



cutting through complexity™

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

London Borough of Tower Hamlets

**DRAFT** 18 September 2015



The contacts at KPMG in connection with this report are:

**Andrew Sayers**

*Partner*

*KPMG LLP (UK)*

Tel: + 44 [0]207 694 8981

[andrew.sayers@kpmg.co.uk](mailto:andrew.sayers@kpmg.co.uk)

**Antony Smith**

*Manager*

*KPMG LLP (UK)*

Tel: + 44 [0]207 311 2355

[antony.smith@kpmg.co.uk](mailto:antony.smith@kpmg.co.uk)

## Report sections

|   | Page |
|---|------|
| ■ Introduction  | 2    |
| ■ Headlines   | 3    |
| ■ Consideration of BV Inspection report and other matters | 6    |
| ■ Financial statements                                    | 12   |
| ■ Conclusion on arrangements to secure value for money    | 15   |

## Appendices

|  |    |
|--|----|
| 1. Key issues and recommendations              | 16 |
| 2. Declaration of independence and objectivity | 19 |
| 3. Proposed independent auditor's report       | 21 |
| 4. Materiality                                 | 24 |

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](http://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](mailto: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, 3<sup>rd</sup> Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to [complaints@audit-commission.gsi.gov.uk](mailto:complaints@audit-commission.gsi.gov.uk). Their telephone number is 0303 4448 330.

**This report updates, and should be read in conjunction with, our interim report issued in September 2014.**

**This document summarises our consideration of the BV Inspection report produced by PwC and published in November 2014, the Mayoral election judgment issued in April 2015 and other matters raised with us as auditors.**

**We set out in Appendix 3 our proposed opinion which will be qualified in respect of the Authority's arrangements to secure value for money. We have also made a Section 11 recommendation in relation to the need for governance processes across the Authority to be reviewed.**

### Scope of this report

This report should be read in conjunction with the 'Interim report to those charged with governance (ISA 260) 2013/14' (the interim report) that we issued to the Audit Committee in September 2014.

Since the interim report our primary focus has been on the consideration of matters raised in:

- the 'Best Value Inspection of London Borough of Tower Hamlets' report (the BV Inspection report) produced by PricewaterhouseCoopers LLP (PwC), dated 16 October 2014, and published by the Secretary of State for Communities and Local Government on 4 November 2014;
- the Mayoral election judgment issued in April 2015; and
- other matters raised by DCLG, the Commissioners, Members and electors.

Whilst these matters principally impact our consideration of the arrangements to secure value for money we have also considered the impact on our financial statements audit and in relation to an auditors statutory powers.

### Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages based on the work completed.
- Section 3 summarises our consideration of the matters noted above.
- Section 4 sets out our key findings from our audit work in relation to the 2013/14 financial statements of the Authority and the Fund.
- Section 5 outlines our key findings from our work on the

consideration of the arrangements to secure value for money.

In Appendix 1 we have included further recommendations raised since the interim report.

In Appendix 3 we have included a draft of our proposed opinion.

### Acknowledgements

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

**This table summarises the headline messages for the Authority and the Fund based on the work completed to date. Sections three to five of this report provide further details on audit differences, completion steps and the consideration of the arrangements to secure value for money.**

|   |  |
|---|--|
| <b>Proposed financial statement audit opinion</b> | <p>Based on our work completed to date we anticipate providing an unqualified opinion on the Authority's financial statements.</p> <p>We are in the process of considering the wording of the Authority's updated Annual Governance Statement so that we are satisfied that it accords with our current understanding.</p>   |
| <b>Audit adjustments</b>                          | <p>The Authority identified two adjustments with a total value of £5.0 million. Our audit has not identified any further audit adjustments to the primary statements. The impact of the adjustments is to:</p> <ul style="list-style-type: none"> <li>■ Not change the balance on the general fund account as at 31 March 2014;</li> <li>■ Decrease the surplus on provision of services for the year by £1.3 million; and</li> <li>■ Decrease the net worth of the Authority as at 31 March 2014 by £1.3 million.</li> </ul> <p>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.</p> |
| <b>Key financial statements audit risks</b>       | <p>We review risks to the financial statements of the Authority 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.</p> <p>We have worked with officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately. Details of the work undertaken on the significant risks and other areas of audit focus are contained in section 3 of our interim report.</p>  |
| <b>Accounts production and audit process</b>      | <p>We have noted that the quality of the accounts and the supporting working papers has been maintained. Officers dealt efficiently with audit queries. Further details are contained in section 3 of our interim report.</p>  |
| <b>ISA 260 Report 2012/13</b>                     | <p>We made eight recommendations in our <i>ISA 260 Report 2012/13</i>, (none were rated as high priority). We are satisfied that two of the recommendations have been implemented and for a third (Member taxi expenses) there were no claims recorded in the General Ledger after September 2013 when the recommendation was made.</p> <p>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). The remaining two recommendations relating to the completion of the corporate governance review and explanations in budget variance reports have not been implemented. Details of the follow up and status of these recommendations is included in the interim report.</p>  |

