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TOWER HAMLETS

London Borough of Tower Hamlets

Update report to the Audit Committee on the audits for the years ended 31 March 2019 and 31 March 2020

Issued 26 March 2021 for the meeting on 7 April 2021

Contents

1. Introduction

Introduction

The key messages in this report

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understandin g of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

We have pleasure in presenting an update report to the audit committee of the London Borough of Tower Hamlets (the Council) on our work on the audits of the financial statements for the year ended 31 March 2019 and 31 March 2020.

Matters covered in this report

We issued a report on our work on the 2018/19 audit in July 2019 which discussed emerging findings from the audit and an update report in November 2020 which described further challenges encountered in the audit process for both the 2018/19 and 2019/20 audits.

This report:

- Provides an update on issues reported in our July 2019 report
- Reports on other issues which have arisen since the issue of that report
- Provides an update on areas of significant audit risk identified in our 2018/19 and 2019/20 audit plans
- Provides an update on progress on other areas of audit work
- Reports on work performed in response to the impact of the pandemic on matters relevant to our audit
- Identifies areas where we expect to make additional control observations.

As a number of issues identified are common to the audits for both years, we have prepared a single update report.

We have highlighted which year each issue is relevant to using these icons: FY 19 FY 20

In our final reporting we will prepare separate reports for each financial year.

As a reminder, we have determined materiality for both years to be £25m.

Status of our work

Our audits for the years ended 31 March 2020 and 31 March 2019 are ongoing.

Since our report to the December 2020 audit committee meeting, we have coordinated our activity with officers through a series of "sprints". The greater concentration of effort has been successful in bringing some of the more challenging issues to a close – and where we have been able to do that, we report our conclusions in this document.

However, the approach has also meant that progress has been made on a narrower front and a substantial amount of work remains to be done in areas which we would expect to be more routine.

Our work on the pension scheme financial statements for both years is in progress. We understand that officers are aiming to arrange a meeting of the Pensions Committee in June and will work towards bringing reports on the findings from the pension scheme audits to that meeting, before bringing final reports to the audit committee meeting in July.

Conclusions

As our audits are in progress, we are not yet in a position to conclude.

We report in this document on uncorrected misstatements, together with other actual or possible misstatements where we are not able to quantify the amount of the misstatement. Whilst these matters are individually immaterial, in concluding our audit we will need to consider whether they may be material in the aggregate. If this was the case and they remained unadjusted, this would result in the qualification of our opinion

In our July 2019 report, we said that our value for money conclusion for 2018/19 would be qualified as improvements in childrens' services, following an earlier assessment by Ofsted that services were inadequate, were not in place for the whole of 2018/19. In this document we report that we expect both the 2018/19 and 2019/20 value for money conclusions will also be qualified due to weaknesses in financial reporting arrangements and explain the background to this judgement.

Introduction

Guide to other icons used in this report

We have used the following icons to focus attention on key points in this document

Misstatements		These are used to highlight misstatements which:
	Corrected	• were corrected in the version of the accounts circulated to the audit committee in January 2021
	Corrected	• officers inform us will be corrected in the version of the accounts to be circulated to the April committee. As a result of the timing for preparation of our respective papers, we have not been able to verify that this has been correctly updated
	Uncorrected	• are individually immaterial and officers have informed us that the misstatement will not be corrected
	Uncorrected	• are individually material and officers have informed us that the misstatement will not be corrected. There are no items in this category
Areas of unresolved uncertainty or outstanding work		This is used to highlight comments relating to unresolved issues, uncertainty or outstanding work, the completion of which is not routine:
	!	• and which relate to matters which are potentially material to the accounts.
	!	• and which relate to matters which are not expected to be material to the accounts but which may be material in combination with other matters.
	!	This is used to highlight comments relating to outstanding work which is of a routine nature. Note that this is not intended to represent a statement of all work which is required to complete our work on the accounts as a whole
Control observations	C	This is used to highlight comments where we expect to make control observations in our final report.

2. Update on issues reported in our July 2019 report

Update on issues reported in our July 2019 report

Area	Observation
Release of creditor balance FY 19	In our report in July 2019 on the 2018/19 accounts, we reported on an interim basis on a release of a credit of £20.0m which had been brought forward on the balance sheet as part of a larger credit balance relating to the collection of taxes. We requested an explanation of the release of the credit in the original version of the 2018/19 accounts. Officer's subsequent investigation of the balance concluded that: • The amount had accumulated over a period of several years and related to posting errors involving the bad debt provision for business rates arrears. The amount represented the part of the provision which was identified to be in excess of requirement as a result of the posting errors. • This position was identified in 2014/15 and the amount which was in excess of requirement was transferred to an account included in Short term creditors. • In the original version of the 2018/19 accounts, authorised for issue in May 2019, an entry was made to release the credit to the General Fund. • As the amount was originally charged to the Collection Fund as a bad debt provision and was now in excess of the required amount, the liability should have been released in the Collection Fund and not to the General Fund. On the basis of this conclusion: • Officers wrote to MHCLG in September 2019 for guidance and MHCLG have agreed that the amount can be accounted for as an in-year release of the provision in the Collection Fund. This means that the benefit of the reversal is subject to the 100% local retention and pan London pooling arrangements applicable to 2018/19. • Correcting entries have been made in the Council accounts and supplementary Collection Fund statement in line with the guidance from MHCLG. We inspected officers' concluding report prepared as a basis for these entries. We concluded that: • The information provided through officers' investigation is not sufficient to determine which original entries (if any) were erroneous. • The analysis of entries giving rise to the original credit supports that the credit relates to the collection and disbursement of business rates. • Our work on the Collection Fund does not identify the need for a balance to be held (either amounts due to business rates payers; bad debt provision; or amounts due other preceptors arising from transactions in the period). • Whilst the quality of records means that the position is not certain, it is, as a result, probable that the amount: forms part of the Collection Fund balance sheet; is in excess of any requirement; and should be released to the Collection Fund. • The credit has been released on the bad debt expense line within the Collection Fund supplementary statement. Officers have explained why this is the appropriate classification, but the evidence for this (or alternate) classifications is very limited. However, the amount is immaterial to the presentation of the Collection Fund.

Corrected

!

Update on issues reported in our July 2019 report

Area	Observation
Release of creditor balance (continued) FY 19	Our procedures also included considering whether it was appropriate to account for the release of the credit as a current year item in the Council's accounts or whether opening balances and prior year information should be restated. Officers have told us that they have been unable to determine the reason for the decision taken in 2014/15 to carry forward the "excess" provision amount, rather than release to the Collection Fund. We have concluded: • As the excess provision amount was substantially accumulated during a period when the council was acting as an agent for central government in the collection of all business rates, it is reasonable to conclude that officers, at that time, considered it was likely that amounts previously deducted from past remittances to central government in relation to the excess provision would need to be paid to central government in the future and therefore that it was appropriate to carry this credit balance on the balance sheet. The lack of adequate contemporaneous documentation (as explained further below) increases the amount of judgement involved in this accounting decision • The release of the credit therefore arises from a change in estimate arising from the department's clarification of its expectations. • It is therefore appropriate to account for the release in 2018/19 and not by restatement of opening balances. Officers' investigations identified a brief comment in a working paper in 2014/15 on the accounting treatment. However, this did not adequately explain either the preceding treatment or the rationale for transferring the credit to a separate, short term creditor account. Similarly, we have not been able to obtain documentation which explains the decision to carry forward this credit at subsequent year ends or which explains either the decision to release the credit in 2018/19 or the initial decision to release this to the General Fund and not the Collection Fund. This type of documentation forms an important part of the Council's accounting records and the absence of the documentation and appropriate internal scrutiny of the decision-making represents a significant control deficiency. C

Update on issues reported in our July 2019 report

Area	Observation
Deficit contribution FY 19 FY 20	In our July 2019 report, we reported on an interim basis on the accounting for a lump sum payment contribution in 2017/18 of £43.4m. The 2016 triennial valuation of the Tower Hamlets Local Government Pension Scheme (LGPS) administered by the Council identified a deficit and the actuary requested three annual deficit funding contributions of £15m each. The Council had discussions and correspondence with the actuary over a proposal for the Council to contribute a lower amount in a single payment in 2017/18. Payment of a single upfront lump sum in exchange for a reduction in total deficit funding contribution is a common arrangement promoted by some actuaries in the sector at the time of the last actuarial valuation and there is correspondence with the actuary in this particular instance which supports that he was content with the proposal. The proposal was also approved by the Council's Pension Committee. The requirements in relation to the valuation of local government pension scheme funds and employer contributions are set out in the Local Government Pension Scheme Regulations 2013. They require: • An administering authority to obtain a rates and adjustments certificate at three yearly intervals from 31 March 2016. • A scheme employer to contribute to the appropriate LGPS fund in each year the amount appropriate for that authority as calculated in accordance with the certificate. The rates and adjustment certificate was not updated to reflect the agreement which the Council believes it had reached with the actuary and instead shows the originally proposed payment schedule of three annual instalments of £15m each. Additional wording was not included on the rates and adjustments certificate which would have allowed flexibility in the timing and/or amount of contributions. The Council proceeded to make a single lump sum payment of £43.4m in 2017/18, in line with its assumed agreement with the actuary, and has not made further deficit funding contributions in the current triennial period. The full amount of the lump sum contribution of £43.4m was recognised in the LGPS accounts on receipt of cash in 2017/18, rather than being spread over the three year period. In the Council accounts, under legislation which requires the General Fund to be charged on the basis of contributions payable in respect of the reporting period, the lump sum payment is being charged to the General Fund reserve in 3 equal instalments from 2017/18. The amount deferred at 31 March 2018 and 31 March 2019 has been carried in the Pension Reserve.

