London Borough of Tower Hamlets

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DRAFT – 15 September 2017



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

We note that some work is still ongoing and accordingly this draft report will be updated to produce a final version at the point the financial statements are signed.

Scope of this report

This report summarises the key findings arising from:

- Our audit work at the London Borough of Tower Hamlets ('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 June 2016, 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 August and September 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;

- Considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas;
- Continuing our consideration of the Authority's actions to address issues raised by the 'Best Value Inspection of London Borough of Tower Hamlets' report (the BV Inspection report) produced by PricewaterhouseCoopers LLP (PwC);
- consideration of other matters brought to our attention by the Tower Hamlets Commissioners; and the Department for Communities and Local Government (DCLG); and
- following up on relevant issues included in our *ISA 260 Report 2014/15* presented to the Audit Committee in March 2016.

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.

Acknowledgements

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



Section two: Headlines



In relation to the Authority's and Fund's financial statements we anticipate issuing an unqualified audit opinion subject to the satisfactory resolution of our outstanding work.

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

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| Proposed audit opinion | <p>Our work is complete subject to the receipt of management representations and completion procedures being concluded satisfactorily. We anticipate issuing an unqualified audit opinion on the Authority's financial statements. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.</p> <p>We will issue an unqualified audit opinion in relation to the Fund's financial statements, as contained in the Authority's Statement of Accounts. We issued an unqualified audit opinion in relation to the Pension Fund's financial statements, as contained in the Pension Fund Annual Report on 30 November 2015.</p> <p>We note that we issued our opinion on the 2014/15 financial statements on 12 October 2016. This was done following the receipt of advice that we did not need to determine the objection relating to the Authority's Lender Option Borrower Option loans which raises questions about whether the loans were taken out lawfully and the objector is asking that we apply to court that the LOBO loan borrowing is unlawful. Our consideration of the objection is not yet complete (see certificate section).</p> |
| Audit adjustments | <p>We are pleased to report that our audit of the financial statements did not identify any significant adjustments. The Authority made a number of minor adjustments, all of which were of a presentational nature. There have been no changes that affect the General Fund or HRA balances or the Authority's net worth as at 31 March 2016.</p> |
| Accounts production and audit process | <p>We received complete draft accounts by 30 June 2016 in accordance with the DCLG deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code.</p> <p>The Authority has implemented two out of the three recommendations in our <i>ISA 260 Report 2014/15</i> relating to the financial statements.</p> <p>We have raised two recommendations relating to grant payments and section 106 agreements.</p> <p>The Authority has good processes in place for the production of the accounts and good quality supporting working papers. Officers dealt efficiently with most audit queries. However, the additional work and supporting information needed in relation to the BV Inspection means that the audit process was not completed within the planned timescales.</p> <p>As in previous years, we will debrief with the Accounts 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.</p> |



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| <p>In relation to the Authority's VFM arrangements we anticipate issuing a qualified VFM conclusion on similar grounds to that in 2013/14 and 2014/15.</p> | <p>VFM conclusion and risk areas</p> | <p>We identified one significant risk and two areas of audit focus in relation to our VFM work in our External audit plan 2015/16 issued in June 2016 in relation to the implementation of the BV action plans and Section 11 recommendation.</p> <p>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.</p> <p>In terms of our VFM conclusion our key consideration has been in relation to the progress made on the areas which led us to qualify our VFM conclusion in 2013/14 and qualification for 2014/15. These areas were grant payments and connected decisions; disposal of property and the granting of leasehold interests; spending on publicity; and corporate governance arrangements in the three areas. Our qualification for 2014/15 additionally referred to our Section 11 recommendation made in October 2015 reflecting our view that the Authority needed to ensure that its governance processes were appropriate in a wider sense for the Authority as a whole and as part of its programme of cultural change and not just the areas referred to in the BV Inspection report.</p> <p>Consequently, In terms of 2015/16 we have considered the reporting by the Commissioners to the Secretary of State for Communities and Local Government (SoS for CLG) and the extent to which the Authority's BV action plans were reported as actions completed. We have also considered the progress in relation to our Section 11 recommendation.</p> <p>In their March 2016 letter to the SoS for CLG the Commissioners set out their disappointment with early progress and lack of acknowledgement of the shortcomings in the culture of the Authority and the adverse impact on how some decisions were made (prior to June 2015 when the current Mayor was elected). The Commissioners also emphasised the need to make more progress on the organisational culture piece and the time it will take for this to be successful and become embedded.</p> <p>We have also considered the extent to which the Authority's BV Action Plans were implemented during 2015/16. The reports submitted to Cabinet meetings in September 2015 and March 2016 clearly show that while progress was meaningful there were a significant number of actions that were not completed within 2015/16. We further consider that many of the actions will require time to become established and embedded even once the arrangements/procedures have been put in place.</p> <p>In relation to our Section 11 recommendation the suggested governance review remains relevant and is to be undertaken in conjunction with the other actions currently being undertaken including the programme of cultural change.</p> <p>We have therefore concluded that the Authority has not made proper arrangements to secure economy, efficiency and effectiveness in its use of resources throughout 2015/16. We therefore anticipate issuing a qualified VFM conclusion on similar grounds to that in 2013/14 and 2014/15. Our proposed opinion covering both the financial statements and the VFM arrangements is included in Appendix 6.</p> |
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Financial statements audit risks

We identified the following significant financial statements audit risks in our 2015/16 External audit plan issued in June 2016.

- Property Plant and Equipment (PPE);
- Section 106 agreements;
- Grant payments; and
- Declarations of interest.

