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Report to those charged with governance (ISA 260) 2012/13

London Borough of Tower Hamlets

26 September 2013

Contents

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

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

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andy Sayers, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

Introduction

This report summarises:

- **the key issues identified during our audit of the London Borough of Tower Hamlet's (the Authority's) financial statements for the year ended 31 March 2013; and**
- **our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.**

Financial statements

Our *External Audit Plan 2012/13* presented to you in March 2013 set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place in two tranches during March 2013 (interim audit) and July and August 2013 (year end audit). We carried out the following work:

Control Evaluation

- Evaluate and test selected controls over key financial systems
- Review internal audit function
- Review accounts production process
- Review progress on critical accounting matters

Substantive Procedures

- Planning and performing substantive audit procedures.
- Concluding on critical accounting matters.
- Identifying audit adjustments.
- Reviewing the Annual Governance Statement.

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

Completion

- Declaring our independence and objectivity.
- Obtaining management representations.
- Reporting matters of governance interest.
- Forming our audit opinion.

VFM conclusion

Our *External Audit Plan 2012/13* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have completed our work to support our 2012/13 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2012/13 financial statements.
- Section 4 outlines the key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior year recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Headlines

This table summarises the headline messages. The remainder of this report provides further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion by 30 September 2013. We will also report that the wording of your Annual Governance Statement accords with our understanding.
Audit adjustments	Our audit has identified a total of two audit adjustments with a total value of £4.6 million to date. These adjustments: ■ Reduce the surplus on provision of services balance as at 31 March 2013 by £1.184 million; ■ Reduced the net worth of the Authority as at 31 March 2013 by £1.184 million; but ■ Have no impact on the general fund account balance as at 31 March 2013. We have included the significant audit adjustments at Appendix 3. All of these were adjusted by the Authority and there is no impact on the resources available to the Council.
Critical accounting matters	We have worked with Officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.
Accounts production and audit process	We have noted some issues in the quality of the draft accounts that have resulted in a number of disclosure adjustments. Whilst we do not consider any of the adjustments to be significant individually, we have raised a recommendation about this in Appendix 1, to help the Authority ensure these matters are addressed as part of the Authority's closedown processes in 2013/14. The quality of supporting working papers submitted for audit have been of a high standard and the finance staff have been responsive to audit requests that have allowed the audit to progress to time.
Control environment	The Authority's organisation and IT control environment is effective overall, and controls over the key financial systems are sound. However we did note a number of low level weaknesses in relation to the timeliness of reconciliations, explaining budget variations and school bank account processes. We have raised three recommendations about this in Appendix 1. Our risk based approach was primarily focussed on completing substantive testing over balances included in the financial statements rather than testing the controls in place at the Authority. As a result we have not placed reliance on internal audit's work, instead we use internal audit to inform us about the areas of the Authority's operations that were relevant to our work.

Headlines (continued)

Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ *Agreement of the audit adjustments being processed correctly through the financial statements; and* ■ *Agreement of the final pension fund audited figures.* In addition before we can issue our opinion we require a signed management representation letter and will need to complete our post balance sheet events review up until the point the accounts are signed. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We have noted one area that we wish to bring to the attention of members relating to the importance of completing the corporate governance review and ensuring that any issues identified are addressed promptly to ensure that the Authority's structures and personnel are fit for purpose to meet the future financial challenges facing the Authority. We have explained this issue further in Section four, however do not consider it to be a significant issue for 2012/13. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2013.
Certificate	We have received a number of enquiries from Local Government Electors during 2012 and 2013 relating to Councillors' expenses; virements; potential sale of a heritage asset; a television advert; and a letter from the Mayor about Council Tax benefit changes. At the date of this report we have not yet completed our consideration of these matters, although we have made two recommendations based on our work to date (see Appendix 1 for details). The time taken by the Authority to respond to our information requests and queries in relation to these have been longer than we would normally expect. In addition, as at the date of this report we have not completed the procedures specified by the National Audit Office on your Whole of Government Accounts return. We expect to complete our work and report our findings to management by 4 October 2012. We cannot formally conclude the audit and issue an audit certificate until we have completed the work outlined above. We are satisfied that this work does not have a material effect on the financial statements or on our value for money conclusion.

