

Opinion

Memorandum

London Borough of Tower Hamlets

Audit 2007/08

December 2008



Contents

Introduction	3
Audit approach	4
Main conclusions	5
Detailed report	7
The way forward	14
Appendix 1 – Action plan	15

Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any member or officer in their individual capacity; or
 - any third party.
-

Introduction

- 1 Under the Audit Commission's Code of Practice, as external auditors of the London Borough of Tower Hamlets ('the Council'), we are required to undertake an audit on the Council's financial statements and to give an opinion as to whether they present fairly:
 - the financial position of the Council as at 31 March 2008 and its income and expenditure account for the year ended; and
 - the financial transactions of its Pension Fund during the year ended 31 March 2008 and the amount and disposition of the Fund's assets and liabilities.
- 2 In order to support our financial statements work, we are required to comply with the International Standards on Auditing (ISAs). This includes the requirement to document and assess the reliability of the information produced by the Council's main financial systems. This involves carrying out annual walkthrough tests and cyclical testing of key controls.
- 3 In addition, The Government Resources and Accounts Act 2000 provided the framework for the preparation of Whole Government Accounts (WGA). Section 10 of this act requires the Council to provide information to support WGA by submitting a consolidation pack. As the Council's external auditors we are required to give an audit opinion which states whether the pack is consistent with the Council's financial statements.
- 4 This report sets out the main findings and conclusions from our work on the Council's financial systems, financial statements and on the WGA consolidation pack. The report focuses on the key matters that the Council should consider addressing as part of their closedown process in 2008/09.

Audit approach

- 5 To comply with the ISAs we are required to fully understand the Council's internal control environment and to assess the risks of financial misstatement. We have identified and documented the Council's material systems and this year tested the key controls on the general ledger, payroll, fixed assets, treasury management and council tax.
- 6 We have continued to work closely with Internal Audit and placed reliance on their work in a number of areas. Prior to placing reliance on their work, we reviewed their files and re-performed a test for a sample item.
- 7 The results of our systems work, together with risks identified from analytical reviews of the Council's draft financial statements, review of technical guidance and our cumulative knowledge of the Council were used to inform our financial statements testing strategy.
- 8 Specific risk based tests were devised to address the risks identified. We are also required to undertake certain mandatory tests which include:
 - agreement of figures in the financial statements to the Council's general ledger system;
 - checking compliance with the Statement Of Recommended Practice (SORP);
 - testing material journals;
 - testing cut off arrangements; and
 - substantive testing on bank account reconciliations.
- 9 Issues and potential misstatements identified as part of our financial statements testing were discussed with senior officers in corporate finance. Where the misstatements were deemed to be significant, the Council adjusted their financial statements.
- 10 To give an opinion on the WGA consolidation pack we are required to undertake the following work:
 - review the consolidation pack, to ensure it is free from error messages;
 - ensure that the consolidation pack is consistent with the Council's financial statements;
 - agree the net cost of services worksheet to supporting working papers; and
 - identify and test a sample of significant intra group transactions.

Main conclusions

- 11 The Council's draft financial statements were approved by the Audit Committee on the 30 June 2008. Upon completion of our work we gave an unqualified audit opinion on the Council's financial statements and the Pension Fund statements on 30 September 2008. We also confirmed that the WGA consolidation pack was consistent with the Council's financial statements and this was sent to central government on 1 October 2008 in line with the timetable.
- 12 We are required under ISA260 to formally report key issues and concerns arising from our audit, prior to issuing the opinion, to those charged with governance, which for the Council is the Audit Committee. The Audit Committee considers the issues raised and action taken by officers and then confirms they are satisfied with the outcome. We reported the following issues to the Audit Committee on 18 September 2008:
- the cash flow statement contained eleven errors. Some of these were material and ranged from £25,000 to £27,457,000;
 - the financial statements included net internal debtors of £5.8 million that should have been removed from the balance sheet;
 - the incorrect accounting treatment of premiums totalling £3 million arising as a result of repayment of loans by Central Government following the transfer of Council dwellings under housing choice; and
 - the Council used the incorrect guidance to calculate the rental constraint allowance which resulted in housing subsidy receivable being overstated by £181,000.
- 13 The Council adjusted the draft financial statements to correct these errors.
- 14 At the Audit Committee on 18 September 2008 it was agreed that we would liaise with the Chair of the Audit Committee if anything arose from the issues outstanding that we needed to report to those charged with governance. Two of the outstanding issues resulted in the identification of further non trivial errors. The Council decided to adjust for the following errors which we reported to the Chair of the Audit Committee:
- the Council had calculated actual service charges for 2007/08 and identified a difference of £1,567,000 between estimates included in the accounts for income and amounts that will be invoiced; and
 - the Council reclassified £615,000 of expenditure in relation to the removal of asbestos from buildings, which was initially included as a fixed asset addition (capital expenditure), as HRA revenue expenditure.
- 15 We also identified a few non trivial errors during the audit and these were included within the appendix of our ISA260 report. The Council amended their financial statements and the WGA consolidation pack to correct these errors.

