External Audit Plan 2017/18

London Borough of Tower Hamlets

March 2018

Headlines

Financial Statement Audit

There are no significant changes to the Code of Practice on Local Authority Accounting ("the Code") in 2017/18, which provides stability. Deadlines for producing and signing the accounts have advanced. This is a significant change and needs careful management to ensure the new deadlines are met. The Authority successfully advanced its accounts production last year, and has plans in place to make the further advances needed to meet the new deadlines. As such we do not feel that this represents a significant risk, although it is still critically important. To meet the revised deadlines it is essential that the draft financial statements and all 'prepared by client' documentation is available in line with agreed timetables. Where this is not achieved there is a significant likelihood that the audit report will not be issued by 31 July 2017.

Authority significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- **Valuation of land and buildings:** Whilst the Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. We will consider the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated;
- **Pension liabilities:** The valuation of the Authority's pension liability, as calculated by the Actuary, is dependent upon both the accuracy and completeness of the data provided and the assumptions adopted. We will review the processes to ensure accuracy of data provided to the Actuary and consider the assumptions used in determining the valuation;
- **Grant payments/property leases:** The Best Value Inspection concluded that the Authority had not achieved its best value duty with regard to the payment of grants and connected decisions between 2010 and 2014. In the 2015/16 and 2016/17 financial years, a small number of grant payments have been identified that were not made in accordance with all of the conditions set by Commissioners (appointed by the Secretary of State for Communities and Local Government (SoS for CLG) following the Best Value Inspection, from December 2014 to March 2017). Specifically for the organisations receiving the grant there was no formal agreement in place setting out the agreed use/occupation of the property. Thus for 11 organisations (50 payments) in 2015/16 and 5 organisations (20 payments) in 2016/17, the Authority has concluded that no formal property agreement was in place. Therefore these payments (£151,000 in 2015/16; and £79,000 in 2016/17) were considered to be unlawful and where disclosed in the respective years' financial statements. The total value of grant payments made for the relevant grant claim streams over the two financial years was £6.3 million. We will continue to test grant payments made to ensure they are made in accordance with relevant conditions; and
- **Declarations of interest:** In 2015/16 we noted some weaknesses in the Authority's systems and approach to the new requirement for all staff to complete an annual declaration of interest. The Authority has taken significant steps to address issues and ensure systems and processes are more robust. The most recent Internal Audit report (August 2017) however, only gave a 'limited' assurance on the basis of weaknesses/issues identified. We will review steps taken to address issues raised by Internal Audit.

Pension fund significant risks

- **Valuation of investments:** The pension fund invests in a range of assets and funds, some of which are inherently harder to value. We will verify a selection of investments to third party information and confirmations.

Headlines

Value for Money Audit

Our risk assessment regarding your arrangements to secure value for money has identified the following VFM significant risk to date:

– **Best Value Improvement Plan:** The SoS for CLG decided to end the 2014 Directions (applied after the 2014 Best Value Inspection) and not extend the appointment of the Commissioners beyond March 2017 in recognition of the Authority's progress. In light of the work that the Authority has identified as still needing to be completed, the SoS CLG made three new, less intrusive Directions (in force until 30 September 2018) which require the Authority to set up a Best Value Improvement Board (with cross party and independent membership); submit quarterly progress reports on the Best Value improvement plan to the SoS CLG; and set up an independent review of achievement of the BV improvement plan with a report to the SoS CLG by 1 August 2018.

  Also an Ofsted inspection undertaken in January and February 2017 rated the Authority's services for children in need of help and protection, children looked after and care leavers and the local safeguarding children board inadequate overall with some features requiring improvement. The Authority has established a Children's Services Improvement Board led by an Independent Chair and agreed an Improvement Plan. Ofsted are carrying out quarterly monitoring visits to ensure that its recommendations are being robustly addressed. The Children's Service Improvement Board will continue to focus on the themes identified in the Ofsted report looking at progress made and providing support and challenge on areas of on-going work. Quarterly progress updates will be provided to the Best Value Improvement Board and the Council's Cabinet and Overview and Scrutiny Committee.

We will review the work undertaken by the Authority to consider the progress in implementing the Best Value and Children's Services Improvement Plans and the extent of embeddedness within the Authority to the extent that this can be assessed during 2017/18.

Other information

Logistics and team

Our team is led by Andrew Sayers – Partner, and Antony Smith – Manager.