|   |   |
|---|---|
| <p><b>Financial statement control environment</b></p>                             | <p>The Authority's financial statement 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 raised a high priority recommendation around this in the interim report. We have raised a further high priority recommendation in relation to declarations of interest and governance arrangements in schools in this report set out in Appendix 1.</p>  |
| <p><b>Completion</b></p>  | <p>At the date of this report our audit of the financial statements is substantially complete. We have to complete some final testing in relation to s106. In addition we have to complete our final check of the financial statements and review of the updated Annual Governance Statement. We also need to undertake our final review and completion procedures including post balance sheet events review.</p> <p>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.</p> <p>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.</p>  |
| <p><b>Conclusion on arrangements to secure value for money and risk areas</b></p> | <p>We have completed the work that we expected to complete as set out in our <i>External Audit Plan 2013/14</i>, and in addition considered the findings in the BV Inspection report, the Mayoral election judgment issued in April 2015 and other matters raised with us as auditors. We have set out our considerations in Section 3.</p> <p>We anticipate issuing an adverse opinion in respect of the Authority's arrangements to secure value for money. The qualification reflects the matters raised in the BV Inspection report where the Authority has failed to comply with its best value duty in relation to:</p> <ul style="list-style-type: none"> <li>■ Payment of grants and connected decisions;</li> <li>■ The disposal of property and the granting of leasehold interests; and</li> <li>■ Spending on publicity.</li> </ul> <p>In addition to the above specific points, the BV Inspection report also comments that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above. Comments within the Mayoral election judgment and arising from the other matters raised with us as auditors also indicate the governance processes have not always been effective. We have therefore also made a Section 11 recommendation in relation to the need for governance processes across the Authority to be reviewed.</p> |

|  |   |
|--|---|
| <p><b>Auditor statutory powers</b></p> | <p>As part of our work we considered whether we should exercise any of the auditors statutory powers in particular whether or not to issue a report in the public interest or seek a declaration from the court that items of account are contrary to law.</p> <p>Whether or not to issue a report in the public interest or seek a declaration from the court that items of account are contrary to law is a matter for us in the exercise of our discretion. Relevant factors include the quantum of any unlawful item of account or loss, whether there were significant failings in governance, whether the matters that might be the subject of a report are ongoing, whether there has been significant publicity in respect of the issues, whether we have recommendations to make to the Council and whether we believe that our independent view should be expressed in public.</p> <p>In relation to the issue of a public interest report, we have formed the view that we will not issue a public interest report under section 8 of the Audit Commission Act 1998. Whilst the matters that have been raised are significant there has: already been significant publicity in relation to these; action is already being taken to address these; there are on-going public reporting of progress requirements for the Authority; and Commissioner public reporting of their assessments of the Authority's progress.</p> <p>In respect of potential items of account contrary to law we have formed the view that we will not seek a declaration from the court given the amounts involved are not material and the relatively small benefit to be obtained from further action and the significant cost to the local taxpayers of taking court action.</p> |
| <p><b>Certificate</b></p>              | <p>We have received two objections from a Local Government Elector (LGE) in relation to the Authority's 2013/14 financial statements. Both objections relate to parking matters. A further objection by another LGE was recently received in relation to PwC's BV inspection costs, which are only included in the Authority's 2013/14 accounts as a reference to the work being done and a charge expected to be made to the Authority in 2014/15.</p> <p>Until the above matters have all been resolved we will not be in a position to formally conclude the audit and issue an audit certificate.</p> <p>We note that the time taken by the Authority to respond to our information requests and queries in relation to some objections and queries raised by elector's and Members has been longer than we would normally expect.</p>  |

The BV Inspection report produced by PwC for the DCLG was published in November 2014.

We have considered the findings to assess the impact on our audit and in particular our conclusion of arrangements to secure value for money.

### Background

In the interim report we noted that we had completed the work that we expected to complete as set out in our *External Audit Plan 2013/14*, but had yet to consider the matters being investigated by PricewaterhouseCoopers LLP (PwC) as part of the BV Inspection report.