- 16 Overall we found that the quantity and quality of the Council's working papers available at the start of the audit had improved. It was evident that more working papers had been reviewed by finance managers than in previous years. However, the amount of presentational and disclosure errors that we identified in the initial review of the financial statements concerned us as it appeared that there was insufficient time for senior officers to complete a detailed quality review of the final draft statements at the end of the process.
- 17 We reported in previous years that there were significant delays in responding to audit queries and requests for further information. We are pleased to report that the response times to audit queries had improved from previous years.
- 18 There are a number of new challenges facing the Council in preparing their financial statements over the next few years, including the preparation of group accounts taking account of the Housing Arms Length Management Organisation and the introduction of International Financial Reporting Standards in 2010/11. Our recommendations attached in Appendix 1 should be implemented alongside any changes in processes required for these changes.

Detailed report

19 This section focuses on the key matters arising from the systems and financial statements audit. In addition to the issues mentioned in the report, a number of other minor issues that were identified throughout the audit have been fed back to officers in corporate finance to assist the closedown process in future years.

Financial systems audit

- 20 Our walkthrough and key controls testing of the Council's material financial systems demonstrated that controls were generally working as designed. We have placed reliance on internal audit work and incorporated their findings into our risk assessments. Internal audit made specific recommendations in their reports and we have not repeated these here but endorse their recommendations. Our testing identified the following matters arising:
- the Council disposed of 34 Linford Drive in 2007/8. The asset had not previously been included on the Council's asset register; and
 - the Council had problems in migrating data from previous service charges systems and providing audit trails for service charges estimates.

Recommendation	
R1	Complete the implementation of the Council's asset database ensuring that all data is cleansed and reconciles with records held within directorates.
R2	Review the basis of calculating service charge estimates.

Quality of working papers and responses to audit queries

- 21 The Council provided working papers to support the financial statements by the submission deadline of 30 June 2008. The working papers provided to support the financial statements were more comprehensive than in previous years, and had been reviewed by finance managers. There was a noticeable improvement in the quality of the working papers provided to support capital balances.
- 22 Last year we reported that responses to several audit queries and requests for further information remained outstanding for a significant period of time. This year the Council were more proactive in following up queries, and the majority of queries were resolved within a realistic timeframe. Where the Council had difficulties providing information on a timely basis, auditors were given regular updates on the progress made to resolve the query.

Quality assurance

- 23** The Council's closedown plan included arrangements to ensure the financial statements were subject to a quality assurance review by senior officers in corporate finance. However, due to slippage in the closedown programme, there appeared to be insufficient time for officers to undertake a detailed quality assurance process on the draft statements approved by the Audit Committee.
- 24** Our audit identified a significant amount of presentational and disclosure errors within the financial statements. These errors included incorrect cross referencing, casting errors, notes not agreeing to the figures on the primary statements and inconsistencies between the foreword and the main statements. In addition, there were a significant number of errors contained within the cash flow statement. We would expect a good quality assurance process to have identified these errors prior to the statements being approved.

Recommendation

- R3** The Council should ensure that sufficient time is built into the closedown process to undertake a detailed quality assurance review of the draft statements.
- R4** The Council need to strengthen monitoring arrangements to prevent any slippage in the closedown process from impacting on the quality assurance review.

Other presentational issues

- 25** The financial statements presented for audit were largely compliant with the SORP. However, the financial statements did not include a note on Local Authority Agreements, and the leases note did not comply with the disclosure requirements of the SORP.
- 26** The related party transactions note did not disclose Tower Hamlets Primary Care Trust as a related party even though the Council has a pooled budget with this body and have a number of joint appointments between the bodies. In addition, one senior officer and one member had disclosed that they are members of organisations that receive funding from the Council. However, these were not included within the related party note.

