Audit Certification - 2016/17 & 2017/18

London Borough of Tower Hamlets

January 2023

Contents

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Executive summary

Executive Summary

Background

— As the then appointed auditor to London Borough of Tower Hamlets (LBTH) we issued the audit opinion on the 2016/17 financial statements on 29 September 2017. However, we did not issue the audit certificate due to ongoing consideration of two matters brought to our attention by local electors. We were satisfied the two matters would not have a material impact on the 2016/17 financial statements or our conclusion on arrangements to secure value for money.

— We issued the audit opinion on the 2017/18 financial statements of LBTH on 31 July 2018. However, we did not issue the certificate due to one of the issues brought to our attention by local electors, mentioned above, that was still being considered. We were satisfied the matter would not have a material impact on the 2017/18 financial statements or our conclusion on arrangements to secure value for money.

— The issue raised by a local elector, which delayed the certificate on the 2017/18 financial statements, was dealt with in August 2019.

— Following that issue being dealt with in August 2019, we contacted LBTH to start the process to issue our certificates, however no response was received until late 2020 and no formal response was received until February 2021. Due to changes in staffing at KPMG no formal response was made by KPMG until May 2021 (it was at this point that KPMG were notified that a number of prior period adjustments had been identified during the audit of the LBTH 2018/19 financial statements). Consequently, our audit work commenced in July 2021 to understand the potential impact on our 2016/17 and 2017/18 audit certificates.

— It is also worth noting that as noted above we have already issued our audit opinions for both the 2016/17 and 2017/18 financial statements. Consequently, the amounts in these financial statements are fixed. Any matters which we consider to meet the requirement to be reflected as a prior period adjustment can only be referred to in the concluding certificate that KPMG is required to issue to conclude and certify the audits of 2016/17 and 2017/18.

Prior period adjustments (PPAs)

— During the audit of the LBTH 2018/19 financial statements a number of PPAs were identified, which LBTH were in discussion with their new external auditor Deloitte LLP through-out 2021 and 2022.

— The September 2021 version of LBTH's 2018/19 draft financial statements (considered by the Audit Committee in January 2022) identified 10 adjustments (although there was an 'other' category which had no details, but was included in the tables supporting the summary note). Within these 10 adjustments there were a total of 17 separable items set out in the detailed supporting information. This was used as the initial basis for considering the impact of the issues on the LBTH 2017/18 audited financial statements.

— We note two further PPAs were identified and brought to our attention in October and December 2022.

Consideration of PPAs for 2017/18 financial statements

— A further version of the draft financial statements was produced in June 2022, which the Council had labelled as the 'final' version, this merged the PPAs for s106 developers' contributions and disabled facilities grants with grants unapplied in terms of the disclosures, but we have continued to assess them as three separate items regarding PPA considerations.

Executive Summary

Consideration of PPAs for 2017/18 financial statements (continued)

— Following review of the PPAs included in the 2018/19 LBTH draft financial statements we have concluded that there are four that need to be referred to in our concluding certificate (based upon a combination of quantitative and qualitative factors, specifically absolute materiality of £17.5 million; and considering the impact on balance sheet heading, net assets, and usable reserves):

- Property, Plant and Equipment (PPE) relating to the valuation on maintained schools (increased PPE valuation by £307.8 million; no impact on usable reserves);
- Leaseholder contributions (increased usable reserves by £26.3 million);
- Conversion of maintained schools to academies (decreased PPE valuation by £75.9 million; no impact on usable reserves from PPE element); and
- Community Infrastructure Levy (increased usable reserves by £11.9 million).

— The remaining 14 items are not considered to be PPAs either for quantitative or qualitative reasons.

— We have therefore drafted a concluding certificate (Appendix 1) to complete the 2017/18 audit.

Consideration of PPAs for 2016/17 financial statements

— The review of the PPAs set out in the 2018/19 LBTH draft financial statements highlighted that there were also 15 adjustments to be considered relating to the 2016/17 financial statements.

— A further version of the draft 2018/19 financial statements was produced in June 2022, which the Council had labelled as the 'final' version, which merged the PPAs for s106 developers' contributions and disabled facilities grants with grants unapplied in terms of the disclosures, however, we continued to assess these as three separate items regarding PPA considerations.

— Following review of the PPAs included in the 2018/19 LBTH draft financial statements we have concluded that there are three that need to be referred to in our concluding certificate (based upon a combination of quantitative and qualitative factors, specifically absolute materiality of £15 million; and considering the impact on balance sheet heading, net assets, and usable reserves)::

- Property, Plant and Equipment (PPE) relating to the valuation on maintained schools (increased PPE valuation by £442.7 million; no impact on usable reserves);
- Leaseholder contributions (increased usable reserves by £24.1 million); and
- Community Infrastructure Levy (increased usable reserves by £9.4 million).

— In our view the remaining 12 items are not considered to be PPAs either for quantitative or qualitative reasons.

