cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

London Borough of Tower Hamlets

March 2016

Contents

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

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

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

Section one

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for the Authority; and**
- **our assessment of the Authority's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at the London Borough of Tower Hamlets ('the Authority') in relation to the Authority's 2014/15 financial statements; and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

We have also separately issued our *Report to those charged with governance (ISA 260) 2014/15* in respect of the Pension Fund administered by the London Borough of Tower Hamlets in November 2015. This was specifically to enable the Authority to publish the Pension Fund Annual Report, with the audited Pension Fund financial statements included, by the statutory deadline of 1 December 2015. There were no significant matters arising from our work and the Audit Committee received a copy of our report at its meeting on 8 December 2015.

Financial statements

Our *External Audit Plan 2014/15*, presented to you in June 2015, set out the four stages of our financial statements audit process.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during July/August 2015 and additional work and testing in January 2016.

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work. We have now completed the work to support our 2014/15 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas;
- considering 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 (SoS CLG) on 4 November 2014;
- consideration of other matters brought to our attention by the Tower Hamlets Commissioners; and the Department for Communities and Local Government (DCLG); and
- following up on relevant issues included in our *Final ISA 260 Report 2013/14* issued on 8 October 2015.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority.
- Section 4 outlines our key findings from our work on the VFM conclusion.

There are no recommendations arising as a result of our audit of the financial statements in 2014/15. We have also not made any new recommendations in relation to our 2014/15 VFM conclusion work. The recommendations raised in our *Final ISA 260 Report 2013/14* remain applicable and we have set out the progress in implementing them in Appendix 1.

Acknowledgements

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

Headlines

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

Proposed audit opinion	Subject to finalisation of our consideration of the objection relating to the Authority's Lender Option Borrower Option loans (see Completion section below), we anticipate issuing an unqualified audit opinion on the Authority's financial statements. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007. We issued an unqualified audit opinion in relation to the Pension Fund's financial statements, as contained in the Pension Fund Annual Report on 30 November 2015.
Audit adjustments	Our audit has not identified any material or significant audit adjustments. We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 ('the Code')*. We understand that the Authority will be addressing these where significant. There have been no changes that affect the General Fund or HRA balances or the Authority's net worth as at 31 March 2015.
Key financial statements audit risks	We identified the following key financial statements audit risks in our 2014/15 External audit plan issued in June 2015. ▪ Property, Plant and Equipment; ▪ Payment of Grants; ▪ Accounting for Local Authority Maintained Schools; and ▪ Section 106 Agreements. We have worked with officers throughout the year to discuss these key risks and our detail findings are reported in section 3 of this report. There are no significant matters, in relation to our audit of the financial statements, arising as a result of our audit work in these key risk areas.
Accounts production and audit process	We have noted that the Authority has maintained the quality of the accounts and the supporting working papers. Officers dealt efficiently with audit queries. The Authority has implemented the recommendations in our *Final* and *Interim ISA 260 Reports 2013/14* relating to the financial statements, but those relating to VFM are yet to be implemented (see Appendix 1 for details).
Completion	At the date of this report our audit of the financial statements is substantially complete. We need to undertake a final check of the financial statements and review the updated Annual Governance Statement. We also need to undertake our final review and completion procedures including our post balance sheet events review. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements. We have very recently received an objection relating to the Authority's Lender Option Borrower Option loans. The objection raises questions about whether the loans were taken out lawfully and that we apply to court that the LOBO loan borrowing is unlawful. As the value of the borrowing is material (£77 million) this objection will impact on when we are able to finalise our audit opinion.