We have worked with officers throughout the year to discuss these key risks and our detailed findings are reported in section 3 of this report. In summary:

- There are no matters of any significance arising as a result of our audit work in PPE.
- In relation to section 106 agreements we have noted two small schemes where the Authority has not spent the monies received within the timescales specified, although we understand there is very limited risk that the funds could be lost.
- For declarations of interest we have noted that there are potential shortcomings in the system in place now that all staff are required to make an annual declaration.
- In relation to grant payments and property leases several issues have been identified:
 - Several Mainstream Grant payments have been identified that were not made in accordance with all of the conditions set by Commissioners. Specifically for the organisations receiving the grant there was no formal agreement in place setting out the agreed use/occupation of the property. Consequently, these payments are considered to be unlawful. In total there were four payments to two organisations in 2015/16 (total value - £14,000); and three payments to a further organisation in 2016/17 (total value – £17,721);
 - The Authority did not hold a central register of grant payments for 2015/16. It is therefore difficult for central teams to gather information or track the grants that are being paid by the Authority. Whilst a central register is now in place, the Authority should conduct internal checks to ensure the completeness of this register;
 - Detailed testing of 19 grant streams identified two further concerns: For one grant stream approved by Commissioners (total stream value £300,000) the Authority could not identify any 2015/16 payments; and for a further grant stream, the amount spent by the Authority in 2015/16 exceeded the amount authorised by the Commissioners by £34,000;



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| | <p>Financial statements audit risks (cont.)</p> | <ul style="list-style-type: none"> • Detailed testing of a further 15 projects delivered by organisations occupying Authority properties and in receipt of a Mainstream Grant in 2015/16 identified six projects (four organisations) where there was no formal property agreement in place. Subsequently, reports to the Authority's Grants Determination Committee in January and February 2017 summarise the overall position. The reports show a complex position with 41 organisations requiring additional information to ascertain whether the Commissioners' requirements had been met. • The Council's review of the position for these 41 organisations was completed in June 2017 and identified 27 organisations with issues requiring further work/assessment. Of these 27 organisations, the Council has concluded that as of June 2017 there was no evidence that appropriate property agreements were not in place; appropriate arrangements are now in place; or the organisation is considered, by Members, to be working constructively with the Council to ensure formal arrangements will be in place as soon as possible. • For the remaining 11 organisations the Council has concluded that no formal property agreement was in place for 2015/16 and that this continues to be the case. Therefore the 50 payments made to these 11 organisations in 2015/16 are considered to unlawful. The total value of the payments made was £151,778. The position will be set out and summarised as an additional disclosure in the Council's financial statements. • The additional disclosure will also highlight that the Council made over 1,500 grant payments in 2015/16 with a total value of £3.4 million. |
| | <p>Completion</p> | <p>At the date of this report our audit of the financial statements is complete.</p> <p>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 will provide a draft of this representation letter to the Section 151 Officer in due course. 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 are asking management to provide specific representations on the following: grant payments (particularly in relation to completeness and lawfulness); and section 106 agreements (where the timescale for the use of the monies received has been exceeded). 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> |
| | <p>Certificate</p> | <p>We have two objections from Local Government Electors relating to earlier years. One is in relation to parking matters and the Authority's 2013/14 financial statements. The other objection refers to the Authority's Lender Option Borrower Option loans and relates to 2014/15.</p> <p>Until the above matters have been resolved we will not be in a position to formally conclude the audit and issue an audit certificate.</p> |



Section three: Financial Statements

Proposed opinion and audit differences



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

We have identified no issues in the course of the audit of the Fund that are considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements and the Fund's financial statements, as contained both in the Authority's Statement of Accounts.

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 Committee on 29 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 four for more information on materiality) level for this year's audit was set at £15 million. Audit differences below £750,000 are not considered significant.

We have not identified any significant misstatements.

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 2015/16 ('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 significant misstatements.

For the audit of the Fund we used a materiality level of £20 million. Audit differences below £1 million are not considered significant.

We anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Audit Committee on 29 September 2016.

We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code. We understand that the Fund will be addressing these where significant.

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.

Pension fund annual report

We issued an unqualified audit opinion in relation to the Pension Fund's financial statements, as contained in the Pension Fund Annual Report on 30 November 2016.

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 June 2016, we identified the significant risks affecting the Authority's 2015/16 financial statements. We have not yet completed our testing of all of these areas. We have set out our evaluation following our substantive work or a position statement. There were no significant risks identified for the Pension Fund.

Property Plant and Equipment (PPE)

— Risk

The Authority has a significant asset base primarily relating to Council dwellings; and operational buildings. The potential for impairment/valuation changes makes this balance inherently risky due to the high level of judgement and estimation uncertainty.

— Findings

We have considered the Authority's approach to valuation of PPE with reference to accounting standards and the Code; the information provided to the valuer; reports received by the Authority from its valuer and the judgements made by the Authority in response to those reports. We have compared your valuer's assumptions to benchmarks and to assumptions used for 2014/15 for consistency and ensured that the valuer explicitly considered upward trends as well as impairments in conducting the valuations; and also whether there were material changes in valuations for asset classes valued more than 12 months ago. We also considered disposals (in relation to the BV Inspection findings and consequent Direction); and the completeness of information held on the new fixed asset system. We have no matters to bring to your attention as a result of completing this work.



Grant payments

— Risk

The Best Value Inspection completed in 2014 concluded that the Authority had not achieved its best value duty with regard to the payment of grants totalling £12.2 million and connected decisions in the period from 25 October 2010 to 4 April 2014. Consequently, the award of grants became the responsibility of independent Commissioners who were appointed by the Secretary of State for CLG from January 2015. (2015/16 represented the first full year of the new arrangements being in place.)

— Findings

Our planned approach was to consider the detailed approach and systems put in place by the Authority and Commissioners and to assess whether any conditions/delegation arrangements have been implemented effectively by Authority officers. We had to select our sample for testing from a list of grant programmes, rather than a complete list of grant payments made as planned originally, as the Authority did not hold a central register of grant payments for 2015/16. As a consequence it is also difficult for central teams to gather information or track the grants that are being paid by the Authority. We understand that the Authority has a single system for recording grant payments in 2016/17. The Authority should conduct internal checks to ensure the completeness of this register for the whole year. The Authority should also establish a central mechanism for monitoring grant payments (in line with the above register) to ensure payments are in accordance with Commissioner/Authority requirements (eg formal signed property agreement); and do not exceed the limits authorised by the Commissioners/Authority.

The Commissioners/Authority officers have identified several Mainstream Grant payments that were made where the conditions set by Commissioners had not been met. Specifically for the organisations receiving the grant there was no formal agreement in place, between the organisation and the Authority, setting out the agreed use/occupation of the property. Consequently, these payments are considered to be unlawful. In total there were four payments to two organisations in 2015/16 (total value - £14,000); and three payments to a further organisation in 2016/17 (total value – £17,721).