— We have therefore drafted a concluding certificate (Appendix 2) to complete the 2016/17 audit.

2017/18 items considered to be PPAs

Property Plant and Equipment Adjustments

Extract from LBTH 2018/19 financial statements:

It was identified that there were errors in the methodology used to produce the valuations for some properties. This required a revaluation of assets, primarily the maintained schools, resulting in increases in valuations of £442.7 million as at 1 April 2017 and £307.8 million at 31 March 2018.

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Increase in valuation of PPE (schools)	Balance sheet	2,486,991	307,831	12.4%	Yes	Yes	Yes
Increase in revaluation reserve	Balance Sheet	- 665,233	-280,207	42.1%	Yes	Yes	Yes
Increase in Capital Adjustment Account	Balance Sheet	- 1,513,792	-27,624	1.8%	Yes	Yes	Yes
Reduction in service expenditure	CIES	538,669	-25,395	-4.7%	Yes	Yes	Yes
Change in revaluation of NCA	CIES	- 216,962	103,450	-47.7%	Yes	Yes	Yes

Commentary

- Stage 1 (£46 million) arose from valuers amending for correct site areas, plus a change in land value per hectare.
- Stage 2 (£242 million) was removing the land value aspect of the change as this was not correct to change for methodology (only data changes).
- Further Reclassification of Schools (£86 million) as actual school plans did not support GIA information provided to valuers, plus reclassifications of a small number of assets. Manual adjustments made earlier removed and incorporated into latest valuation.
- These movements include increase of £65.7 million for PPE relating to revaluing academy schools that are not LBTH's at 31/3/18; £67.1 million increase in revaluation reserve; and £1.4 million decrease in CAA. This has been excluded in the above table.
- The CIES adjustments mainly relate to the impact of valuation movements as a result of previous valuation movements. Their impact is then reversed through the Movement in Reserves Statement, such that there is no impact on usable reserves.

Conclusion

All of the adjustments relate to the valuation of school land (either area covered or land value) i.e. prior to 2017/18 and thus would have applied in 2017/18. The scale of the change in valuations is a material adjustment that is referred to in the concluding certificate.

Leaseholder contributions

Extract from LBTH 2018/19 financial statements:

It was identified that billing leaseholders for their share of the costs of major works on housing blocks had fallen behind. This was due in particular to the expanded programme of Decent Homes, and the need to obtain final completion information from contractors. A pro-active exercise of catch-up billing was put in place. However at 31 March 2018, £10.5 million of contributions should have been accrued for, and a further £15.7 million should have been recognised (rather than held as receipt in advance) and these are now adjusted for in the accounts.

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Increase in short-term debtors	Balance Sheet	100,800	10,543	10%	Yes	Yes	Yes
Decrease in capital grants, receipts in advance	Balance Sheet	- 104,772	15,719	-15%	Yes	Yes	Yes
Increase in Capital Grants Unapplied	Balance Sheet	- 92,836	- 26,262	28%	Yes	Yes	Yes
Increase in taxation and non-specific grant income	CIES	- 327,304	- 2,155	1%	Yes	Yes	Yes

Commentary

- Billing leaseholders for their share of the costs of major works on housing blocks had fallen behind. This was due in particular to the expanded programme of Decent Homes, and the need to obtain final completion information from contractors. So, whilst at the time of accounts preparation the amounts may not have been finalised, LBTH should have been able to calculate an estimate of the leaseholder contributions that needed to be accrued for.
- Consequently, at 31 March 2018, £10.5 million of contributions should have been accrued for, and a further £15.7 million should have been recognised (rather than held as receipt in advance).
- The small increase in CIES income is because the works were largely done before 31 March 2016. So main recognition of income would, in effect, have been accounted for prior to 2016/17. However, as not actually billed the balances remain on the Balance Sheet in 2016/17 and 2017/18.

Conclusion

The amounts involved are material and there is a material impact on usable reserves, this is a material adjustment and therefore is referred to in the concluding certificate.

Academy conversions

Extract from LBTH 2018/19 financial statements:

During 2018/19 it was identified that four schools had transferred out of Council control to academy status during 2017/18. The book value of the non-current assets of those schools was £75.9 million at 31 March 2018 prior to the revaluation exercise described in section (a) above. Together with the additional loss of £56.8m described in (a), above, other operating expenditure has been restated to increase in total by £132.7m in relation to this disposal transaction.

NOTE: section (a) refers to Property, Plant and Equipment, referred to on page 7 of this report.

