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Mr K Bartle
Divisional Director of Finance, Procurement and Audit
London Borough of Tower Hamlets
5 Clove Crescent
London E14 2BG

Dear Kevin,

Review of 2018/19 year end close

In August 2020 I was appointed to carry out an independent review of issues arising in connection with the Council's 2018/19 year-end close. Having been at various times a consultant, practitioner and external auditor, I have extensive experience of all aspects of local authority year-end close and audit. A short CV has been provided at the end of this report.

My detailed findings are set out as follows together with some practical suggestions for improvement:

Appendix 1	Leadership, resourcing, planning and closedown delivery
Appendix 2	Systems and processes
Appendix 3	Errors identified to date
Appendix 4	Managing the audit process

My assessment in summary is provided below:

An extensive restructuring exercise during 2019 led to the departure of 15-20 Finance staff, including both the Chief Accountant and the Capital Accountant. Restructuring activities during April and May 2019 in particular were largely responsible for slippage against the 2018/19 closedown plan. Consequently, although the Council did manage to prepare a Statement of Accounts by 31 May 2019, there was insufficient time before the start of the audit to compile working papers or carry out pre-audit checks and review.

The Council's approach to 2018/19 closedown was typical of many local authorities in that:

- most work was carried out by a small group of 4 people within the Corporate Finance team, during the 6-week period between mid-April and the end of May
- attention was focussed primarily on managing outturn against budget, rather than meeting external audit expectations or on current technical financial reporting requirements.

This approach needs to be updated in the light of current, more challenging timescales and increasingly complex financial reporting. Successful authorities recognise that an orderly year-end close is important to the whole organisation in terms of both the risk of reputational damage if the audit opinion is qualified or delayed, and the potential impact on current service budgets if the historic financial position is subsequently found to be incorrect.

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Culturally therefore these more successful authorities expect all service departments, as well as Treasury and Exchequer functions, to support the Corporate Finance team by:

- making staff time available to support closedown work
- ensuring that in-year financial information is accurate and up to date
- adhering to corporate timetables and guidance on year-end close, especially in key areas such as accruals, cut-off, reconciliation work and the use of reserves
- responding promptly to audit queries and internal requests for further information

Successful authorities also provide visible engagement and leadership at s151 officer level, to:

- reinforce the importance of year-end reporting and audit as a corporate priority
- ensure that any technical accounting issues or slippage are promptly identified and resolved
- manage the relationship with external audit, and
- ensure that as much work as possible is completed in advance of 31 March each year.

When considering the quality of the financial systems and processes underpinning the production of the Council's 2018/19 accounts, CIPFA's independent review of financial management in 2017 highlighted a number of ledger issues affecting year-end close which have not yet been addressed. Journal mis-postings and coding errors, coupled with shortcomings in the Chart of Accounts, are the underlying reason for many of the errors identified by audit work to date.

It should also be recognised that:

- some financial systems, particularly in respect of grant income, schools accounting and sundry debtors' income, have deteriorated since 2017/18 and need to be improved
- there are no regular reviews in place to confirm that financial systems are reconciled to ledger balances monthly and that all suspense and holding account items are cleared

To address these issues, the Council should:

- establish a project plan, as a priority, to address shortcomings highlighted by CIPFA in 2017
- simplify the current coding structure so that it reflects the required layout and format of the Statement of Accounts
- put arrangements in place to manage the appropriate roll-forward, reversal or re-start of Agresso ledger codes each year end.
- establish ongoing financial systems that support all key items and disclosures, and
- ensure that these systems are reconciled to relevant ledger codes on a regular basis throughout the year

Other material errors identified to date have largely been due to the increased audit focus on asset valuations, and the impact of IFRS 15 on revenue streams such as leaseholder contributions and community infrastructure levies. These were new issues for 2018/19 and would not necessarily have been a focus for KPMG's audit in the previous year, but have highlighted the Council's tendency to over-rely on external information such as:

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- reports prepared by actuaries and valuers, without adequate consideration of how that information can be audited
- the format and content of CIPFA's example accounts without fully considering the local impact of new reporting requirements such as IFRS15 (introduced in 2018/19) or, looking forward, the introduction of IFRS 16 with effect from 1 April 2021.

Given the unprecedented combination of less fee cover, heightened quality expectations from the Financial Reporting Council, and an unfamiliar client, it is not surprising that Deloittes needed to undertake more extensive audit testing than their predecessors and required much more comprehensive working papers. It would have been helpful however for the local audit team to set out their expectations more clearly, and to prioritise requests for information.

40% of all local authority audit opinions were unsigned at 31 July 2019 so at this point the Council was not in a unique or even unusual position, but more decisive action could have been taken subsequently to manage the audit process and focus on resolving key issues. It is encouraging to see that since September 2020 better project management arrangements have been put in place, and a significant number of outstanding audit queries have been responded to. As new processes however these need to be maintained and developed and it is too early as yet for me to form a view about their overall effectiveness.

Going forward, discussions with Deloittes should clarify how best to prioritise outstanding queries and aim to complete the audit of the revised Statement of Accounts by an agreed date which is both realistic and achievable. The s151 officer has a key role to play in this regard by attending progress meetings, providing visible encouragement and leadership and closely monitoring progress against plan.

I hope you find my report useful and I look forward to discussing it with you in due course.

Kind regards

Peter Worth, Director

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Appendix 1 – Leadership, resourcing, planning and closedown delivery

Leadership and management

1. Five meetings of the Closure of Accounts Group (CAG) were held between October 2018 and May 2019 to monitor progress, attended by 5-8 people. These meetings were chaired by the Chief Accountant but out of the other staff most heavily involved in producing the accounts only one of these was regularly in attendance.

2. The meetings which did take place appear to have been largely focussed on managing reported outturn against budget and on the more operational aspects of year-end close. Looking forward, officers have recognised that for 2020/21 year-end close the Council needs to place an increased emphasis on:

    - technical financial reporting and Code requirements
    - corporate expectations regarding the quality of audit trail and working papers
    - managing the audit process.

3. The Council's s151 officer did not attend CAG meetings or early meetings with external audit, although he did receive regular briefings from the then Chief Accountant and appears to have accepted their assurances that 2018/19 closedown work was on track. This was perhaps understandable in the circumstances - the s151 officer was new in post, responsible for a major restructuring exercise, and expected the audit process to be "low risk" given the Council's experience in previous years.

4. However, responsibility for producing the accounts is a key part of the s151 role, and local authorities with the best track record in managing and delivering year end close tend to provide very visible engagement and leadership at senior management level, both internally and in terms of managing the relationship with external audit. This helps to reinforce the importance of financial reporting as a corporate priority and to ensure that:

    - management judgement is exercised and evidenced on a timely basis, with meeting notes used to provide a record of the discussions and decisions arrived at
    - speedy and informed decisions are taken to address any problems identified e.g. by approving access to additional resources if required
    - service departments follow corporate guidance in relation to year-end close

Regular and visible input from the Council's s151 officer is necessary to reinforce the fact that closedown is a corporate priority, enable key judgements to be documented and ensure any problems or slippage are promptly identified and resolved.

Resourcing

5. Year-end closedown work has traditionally been led, and largely delivered, by the Council's Corporate Finance team with relatively little input from service-based finance staff or from Treasury and Exchequer functions. In 2018/19 over 50% of closedown work was completed by just 4 individuals.

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6. This approach is common amongst smaller local authorities (particularly district councils) and works reasonably well when longer timescales are available for year-end close and audit. However, over-reliance on a small group of people creates:

- key-person risk i.e. there is no resilience within the Finance team if a key person leaves
- bottlenecks when working to tight deadlines is required, which tends to result in short-cuts taking place or tasks such as quality assurance not being undertaken.

7. Local authorities which have been most successful in achieving and maintaining earlier year-end close have, in in my experience, moved towards a resourcing model where work is shared across the whole Finance team and all of the service-based accountants with typically 15-20 individuals involved in preparing core statements and disclosure notes. This creates resilience as more staff become familiar with material accounting entries, year-end reporting and external audit requirements, thus reducing key-person risk as discussed above.

8. Successful authorities also recognise that year-end close is important to the whole organisation in terms of both the risk of reputational damage if the audit opinion is qualified or delayed, and the potential impact on current service budgets if the historic financial position is subsequently found to be incorrect. Culturally therefore these authorities expect all service departments, as well as Treasury and Exchequer functions, to support the Corporate Finance team by:

- ensuring that in-year financial information is accurate and up to date
- adhering to corporate timetables and guidance on year-end close, for example on accruals, cut-off, reconciliation work and the use of reserves
- responding promptly to audit queries and internal requests for further information.

9. For 2020/21 year-end close the s151 officer has advised the Corporate Leadership Team that all Finance staff, including those in service-based, Treasury and Exchequer functions, will be expected to contribute to production of the Statement of Accounts. This development is to be welcomed but does represent a cultural change for the Council and, if implementation is to be successful all Corporate Directors will need to support the s151 officer in this initiative.

Culturally the Council should recognise that year-end close and audit is a corporate priority, and all Corporate Directors should support the Corporate Finance team by:

- making staff time available as necessary to assist with closedown work
- ensuring that in-year financial information is accurate and up to date
- adhering to corporate timetables and guidance on year-end close, especially in key areas such as accruals, cut-off, reconciliation wok and the use of reserves
- responding promptly to audit queries and internal requests for further information

Training and skills

10. Staff in the Corporate Finance team attended training events on Code changes for 2018/19 and guidance was issued in early January 2019 to staff in the wider Finance team and to spending departments. However, there is no record of any specific training on the expected

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quality of audit trail and working papers, or potential issues arising from the change in audit provider and new PSAA contracts (see Appendix 4).

11. Staff we contacted as part of this review have also commented on the need for further training and have emphasized that local authority financial reporting is a highly specialized area even for qualified accountants so there is a general need for upskilling in this area.

All Finance staff should expect to be involved in year-end work and should be provided with adequate and up-to-date training in this regard. Local authorities who do this most successfully have a programme of short, but regular, training events throughout the year.

Closedown plans

12. The Council's detailed closedown plan for 2018/19 identified 415 tasks to be completed between mid-August 2018 and 31 May 2019. This plan covered all of the main areas but in my experience, closedown plans for London and metropolitan authorities are usually more detailed, typically listing 500-600 (and in some cases up to 1,000) separate tasks. For example, no separate work was identified to ensure that:

- internal recharges were correctly reversed out of the financial statements
- schools' transactions and balances were correctly accounted for
- the DSG disclosure note was accurately prepared.

13. Errors in respect of all these issues were subsequently identified during the audit.

14. Although the plan sets out expected completion dates and, in most cases, identifies a preparer and reviewer for each task, there were no separate dates for preparation and review. Also, over 90 tasks were allocated generically to spending departments or finance teams, rather than to named individuals, and 7 tasks were not allocated to any named department or individual, these included pooled budget disclosures, ledger postings to the Lease Equalisation Provision and Revaluation Reserve, and transfers to/from Earmarked Reserves for revenue grant funding.

Closedown planning should clarify accountability for all tasks identified and ensure that detailed working papers are prepared to support all core statement and disclosure notes.

Project delivery

15. Although the closedown plan was reasonably comprehensive, the scheduling of individual tasks within the plan was unsophisticated, with:

- large numbers of different tasks due to be completed on the same date
- core statements and disclosure notes being prepared at the same time by different people.

16. This increases the likelihood of bottlenecks and creates the risk of inconsistencies and discrepancies arising in the draft Statement of Accounts through late adjustments being incorrectly or incompletely processed.

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17. In terms of the detailed monitoring of deliverables, although the closedown plan includes columns for actual completion dates and a “traffic light” risk assessment system, this does not appear to have been used to its full potential in terms of monitoring progress and highlighting problems or delays. No effective action was taken to address slippage against plan during the critical period between 1 April and 31 May 2019.

Closedown work should be scheduled to avoid bottlenecks and to ensure that all disclosure notes are completed and reviewed before core statements are prepared. The closedown plan includes columns for actual completion dates and a “traffic light” risk assessment system, which should be used to monitor progress and highlight delays.

18. Completing early work wherever possible helps to spread the workload and maximises the time available at the end of the process for pre-audit checks and review. Ideally, a template Statement of Accounts (including updated accounting policies, critical judgements and key accounting estimate disclosures) should be in place by early January and over one-third of all disclosure notes can be prepared to an acceptable level of accuracy by using budget and Quarter 3 forecast outturn.

19. In 2018/19 some early work was undertaken, with accounting policies updated in February and a template Statement of Accounts prepared in March 2019. However, this approach was limited with over 300 tasks (almost 70% of the total) planned to take place (largely by just 4 people) in the 5 weeks between 1 April and 23 May.

The Council should aim to complete as much closedown work as possible prior to 1 April each year, using budget and Quarter 3 information where possible to draft disclosure notes.

Audit trail and working papers

20. The external audit team provided a list of working paper requirements (the “Prepared by Client” list or PBC) at the planning stage but this seems to have been used more as a reference document than as a key driver for closedown work and planning. Deloittes report to the Audit Committee in July 2019 provides a clear summary of their perceived deficiencies in the working papers provided for audit, namely that:

- a complete set of working papers was not available at the start of the audit
- some working papers were not available until well into week 2 of the site visit
- most working papers were not sufficiently detailed
- some working papers were not consistent with the draft Statement of Accounts
- further information was not being provided within the timescales agreed.

21. The use of checklists, templates and proformas is one of the principal ways of ensuring that working papers are prepared to a consistent standard and meet external audit needs. In 2018/19 proformas were used by spending departments to provide information in a standard format to the Corporate Finance team, but working paper templates were not used on a consistent basis to:

- standardise the layout of working papers

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- assist the auditors with signposting and navigation
- ensure that working papers provided a clear and consistent audit trail
- confirm that Code accounting and disclosure requirements had been met
- evidence pre-audit checks and review.

22. I understand however that a more consistent approach to working papers is being implemented for 2019/20 and 2020/21.

> The PBC is one of the key drivers for the audit and the contents of this list should be discussed and agreed well in advance with a view to ensuring that all working papers requested are available at the start of the audit.
>
> Checklists, templates and proformas should also be introduced to ensure that working papers are prepared to a consistent standard which meets external audit needs.

Pre-audit assurance and review

23. The 2018/19 closedown plan was based on the premise that 15 working days would be available, between 13 and 31 May 2019, to complete pre-audit reviews and consistency checks prior to the start of the audit. In the event, delays in finalising the draft financial statement meant that little, if any, time was available for this review.

24. 3 specific components of pre-audit review were included in the closedown plan and would have provided good assurance to both the s151 officer and the audit team, but were not available at the start of the audit:

- analytical review on core statements and key disclosure notes, to explain the reasons for material changes compared to the previous year
- the PBC list, annotated to confirm that all information requested is available
- completed Code disclosure checklist.

25. In addition, the CIPFA 2018 publication “Streamlining the Accounts” contains a useful consistency check which should be completed at the pre-audit stage.

26. A pre-audit review of the draft financial statements and supporting working papers should have been carried out by someone with appropriate levels of expertise. In 2018/19, however, over 40% of tasks in the closedown plan received no independent check, partly because senior staff were involved in restructuring and recruitment activities.

> Closedown work should include detailed checks on the draft financial statements, and a full review of year-end working papers, at the pre-audit stage.

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Appendix 2 –Systems and processes

1. The Statement of Accounts is compiled from four key information sources, namely:

   - ledger reports from Agresso
   - outputs from other financial systems and accounting records
   - valuations by external experts in respect of property assets and pension liabilities
   - judgments and accounting estimates made by management

2. Each of these areas is considered in turn below.

Ledger reports

3. The Statement of Accounts is compiled in the first instance from the Agresso ledger system. To produce fit-for-purpose financial statements the ledger needs to provide information which:

   - is accurate and up to date
   - records transactions based on total gross income and expenditure, not just the net position for separate project codes
   - minimises the need for extensive spreadsheet re-analysis which creates scope for error and complicates the audit trail.

4. CIPFA's 2017 review of financial management commented that:

   - *Agresso was designed around an organisation structure that has never been implemented [this means that] extensive re-analysis of information using spreadsheets needs to be carried out.*
   - *although Agresso can allocate a code based on a description…staff will often over-ride the suggested code…..over 1,000 people have access to the coding structure in Agresso which can cause major problems*
   - *there is a high error rate on journals ….and a huge volume of miscoding errors by administrative staff. Finance staff spend large amounts of time on correcting these errors.*

5. It is disappointing to note that these issues have still not been addressed, although it is now 3 years since CIPFA issued their report. The reason given for this is that the Council has prioritised improvements to IT systems with a more direct impact on services affecting local people, such as the Mosaic system for managing social care.

6. As a consequence, however, journal mispostings and coding errors, caused partly by systems weaknesses and partly by widespread personnel changes during 2018/19, are the underlying reason for many of the errors identified to date.

7. Officers I spoke to during this review have also commented that:

   - there are significant shortcomings in the current Chart of Accounts, which reflects neither the Council's organisational structure nor the requisite layout of year-end financial statements
   - the Agresso system has never been formally "closed" so still includes balances rolled forward since the initial implementation of the system in 2013

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8. Both factors create the need for extensive re-analysis and year-end journal adjustments which create extra work, complicate the audit trail and increase error risk.

9. Agresso ledger systems can work very effectively but time and attention must be given to:

- setting up an appropriate coding structure and accurate interrogation reports
- restricting who can set up new ledger codes and process journal adjustments
- putting appropriate controls in place to authorise and review material adjustments.

10. With regard to coding structures, the CIPFA Code of Practice previously required all service income and revenue costs to be allocated over a standard 12-line analysis (SeRCoP) with overheads and central recharges allocated to each line separately. This is no longer required, and Code guidance suggests that items with net expenditure below 15% of the Net Cost of Services total are amalgamated in the Comprehensive Income and Expenditure Statement and related disclosure notes. Therefore, the simplest accounting treatment is to:

- manage all overheads, governance and corporate service costs centrally for budget purposes, rather than reallocate them to service departments
- report all these costs together as a single item in the Statement of Accounts
- combine other service areas where possible to reduce the level of detail reported in the Comprehensive Income and Expenditure Statement (CIES) and disclosure notes

11. Currently the Council's CIES has three separate lines for governance and central support costs, going forward I suggest these are amalgamated into a single line in the financial statements.

> The Council should, as a priority, address the shortcomings in the current ledger system highlighted by CIPFA in 2017. A project plan should be established to deliver the required improvements within achievable timescales, and subject to regular monitoring by the Audit Committee.
>
> The Council should simplify the current coding structure so that it reflects, with minimal re-analysis, the required layout and format of the Statement of Accounts.
>
> Arrangements should also be put in place to manage the appropriate roll-forward, reversal or re-start of specified ledger codes each year end.
>
> The Council should also simplify the presentation of the CIES and underlying processes for the accounting and management of overheads, governance and corporate service costs.
>
> Action should be taken to minimise journal mispostings and coding adjustments, through a combination of staff training and by restricting who can initiate and authorise such transactions.

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Other financial information

12. Although year-end financial statements are prepared primarily from ledger reports, this evidence alone is unlikely to provide an adequate audit trail or sufficient information for every detailed disclosure note. A key component of closedown work involves ensuring that:

- every ledger balance and disclosure note can be supported by accurate information, derived either from year-end working papers or from other financial systems and processes
- all feeder systems have been reconciled to relevant ledger codes
- all working papers are available for audit.

13. The Council's closedown plan for 2018/19 did identify most feeder system reconciliations, but the following were not referred to specifically and subsequently audit adjustments were required:

- income and debtor reconciliations for leaseholder contributions and community infrastructure levy amounts
- income and debtor/creditor reconciliations for revenue grant claims.

14. Also, whilst the closedown plan correctly identified the overall requirement to prepare the Collection Fund and HRA accounting statements, it did not "unpack" separate reconciliation tasks in terms of, for example, income and debtor reconciliations for Council Tax and Business Rates systems, reconciliations back to NDR 1 and 3 returns, or the identification and reconciliation of payments made in advance.

15. Currently, there are no regular reviews in place to confirm that financial systems are reconciled to ledger balances monthly and that all suspense and holding account items are cleared. Relying on year-end processes to identify and resolve reconciliation issues creates additional demands on the closedown team at what is already a very busy time of year. It also increases the risk that in-year financial reporting will be based on incomplete or incorrect information, and therefore may be inconsistent with the Council's end of year accounts.

16. The most successful closedown plans include early work to:

- map each core statement and disclosure note, against the relevant information source(s)
- identify a named "lead officer" for each key area of closedown work
- confirm, for each item identified, external audit working paper requirements
- where possible, establish ongoing financial systems to collect the necessary information rather than rely on one-off exercises at the year-end
- reconcile each information source to relevant ledger codes on at least a monthly basis
- ensure that reconciliations are kept up to date throughout the year
- confirm arrangements for compiling working papers and audit evidence at the year end.

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The Council should confirm that all Agresso ledger codes and disclosure notes are supported by ongoing financial systems and/or year-end work. Arrangements should be put in place to carry out and evidence regular reconciliation work which confirms the accuracy of these balances on a monthly basis rather than relying on year-end work.

Good practice is to operate a "dashboard" approach with regular (i.e. monthly) reports to the s.151 officer to provide assurance to him/her that all reconciliations are occurring on time and to identify where they are not so that corrective action can be undertaken in a timely manner.

Asset Valuations

17. Land, buildings and social housing stock comprise 80% of the total asset value in the Balance Sheet and represent a major focus for external audit work. Whilst the CIPFA Code of Practice on Local Authority Accounting does not require all land and buildings to be revalued on an annual basis, it does expect that:

- revaluations of operational assets will be carried out at least once every five years, and whenever a material change in value takes place
- non-operational assets e.g. surplus assets and assets held for sale will be carried at open market value – in practical terms this usually involves annual revaluation
- a desktop impairment review covering all assets will be carried out each financial year.

18. The Council appointed Wilks Head and Eve LLP as external valuers and in 2018/19 their work consisted of:

- a desktop valuation of schools at 31 March 2019
- a full valuation of Council dwellings at 1 April 2018, plus a report on market changes during 2018/19 which officers used to produce an adjusted valuation at 31 March 2019
- a full valuation of other properties in line with the Council's 5 year rolling programme. The effective date of this valuation was 1 April 2018, not 31 March 2019.

19. This approach did not meet either Code requirements or the RICS valuation guidance which states (in VPGA 1) that *"Valuations for inclusion in financial statements must comply strictly with the applicable financial reporting standards adopted by the entity"* and that *"where the entity has adopted IFRS the basis of value will be fair value and the requirements of IFRS 13 Fair Value Measurement will apply".*

20. Other deficiencies were identified by Deloittes as follows:

- The valuation process was highly dependent on information provided by finance officers regarding, for example the location, condition and function of properties, the number and build type of council dwellings and the floor space of schools.
- A paper was not prepared to evidence the information provided to the valuer or the controls put in place to ensure the completeness and accuracy of this information.
- Neither was any evidence available to support the Council's review of the reasonableness of valuation reports received

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- Valuation reports obtained from Wilks Head and Eve LLP did not provide sufficient detail to enable the information to be audited without extensive further work.

Given the significance of asset valuations to the audit process, tenders and contracts for external valuers should emphasise that all work is carried out to a standard that meets Code and RICS Red Book requirements in full. Contracts should only be awarded to valuers who can demonstrate a proven track record in meeting external audit requirements. Valuation processes, including all key estimates and assumptions, should be fully documented with officers undertaking, and evidencing, adequate review and challenge of all valuation reports received.

Pension liabilities and IAS 19

21. Pension liabilities are another key audit area as they represent the single largest liability on the Balance Sheet. Audit work in 2018/19 identified that:

- unfunded pension liabilities for Teachers' Pensions had not been included in the Statement of Accounts
- following the decision to pay 3 years' deficit funding as a single lump sum instead of in annual instalments, the Council did not obtain a revised Rating and Adjustments certificate from the actuary to support IAS19 entries in the accounts.

22. Deloittes also queried information provided by the actuaries in respect of:

- recent legal cases, such as McCloud
- assumptions on future salary increases
- the estimation basis for membership numbers.

23. The auditors clearly felt that officers had over-relied on reports provided by the pension fund actuaries, and that the need to provide additional information over and above the IAS19 valuation itself had not been considered. No evidence was available to confirm that officers had carried out any meaningful review of the IAS 19 reports or had challenged any of the assumptions or estimates involved.

The Council should liaise with its actuaries each year end to ensure that officers understand and agree with all key assumptions underpinning IAS 19 valuations and reports, and that evidence can be provided, if necessary, to support the judgements, estimates and assumptions arrived at. Actuaries' reports and correspondence should confirm how they have taken account of recent legal cases and other current developments when assessing year end pension liabilities. Working papers provided for audit should demonstrate how the accounting implications of any prepayments or deficit funding arrangements have been considered and applied.

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Key accounting estimates and judgements

24. Deloittes' report to the Council in July 2019 commented that *"Accounting papers were not prepared to explain and support key judgements and estimates…. It is good practice (and the expectation of the Financial Reporting Council) for organisations to prepare accounting papers in respect of all key matters in the application of accounting standards, calculation of material estimates and management's exercise of judgment within Code requirements, and for these papers to be presented to the audit committee prior to approval of the statement of accounts."*

25. The auditors also commented that the Council had tended to over-rely on CIPFA's example Statement of Accounts (which are intended for general guidance only), with the result that in some cases unnecessary or inaccurate disclosures were provided, and in other cases material disclosures had been left out. For example:

- calculation of the NNDR appeals provision was based on unreliable information and the original estimate of £1.3m was subsequently increased to over £14m
- having decided to prepay 3 years' pension deficit funding as a single lump sum, the Council did not set out the rationale for this arrangement, or the accounting treatment that it intended to adopt
- the Statement of Accounts did not explain the rationale behind depreciation policies for infrastructure assets

26. Perhaps most importantly, the Council had not adequately addressed new Code requirements in respect of IFRS 15 which, although minimal for many local authorities, had a significant impact for London authorities such as Tower Hamlets with material levels of leaseholder contributions to capital improvement works and Community Infrastructure Levy (CIL) income.

27. Looking forward, the introduction of IFRS 16 with effect from 1 April 2021 will require a thorough review of all lease and lease-type financial arrangements and will involve all spending departments across the Council.

28. I suggest the following processes are put in place:

Discussions should be held with the external audit team early in the New Year to identify and agree the basis for: • exercising and disclosing key management judgements and material estimation techniques • implementing new Code requirements and other significant changes to the Statement of Accounts • dealing with any other complex or contentious accounting issues. Particular attention should be given to the implementation of IFRS 16 for 2020/21, and project plans for successful implementation put in place as soon as possible.

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Arrangements should then be made to obtain any additional information from external experts, (e.g. valuation reports, legal advice or formal accounting views) and for officers to prepare briefing papers or Council reports on material items as required.

The template Statement of Accounts should be re-drafted to include updated disclosure notes and revised accounting policies by 31 January, then be presented to auditors and Those Charged with Governance in advance of 31 March each year.

29. Adopting this approach would enable the general principles underpinning the Statement of Accounts to be finalised at an early stage so that the period between 1 April and 31 May can focus on the accuracy of detailed balances and transactions.

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Appendix 3 – Errors identified to date

1. Officers have reported audit adjustments made to date to the Audit Committee as follows:

	Reported in original draft accounts	Reported in revised draft accounts	Change
	£m	£m	£m
General Fund	26.8	27.3	0.5
HRA	53.7	53.8	0.1
Other revenue reserves	156.1	152.6	(3.5)
Capital reserves	285.1	333.0	47.9
Total impact on useable reserves	**521.7**	**566.7**	**45.0**

Source: Statement of Accounts 2018/19 Progress Update, Audit Committee 13 May 2020

2. However, audit work on the revised Statement of Accounts is still at a relatively early stage so further adjustments may be required.

3. Several of the errors identified to date above affected the opening Balance Sheet as at 1 April 2018, however in terms of value the most significant adjustments relate to either:

- PPE revaluation issues, reflecting the fact that the increasing focus of the Financial Report Council on this issue has tended to drive an increasing level of audit work in this area, and has increased the requirement for auditors to challenge the content of valuation reports and the accuracy of source data, estimation techniques and assumptions that underpin them
- Third party contributions to capital expenditure in terms of either the Community Infrastructure Levy (CIL) or leaseholder contributions to major capital works. Prior to 2018/19 the Council had accounted for these items on a cash basis as and when monies were received however the introduction of IFRS 15 created the requirement to account for such transactions on an accruals basis as soon as the "obligating event" occurred. Since this was a new Code requirement for 2018/19 it would have been a specific focus of attention for Deloittes in 2018/19 but not for KPMG in the previous year.

4. It is worth also noting that, out of the 15 separate issues identified to date:

- 5 were above materiality when considered on an individual basis
- a further 4 items, though not individually material, were material when considered in aggregate alongside the other audit errors identified
- the other 6 items were not material on either an individual or aggregate basis, so the option was available for the Council and the auditors not to adjust the financial statements.

5. Some authorities adopt a policy of adjusting for material items only and this tends to facilitate a speedier completion of the audit although it can also lead to errors being perpetuated in the accounts and ongoing systems weaknesses not being addressed. The approach adopted by Tower Hamlets has been to investigate in detail every issue raised by the auditors and to

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adjust the accounts even where the error found is not material. This process has been time consuming but has served to provide a thorough understanding of the issues being raised, as well as significantly increasing the overall level of useable capital reserves by including 3rd party contributions expected but not yet received.

6. Going forward, it is usually helpful for both auditors and auditees to agree a "protocol" before the start of the audit setting out how errors identified are to be reported and addressed in the context of materiality.

7. Most of the errors identified to date have been due to either weaknesses in underlying financial systems, or a failure to ensure that closedown planning meets in detail all Code and audit requirements. Therefore, the Council should:

- update its approach to revenue recognition in the light of IFRS 15
- improve processes for controlling year end cut-off
- ensure that items are not carried forward on the Balance Sheet without a detailed review to confirm accuracy and completeness of audit trail
- ensure that land and buildings valuations meet Code and RICS requirements
- improve liaison with spending departments to ensure that the Fixed Asst Register is accurate and up to date.

8. Audit work also identified weaknesses in a number of specific but important financial processes which are considered below.

Fixed asset register records

9. An accurate and up to date Fixed Asset Register is key to accurate capital accounting and underpins many of the most significant items in the Balance Sheet. External audit work identified that:

- Schools converting to academy status were not removed from the Fixed Asset Register on a timely basis, consequently school building valuations were overstated on the Council's year-end Balance Sheet.
- New temporary accommodation for homeless households had not been correctly classified in the Fixed Asset Register and was also therefore incorrectly valued.

10. Improved liaison with service departments, on a more regular basis throughout the year, should help to eliminate this type of issue. In other respects, however, the Fixed Asset Register appears to have been accurately maintained and was reconciled to ledger records at the year end. It is also encouraging to note that external audit work did not appear to highlight any significant issues regarding:

- duplicate asset records
- inconsistencies between the Fixed Asset Register and Land Registry records
- inconsistencies between the Fixed Asset Register and the Council's other financial systems e.g. tenant rent rolls and leaseholder sundry debtor systems
- incorrect posting of revaluation adjustments.

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11. As described in Appendix 2, most audit issues identified to date related to the valuation process rather than the accuracy of the Fixed Asset Register itself.

Other capital transactions

12. Audit work identified that capital purchases of £3.4m had not been accrued for as at 31 March 2019. Their reports to date also comment that, although no instances were identified of revenue spend being incorrectly identified as capital (or vice versa), there did not appear to be any documented internal controls or processes that would prevent this from occurring. Deloittes have recommended that the Council implements such a control, for example by issuing guidance to service departments or through evidenced pre-audit review.

13. It is again encouraging to note that audit work to date has not highlighted any specific issues regarding capital financing transactions such as calculation of the Capital Finance Requirement, annual set aside for Minimum Revenue Provision and identification of capital transactions.

Levies and recharges

14. Audit work has identified that recharges to leaseholders for capital works in 2018/19 and 2017/18 had not being accurately identified and accounted for. Similarly, delays in collecting Community Infrastructure Levies (CIL) meant that the full amounts due had not been properly recognised in the Council's year-end Balance Sheet.

15. These transactions represent a significant source of income for the Council and need to be collected and accounted for on a timely basis. The previous approach, which only recognised these transactions following the receipt of cash, does not provide an effective control over monies due to the Council and is no longer acceptable accounting practice under IFRS 15. Internal Audit's recent review of sundry debtors' systems has also highlighted the failure to recognise all income sources (both capital and revenue) on a timely basis.

Feeder systems and regular reconciliation processes should be established to ensure that all income due to the Council is accurately and promptly invoiced, collected and recorded.

Schools transactions

16. How to account for DSG funding deficits has been a contentious area for several years now. In 2018/19 the Council initially treated the £4.7m deficit as a trade receivable, however as the Department for Education do not currently accept that there is a legal liability to repay funding deficits, that accounting treatment was challenged by external audit. Current CIPFA guidance, issued in March 2020, recommends that DSG overspends are carried forward as a negative balance within earmarked reserves.

A consistent approach to accounting for DSG funding deficits should be decided upon, taking account of current DfE and CIPFA guidance, and disclosed as a key management judgement in the Statement of Accounts.

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17. A number of other audit adjustments also relate to schools' transactions as follows:

- £47.8m of internal transactions and recharges within Children's Services had not been correctly eliminated from income and expenditure lines in the Comprehensive Income and Expenditure Statement in 2018/19. A similar error also occurred in 2017/18
- schools cash balances had not been correctly recognised in the Balance Sheet
- cash paid by individual schools into corporate bank accounts had been included in receivables rather than cash and cash equivalents.

18. These issues seem to reflect a tendency for schools not to provide financial information in a standard format on a timely basis, and not to prioritise closedown processes such as bank reconciliations, managing cut-off and information requests.

The Council should aim to set up a monthly monitoring process whereby all schools provide copies of bank reconciliations and budget monitoring statements within 10 days of each month-end, and this information is used to confirm each schools' cash balances, reserves balances and spend to date against DSG allocation.

Journal postings can then be made on a regular basis throughout the year to eliminate internal transactions and recharges and post accurate figures for schools' cash balances and reserves to the Balance Sheet.

19. This approach reduces the need for additional work at the year-end by establishing a process that provides accurate information throughout the year. Discussions with officers have indicated that a similar system to that recommended above was in place prior to the recent restructuring but has lapsed due to a combination of staff shortages and the departure of experienced personnel.

Grant income

20. Two separate issues were identified by external audit, namely that debtors for grant claim income due but not yet received had been incorrectly recognised as at 31 March 2019, and that creditor balances had been incorrectly recognised for unused grant receipts.

21. A comprehensive grant claims register would help to resolve such issues by:

- Matching grant claim entitlement against cash receipts
- Matching grant income against relevant service expenditure
- Allocating grant transactions to the correct financial years
- Calculating year end accruals and prepayments
- Maintaining evidence to demonstrate whether grant conditions have been met
- Providing an assessment of whether grant stipulations or conditions apply

22. Discussions with officers have indicated that a central grant claims register was in place prior to 2018/19, but this system no longer operates and recording grant income is now the responsibility of individual spending departments.

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Grant income is one of the most significant items in the Statement of Accounts therefore a comprehensive grant claims register should be put in place as soon as possible, and reconciled to ledger records on a monthly basis to better inform budget management and year-end financial reporting.

Year-end accruals

23. The current ledger system permits debtor and creditor balances to be carried forward on the Balance Sheet indefinitely rather than requiring year end accruals and similar adjustments to be reversed out at the start of each financial year then re-appraised as part of year-end closedown. Consequently, £20.0m of "unexplained" Business Rate creditors were found to have been carried forward in the Balance Sheet for a number of years, these balances were transferred back to the Collection Fund in 2018/19.

24. Audit work also identified a number of year-end accruals which were not required, either because the goods or services had been supplied after the year end, or because the invoice had already been paid. Guidance notes to spending departments did cover year-end cut off, however it would appear that this guidance was not followed in full.

More detailed guidance and training on year-end cut off should be provided to spending departments. In order to minimize the number of year-end postings the Council should implement a de-minimis policy for accruals, say £20-25,000, and suspend payroll and creditor payment runs for 7-10 days over the year end date An "accruals team" should be established to check all accruals over an agreed threshold (say £250,000) and 10% - 15% of accruals below this threshold on a sample basis to confirm the accuracy of the entries in the Statement of Accounts. Alternatively, additional testing of year-end accruals could be provided by Internal Audit.

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Appendix 4 – External audit

The new audit framework

1. New contracts for external audit suppliers were let by Public Sector Audit Appointments (PSAA) Limited for 2018/19. This represented a significant change in terms of:

   - audit suppliers – 25% of local authorities received new audit suppliers for 2018/19 as a result of the contract procurement process who, to meet International Auditing Standards, were required to carry out additional audit testing to confirm the opening Balance Sheet position at 1 April 2018.
   - fee cover – PSAA negotiated significant fee reductions and at Tower Hamlets the baseline audit fee reduced from £210,00 to £165,000 per annum
   - audit scope – previously the PSAA had determined the scope of the audit but for 2018/19 and future years each individual audit firm would be responsible for determining the nature of audit work and the method of delivery

2. Under these new arrangements, from 2018/19 the Financial Reporting Council (FRC) rather than the PSAA became responsible for the oversight of audit quality. In October 2018, the FRC had issued a report entitled “Developments in Audit”. This report explained that because of the significant deterioration in the quality of audits inspected the FRC intended to strengthen its supervisory and enforcement capacity.

3. Areas of particular concern to the FRC are listed below, which largely explains the heightened audit focus on these areas in 2018/19:

   - failure to challenge or evidence the basis for key management judgements and material accounting estimates
   - failure to challenge information provided by independent experts and advisors, and to document the key assumptions underpinning their work
   - failure to ensure that non-current assets were valued in line with RICS Red Book requirements.

4. This unprecedented combination of significantly reduced fee cover, heightened quality expectations and an unfamiliar client explain why Deloittes needed to carry out mor extensive audit testing and required more detailed and comprehensive working papers. Given that the Council was accustomed to a different audit approach and a different audit team however, it might have been helpful for the auditors to set out their expectations well in advance.

Detailed meetings between the Council and their auditors at the planning stage should have covered not just the logistical arrangements for the audit but also current Code and FRC requirements, the overall approach to the audit and working paper requirements.

Managing the audit process

5. Delays in completing local government audits were widespread in 2018/19, with 40% of all opinions not signed off by 31 July. However, by 31 December 2019 more than half of these outstanding audits, including 12 out of 19 London boroughs, had been completed. Only 57

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audits remained outstanding at 30 June 2020. These include 4 London boroughs, one of which is Tower Hamlets. All 4 were new audit appointments in 2018/19.

6. Deloittes report to the Audit Committee in July 2019 provided a comprehensive summary of the issues arising to date and there have been regular meetings between officers and the audit team since this date to discuss and progress the matters identified.

7. The Audit Committee has also received regular update reports but is understandably concerned about the length of time it has taken to progress the audit and to address the matters identified. Going forward, it might be helpful if the Committee also received more detailed information about the audit process as well as high level messages about proposed changes to the Statement of Accounts.

8. My discussions with Council staff and the external audit team indicated that, until recently, most meetings between officers and audit were not minuted and there was no formal record of "next steps", or actions agreed. Also, there has been a lack of clarity (on both sides) about which audit issues have been actioned and which still need to be addressed.

9. New processes are now in place to address this, with

- better project management (via regular "glidepath" reports)
- action plans and trackers which allocate responsibility to specific named individuals for responding to audit queries and providing further information
- a 2-day turnround target for all queries and requests for information
- regular meetings both within the Council and with external audit to track progress
- more pro-active involvement from senior management.

10. Whilst very welcome, these are still relatively new arrangements which need to be maintained and developed. Although it is too early as yet for me to comment on their overall effectiveness, the Council can now assess with some degree of accuracy the number of audit queries being raised and responded to.

11. According to this monitoring information, as at 26 October 2020, over 40 audit queries remained outstanding (and overdue) in respect of 2018/19, and over 50 in respect of 2019/20, out of a total of over 720 queries raised in total. This represents a significant improvement on the position at the beginning of September when over 230 queries needed to be addressed.

12. Principal reasons for these delays have been identified as follows:

- both the Chief Accountant and the Capital Accountant left the Council during 2019, delays arose due to the time required to find replacements and for new staff to get "up to speed" with audit issues and outstanding requirements
- subsequently, further staff changes have also contributed to delays in providing information to the auditors and processing adjustments once agreed
- some of the key issues identified, particularly on IAS19 accounting and land and buildings valuations, required input from external valuers and advisers.

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13. Whatever the reasons, it seems fairly obvious that the Council's Finance team, and the current Chief Accountant in particular, have been swamped with both the level and complexity of audit queries and requests for information, and I am unclear about why the decision was not taken to concentrate on resolving 2018/19 issues before moving on to the following year.

14. It is encouraging to see that the Corporate Leadership Team now recognise that completion of the 2018/19 audit is a Council priority and have committed to providing additional staff resources if necessary. However, my discussions with the external audit team indicated that audit work on the revised Statement of Accounts is still at a relatively early stage, and a significant number of responses to audit queries have yet to be formally cleared. In September 2020, the Audit Manager and Engagement Lead anticipated that a considerable amount of detailed audit testing and in all probability further audit adjustments, would be required before an opinion could be issued.

15. The Council should therefore take further steps to expedite audit sign-off by:

- securing Deloittes commitment to complete the 2018/19 audit by an agreed date which is both realistic and achievable
- ensuring that the s151 officer regularly attends progress meetings with the external audit team, provides visible encouragement and leadership and closely monitors progress against plan.

Processes recently put in place to manage the audit process and to treat completion of the 2018/19 audit as a corporate priority need to be maintained and developed. Discussions with Deloittes should clarify how best to prioritise outstanding queries and complete the audit of the revised 2018/19 Statement of Accounts by an agreed date which is both realistic and achievable. The s151 officer should reinforce this process by regularly attending progress meetings with the external audit team, providing visible encouragement and leadership and closely monitoring progress against plan. Reports to Those Charged with Governance should be more detailed and cover audit processes as well as proposed changes to the Statement of Accounts.

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Appendix 5 - About Peter Worth (BA Hons), CIPFA, MAAT

A nationally recognised authority on local government accounting, Peter has over 30 years' experience of providing advice on issues such as:

- IFRS and Code requirements
- Capital accounting and financing
- Treasury Management and Investing
- Pensions and LGPS
- Group Accounting
- Managing the audit process

Peter spent seven years working in local authorities before he joined the Audit Commission in 1988. As one of their senior technical managers he was instrumental in establishing their well-regarded Technical Helpdesk Service. Peter left the Audit Commission in 2012 to set up Worth Technical Accounting Solutions which now has a portfolio of local government clients including:

- Westminster City Council
- City of London Corporation
- The States of Jersey Government
- London Borough of Waltham Forest
- South Gloucestershire Council
- Transport for Greater Manchester

Peter has a proven track record in helping local authorities to:

- Resolve longstanding technical accounting issues
- Achieve faster year end close
- Improve the quality of published Statement of Accounts
- Improve the quality of audit trail and year end working papers
- Expedite the external audit process.

Combining consultancy work with his role as a CIPFA associate and longstanding member of CIPFA's Local Authority Accounting Panel ensures that Peter remains in touch with both national developments and current issues for practitioners. He regularly delivers training and presentations to professional bodies, elected members and stakeholders on accounting and audit issues, and has worked with central government on a range of matters affecting local government finance.

Peter has co-authored various CIPFA publications including Streamlining the Accounts, Code Guidance Notes for Practitioners and the example Local Government Pension Fund accounts.

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