The results of our detailed testing of 19 grant streams (supported by sample testing of payments within the selected grant streams) identified two further concerns:

- For one grant stream the central team could not identify any 2015/16 payments (even though the grant had been approved by the Commissioners – total value of the stream approved was £300,000). Further, the Directorate did not confirm whether or not there had been any expenditure on this grant stream in 2015/16. So, we have not been able to gain assurance that payments made on this grant stream (if any were made in 2015/16) met the Commissioners' directions; and
- For a further grant stream, the amount spent by the Authority in the year (£234,960) exceeded the amount authorised by the Commissioners (£201,000). We have not been able to ascertain whether additional approval was sought or whether Commissioners/Corporate Director of Resources were informed about the 'over spend'.



Grant payments (cont.)

— Findings (cont.)

In relation to the latter point, we have perused all of the grant streams and compared the amount of grant approved with the level of expenditure recorded by the central team. Whilst this has not identified any obvious further examples, the limitations already described (eg no central payment system) may mean that there are such examples, but they would be difficult to identify unless they were on a significant scale, when the Authority's budgetary controls would highlight anomalies for review/further investigation.

All other grant expenditure tested was incurred in line with the conditions imposed by the Commissioners.

As our work has not identified any errors in terms of the recording of expenditure for financial statements purposes and we are already proposing a qualified opinion on the Authority's arrangements for securing VFM in its use of resources, we have not extended our work further. However, we have added a recommendation to the Authority referring to the need for further improvements relating to its systems/controls for grant payments.



Section 106 agreements

— Risk

The Commissioners highlighted this as an additional area of concern from the enquiries they have made. The Authority has also had an independent review undertaken of its arrangements in relation to s106 systems, processes, controls and monitoring arrangements.

— Findings

We have tested a selection of schemes and the overall controls employed by the Authority to ensure that section 106 agreement funds are being used in accordance with the conditions agreed as part of the planning process. Our testing of 27 schemes did not identify any issues in terms of balances held and monies spent during 2015/16. We noted that there are two schemes which have gone beyond the time when the s106 agreement requires the funds to have been spent. (PA/06/01439 expired October 2015 and the balance at 31 March 2016 was £3m we understand this balance has been committed to two projects which have commenced in 2016/17 and that the developer making the original payment has been dissolved; and there is one further small scheme which has gone beyond the time when the s106 agreement required the funds to have been spent (PA/02/1852 - £40,000). We understand that due to the circumstances of each scheme that there is very limited risk of the funds being lost. We have also noted a further scheme which is due to expire in January 2017 with a balance of £2.1m at 31 March 2016 where there are approved schemes in place that are due to use the balance during 2016/17. We will review the position on this scheme as part of our 2016/17 audit (PA/06/2068).

We have also considered the results of the independent review and the Authority's response. The review raised a number of recommendations for improvements, which the Authority has responded to positively. The Authority has reported that all recommendations have been implemented except those that required the implementation of a new software system which has been procured and is in the process of being implemented.



Declarations of interest

— Risk

We reported in our 2014/15 ISA260 report to the Authority that the Authority had taken the actions agreed in response to our 2013/14 recommendations in this area (made in October 2015). However, the Commissioners have informed us that they remain concerned as to whether declarations are being made appropriately and completely by both officers and Members.

— Findings

We have reviewed the actions taken by the Authority which now include a requirement for all staff to complete an annual declaration. Our testing of the declarations made has not identified any issues. However, we have noted a number of concerns:

- The initial response by staff to the new requirement was slow. We understand that the Authority has now received over 90% of expected returns, which has taken 6 months and a 100% return is essential to meet the aims of the exercise;
- We understand that the Authority is satisfied that every member of staff has been identified and therefore required to complete a declaration form, but our experience elsewhere suggests that it is worthwhile obtaining further assurance on this aspect, such as from an internal audit review;
- Human Resources have provided Corporate Directors and Heads of Service with reports that identify whether submitted declarations have been authorised or rejected by line managers to help inform whether to consider further appropriate action if there are areas of concern. In view of the concerns expressed by the BV Inspection and Commissioners we would anticipate that a further level of assurance is sought as to how robust the process has been in terms of considering the declarations made and any follow up action taken; and
- There is little in the way of comprehensive training so that staff are clear what the Authority's requirements and objectives are understood clearly by staff and that they have the necessary information to complete declarations properly and to support the Authority in terms of any issues that might arise from incomplete declarations.

We have therefore reflected these points in our consideration of the implementation of our recommendation in our *ISA 260 Report 2014/15* (see Appendix 2).



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 tables below set 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.

Subsequently, we have revised our assessment and consider that conditional grant income (which is predominantly made up of s106 ie developers' contributions (80% of the total of £76 million)) should be considered as a risk. This work has therefore been reported within the significant audit risks for section 106 agreements earlier in this section.

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.

Other areas of focus



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

The table sets out our detailed findings for each area of audit focus.

Pension assets/liabilities

— Risk

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.

— Findings

We have:

- Confirmed that the information provided to the actuary from the Authority is reasonable;
- Reviewed the actuarial valuation and considered the disclosure implications; and
- Considered the approach adopted and assumptions made by your actuaries to benchmarks and other information available to us and to the assumptions used for 2015/16 for consistency with previous years.

No issues were noted as a result of our procedures.

Payroll

— Risk

Payroll represents a significant proportion of the Authority's annual expenditure (approaching 33% of gross spend at £464m in 2014/15). Whilst not considered overly complex from a material error perspective, we consider that it is important from an audit perspective to understand the nature of the Authority's expenditure in this area.

— Findings

We have:

- Reviewed and tested reconciliations for gross pay and deductions (eg pensions, tax and national insurance); and
- Complete substantive analytical review of payroll costs and testing supporting system information used to compile the review.

No issues were noted as a result of our procedures.



Income from property leases

— Risk

Commissioners have identified concerns relating to the robustness and comprehensiveness of information relating to occupation of Authority property and formal support to explain/justify related decisions when determining any charges to be paid by the organisation occupying Authority property. This also impacts on VFM in that the amounts due/collected/written off are accurately recorded but the concern is with the process for agreeing arrangements formally and implementing them appropriately.

— Findings

We have considered the Authority's approach to having formal property agreements and the information held to support its decision making and tested a sample of agreements to assess whether the approach to formal property agreements is followed in practice. (This area is closely linked to our work on grants.) We selected a sample of Authority properties and identified 15 organisations using the properties in our sample. We made no distinction as to whether the building had been classed as a community building or not when selecting our sample, as it was our understanding that the Commissioners' requirements made no such distinction.

Our testing identified six projects, involving four organisations, where there was no formal property agreement in place. The Authority reported the position to the Grants Determination Committee in January and February 2017. The position reported to the Committee shows a complex position with a total of 41 organisations requiring additional information to ascertain whether the Commissioners' requirements had been met.