Our work will be completed in four phases from December to July and our key deliverables are this Audit Plan, and a Report to Those Charged With Governance.

Fees

Our fee for the 2017/18 audit is £209,918 (£231,996 2016/2017 – note that this includes £22,078 for additional work needed in relation to the Best Value Inspection and associated risks, but does not include fees that will be needed to consider the objection received in relation to the Authority's PFI schemes which we accepted in December 2017). The 2017/18 fee is in line with the scale fee published by PSAA, but additional work may be needed in relation to the Best Value and Children's Services Improvement Plans. Any additional fees will need approval by PSAA.

Acknowledgement

We thank officers and Members for their continuing help and cooperation throughout our audit.

Content

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This report is addressed to the London Borough of Tower Hamlets (the Authority) and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. PSAA issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on PSAA's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

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

1. Introduction

Background and statutory responsibilities

This plan supplements our 2017/18 audit fee letter 2017/18 dated 21 April 2017, which set out details of our appointment by PSAA.

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014, the NAO's Code of Audit Practice and the PSAA Statement of Responsibilities.

Our audit has two key objectives, requiring us to audit / review and report on your:

- **Authority and Pension Fund Financial statements:** Providing an opinion on your accounts. We also review the Annual Governance Statement and Narrative Report and report by exception on these; and
- **Use of resources:** Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary. Any change to our identified risks will be reported to the Audit Committee.

Financial statements audit

Our financial statements audit follows a four stage process:

- Financial statements audit planning
- Control evaluation
- Substantive procedures
- Completion

Appendix 1 provides more detail on these stages. This plan concentrates on the Financial Statements Audit Planning stage.

Value for Money

Our Value for Money (VFM) arrangements work follows a five stage process:

- Risk assessment
- Links with other audit work
- Identification of significant VFM risks
- Review work (by ourselves and other bodies)
- Conclude
- Report

Pages 13 to 15 provide more detail on these stages. This plan concentrates on explaining the VFM approach for 2017/18 and the findings of our VFM risk assessment.

2. Financial statements audit planning

Financial statements audit planning

Our planning work takes place December to January 2018 and involves: determining materiality; risk assessment; identification of significant risks; consideration of potential fraud risks; identification of key account balances and related assertions, estimates and disclosures; consideration of Management's use or experts; and issuing this plan to communicate our audit strategy.

Authority risk assessment

Professional standards require us to consider two standard risks. We are not elaborating on these standard risks in this plan but consider them as a matter of course and will include any findings arising from our work in our ISA 260 Report.

— **Management override of controls:** Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit incorporates the risk of Management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

— **Fraudulent revenue recognition:** We do not consider this generally to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures, except for conditional grant income (which is predominantly made up of section 106 ie developers' contributions (90% of the total of £83 million in 2016/17)). We will therefore combine this work with the other area of focus for section 106/CIL agreements.

Key: ● Significant risk ● Other area of audit focus ● Other areas considered

2. Financial statements audit planning

Authority significant audit risks

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

Valuation of land and buildings
Risk: The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees land and buildings revalued over a five year cycle. As a result individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. In addition, as the valuation is undertaken as at 1 April, there is a risk that the fair value is different at year end.
Approach: We will review the approach that the Authority has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach. We will assess the risk of the valuation changing materially in year. We will consider movement in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values have moved materially over that time.
In relation to those assets which have been revalued during the year we will assess the valuer's qualifications, objectivity and independence to carry out such valuations and review the methodology used (including the underlying data and assumptions).
Pension liabilities
Risk: The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of the London Borough of Tower Hamlets Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018. Valuation of the Local Government Pension Scheme relies on assumptions, most notably actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation.
There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. Assumptions should reflect the profile of the Authority's employees and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.
Approach: We will review controls that the Authority has in place over the information sent directly to the Scheme Actuary. We will liaise with the auditors of the Pension Fund to gain an understanding of the effectiveness of controls operated by the Pension Fund. This will include consideration of the process and controls with respect to the assumptions used in the valuation. We will evaluate the competency, objectivity and independence of Hymans Robertson.
We will review the appropriateness of key assumptions in the valuation, compare them to expected ranges, and consider the need to make use of a KPMG actuary. We will review the methodology applied in the valuation by Hymans Robertson. In addition, we will review the overall Actuarial valuation and consider the disclosure implications in the financial statements.