### Consideration of BV Inspection report

In seeking to satisfy ourselves that the Authority has made proper arrangements for challenging how it secures economy, efficiency and effectiveness in its use of resources, we have considered the findings of the BV Inspection report produced by PricewaterhouseCoopers LLP (PwC) for the Department for Communities and Local Government (DCLG) dated 16 October 2014 and published on 4 November 2014. We have also held discussions with DCLG, PwC and the Commissioners appointed by the Secretary of State for Communities and Local Government and, where necessary, made further enquiries in relation to matters raised.

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

- The payment of grants totalling £12.2 million (note 1) and connected decisions in the period from 25 October 2010 to 4 April 2014 (of which £5.5 million related to grants paid in 2013/14);
- The long-leasehold disposal of Poplar Town Hall in 2011/12 (for £875,000) and the granting of short leasehold interests in Sutton Street Depot and a property in Mellish Street of five and three years and at annual rents of £117,000 and £21,000 respectively in 2013/14; and
- Spending and the decisions by the Authority in relation to publicity for two aspects (the use of three media advisors in the Mayor's office from February 2012 to May 2014; and an Ofcom ruling in 2013 that advertisements broadcast on television in January 2012

Note: (1) The figure is slightly different to the PwC report of £12.9 million which referred to awards in the period whereas we have referred to payments and assumed that the mainstream grants due in 2014/15 will be paid in accordance with the 27 month agreement that is in place.

and costing £5,500 amounted to political advertising).

The BV Inspection report also comments that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above.

Subsequently the Secretary of State for Communities and Local Government appointed Commissioners to oversee the work of the Authority in these areas of operation. The Commissioners will also play a consultative role in the development of a plan to deal with weaknesses in the processes for entering into contracts identified in the report, but will not be able to issue binding directions to the Authority except in circumstances where they fail to adopt recommendations of the statutory officers.

In response to the BV Inspection report a series of 7 Best Value action plans have been drawn up to address the shortcomings identified. These are available on the Authority's website. Whilst work on the action plans is ongoing we have reviewed these and are satisfied that relevant matters for consideration have been identified. We will monitor progress against the action plans as part of future audits.

### Financial statements

We have considered the impact of these items on the financial statements. Whilst the findings of the BV Inspection indicate issues with arrangements to secure value for money, the various matters have been accounted for within the financial statements appropriately.

### Conclusion of arrangements to secure value for money

The matters raised in the BV Inspection report raise concerns in relation to the adequacy of the Authority's arrangements for challenging how it secures economy efficiency and effectiveness in its use of resources in the areas highlighted above. We have considered these in forming our conclusion of arrangements to secure value for money, see section 5.

We have considered the matters raised with us by DCLG, the Commissioners, Members and electors to assess the impact on our audit and in particular our conclusion of arrangements to secure value for money.

In addition to the consideration of the BV inspection report a number of matters have been raised with us as auditors by DCLG, the Commissioners, Members and electors.

We also note that the Mayoral election judgment issued in April 2015 highlighted some areas of potential concern, which it has been

necessary for us to consider.

We have outlined below the key matters raised and summarised our consideration of them.

| Area   | Consideration  |
|--|--|
| <p><b>Section 106</b></p> <p>Queries have been raised with us as to the operation of s106 payments. In particular:</p> <ul style="list-style-type: none"> <li>■ whether s106 agreements are in accordance with the original planning consents;</li> <li>■ whether payments have been made in accordance with the agreements (in particular some agreements in relation to public art were raised with us);</li> <li>■ whether payments are being made on a timely basis; and</li> <li>■ the delay in concluding the review of a funding arrangement relating to the delivery of projects funded by certain s106 monies.</li> </ul> | <p>As a consequence of the issues raised we extended our work in this area. In particular we extended our testing of payments and traced a sample of items from original planning consents through to current payments. We also enquired about the payments made in relation to public art and the review of the funding arrangement.</p> <p>With the exception of the items of public art our testing indicated the s106 payments were in accordance with the agreements, which aligned to the original planning consents. In the case of public art there were five items identified where s106 payments had been made on the basis that a piece of public art would be commissioned and displayed. In two cases (a payment of £90,000 and an initial payment of £10,000) the monies do not appear to have been used for a piece of public art. For the remaining three, no payments have yet been made in relation to the schemes. We reviewed the papers in relation to the £90,000 scheme and note that the change in how the £90,000 was to be used followed the procedures laid down and included obtaining the specific consent of the developers to the change proposed by the Authority.</p> <p>Payments to date have been made in accordance with the timescales agreed with developers, although we note some, with significant balances remaining, are reaching the time limits set out in agreements and some instances where payments were made in advance of the receipt of s106 monies by temporarily using other s106 monies.</p> <p>In relation to the funding arrangement this was reviewed in 2011 and the outcome of the review delayed within the then Mayor's office. We have not been able to establish the reason for the delay. We note that recently the current Mayor has authorised the funding agreement to continue.</p> <p>We have raised a recommendation in relation to s106 in Appendix 1, recommending that an independent review of the processes, controls and overall monitoring should be undertaken.</p> |