The Council's review of the position for these 41 organisations was completed in June 2017 and identified 27 organisations with issues requiring further work/assessment. Of these 27 organisations, the Council has concluded that as of June 2017, for seven organisations there was no evidence that a formal property agreement was not in place for 2015/16; for one organisation a lease was agreed in 2016/17 and consequently grant payments have been authorised; and for nine organisations the organisation is considered, by Members, to be working constructively with the Council to ensure formal arrangements will be in place as soon as possible and thus all previous grant payments have been authorised.

For the remaining 11 organisations the Council has concluded that no formal property agreement was in place for 2015/16 and that this continues to be the case. Therefore the 50 payments made to these 11 organisations in 2015/16 are considered to be unlawful. The total value of the payments made was £151,778.

The Council also highlighted that it made over 1,500 grant payments in 2015/16 with a total value of £3.4 million.

As our work has not identified any errors in terms of the recording of expenditure for financial statements purposes and we are already proposing a qualified opinion on the Authority's arrangements for securing VFM in its use of resources, we have not extended our work further. However, we have added a recommendation to the Authority referring to the need for further improvements relating to its systems/controls for grant payments.



Youth services

— Risk

There have been several investigations and audits within the Authority's youth service in the last two years each giving cause for concern. We understand a root and branch review has been commissioned into Youth Services more generally to provide a holistic view. Although not material in financial statement terms the gross budget for the service is significant at approaching £9 million in 2015/16. Again this is an area that also impacts on VFM.

— Findings

The Authority has taken considerable action with regards to the Youth Service in terms of improving its governance; spending controls; and service delivery. New senior officers have been appointed to manage the Service and it has been moved to a different Directorate to give it a greater opportunity with more of a 'fresh' start. There is a detailed action plan in place which is in the process of being implemented.

In addition the Youth Services Project Group will oversee the progress of investigations (current and future) into individuals and organisations that are known to the Youth Service from the various investigations that have been completed previously. This group will ensure that suitable pace is injected into the progress of the investigations and other arising issues enabling management within the Youth Service to conclude on historical matters and concentrate of the future of the Youth Service. The Project Group comprises senior officers from Children's Services, Human Resources, Internal Audit, Finance, Legal Services, and Communications.

Accounts production and audit process



We have noted that the quality of the accounts and the supporting working papers have been maintained.

Officers dealt efficiently with audit queries. However, the additional work and supporting information needed in relation to the BV Inspection means that the audit process has not been completed within the planned timescales.

The Authority has implemented two of the three recommendations in our ISA 260 Report 2014/15.

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 maintained its financial reporting process. 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 <i>Accounts Audit Protocol</i> , which we issued in June 2016 and discussed with the Financial Accountant, set out our working paper requirements for the audit. The quality of working papers provided met the standards specified in our <i>Accounts Audit Protocol</i> . |
| Response to audit queries | Officers resolved the majority of audit queries in a reasonable time. However, the additional work and supporting information needed in relation to the BV Inspection means that the audit process has not been completed within the planned timescales. |

| Element | Commentary |
|---------------------------|---|
| Pension Fund Audit | The audit of the Fund was undertaken alongside the main audit. There are no specific matters to bring to your attention relating to this at this audit. |

Prior year recommendations

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report.

The Authority has implemented two of the three recommendations in our *ISA 260 Report 2014/15*. Appendix two provides further details of the remaining recommendation.



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 London Borough of Tower Hamlets and the London Borough of Tower Hamlets Pension Fund for the year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the London Borough of Tower Hamlets and the London Borough of Tower Hamlets 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 five 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 Director, Resources for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

We have included specific representations in relation to grants and section 106/Community Infrastructure Levy agreements.

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.



Section four: Value for Money



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.

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

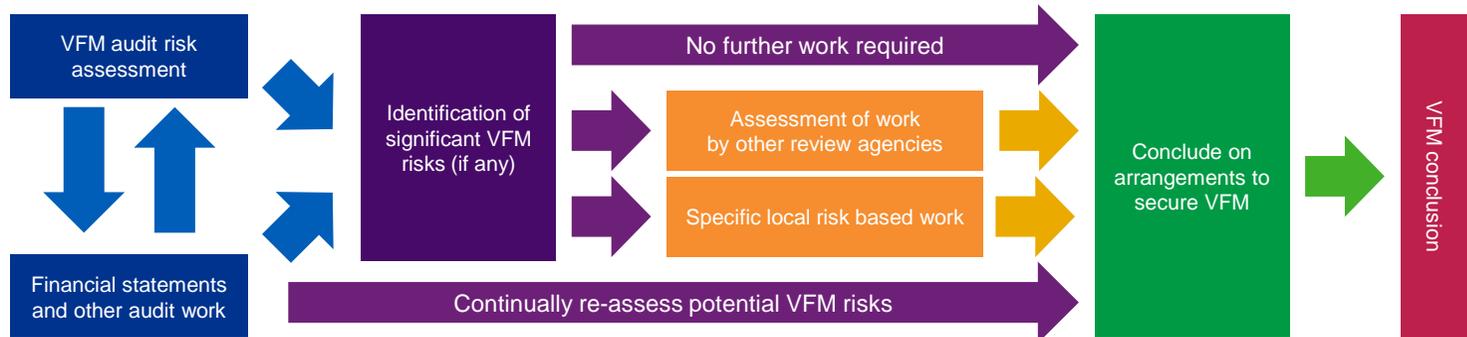
We have concluded that the Authority has not made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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.

Informed decision making

Sustainable resource deployment

Working with partners and third parties



Specific VFM Risks



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.

Consideration of BV Inspection report and subsequent action plans

In seeking to satisfy ourselves that the Authority has made proper arrangements for challenging how it secures economy, efficiency and effectiveness in its use of resources, we have continued our consideration of the findings of the BV Inspection report and more specifically the Authority's progress towards implementing the action plans that it produced in response.

In relation to 2015/16 it is important to note that we are looking at the financial year as a whole when considering the VFM conclusion.

The Commissioners have reported that the Authority did not make meaningful progress in accepting the BV Inspection findings and Directions and considering how to address the concerns identified until the current Mayor was elected in June 2015. Furthermore, in their March 2016 letter to the SoS for CLG they commented that although good progress was now being made, they still felt that the Authority had wasted a significant amount of time in the immediate period after the BV Inspection Report had been published.

