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Interim report to those charged with governance (ISA 260) 2013/14

London Borough of Tower Hamlets

8 September 2014

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. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.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.

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 appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 4448 330.

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements to date for the year ended 31 March 2014 for both the Authority and its pension fund; and**
- **our assessment based on the work to date of the Authority's arrangements to secure value for money.**

The Secretary of State appointed PwC to undertake an inspection of the Authority. A number of areas set out in their appointment and direction have a correlation with my responsibilities as the appointed auditor under the Audit Commission Act 1998. Consequently we will not be in a position to conclude our audit until we have had the opportunity to consider the findings from the PwC inspection.

Scope of this report

This interim report summarises the key findings arising from:

- our audit work to date at the London Borough of Tower Hamlets ('the Authority') in relation to the Authority's 2013/14 financial statements and those of the Local Government Pension Scheme it administers ('the Fund'); and
- the work undertaken to date to support our 2013/14 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

PricewaterhouseCoopers LLP (PwC) are carrying out an inspection of the Authority, as directed by the Secretary of State for Communities and Local Government, under Section 10 of the Local Government Act 1999. The areas set out by the Secretary of State to be included within the scope of the inspection have a correlation with our responsibilities as the appointed auditor under the Audit Commission Act 1998.

PwC were originally scheduled to report by the end of June 2014 but subsequently an announcement was made indicating the inspection had been delayed, but no revised timescale appears to have been published.

Given the correlation of the scope of the inspection with our responsibilities we will not be in a position to conclude our audit of the financial statements for 2013/14, or conclude on the Council's arrangements in place for securing economy, efficiency and effectiveness in its use of resources for 2013/14, until we have had the opportunity to consider the findings from the PwC inspection.

Financial statements

Our *External Audit Plan 2013/14*, presented to you in March 2014, set out the four stages of our financial statements audit process.

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place during April 2014 (interim audit) and July/August 2014 (year end audit).

A final report will be produced when our audit work is complete.

VFM conclusion

Our *External Audit Plan 2013/14* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have now completed the work that we expected to complete as part of the Plan to support our 2013/14 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion; and
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages based on the work completed to date.
- Section 3 sets out our key findings from our audit work to date in relation to the 2013/14 financial statements of the Authority and the Fund.
- Section 4 outlines our key findings from our work to date on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Headlines

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

Proposed audit opinion	Based on our work completed to date in relation to our planned programme of audit work we have not identified any matters that would impact adversely on our audit opinion on the Authority's financial statements. In addition the wording of your Annual Governance Statement accords with our current understanding. Similarly for the Fund, based on our work completed to date we have not identified any matters that would impact adversely on our audit opinion on the Fund's financial statements, as contained in the Authority's Statement of Accounts. We have not yet received a draft version of the Pension Fund Annual Report. However, as noted on page 2 we are not able to conclude our work and form our audit opinion on the Authority's financial statements for 2013/14, until we have had the opportunity to consider the findings from the PwC inspection.
Audit adjustments	The Authority has identified two adjustments with a total value of £5.0 million. To date our audit has not identified any further audit adjustments. The impact of the adjustments is to: ■ Not change the balance on the general fund account as at 31 March 2014; ■ Decrease the surplus on provision of services for the year by £1.3 million; and ■ Decrease the net worth of the Authority as at 31 March 2014 by £1.3 million. The Authority identified adjustments related to grossing up debtors and creditors by £3.7million and the late notification of a creditor by an NHS organisation (£1.3 million). For the former there is no impact on net worth or the General Fund balance and for the latter there was an earmarked reserve set aside for such items and therefore there is no impact on the Authority's General Fund balance.
Key financial statements audit risks	We review risks to the financial statements of the Authority and the Fund on an ongoing basis. We identified one significant risk specific to the Authority for 2013/14 relating to the implementation of the new General Ledger system. We did not identify any significant risks specific to the Fund for 2013/14. We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.
Accounts production and audit process	We have noted that the quality of the accounts and the supporting working papers has been maintained. Officers dealt efficiently with audit queries.

Headlines

This table summarises the headline messages. The remainder of this report provides further details on each area.