Proposed opinion and audit differences

Our audit has identified a total of two audit adjustments to date.

The impact of these adjustments is:

- **to reduced the surplus on provision of services for the year by £1.184 million; and**
- **to reduce the net worth of the Authority as at 31 March 2013 by £1.184 million; but**
- **there is no impact on the general fund account as at 31 March 2013.**

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2013.

Audit differences

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

We did not identify any material misstatements. Our audit identified two significant audit differences, which we set out in Appendix 3. It is our understanding that these will be adjusted in the final version of the financial statements.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2013.

The decrease in net worth is the result the exclusion of a provision in relation to MMI for £1.184 million. This was initially held within an insurance reserve within usable reserves.

In addition, we identified a number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting the United Kingdom 2012/13 ('the Code')*. We understand that the Authority will be addressing these where appropriate.

Movements on the General Fund 2012/13

£'000	Pre-audit	Movement	Post-audit
Surplus on the provision of services	59,894	(1,184)	58,710
Adjustments between accounting basis & funding basis under Regulations	(35,592)	0	(35,592)
Transfers to earmarked reserves	(12,622)	1,184	(11,438)
Increase in General Fund	**11,680**	**0**	**11,680**

Balance Sheet as at 31 March 2013

£'000	Pre-audit	Movement	Post-audit
Property, plant and equipment	1,753,825	0	1,753,825
Other long term assets	5,482	0	5,482
Current assets	356,620	0	356,620
Current liabilities	(153,425)	(1,184)	(154,609)
Long term liabilities	(728,440)	0	(728,440)
Net worth	**1,234,062**	**(1,184)**	**1,232,867**
General Fund	(38,060)	0	(38,060)
Other usable reserves	(241,097)	1,184	(239,913)
Unusable reserves	(954,905)	0	(954,905)
Total reserves	**(1,234,062)**	**1,184**	**(1,232,867)**

Proposed opinion and audit differences (continued)

The wording of your Annual Governance Statement accords with our understanding.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

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

Critical accounting matters

We have worked with Officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

In our *External Audit Plan 2012/13* presented to you in March 2013, we identified the key risks affecting the Authority's 2012/13 financial statements.

We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each risk.

Key audit risk	Issue	Findings
	As at 31 March 2012 the valuation of the Authority's Estate was £1.8 billion split over Authority Dwellings, Operational Land and Buildings and Infrastructure Assets. The Authority employs a valuer to determine the fair value of these assets. However, there is a risk due to the size and assorted nature of the Authority's estate, that this value will be materially misstated.	We have assessed the instructions provided to the valuer by the Authority and found that they were comprehensive and provide the Authority with the information they require to be compliant with International Financial Reporting Standards (IFRS). We have noted that the Authority does not explicitly consider revaluations in the period between formal valuations. We have raised a recommendation about this in Appendix 1. We have assessed the qualifications and experience of the valuer and determined that we could place reliance on their work. We have performed substantive procedures over a sample of valuations and their associated depreciation calculations and have gained assurance that the accounting treatment has been applied correctly.

Critical accounting matters (continued)

Key audit risk	Issue	Findings
Actuarial Present Value of Retirement Benefits	The Authority is required to provide the value of the pension fund asset/liability as at the reporting date, taking into account numerous and complex assumptions. This creates a risk that the financial statements may be materially misstated. Small changes to these assumptions can have a large effect on the reported value and the Authority should ensure that the information provided to the actuary is up to date and complete to ensure the values reported in the accounts take into account all requisite information.	We have reviewed the instructions provided to the actuary and the information supplied to the actuary to come to their conclusions. We have also undertake tests of detail on the accounting entries performed as a result of the information returned from the actuary and ensure they are compliant with IAS 19. No issues have been identified.
Accounts receivable and accounts payable	Your previous auditors identified a potential £12 million uncertainty in your accounts relating to the treatment of accounts receivable and accounts payable in 2011/12. They also noted that the Authority was unable to separately identify its year end accrual balance. If the Authority does not address these issues there is a risk that the 2012/13 accounts could be materially misstated.	We have reviewed the work completed by the Authority to address this issue. This involved the Authority reviewing all of its debtor and creditor codes and identifying any historic balances and codes that should be closed. We have reviewed the work completed by the Authority and tested a sample of 25 codes to confirm whether it was reasonable for the code to have been closed. We have undertake detailed substantive testing over the accounts receivables, accounts payable and accruals balances. No issues have been identified.