Consequently, in terms of our VFM conclusion our key consideration has been in relation to the progress made on the areas which led us to qualify our VFM conclusion in 2013/14 and in 2014/15. These areas were grant payments and connected decisions; disposal of property and the granting of leasehold interests; spending on publicity; and corporate governance arrangements in the three areas. Our qualification for 2014/15 additionally referred to our Section 11 recommendation made in October 2015 reflecting our view that the Authority needed to ensure that its governance processes were appropriate in a wider sense for the Authority as a whole and as part of its programme of cultural change and not just the areas referred to in the BV Inspection report.

In terms of 2015/16 we have considered the reporting by the Commissioners to the SoS for CLG and the extent to which the Authority's BV action plans were reported as actions completed.

The Mayor's letter to the SoS CLG was positive about progress being made whilst realising that the organisational aspect in particular will take some time to become embedded.

The Commissioners' response notes their disappointment with early progress and lack of acknowledgement of the shortcomings in the culture of the Authority and the adverse impact on how some decisions were made. The Commissioners also emphasised the need to make more progress on the organisational culture piece and the time it will take for this to be successful and become embedded.

We have also considered the extent to which the Authority's BV Action Plans were implemented during 2015/16. The reports submitted to Cabinet meetings in September 2015 and March 2016 clearly show that while progress was meaningful there were a significant number of actions that were not completed within 2015/16. We further consider that many of the actions will require time to become established and embedded even once the arrangements/procedures have been put in place.

Indeed the Cabinet report (6 September 2016) states the following:

The Council is now in a position to report that more than 95% of the actions within the Best Value Plans are complete. More significantly, progress has been made in delivering the related outcomes and further information on this is provided below.

It is also recognised that implementing significant organisational change is a long-term, iterative process. As such, this update report also addresses issues, which fall outside of the formal Best Value Plans agreed with the Secretary of State, that have been identified by the Council or the Commissioners as matters where further work is required and underway.

Specific VFM Risks



Conclusion of arrangements to secure value for money

The matters raised in the BV Inspection report raise concerns in relation to the adequacy of the Authority's arrangements for challenging how it secures economy efficiency and effectiveness in its use of resources in the areas highlighted above.

We are required to conclude on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources, for the whole of 2015/16. So although considerable progress is being reported, we anticipate issuing an adverse opinion in respect of the Authority's arrangements to secure value for money on similar grounds to our 2013/14 and 2014/15 VFM conclusions.

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;
- Continued our consideration of the Authority's actions to address issues raised by the BV Inspection report produced by PwC;
- Considered other matters brought to our attention by the Tower Hamlets Commissioners; and the DCLG; and
- Followed up on relevant issues included in our *ISA 260 Report 2014/15* presented to the Audit Committee in March 2016.

Key findings

On the previous pages we have specifically considered the progress towards implementing the BV action plans that the Authority has drawn up in response to the BV Inspection and subsequent considerations from the Commissioners appointed by the DCLG.

On the following pages we have set out the findings in respect of those areas where we identified a residual audit risk for our VFM conclusion in our Audit Plan.

Specific VFM Risks



We have identified a number of specific VFM risks.

In most cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

We have undertaken work in response these risks as summarised in the assessment column.

| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|--|--|--|
|  <p>Implementation of BV action plans and section 11 recommendation</p> | <p>The Authority monitors progress towards implementation regularly and reports on a monthly basis to the Best Value Programme Board. Internal Audit have an agreed programme to review the accuracy of each of the seven action plans as regards the implementation of the individual milestones. The next stage will be for the Authority to be able to demonstrate that the actions have had the planned impact; have addressed the weaknesses in the Authority's arrangements that were highlighted by the BV Inspection report; Electoral Court judgement; and SoS CLG's Directions; and are embedded into the Authority's culture.</p> <p>This is relevant to the informed decision making, sustainable resource deployment, working with partners and third parties sub-criteria of the VFM conclusion.</p> | <p>Our section 11 recommendation centred around the Authority undertaking a detailed review of its governance processes across the Authority to satisfy itself that they are appropriate and operating effectively. We are satisfied that the steps necessary for the Authority to address the matters raised have been integrated into the Organisational Culture BV action plan.</p> <p>Our consideration of the progress towards implementation of the BV action plans has been set out earlier in this Section.</p> <p>Specific risk based work required: Yes, see earlier in this Section.</p> <p>As noted earlier in this section, our consideration of the Authority's progress towards implementing the BV action plans for 2015/16 as a whole is considered to have an adverse impact on the overall VFM conclusion.</p> |

Specific VFM Risks (cont.)



| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|--|--|
| <p style="text-align: center;">Governance in schools →</p> | <p>In 2013/14 Internal Audit reviews found that over half of the schools audited (14 out of 27) fell below the minimum standard of financial control, and management. Internal Audit have also investigated other schools where external referrals alleging irregularity at some schools have been received. Whilst these investigations have not been finalised, it is clear that there are also weaknesses in the governance arrangements of these schools. The Authority has taken action to reinforce the importance of governance and the role of Governors in managing schools. As part of our 2014/15 audit we commented that it would take time for the full impact of the actions to take effect.</p> <p>This is relevant to the informed decision making and working with partners and third parties sub-criteria of the VFM conclusion.</p> | <p>The Authority has taken action to reinforce the importance of governance and the role of Governors in managing schools. It has reviewed its guidance and issued the latest guidance to schools and governors. Also training and guidance on governance arrangements has been delivered to both Governors and Schools Business Managers.</p> <p>The Authority is also making further enhancements to arrangements by giving direct support to those schools which have been identified in internal audit reports as consistently receiving limited assurance through additional workshops delivered by Mazars and Schools Finance.</p> <p>We have considered the impact/progress by liaising with Internal Audit (IA) on results of recent audits. The annual report for schools in 2014/15 showed that 9 schools received a 'substantial' rating, but 5 had limited assurance and 2 had nil assurance. For 2015/16 the IA annual report shows that of the 25 schools receiving an audit 21 received a 'substantial' assurance rating and 4 had a limited assurance. Representing a significant improvement and positive direction of travel.</p> <p>We have also reviewed the 2015/16 annual report for schools which sets out the findings from the reviews and common issues, although we do not consider (in view of the overall assurances given) that these are significant in overall terms for the VFM conclusion.</p> <p>Specific risk based work required: Yes as per above</p> <p>No adverse impact on the overall VFM Conclusion.</p> |