ISA 260 Report 2012/13	We made eight recommendations in our *ISA 260 Report 2012/13,* (none were rated as high priority). We are satisfied that one of the recommendations has been implemented and for a second (Member taxi expenses) there were no claims recorded in the General Ledger after September 2013 when the recommendation was made. We have not yet been able to complete our work to assess whether the recommendation relating to evidence to support compliance with the Publicity Code has been implemented. For the remaining five recommendations, three have been superseded by the findings of our audit work this year (annual review of PPE; timeliness of reconciliations and school bank reconciliations) – see Appendix 1 for further details. The remaining two recommendations relating to the completion of the corporate governance review and explanations in budget variance reports have not been implemented (see Appendix 2 for details).
Control environment	The Authority's organisational and IT control environment is generally effective overall, but we have identified weaknesses in controls over certain key financial systems. Key reconciliations (the main bank account reconciliation and the payroll reconciliation) were not completed on a regular basis throughout the year, we have raised a high priority recommendation around this.
Completion	At the date of this report our underlying audit of the financial statements is substantially complete although we have some areas where we are following up outstanding queries. In addition we have to complete our review procedures, consideration of the findings arising from the PwC inspection (when available) and completion procedures. Before we can issue our opinion we require a signed management representation letter, which covers the financial statements of both the Authority and the Fund. However, we will not request the representation letter until we are in a position to issue our audit opinion and VFM conclusion ie following our consideration of the findings from PwC's inspection on behalf of the Secretary of State. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's and the Fund's financial statements.
VFM conclusion and risk areas	We have completed the work that we expected to complete as set out in our *External Audit Plan 2013/14*, and have not identified any issues impacting negatively on our assessment as to whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. However, as noted on page 2, we are not able to complete our work and conclude on the Council's arrangements in place for securing economy, efficiency and effectiveness in its use of resources for 2013/14, until we have had the opportunity to consider the findings from the PwC inspection.

Headlines

This table summarises the headline messages. The remainder of this report provides further details on each area.

Certificate	We have received a number of enquiries from Members during 2013 and 2014 relating to television adverts; the Authority's publication - East End Life; and treatment of Authority assets. We were also specifically referred to in a Council motion relating to the sale of Poplar Town Hall and have considered the report prepared on this by Mazars on behalf of the Authority. In addition we have received a whistle-blowing referral relating to costs of IT purchases and IT services at a Council school, about which we have liaised with Internal Audit who are undertaking an initial review. At the date of this report we have not yet completed our consideration of all of these matters, although we have made one recommendation based on our work to date (see Appendix 1 for details). The time taken by the Authority to respond to our information requests and queries in relation to some of these have been longer than we would normally expect. In addition, as at the date of this report we have not completed the procedures specified by the National Audit Office on your Whole of Government Accounts return. We expect to complete our work and report our findings to management by 3 October 2014 on any issues arising with respect to the Whole of Government Accounts return. We understand that two Local Government Electors (LGEs) have been in contact with the Council on different matters and that both are considering whether to exercise their rights to make an objection to the Council's 2013/14 financial statements. At the date of this report we have not yet received any formal objection. If we receive an objection we will not be able to formally conclude the audit and issue an audit certificate until we have completed a review of any objection.

Proposed opinion and audit differences

To date we have identified no audit differences in the course of the audit of the Authority's financial statements that are considered to be material.

The Authority has identified two adjustments with a total value of £5.0m.

The impact of the adjustment is to:

- **Leave the balance on the general fund account as at 31 March 2014 unchanged;**
- **Decrease the surplus on the provision of services for the year by £1.3 million; and**
- **Decrease the net worth of the Authority as at 31 March 2014 by £1.3 million.**

Proposed audit opinion

Based on our work completed to date for our planned programme of audit work we have not identified any matters that would impact adversely on our audit opinion on the Authority's financial statements. However, as noted above we are not able to finalise our audit and form our audit opinion on the Authority's financial statements until we are able to review PwC's findings arising from their inspection.

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 level for this year's audit of the Authority's financial statements was set at £23 million. Audit differences below £1.1 million are not considered significant.

The Authority identified adjustments related to grossing up debtors and creditors by £3.7 million and the late notification of a creditor by an NHS organisation (£1.3 million). For the former there is no impact on net worth or the General Fund balance and for the latter there was an earmarked reserve set aside for such items and therefore there is no impact on the Authority's General Fund balance.

The tables on the right illustrate the total impact of the adjustments on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2014.

There is no net impact on the General Fund balance as at 31 March 2014 as a result of Authority identified adjustments.