## Consideration of other matters (continued)

| Area  | Consideration  |
|---|--|
| <p><b>New Town Hall and civic hub</b></p> <p>A query was raised with us as to the decision to purchase and redevelop the Grade-II listed Old Royal London Hospital building, part of the Council's civic hub regeneration plans to relocate the Town Hall to this site. In particular that the decision to purchase the building (for £9 million) was not based on proper financial and workforce planning and did not represent value for money.</p> | <p>We have reviewed various papers associated with the decision including the papers prepared for the February 2014 Council meeting in relation to the acquisition of the site; the minutes of the Council meeting at which the reports were discussed and following which the then Mayor agreed the purchase recommendation in the report; and the OBC report prepared in February 2014.</p> <p>Whilst the papers contain detail of the proposals, and the earlier papers various options, they contain limited detail on the:</p> <ul style="list-style-type: none"> <li>■ Future vision of the Council including structures and delivery models;</li> <li>■ Workforce planning; and</li> <li>■ Financial planning.</li> </ul> <p>We have reviewed the supporting papers and note that these include financial planning, together with independent advice on the potential value of the site. The latter suggests that the site (in January 2015) was worth £11.75m based on its proposed use as a Town Hall. There is, however, no substantive analysis of workforce planning or the future vision of the Council.</p> <p>We note that the OBC (and subsequent FBC considered by Cabinet in April 2015) has used a range of assumptions around workspace requirements including: reduced staff numbers; space for each workstation; workstation to staff ratios etc. Whilst these assumptions do not address the lack of a future vision for Council structures and delivery models, they do mean that the options for a new Town Hall could be assessed and modelled in terms of space requirements. Consequently, the proposals in February 2014 were considered on the basis that the new site would be able to accommodate all staff if required, with the option of letting space to other public sector organisations if less space was required.</p> <p>Whilst we recognise that the papers make clear the need to progress with the purchase means that the full assessment cannot be performed it is less clear to us why the decision in relation to the relocation of the Authority's Town Hall was not addressed in greater detail at an earlier stage. We note that various options were considered at various times but in the event final decisions were not made. As it stands there is very limited time for the Authority to complete a purpose built building prior to the expiry of the current Town Hall's lease.</p> <p>We note, however, that under the current Mayor the decision is being reviewed. We understand this is to include contingency plans reflecting the timing of the expiry of the current lease.</p> |

## Consideration of other matters (continued)

| Area   | Consideration  |
|--|--|
| <p><b>Mayoral electoral judgment</b></p> <p>The Mayoral electoral judgment raised a number of matters around the governance of the Authority, including in relation to expenditure on mayoral advisors (see below).</p>        | <p>In response to the Mayoral electoral judgment the Authority has undertaken a review of the judgement to determine areas that require follow up. An action plan has been drawn up to address the matters raised. Whilst work on the action plan is ongoing we have reviewed the action plan compared to the judgment and are satisfied that relevant matters for consideration have been identified. We will monitor progress against the action plan as part of future audits.</p>  |
| <p><b>Mayoral expenses</b></p> <p>As noted above various issues have been raised as to whether Mayoral expenses, particularly around Mayoral advisors under the previous Mayor, were appropriately borne by the Authority.</p> | <p>We extended our sample testing of mayoral expenses. The total amount of expenditure in 2013/14 is £737k.</p> <p>Some of the expenditure related to an individual mentioned in the Mayoral electoral judgment where the judge has indicated the expenditure (which amounted to approximately £55,000) may not be lawful as it related to political activities.</p> <p>In addition our sample testing revealed that the information available to support the expenditure was limited and in some cases insufficient to determine whether the expenditure was appropriately borne by the Authority. We have made a recommendation in this regard in Appendix 1.</p> <p>We considered whether we should exercise an auditor's powers to seek a declaration from the court that these items of account are contrary to law. We have formed the view that we will not seek a declaration from the court given the amounts involved are not material and the relatively small benefit to be obtained from further action and the significant cost to the local taxpayers of taking court action.</p> |