Recommendation

- R5** The Council should review all the notes to the financial statements and ensure that they are compliant with the SORP.
- R6** Ensure that all senior officers and member's disclosures are considered when compiling the related party transaction note.

Annual Governance Statement

27 This was the first year that the Council was required to include an Annual Governance Statement within their financial statements. We found that the Annual Governance Statement was consistent with the guidance and our knowledge of the Council. A comparison with other authorities highlighted the following areas that the Council should consider strengthening in future years:

- the section on identifying and communicating the Council's vision of its purpose and intended outcomes for citizens and service users should clearly cover these areas;
- the Council has disclosed the governance arrangements in its most significant partnership, but it should expand on the governance arrangements in other partnerships; and
- in the significant governance issues section the Council should be more explicit on the actions and recommendations that are being implemented to address significant issues.

Recommendation

R7 The Council should strengthen the Annual Governance Statement in the following areas:

- communicating the Council's vision;
- expanding the governance arrangements in respect to partnerships to include all partnerships; and
- actions and recommendations to address significant governance issues.

Statement of Recognised Gains and Losses (STRGL)

28 A detailed review of the STRGL was undertaken in 2007/08. We identified the following significant entries that were incorrectly included within the STRGL. The Council subsequently amended their financial statements to remove these entries.

- Movements between insurance reserve and provision of £4,317,000 should have been coded to the income and expenditure account and not included on the STRGL.
- The write off of government grants deferred of £14,834,000 should have been coded to the income and expenditure account.
- Premiums of £10,850,000 were reclassified as interest payable in the income and expenditure account. Originally the Council had sought guidance from CIPFA, the Local Authority's Accounting Panel and other Local Authorities regarding the treatment of repayment of premiums of housing stock overhanging debt but had not received a response from these bodies and decided to net off the repayment from the impairment.

- 29 There is no impact on the overall general fund surplus as a result of these adjustments as all entries are reversed out through the statement of movement on the general fund balance.

Recommendation

- R8** The Council should review all gains and losses and ensure that they are correctly classified.

Income and Expenditure account

- 30 We are pleased to report that an analytical review was received at the start of the audit which compared outturn figures to last year and to budget, and that this was undertaken on a Best Value Accounting Code of Practice (BVACOP) basis. Explanations were received for significant variances. This was an improvement from previous years.
- 31 In previous years we have reported that our testing had identified income and expenditure coded to the incorrect year. The Council has strengthened arrangements in this area as our audit testing did not identify any problems in this area in 2007/08.

Accounting for fixed assets

- 32 The Council had reviewed, updated and reconciled their fixed asset register to records held within corporate directorates and to supporting legal documentation during the year. Capital entries within the financial statements were subject to a more rigorous review process than in previous years. As a result of these processes, there was an increase in the quality of the working papers supporting capital entries in the financial statements. Response times to queries from the capital section also improved from previous years.
- 33 The Council capitalised £615,000 relating to the removal of asbestos from Council Houses. After investigation, the Council found that, from their evidence, the expenditure did not meet the capitalisation criteria of either adding to the asset value or increasing the asset life. The Council amended the financial statements and classified the expenditure as repairs and maintenance expenditure. This reduced the HRA surplus by £615,000.

Recommendation

- R9** The Council should ensure that all expenditure that is capitalised meets the requirements of FRS 15.

Detailed report

Housing Revenue Account (HRA)

- 34** Audit testing identified the following two errors to the HRA that were considered non-trivial.
- The Council's service charges income included within the HRA were based on 2006/07 estimates updated for inflation. At the time of preparing the financial statements the Council had updated information that should have been used as a basis for their estimate. When the Council calculated their 2007/08 final service charges there was a difference of £1,567,000 from their estimate.
 - The Council calculated their rental constraint allowance at £951,000 using the 2006/07 guidance rather than the revised guidance issued for 2007/08. This resulted in the Council overstating subsidy receivable by £181,000.
- 35** The Council amended their accounts for the above errors which reduced the HRA surplus by £1,748,000.
- 36** We identified a few disclosure issues that related to the treatment of overhanging debt resulting from housing choice programme and subsequent repayment of the Council's debt by Central Government. The Council agreed to adjust their disclosures in relation to these transactions. The main impact of the adjustments was a transfer of £3 million of premiums from the HRA to the general fund. However, the adjustment does not have any impact on Council tax payers or on housing rent levels, as the adjustment is reversed out through the statement of movement general fund and HRA balances.