Movements on the General Fund 2013/14

£m	Pre-audit	Post-audit	Ref
Surplus on the provision of services	21.7	20.4	*Page 6*
Adjustments between accounting basis & funding basis under Regulations	13.2	13.2	-
Transfers to earmarked reserves	(8.0)	(6.7)	*Page 6*
Increase in General Fund	**26.9**	**26.9**	

Balance Sheet as at 31 March 2014

£m	Pre-audit	Post-audit	Ref
Property, plant and equipment	1,839.3	1,839.3	-
Other long term assets	9.9	9.9	-
Current assets	450.1	453.8	*Page 6*
Current liabilities	(205.8)	(210.8)	*Page 6*
Long term liabilities	(699.7)	(699.7)	-
Net worth	**1,393.8**	**1,392.5**	
General Fund	(65.0)	(65.0)	-
Other usable reserves	(253.1)	(251.8)	*Page 6*
Unusable reserves	(1,075.7)	(1,075.7)	-
Total reserves	**(1,393.8)**	**(1,392.5)**	

Proposed opinion and audit differences (continued)

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

We therefore anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts and the Pension Fund Annual Report at the same time as we are able to issue the opinion on the Authority's financial statements.

The wording of your Annual Governance Statement accords with our current understanding.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2013/14 ('the Code')*. We understand that the Authority will be addressing these.

Pension fund audit

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

For the audit of the Fund we used a materiality level of £18 million. Audit differences below £900,000 are not considered significant.

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion at the same time that we are able to issue the opinion on the Authority's financial statements.

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.

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.

We have made a few minor comments in respect of its format and content which the Authority has agreed to amend.

Pension Fund Annual Report

The Pension Fund Annual Report is in the process of being prepared for the Pensions Committee on 17 September. We are therefore yet to confirm that:

- it complies with the requirements of the Local Government Pension Scheme (Administration) Regulations 2008; or
- the financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

The statutory deadline for publishing the document is 1 December 2014. The Pension Fund Annual Report is currently due to be approved by the Pensions Committee on 17 September 2014.

Key financial statements audit risks

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

In our *External Audit Plan 2013/14*, presented to you in March, we identified the key risks affecting the Authority's and the Fund's 2013/14 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

Since our External Audit Plan we have identified, and added, National Non-Domestic Rates (NNDR) as a further area of key audit focus as a result of the implementation of the Business Rates Retention Scheme in 2013/14.

The table below sets out our detailed findings for each of the areas of focus and risks that are relevant to the Authority and Pension Fund. We have indicated in each case whether these relate to the audit of the Authority's financial statements or those of the Fund.

Additionally, we considered the risk of management override of controls, which is a standard risk for all organisations.

Our 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, did not identify any issues.

Key audit risk	Issue	Findings
New General Ledger system	The Authority has installed a new ledger system (Agresso) which went live on 1 April 2013. There are risks to the completion and compilation of the financial statements associated with such a significant change. We also understand that the Authority has had some issues in ensuring that the migration of data from the previous ledger has been completed satisfactorily. Other risk areas include accurate processing and coding; system access for joiners, leavers and staff changing role; and segregation of duties. This risk affects only the Authority.	Our IT team has undertaken a separate exercise to review access and operation controls. We have also reviewed the completeness and accuracy of the general ledger data migration of closing balances from the previous finance system (ie as at 31 March 2013) to Agresso (migration and reconciliation). We have considered the results of the work completed by our IT team and tested the ledger as necessary. Based on the results of this work we are satisfied that we are able to rely on the outputs from the general ledger when undertaking our audit of the financial statements.

Key financial statements audit risks (continued)