2. Financial statements audit planning

Authority significant audit risks (continued)

Grant payments/ property leases

Risk: In The Best Value Inspection concluded that the Authority had not achieved its best value duty with regard to the payment of grants and connected decisions between 2010 and 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 (the responsibility for grant payments was returned to the Authority in 2016).

In the 2015/16 and 2016/17 financial years, a small number of 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. Thus for 11 organisations (50 payments) in 2015/16 and 5 organisations (20 payments) in 2016/17, the Authority has concluded that no formal property agreement was in place. Therefore these payments (£151,000 in 2015/16; and £79,000 in 2016/17) were considered to be unlawful and where disclosed in the respective years' financial statements. The total value of grant payments made for the relevant grant claim streams over the two financial years was £6.3 million.

Approach: We will consider the detailed approach and systems put in place by the Authority and test payments as considered necessary. We will also assess whether any conditions/ delegation arrangements have been implemented effectively by Authority officers.

Declarations of interest

Risk: Declarations was an on-going area of concern for the Authority's Commissioners, particularly about whether declarations were being made appropriately and completely by both officers and Members. Our 2015/16 consideration of the Authority's approach noted some weaknesses in the Authority's systems and approach to the new requirement for all staff to complete an annual declaration of interest.

The Authority has taken significant steps to address issues and ensure systems and processes are more robust, for example over 99% of staff had completed a declaration, and there is a specific HR team set up to work on and monitor completion of declaration of interests, and provide support and training to staff and line managers.

However, the most recent Internal Audit report (August 2017) only gave a 'limited' assurance on the basis of weaknesses/issues identified including: a lack of written procedures; inconsistent management actions in response to declarations made by staff; declarations found to be incomplete (when compared with 'open search' material); and a lack of declarations for family relationships within the Authority.

Approach: We will therefore consider the Authority's actions taken and any follow up work undertaken by Internal Audit and consider what/whether any testing should be undertaken in 2018.

2. Financial statements audit planning

Authority other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Faster close

Risk: In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

During 2016/17, the Authority started to prepare for these revised deadlines and advanced its accounts production timetable so that draft accounts were ready by 14 June 2017 (accounts were signed on 29 September 2017). Whilst this was an advancement on the timetable applied in preceding years, further work is still required in order to ensure that the statutory deadlines for 2017/18 are met.

To meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. There are logistical challenges that will need to be managed including:

— Ensuring that any third parties involved in the production of the accounts (including valuers, actuaries, and schools) are aware of the revised deadlines and have made arrangements to provide the output of their work accordingly;

— Revising the closedown and accounts production timetable to ensure that all working papers and supporting documentation are available at the start of the audit;

— Ensuring that the Audit Committee meeting schedules have been updated to permit signing in July; and

— Applying a shorter paper deadline to the July meeting of the Audit Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline. There is an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts return. This is not seen as a breach of deadlines.

Approach: We will continue to liaise with officers in preparation for our audit to understand the steps the Authority is taking to meets the revised deadlines. We will look to advance audit work into the interim visit to streamline the year end audit work. Where there is greater reliance upon accounting estimates we will consider the assumptions used and challenge the robustness of those estimates.

Authority other areas of audit focus (continued)

Section 106/CIL agreements

Risk: This has historically been highlighted as an area of concern by Commissioners. The Authority has responded positively to an independent review of its arrangements in relation to s106 systems, processes, controls and monitoring arrangements, and matters arising from our 2015/16 testing had been, or were being, addressed when we reviewed the position for 2016/17.

In respect of the independent review in 2016, all recommendations have been implemented except those that require the implementation of a new software system which had been procured. The Authority is in the process of linking CIL, Accolade and Agresso and the links will need to be fully tested before final implementation.

Approach: We will sample test 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. We will also review progress on the new system implementation.

Payroll

Risk: Payroll represents a significant proportion of the Authority's annual expenditure (approaching 38% of gross spend at £477 million in 2016/17). 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.

Approach: We will:

- Review and test reconciliations for gross pay and deductions (eg pensions, tax and national insurance).
- Complete substantive analytical reviews of payroll costs and test supporting system information used to compile our review.