Accounts production and audit process

Officers dealt efficiently with audit queries and working papers were of a good standard which enabled the audit process to be completed within the planned timescales.

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	We have some issues with the quality of accounts this year. In particular the draft accounts did not appear to have been thoroughly proof read or checked against the Code. The Authority needs to strengthen its financial reporting processes through ensuring that the accounts are fully quality checked prior to being submitted for audit.
Completeness of draft accounts	We received a complete set of draft accounts on 20 June 2013. This was ahead of the audit starting.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 2 March 2013 and discussed with the Authority, set out our working paper requirements for the audit. The quality of working papers provided was good and met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved the majority of audit queries in a reasonable time. In some cases, however, we experienced delays, specifically where requests were from directorates rather than directly with the corporate finance team.

Element	Commentary
Group audit	To gain assurance over the Authority's group accounts, we placed reliance on work completed by KPMG on the financial statements of Tower Hamlets Homes. There are no specific matters to report pertaining to the group audit.

As a result of the above we have raised a recommendation in respect of the quality of the accounts submitted for audit. This is included in Appendix 1.

Completion

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

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

Once we have finalised our opinions and conclusions we will prepare our *Annual Audit Letter* and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of the London Borough of Tower Hamlets for the year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and the London Borough of Tower Hamlets, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 4 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Authority, a draft of which is reproduced in Appendix 5. We require a signed copy of your management representations before we issue our audit opinion.

We are seeking a specific representation over amounts paid to Senior Officers.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc)

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2012/13 financial statements.

VFM conclusion

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

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

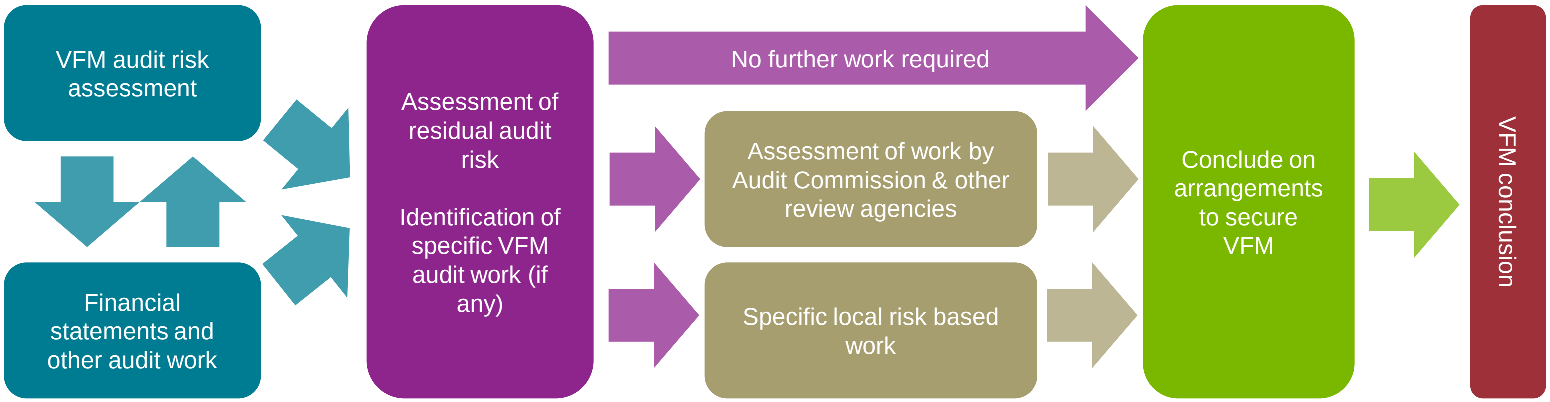
The key elements of the VFM audit approach are summarised in the diagram below.

Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

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

The following page includes further details of our VFM risk assessment



Specific VFM risks

We have identified one specific VFM risk.

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this risk area are adequate.

Work completed

In line with the risk-based approach set out on the previous page, and in our Audit Plan we have

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit; and
- considered the results of relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas.