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

Area of Audit Focus	Issue	Findings
Property, Plant and Equipment	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. We also made a recommendation in this area in our *ISA 260 Report* on the 2012/13 financial statements. This risk affects only the Authority.	We have completed detailed testing of the following as part of our financial statements audit: ▪ Reviewed management's assessment of property valuations and impairment calculations. ▪ Confirmed the information provided to the valuer from the Authority. ▪ Compared the assumptions made by your valuer to benchmarks and to the assumptions used for 2012/13 for consistency. ▪ Followed up progress on issues raised by us in our 2012/13 ISA 260 report. Our detailed testing has been completed with only one presentational issue identified, which is being addressed by the Authority. Although not an issue for this year we have made a recommendation about the approach to future valuations, see Appendix 1.
Member enquiries	We have received a number of enquiries from Members during 2013 and 2014 relating to television adverts; the Authority's publication - East End Life; and treatment of Authority assets. We were also specifically referred to in a Council motion relating to the sale of Poplar Town Hall and have considered the report prepared on this by Mazars on behalf of the Authority. In addition we have received a whistle-blowing referral relating to costs of IT purchases and IT services at a Council school, about which we have liaised with Internal Audit who have been undertaking an initial review. This risk affects only the Authority.	We have not yet completed our consideration of all of these matters and will report to the Authority and the Members making the enquiries as appropriate at the conclusion of our work. The time taken by the Authority to respond to our information requests and queries in relation to these continues to be longer than we would normally expect. The work in relation to these enquiries is not part of the scale fee set by the Audit Commission. Therefore the work needed to consider the matters raised is an additional fee which we have currently estimated to be £14,340 and this additional fee has been agreed by the Audit Commission.

Key financial statements audit risks (continued)

We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

Area of Audit Focus	Issue	Findings
NNDR	Due to the introduction of Business Rate Localisation, with effect from 1st April 2013, there were significant changes in the requirements for the disclosure of NDR balances and transactions, as per the CIPFA Code. Furthermore, there were significant variances in the balance sheet and the CIES as a result of the change of accounting treatment. These factors meant that non-domestic rates were reassessed as an area of audit focus and therefore have been included as such. This risk affects only the Authority.	We have completed our review of the disclosure requirements and changed accounting treatment relating to NDR balances and transactions in the Authority's financial statements. We have not identified any issues from the work we have done.
LGPS Triennial Valuation	The Pension Fund has undergone a triennial valuation with an effective date of 31 March 2013 in line with the Local Government Pension Scheme (Administration) Regulations 2008. The Authority's share of pensions assets and liabilities for each admitted body is determined in detail, and a large volume of data is provided to the actuary to support this triennial valuation. The IAS 19 numbers included in the financial statements for 2013/14 are based on the output of the triennial valuation rolled forward to 31 March 2014. For 2014/15 and 2015/16 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There is a risk that the data provided to the actuary for the valuation exercise was inaccurate and that these inaccuracies affect the actuarial figures in the accounts. This risk affects both the Authority and the Fund.	For the audit of the Pension Fund, we completed work to agree the data provided to the actuary back to the systems and reports from which it was derived, and to understand the controls in place to ensure the accuracy of this data. This work focused on the data relating to the Authority itself as largest member of the Pension Fund.

Accounts production and audit process

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

Officers dealt efficiently with audit queries

The Authority has implemented some of the recommendations in our *ISA 260 Report 2012/13* and others have been superseded by work we have completed this year. This leaves two recommendations outstanding.

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 strengthened its financial reporting processes by including additional quality checks. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June 2014.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued in March 2014 and discussed with the Authority, set out our working paper requirements for the audit. The quality of working papers provided generally met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved audit queries in a reasonable time. Where the issues raised were more complex there was appropriate communication around these issues as they were being considered and resolved.

Element	Commentary
Pension fund audit	The audit of the Fund is almost complete. There are no specific matters to bring to your attention relating to this.

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.

We made eight recommendations in our *ISA 260 Report 2012/13,* (none were rated as high priority). We are satisfied that one of the recommendations has been implemented and for a second (Member taxi expenses) there were no claims recorded in the General Ledger after September 2013 when the recommendation was made. We have not yet been able to complete our work to assess whether the recommendation relating to evidence to support compliance with the Publicity Code has been implemented.

For the remaining five recommendations, three have been superseded by the findings of our audit work this year (annual review of PPE; timeliness of reconciliations and school bank reconciliations) – see Appendix 1 for further details. The remaining two recommendations relating to the completion of the corporate governance review and explanations in budget variance reports have not been implemented (see Appendix 2 for details).

Control environment for key financial systems

The Council's organisation and IT control environment is effective, and controls over the majority of the key financial systems are sound.

However, there are some weaknesses in respect of non-completion of in-year monthly bank and payroll reconciliations.

We needed to complete additional substantive work in these areas at year-end as a result.

Organisational and IT control environment

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit. We therefore obtain an understanding of the Council's overall control environment and determine if appropriate controls have been implemented.

The Council also relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on reports generated from these we sample test underlying data to ensure the reports can be relied upon.

We did not identify any issues in the accuracy of underlying data in systems generated reports that we tested as part of our financial statements audit.

Review of Internal Audit

Our risk based approach is mainly focussed on completing substantive testing over balances included in the financial statements rather than testing the controls in place at the Council, which does not require us to place reliance on Internal Audit's work.

We used Internal Audit to inform ourselves on the areas of the Council's operations that were relevant to our work and have taken assurance from Internal Audit's contribution to an effective control environment.

We noted in the Internal Audit reports weaknesses in respect of individual financial systems. Internal Audit included recommendations in their reports as appropriate.

Since April 2013, the United Kingdom Public Sector Internal Audit Standards (PSIAS) apply across the whole of the public sector, including local government. These standards are intended to promote further improvement in the professionalism, quality, consistency and effectiveness of internal audit across the public sector. We are satisfied that internal audit are working towards becoming fully compliant with the PSIAS.

Controls over key financial systems

Where we have determined that this is the most efficient audit approach to take, we test selected controls that address key risks within the financial systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Our assessment of a system will not always be in line with your internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

Key findings

Based on the work of your internal auditors, and our own work on controls over the year end process, and testing of underlying data the controls over the key financial systems are sound, except for the following weakness:

- Key reconciliations (the main bank account reconciliation and the payroll reconciliation) were not completed on a regular basis throughout the year.

Recommendations are included in Appendix 1. The weakness identified meant that we needed to complete additional substantive work at year-end.

Completion

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

Before we can issue our opinion we require a signed management representation letter which we will request when we are in a position to complete our audit.

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

Interim 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 2014, 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 Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 3 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 will provide a template to the interim Corporate Director of Resources for presentation to the Audit Committee when we are in a position to complete our audit. We will require a signed copy of your management representations before we issue our audit opinion.

At the time we request management representations we will consider if we need to seek specific management representations for any particular issues.

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 or our previous reports relating to the audit of the Authority's 2013/14 financial statements.

VFM conclusion

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

We have completed the work that we expected to complete as set out in our *External Audit Plan 2013/14*, and have not identified any issues impacting negatively on our assessment as to whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

However, as noted earlier, we are not able to reach a conclusion about the Authority's arrangements for VFM until we are able to review PwC's findings arising from their inspection.

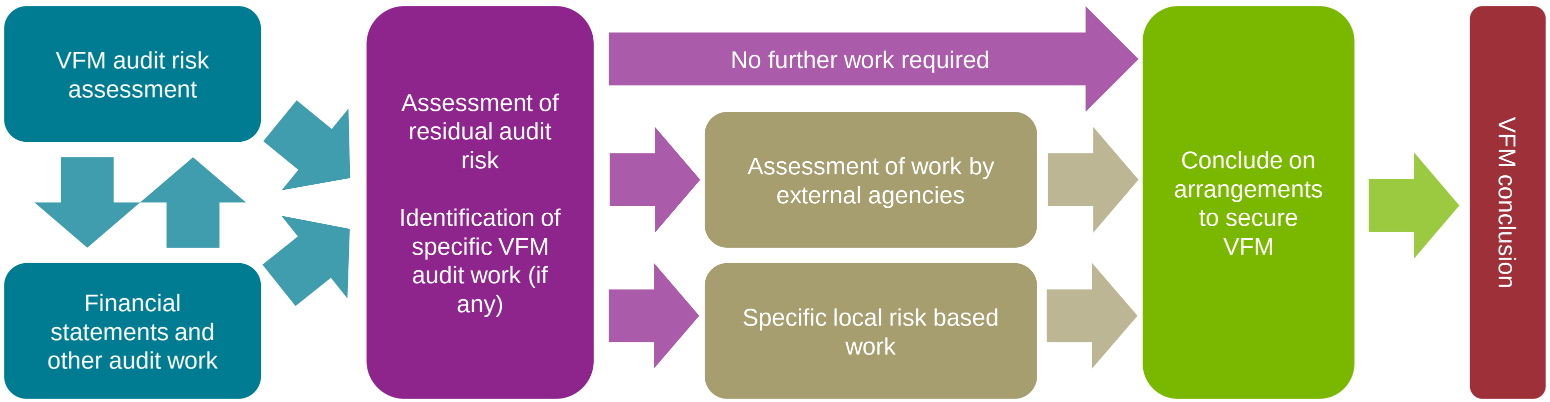
Background

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

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

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

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



Work completed

We have completed the work that we expected to complete as set out in our *External Audit Plan 2013/14*, and have not identified any issues impacting negatively on our assessment as to whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

However, as noted on page 2, we are not able to reach a conclusion about the Authority's arrangements for VFM until we are able to review PwC's findings arising from their inspection.