Youth services

Risk: Reviews have uncovered historical shortcomings and wide spread malpractice in the Authority's youth service. We have noted that the Authority had completed the interim actions to stabilise the Service. In December 2016 the Authority agreed to implement a proposal to transform the Council's youth service. This includes a restructure of the youth service, from January 2017 to enable the service to be delivered through a combination of internal resources and external commissioning. The new approach is also aimed at resolving the longstanding issues associated with service values and culture through a three year strategic and operational plan.

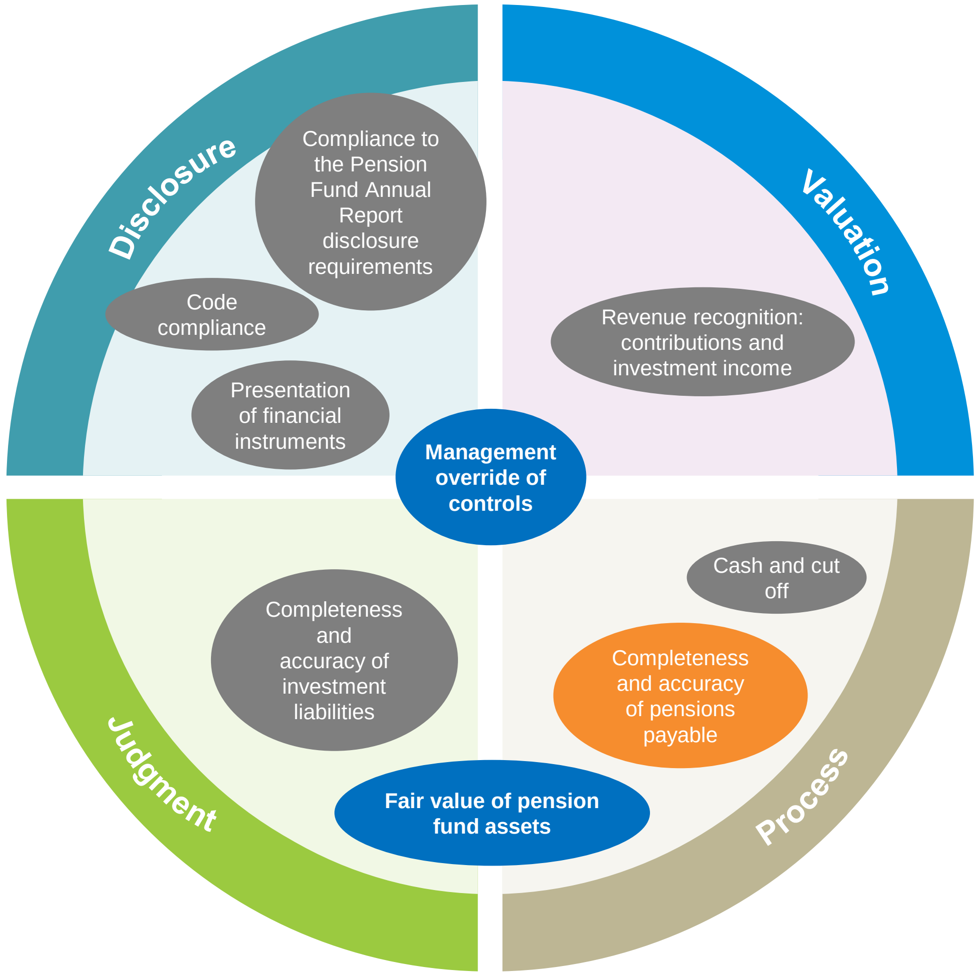
Approach: We will consider the action plan specifically in relation to dealing with/ clearing the historical shortcomings and will consider undertaking further work if considered necessary to fulfil our audit responsibilities.

2. Financial statements audit planning

Pension Fund risk assessment

Professional standards require us to consider two standard risks. We are not elaborating on these standard risks in this plan but consider them as a matter of course and will include any findings arising from our work in our ISA 260 Report.

- **Management override of controls:** Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit incorporates the risk of Management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.
- **Fraudulent revenue recognition:** We do not consider this to be a significant risk for local authority Pension Funds as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.



Key: Significant risk · Other area of audit focus · Other areas considered

2. Financial statements audit planning

Pension Fund significant audit risks

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

Valuation of investments
Risk: The Pension Fund invests in a wide range of assets and investment funds. At 31 March 2017 the Pension Fund had investment assets totalling £1.37 billion. The investment portfolio includes derivative contracts which can be complex to value. Given the size and potential for complexity in the investment portfolio we consider this to be a significant audit risk for 2017/18. **Approach:** We will undertake detailed testing of investments as part of our final accounts audit, including assessing the design and operation of controls in place, obtaining independent confirmations from the Custodian (and Fund Managers as necessary) to verify year end balances, undertaking substantive testing over sales and purchases made in the year, reviewing year on year movements, and comparing performance to known benchmarks.