Headlines

VFM conclusion and risk areas	We identified three VFM key areas of focus in our External audit plan 2014/15 issued in June 2015: Medium Term Financial Standing; Best Value Inspection; and Governance in Authority Schools. We have worked with officers throughout the year to discuss these VFM key areas of focus and our detailed findings are reported in section 4 of this report. We issued an adverse opinion in respect of the Authority's arrangements to secure value for money for 2013/14 on 8 October 2015. The qualification reflected the matters raised in the BV Inspection report where the Authority had failed to comply with its best value duty in relation to: - Payment of grants and connected decisions; - The disposal of property and the granting of leasehold interests; and - Spending on publicity. In addition to the above specific points, the BV Inspection report also commented that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above. Comments within the Mayoral election judgment and arising from the other matters raised with us as auditors also indicated that the governance processes had not always been effective. In relation to 2014/15 it is important to note that the BV Inspection report was only published in November 2014. Subsequently the SoS CLG appointed Commissioners to undertake an executive decision-making role in relation to all grant decisions, and to oversee the work of the Authority in specified areas of operation in December 2014. The Commissioners 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. Thus the Authority only formally became aware of the concerns and issues raised and their seriousness later in the 2014/15 financial year. Furthermore, the Commissioners reported in March 2015 that they were not satisfied with the progress that the Authority was making to address the issues included in the Directions issued by the SoS. We therefore anticipate issuing an adverse opinion in respect of the Authority's arrangements to secure value for money on similar grounds to those set out in our 2013/14 opinion.
Section 11	Our *Final ISA 260 Report 2013/14* included a section 11 recommendation (that is a recommendation which requires the Authority to consider the recommendation at a public meeting and to publish a summary of the decisions, once approved by the auditor, in a local newspaper). The recommendation required the Authority to undertake a detailed review of its governance processes across the Authority to satisfy itself that they are appropriate and operating effectively. At the Council meeting on 20 January 2016, and the General Purposes Committee meeting on 8 February 2016 it was agreed to accept the Section 11 recommendation and specific courses of action were set out to address the requirements of the recommendation.

Headlines

Other matters	We have been made aware of two other matters which we comment on below: ▪ Community Infrastructure Levy (CIL) and section 106 funds – comments made about the charge levels set for developments in the Isle of Dogs and about spending of s106 funds. In terms of the CIL we have reviewed the Council's approach and noted that the Authority has followed the recommendations of the Planning Inspectorate's independent examiner, who reviewed the proposed scheme in detail. The examiner was satisfied that the scheme proposed by the Council would not, on balance, prevent proposed developments from going ahead. Indeed the implication from the examiner's report is that higher charges could have had an adverse impact on the number of developments going ahead. In terms of s106 we have tested these as part of our audit (as a significant risk – see Section 3) and recommended that the whole process is reviewed (a recommendation in our *Final ISA 260 Report 2013/14* – see Appendix 1 for a summary position on progress to implement). ▪ East End Life –publicity was one of the areas covered by the BV Inspection report, and consequently one of the Authority's BV action plans looks at Communications. We have also been made aware of concerns held by the Commissioners regarding progress towards ensuring that the Authority is compliant with the Code of Recommended Practice on Local Authority Publicity (Publicity Code). The Mayor has recently confirmed (5 January 2016) that the Authority will be compliant with the Publicity Code (as regards East End Life) by 18 May 2016.
Certificate	We have received four objections from two Local Government Electors. Two are in relation to parking matters and the Authority's 2013/14 financial statements and one relates to the Best Value Inspection fee in the 2014/15 financial statements. The other objection relates to the Authority's Lender Option Borrower Option loan (see Completion section on page 3). 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. Also we have not yet completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack.

Proposed opinion and audit differences

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

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

Proposed audit opinion

Subject to finalisation of our consideration of the objection relating to the Authority's Lender Option Borrower Option loans and a small number of outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Audit Committee on 22 March 2016.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality level for this year's audit was set at £15 million (see Appendix 4 for more information on materiality). Audit differences below £750,000 are not considered significant.

We did not identify any material misstatements.

We identified a small number of presentational adjustments that were required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 ('the Code')*. We understand that the Authority will be addressing these where significant.

There have been no adjustments that affect the General Fund or HRA balances or the Authority's net worth as at 31 March 2015.

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 number of comments in respect of its format and content which the Authority has agreed to amend where significant.