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

We concluded that we did not need to carry out additional work for this risk as there was sufficient relevant work that had completed by the Authority, the Audit Commission, other inspectorates and review agencies in relation to this risk area.

Key findings

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Savings plans	As at December 2012, the Authority forecast that it will deliver its 2012/13 budget in overall terms. This included a savings programme totalling £23.656 million. The Authority currently estimates that another £26.029 million in savings will need to be achieved during 2013/14 and £21.260 million in 2015/16 to address the further reductions to local authority funding. Against a backdrop of continued demand pressures in Adult Social Care and Children's Services it will become more and more difficult to deliver these savings in a way that secures longer term financial and operational sustainability. This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.	In conjunction with our VFM work we have critically assessed the controls the Authority has in place to ensure a sound financial standing, specifically that its Medium Term Financial Plan has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Authority can continue to provide services effectively. We have also reviewed how the Authority is planning and managing its savings plans. We have not identified any significant issues with these plans and note that the Authority continues to focus on its 2014/15 savings targets. We have reviewed the Authority's provisions including the methodology behind them to ensure that they are made on robust assumptions and are reasonable.

Key findings

We have concluded that the Authority's arrangements for securing financial resilience and economy, efficiency and effectiveness are adequate.

The table below, summarises the scope of our work along with our key findings. The results of this work has been reflected in our VFM conclusion.

Criteria and scope of our work	Key findings from our work
Securing financial resilience We considered the Authority's arrangements for ensuring robust financial governance, planning and control. As a result, we focused on whether the Authority has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.	Our review of the Authority's arrangement to achieve financial resilience found that the Authority has adequate arrangements in place as at 31 March 2013. Whilst the Authority's financial planning and governance arrangements are sound, significant further financial pressures are forecast in the short to medium term. The Authority should continue to review and update its financial plans in response to changes in funding and demand for services. The Authority achieved a revenue under spend of £5 million in 2012/13 against a background where it had to achieve overall budget savings of £23 million. The Authority has set a balanced budget for 2013/14 and 2014/15 which includes a further £7 million of savings and using £13 million of reserves. The Authority anticipates more cuts in resources amounting to £20 million in 2015/16. There is a considerable budget gap after 2015/16 needing to be filled on an on-going basis. The Authority is working hard to ensure that it has a robust medium term balanced position, but realises this represents a significant challenge.
Securing economy, efficiency and effectiveness We considered the Authority's arrangements for prioritising resources and achieving efficiency and productivity. We also considered the Authority's performance in the year. As a result, we focused on how the Authority is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.	Our review of the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources found that that its arrangements are sound. The Authority has consulted widely on its savings proposals and has started similar processes looking at the future challenges faced by the Authority (see financial resilience commentary above). Making use of information from a range of sources the Authority has a good understanding of its costs and performance against targets. The key targets are derived from the Authority's Strategic Plan. Their delivery is monitored regularly at a range of levels within the Authority. The "forensic systems" in place to monitor/ ensure delivery of the Authority's savings plans include the Change and Efficiency Board, Directorate Management Teams, and Corporate Transformation Delivery Group. The Authority is also undertaking a corporate governance review in conjunction with the Local Government Association. The results of this review will be important to ensure the Authority's structures are fit for purpose to face the future financial challenges. This is particularly important given the potentially increased level of organisational risk as a result of the comparatively high number of senior officer changes (and interim staff/post holders being in place) over the last 12 months – including the Chief Executive Officer; Chief Financial Officer; and Monitoring Officer.

Appendix 1: Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

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

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Formal review of draft accounts against the code** We have identified a number of disclosure errors in the 2012/13 accounts. Most of these could have been avoided if a comprehensive review of the accounts had been completed ahead of the accounts being submitted for audit. Whilst we appreciate the preparation time for accounts is time pressured, we recommend that the Authority complete a full proof read and sense check of the accounts ahead of submitting them for audit. This should include a comparison against the Code to ensure all disclosures are correct and complete.	Officers will ensure the draft accounts are reviewed as much as possible prior to submission to auditors. K Miles June 2014
2	❷	**Completion of corporate governance review** The Authority should complete the planned corporate governance review and ensure that any issues identified are addressed promptly to ensure that the Authority's structures and personnel are fit for purpose to meet the future financial challenges facing the Authority.	Officers will keep the auditors briefed as the governance review continues. C Holme March 2014