Pension Fund other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Calculation of benefits
Risk: The calculation of benefits can be complex. In 2016/17 a total of £52 million was paid out by the Pension Fund (pensions and lump sums). Given the quantity and complexity of these calculations there is a risk of misstatement. **Approach:** We will complete substantive analytical reviews of pensions in payment and test supporting system information used to compile our review; and test a sample of lump sum benefit calculations.

2. Financial statements audit planning

Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements. Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

For the Authority materiality for planning purposes has been set at £17.5 million which equates to 1.4% of 2016/17 Authority expenditure. The threshold above which individual errors are reported to Audit Committee is £850,000.

For the Pension Fund materiality for planning purposes has been set at £17.5 million which equates to 1.3% of 2016/17 net assets. The threshold above which individual errors are reported to Audit Committee is £850,000.

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 unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260(UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance.

ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

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 £850,000.

In the context of the Pension Fund we propose that an individual difference could normally be considered to be clearly trivial if it is less than £850,000.

If Management has corrected material misstatements identified during the audit, we will consider whether those corrections should be communicated to Audit Committee to assist it in fulfilling its governance responsibilities.

3. Value for money arrangements work

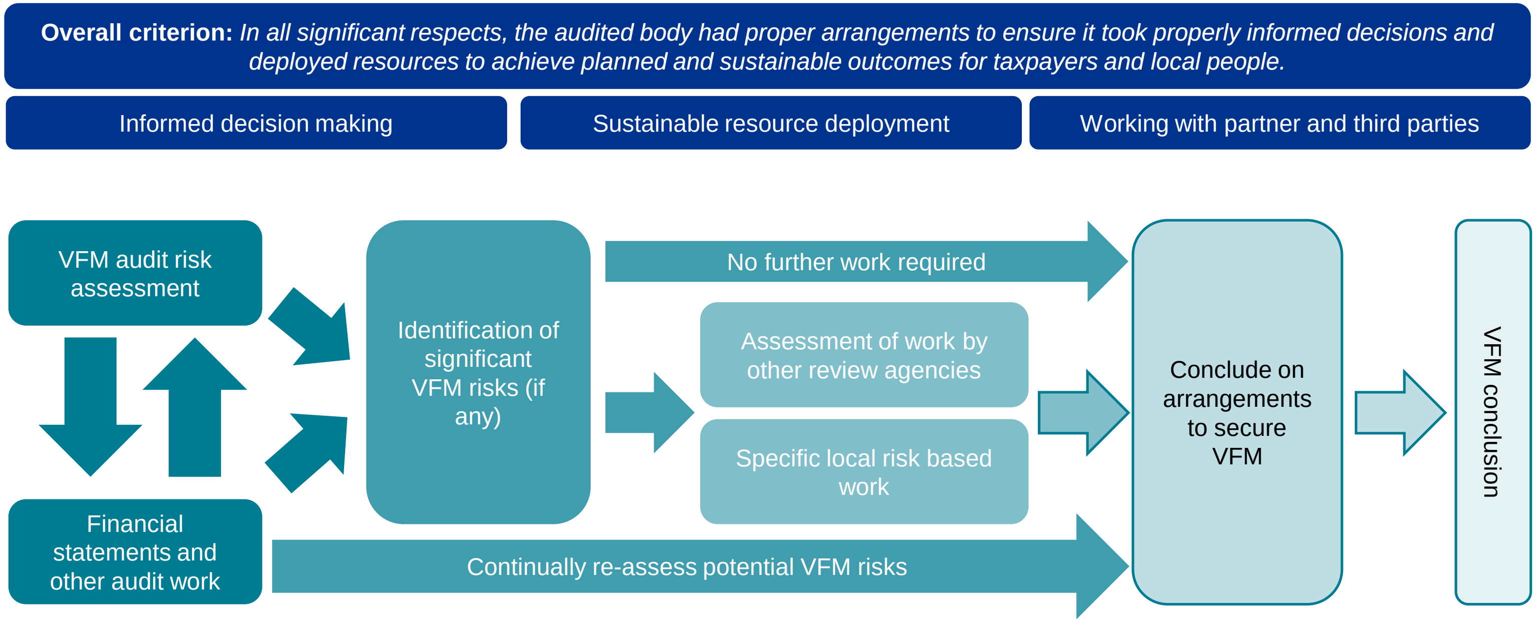
For our value for money conclusion we are required to work to the NAO Code of Audit Practice (issued in 2015 after the enactment of the Local Audit and Accountability Act 2014).

Our approach to VFM work follows the NAO's new guidance that was first introduced in 2015-16, is risk based and targets audit effort on the areas of greatest audit risk.

We have planned our audit to draw on our past experience of delivering this conclusion and have updated our approach as necessary. We will also consider reports from your regulators and review agencies.

The Local Audit and Accountability Act 2014 requires auditors of Local Government Bodies to be satisfied that the organisation "has made proper arrangements for securing economy, efficiency and effectiveness in its Value for Money". 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 process is shown in the diagram below:



We have completed our initial VfM risk assessment and have identified one significant risk for the VfM conclusion (see overleaf for details). We will keep this under review during our audit and notify the Audit Committee of any change.

3. Value for money arrangements work

Significant VFM Risks

Those risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

Implementation of Improvement Plans (Best Value and Children's)

Risk: The SoS for CLG decided to end the 2014 Directions (applied after the 2014 Best Value Inspection) and not extend the appointment of the Commissioners beyond March 2017 in recognition of the Authority's progress. In light of the work that the Authority has identified as still needing to be completed, the SoS CLG made three new, less intrusive Directions (in force until 30 September 2018) which require the Authority to set up a Best Value Improvement Board (with cross party and independent membership); submit quarterly progress reports on the Best Value improvement plan to the SoS CLG; and set up an independent review of achievement of the BV improvement plan with a report to the SoS CLG by 1 August 2018.

Also an Ofsted inspection undertaken in January and February 2017 rated the Authority's services for children in need of help and protection, children looked after and care leavers and the local safeguarding children board inadequate overall with some features requiring improvement. The Authority has established a Children's Services Improvement Board led by an Independent Chair and agreed an Improvement Plan. Ofsted are carrying out quarterly monitoring visits to ensure that its recommendations are being robustly addressed. The Children's Service Improvement Board will continue to focus on the themes identified in the Ofsted report looking at progress made and providing support and challenge on areas of on-going work. Quarterly progress updates will be provided to the Best Value Improvement Board and the Council's Cabinet and Overview and Scrutiny Committee.

Approach: We will review the work undertaken by the Authority to consider the progress in implementing the Best Value and Children's Services Improvement Plans and the extent of embeddedness within the Authority to the extent that this can be assessed during 2017/18.

VFM sub-criterion: This risk is related to the following Value For Money sub-criterion:

— Informed decision making; and

— Working with partners and third parties.

3. Value for money arrangements work

VFM other areas of focus

Those risks with less likelihood of giving rise to a significant VFM risk but which are nevertheless worthy of audit understanding.

Medium Term Financial Strategy

Risk: Local Authorities continue to be subject to a challenging financial regime with reduced funding from Central Government whilst having to maintain a statutory and quality level of services to local residents. The Authority is estimating an under spend (of around £1.5 million) for 2017/18. The Authority's balanced budget for 2017/18, includes the delivery of £26 million of approved savings plans (£20 million for 2017/18 and £6 million slippage from 2016/17).

The reported net underspend includes some significant pressures. There is a £10.5 million overspend forecast in Children's Services. This is mainly due to social care (and reflects the national picture, with the Local Government Association reporting that 75% of Council's reporting overspends in this area). The overspend in part reflects one-off costs of £4.2 million (spread over two years) as part of the Council's Improvement Plan responding to Ofsted's inspection reported in April 2017. The Council is also dealing with increased demand (such as a 15% increase in caseload, 41% more monthly contacts, and 66% more referrals); and addressing the balance of older children within its care systems (as they are both more costly and have an impact on costs when the children become adults as some costs fall on the children's services budget – meaning there will be an increase in caseload in the short-term. For adult services there have also been pressures on social care budgets, but these have been mitigated by increased funding from the Improved Better Care Fund and new Adult Social Care Grants. However, the Council is also reporting that there will be a £13.7 million under spend on its corporate costs budget, which includes provisions for unforeseen events (contingencies) and Council wide budgets for savings, growth and inflation.