Movements on the General Fund 2014/15

£m	Pre-audit	Post-audit	*Ref (App.3)*
Surplus on the provision of services	20.4	20.4	-
Adjustments between accounting basis & funding basis under Regulations	13.2	13.2	-
Transfers to earmarked reserves	(6.7)	(6.7)	-
Increase in General Fund	**26.9**	**26.9**	

Balance Sheet as at 31 March 2015

£m	Pre-audit	Post-audit	*Ref (App.3)*
Property, plant and equipment	2,042.6	2,042.6	-
Other long term assets	9.9	9.9	-
Current assets	533.6	533.6	-
Current liabilities	(222.1)	(222.1)	-
Long term liabilities	(861.1)	(861.1)	-
Net worth	**1,502.9**	**1,502.9**	
General Fund	(71.4)	(71.4)	-
Other usable reserves	(304.6)	(304.6)	-
Unusable reserves	(1,126.9)	(1,126.9)	-
Total reserves	**(1,502.9)**	**(1,502.9)**	

Section three

Financial Statements (continued)
Significant risks and key areas of audit focus

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2014/15*, presented to you in June 2015, we identified the significant risks affecting the Authority and the Pension Fund's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority. Those relating to the Pension Fund were included in a separate *Report to those charged with governance (ISA 260) 2014/15* in November 2015 and are not repeated here. There were no significant matters arising from our work and the Audit Committee received a copy of our report at its meeting on 8 December 2015.

Significant audit risk	Issue	Findings
Section 106 Agreements	Section 106 agreements – the Commissioners have highlighted this an additional area of concern from the enquiries they have made at the Authority.	We have reviewed a selection of schemes and tested this sample to assess whether the section 106 agreement funds are being used in accordance with the conditions agreed as part of the planning process. Our detailed testing has been completed and we have no matters to bring to your attention, although we note that the Authority is in the process of responding to our ISA260 2013/14 report recommendation on the arrangements for s106 agreements more generally (see Appendix 1, recommendation 3).
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 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 2013/14 for consistency. ▪ Ensured that your valuer explicitly considered upward trends as well as impairments in conducting the valuations; and also whether there were material changes in valuations for asset classes valued more than 12 months ago. ▪ Considered the accounting treatment and valuation of the PFI scheme and disposals/decommissioning of assets. Our detailed testing has been completed and we have no matters to bring to your attention.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

Significant audit risk	Issue	Findings
 	LAAP Bulletin 101 *Accounting for School Assets used by Local Authority Maintained Schools* issued in December 2014 has been published to assist practitioners with the application of the Code in this respect. The challenges relate to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools. Authorities will need to review the agreements under which assets are used by VA/VC and Foundation schools and apply the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases. This is a key area of judgement and there is a risk that Authorities could omit school assets from, or include school assets in, their balance sheet. Particular risks surround the recognition of Foundation School assets which may or may not be held in Trust. Authorities should pay particular attention to the nature of the relationship between the Trustees and the school governing body to determine whether the school controls the Trust and the assets should therefore be consolidated into their balance sheet.	We have reviewed the Authority's judgements made in relation to the latest guidance in terms of accounting for school assets. This included: ▪ Determining whether the Authority has identified all relevant maintained schools within its area and undertaken a review of the agreements underpinning the use of school assets by VA, VC and Foundation schools; ▪ Considering the Authority's application of the relevant accounting standards to account for these schools and challenging its judgements where necessary; and ▪ Determining whether the basis of valuation of assets which are brought on balance sheet at 1 April 2013 is appropriate and the valuations are undertaken by qualified valuers (if applicable). Our detailed testing and assessment of the Authority's approach has been completed and we have no matters to bring to your attention.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

Significant audit risk	Issue	Findings
	Payment of grants and connected decisions – PwC's BV Inspection was completed on behalf of the DCLG in 2014. The report concluded that the Authority had not achieved its best value duty with regard to the payment of grants totalling £12.2 million and connected decisions in the period from 25 October 2010 to 4 April 2014. Consequently, the award of grants became the responsibility of independent Commissioners who were appointed by the SoS CLG from January 2015.	The position for 2014/15 is complex, particularly in terms of identification of all grants in accordance with the SoS CLG's December Direction which is very broad. The weaknesses identified in the BV Inspection report remained for most of 2014/15 and the Commissioners have reported that there was no comprehensive list of grants made by the Authority until 2015/16. We have therefore worked with the Authority to attempt to identify all major grants paid in 2014/15 and also referred to the grants approved by Commissioners from January 2015. There is a risk around whether all grants paid after the appointment of the Commissioners have been identified as grants. Hence there is a risk that any such grants would have been formally approved by the Commissioners (in addition to the Authority's normal approval process for payment of grants) as required by the SoS CLG's December Direction in 2014/15 (for which we are seeking a specific representation in the letter of representation). We consider that the risk of material omission, ie that grant payments not approved by the Commissioners after their appointment in December 2014, to be minimal. From the listing of grants made we tested a sample to ensure they were awarded appropriately in terms of the financial statements. Based on this testing we have no matters to bring to your attention.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risk		Summary of findings
Management override of controls	Audit areas affected ■ All areas	Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. There are no matters arising from this work that we need to bring to your attention.
Fraud risk of revenue recognition	Audit areas affected ■ None	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. In our External Audit Plan 2014/15 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue. This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work, although throughout our work we remained alert to any indications of fraud.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2014/15*, presented to you in June 2015, we identified two areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