## Consideration of other matters (continued)

| Area  | Consideration  |
|---|--|
| <p><b>Tower Hamlets Homes (THH) major works and service charges</b></p> <p>Allegations of corruption and mismanagement have been made in relation to THH, an arms-length management organisation of the Council, particularly in relation to major works. We understand complaints have also been received regarding service charges including a lack of transparency and accountability with how these charges have been calculated.</p> | <p>We have reviewed various reports prepared for THH and also requested the THH auditors (a separate KPMG LLP team) to undertake enquiries on our behalf into major works, service charges and complaints procedures.</p> <p>In relation to major works the process for informing leaseholders is set out under Section 20 of the 1985 Landlord and Tenant Act. There are consultation requirements in relation to any works resulting in a bill of over £250 for a property. THH must closely follow these requirements and be able to demonstrate compliance. We have considered the processes in place in this regard.</p> <p>We note that the majority of major works relate to improvements to meet Decent Homes standards and the THH Decent Homes Claim has been reviewed by an independent accounting firm.</p> <p>In relation to service charges these were subject to review in 2014 by an independent firm of accountants. We have reviewed the report and this does not highlight significant concerns in the way service charge expenditure is managed and service charges calculated. We understand the recommendations made in that report are being actioned.</p> <p>The complaints process appears reasonable for an organisation of this size, clearly advertised and there is clearly detailed reporting and root cause analysis to try and drive improvement.</p> <p>Based on the above we do not consider any action by us as auditors is required.</p> |
| <p><b>Henry Moore sculpture ‘Draped Seated Woman’</b></p> <p>Concerns were raised that the Authority did not have title over the above sculpture and had not undertaken sufficient due diligence in this regard. Connected with this concern was raised at the Authority’s decision to pursue a legal challenge against another public authority in a dispute over title.</p>   | <p>The decision in the High Court confirmed the Authority had title over the sculpture. In light of this we do not consider any action by us as auditor is required.</p>   |

## Consideration of other matters (continued)

| Area  | Consideration   |
|---|---|
| <p><b>Other matters</b></p> <p>We 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.</p> <p>In addition we have received a whistle-blowing referral relating to costs of IT purchases and IT services at an Authority school.</p> | <p>With the exception of the matters pertaining to East End Life, all the enquiries from Members have been covered by the BV Inspection report. Where appropriate we undertook our own investigation and we have in previous reports made recommendations in some of these areas.</p> <p>As regards East End Life, Directions were made by the Secretary of State against various Authorities in relation to their operation of such publications. The future of such publications is currently subject to judicial review by another Authority. The current mayor has confirmed the Council's intention to be compliant with the Publicity Code by March 2016.</p> <p>In relation to the whistle-blowing referral we are liaising with Internal Audit who are undertaking an initial review.</p> |

We have not identified any material audit differences in relation to the primary statements in the course of the audit of the Authority's financial statements.

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

The impact of these adjustments 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 we anticipate giving an unqualified opinion on the Authority's financial statements, although we will be qualifying our conclusion of arrangements to secure value for money (see Section 4 for details).

#### 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.

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'). The Authority has addressed these.

| Movements on the General Fund 2013/14                                  |             |             |
|--|-------------|-------------|
| £m   | Pre-audit   | Post-audit  |
| Surplus on the provision of services                                   | 21.7        | 20.4        |
| Adjustments between accounting basis & funding basis under Regulations | 13.2        | 13.2        |
| Transfers to earmarked reserves  | (8.0)       | (6.7)       |
| <b>Increase in General Fund</b>  | <b>26.9</b> | <b>26.9</b> |

| Balance Sheet as at 31 March 2014 |                  |                  |
|-----------------------------------|------------------|------------------|
| £m                                | Pre-audit        | Post-audit       |
| Property, plant and equipment     | 1,839.3          | 1,839.3          |
| Other long term assets            | 9.9              | 9.9              |
| Current assets                    | 450.1            | 453.8            |
| Current liabilities               | (205.8)          | (210.8)          |
| Long term liabilities             | (699.7)          | (699.7)          |
| <b>Net worth</b>                  | <b>1,393.8</b>   | <b>1,392.5</b>   |
| General Fund                      | (65.0)           | (65.0)           |
| Other usable reserves             | (253.1)          | (251.8)          |
| Unusable reserves                 | (1,075.7)        | (1,075.7)        |
| <b>Total reserves</b>             | <b>(1,393.8)</b> | <b>(1,392.5)</b> |

**We issued an unqualified audit opinion on the Pension Fund financial statements that were included in the Pension Fund Annual Report on 28 November 2014.**

**The wording of your Annual Governance Statement has been revised to reflect the findings in the BV Inspection report. We need to complete our assessment of whether it accords with our current understanding.**

#### **Pension fund audit**

Our audit of the Fund 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 were not considered significant.

We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code*. These were addressed by the Fund as appropriate.

We issued an unqualified audit opinion on the Pension Fund financial statements that were included in the Pension Fund Annual Report on 28 November 2014.