The Authority's latest MTFS includes a further £36 million in savings schemes/projects that will need to be delivered during the three years 2018/19 to 2020/21, the vast majority of which have been approved and are in the process of being finalised. General Fund reserves are estimated to be £26.5 million at 31 March 2021, £5.2 million less than as at 31 March 2017. Also the level of earmarked reserves are projected to fall by £96 million to £39 million by 31 March 2021. Of the £96 million being used, the majority (£64 million) reflects significant investments by the Authority in relation to new Civic Centre; ICT and transformation projects; and delivering Mayoral priorities, with the remaining £32 million included within annual budgets over the four years to 2021.

The delivery of the planned savings is critical to ensure the Authority's financial resilience is maintained. Consequently, the Authority will need to continue to manage its savings plans to secure longer term financial and operational sustainability.

Approach: We will review overall management arrangements that the Authority has for managing its financial position. This will include the processes to develop a robust Medium Term Financial Strategy, 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 Full Council.

VFM sub-criterion: This risk is related to the following Value For Money sub-criterion: Informed decision making; Sustainable resource deployment; and Working with partners and third parties.

3. Value for money arrangements work

VFM other areas of focus (continued)

‘Clear Up’ Project
Risk: In September 2016 the Authority set up an independent ‘Clear Up’ team to deal with any remaining allegations of impropriety or serious concerns that were brought to the team’s attention. The final report was considered by the Council in July 2017. All matters identified as requiring further action have been allocated to a Corporate Director/Divisional Director to addressed. The Corporate Leadership Team will monitor progress every other month until all the matters have been completed. Quarterly reports on progress will be submitted to the Overview and Scrutiny Committee and if required to Cabinet. The Standards Advisory Committee will also receive regular reports as some of the issues raised fall within its terms of reference.
Approach: We will consider the Authority’s progress in addressing the actions identified and may undertake further work if considered necessary to fulfil our audit responsibilities.
VFM sub-criterion: This risk is related to the following Value For Money sub-criterion: Informed decision making; and Working with partners and third parties.

4. Other matters

Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified approach for 2017/18 have not yet been confirmed

Elector challenge

The Local Audit and Accountability Act 2014 gives electors certain rights. These are: the right to inspect the accounts; the right to ask the auditor questions about the accounts; and the right to object to the accounts. As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece where we interview an officer and review evidence to form our decision to a more detailed piece where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised. Costs incurred responding to questions or objections raised by electors is not part of the fee. This work will be charged in accordance with PSAA's fee scales.

Our audit team

Your audit team has been drawn from our specialist public sector assurance department and is led by two key members of staff:

- **Andrew Sayers:** your Partner has overall responsibility for the quality of the KPMG audit work and is the contact point within KPMG for the Audit Committee, the Chief Executive and Corporate Director of Finance and Resources.
- **Antony Smith:** your Manager is responsible for delivery of all our audit work. He will manage the completion of the different elements of our work, ensuring that they are coordinated and delivered in an effective manner.

The core audit team will be assisted by other KPMG staff, such as risk, tax, clinical or information specialists as necessary to deliver the plan.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but in ensuring that the audit team is accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the finance team and the Audit Committee. Our communication outputs are included in Appendix 1.

Independence and Objectivity

Auditors are required to be independent and objective. Appendix 2 provides more details of our confirmation of independence and objectivity.

4. Other matters

Audit fee

Our Audit Fee Letter 2017/2018 issued in April 2017 first set out our fees for the 2017/2018 audit. This letter also set out our assumptions. We have not considered it necessary to seek approval for any changes to the agreed fees at this stage.

Should there be a need to charge additional audit fees then this will be agreed with the Corporate Director of Finance and Resources and PSAA. If such a variation is agreed, we will report that to you in due course.

The planned audit fee for 2017/18 is £209,918 for the Authority (2016/17: £231,996 – note that this includes £22,078 for additional work needed in relation to the Best Value Inspection and associated risks, but does not include fees that will be needed to consider the objection received in relation to the Authority's PFI schemes which we accepted in December 2017). The planned audit fee for 2017/18 is £21,000 for the Pension Fund (2016/17: £21,000).