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

Areas of audit focus	Issue	Findings
Accounting for pension assets and liabilities	Pension valuations require a significant level of expertise, judgement and estimation and are therefore more susceptible to error. This is also a very complex accounting area increasing the risk of misstatement.	Our audit included: ▪ Confirming the information provided to the actuary from the Authority. ▪ Reviewing the actuarial valuation and considering the disclosure implications. ▪ Considering the assumptions made by your actuaries to benchmarks, which are collated by our KPMG actuaries and PwC's review of actuarial assumptions commissioned by PSAA Ltd, and to the assumptions used for 2014/15 for consistency. There are no matters arising from this work that we need to bring to your attention.
Payroll	Payroll represents a significant proportion of the Authority's annual expenditure (approaching 35% of gross spend at £484m in 2013/14). Whilst not considered overly complex from a material error perspective, we consider that it is important from an audit perspective to understand the nature of the Authority's expenditure in this area.	Our audit included: ▪ Reviewing and testing reconciliations for gross pay and deductions (eg pensions, tax and national insurance). ▪ Completing substantive analytical review of payroll costs and testing supporting system information used to compile the review. There are no matters arising from this work that we need to bring to your attention.

Accounts production and audit process

The Authority has a well established and sound accounts production process. This operated well in 2014/15, and the standard of accounts and supporting working papers was good.

Officers dealt promptly and efficiently with audit queries and the audit process was completed within the planned timescales.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority continues to maintain a good financial reporting process and produce statements of accounts to a good standard. We consider that accounting practices are appropriate
Completeness of draft accounts	We received a complete set of draft accounts on 30 June 2015. The Authority have made a small number of presentational changes to the accounts presented for audit however there have been no changes which we consider to be fundamental.
Quality of supporting working papers	We issued our *Accounts Audit Protocol* including our required working papers for the audit on 8 June 2015. The quality of working papers provided was good and fully met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved all audit queries in a timely manner.

Prior year recommendations

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

The Authority has implemented four of the recommendations in our ISA 260 Report 2013/14 relating to: timely completion of key reconciliations; clearing old items from school bank reconciliations; ensuring valuations of other land and buildings are clear that they cover upward movements as well as impairments; and support for Mayoral expenses. Also one of the recommendations has been superseded, the letting of properties to the voluntary/third sector is now part of the Commissioner's requirements and covered by the BV action plans for property and grants.

In relation to the remaining recommendations where implementation is not complete, it is important to note that the Final ISA 260 Report 2013/14 was issued on 8 October 2015.

Appendix 1 provides further details of the recommendations not yet implemented fully, all of which relate to the VFM conclusion rather than the financial statements.

Financial Statements (continued)
Completion

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

Before we can issue our opinion we require a signed management representation letter.

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 2015, we confirm that there were no relationships between KPMG LLP and the London Borough of Tower Hamlets and the London Borough of Tower Hamlets Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 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 Corporate Director, Resources for presentation to the Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

We will be seeking the following specific management representations:

- That the Authority has informed us of all significant grants paid and significant grant funding schemes operating during the year ending 31 March 2015; and
- That the Authority has no known unlawful items of account, other than the nine burial subsidy payments totalling £2,250 that are disclosed in Note 9 of the Authority's financial statements.

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.

VFM conclusion

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

We have concluded that the Authority has not made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

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.