Appendix 1: Key issues and recommendations

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
3	2	**Reimbursement of member taxi expenses** Following a number of enquires in regard to taxi expenses we completed a review of the process in place as part of our interim audit. As a result of this work we have raised the following recommendations: ▪ There needs to be a clear, published Authority policy for taxi usage in place; and ▪ All journeys need to include sufficient justification for why the journey is required and be authorised appropriately.	The current arrangements around the use of taxis by Members will be reviewed. John S Williams March 2014
4	2	**Evidence to support decisions relating to the Publicity Code** There was no comprehensive contemporaneous written evidence setting out what considerations were taken into account before the decisions were taken on two enquiries we received. One was about commissioning an advert for broadcast on several local television stations and the other related to producing and distributing a letter to everyone on the Council Tax database. The Council needs to ensure that it maintains appropriate written evidence to support significant decisions relating to the Code of Recommended Practice on Local Authority Publicity.	A new code guiding local authority publicity to which all local authorities have to have regard when making decisions on publicity was approved by government on March 30th 2011. It was incorporated into local practice in an LBTH Cabinet report in July 2011 - at the same time as the commissioning of the adverts for local broadcast. The new code was therefore not yet fully implemented. However the code has since been implemented in full, and pending final agreement, an additional communications protocol has been developed to provide specific guidance on the steps to be taken before significant communications activity is commissioned. T Sulaiman November 2013

Appendix 1: Key issues and recommendations

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
5	2	**Annual review of Property Plant and Equipment (PPE) for revaluation** The Code requires that PPE assets are valued sufficiently frequently to ensure that they are materially correct. Therefore whilst the Code allows for assets to be valued on a five year rolling basis, in the intervening period assets should be reviewed to ensure they are materially correct. One mechanism that can be used to do this is to apply relevant indices to the asset class annually and determine if they result in a material change. The Authority currently only considers impairments not valuation gains on an annual basis. We therefore recommend that the Authority, in conjunction with their valuer, identify relevant indices that can be considered annually to assesses if there has been a material change in asset values.	Council officers will work with the auditors to agree an approach to assessing material variations to Council assets. K Miles/ Council valuers March 2014
6	3	**Budget Variances** As part of our interim audit we reviewed the processes and controls in place over budget monitoring. We identified that not all variances over the prescribed £250,000 variance level were being adequately explained. The Authority should consider if a standard £250,000 threshold is appropriate across all directorates or if a more tailored approach would be more appropriate. The Authority must then ensure that it complies with these thresholds.	Officers will ensure suitable budget variance comments are included within the regular budget monitoring reports. K Miles September 2013

Appendix 1: Key issues and recommendations

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
7	3	**Timeliness of reconciliations** We noted that for the monthly cash and debtor reconciliations were not always completed in a timely manner, in excess of two weeks after month end, and that they were not always signed off as reviewed. We recommend that all monthly control account reconciliations are completed within two weeks of month end and are formally signed off to evidence review.	Once Agresso is fully operational, there is a priority to ensure timely reconciliations are built into the system. P Thorogood December 2013
8	3	**School cash reconciliations** We reviewed a sample of ten school bank reconciliations and noted that the supporting documentation did not always agree to the figures recorded on the reconciliation, reconciling items were not always adequately explained and in one case there was a negative cash balance. Whilst these issues do not have a material impact on the accounts we recommend that the Authority work with the schools to ensure that cash reconciliations are completed fully and agree to supporting documentation.	Finance officers from the school's support team will follow up these bank reconciliation discrepancies with schools during the year. S Patel March 2014

Appendix 2: Follow up of prior year recommendations

The Authority has implemented all of the recommendations raised by the Audit Commission in the 2011/12 ISA 260 report

This appendix summarises the progress made to implement the recommendations identified in the Audit Commissions *ISA 260 Report 2011/12* and details the progress made against the high rated risks below.