Grants and claims work

We undertake other grants and claims work for the Authority that does not fall under the PSAA arrangements:

- Housing benefits grant claim: This audit is planned for September. Our fee for this work is £20,327; and
- Pooled housing capital receipts: This audit is planned for October. Our fee for this work is £3,250; and
- Teachers pension contribution return: This audit is planned for October. Our fee for this work is £3,750.

Public interest reporting

In auditing the accounts as your auditor we must consider whether, in the public interest, we should make a report on any matters coming to our notice in the course of our audit, in order for it to be considered by Members or bought to the attention of the public; and whether the public interest requires any such matter to be made the subject of an immediate report rather than at completion of the audit.

At this stage there are no matters that we wish to report.

Appendix 1: Key elements of our financial statements audit approach

Communication

Continuous communication between you and us

- Audit strategy and plan
- ISA 260 (UK&I) Report
- Annual Audit Letter

Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep

Audit workflow

- Initial planning meetings and risk assessment
- Interim audit
- Year end audit of financial statements and annual report
- Sign audit opinion

Planning

- Perform risk assessment procedures and identify risks
- Determine audit strategy
- Determine planned audit approach

Control evaluation

- Understand accounting and reporting activities
- Evaluate design and implementation of selected controls
- Test operating effectiveness of selected controls
- Assess control risk and risk of the account being misstated

Substantive testing

- Plan substantive procedures
- Perform substantive procedures
- Consider if audit evidence is sufficient and appropriate

Completion

- Perform completion procedures
- Perform overall evaluation
- Form an audit opinion
- Audit Committee reporting

KPMG

Appendix 2: Independence and objectivity requirements

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF THE LONDON BOROUGH OF TOWER HAMLETS

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

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

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

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values; Communications; Internal accountability; Risk management; and Independent reviews.

The conclusion of the audit engagement leader as to our compliance with the FRC Ethical Standard in relation to this audit engagement [and that the safeguards we have applied are appropriate and adequate] is subject to review by an engagement quality control reviewer, who is a Partner not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity.

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

We confirm that we have not undertaken any non-audit services during 2017/18.

Independence and objectivity considerations relating to other matters

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

Appendix 2: Independence and objectivity requirements

Confirmation of audit independence

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

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

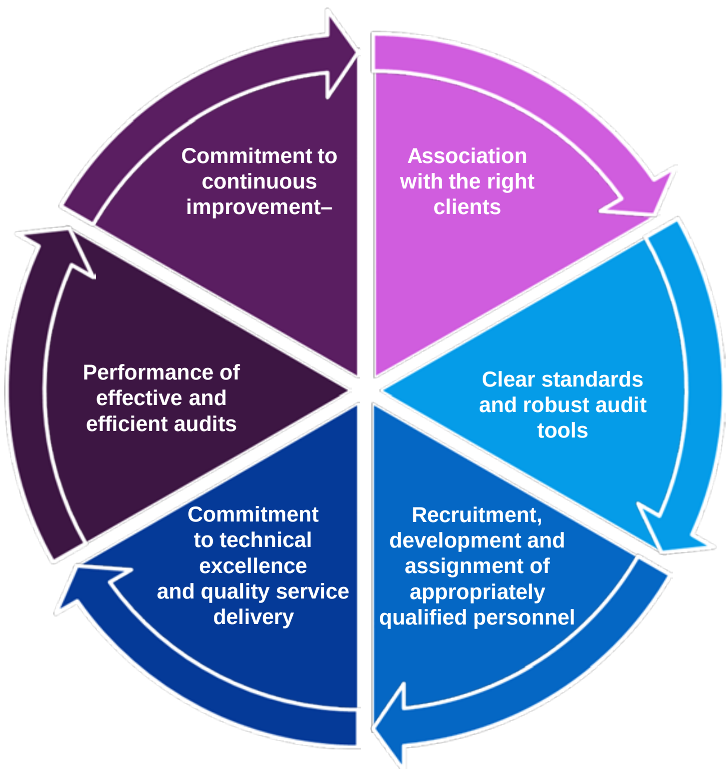
We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Appendix 3: Quality framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework

- Comprehensive effective monitoring processes
- Proactive identification of emerging risks and opportunities to improve quality and provide insights
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

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



- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Relationships built on mutual respect
- Insightful, open and honest two way communications

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

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

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists

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. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andrew Sayers, the engagement lead to the Authority and the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, who will try to resolve your complaint. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.