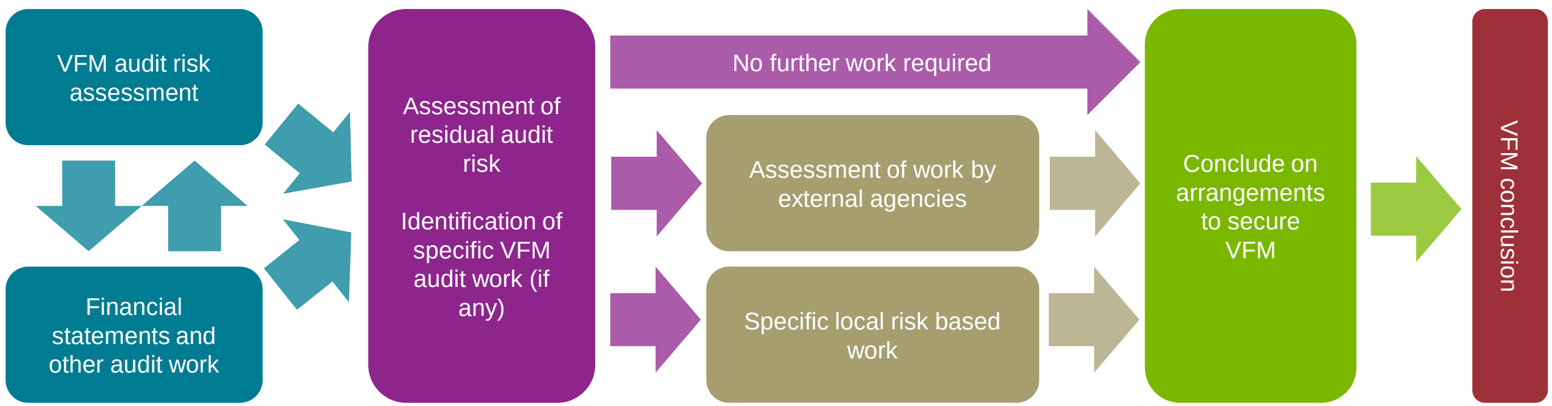
Work completed

We performed a risk assessment earlier in the year and have reviewed this throughout the year.

We have identified three areas of audit focus in relation to our VFM conclusion.

The following pages include further details of our VFM risk assessment and the work we have completed in order to enable us to reach a conclusion as to the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources.

We have also considered the BV Inspection report produced by PwC, dated 16 October 2014, and published by the SoS CLG on 4 November 2014.



VFM conclusion (continued)

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

We have concluded that the Authority has not made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

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 PwC for the DCLG dated 16 October 2014 and published on 4 November 2014.

Our detailed consideration of the BV Inspection report was set out in our *Final ISA260 report 2013/14*.

In relation to 2014/15 it is important to note that the BV Inspection report was only published in November 2014. Thus the Authority only formally became aware of the concerns and issues raised and their seriousness later in the 2014/15 financial year.

Furthermore, the Commissioners reported in March 2015 that they were not satisfied with the progress that the Authority was making to address the issues included in the Directions issued by the SoS.

Therefore for completeness we have repeated our key considerations of the BV Inspection report that led to our adverse opinion in respect of the Authority's arrangements to secure value for money in our 2013/14 opinion.

The DCLG instructed PwC to cover specific matters as part of the BV Inspection. The report concluded 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 advertisments broadcast on television in January 2012 and costing £5,500 amounted to political advertising).

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

Subsequently the SoS CLG appointed Commissioners to oversee the work of the Authority in these areas of operation. The Commissioners 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.

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 therefore anticipate issuing an adverse opinion in respect of the Authority's arrangements to secure value for money on similar grounds to our 2013/14 opinion.

VFM criterion	Met
Securing financial resilience	✓
Securing economy, efficiency and effectiveness	**X**

Specific VFM risks

We have identified a number of specific VFM risks.

Except for the issues referred to in our consideration of the BV Inspection report and its impact on our VFM conclusion, we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

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, inspectorates and review agencies in relation to these risk areas.

Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we did not need to carry out significant additional work for these risks as there was sufficient relevant work that had completed by the Authority, inspectorates and review agencies in relation to these risk areas.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Medium Term Financial Standing	The Authority's out-turn for 2014/15 was break-even after the planned transfer to increase the General Fund (GF) reserve by £6.4 million. For 2015/16 the Authority is estimating a small under spend (of around £140,000), after the planned use of £7.8 million from the GF reserve. The Authority has a balanced budget for 2016/17 including planned use of the GF reserve of £24.1 million. The Authority currently estimates that a further £58 million in savings will need to be achieved during 2017/18 to 2019/20 (including planned use of the GF reserve of £27.5 million – which will result in a planned GF reserve balance of £36.1 million at 31 March 2020). We are aware the Authority is in the process of developing and agreeing proposals with Members for these future estimated savings. The need for savings could have a significant impact on the Authority's financial resilience. Consequently, the Authority will need to continue to manage its savings plans to secure longer term financial and operational sustainability. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.	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 for 2015-2020 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 budget for 2015/16 will be delivered as planned and has a balanced budget for 2016/17. 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

Specific VFM risks (continued)

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Best Value Inspection	The BV Inspection undertaken by PricewaterhouseCoopers LLP identified areas where the Authority had failed to comply with its best value duty: ▪ Payment of grants and connected decisions; ▪ The disposal of property and the granting of leasehold interests; and ▪ Spending on publicity. In addition to the above specific points, the BV Inspection report also commented that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above. This is relevant to the economy, efficiency and effectiveness criterion of the VFM conclusion.	The SoS CLG appointed Commissioners to oversee the work of the Authority in these three areas of operation. The Commissioners also play a consultative role in the development, monitoring and implementation of plans to deal with weaknesses in the processes for entering into contracts identified in the BV Inspection report. We have met with the Commissioners and Authority officers throughout 2015 to consider the progress being made to address the weaknesses set out in the PwC report and planned to be addressed by the Authority's BV Action Plans. The key response from the Authority to the BV inspection report and following discussions with Commissioners, was to develop improvement plans for the particular areas covered by the BV Inspection report. There are additional plans around elections, recruitment of statutory officers and organisational culture. The Authority monitors progress towards implementation regularly and reports on a monthly basis to the Best Value Programme Board. Internal Audit have an agreed programme to review the accuracy of each of the seven action plans as regards the implementation of the individual milestones (the first one has been completed for the procurement action plan and concluded with a 'substantial' assurance that the actions reported as complete/implemented were accurate). The next stage will be for the Authority to be able to demonstrate that the actions have had the planned impact and have addressed the weaknesses in the Authority's arrangements that were highlighted by the BV Inspection report; Electoral Court judgement; and SoS CLG's Directions. We will look to work with the Authority and the Commissioners to consider how this can be assessed during 2016.

Specific VFM risks (continued)

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Governance in Authority Schools	In relation to Authority schools, the 2013/14 Annual Governance Statement referred 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. This is relevant to the economy, efficiency and effectiveness criterion of the VFM conclusion.	Whilst the Internal Audit investigations have not been finalised, it is clear that there are weaknesses in, or concerns about, the governance arrangements of a significant proportion of the Authority's schools. The Authority has reviewed its guidance and issued the latest guidance to schools and governors. Also training and guidance on governance arrangements has been delivered to both Governors and Schools Business Managers (we understand that the Governor Conference was attended by over 50 Governor representatives). The Authority is also planning to further enhance arrangements by giving direct support to those schools which have been identified in internal audit reports as consistently receiving limited assurance through additional workshops delivered by Mazars and Schools Finance. The above actions show that the Authority is reinforcing the importance of governance and the role of Governors in managing schools. Given that we made the recommendation in October 2015, and the Authority's actions are subsequent to this we conclude that it will take time for the full impact to take effect. We will therefore consider the impact by liaising with Internal Audit on results of recent audits, review the 2015/16 annual Internal Audit report on schools. In the meantime we have noted that the annual report for schools in 2014/15 showed that 9 schools received a 'substantial' rating, but 5 had limited assurance and 2 had nil assurance. For 2015/16 the IA reviews completed to date have shown that all 9 schools audits have received a 'substantial' rating.

Section 11 recommendation

We have recommended that the governance processes across the Authority be reviewed as part of a formal section 11 recommendation.

The Authority is working towards implementation of the recommendation and is in the process of compiling a detailed response plan.