Specific VFM risks

We have identified one area of audit focus in relation to VFM.

Work completed

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

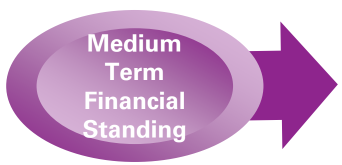
- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit; and
- considered the results of relevant work by the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

Key findings

Our initial risk assessment did not identify any residual risks for our VFM conclusion as there was sufficient relevant work that had completed by the Authority, other inspectorates and review agencies in relation to these risk areas.

We shall consider the position further when we are able to review PwC's findings arising from their inspection.

In our External Audit Plan 2013/14, presented to you in March 2014, we identified a specific area of focus for our VFM conclusion. The table below sets out our findings in respect of this.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	Even after using reserves of £38 million, the Authority estimates that it will need to deliver £67 million in savings during the two years 2015/17 to address further reductions to local authority funding and continued cost pressures. The Authority will need to continue to manage its savings plans to secure longer term financial and operational sustainability.	Our VFM work has included a focus on how the Authority is planning and managing its savings plans, specifically that its Medium Term Financial Plan has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Authority can continue to provide services effectively. The Authority has developed plans that mean it is confident that a balanced budget will be achieved for 2015/16 and has an agreed timetable to meet this. The Authority is continuing to drive out inefficiencies and secure economies through continuing to review services and the best means of delivery and identify savings in areas such as procurement.

Appendix 1: 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		
❶ ***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.	❷ ***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.	❸ ***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❶	**Completion of key reconciliations** At the time of our interim audit we identified that a reconciliation had not been carried out for the main Authority bank account during 2013/14 since the implementation of Agresso. Although the 31 March 2014 reconciliation was completed by the Authority, this involved a considerable amount of time and effort from Authority officers as it covered the whole year in one go. At the time of our final audit visit we identified that a payroll reconciliation had not been carried out for the main Authority payroll during 2013/14. These are both key controls which are required to be in place through-out the year in order to maintain a robust control environment. **Recommendation** The Authority should implement a process whereby going forward each of these reconciliations is completed on a monthly basis. The Authority is required to implement a review process by which non completion of key reconciliations is escalated to the relevant Service Head.	It is agreed that the scale of implementation of a new financial system led to delays in continuing the main bank reconciliation from 31st March 2013 and this was not finalised until the 2013/14 year end. This process has now been fully implemented and is now running monthly. Payroll reconciliations were completed for year end. During the year reconciliations of net pay and tax were reconciled monthly to the BACS payments, and payroll interfaces to the general ledger were reconciled to the payroll system at regular intervals. 3rd party deductions were however only reconciled at year end. A revised procedure is now being implemented to cover all payroll reconciliations monthly. In addition a key controls report is now produced monthly for all key financial controls, and is reviewed by relevant service heads, and any key control which has not been completed or is out of tolerance is now flagged each month for corrective action. Responsible Officer : Richard Lungley Due Date: March 2015