Recommendation

R10 The Council should base estimates for service charges income using the latest information available at the time of preparing their financial statements.

R11 The Council strengthen its processes to identify and implement all changes in government legislation that impact on the financial statements.

Debtors

- 37** Included within the debtors balance of £119 million there was a balance of £5.9 million that related to amounts owed to the Council by schools with only £105,000 showing within creditors for amounts the schools were showing as being owed. Therefore, net internal debtors relating to schools balances of £5.8 million were included within the Council's financial statements. The Council corrected their financial statements by reducing net debtors and schools balances by £5.8 million.
- 38** The Council incorrectly coded a new rent sundry tenants account to the debtors balance when it should have been coded to cash and bank. The Council adjusted their financial statements by increasing the cash balance and reducing debtors balance by £878,000.

Recommendation

R12 Internal debtors and creditors should be removed from the financial statements.

R13 The Council should ensure that new accounts are correctly coded on the balance sheet.

Loans and borrowings

- 39** The Council are required to disclose the fair value of their borrowings in a note to their financial statements. To obtain the fair value of loans the Council used the advice of Sector. For Public Works Loan Board Loans (PWLB), Sector estimated the fair value of loans on the basis of PWLB's terms for new loans.
- 40** The basis used by Sector is different to that envisaged by the relevant financial reporting standard, FRS26 which requires PWLB loans to be valued on the basis of redemption values as at 31 March 2008. The difference of £6.5 million does not impact on the Council's Income and Expenditure Account and Balance Sheet. The Council amended the note to their statements.

Reserves

- 41** The Council included £16 million of reserves that related to the HRA within the general fund earmarked reserves. The Council agreed to amend their financial statements and transfer these reserves to the HRA.

Leases

- 42** The Council disclosed their operating leases in respect of Mulberry Place and Anchorage House. However, the Council has smaller leases on equipment and information technology that should also have been disclosed. In the future, the identification of all leases is likely to have a higher profile as they will need revisiting as part of the implementation of International Financial Reporting Standards.

Recommendation

R14 The annual payments of all operating leases should be disclosed in the financial statements.

Whole Government Accounts

- 43** The Whole Government Accounts consolidation pack was submitted on a timely basis which enabled us to achieve the deadline for submission of 1 October 2008. The pack presented for audit contained a few cells with validation errors. In addition, there were a number of presentational errors identified in the pack which we would have expected to have been identified through the review process. The consolidation pack was amended by the Council.

Recommendation

R15 The consolidation pack should be subject to a detailed review by a senior officer with validation errors identified and removed.

Future accounting issues

- 44** The Council's Housing Arms Length Management Organisation (ALMO) commenced during 2008/09. As a result the Council will be required to complete group accounts for the first time in 2008/09. The Council will need to ensure that there are strong arrangements in place to incorporate the ALMO's transactions and working papers into their accounts closing process. There will also need to be strong arrangements in place to enable audit queries to be answered on a timely basis.
- 45** The first local authority International Financial Reporting Standards (IFRS) based accounts are due to be prepared for 2010/11. This is quite a challenging timetable as many of the 2009/10 figures will need to be restated on an IFRS basis, which may require preparatory work during 2008/09. Some of the main areas the Council will need to focus on are:
- PFI schemes;
 - leases;
 - fixed assets; and
 - annual leave accruals.

The way forward

- 46 The key areas which require attention, together with our recommendations, are set out in the Action Plan at Appendix 1. Officers in corporate finance have been provided with a schedule which contains all the errors and uncertainties identified in the audit, and should refer to this when closing the accounts in 2008/09. We will assess the extent to which the Council has addressed these issues as part of the 2008/09 audit.

Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
7	R1 Complete the implementation of the Council's asset database ensuring that all data is cleansed and reconciles with records held within directorates.	2	Jim Ricketts	Agreed	Reconciliation between assets on the Tech Forge system and existing asset register to be undertaken. Procedures for maintenance of register to be reviewed.	31 January 2009
7	R2 Review the basis of calculating service charge estimates.	3	Paul Leeson/Derek Young	Agreed	A review of service charges is being commissioned by the Council and should be completed before the year end. Additional scrutiny will be applied by the Finance Manager, Development and Renewal to these figures as part of year-end procedures.	31 March 2009
8	R3 The Council should ensure that sufficient time is built into the closedown process to undertake a detailed quality assurance review of the draft statements.	3	Alan Finch	Agreed	The closure of accounts timetable will build in adequate time for this process and will be managed to ensure that this is accomplished. Corporate Head of Finance will undertake quality review of the Draft Statements prior to submission.	31 January 2009
8	R4 The Council need to strengthen monitoring arrangements to prevent any slippage in the closedown process from impacting on the quality assurance review.	3	All FMs/ Gary Moss	Agreed	All officers responsible and accountable will ensure closure tasks are delivered on time. Tight central monitoring of the timetable will be undertaken and slippage to deadlines will only be allowed under very exceptional circumstances.	31 March 2009

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
8	R5 The Council should review all the notes to the financial statements and ensure that they are compliant with the SORP.	2	Gary Moss/Feroza Begum	Agreed	SORP Checklist is now included as an additional task on the 2008/09 closure of accounts timetable	31 May 2009
8	R6 Ensure that all senior officers and member's disclosures are considered when compiling the related party transaction note.	2	Gary Moss/Final Accounts	Agreed	The process for collecting disclosures is under review. Final Accounts Closure Team will work with Democratic Services to ensure procedure is updated to include a three-way check, membership interest, form submissions and JDE.	30 April 2009
9	R7 The Council should strengthen the Annual Governance Statement in the following areas: <ul style="list-style-type: none"> communicating the Council's vision; expanding the governance arrangements in respect to partnerships to include all partnerships; and actions and recommendations to address significant governance issues. 	1	Minesh Jani	Agreed	The good practise identified by other Authorities will be captured as part of the 2008/09 AGS.	31 May 2009
10	R8 The Council should review all gains and losses and ensure that they are correctly classified.	2	Gary Moss/Feroza Begum	Agreed	Final Accounts Closure Team to prepare guidance note and timetable in work as part of 2008/09 closure process.	31 January 2009
10	R9 The Council should ensure that all expenditure that is capitalised meets the requirements of FRS 15.	2	Jim Ricketts	Agreed	Types of expenditure will be categorised and analysed according to criteria for capital expenditure. Pro-forma to set up capital codes to be expanded to establish which criteria is satisfied to justify capitalisation. This work will be included in the closure of accounts timetable.	31 January 2009

Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
11	R10 The Council should base estimates for service charges income using the latest information available at the time of preparing their financial statements.	3	Paul Leeson/Derek Young	Agreed	An exercise to establish the draft actualisation of service charges for 2008/09 will be carried out during the closure of accounts and any material adjustments made to the accounts.	31 March 2009
11	R11 The Council strengthen its processes to identify and implement all changes in government legislation that impact on the financial statements.	3	Gary Moss/Feroza Begum	Agreed	Scheduled in 2008/09 timetable for an impact assessment to be carried out on the accounts.	31 January 2009
12	R12 Internal debtors and creditors should be removed from the financial statements.	3	Gary Moss/Feroza Begum	Agreed	Process has been agreed between Final Accounts Closure Team and Directorate Finance Manager. Included on 08/09 timetable as a separate task.	31 January 2009
12	R13 The Council should ensure that new accounts are correctly coded on the balance sheet.	2	Gary Moss/Final Accounts	Agreed	A full CAT code review is scheduled for December/January 2009.	31 January 2009
12	R14 The annual payments of all operating leases should be disclosed in the financial statements.	1	Gary Moss/IFRS Accountant	Agreed	IFRS Accountant, with support from services, to identify those requiring disclosure.	31 March 2009
13	R15 The consolidation pack should be subject to a detailed review by a senior officer with validation errors identified and removed.	3	Gary Moss/Feroza Begum	Agreed	Guidance note will be prepared for 2008/09 to ensure similar errors do not recur.	31 March 2009

The Audit Commission

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

Copies of this report

If you require further copies of this report, or a copy in large print, in Braille, on tape, or in a language other than English, please call 0844 798 7070.

© Audit Commission 2008

For further information on the work of the Commission please contact:

Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ

Tel: 0844 798 1212 Fax: 0844 798 2945 Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk