

Progress report

Audit Committee 26 June 2012

London Borough of Tower Hamlets

Audit 2011/12

The Audit Commission is a public corporation set up in 1983 to protect the public purse.

The Commission appoints auditors to councils, NHS bodies (excluding NHS foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

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Introduction

- 1 The purpose of this paper is to provide the Audit Committee with a report on progress in delivering our responsibilities as your external auditors. It includes an update on the externalisation of the Audit Practice.
- 2 If you require any additional information regarding the issues included within this briefing, please contact your District Auditor or Engagement Manager.
- 3 Finally, please also remember to visit our website (www.audit-commission.gov.uk) which now enables you to sign up to be notified of any new content that is relevant to your type of organisation.

Progress report

Financial statements

4 Our 2011/12 audit is progressing well. We have continued to liaise effectively with the corporate finance team. The work proposed remains as set out in the detailed 2011/12 audit plans agreed by the Audit Committee in March 2012.

5 We have substantially completed our interim audit. This has involved updating our understanding of the Council's control environment, updating our documentation of the key financial systems and testing the key controls within those systems. The one key area where work is outstanding is our review of the accounts receivable system.

6 We will feed our findings into our testing strategies for our work on the Council's financial statements, but there are no matters that we wish to bring to your attention at this stage.

Assurances from the Audit Committee

7 In order to comply with International Standards on Auditing (UK&I) 240 and 250, we are required to obtain an understanding of how the Audit Committee, as those charged with governance, exercises oversight of management's arrangements to prevent and detect fraud and to maintain legality.

8 A paper entitled 'Enquiries of those charged with Governance' has been shared with the Council to support our work in this area. Responses from management and the Chairman of the Audit Committee, on behalf of those charged with governance, are attached at appendix 1.

VFM conclusion

9 The audit plan presented to the Audit Committee at its last meeting outlined two specific risks to consider in the context of our work to support the 2011/12 VFM conclusion:

- financial resilience; and
- governance.

10 Our work to address these risks is ongoing. As part of our ongoing review of the Council's governance arrangements, we will consider the Council's arrangements for the appointment of a new Chief Executive.

Update on outsourcing the work of the Audit Practice

11 Following the award of geographical contracts for the audit of principal local authorities and NHS bodies, the Audit Commission has held meetings in each contract area to introduce the winning firms to audited bodies.

12 It has in parallel commenced consultation on the appointment of auditors to individual bodies with a view to making those appointments at its Board meeting on 26 July 2012. Firms will take up audit appointments for the 2012/13 audit year from 1 September 2012 when the interim appointment of the current auditor will come to an end.

13 Following consultation with audit suppliers, the Audit Commission has put in place arrangements to facilitate the smooth transfer of any part-completed 2011/12 work from the Audit Practice to incoming audit firms so that they can maximise reliance on the work of the Audit Practice and complete the work expeditiously.

Update on the residual Audit Commission

14 The Commission is reducing and reshaping its workforce so that it can deliver its remaining core functions of audit regulation, contract management and sector support.

15 The Department of Communities and Local Government has advertised for a new Chairman of the Audit Commission to lead through the period of transition and downsizing. The new Chairman will take up post following the end of the term of office of the current Chairman in September 2012.

Other matters of interest

2012/13 audit fees

Fee scales for 2012/13 audits of local government and NHS bodies

16 Following a consultation exercise, the Audit Commission has agreed the work programme and fee scales for 2012/13 audits of local government and NHS bodies. It sent out letters notifying organisations of the new fees on Wednesday 11 April 2012.

17 As previously advised, the outsourcing of the Audit Commission's in-house Audit Practice means that these fees will be fixed for a five-year period, irrespective of the rate of inflation.

Fee scales for 2012/13 National Fraud Initiative

18 The Audit Commission's consultation on its proposals for the 2012/13 National Fraud Initiative (NFI) work programme and scale of fees ended in March 2012 and the results of this exercise were published on 30 May 2012.

19 The Commission did not propose to introduce any new mandatory data matches in the NFI for 2012/13, so the main work programme will remain unchanged from 2010/11.

20 In recognition of the financial pressures that public bodies are facing in the current economic climate, the scale of fees for mandatory participants will also remain the same as for NFI 2010/11.

2010/11 National Fraud Initiative

21 In May 2012 the Audit Commission published the results of the NFI for 2010/11.

22 The NFI is a data matching exercise which is hosted on a secure website. It compares information held by around 1,300 organisations including councils, the police, hospitals and 77 private companies. This helps to identify potentially fraudulent claims, errors and overpayments.

23 When there is a 'match', there may be something that warrants investigation and examples of the data matches the NFI undertakes are set out in the table below.

Table 1: **Examples of data matches covered by the NFI**

Data Match	Possible fraud or error
Pension payments to records of deceased people.	Obtaining the pension payments of a deceased person.
Housing benefit payments to payroll records.	Claiming housing benefit by failing to declare an income.
Council tax records to electoral register.	A council taxpayer gets single person discount whilst living with other countable adults and thus being ineligible.
Payroll records to other payroll records.	An employee is working for one organisation while being on long-term sick leave at another.

24 The latest NFI in England identified almost £229 million of fraud, overpayments and errors. This is made up of £139 million for 2010/11 plus £90 million not previously reported from earlier exercises. Over the same period, £47 million was identified in Scotland, Wales and Northern Ireland, raising the UK-wide total to £275 million.

25 The highest value categories identified in England continue to be pensions (£98 million), council tax single person discount (£50 million) and housing benefit (£31 million).

26 The latest report is accompanied by a series of case studies from the private and public sectors and a briefing for elected members. The briefing includes a series of questions that members can put to officers.

27 Since the initiative's start in 1996, the programme has helped detect £939 million, taking it a step closer to achieving a £1 billion payback to the public purse.

Public Sector Internal Audit Standards

28 The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (IIA) announced a formal collaboration in May 2011.

29 This collaboration has recently led to the formation of the UK Internal Audit Standards Advisory Board, which will provide oversight and challenge to the development of UK-wide Public Sector Internal Audit Standards.

30 The new unified set of internal audit standards will be based on the mandatory elements of the IIA's International Professional Practices Framework and it is proposed that they will apply across the UK to central and local government and the NHS (excluding foundation trusts).

Payment by results

31 The Audit Commission published *Local payment by results* on 5 April 2012. This is a briefing paper which considers potential issues arising from local authorities using payment by results (PbR) as a method of commissioning and paying for services.

32 PbR is a new approach, where commissioners pay service providers according to how well they achieve specified outcomes, rather than by outputs or volumes of service. These outcomes may be social, economic, financial, or a combination of all three. PbR is not the only contract type that rewards good performance, and commissioners should always consider other options alongside PbR to choose the most suitable approach.

33 What sets PbR apart from other contract types is that a significant amount of payment is withheld until the results are delivered. The payment is directly related to the level of success.

34 National PbR schemes are developing quickly. Some early schemes include reducing reoffending; diverting young offenders from custodial sentences; helping the unemployed to find work; preventing children from being taken into care; keeping frail older people in their own homes; and improving the management of chronic health conditions.

35 The briefing sets out to help councils understand what PbR might entail. As most schemes are at an early stage, the Audit Commission has identified a range of issues that local commissioners should consider if they are to use PbR successfully, drawing on some national and international examples.

36 The briefing suggests that there are five principles that any PbR scheme needs to meet if it is likely to succeed:

- a clear purpose;
- a full understanding of the risks;
- a well-designed payment and reward structure;
- sound financing; and
- effective management and evaluation.

37 The Audit Commission has sent the briefing to council chief executives and other key stakeholders.

The rights of local electors

38 The Audit Commission has published an updated version of *Council accounts: a guide to your rights*. The publication aims to help local electors by explaining their rights and how to engage with auditors in relation to the accounts. It also points electors to other sources of advice and more information where they have concerns that are not about the accounts.

39 The publication is accompanied by a Notice of an Objection form designed to assist electors wishing to present their objection to an item or items of accounts to the auditor.

40 Members of the Audit Committee may find it helpful to familiarise themselves with the document which can be found on the Audit Commission's website.

NAO role in local VFM studies

41 The NAO currently carries out around 60 VFM studies on central government initiatives and programmes each year. From next year, it will produce an increasing number of studies focusing on the local government sector.

42 A new Local Government Reference Panel has been set up to give councils an input to the NAO's programme of local government value for money studies. The panel, which will meet twice a year, includes representatives from nine local authorities as well as from CIPFA, Community Service Volunteers and the University of Birmingham.

43 The programme comprises three studies in 2012/13, the first being communication between central and local government, rising to four in 2013/14 and six in 2014/15.

44 Subject to Parliamentary approval, the NAO eventually expects to assume the Audit Commission's role in setting the framework for local audit, through a code of audit practice.

CIPFA's brief guide to Local Government Finance reforms

45 As the Local Government Finance Bill enters its concluding stages in the House of Commons, CIPFA has published a guide to some of the proposed changes.

46 CIPFA's *Brief Guide to Local Government Finance Reforms* seeks to answer some common questions that local government officers and elected members may have surrounding the localisation of support for council tax and business rate retention.

47 The guide explains the purpose of the proposals and their impact. It includes simplified examples of the proposed changes. At the time of writing, all the legislation and guidance has yet to be published, so the guide represents the latest known position. CIPFA will publish additional guidance once the detail becomes known.

Key considerations

48 The Audit Committee may wish to consider the following questions in respect of the issues highlighted in this briefing paper.

- Has the Committee asked officers the questions set out in the Audit Commission's NFI briefing for elected members? Is the Committee satisfied with the answers?
- Have officers considered the Audit Commission's briefing paper on local payment by results agreements?

Contact details

49 If you would like further information on any items in this briefing, please contact either your District Auditor or Engagement Manager.

50 Alternatively, all Audit Commission reports – and a wealth of other material – can be found on our website: www.audit-commission.gov.uk.

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Appendix 1 Enquiries of those charged with governance

Enquiries of those charged with governance

Table 2: **ISA 240 The auditor's responsibilities relating to fraud in an audit of financial statements**

Question	Response
<p>Are you aware of any actual, suspected or alleged fraud?</p>	<p>Yes, the audit committee receives regular reports from the anti fraud team setting out the types and significance of frauds across the authority. In line with our protocols, all significant frauds in between meetings would be reported to the Cabinet Member and me as the Chair of the Audit Committee.</p> <p>At the end of the financial year, the Audit Committee also receives an annual report summarising the work of the anti fraud team.</p> <p>In September 2011, the Committee also received a paper from the Audit Commission setting out how the Council was performing against frauds raised in Protecting the Public Purse 2010.</p>
<p>Has management disclosed to you the conclusion of its assessment over the risk of fraud within the financial statements of both the Council and the Pension Fund?</p>	<p>The briefing note accompanying the statement of accounts highlights any significant risk around fraud within the financial statement of both the Council and Pension Fund. This was presented to the Audit Committee on 29 June 2011. A similar note will accompany the 2011/12 Accounts.</p>
<p>Have you considered the risk of material misstatements (misreporting) by management in relation to both the Council and the Pension Fund?</p>	<p>This was discussed at the Audit Committee on 29 June 2011 And will again be discussed as part of the review of the 2011/12 Accounts.</p>
<p>What is the Audit Committee's assessment of the impact of misappropriation on the financial statements of both the Council and the Pension Fund?</p>	<p>From the information we have received from officers and the anti fraud team, the impact of material misappropriation on the financial statements is regarded as low.</p>

Question	Response
<p>What oversight have you exercised over management's processes for identifying and responding to the risks of fraud, and the controls put in place by management to mitigate those risks? See appendix 1.</p>	<p>The Audit Committee's TOR set out clearly the role of the committee in being the body responsible for receiving and scrutinising the authority's arrangements for fraud. A number of processes are in place for management to report fraud such as whistle blow procedures / audit / fraud team etc and for these to be reported regularly to the committee. Over the last year, we have received reports from the Anti Fraud team that have highlighted reactive and proactive fraud work and the nature and range of frauds.</p>
<p>How do you exercise oversight of management's processes in relation to:</p> <ul style="list-style-type: none"> ■ communication to employees of views on business practice and ethical behaviour; and ■ communication to those charged with governance the processes for identifying and responding to fraud. 	<p>There has been some communication to staff of business practices via Tower Hamlets Now, the intranet, and posters advising of the Council's whistle blow number. The communication arrangements for those charged with governance is in place via the Audit Committee via the annual refresh of the Council's anti fraud arrangements.</p>

Table 3: **ISA 250 Consideration of laws and regulations in an audit of financial statements**

Question	Response
<p>Are you aware of any non-compliance, by either the Council or the Pension Fund, with relevant laws and regulations?</p>	<p>Not aware of any material non-compliance by the council or the Pension Fund with relevant laws or regulations.</p>
<p>If there have been instances of non-compliance, has the Audit Committee ensured that these have been brought to the attention of the auditor?</p>	<p>There have not been any such instances but protocols are in place for raising matters with those charged with governance and the external auditor and for ensuring the matter is pursued as necessary.</p>
<p>If there have been instances of non-compliance, what oversight has the Audit Committee had to ensure that actions are taken by management to address any gaps in control?</p>	<p>There have not been any instances of non-compliance but the Audit Committee receives regular reports that highlight failure to comply with laws, regulations, policies, procedures etc. The reports set out the nature of the issue(s) and management is asked to respond to the matter raised at the Committee (as the accountable person). The matter is minuted and the audit committee receives updates to ensure appropriate action can be taken, including further updates from management and the Audit Committee recommendation to improve governance.</p>

Question	Response
How do you gain assurance that all relevant laws and regulations have been complied with?	<p>From a number of sources including:</p> <ul style="list-style-type: none"> ■ having appropriate compliance requirements built into the Councils constitution and regulatory framework (including job descriptions); ■ the external and internal audit of the compliance requirements; ■ monitoring and performance reports from management; and ■ risk management assessments.

Table 4: **ISA 570 Going concern**

Question	Response
Have you assessed the process management has followed in forming a view on going concern of the Council and the assumptions on which that view is based?	The assessment of the process followed formed part of the papers submitted to the Audit Committee in June / September each year as part of the annual Financial Report.
Have you assessed the process management has followed in forming a view on going concern of the Pension Fund and the assumptions on which that view is based?	The assessment of the process followed formed part of the papers submitted to the Audit Committee in June / September each year as part of the annual Financial Report.

Table 5: **ISA 580 Written representations**

Question	Response
Have you made suitable arrangements to consider the letter of management representations, acknowledging their collective responsibility towards the financial statements?	This is an agreed protocol with the Audit Commission and includes the roles and responsibilities around the financial statements.

Enquiries of management

Table 6: **ISA240 The auditor's responsibilities relating to fraud in an audit of financial statements**

Question	Management Response
<p>What was management's assessment of the risk that the financial statements may be materially misstated due to fraud and what were the principal reasons?</p>	<p>The risk that the financial statements may be materially misstated due to fraud is regarded as being low. In making this assessment, management has relied upon the a number of assurance providers, chiefly:</p> <ul style="list-style-type: none"> ■ the risk of fraud identified by management on risk registers is low; ■ the annual governance statement has not identified fraud risk as an area of concern; and ■ the work of the corporate anti fraud team and that of other fraud teams across the authority.
<p>What process was employed to identify and respond to the risks of fraud more generally and specific risks of misstatement in the financial statements?</p>	<p>Broadly, the general risks around fraud were considered and their implications of financial statements assessed. From this exercise, none of the fraud that we are aware of was regarded significant in relation to the financial statement.</p>
<p>Management's awareness of any actual or alleged instances of fraud?</p>	<p>The S151 officer and the monitoring officer receive regular updated on actual or alleged instances of fraud from the Head of Audit and the Service Head, Risk Management and Audit. Both officers also receive updates from their management. The Corporate Management team is appraised of all actual or alleged frauds by regular reports of the Anti fraud team.</p>
<p>How has management communicated expectations of ethical governance and standards of conduct and behaviour to all relevant parties (including employees) and when?</p>	<p>A governance framework is in place through various policies / procedures and guidance that set out the ethics and behaviour standards including; codes of conduct, procedures around hospitality and gifts, declarations of interests, member officer protocols etc. These are all maintained on the Council intranet. The Standards Committee receives regular updates and would look into any suggestion of poor governance in this area. The Audit Committee will also have a role around internal control / risk and governance.</p> <p>Appropriate training is also provided for management, their staff and Members.</p>

Question	Management Response
<p>What arrangements are in place to report fraud to those charged with governance?</p>	<p>The Audit Committee is the body charged with delivering good governance. The Audit Committee receives quarterly updates on the Council's response to actual and purported fraud including work on NFI / Parking Fraud / Homelessness / Benefit Fraud and any other types of fraud. The Audit Committee also receives an annual report summarising the activity for the year.</p>
<p>Do all of the above arrangements and responses also apply to the Pension Fund? Are there any additional anti-fraud arrangements in place for the Pension Fund, particularly in relation to outsourced administration function and fund management?</p>	<p>The activities of the anti fraud team capture all activities of the Council which includes the pension fund. In addition however, the authority also employs a private company to act as the custodian of the council's pension investment, who would bring fraud related matters to the attention of the Council.</p>

Table 7: **ISA 570 Going concern**

Question	Management Response
<p>How has management formed a view on going concern?</p>	<p>From a review of the council's Medium Term Financial Plan and the annual financial report (including the statement of accounts) consideration of reserves and balances, future commitments, contingencies and liabilities, and cashflows. For the Pension Fund, there are specific statutory regulations that govern the assessment of going concern including full triennial valuations and interim annual valuations.</p>
<p>What principal assumptions have been used in reaching this view and why does management feel the assumptions are appropriate?</p>	<p>The principal assumptions are:</p> <ul style="list-style-type: none"> ■ a balanced budget and Medium Term Financial Plan; ■ the affordable borrowing assessment reflected in the annual Treasury and Investment Strategy; ■ the level of reserves and supporting evidence set out in the Medium Term Financial Plan; and ■ the Council's governance framework and associated systems of financial control. <p>In deciding on the going concern of the authority, assurances have been sought from management over the principal assumptions built into the Medium Term Financial Plan, the contingent liabilities set out in the annual statement of accounts and comfort obtained therein.</p>

Question	Management Response
Is the above consistent with the strategic business plan and the financial information provided to you throughout the year?	Yes, reported to the Cabinet quarterly and CMT monthly.
Have there been any significant issues raised with you during the year (eg, adverse comment by internal and external audit on weaknesses in systems of financial control, or significant variances to activity levels compared to those planned), which could cast doubts on the assumptions made?	None
Have the implications of any known statutory or policy changes been appropriately reflected in the business plan and financial forecasts (eg the impact of IFRS)?	Yes, all statutory and policy changes have been reported to Cabinet and Full Council with appropriate Financial Comments and have been fully reflected in both the Medium Term Financial Plan and the Annual Financial Report.
Does a review of available financial information (annual accounts, in-year financial monitoring reports, future year financial forecasts) identify any of the following adverse financial indicators: <ul style="list-style-type: none"> ■ negative cash flow (ie, expenditure greater than income); and ■ the need to take out new loans. If so, what action is being taken to improve financial performance?	None of these adverse financial indicators have been identified. The Council has a robust Medium Term Financial Plan and Treasury Management Strategy. The MTFP balances over a three-year period with an appropriate application of Reserves and the capital programme within the MTFP is fully financed.
Does the organisation have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council's objectives? If not, what action is being taken to obtain those skills?	Yes; the level and competency of staff resources required to deliver the Council Strategic Plan are reflected in the team plans and staff PDRs which in turn have been reflected in the resource budgets built into the MTFP. The level of vacancy at senior levels and use of agency staff has been reduced significantly and there has been considerable additional investment in apprenticeships and graduate training opportunities.
Have management formed a view on the going concern status of the Pension Fund, taking into account relevant financial and performance information, known statutory and policy changes and organisation capacity? Why does management feel that this view is appropriate?	Yes, management has considered the status of the pension fund and consider it a going concern based on the information contained in the annual Financial Report and the independent valuation by the Fund's Actuaries Provision has been included in the MTFP for additional future employer contributions and regular monitoring reports are presented to Pension Committee.

Table 8: **ISA 250 Consideration of laws and regulations in an audit of financial statements**

Question	Management Response
<p>How have you gained assurance, for both the Council and the Pension Fund, that all relevant laws and regulations have been complied with?</p>	<p>Assurance obtained from management in the form of completion of a Cipfa checklist to assess compliance, accounts and audit regs and the legal sign off together with a comprehensive audit programme that includes the review of such compliance as part of all systems and probity audits</p>
<p>Are there any potential litigations or claims that would affect the financial statements of either the Council or the Pension Fund?</p>	<p>None that have not been fully provided for within the Council's accounts.</p>
<p>Are there any related parties, any changes in related parties from prior period, the nature of the relationships, and any transactions during the period with the related parties?</p>	<p>Related party transactions are identified in the notes to the accounts and brought to the Audit Committee's attention annually.</p>
<p>What controls are in place to identify, account for, and disclose, related party transactions and relationships?</p>	<p>A system is in place for members to declare relationships with organisations as part of their declaration(s) of interests. The declarations are all retained on line and the Democratic Services team regularly monitor and update the declarations as necessary.</p>

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