Background to the 2013/14 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 indicated the governance processes had 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 Judgment action plan.

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

We therefore recommended 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.

We also commented that the governance review should be co-ordinated with the other actions being undertaken and proposed including the programme of cultural change.

The Authority's response to the Section 11 recommendation

The Authority considered the Section 11 recommendation at a meeting of the Council on 20 January 2016, and at the General Purposes Committee on 8 February 2016.

At the Council and General Purposes Committee meetings it was agreed to accept the Section 11 recommendation and that the following courses of action would be undertaken:

- Continue with actions identified in the Best Value Action Plan in keeping with the agreed timescales.
- Set up a ‘Governance Working Group' with formal Terms of Reference to thoroughly review the governance processes of the Authority.
- Construct a ‘Governance Working Group Action Plan', with identifiable tasks, responsible officers and timeframes.
- Complete other items identified in the *Final ISA260 Report 2013/14.*
- Report progress to the General Purposes Committee and the Audit Committee regular basis.

We will continue to monitor the Authority's progress to implement the section 11 recommendation.

Appendix 1: Follow up of prior year recommendations

Although the Authority has not yet implemented all of the recommendations in our *ISA 260 Reports 2013/14* good progress has been made. Those recommendations where action is in progress were made in October 2015, so there has been limited time to implement these yet. In addition the nature of the recommendations means that where the Authority has taken action, it is expected that it will take time to show that the Authority's actions have been effective.

Nevertheless we re-iterate the importance of continuing to implement these recommendations and ensuring that the actions taken have been effective.

This appendix summarises the progress made to implement the recommendations identified in both our *Interim* and *Final ISA 260 Reports 2013/14* (excluding the formal recommendation made under Section 11 of the Audit Commission Act 1998 - see Section five) and re-iterates any recommendations still outstanding.

It is important to note that the *Final ISA 260 Report 2013/14* was issued on 8 October 2015 in the context of progress to implement the three outstanding recommendations made in that report.

Number of recommendations that were:	
Included in original reports	8
Implemented in year or superseded	5
Remain outstanding (re-iterated below)	3

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at 8 March 2016
1	❶	**Governance arrangements in schools** The Annual Internal Audit (IA) 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. **Recommendation** 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.	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. Responsible officer: Kate Bingham Due Date: December 2015	The Authority has reviewed its guidance and issued the latest guidance to schools and governors. Also training and guidance on governance arrangements has been delivered to both Governors and Schools Business Managers (we understand that the Governor Conference was attended by over 50 Governor representatives). The Authority is planning to further enhance arrangements by giving direct support to those schools which have been identified in IA reports as consistently receiving limited assurance through additional workshops delivered by Mazars and Schools Finance. The above actions show that the Authority is reinforcing the importance of governance and the role of Governors in managing schools. Given that we made the recommendation in October 2015, and the Authority's actions are subsequent to this we consider that it will take time for the full impact to take effect. We will therefore consider the impact by liaising with Internal Audit on results of recent audits, review the 2015/16 annual Internal Audit report on schools. In the meantime we have noted that the annual report for schools in 2014/15 showed that 9 schools received a 'substantial' rating, but 5 had limited assurance and 2 had nil assurance. For 2015/16 the IA reviews completed to date have shown that all 9 schools audits have received a 'substantial' rating.

Appendix 1: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at 8 March 2016
2	❶	**Declarations of Interest** The BV Inspection report refers to several instances where there are relationships with other parties. The BV Inspection report does not conclude as to whether these relationships represented significant concerns or were improper. However, there appears to be the potential for interests that should be declared not being so, possibly due to due to incomplete knowledge about who the Authority is doing business with, or seeking to do business with. As a minimum this gives the potential for reputational damage to the Authority. **Recommendation** The Authority should: 1. Review its policies, procedures and processes for identifying potential interests and ensuring declarations are up to date and complete; 2. 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 3. 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.	1. Agreed – The Authority'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. Responsible officer: Melanie Clay Due Date: December 2015 2. Agreed – The current arrangements to ensure members and officers are aware of organisations and individuals seeking to do business with or interact with the Authority 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. Responsible officer: Melanie Clay/Zena Cooke Due Date: December 2015 3. 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. Responsible officer: Melanie Clay (members) and Zena Cooke (officers) Due Date: December 2015	The Authority's policies, procedures and processes have been reviewed and officers are continuing 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. Officers are required to complete declaration of Interest forms on a 6 monthly basis as part of the Performance Development Review process and the form is accessible via the self-service HR module. Information and training is available to remind officers of their obligations and responsibilities in this respect. A list of organisations receiving financial assistance from the Authority is being compiled to guide Members and Officers in making their declarations. Annual mandatory training is continuing to be provided for all Members. The regular review of forms includes a reminder to ensure interest declarations are complete and up to date. In relation to officers, regular reminders continue to be issued to staff to update their online declaration forms. Based on the above the Authority has taken the actions agreed. However, the Commissioners have informed us that they remain concerned as to whether declarations are being made appropriately and completely. We will therefore consider the Authority's actions taken and consider what/whether any testing should be undertaken in 2015/16.