#### **Annual Governance Statement**

The Annual Governance Statement has been revised to reflect the findings from the BV Inspection report. We are therefore in the process of considering the wording of your updated Annual Governance Statement so that we are satisfied that it accords with our current understanding. We are specifically required to confirm 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.

As part of our consideration we note that, in relation to Authority schools, the Annual Governance Statement refers to weaknesses in the governance arrangements within schools. In particular the Annual Internal Audit Report for Schools 2013/14 states that over half of the schools audited (14 out of 27) fell below the minimum standard of financial control, and management. Internal Audit have also investigated other schools where external referrals alleging irregularity at some schools have been received. Whilst these investigations have not been finalised, it is clear that there are also weaknesses in the governance arrangements of these schools.

We have included a recommendation in this report in relation to governance in Authority schools.

## 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*.**

### 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/Public Sector Audit Appointments Limited's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 2 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 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 the interim report relating to the audit of the Authority's 2013/14 financial statements.

**Our conclusion on arrangements to secure value for money considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.**

**Having regard to the findings of the BV Inspection report and other matters identified in section 3 we anticipate issuing an adverse opinion in respect of the Authority's arrangements to secure value for money.**

**We have also recommended that the governance processes across the Authority be reviewed.**

### Background

In the interim report we noted that we had completed the work that we expected to complete as set out in our External Audit Plan 2013/14, but had yet to consider the matters being investigated by PricewaterhouseCoopers LLP (PwC) as part of the BV Inspection report.

In addition since that time additional matters have come to our attention based on the Mayoral election judgment issued in April 2015 and further matters raised by DCLG, the Commissioners, Members and electors..

### Adverse conclusion of arrangements to secure value for money

Our consideration of the BV Inspection report and the other matters is set out in Section three of this report.

Having considered the findings of the BV Inspection report, the other matters raised with us and our knowledge of local circumstances and other evidence gathered during this and previous audits, we are issuing an adverse conclusion on the Authority's arrangements for challenging how it secures economy efficiency and effectiveness in its use of resources.

### Section 11 recommendation

In addition to matters raised in the BV Inspection report, comments within the Mayoral election judgment and arising from the other matters raised with us as auditors indicate the governance processes have not always been effective.

As noted previously in this report various actions are being taken by the Authority (in conjunction with the Commissioners) to address the shortcomings that have been identified. For example the Best Value Action Plans and Mayoral Election Judgement action plan.

Whilst we are satisfied that the Authority is taking sufficient steps to address the specific matters identified to date, the extent of matters raised that impact on governance suggest to us that a wider review of governance should be undertaken.

We therefore recommend that the Authority should undertake a detailed review of its governance processes across the Authority to satisfy itself that they are appropriate and operating effectively. This should include consideration of the:

- roles and responsibilities of the various officers and executive committees and the interaction with members and member committees;
- delegation and escalation processes; and
- the sufficiency of analysis and support in relation to decisions by members, officers and relevant committees.

This governance review should be co-ordinated with the other actions currently being undertaken and proposed including the programme of cultural change.

*Where, as in this case, an auditor makes a Section 11 recommendation the Authority is required to comply with sections 11 and 12 of the Audit Commission Act. This requires the Authority to consider the recommendation at a meeting within one month of the day the recommendation is made, although the auditor has discretion under section 11(6) of the Audit Commission Act 1998 to set a different timescale. There are various requirements in relation to advertising the meeting. Following the meeting the Authority should notify the auditor of the decisions made at the meeting regarding the recommendation and publish a summary of the decisions (once approved by the auditor) in a local newspaper. In this case, as the Audit Commission Act allows, I am discussing with the Authority an extension to the time for the recommendation to be considered at a meeting.*



We have raised four additional recommendation since the interim report.

We have given these additional recommendations a risk rating and agreed what action management will need to take.

We will formally follow up these recommendations and the four recommendations made in the interim report as part of the 2014/15 audit.

| Priority rating for recommendations  |  |   |
|--|--|---|
| <p><b>1</b> <b>Priority one:</b> issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p> | <p><b>2</b> <b>Priority two:</b> issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.</p> | <p><b>3</b> <b>Priority three:</b> issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.</p> |

| No. | Risk     | Issue and recommendation   | Management response / responsible officer / due date  |
|-----|----------|--|---|
| 1   | <b>1</b> | <p><b>Declarations of Interest</b></p> <p>The BV Inspection report refers to several instances where there are relationships with other parties. The BV Inspection report does not conclude as to whether these relationships represented significant concerns or were improper. However, there appears to be the potential for interests that should be declared not being so, possibly due to incomplete knowledge about who the Authority is doing business with, or seeking to do business with. As a minimum this gives the potential for reputational damage to the Authority.</p> <p><b>Recommendation</b></p> <p>The Authority should:</p> <ol style="list-style-type: none"> <li>Review its policies, procedures and processes for identifying potential interests and ensuring declarations are up to date and complete;</li> <li>Consider whether improvements can be made to ensure relevant members and officers are aware of organisations and individuals seeking to do business with or interact with the Authority; and</li> <li>Ensure that all relevant members and officers receive at least annual training and reminders about their responsibilities and the need to ensure interest declarations are complete and up to date.</li> </ol> | <ol style="list-style-type: none"> <li>Agreed – The council's policies, procedures and processes will be reviewed, to further assist members in discharging their responsibility to register all relevant interests. Officers will continue to undertake a six-monthly review of forms including a reminder to each member of their current register entry and the need to update this to reflect any changes. Where necessary Members will be provided with the opportunity to complete forms on site whilst attending meetings at the Town Hall.<br/><br/>Responsible officer: Melanie Clay<br/>Due Date: December 2015</li> <li>Agreed – The current arrangements to ensure members and officers are aware of organisations and individuals seeking to do business with or interact with the council will be reviewed. A list of organisations receiving financial assistance from the authority will be made available to guide Members and Officers in making their declarations.<br/><br/>Responsible officer: Melanie Clay/Zena Cooke<br/>Due Date: December 2015</li> <li>Agreed - Annual mandatory training will continue to be provided for all members and the forthcoming governance review will consider further enhancements to the member development programme. The regular review of forms will include a reminder to ensure interest declarations are complete and up to date. In relation to officers, regular reminders will continue to be issued to staff to update their online declaration forms.<br/><br/>Responsible officer: Melanie Clay (members) and Zena Cooke (officers)<br/>Due Date: December 2015</li> </ol> |

## Appendix 1: Key issues and recommendations (continued)

| No. | Risk | Issue and recommendation  | Management response / responsible officer / due date  |
|-----|------|---|---|
| 2   | 1    | <p><b>Governance arrangements in schools</b></p> <p>The Annual Internal Audit Report for Schools 2013/14 states that over half of the schools audited (14 out of 27) fell below the minimum standard of financial control, and management. Internal Audit have also investigated other schools where external referrals alleging irregularity at some schools have been received. Whilst these investigations have not been finalised, it is clear that there are also weaknesses in the governance arrangements of these schools.</p> <p><b>Recommendation</b></p> <p>The Authority should review its governance arrangements for schools and ensure that their effectiveness is improved for all schools and that there are robust mechanisms in place to support schools in understanding their governance responsibilities and provide appropriate guidance, training and support.</p>  | <p>Agreed - Officers will work with schools to improve the effectiveness of governance arrangements. Chairs of the Finance and Resources Committees will receive training to ensure that assurance frameworks are put in place.</p> <p>Responsible officer: Kate Bingham<br/>Due Date: December 2015</p>  |
| 3   | 1    | <p><b>S106 arrangements</b></p> <p>Our consideration of s106 arrangements highlighted that:</p> <ul style="list-style-type: none"> <li>■ the spreadsheet to record s106 receipts and payments did not cast;</li> <li>■ that certain items appear not to have been paid strictly in line with the original agreements;</li> <li>■ there were funds relating to one scheme that we tested that were close to the deadline for spending the s106 funds, and the plans in place would not be completed before the deadline; and</li> <li>■ there were instances where payments were made in advance of receiving s106 monies, temporarily utilizing other s106 funds.</li> </ul> <p><b>Recommendation</b></p> <p>The Authority should independently review its arrangements in relation to s106 receipts and payments to ensure they are effective and there are robust processes, controls and monitoring arrangements in place to ensure payments are made in accordance with agreements and aligned to original planning consents.</p> | <p>Agreed - An independent review of the arrangements in relation to s106 receipts and payments will be undertaken to ensure effective and robust processes, controls, monitoring and reporting arrangements are in place, in accordance with agreements and aligned with the planning consents.</p> <p>Responsible officer: Chris Holme<br/>Due Date: March 2016</p> |

## Appendix 1: Key issues and recommendations (continued)

| No. | Risk            | Issue and recommendation   | Management response / responsible officer / due date  |
|-----|-----------------|--|---|
| 4   | <p><b>1</b></p> | <p><b>Mayoral expenses</b></p> <p>Our testing of Mayoral expenses identified that the supporting documentation retained was limited and in some cases did not enable us to determine whether the expenditure was appropriately borne by the Authority.</p> <p><b>Recommendation</b></p> <p>The Authority should ensure that sufficient documentation is retained for all expenses including Mayoral expenses. This should be sufficient to evidence that expenditure is appropriate to be borne by the Authority by, for example, including the reasons for the expenditure and precise details of service provided and in relation to functions the nature of the function and attendees.</p> | <p>Agreed - The council will ensure that sufficient supporting documentation is retained for all expenses.</p> <p>Responsible officer: Melanie Clay<br/>Due Date: December 2015</p> |

**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.

**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 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.

## Appendix 3: Proposed independent auditor's report to the members of the London Borough of Tower Hamlets

We have audited the financial statements of the London Borough of Tower Hamlets for the year ended 31 March 2014 on pages [a] to [b]. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

This report is made solely to the members of the Authority, as a body, in accordance with Part II of the Audit Commission Act 1998. Our audit work has been undertaken so that we might state to the members of the Authority, as a body, those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members of the Authority, as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of the Corporate Director of Resources and auditor

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

### Scope of the audit of the financial statements

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

Resources; and the overall presentation of the financial statements.

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

### Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of the Authority as at 31 March 2014 and of the Authority's expenditure and income for the year then ended;
- give a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2014 and the amount and disposition of the fund's assets and liabilities as at 31 March 2014; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

### Matters on which we are required to report by exception

The Code of Audit Practice 2010 for Local Government Bodies requires us to report to you if:

- the annual governance statement set out on pages [d] to [e] does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007; or
- the information given in the explanatory foreword for the financial year for which the financial statements are prepared is not consistent with the financial statements; or
- any matters have been reported in the public interest under section 8 of Audit Commission Act 1998 in the course of, or at the conclusion of, the audit; or

## Appendix 3: Proposed independent auditor's report to the members of the London Borough of Tower Hamlets (continued)

- any other special powers of the auditor have been exercised under the Audit Commission Act 1998.

We have nothing to report in respect of these matters.

### Exception Report

The Code of Audit Practice 2010 for Local Bodies requires us to report to you if any recommendations have been made under section 11 of the Audit Commission Act 1998. We issued a recommendation under section 11(3) of the Audit Commission Act 1998 in our Report to Those Charged with Governance dated xx September 2015 which stated that the Authority should undertake a detailed review of its governance processes across the Authority to satisfy itself that they are appropriate and operating effectively.

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

#### Authority's responsibilities

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

#### Auditor's responsibilities

We are required under Section 5 of the Audit Commission Act 1998 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its

use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

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

We have undertaken our audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2013, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

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

### Basis for adverse conclusion

In considering the Authority's arrangements for challenging how it secures economy, efficiency and effectiveness in its use of resources, we have taken into account the findings of the Best Value Inspection of the London Borough of Tower Hamlets Report (the Report) produced by PricewaterhouseCoopers LLP (PwC) for the Department for Communities and Local Government (DCLG) dated 16 October 2014 and published on 4 November 2014.

## Appendix 3: Proposed independent auditor's report to the members of the London Borough of Tower Hamlets (continued)

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

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

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

Having considered the findings of the Best Value Inspection report, our knowledge of local circumstances and other evidence gathered during this and previous audits, we are issuing an adverse conclusion on the adequacy of the Authority's arrangements for challenging how it secures economy, efficiency and effectiveness in its use of resources.

In the light of the above, taken together with comments within the Mayoral election judgment (as set out in the High Court of Justice, Queen's Bench Division, in the matter of the Representation of the People Act 1983, and in the matter of a mayoral election for the London Borough of Tower Hamlets held on 22 May 2014) and arising from the other matters raised with us as auditors indicate the governance processes have not always been effective. We have therefore raised a recommendation under section 11(3) of the Audit Commission Act 1998 that the Authority should undertake a detailed review of its governance processes across the Authority to satisfy itself

that they are appropriate and operating effectively. This governance review should be undertaken in conjunction with the other actions currently being undertaken and proposed including the programme of cultural change.

### **Adverse conclusion**

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2013, the matters reported in the basis for adverse conclusion paragraph above prevent us from being satisfied that, in all significant respects, the London Borough of Tower Hamlets put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2014.

### **Delay in certification of completion of the audit**

#### **Due to matters brought to our attention by a local authority elector**

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

Andrew Sayers

for and on behalf of KPMG LLP, Appointed Auditor

*Chartered Accountants*

15 Canada Square, London, E14 5GL

September 2015



**For 2013/14 our materiality is £23 million for the Authority's accounts. For the Pension Fund it is £18 million.**

### Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

Materiality for the Authority was set at £23 million which is approximately two percent of gross expenditure.

### Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £1.1 million for the Authority.

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

### Materiality – pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £18 million which is approximately two percent of total net assets. An individual difference could normally be considered to be clearly trivial if it is less than £900k for the Pension Fund.



*cutting through complexity™*

© 2015 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.