Number of recommendations that were:	
Included in original report	9
Implemented in year	8
Superseded	1

Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2013
1	Evidence the operation of controls more consistently to strengthen the internal control environment.	Officers will review processes for the reconciliation of rent and service charge systems and treasury to ensure undertaken. Reconciliations will be incorporated into the new financial system during the implementation process. Internal Audit will carry out a review to provide assurance that reconciliations have been carried out for the first six months of 2012/13 and evidenced. December 2012	**Implemented** We have not identified any significant weaknesses within the control environment. We have raised a low priority recommendation in relation to the timeliness of some reconciliations.
1	Implement controls to prevent the pre-receipting of goods and services in the accounts payable system.	Officers will conduct a review during the year to ensure material pre-receipting has not been performed on R2P. New system guidance will remind officers that pre-receipting (where payment in advance is not required) is contrary to financial regulations. December 2012	**Implemented** Our testing has not identified any instances of pre-receipting of goods.
1	As part of the work to migrate the accounts payable data to the new system, undertake a thorough review of all creditor balances to ensure the data held is robust.	Debtor and creditor balances will be reviewed as part of the data migration to the new finance system. March 2013	**Implemented** We have reviewed the process undertaken by the Authority to clear old balances. No issues identified.

Appendix 2: Follow up of prior year recommendations

Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2013
➊	Continue to review and update the Authority's financial plans in response to changes in funding and demand for services.	As part of the budget process, officers will continue to monitor Government announcements and pressures on services to ensure risk is adequately understood and referenced to plans. Ongoing	**Implemented** We have reviewed the Authority's financial plans as part of our work on VFM. We have not identified any issues.
➊	Maintain a watching brief on the adequacy of the Authority's governance arrangements.	The CFO and Monitoring Officer will maintain an oversight of governance arrangements through appropriate use of internal controls. Ongoing	**Superseded** We are aware that the Authority is in the process of starting a corporate governance review and have raised a recommendation to ensure the results are acted upon.

Appendix 3: Audit differences

This appendix sets out the significant audit differences. It is our understanding that all of these will be adjusted.

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

Corrected audit differences

The following table sets out the significant audit differences identified by our audit of the London Borough of Tower Hamlet's financial statements for the year ended 31 March 2013. It is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this.

	Impact (£000)				
No.	Income and Expenditure Statement	Adjustments btw. accounting basis & statute	Liabilities	Reserves	Basis of audit difference
1			Dr provisions for accumulated absences £3,369		Per the code the Authority is required to account for employee annual leave that is not taken at the financial year end. This should be shown as an accrual rather than a provision.
			Cr Short-term creditors £3,369		
2	Cr Non-distributed costs expenditure £1,184	Dr General fund £1,184	Cr Provisions £1,184	Dr Earmarked reserves £1,184	Municipal Mutual Insurance Ltd (MMI) entered into administration on 13 November 2012. The administrators wrote to all members advising that a levy of 15% would be placed on all members. As a result a provision should be made for this amount. The Authority holds an insurance reserve that covers the full MMI insurance fund however for 2012/13, 15% is required to be disclosed as a provision.
	Cr £1,184	**Dr £1,184**	**Dr £1,184**	**Cr £1,184**	**Total impact of adjustments**

Appendix 3: Audit differences (continued)

In addition to the audit adjustments to the core financial statements listed above our audit also identified several adjustments to the notes and general presentational amendments . We have detailed the key adjustments in the table below

Note	Key changes
1 and 2	A number of changes were made in relation to accounting policies in particular updating the critical accounting policies to include schools and valuation and changes in accounting policy.
15	The financial instruments note required some minor wording adjustment to bring it in line with the Code.
31 and 35	Multiple presentational changes to ensure notes are code compliant, including: • Updating the Health Act; and • Correction of the audit fee note to reflect non-audit fees and expected fees relating to enquiries received.
33	Multiple presentation changes to ensure the note was code compliant, including: • The inclusion of a payment made to a senior manager not previously disclosed; • The inclusion of the salary of the Adults, health and Wellbeing interim director into the detailed table; and • updating the number of staff earning over £50,000 .
39 and 40	Updating the lease and PFI disclosures to reflect the requirements of the code. This includes more information in relation to the type of leases held and the details of the PFI scheme.
41	Minor adjustments made to the pensions note to update for the change in rate of return on assets.
43	A number of adjustments were made to the Heritage asset note to bring it in line with the code.
Throughout	We also required a number of presentational adjustments to be made throughout the accounts these mainly related to: • correction of grammatical errors; and • ensuring formatting was consistent throughout the accounts .