Appendix 1: Follow up of prior year recommendations (continued)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at 8 March 2016
3	❶	**S106 arrangements** Our consideration of s106 arrangements highlighted that: ▪ the spreadsheet to record s106 receipts and payments did not cast; ▪ that certain items appear not to have been paid strictly in line with the original agreements; ▪ 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 ▪ there were instances where payments were made in advance of receiving s106 monies, temporarily utilizing other s106 funds. **Recommendation** 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.	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. Responsible officer: Chris Holme Due Date: March 2016	A brief for the independent review of the arrangements in relation to s106 receipts and payments has been prepared and Grant Thornton have been appointed to undertake the review. Grant Thornton are expected to complete the review and report their findings to the Authority by the end of March 2016.

Appendix 2: Audit differences

This appendix sets out the audit differences.

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

There is no net impact on the General Fund and HRA as a result of the amendments.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Uncorrected audit differences

We are pleased to report that there are no uncorrected audit differences.

Corrected audit differences

Our audit identified a small number of non material errors in the financial statements. These have been discussed with management and the financial statements have been amended for all of them.

A number of minor amendments focused on presentational improvements have also been made to the draft financial statements. The Finance Department are committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Appendix 3: Declaration of independence and objectivity

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

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd 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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Public Sector Audit Appointments Ltd guidance requires appointed auditors to follow the provisions of ISA (UK &I) 260 Communication of *Audit Matters with Those Charged with Governance*' that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

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 tax team have provided advice throughout 2014/15. 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 2015, we confirm that there were no relationships between KPMG LLP and the London Borough of Tower Hamlets and the London Borough of Tower Hamlets Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix 4: Materiality and reporting of audit differences

For 2014/15 our materiality is £15 million for the Authority's accounts. For the Pension Fund it is £20 million.

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

Materiality

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

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

We used the same planning materiality reported in our External Audit Plan 2014/15, presented to you in June 2015.

Materiality for the Authority's accounts was set at £15 million which equates to around 1.4 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

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

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

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

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £750,000 for the Authority.

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

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

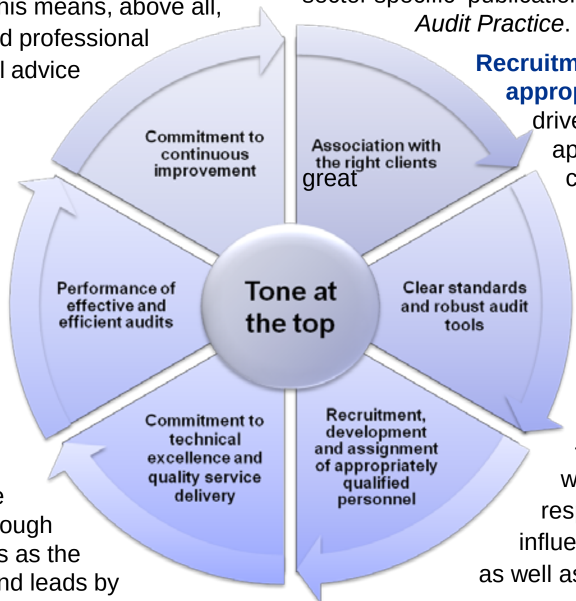
This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.



We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Andrew Sayers as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.

- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.

- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery: Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report issued June 2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.

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