Specific VFM Risks (cont.)



| Key VFM risk | Risk description and link to VFM conclusion | Assessment |
|---|--|--|
|  | <p>Local Authorities are subject to an increasingly challenged financial regime with reduced funding from Central Government whilst having to maintain a statutory and quality level of services to local residents. At the point of our planning the Authority is estimating a small over spend (of around £1.2 million) for 2015/16. The Authority's balanced budget for 2016/17, included the delivery of £21 million of approved savings plans, and the use of £23 million from General Fund reserves. The Authority estimated that a further £58 million in savings would need to be achieved during the three years 2017/18 to 2019/20, after using £4 million of reserves (General Fund reserves were estimated to be £36 million at 31 March 2020). The Authority was in the process of developing and agreeing proposals with Members for these future estimated savings. The need for 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> <p>This is relevant to the informed decision making and sustainable resource deployment sub-criteria of the VFM conclusion.</p> | <p>We have reviewed overall management arrangements that the Authority has for managing its financial position, including the processes to develop a robust Medium Term Financial Strategy (MTFS), ongoing monitoring of the annual budget, review of how savings plans have been developed and how their delivery is monitored, responsiveness to increasing costs of demand led services and changes in funding allocations and the governance arrangements of how the figures are reported through to the Council.</p> <p>The Authority has set a balanced budget for 2016/17 and is in the process of developing its detailed MTFS to 2020 supported by detailed outcome based budgets.</p> <p>Specific risk based work required: Yes, see above and more detailed commentary on the next page.</p> <p>No adverse impact on the overall VFM conclusion.</p> |

Section four - VFM

VFM – Financial position



2015/16 outturn

In terms of its financial standing the Authority is reporting that the revised budget has been met. Indeed there was an under spend of £8 million in total which meant that the planned use of reserves was not required (as contingencies in the budget were not needed to be applied) and the General Fund reserve increased slightly to £72 million.

2016/17 budget

In relation to the MTFS we note that the Authority has agreed a balanced budget for 2016/17. The budget includes £21 million of agreed savings and £23 million use of reserves (which would reduce General Fund reserves to £49 million).

For the £21 million of savings, this was agreed by Members in two batches £4 million in year and £17 million as part of budget setting in February 2016. All of the savings schemes were supported by detailed statements explaining what was being planned and how it would be delivered/achieved. The supporting papers also set out any changes to services; explained any equality implications and included a formal Equalities Impact Assessment (supported by an action plan for any groups affected adversely). In terms of monitoring the savings are built into base budgets and so they are monitored as part of on-going budget monitoring.

MTFS 2017 – 2020

For the period covered by the MTFS (three years from 2017 – 2020) the Authority needs to identify £58 million in savings and is only looking to use £4.5 million from General Fund reserves over this period (leaving reserves at £44 million at 31 March 2020).

The Authority is using 2016/17 to look in great detail at what it does and how it does it using outcomes-based budgeting. Cabinet received an update report in September 2016 setting out progress being made and future planned reporting that would enable the Authority to make informed decisions about resource prioritisation and allocation decisions in a way that provides a stable and considered approach to service delivery and funding the priorities agreed within the Authority's Strategic Plan and takes into account relevant risks and uncertainty. Further work and consideration to develop a balanced budget for the three years 2017-20 took place in the lead up to the Council's final budget decision in February 2017.



Appendices

Appendix 1: Key issues and recommendations

Appendix 2: Follow up of prior year recommendations

Appendix 3: Audit differences

Appendix 4: Materiality and reporting of audit differences

Appendix 5: Independence and objectivity

Appendix 6: Draft audit opinion

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 will formally follow up these recommendations next year.

Priority rating for recommendations

| | | |
|--|--|---|
| <p>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.</p> | <p>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.</p> | <p>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.</p> |
|--|--|---|

| No. | Risk | Issue and recommendation | Management response/responsible officer/due date |
|-----|------|--|--|
| 1 | 2 | <p>Grant Payments/Property Leases</p> <p>Our work has identified several issues relating to grant payments and the controls over them. Matters arising include:</p> <ul style="list-style-type: none"> • No central listing of grant payments in 2015/16 was available, making identification of grants paid difficult; • One instance where the allocation awarded by the Commissioners was exceeded by almost 20% (£34,000); and • Fifty grant payments made in 2015/16 (to 11 organisations), with a value of £152,000 have been identified by the Council as being unlawful due to the lack of a formal property agreement being in place; | <p>The council maintains a grant register that logs all grants and is updated on a monthly basis. All grant payments are made via the council's Agresso payment system and there is a reconciliation of grant payments made. The Council is procuring a new online system and all grants will be recorded on the system once it is fully implemented. This will replace the grants register and will automate the majority of the currently manual processes.</p> <p>All Managers with budget responsibility for grants will be written to in September 2017 and reminded that expenditure must be routinely monitored and any additional approval required is sought from the Grants Determination (Cabinet) Sub Committee.</p> |

Key issues and recommendations (cont.)

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 will formally follow up these recommendations next year.

| No. | Risk | Issue and recommendation | Management response/responsible officer/due date |
|-----|------|---|--|
| 1 | 2 | <p>Grant Payments/Property Leases (cont.)</p> <p>Recommendation</p> <p>The Authority should:</p> <ul style="list-style-type: none"> • Ensure that the single system that the Authority now requires all Directorates to use to record all grant payments is used universally and all grant payments for 2016/17 onwards are captured on it; • Clarify the arrangements for grants (particularly demand led ones) to ensure that additional approval by Commissioners/ the relevant Authority Committee/officer is required (even where the over spend is being managed within the Directorate's overall resources); • Ensure that all unlawful grant payments have been identified and disclosed in the financial statements; and • Ensure that all grant programmes have been assessed to ensure that recipients are complying with the Commissioners' requirements that all grant recipients occupying Authority property must have a formal property agreement in place. | <p>All grant payments to organisations occupying council buildings have been reviewed and any associated unlawful payments have been identified and disclosed in the statement of accounts. On-going monitoring arrangements are in place.</p> <p>The Council completed an exercise to identify all MSG and other grant payments that have been made where an appropriate premises agreement was potentially not in place at the time of payment. In most cases, premises agreements have now been provided. The remaining cases are being monitored and progress updates are regularly reported to Grants Determination (Cabinet) Sub Committee.</p> <p>The checking process for MSG payments and premises agreements has been strengthened and grant officers undertake premises checks, with an additional check between the grant officer and team manager made at the time of the authorisation of MSG payments to ensure premises conditions are met.</p> <p>Responsible Officer - Steve Hill, Head of Benefits Services</p> |

Key issues and recommendations (cont.)