Update on issues reported in our July 2019 report

Area	Observation
Deficit contribution (contribution) FY 19 FY 20	The Council has taken legal advice which has the following conclusions: • The Council had a statutory duty under Regulation 62(1) to "contribute" the amount set out in certificate. • The regulations are highly prescriptive and require payment to be according to the timetable set out in the certificate. • It was not lawful for the Council to pre-pay the amount on its certificate. • The amount of the overpayment is due back from the LGPS fund to the Council and in principle the Council may charge interest on this. • In the subsequent two years, the Council may set-off its liability under the certificate to pay annual contributions of £15m against the initial overpayment. We have concluded that: • As the "overpayment" of contributions in 2017/18 is not a lawful payment of contributions and is repayable to the Council, the amount of the overpayment should be shown within debtors. • The plan assets included in the calculation of the net pension liability should be reduced, consistent with the amended treatment in the pension scheme, explained in our separate report on the pension scheme audit. • Contributions should be charged to the General Fund in 3 equal instalments of £15m, as required by the rates and adjustments certificate (currently they are being charged in 3 equal instalments totalling £43.4m). • Interest income may be recorded totalling £1.6m (i.e. the difference between the contributions required to be paid under the rates and adjustments certificate and the lower amount informally agreed with the actuary), with the result that the overall charge to the General Fund over the triennial period is unchanged.

Corrected

Update on issues reported in our July 2019 report

Area	Observation
Infrastructure assets FY 19	In our July 2019 report we said: • The Council does not record infrastructure assets separately on the fixed asset register. Instead expenditure on infrastructure assets is grouped by type and by year of expenditure. • Part of the annual amount capitalised relates to replacement of a component of asset (e.g. road re-surfacing). In this situation, whilst it may be appropriate to capitalise the new expenditure, an adjustment should be made to remove the existing component from the register and fixed asset balance. It is not part of the Council’s process to do this and the organisation of the fixed asset register does not facilitate this. • This practice is not uncommon in the sector and does not have a significant impact on the carrying amount of infrastructure assets where the actual asset lives approximate to the estimate of useful economic life used in the depreciation calculation (such that the asset or component of the asset has a nil net book value at the point of replacement). • The Council’s policy is to depreciate all infrastructure assets over a life of 40 years. This was longer than the life assumed by other councils. Following a review of asset lives performed by the relevant technical specialists within the Council, officers have reassessed lives to be in the range of 25-100 years, with lives assigned to different categories of infrastructure - in particular a life of 25 years has been assigned for the principal category, roads. The system of capital accounting was introduced into the Local Government SORP in 1996/7. Under transitional arrangements, the accounting guidance permitted existing assets at 1 April 2016 which were required to be held at depreciated cost (including infrastructure assets) to be brought in at nil or notional cost. As a result of these transitional arrangements, the value of assets which lies outside the revised assessment of lives is not significant. We have evaluated the revised lives and consider them to be reasonable, based on comparisons with other local authorities and other research. Changes in asset lives are accounted for by depreciating the remaining net book value over the remaining useful economic life. We have calculated the impact of the change in lives on depreciation to be £6.8m. Whilst officers have made changes to asset lives in 2019/20 to bring into line with the outcome of the internal review, changes had not been made to the version of the 2018/19 accounts circulated to the January 2021 audit committee.

Corrected

Update on issues reported in our July 2019 report

Area	Observation	
Implementation of IFRS 9 and IFRS 15 FY 19 FY 20	In our July 2019 report we said: • The Council is required to adopt the new accounting standards IFRS 9 Financial Instruments and IFRS 15 Revenues from contracts with customers in the year ended 31 March 2019. • Officers had not prepared information to support their conclusion that these new standards did not have a material impact. • The Council had not made any disclosure of the impact of the transition or updated accounting policies.	
	Officers have subsequently provided a paper analysing the accounting of various income streams under IFRS 15. The analysis in the paper is not adequate and in particular does not recognise that the requirement for the leaseholder to contribute to the cost of major works represents a service arrangement within the Council's lease agreements such that contributions should be accounted for under IFRS 15. As a result, the paper does not contain an analysis of the accounting treatment under the new standard. We have discussed our analysis of that income stream in the next section. The form of the analysis of other income streams does not reflect the steps set out in IFRS 15.	!
	Officers have updated the accounting policies section in the statement of accounts to reflect the implementation of IFRS 15 but have not made disclosures relating to the transition.	Uncorrected
	IFRS 9 introduces revised classifications for financial instruments. The Council has classified pooled investments of £55.5m at 31 March 2020 and £49.7m as measured at fair value through other comprehensive income (FVOCI). In the initial version of the 2018/19 accounts, whilst classified as such, the loss was accounted for within the surplus on provision of services. In the updated version of the 2018/19 and in the 2019/20 accounts, the loss is now recorded in other comprehensive income. We disagree with the classification and consider that these instruments should be measured at fair value through the profit and loss account (FVTPL). The practical impact of this is that:	
	• Losses of £5.8m in 2019/20 and £0.5m in 2018/19 should be reclassified from the other comprehensive income section of the CIES to Financing and Investment Income and Expenditure within the surplus on provision of services	Uncorrected
	• Within the Statement of Movement on Reserves, losses have been transferred to the Financial Instruments Revaluation Reserve. Instead, the loss should be charged to a different unusable reserve (CIPFA suggest this is called the pooled investment funds adjustment account).	Uncorrected
	• The regulations governing the pooled investment funds adjustment account are different to those applicable to the financial instruments revaluation reserve. In particular, the regulations only apply to accounts drawn up for years through to 31 March 2023 – following which gains and losses will be charged or credited to the General Fund, unless the current transitional rules are extended.	
	• The disclosure on the categorisation of financial instruments should be updated.	Uncorrected
	We commented in our July 2019 report that IFRS 9 introduces a new way of estimating bad debt provisions. We have not yet received full information on how assumptions in provision models have been developed to complete our work in this area (as well as for provisions against statutory debts).	!

Update on issues reported in our July 2019 report

Area	Observation	
Elimination of internal recharges FY 19	In our July 2019 report we said: • Internal recharges should be eliminated from the presentation of income and expenditure in the Comprehensive Income and Expenditure Statement. • The Council's process for making the elimination entries is complicated because the coding structure adopted does not enable the finance team to readily identify postings within income and expenditure. • Our testing identified charges of £47m which had not been fully netted down. • Officers had informed us that there was a similar misstatement in the prior year information (£45m). • As this amount is material, the comparative information should be restated to correct this error. These have been corrected in the January 2021 version of the accounts in both the current and prior year comparative information. We discuss judgements relating to prior year restatements from page 30. We will complete our testing of recharges with remaining work on the income and expenditure account.	Corrected !
Cash flow statement FY 19 FY 20	In our July 2019 report we said that the Council, in preparing the cash flow statement, had included Money Market Funds and other pooled investments in cash equivalents and requested that officers perform an assessment of how individual instruments are classified. We subsequently broadened this request to include the classification of instruments on the balance sheet between cash and cash equivalents, current investments and non current investments. Key considerations in relation to cash equivalents are: • Whether instruments are held to meet short term cash commitments and not for investment • Whether instruments are subject to only "insignificant risk of changes in value" The 2018/19 accounts have been updated to exclude pooled investments totalling £20m from cash equivalents at 31 March 2019. In addition, transfers have been made between current and non current investments. Whilst we have received information on the terms of various instruments, we have not received officers' assessment of their classification. As a result we have not concluded on this area.	Corrected !