Appendix 1: 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.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
2	2	**School bank reconciliations** During our review of the school bank reconciliation, we noted that for two schools, Sir John Cass and Olga there were outstanding reconciling items at the year end which had been initially entered into the ledger several years ago. It is noted that schools are provided with copies of the close down procedures at the year end, which does suggest reviewing transactions / cheques over six months old. In the case of these schools these transactions had not been cancelled. **Recommendation** The Schools Finance Team, during their review of the reconciliations completed by individual schools, should challenge schools which submit reconciliations containing transactions which are over six months old. Schools should be required to submit justification for the inclusion of any aged items within their reconciliations.	As stated by the auditor, the schools finance team issue all maintained schools accounting guidance which recommends schools review cheques older than six months and reverse in their finance system where applicable. As part of planning for the 2014/15 accounts closure, the school finance team will include further guidance on un-reconciled items in the schools newsletter. The school finance team will also sample a number of schools to ensure any cheques older than 6 months are challenged and appropriate action is taken. Compliance testing will take place in Jan/Feb 2015. Responsible Officer : Sailesh Patel Due Date: March 2015
3	2	**Other Land and buildings valuations** During our review of Property, Plant and Equipment valuations, we noted that for it was not straightforward to identify that the valuer had looked at upward trends as well as impairments when completing the formal valuations for 2013/14 (even though the Authority expressly requested this). We also noted that the valuer only commented about price movements for the last 12 months, but the Authority has a minority of assets that were last valued between 2 and 4 years ago. **Recommendation** The Authority should continue to work with the valuer to ensure that the report received explicitly covers all of the elements that it has requested. Also the Authority needs to ensure that there is appropriate consideration of assets that have not been valued in the last 12 months to ensure that the values disclosed remain materially accurate between valuations.	For the 2014/15 property valuation, officers have asked Valuers to consider upward trends as well as impairments in conducting the valuations. The Valuers have also been asked to consider material changes in valuations for asset classes valued more than 12 months ago. Officers will work with Valuers to minimise additional valuation costs from this work, for example with the use of valuation indices as part of a desk top valuation exercise. Responsible Officer : Kevin Miles Due Date: March 2015

Appendix 1: 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.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
4	3	**111 – 113 Mellish Street** During our review of what happened in relation to a Member enquiry about the above site we noted that: the time period available for considering and auctioning the letting of the site was relatively short; there were areas where the documentation supporting the decisions could be improved – particularly the use of an SLA approach, which allowed for reductions in the rental income; and the procedures for allocating properties were written and established in August 2010, since when there have been a number of changes in the process. **Recommendation** We have therefore recommended to the Authority that: • It considers the nature, size and complexity of arrangements being planned for community use/letting and ensure that the timeframes reflect this appropriately to help ensure the Council receives a good selection of quality applications. • The importance of evidencing the basis of decisions is reiterated and, as necessary incorporated in relevant procedural documentation. • Procedures are revised to reflect the updated process and include guidance on the documentation to be retained to support decisions.	The Corporate Property and Capital Delivery Service Plan will review and update the procedures for allocating properties. This will require the input of the third sector team, specifically in relation to properties that are let for community use as this might require slightly different processes in light of the fact that many community organisations won't have the commercial experience and resources compared to properties let on the open market. The review will include timescales for considering and auctioning the letting of the site, as well as the level of documentary evidence to back up the decisions that are made. Ann Sutcliffe October 2014

Appendix 2: Follow up of prior year recommendations

The Authority has not implemented all of the recommendations in our *ISA 260 Report 2012/13.*

We re-iterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2012/13* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	8
Implemented in year or superseded	6
Remain outstanding (re-iterated below)	2

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2014
1	2	**Completion of corporate governance review** The Authority should complete the planned corporate governance review and ensure that any issues identified are addressed promptly to ensure that the Authority's structures and personnel are fit for purpose to meet the future financial challenges facing the Authority.	Officers will keep the auditors briefed as the governance review continues. C Holme March 2014	We understand that the review has not yet been completed.
2	3	**Budget Variances** As part of our interim audit we reviewed the processes and controls in place over budget monitoring. We identified that not all variances over the prescribed £250,000 variance level were being adequately explained. The Authority should consider if a standard £250,000 threshold is appropriate across all directorates or if a more tailored approach would be more appropriate. The Authority must then ensure that it complies with these thresholds.	Officers will ensure suitable budget variance comments are included within the regular budget monitoring reports. K Miles September 2013	Our testing this year identified that there were still examples where the variance explanations were not sufficiently comprehensive.

Appendix 3: Interim declaration of independence and objectivity

The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of both the Commission and the Authority.

Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the 'Code') which states that:

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

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission's *Standing Guidance for Local Government Auditors* ('Audit Commission 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. Audit Commission 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.

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.

Appendix 3: Declaration of independence and objectivity (continued)

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

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

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

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

Non-audit work

Our IT advisory team completed an IT systems post-implementation review during 2013/14, in addition our tax team have provided advice throughout 2013/14. We have considered the scope of the work in the context of the Auditing Practices Board's (APB) Ethical Standards and Audit Commission requirements and concluded it does not impair our independence

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 2014, 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 Audit Commission's requirements in relation to independence and objectivity.

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