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 will formally follow up these recommendations next year.

| No. | Risk | Issue and recommendation | Management response/responsible officer/due date |
|-----|------|--|--|
| 2 | 3 | <p>Section 106 agreements</p> <p>Our testing of 27 schemes noted that there are two schemes which have gone beyond the time when the s106 agreement required the funds to have been spent. We understand that due to the circumstances of each scheme that there is very limited risk of the funds being lost. We have also noted a further scheme which is due to expire in January 2017 with a balance of £2.1m at 31 March 2016 where there are approved schemes in place that are due to use the balance during 2016/17. We will review the position on this scheme as part of our 2016/17 audit.</p> <p>We have also considered the results of the independent review and the Authority’s response. The Authority has reported that all recommendations have been implemented except those that required the implementation of a new software system which has been procured and is in the process of being implemented.</p> <p>Recommendation</p> <p>The Authority needs to continue to monitor its performance compared with deadlines set out in section 106 agreements and try to ensure that there are no future instances where the monies are not spent in advance of the deadlines.</p> <p>The Authority also needs to complete the implementation of the new software system to address the remaining recommendations from the independent review.</p> | <p>A robust approach continues to be in place regarding the monitoring of time bound s106 agreements. A forward programme of all contributions due to expire within the next 3 years is reported to the Infrastructure Delivery Steering Group (IDSG) on a monthly basis. This allows the governance structure a frequent oversight of those contributions due to expire and facilitates the programming and spend of contributions prior to their expiry dates.</p> <p>There have been developments on the two s106 schemes mentioned on page 15 of this report. Following 2016/17 spend on projects, the £3 million on PA/06/1439 (as of March 2016) has now reduced to £1m. Also, the £2.1 million held on PA/06/2068 is no longer classed as expired as a further £714,000 was received in June 2017. The expiry date of the whole contribution is five years after full payment; hence the expiry date is now June 2022.</p> <p>The specific recommendation stemming from the Independent Review of s106 processes was to “consider procuring integrated s106 and CIL Software’. This recommendation has been completed with the system being considered, then later procured in May 2016. Testing is currently underway with implementation of the S106 module scheduled to take place by March 2019.</p> <p>Responsible Officer – Owen Whalley (Directorate Management Team, Planning & Building Control)</p> |

Follow up of prior year recommendations

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2014/15*.

We re-iterate the importance of the outstanding recommendation and recommend that the matter noted from our 2015/16 consideration are addressed.

At this stage we have not drafted and agreed with officers recommendations in relation to the current year, these will be reported to the Audit Committee at a subsequent meeting, We anticipate raising some recommendations in relation to grants.

This appendix summarises the progress made to implement the recommendations identified in our ISA 260 Report 2014/15 and re-iterates any recommendations still outstanding.

| Number of recommendations that were: | |
|--|---|
| Included in original report | 3 |
| Implemented in year or superseded | 2 |
| Remain outstanding (re-iterated below) | 1 |

| No. | Risk | Issue and recommendation | Officer responsible and due date | Status as at December 2016 |
|-----|------|---|--|--|
| 1 | 1 | <p>Declarations of Interest</p> <p>The BV Inspection report refers to several instances where there are relationships with other parties. The BV Inspection report does not conclude as to whether these relationships represented significant concerns or were improper. However, there appears to be the potential for interests that should be declared not being so, possibly due to due to incomplete knowledge about who the Authority is doing business with, or seeking to do business with. As a minimum this gives the potential for reputational damage to the Authority.</p> <p>Recommendation</p> <p>The Authority should:</p> <ol style="list-style-type: none"> Review its policies, procedures and processes for identifying potential interests and ensuring declarations are up to date and complete; Consider whether improvements can be made to ensure relevant members and officers are aware of organisations and individuals seeking to do business with or interact with the Authority; and Ensure that all relevant members and officers receive at least annual training and reminders about their responsibilities and the need to ensure interest declarations are complete and up to date. | <p>Corporate Director Governance and Corporate Director Resources</p> <p>December 2015</p> | <p>As noted in Section 3 we have noted that there are some weaknesses in the Authority's systems and approach to the new requirement for all staff to complete an annual declaration of interest. In particular these relate to completeness of records to ensure all staff have completed a return; for those staff identified to date there has not yet been a 100% return of declarations; training should be enhanced to ensure staff understand the importance of the declarations and completing them fully and accurately; obtaining further assurance about the process and consideration/assessment of the returns received and whether any further action is needed.</p> <p>We will therefore continue to follow up this recommendation next year.</p> |

Appendix three

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for all of the matters 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

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 Finance Department is 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 million.

We report all audit differences over £750,000 million for the Authority's accounts and £1 million for the Pension Fund, to the Audit 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.

We used the same planning materiality reported in our External Audit Plan 2015/16, presented to you in June 2016.

Materiality for the Authority's accounts was set at £15 million which equates to around 1.2 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the 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 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 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.

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 million which is approximately 1.78 percent of gross assets. An individual difference could normally be considered to be clearly trivial if it is less than £1 million.

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 *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 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 the London Borough of Tower Hamlets and the London Borough of Tower Hamlets Pension Fund for the financial year ending 31 March 2016, we confirm that there were no relationships between KPMG LLP and the London Borough of Tower Hamlets and the London Borough of Tower Hamlets 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 Independence

Audit Fees

Our scale fee for the Authority audit and Pension Fund audits was £230,918 plus VAT (£300,890 in 2014/15). This fee was in line with that highlighted within our audit plan agreed by the Audit Committee in June 2016. Additional fees will be required for the additional work we have needed to undertake relating to the BV Inspection issues and the Authority’s response (the additional fees to date for 2014/15 are £22,000, although this does not include dealing with the LOBO objection which we are in the process of considering).

Our scale fee for certification for the HBCOUNT is £20,327 plus VAT (£30,450 in 2014/15), and fees for other grants and claims (Teachers’ Pensions Return and Capital Receipts Return) was £6,500 plus VAT.