Appendix 4: Declaration of independence and objectivity

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

Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the Code) which states that:

"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission's Standing guidance for local government auditors (Audit Commission Guidance) and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* (Ethical Standards).

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

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

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

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

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Appendix 4: Declaration of independence and objectivity (continued)

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

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the Ethics and Independence Manual ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual Ethics and Independence Confirmation. Failure to follow these policies can result in disciplinary action.

Non-audit work

Our IT advisory team completed an IT systems implementation review during 2012/13, in addition our tax team have provided advice throughout 2012/13. We have considered the scope of the work in the context of the Auditing Practices Board's (APB) Ethical Standards and Audit Commission requirements and concluded it does not impair our independence.

Auditor declaration

In relation to the audit of the financial statements of the London Borough of Tower Hamlets for the financial year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and the London Borough of Tower Hamlets, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

Appendix 5: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

We require a signed copy of your management representations before we issue our audit opinion.

We have requested a specific representation over amounts paid to Senior Officers.

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of the London Borough of Tower Hamlets ("the Authority") for the year ended 31 March 2013, for the purpose of expressing an opinion:

- as to whether these financial statements give a true and fair view of the financial position of the Authority and the Group as at 31 March 2013 and of the Authority's and the Group's expenditure and income for the year then ended;
- whether the Pension Fund financial statements give a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2013 and the amount and disposition of the Fund's assets and liabilities as at 31 March 2013, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- whether the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

These financial statements comprise the Authority and Group Movement in Reserves Statements, the Authority and Group Comprehensive Income and Expenditure Statements, the Authority and Group Balance Sheets, the Authority and Group Cash Flow Statements, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the Collection Fund and the related notes. The Pension Fund financial statements comprise the Fund Account, the Net Assets Statement and the related notes.

The Authority confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

The Authority confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

Financial statements

The Authority has fulfilled its responsibilities, as set out in regulation 8 of the Accounts and Audit (England) Regulations 2011, for the preparation of financial statements that:

- give a true and fair view of the financial position of the Authority and the Group as at 31 March 2013 and of the Authority's and the Group's expenditure and income for the year then ended;
- give a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2013 and the amount and disposition of the Fund's assets and liabilities as at 31 March 2013, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

The financial statements have been prepared on a going concern basis.

Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.

All events subsequent to the date of the financial statements and for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 requires adjustment or disclosure have been adjusted or disclosed.

Information provided

The Authority has provided you with:

- access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
- additional information that you have requested from the Authority for the purpose of the audit; and

Appendix 5: Draft management representation letter

- unrestricted access to persons within the Authority and Group from whom you determined it necessary to obtain audit evidence.

All transactions have been recorded in the accounting records and are reflected in the financial statements.

The Authority acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Authority acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

The Authority has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

The Authority has disclosed to you all information in relation to:

a) Fraud or suspected fraud that it is aware of and that affects the Authority and the Group and involves:

   - management;
   - employees who have significant roles in internal control; or
   - others where the fraud could have a material effect on the financial statements; and

b) allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, analysts, regulators or others.

The Authority has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

The Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

The Authority has disclosed to you and has appropriately accounted for and/or disclosed all payments made to Senior Officers in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

The Authority has disclosed to you the identity of the Authority's and the Group's related parties and all the related party relationships and transactions of which it is aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as the Authority understands them and as defined in IAS 24, except where interpretations or adaptations to fit the public sector are detailed in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

On the basis of the process established by the Authority and having made appropriate enquiries, the Authority is satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with its knowledge of the business.

The Authority further confirms that:

a) all significant retirement benefits, including any arrangements that:

are statutory, contractual or implicit in the employer's actions;

- arise in the UK and the Republic of Ireland or overseas;
- are funded or unfunded; and
- are approved or unapproved,
- have been identified and properly accounted for; and

b) all settlements and curtailments have been identified and properly accounted for.

This letter was tabled and agreed at the meeting of the Audit Committee on 26 September 2013.

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