Update on matters reported to the July 2019 meeting

Area	Observation	
Accounting policies FY 19	In our report to the July 2019 meeting we said: • The Council has not taken the opportunity to review its statement of accounting policies so that only important and relevant information is included. As a result the statement includes accounting policies dealing with account balances, or aspects of the accounting, which are immaterial. • Accounting policies have not been updated to reflect changes in the Code resulting from the adoption of IFRS 9 or IFRS 15 or updated for a change to accounting standards incorporated into the Code in an earlier year relating to pension accounting. The Council has updated the accounting policies to bring into line with the Code. The accounting policies note is based on example wording published by CIPFA. The Council has removed example wording in a number of areas which deal with matters which are not relevant or which are immaterial. To achieve best practice, there remain opportunities to remove or simplify wording so that the level of detail is proportionate to the significance of the item, but we conclude our initial concerns have been satisfactorily addressed in material respects.	Corrected
Narrative report FY 19	In our report to the July 2019 meeting we said: • As a whole, the narrative report was very short • The content of the report did not meet the objective of providing information on the authority, its main objectives and strategies and the principal risks that it faces. • The report was not fair and balanced as it focused on key achievements in the year without giving similar weight to describing some of the challenges it has faced. KPIs reported focused on volumes, rather than measuring progress towards the meeting the Council's strategic objectives. • The report did not highlight and explain the linkages between information presented in the narrative report and the information within the financial statements and in some cases was not consistent with the information within the financial statements. Officers have re-written the Narrative Report to substantially address these points. To further improve compliance with the Code requirements, the Council should consider including a commentary on cash flows during the year and factors that may affect future cash flows.	Corrected

Update on matters reported to the July 2019 meeting

Area	Observation

Critical accounting judgments

FY 19 FY 20

In our report to the July 2019 meeting, we explained that:

- IAS 1 requires entities to make disclosures about the assumptions it has made about the future and other major sources of estimation uncertainty at the year end that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year.
- This is an important disclosure as it helps a user of the accounts assess an entity's financial position and performance and understand the sensitivities to changes in assumptions.

We reported that:

- Some of the matters reported did not meet the criteria above for inclusion in the disclosure
- Some of the specific disclosure requirements had not been met and the information included was not presented in a way that helps users of the financial statements to understand the judgements management makes about the future and about other key sources of estimation uncertainty.

Officers have reduced the areas discussed in both the 2018/19 and 2019/20 accounts and the disclosure now deals solely with the valuation of properties and the estimation of the pension liability.

Officers have added information about the sensitivity to changes in key assumptions in the pension valuation.

Corrected

In relation to the valuation of properties, officers have added wording to the January 2021 version to refer to a material uncertainty due to the impact of the pandemic – although, as this is a key point, we recommend that this is explained in greater detail. The remainder of the narrative provides a generic explanation, but does not provide further detail, for example, the sensitivity of the valuation of schools land to the assumption on land prices and how the Council has changed its estimate for this in 2018/19.

Uncorrected

In the version of the 2018/19 accounts circulated to the audit committee for the meeting in May 2020, officers added disclosures dealing with judgements made in applying accounting policies other than those involving estimations. Typically, these disclosures cover significant issues in applying accounting standards where management has had to exercise judgement in situations where a different judgement might have led to a materially different accounting treatment.

Uncorrected

We challenged officers on whether the items added to the May 2020 version of the accounts (the impact of funding levels due to Brexit; accounting for PFI contracts; the accounting for schools; and the decision on whether to prepare group accounts) involved the application of judgement which was significant enough to warrant disclosure as critical judgements. Officers concluded that they did not and removed these disclosures from the versions of both the 2018/19 and 2019/20 accounts circulated to the January 2021 audit committee meeting.

Corrected

Update on matters reported to the July 2019 meeting

Area	Observation
NNDR appeals provision FY 19 FY 20	In our July 2019 report, we said that: • The Council has made a provision of £1.3m for appeals made by business ratepayers to their bills. • The amount settled in the following year has been significantly in excess of the amount provided in each of the previous two year ends which indicated that the Council may historically have underprovided in this area. • In calculating the amount of income to be transferred from the Collection Fund in 2019/20, allowance has been made for a much higher appeals repayment amount which suggested Council may have anticipated claims in excess of the amount provided • We had been provided with an analysis prepared by an external adviser which indicates a provision requirement of £8.9m for appeals made against the 2010 Ratings List, of which the Council's share would be £5.8m. • No provision has been made for appeals against the 2017 Ratings List. In the updated version of the accounts circulated to the audit committee for the January 2021 meeting, officers have increased the appeals provision at 31 March 2019 by £12.8m. This was determined as an amount equal to the Council's share of the reversal of the credit of £20m discussed earlier (resulting in the aggregate of these two adjustments having no impact on the Collection Fund surplus). Whilst a revised provision calculation has not been prepared, the Council has supported its view that the revised provision is reasonable by reference to a comparison with other authorities and to the value of payments made after the balance sheet date. The comparison with other authorities shows that the revised provision remains towards the bottom (but no longer at the extreme) end of the range - but other points on that range might give a provision that was materially higher. The Council's share of the payments made in 2019/20 relating to periods prior to 1 April 2019 is approximately £2m lower than the revised provision, but officers' analysis does not take into account appeals which have been lodged but not yet determined. The provision in the 2019/20 accounts used information on lodged appeals. The methodology uses an assumption on expected proportion of successful appeals. We have requested information on how this assumption was developed but have not received this. Together, the information provided suggests that provisions are appropriate in material respects, but further explanation and analysis is needed to pinpoint and support a more precise estimate. We have noted to officers that the disclosure on movements in the provision in 2019/20 accounts, which shows usage of the provision in 2019/20 of £34m, is inconsistent with information provided on payments made to ratepayers following a successful appeal in 2019/20.

Uncorrected

Update on matters reported to the July 2019 meeting

Area	Observation	
Pension assets FY 19	In our July 2019 report we said that: • The actuary had estimated the pension assets and not used actuals • The estimate is approximately £28m higher than the Council's share of the net assets shown in the pension fund financial statements. We asked officers to assess the impact of this. In response officers commissioned the actuary to provide an updated actuarial assessment at 31 March 2019 using actuals. The 2018/19 accounts have been updated, resulting in an reduction in the net pension liability of £16.5m.	Corrected
Other matters originally concluded on in our July 2019 report FY 19	In our July 2019 report we concluded on the matters which follow. Due to the elapse of time since our previous reporting, we have provided a summary: • During 2017/18, five grant maintained schools converted to academy status. On conversion, the Council entered into 125 year leases at peppercorn rent which should have resulted in the de-recognition of non-current assets held by those schools. The Council did not capture four of these transactions in preparing the 2017/18 accounts. As a consequence, non current assets were overstated by £76m in the prior year. This has been corrected by restatement of opening balances and comparative information. Our testing of this restatements (as well as the treatment of previous academy transfers) was satisfactory. • During the year the Council redeemed its LOBO loan early and paid a premium of £18m. As required by the Code this has been charged in full to the Comprehensive Income and Expenditure Statement but under legislation the charge to the General Fund is being over the term of the original loan with the deferred portion carried forward in the Financial Instrument Adjustment Account. There are no issues arising from our testing. There have been no changes to the position previously reported.	

3. Issues arising since the issue of our July 2019 report

Issues arising since in our report to the July 2019 meeting

Area	Observation
Restatement of prior periods FY 19 Corrected	Our initial work during 2019, and subsequent investigations carried out by officers, identified accounting issues impacting on prior periods.

Officers concluded on the basis of these investigations that comparative information for 2017/18 and opening balances at 1 April 2017 and 1 April 2018 should be restated. The table is based on information included in the version of the 2018/19 accounts circulated to the January 2021 meeting and does not reflect further changes which officers propose to make.

Description of restatement	Page ref	Effect on net assets at 1 April 2017		Effect on 2017/18 total comprehensive income		Effect on net assets at 31 March 2018	
		Assets	Liabilities	Income	Expenses	Assets (£m)	Liabilities (£m)
		£m	£m	£m	£m	£m	£m
PPE valuation (Note 1)	29-31	268.9	-	-	15.3	284.2	-
Academy conversion	17	-	-	-	(75.9)	(75.9)	-
Schools cash and other balances (Note 2)	25-26	3.8	(2.2)	(3.5)	(3.8)	(2.5)	(3.2)
Teachers pension	27	-	(9.4)	-	-	-	(9.4)
Leaseholder contributions (Note 2)	22	15.5	6.1	2.2	-	8.1	15.7
Community infrastructure levy	23	12.2	-	(0.3)	-	10.3	1.6
Grant income recognition	34	-	3.7	1.1	-	-	4.8
Bank accounts in credit offset	21	33.7	(33.7)	-	-	7.9	(7.9)
Debtor/creditor classification	21	(2.8)	2.8	-	-	1.1	(1.1)
Offset of internal income and expenses	13	-	-	42.8	(42.8)	-	-
Total		**331.3**	**(32.7)**	**42.3**	**(107.2)**	**233.2**	**0.5**

Note 1: We understand that the restatement for the valuation of PPE includes at 1 April 2017 will be increased to £443m in the final version of the accounts to be circulated to the audit committee with consequent changes to 2017/18. We have not seen information supporting the final positions.

Note 2: These have been amended to the version circulated to the audit committee in January 2021 to correct for inconsistencies between primary statements. We understand that these will be further updated for items identified in our commentary.

We have provided a commentary on the circumstances and accounting issues giving rise to these restatements elsewhere within the report and as referenced in the table.

Issues arising since in our report to the July 2019 meeting

Area	Observation
Restatement of prior periods (continued) FY 19	The decision on whether to restate prior periods typically involves two key areas of judgement. 1. Firstly prior period information is only restated where there has been a change in accounting policy or to correct for a material error. Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. The first area of judgement can therefore be in determining whether or not an item is a prior period error. Our principal challenge in relation to this area of judgement was to the selection of an appropriate value per hectare for developed land. We discuss that on page 31. 2. The second area of judgement is whether a prior period error is material. IAS 8.42 requires restatement only of material prior period errors. Immaterial prior period errors shall not be corrected through restatement of comparatives. Officers have decided to correct all prior period errors identified. Adjustments to the valuation of properties (which we are advised will be £308m at 31 March 2018 and £442m at 1 April 2017 – see page 19) and to derecognise academies at 31 March 2018 (£76m) are 18, 12 and 3 times materiality set for planning purposes, respectively and we regard as material. In our report to the audit committee in December 2020, we highlighted this as an area where we would normally expect management to prepare a position paper setting out and explaining their view and requested that this be done. This has not been done and the position on whether other adjustments are individually material involves greater judgement. In the case where more than one prior period error has been identified, the accounting guidance requires consideration of the collective effect of errors, as well as whether they are individually material. Where a material prior period error is being corrected through restatement of comparative balances, this does not automatically mean that any other prior period errors identified should also be corrected regardless of their materiality. However, in this case, in view of the volume and size of other errors identified, we consider the approach taken by officers is, in general, reasonable.

Issues arising since in our report to the July 2019 meeting

Area	Observation	
Restatement of prior periods (continued) FY 19	We have made provided comments on the principal restatements as cross referenced on page 19. We note the following additional observations on other restatements. Our work on some of these restatements is ongoing:	
	• Short term debtors and short term creditors at 31 March 2018 have been restated to correct errors in the mapping of individual general ledger codes, including bad debt provisions incorrectly mapped to short term creditors and components of amounts due to other preceptors for local taxation collected on their behalf not being appropriately grouped and reported in either short term debtors and short term creditors. Whilst the net change to the presentation of the balance sheet is insignificant, officers have concluded that it is appropriate to make these changes due to their impact on individual note lines. We have commented on instances where the mapping remains incorrect.	Uncorrected
	• Provisions have been restated to classify provisions of £2.3m from non current to current at 1 April 2017. It is not clear why this has been done, in particular as the level of actual payments in 2017/18 is much closer to the originally stated position.	Uncorrected
	• There were inconsistencies between the primary statements in the restatement note in the version circulated to the January 2021 audit committee meeting. We understand these will be resolved in the version to be circulated to the April 2021 meeting.	Corrected
	• Short term debtors and short term creditors have been restated at 1 April 2017 to include internal loans of £2.2m between the Council and individual schools. This restatement is not correct as they are internal balances which should be eliminated on consolidation of the schools into the Council's accounts.	Uncorrected
	• The Council holds many bank accounts, some of which are in a debit (asset) position and some in a credit (liability) position. In the past the Council has presented the net position in cash and equivalents, offsetting credits against debits. Under the accounting rules, the Council can offset assets and liabilities only if it has a legally enforceable right to do so and intends to exercise the right of set-off (i.e. to settle net), or to settle simultaneously. In this case, the Council only has a legally enforceable right to offset certain of its accounts and not all and is also not able (because of the way the accounts are operated) to assert that it intends to settle net. The way in which the restatement has been calculated does not take into account this second condition.	

Issues arising since in our report to the July 2019 meeting

Area	Observation
Recognition of income from major works FY 19 FY 20	In the initial version of the 2018/19 accounts, as well as in accounts for previous years, the Council applied its revenue recognition policy in the following way to major works income:

- Entries were recorded on invoicing. For works completed prior to 31 March 2017, invoicing occurred once the works were complete and final accounts agreed with contractors. For works completed from 1 April 2017, invoicing occurred at the start of the year in respect of the works planned for the year ahead with a second, invoice after the year end to true-up to the actual spend in the year.
- Revenue was deferred within capital grants in advance and recognised on receipt of cash.

Under IFRS 15 Revenue from contracts with customers, revenue is either recognised over time or at a point in time depending on an analysis of how performance obligations in the contract are satisfied. In this case, the obligation to carry out the works is satisfied over time and therefore contributions should have been recognised as spend on the capital project was incurred.

The accounts for 2018/19 have been amended to bring into line with this treatment:

Description of restatement	Effect on assets at 1 April 2017	Effect on 2017/18 income	Effect on assets at 31 March 2018	Effect on 2018/19 income	Effect on assets at 31 March 2018
	£m	£m	£m	£m	£m
Leaseholder contributions	21.6	(1.7)	23.8	5.8	29.6

In addition an adjustment was made to the initial version of the 2019/20 accounts published in August 2020 to increase accrued income by £4.1m.

The previous accounting standard required the use of the percentage of completion method when accounting for the rendering of services and therefore, in practical terms, resulted in the same accounting treatment as under IFRS 15. As a result, the change does not result from the transition to IFRS 15 but, instead, from the incorrect application of the Council's revenue policy to this transaction stream. This means that the change has needed to be dealt with by restating comparative information and opening balances and not through the modified retrospective approach under which comparative information is not restated.

We have performed procedures including:

- Re-calculating restated accrued income at 1 April 2017, 1 April 2018 and 31 March 2019 for a sample of leaseholders, agreeing inputs to that calculation to records of individual and block gross values and capital expenditure records and testing whether recognition principles have been correctly applied, based on the timing of the related capital expenditure.
- Testing the completeness of income recorded in 2017/18 and 2018/19 by tracing from the items in the capital programme to income records for the relevant year.

These procedures were performed without exception.

Issues arising since in our report to the July 2019 meeting

Area	Observation
Recognition of community infrastructure levy FY 19 FY 20	The Code provides the following guidance on the recognition and presentation of community infrastructure levy:

- Revenue should be recognised when payment is due under the relevant legislation, which is on commencement of the development
- Where the authority is collecting on behalf of the charging authority (in London, for the Mayor of London), amounts collected do not form part of the revenue of the collecting authority and should be carried in creditors until paid over to the charging authority.

Our sample testing as part of the 2018/19 audit identified errors in the recognition of community infrastructure levy. These errors arose because the Council's practice had been to recognise income on invoicing which frequently did not coincide with commencement date for the development. The position was made worse by delays, sometimes substantial, in invoicing. Whilst these, in turn, arise from delays in receiving information from developers, officers have recognised that there are actions which can be taken to accelerate the process and have developed an improvement plan to do so.

In response to our initial findings, officers have undertaken an exercise to review all transactions. As it was apparent that this issue also impacted on prior periods, the exercise covered the period from 1 April 2017 and resulted in the following adjustments to 2018/19 and 2017/18:

	Effect on net assets at 1 April 2017	Effect on 2017/18 income	Effect on net assets at 31 March 2018	Effect on 2018/19 income	Effect on net assets at 31 March 2018
	£m	£m	£m	£m	£m
Community infrastructure levy	12.2	(0.3)	10.3	7.9	19.8

Officers also identified developments which had commenced during 2019/20 where income had been omitted from the initial version of the accounts published in draft in August 2020. This resulted in an additional accrual of income at 31 March 2020 of £31.1m which was incorporated into the version presented to the audit committee in April 2021.

Our testing of the updated accounts for 2018/19 and 2019/20 included:

- Understanding the Council's process for capturing and recording the commencement of developments
- Testing accrued income at 1 April 2017, 31 March 2018, 31 March 2019 and 31 March 2020 to commencement notices, invoice and subsequent receipt of cash
- Testing income in 2018/18, 2018/19 and 2019/20 to commencement notices, invoice and subsequent receipt of cash
- Tracing a sample of developments from the Exacon system (used to record information on projects which have commenced) to income records.

This testing identified two, further errors:

Corrected

- The incorrect accrual of income of £3.3m at 31 March 2020 relating to levy collected on behalf of the Mayor London which is therefore not income of the Council.
- The incorrect accrual of income of £2.8m at 1 April 2017 relating to a development which did not commence until 2017/18.

Issues arising since the issue of our July 2019 report

Area	Observation
Indemnity given to Tower Hamlets Homes Limited in respect of future pension costs FY 19 FY 20	Staff who transferred from the Council to Tower Hamlets Homes Limited (THHL) continued to be members of the Local Government Pension Scheme administered by the council. At that time, the council entered into a management agreement with THHL in which it agreed to meet the cost of benefits accrued by transferring employees up to the date of their transfer. On 31 March 2009, the then Corporate Director, Resources appears to have extended this obligation by writing to the Board of THHL and agreeing that the Council "indemnifies THHL in respect of all liabilities that have arisen or may arise from pension obligations". On the basis of this letter, the Council has recorded a pension liability equal to the full amount of the liability relating to the THHL section of the London Borough of Tower Hamlets Pension Scheme (i.e. the liability recorded relates to the cost of settling benefits accrued from individuals' service both before and after their transfer to THHL). In turn, THHL has recorded both a liability and reimbursement asset of the same amount. Using statutory mitigation arrangements, the relevant revenue account (in this case the Housing Revenue Account) is being charged as contributions become payable, rather than as benefits are earned by individuals. Pension benefits which have accrued relating to individuals' service with the Council prior to their transfer to THHL represent post-employment benefits and are accounted for in the same way as pension benefits provided to other Council staff. Conversely, pension benefits which individuals have accrued in respect of service rendered after their transfer to THHL do not represent employee benefits from the perspective of the Council. This is because they do not arise from service rendered to the Council (or the individual's termination) – instead they arise from the commercial arrangements put in place between the Council and THHL. As a result, benefits accruing after an individual's transfer date fall outside the scope of IAS 19 Employee Benefits and should instead be accounted for under IAS 37 Provisions, Contingent Liabilities and Contingent Assets. The consequences of this analysis are, in relation to the part of the liability attributable to post transfer service, that: • The liability should be classified within Provisions on the balance sheet and not under Liability related to defined benefit pension scheme. • The liability should be quantified using the measurement rules of IAS 37 which are different to IAS 19. • Entries to the Comprehensive Expenditure and Income Statement should be calculated and presented on a different basis to that currently reflected. • Statutory mitigation arrangements do not apply. As a result, the full amount of the provision should be charged to the Housing Revenue Account and subsequent changes in the provision charged or credited to the Housing Revenue Account. We are not able to quantify the adjustments needed as an exercise has not been performed to split the pension liability between amounts attributable pre and post transfer service and to re-measure the part attributable to post transfer service under IAS 37.

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Other matters (continued)

Issues arising since in our report to the July 2019 meeting

Area	Observation
Cash at bank - schools FY 19 FY 20	Officers identified errors in relation to the recording of cash and other transactions involving schools.

We have explained our work and findings in this area in more detail as we are aware that this has been an area of focus for the audit committee.

These issues arose because of:

- The complex system of entries used to record disbursements and other flows between the Council and individual schools
- The use of only a single general ledger control account within the main Council ledger to record the balances for some seventy different bank accounts together with, we understand, a failure to perform a full reconciliation between the general ledger control account on the one hand and the total of the reconciled cash books for the individual schools on the other.

The Council has spent time investigating the accounting for transactions with schools, which has been complicated by the complexity of the postings. The changes reflected in the current version are:

£m – net assets	31 March 2020	31 March 2019	31 March 2018	1 April 2017
Change from previously published version of 2017/18 accounts or original version of the 2018/19 and 2019/20 accounts	(1,149)	(9,669)	(5,714)	1,568

Our procedures have focused on changes to cash balances and has included:

- Discussion of the nature of changes made between original and final versions of the accounts
- Requesting a full reconciliation between the general ledger control account and the individual reconciled cash book balances
- Performing procedures to test the completeness of cash book amounts included in that reconciliation
- Performing tests on the reconciled cash balances on a sample basis.

At the time of writing we are waiting for information in relation to changes made to other account balances in relation to schools postings.

Other matters (continued)

Issues arising since in our report to the July 2019 meeting

Area	Observation
Cash at bank – schools (continued) FY 19 FY 20	We found that: • There are differences between the reconciled cash position and amended general ledger control account balance of £699k, £934k, £2,625k and £1,560k at 31 March 2020, 31 March 2019 and 31 March 2018 and 1 April 2017 respectively. • In relation to correcting journals posted to the general ledger control account, it was apparent because of the difference to reconciled cash books that the correcting journals made so far are incomplete and we have therefore we performed no further work. • The reconciled cash position incorrectly included amounts due from HMRC of £1,246k, £1,644k, £1,189k and £1,499k at 31 March 2020, 31 March 2019, 31 March 2018 and 1 April 2017, respectively. Officers have informed us that these amounts relate to input tax on schools expenditure for the final month or two months of each year which are to be reclaimed from HMRC. On this basis, these amounts should be classified in short term debtors and not in cash and cash equivalents. Officers' investigation also found that, as a result of an oversight, amounts relating to Feb/March 2020, Feb/March 2019 and Feb/March 2018 input tax had not been subsequently reclaimed and remain outstanding. The explanation provided suggests that these amounts should accumulate over the period, but this is not reflected in the position currently reflected in officers' analysis. Officers also believe that it may not now be possible to claim the full amount as records may be incomplete. • Our sample of reconciling items in individual cash book reconciliations identified a high rate of error (approximately half at 31 March 2020 and 31 March 2019), where payments were deducted from the cash balance before their release, resulting in the understatement of both cash and short term creditors or included invalid entries and should be released to income. Officers have not quantified the error and therefore no adjustment has been made. The amount of unpresented cheques and BACS is £2,348k, £8,127k, £7,309k and £25,712k at 31 March 2020, 31 March 2019, 31 March 2018 an 1 April 2017, respectively, representing the maximum amount of error at each reporting date. In view of the uncertainty over the correct balance, we have not proposed an adjustment but will evaluate the impact of the uncertainty on the scope of our audit and on our opinion in aggregate with other issues identified.

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Other matters (continued)

Issues arising since in our report to the July 2019 meeting

Area	Observation
Unfunded pension obligations FY 19	Where an authority chooses to enhance the pension entitlement of an employee in the Local Government Pension Scheme or Teachers Pension Scheme, the authority and not the scheme is responsible for payment of additional benefits. The liability to make these additional payments is recognised when the additional benefits are awarded, resulting in the recording of an additional pension liability on the balance sheet. Authorities have typically made such awards linked to early retirement schemes. We challenged officers on why the Council had not recorded a separate liability on its balance sheet. The Council does not make any direct payments in relation to the local government pension scheme as this liability was previously settled through a lump sum payment. A provision of £9.1m has been made at 31 March 2019 in respect of future payments to teachers. As this obligation has been in existence for several years, the omission of this liability from the balance sheet represents an error in prior periods. Officers have corrected this misstatement by restating comparative information and opening balances (see page 30 for further comments on restatement of prior periods).
Disclosures relating to higher paid employees FY 19 FY 20	The Code requires disclosure of the number of employees receiving remuneration of more than £50,000 in bands of £5,000. As part our preliminary procedures, we gained an understanding of the Council's process for compiling this disclosure. We identified that the disclosure is prepared from reports extracted from the Council's payroll system. Whilst a number of schools use the corporate payroll arrangement, over twenty schools have made arrangements with external providers for payroll processing. As a result, higher paid employees at schools which have opted out of the corporate payroll arrangement have been wrongly excluded from the disclosure. Officers have updated the disclosure to include an additional 612 employees paid over £50,000 (a 78% increase over the number of staff originally disclosed). The method of compilation was the same in the prior year. Officers have also therefore restated comparative information, increasing the number of higher paid employees by 240 (or 32%). In view of the quantum of the change and the closer interest some users of the accounts have in this information, we agree with officers that the prior year error is material and the comparative information should therefore be restated. Where a material prior period error is corrected, the Code requires disclosure of the nature of the error. This has not been done. Officers have prepared the revised disclosures based on payroll reports submitted by the schools using outsourced providers. For a number of schools there are large variances between the total of these reports and total staff costs in returns submitted by those schools and consolidated into the accounts. We have requested information on how officers have assurance over the completeness and accuracy of the payroll reports in the light of the unreconciled differences and will complete our testing once we have this.

Corrected

Corrected

Uncorrected

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4. Update on significant audit risks identified in our 2018/19 and 2019/20 audit plans

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Valuation of properties The Council is required to hold property assets within Property, Plant and Equipment at valuation. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value. FY 19 FY 20	**Update on the design and implementation of key controls** The valuation of properties has not been well controlled. Whilst the Council is taking steps to remediate the position, the following significant control deficiencies were present in the production of both 2018/19 and 2019/20 original draft statements of accounts: • The Council did not have controls to ensure that information provided to the valuer for the purpose of his valuation was complete and accurate and the design of controls over subjective inputs to the valuation is not clear. C • The valuer's report does not provide a commentary on changes in the overall valuation amount compared to previous valuation and, internally, a summary has not been prepared to inform management review. At a more detailed level, we have not been able to obtain documentation to be clear on how changes in individual asset values have been scrutinised and followed up with the valuer. This would require formalising the criteria for selection of individual asset values for investigation, consistently applying these criteria and then documenting the conclusion on exceptions for review and approval. C • The calculation and recording of entries relating to the valuation is performed in the fixed asset register. The fixed asset register is maintained on an excel spreadsheet. Typical spreadsheet controls we would expect to see over the design and maintenance of a spreadsheet used for the initiation and recording of significant financial transactions have not been adopted. C **Update on our substantive audit procedures** Our testing and subsequent investigations carried out by officers has identified a number of issues. ***Developed land areas for schools*** (i.e. the footprint of the buildings together with ancillary built on land such as playgrounds and car park): We requested information on building and land areas used in the valuation during our original field visit in June 2019 for the purpose of the 2018/19 accounts audit. Officers' follow-up to this request identified the following: • This data was generated by the valuer, rather than by the Council. • We understand that the areas used for the original valuation at 31 March 2019 were derived from either the building footprint or gross development value of the building, but did not receive a complete explanation. • The areas used in the original valuation varied significantly to the actual developed land area. • The developed land areas used at 31 March 2018 are the same as those used in the original valuation at 31 March 2019 • The valuation at 31 March 2017 did not use separate assumptions for land areas and value per hectare – instead values for developed land were derived as a percentage of the gross development value of the building.

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Valuation of properties (continued) FY 19 FY 20	In the light of these enquiries, officers: • Obtained updated valuations at 31 March 2019 and 31 March 2018 using the actual land areas measured by the valuer. • Adjusted the carrying value of other land and building at 31 March 2019 and restated the carrying value at 31 March 2018 for the new valuations in the April 2021 version of the accounts. • Prepared the 2019/20 accounts using a valuation at 31 March 2020 based on the actual land areas. Our valuation specialists have re-performed the measurement of a sample of the revised land areas and did not identify any issues. Where a material error is identified in prior period information, the information needs to be corrected for the earliest period presented (in the case of the 2018/19 accounts, back to 1 April 2017): • Whilst we do not fully understand how the valuer arrived at the developed land areas used in the valuation at 31 March 2018, they are significantly less than either actual areas. We have therefore agreed with officers that the original data was incorrect; that the change between original and revised valuations therefore represents a material error in the prior period accounts; and that it is therefore appropriate to correct by restating opening balances and comparative information. **Corrected** • In relation to the valuation at 31 March 2017, we do not agree that the approach taken in the original valuation of developed land was appropriate. We have therefore agreed with officers that the April 2021 version of the statement of accounts will be further updated to restate the opening balance sheet at 1 April 2017. **Corrected** ***Schools building areas***: The valuation of school buildings uses information on their gross internal area. That data is provided by the Council to the valuer. We requested information to support a sample of building areas. Officers have informed us that they: • Have identified discrepancies with site plan information for the sample items selected by us and in the light of this, extended their investigation to cover the building areas for all schools • Estimated the impact of all errors identified at 31 March 2020, 31 March 2019, 31 March 2018 and 1 April 2017 respectively. • Propose to adjust the accounts to correct for these errors. As the information on this further adjustment was provided at the time of preparing this report, we have not yet tested this information. The presence of past errors is indicative of insufficient consideration in prior years as to whether the site areas were appropriate for the Modern Equivalent Asset.

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Valuation of properties (continued) FY 19 FY 20	***Price per hectare for developed land at schools:*** The valuation of land used in preparing the published accounts for 2017/18 assumed a value of £17.8m per hectare for developed land. The same assumption was used for the valuation at 31 March 2019 in the initial version of the 2018/19 accounts. In the updated version of the 2018/19 accounts submitted to the audit committee in May 2020, the valuation at 31 March 2018 and 31 March 2019 were both updated for a change in the assumption from £17.8m to £11.1m per hectare. We challenged officers on the basis for the change in assumption and for considering this to be a prior period error. Following further discussion with the valuer, we concluded that this was a change in estimate, rather than the correction of an error, and in the version of the 2018/19 submitted to the January 2021 audit committee meeting, the restated carrying amount has been updated to reflect the original price of £17.8m per hectare. We found: • Based on research carried out by the valuer and other information considered by our valuation specialist, transaction values are highly dependent on the density of the subsequent development and we have concluded that both original and revised price per hectare both fall within the wide range of observed market prices. • The transactions which the valuer has relied on for the lower price per hectare relate to market transactions completed after the date of approval of the 2017/18. We therefore agreed with officers that this was a change in accounting estimate and not an error and therefore whilst it was appropriate to use this assumption at 31 March 2019, prior periods should not be restated for this. ***Properties not subject to valuation at the reporting date:*** The Code does not require properties to be revalued on an annual basis, but does require valuations to be carried out where there has been a material change. The Council assesses whether there has been a material change over the financial year through its review of the market review report commissioned from its valuer. On the basis of this review, officers have concluded that there has not been a material change in the value of non dwelling properties which were not subject to valuation at the year end. The Council has not determined the level of change it considers to be material or evaluated the possible cumulative change since the date of the last valuation of properties (noting that for some properties this is earlier than the start of the financial year). We have requested this assessment to be prepared before we finalise our conclusion.

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Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk | **Status update**

Valuation of properties (continued)

FY 19 FY 20

Identification of Council's interest in properties: Other procedures performed in support of our work on the valuation of properties, but which did not form part of the significant risk, included testing whether properties were in operational existence, the Council had title to the asset and where subject to a lease, this had been taken into account in the valuation. This testing identified the following exceptions:

- Two assets were surplus, but were classified in other land and buildings within the Property, Plant and Equipment note. In addition to the disclosure misstatement, surplus assets are required to be valued on a different basis, which reflects the property's highest alternative use, rather than its existing (or previous) use. The Council has obtained new valuations for these properties on the correct valuation basis which has resulted in changes in their previously recorded values at 31 March 2020 of £14.3m (increase) and £1.8m (decrease). As the properties have been surplus for a number of years, the Council has also obtained revised valuation at earlier reporting dates. The accounts for both years have been updated for these changes, including restatement of comparative information. We have asked officers how they are assured that there are no other surplus assets included in operational categories, but have not yet seen information relating to this.

  Corrected

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- One property which was recorded twice on the fixed asset register (once in its current use and once in a previous use), resulting in the overstatement of other land and buildings by £2.4m. Again, this error impacts on earlier reporting dates. The accounts for both years have been updated for these changes, including restatement of comparative information. We have again asked officers to provide information on how they are assured that all properties are in operational existence.

  Corrected !

- Three properties which are registered in the name of a predecessor body and not the Council. We have seen documentation which demonstrates that these assets previously transferred to the Council and recommend that the registration is brought up-to-date.

  C

- One property where a lease has been granted over part of the property. The lease had been taken into account by the valuer, but following enquiries of the valuer, we are satisfied that the impact on the valuation is clearly trivial.

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Valuation of properties (continued) FY 19 FY 20	***Other findings and observations relating to the valuation:*** We have the following additional findings and observations regarding the valuation process and outcome: • As specialised assets, schools are valued on a depreciated replacement cost basis as market information is not available. This approach involves the application of the Modern Equivalent Asset principle. In relation to land, this means selecting and valuing a hypothetical site which represents the least expensive site in size and location that would realistically be suitable and appropriate for the replacement facility – rather than valuing the land on which the existing building sits. In practice it is not uncommon for actual land areas to be used. • In valuing the York Hall Leisure Centre, the valuer has deferred both the net replacement cost and land values for three years at 7%, to reflect the fact there is a lease in place, with an unexpired term of three years, at a peppercorn (i.e. nil), rent. The lease is granted to an operator and is in substance a service agreement which we would expect to be disregarded for valuation purposes and vacant possession assumed. The impact is to undervalue the asset by £2.0m. We have requested the Council verify with the valuer whether there are similar circumstances where the same approach has been taken. ! • There are several non school assets where the valuation has increased as consequence of changes in floor area information which the Council had provided to the valuer. We have requested the Council verify that these changes reflect extensions or other changes to the occupied space since the last valuation, rather than the correction of an error in previous information. ! • RICS guidance requires valuation reports to "clearly and accurately set out the conclusions of the valuation in a manner that is neither ambiguous nor misleading, and which does not create a false impression". The report is not clear in a number of respects. For example, there is no summary in the report setting out what is included in the overall valuation and the aggregate value for each category of asset valued. Nor is there is any linkage to the appropriate supporting information and valuation spreadsheets. This makes it impossible for the reader of the report to understand what has been valued without further direct enquiry of the valuer. Also two valuation dates have been adopted, but the report does not clarify which assets have been valued at each of the respective valuation dates. The guidance requires that a commentary is given in relation to the possible differences between Existing Use Value and Market Value. This has not been provided. We recommend the Council take up these points with the valuer for the purpose of the 31 March 2021 valuation and request updates to future reports where matters are not clear. C

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Capitalisation of expenditure The Council has a substantial capital programme, including revenue expenditure which, for funding purposes, is treated in the same way as capital expenditure (REFCUS). Determining whether or not expenditure should be capitalised can involve judgement as to whether costs should be capitalised under International Financial Reporting Standards. The Council has greater flexibility over the use of revenue resource compared to capital resource. There is also, therefore, an incentive for officers to misclassify revenue expenditure as capital. FY 19 FY 20	**Update on the design and implementation of key controls** As reported in our July 2019 report, we were not able to identify a documented internal control to prevent or detect the incorrect classification of revenue spend as capital. We have not been provided with this information in relation to our 2019/20 audit. **Update on our substantive audit procedures** We selected a sample of capital items (including REFCUS) in the year to test whether they have been appropriately capitalised in accordance with the accounting requirements. Our work is not yet concluded as we have not yet received satisfactory responses to queries or requests for information on some sample items. Whilst we have so far not identified any sample items which we have concluded are revenue items which have been incorrectly classified as capital, we have identified the following other issues: • An item of £276k was incorrectly coded to a school which had previously converted to an academy, rather than a school which remained under the control of the Council. This resulted in the amount being accounted for as REFCUS and expensed, rather than being capitalised. If the error rate in our sample was found in the remainder the population, this would give an error of £16m. • Expenditure relating to refurbishments included expenditure on fixtures, fittings and equipment, but was classified in its entirety within other land and buildings. Our inspection of assets included within fixtures, fittings and equipment, which is substantially limited to previous purchases of refuse collection vehicles, suggests that this practice is common and has operated for a number of years. In addition to the impact on disclosure information, the practical consequence of coding expenditure on fixtures, fittings and equipment in this way is that the expenditure will be written out of the Property, Plant and Equipment balance when next subject to valuation where the type of expenditure falls outside the scope of what is considered by the valuer in their valuation. We have not yet received officers' assessment of this point.

Uncorrected

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Recognition of grants and contributions Recognition of grant income and contributions is not inherently complex and does not involve significant judgement and was not, as a result, identified as a significant audit risk in our audit plan for 2018/19. However, following issues identified in our initial testing in 2018/19, we identified as a significant audit risk in our 2019/20 audit plan. The errors principally arose as a result of applying the wrong recognition basis, but also because of inadequate control over the reconciliation of control accounts. We will consider what additional work, if any, is needed in relation to the 2018/19 once our originally planned work is complete. FY 19 FY 20	**Update on the design and implementation of key controls** The Council has prepared and shared with us process notes in relation to grant income and contributions. We are not clear from these what controls operate within this process to ensure that grant income and contributions are recognised in the correct period and in practice errors have been identified in both 2018/19 and 2019/20. C **Update on our substantive audit procedures** We selected a sample of grants and contributions and tested whether they had been recognised in the correct period. Separate selections were made in relation to leaseholder contributions to major works and community infrastructure levy and the findings from that work is discussed in the previous section and are not covered here. Our testing of amounts recorded in the initial version of the 2018/19 accounts identified that an overspend on dedicated schools grant of £5.1m had been inappropriately carried forward on the balance sheet; and recognition of the unspent part of allocation of Flexible Homelessness Support Grant of £5.2m had been deferred, although there were no conditions preventing its recognition. In response to these findings, officers performed an exercise to review all accrued and deferred grant balances at 31 March 2019 and earlier reporting dates. The accounts have been amended (including the restatement of comparative information) to correct for the results of our initial testing and officers review resulting in a net release from the balance sheet to grant income at 31 March 2019, 31 March 2018 and 1 April 2017 of £2.7m, £4.8m and £3.7m respectively. Corrected Our testing of updated breakdowns for 2018/19 and on breakdowns for 2019/20 is not complete as information or explanations for some sample selections is outstanding. ! Our findings to date include the following: • The Council has recorded the incorrect amount of "business rate related grant" in 2019/20 because an entry of £2.4m to true-up the initial 2017/18 allocation to bring income into line with the final calculated entitlement amount was not accrued at 31 March 2018 or 31 March 2019. This resulted in an understatement of short term creditors at 31 March 2018 and 31 March 2019 and an understatement of income in 2019/20. Uncorrected

Update on significant audit risks included in our 2018/19 and 2019/20 audit plans

Risk	Status update
Recognition of grants and contributions (continued) FY 19 FY 20	• In addition to the release of deferred income relating to the Flexible Homelessness Support Grant, the Council has released previously deferred amounts at 31 March 2019, 31 March 2018 and 1 April 2017 of £2.2m, £1.0m and £0.8m, respectively. These include the release of amounts where the officers have been unable to locate information relating to the original grant and in the absence of information or record of subsequent contact from the grant funder have formed the view that there are no remaining conditions. The approach is not unreasonable, but there is a residual risk that there are remaining conditions to be fulfilled (and/or amounts may not be applied in accordance with the wishes of the grant funder). • Amounts of £2.1m carried in short term debtors at 31 March 2018 in relation to the PFI grant. As all amount are paid in year, we would not expect there to be a remaining balance on this account and therefore proposed an adjustment to write-out this amount.

Uncorrected

5. Impact of the covid-19 pandemic on the statement of accounts and our audit

Impact of the covid-19 pandemic on the statement of accounts and our audit

Issue	Potential Impact on annual report and financial statements
Requirements FY 19 FY 20	CIPFA has issued guidance highlighting the importance of considering the impact of COVID-19 in preparation of the 2019/20 financial statements, including communicating risks and governance impacts in narrative reporting. This is consistent with the Financial Reporting Council's guidance to organisations on the importance of communicating the impact of COVID-19 and related uncertainties, including their impact on resilience and going concern assessments. Entity-specific explanations of the current and expected effects of COVID-19 and the Council's plans to mitigate those effects should be included in the narrative reporting (including where relevant the Annual Governance Statement), including in the discussion on Principal Risks and Uncertainties impacting an organisation. As well as the effects upon reserves, financial performance and financial position, examples of areas highlighted by CIPFA include the impact on service provision, changes to the workforce and how they are deployed, impacts upon the supply chain, cash flow management, and plans for recovery. Risks highlighted include those relating to subsidiaries and investments, capital programmes, and resilience of the community including partner organisations and charities.
Actions	A thorough assessment of the current and potential future effects of the COVID-19 pandemic is required including: • A detailed analysis across the council's operations, including on its income streams, supply chains and cost base, and the consequent impacts on financial position and reserves; • The economic scenario or scenarios assumed in making forecasts and on the sensitivities arising should other potential scenarios materialise (including different funding scenarios); • Any material uncertainties relating to the council's financial position, the financial sustainability of the Council, and the potential requirement for a section 114 notice; and • The effect of events after the reporting date, including the nature of non-adjusting events and an estimate of their financial effect, where possible

Impact on the Council	Impact on annual report and financial statements	Impact on our audit
We have considered the key impacts on the business such as: • Interruptions to service provision. • Supply chain disruptions. • Unavailability of personnel. • Reductions in fees and charges. • The closure of facilities and premises.	We have considered the impact of the outbreak on the annual report and financial statements, discussed further on the next slide including: • Principal risk disclosures • Impact on property, plant and equipment • Valuation of commercial or investment properties • Impact on pension fund investment measurement and impairment • Financial sustainability assessment • Events after the reporting period and relevant disclosures • Bad debts provision policy • Narrative reporting • Impairment of non-current assets • Allowance for expected credit losses	We have considered the impact on the audit including: • Resource planning • Timetable of the audit • Impact on our risk assessment • Logistics including meetings with entity personnel.

Impact of the covid-19 pandemic on the statement of accounts and our audit

Issue	Potential Impact on annual report and financial statements	Audit response
Impact on property, plant and equipment FY 20	The Royal Institute of Chartered Surveyors has issued a practice alert, as a result of which valuers have identified a material valuation uncertainty at 31 March 2020 for most types of property valuation. This has impacted the Council and has required specific disclosure in the financial statements.	The Council has considered its approach to the measurement of property, plant and equipment (PPE). Where property held at current value using market information, the Council considered with their valuers the impact that COVID-19 has had on current value. The accounts include the following disclosure: "In particular, arising from the potential impact of the Covid-19 pandemic on property values, their valuations are reported on the basis of "material valuation uncertainty". As explained in section 2, we recommend that this is further explained and given greater prominence. In view of the significance of this matter (and as is common with local authorities and other reporters with 31 March 2020 year end and significant property portfolios carried at market based valuations) we will include an additional paragraph drawing attention to the uncertainty and the Council's disclosure. The expected wording of this audit report modification is as follows: **"Emphasis of matter: Material uncertainty related to the valuation of the Council's land and buildings** We draw attention to note 4, which describes the effects of the uncertainties created by the coronavirus (COVID-19) pandemic on the valuation of the Council's land and buildings. As noted by the Council's external valuer, the pandemic has caused extensive disruptions to businesses and economic activities and the uncertainties created have increased the estimation uncertainty over the valuation of the land and buildings at the balance sheet date. Our opinion is not modified in respect of this matter".

Impact of the covid-19 pandemic on the statement of accounts and our audit

Issue	Potential Impact on annual report and financial statements	Audit response
Impact on pension fund investment measurement FY 20	As a result of the COVID-19 pandemic pension fund investments have been subject to volatility.	The audit of the pension assets of the London Borough of Tower Hamlets scheme is ongoing and is the subject of a separate report to this meeting.
Expected credit losses and bad debt provisions FY 20	Under the expected credit loss model for financial instruments, the Council needs to provide for expected credit losses based on the unprecedented conditions at the balance sheet date. The impact of conditions at the balance sheet on future cash flows for other receivables balances which are not financial instruments also needs to be	The Council has principally estimated bad debt provisions by applying percentages to categories based on age. We have requested information on how percentages selected have been derived and/or how they compare to past experience. We have received information in respect of Council Tax and Business Rates but the data is not at a level of detail which allows us to test whether it is accurate. We have not received information for other types of receivables. With one minor exception the Council has not modified its approach or assumptions in the light of the pandemic or explained why this is not required. IFRS 9 as adopted by the Code requires substantial disclosures to measure both quantitative and qualitative information about amounts arising from expected credit losses and credit risk exposure. We consider further information should be provided in relation to the Council's investments.

Uncorrected

Impact of the covid-19 pandemic on the statement of accounts and our audit

Issue	Potential Impact on annual report and financial statements	Audit response
Covid-19 related income received pre year end FY 20	• There were 2 main receipts of income related to Covid-19 that were received pre 31 March 2020 ○ **Covid-19 LA Support grant.** This was the first tranche of £1.6bn passed out to Councils by MCHLG on March 27 2020. The Council received £10.4m. This grant was unringfenced and without conditions and therefore should be recognised in income with any unspent amounts carried in reserves. ○ **S31 Business Rates relief grant.** This brought forward the receipt of business rate reliefs to ease cash flow pressures that would otherwise have been distributed over the course of 2020/21. The Council received £10.4m. The Council is required to report on this matter and the government can reclaim overpaid sums. It is correct to recognise this grant in receipts in advance (creditors) to release the income over the course of 2020/21.	• These grants have been correctly recognised or deferred. • As the covid-19 grant is unringenced it should be presented with the "Taxation and non-specific grant income" line. In the original version of the 2019/20 accounts it was presented as part of the net cost of services. This has now been corrected.
Narrative and other reporting issues FY 19 FY 20	The following areas need to be considered by local authorities as having being impacted on by the COVID-19 pandemic. • Narrative reporting as well as the usual reporting requirements will need to cover the effects of the pandemic on services, operations, performance, strategic direction, resources and financial sustainability. • Reporting judgements and estimation uncertainty, the Council will need to report the impact on material transactions including decisions made on the measurements of assets and liabilities.	The narrative report adequately discloses matters related to Covid-19, including risks, potential impacts and other issues. The report is compliant with the guidance in this area.

Corrected

6. Update on our work on the value for money conclusion

Update on value for money work

FY 19

FY 20

In our July 2019 report, we said that our value for money conclusion for 2018/19 would be qualified as improvements in childrens' services, following an earlier assessment by Ofsted that services were inadequate, were not in place for the whole of 2018/19.

Our work on VFM is ongoing.

Additional risk identified

In our 2019/20 audit plan, we identified an additional risk in relation to financial reporting.

The Council's statement of accounts has been significantly delayed and there has been a period of uncertainty over the true financial performance in 2018/19 and amount of resources available at 31 March 2019 while officers investigate and quantify potential or actual misstatements in the draft statement of accounts. The Council has recognised in its updated draft annual governance statement for 2018/19 that there significant deficiencies in controls over financial reporting.

Reliable and timely financial reporting that supports the delivery of strategic priorities is a key component of informed decision-making.

This risk also relates to our 2018/19 audit.

Our assessment of this risk

We concluded that this is a significant audit risk. This is due to:

1. The length of time taken to provide information and explanations to support transactions in the accounts; to investigate issues which have arisen; and prepare amended financial statements leading to an expected delay in excess of 18 months for the target date for issue of our opinion of 31 July 2019.
2. The volume, size and pervasiveness of corrections required in relation to both current and prior period information reported in the statement of accounts originally authorised for issue in May 2019, in particular correction to or prolonged uncertainty over the amount of usable reserves available to meet future spending requirements and therefore strategic objectives (or timing in recognition of these resources) (see the appendix to this document for a summary of the changes made). Of particular note are:

- In the original accounts a reversal of a creditor was recorded in the general fund and not the collection fund. The correction of the error, together with the correction of an error in the estimate for appeals to business rates, resulted in a reduction in council revenue resources of £20m
- The earlier recognition of capital resources of £30m in respect of contributions from leaseholders to major works and £20m due from developers in respect of community infrastructure levy and other government grants of £7m.
- The restatement of prior period accounts, including the restatement of PPE by £440m.
- The Council commissioned an independent report into the accounts closure process which identified weaknesses in the accounts closure process, including weaknesses in the leadership of that process
- These and other weaknesses in related accounting and business processes, including the following resulted in material misstatement of the accounts and delays in the accounts and audit process:
- Inadequate controls in areas of significant risk of material misstatement which resulted in material misstatement including controls over journals, controls over the valuation of properties and controls over the calculation of estimates
- Inadequate control reconciliation processes, in particular in relation to the reconciliation of the schools disbursement account resulting in prolonged uncertainty over the amount of schools cash balances
- Inadequate VAT accounting processes resulting in the under claim for input tax of £4m
- Inadequate training of staff resulting in incorrect application of the Council's accounting policies, in particular in relation to the recognition of income.

Conclusion

We have concluded that the factors considered as part of the risk assessment provide evidence of weaknesses in arrangements for reliable and timely financial reporting that supports the delivery of strategic priorities. Our report will be qualified in this respect.

7. Purpose of our report and responsibility statement

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit Committee and the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- an update on issues reported in our July 2019 report
- other issues which have arisen since the issue of that report
- an update on areas of significant audit risk identified in our 2018/19 and 2019/20 audit plans
- an update on progress on other areas of audit work
- an explanation of work performed in response the impact of the pandemic on matters relevant to our audit
- areas where we expect to make additional control observations.
- .

What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

The scope of our work

Our observations are developed in the context of our audit of the financial statements. We described the scope of our work in our audit plan and again in this report.

This report has been prepared for the Audit Committee and Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

We welcome the opportunity to discuss our report with you and receive your feedback.

Jonathan Gooding

for and on behalf of Deloitte LLP

St Albans

26 March 2021