Non-audit services

We have summarised below the non-audit services that we have been engaged to provide, the estimated fee, the potential threats to auditor independence and the associated safeguards we have put in place to manage these.

| Description of non-audit service | Fee | Potential threat to auditor independence and associated safeguards in place |
|--|----------------|---|
| Conducting business intelligence research on 14 companies of interest to the Authority. The research will include identifying any links between these companies as well as their known public profile. | £36,500 | <p>Self interest – This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. In addition, the audit fee scale rates were set independently to KPMG by the PSAA. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit.</p> <p>Self review – The nature of this work was to conduct business intelligence research on 14 companies of interest to the Authority. The research will include identifying any links between these companies as well as their known public profile. We used information available in the public domain only. Therefore, it does not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. The existence of a separate team for this work is a further safeguard. Consequently, we consider we have appropriately managed this threat.</p> <p>Management threat – This work was advice and support only – all decisions were made by the Authority.</p> <p>Familiarity – This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard.</p> <p>Advocacy – We will not act as advocates for the Authority in any aspect of this work. We will draw on our experience in such roles to provide the Authority with a summary of information obtained but the scope of this work falls well short of any advocacy role.</p> <p>Intimidation – not applicable</p> |
| Fees | £36,500 | |
| Fees as a percentage of external audit fees | 16% | |

Independent auditor's report to the members of the London Borough of Tower Hamlets

We have audited the financial statements of the London Borough of Tower Hamlets for the year ended 31 March 2016 on pages x to x. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014. Our audit work has been undertaken so that we might state to the members of the Authority, as a body, those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members of the Authority, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Corporate Director of Resources and auditor

As explained more fully in the Statement of the Corporate Director of Resources' Responsibilities, the Corporate Director of Resources is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Authority's and the Pension Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Corporate Director of Resources; and the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Narrative Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of the Authority as at 31 March 2016 and of the Authority's expenditure and income for the year then ended;
- give a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2016 and the amount and disposition of the fund's assets and liabilities as at 31 March 2016 other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

Matters on which we are required to report by exception

The Code of Audit Practice requires us to report to you if:

- the Annual Governance Statement which accompanies the financial statements does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007; or
- the information given in the Narrative Report for the financial year for which the financial statements are prepared is not consistent with the financial statements; or
- any matters have been reported in the public interest under Section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of, the audit; or
- any recommendations have been made under Section 24 of the Local Audit and Accountability Act 2014; or

Draft audit opinion

- any other special powers of the auditor have been exercised under the Local Audit and Accountability Act 2014.

We have nothing to report in respect of these matters.

Conclusion on the London Borough of Tower Hamlets' arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities

We are required under Section 20(1) (c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Comptroller and Auditor General (C&AG) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by C&AG in November 2015, as to whether London Borough of Tower Hamlets had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The C&AG determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether London Borough of Tower Hamlets put in place proper

arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2016.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, London Borough of Tower Hamlets had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Basis for adverse conclusion

In considering the arrangements the Authority has put in place to challenge how it secures economy, efficiency and effectiveness we have reviewed the progress made against the findings of the Best Value Inspection of the London Borough of Tower Hamlets Report (the Report) produced by PricewaterhouseCoopers LLP (PwC) for the Department for Communities and Local Government (DCLG) dated 16 October 2014 and published on 4 November 2014, as well as the evidence gathered from our own audit work.

The DCLG instructed PwC to cover specific matters as part of the Best Value Inspection. The report concluded that the Authority had not achieved the best value duty with regard to the following areas:

- The Authority's payment of grants and connected decisions;
- The disposal of property and the granting of leasehold interests; and
- Spending on publicity.

The Report also commented that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above. Subsequently the Secretary of State for Communities and Local Government appointed independent Commissioners to undertake an executive decision-making role in relation to all grant decisions, and to oversee the work of the Authority in these areas of operation. The Commissioners also play a consultative role in the development of plans to deal with weaknesses in the processes for entering into contracts identified in the report, but are not able to issue binding directions to the Authority except in circumstances where they fail to adopt recommendations of the statutory officers.

These matters, taken together with comments within the Mayoral election judgment (as set out in the High Court of Justice, Queen's Bench Division, in the matter of the Representation of the People Act 1983, and in the matter of a Mayoral election for the London Borough of Tower Hamlets held on 22 May 2014) and other matters raised with us as auditors, indicate that governance processes were not operating effectively for the periods covered by these inspections and judgments.

The Authority has developed and published comprehensive action plans including a programme of cultural change (the "BV Action Plans") to address the findings of the reports detailed above. During the course of 2015/16, the Commissioners provided regular, quarterly updates to the Secretaries of State on the improvements being delivered at the Council, including detailed six monthly progress reports in September 2015 and March 2016.

We have considered the extent to which the Authority's BV Action Plans were implemented during 2015/16. The reports submitted to Cabinet meetings in September 2015 and March 2016 clearly show that while progress was meaningful, particularly in the latter part of the year, there were a significant number of actions that were not completed within 2015/16. Whilst we note the progress made we also consider that many of the actions will require time to become established and fully embedded even once the arrangements/procedures have been put in place.

In October 2015, in relation to our audit for the year ended 31 March 2014, we raised a recommendation under section 11(3) of the Audit Commission Act 1998 that the Authority should undertake a detailed review of its governance processes to satisfy itself that they were appropriate and operating effectively. This governance review is to be undertaken in conjunction with the other actions currently being undertaken including the programme of cultural change. The reasons for recommending such a review in respect of the year ended 31 March 2014 are equally applicable to our consideration of the adequacy of the Authority's arrangements to secure economy, efficiency and effectiveness in the use of resources for the year ending 31 March 2016.

Adverse conclusion

On the basis of our work, having regard to the guidance issued by the C&AG in November 2015, the matters reported in the basis for adverse conclusion paragraph above prevent us from being satisfied that, in all significant respects, the London Borough of Tower Hamlets put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2016.

Delay in certification of completion of the audit

Due to matters brought to our attention by local authority electors not being completed by the 28 September 2017

We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of one matter brought to our attention by a local authority elector under the Audit Commission Act 1998, relating to the year ending 31 March 2014; and one matter brought to our attention by a local authority elector under the Audit Commission Act 1998, relating to the year ending 31 March 2015. We are satisfied that this work does not have a material effect on the financial statements or on our conclusion on arrangements to secure value for money.

Andrew Sayers

for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants

15 Canada Square, London, E14 5GL

28 September 2017



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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.

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