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Decrease in value of schools (other L&B)	Balance Sheet	2,486,991	-75,850	-3.0%	Yes	Yes	Yes
Decrease in revaluation reserve	Balance Sheet	- 665,233	36,775	-5.5%	Yes	Yes	Yes
Decrease in Capital Adjustment Account	Balance Sheet	- 1,513,792	39,075	-2.6%	Yes	Yes	Yes
Increase in other expenditure	CIES	- 11,268	75,850	673%	Yes	Yes	Yes

Commentary

- During 2018/19 it was identified that four schools had transferred out of Council control to academy status during 2017/18 (valued at £75.850m).
- Although not included above, there are a number of school balances (relating to the schools becoming academies) that are also removed from balance sheet. The removal of these balances would: decrease cash; increase the General Fund balance and decrease school reserves. However, the gross reserve movements are not material and the net impact on usable reserves is only 15% of materiality. We have therefore concluded that these movements are not PPAs.

Conclusion

Removal of balances related to the schools that became academies during 2017/18 and therefore should no longer have balances in the balance sheet as at 31 March 2018. Although the balances are relatively small (in relation to the PPE and unusable reserve balance sheet headings) they are up to 4 times the level of materiality. As the amounts involved are material this suggests this is a material adjustment that would need to be referred to in the KPMG concluding certificate.

Community Infrastructure Levy (CIL)

Extract from LBTH 2018/19 financial statements:

It was identified that final details in the planning process were causing delays in the raising of invoices for the Community Infrastructure Levy. Whilst some payments on account for initial instalments had been received, the full debt had not formally been raised in the accounts. The additional income has now been correctly recognised in the balance at the end of 2017/18, increasing debtors by £10.2 million (£9.4 million in 16/17), reducing payments in advance by £1.6 million and increasing CIL Receipts in the Capital Grants Unapplied Reserve by £11.8 million (£9.4 million in 16/17).

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Increase in short-term debtors	Balance Sheet	100,800	10,263	10%	Yes	Yes	Yes
Decrease in short-term creditors	Balance Sheet	- 157,986	1,598	-1%	Yes	Yes	Yes
Increase in Capital Grants Unapplied	Balance Sheet	- 92,836	- 11,861	13%	Yes	Yes	Yes
Increase in taxation and non-specific grant income	CIES	- 327,304	- 2,448	1%	Yes	Yes	Yes

Commentary

- Raising debt not currently in accounts (£10.263m) and adjusting receipts in advance to income (-£1.568m) in respect of the Community Infrastructure Levy.
- The Council was significantly behind on invoicing, even when work had been completed and officers knowing that costs needed to be claimed from developers.

Conclusion

Although not material on its own, not referring to this adjustment would lead to the total value of unadjusted issues that would impact materially on revenue reserves ie the list of unadjusted amendments would have a material impact on usable reserves if this matter relating to CIL were not to be treated as a PPA. As such the CIL adjustment is referred to in the concluding certificate.

KPMG

2016/17 items considered to be PPAs

Property Plant and Equipment Adjustments

Extract from LBTH 2018/19 financial statements:

It was identified that there were errors in the methodology used to produce the valuations for some properties. This required a revaluation of assets, primarily the maintained schools, resulting in increases in valuations of £442.7 million as at 1 April 2017 and £307.8 million at 31 March 2018.

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Increase in valuation of PPE (schools)	Balance sheet	2,486,991	442,700	17.8%	Yes	Yes	Yes
Increase in revaluation reserve	Balance Sheet	- 464,596	-444,124	95.6%	Yes	Yes	Yes
Decrease in Capital Adjustment Account	Balance Sheet	- 1,525,680	1,424	0.1%	Yes	Yes	Yes
Increased surplus on revaluation of PPE	CIES	- 82,645	-6,989	-8.5%	Yes	Yes	Yes

Commentary

- Revised valuations (schools). Done in two stages, Stage 1 arose from valuers amending for correct site areas, plus a change in land value per hectare. Stage 2 was removing the land value aspect of the change as this was not correct to change for methodology (only data changes).
- A further reclassification of schools for GIA, plus reclassifications of a small number of assets. Manual adjustments made in stage 2 removed and incorporated into latest valuation.
- It is difficult to distinguish between depreciation error attributable to error versus amendment attributable to estimation. So the Council decided not to amend the 2016/17 CIES for depreciation.

Conclusion

All of the adjustments relate to the valuation of school land (either area covered or land value) i.e. prior to 2016/17 and thus would have applied in 2016/17. The scale of the change in valuations is a material adjustment that is referred to in the concluding certificate.

Leaseholder contributions

Extract from LBTH 2018/19 financial statements:

It was identified that billing leaseholders for their share of the costs of major works on housing blocks had fallen behind. This was due in particular to the expanded programme of Decent Homes, and the need to obtain final completion information from contractors. A pro-active exercise of catch-up billing was put in place. However at 31 March 2018, £10.5 million of contributions should have been accrued for, and a further £15.7 million should have been recognised (rather than held as receipt in advance) and these are now adjusted for in the accounts.

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Increase in short-term debtors	Balance Sheet	80,487	17,984	22%	Yes	Yes	Yes
Decrease in capital grants, receipts in advance	Balance Sheet	- 83,120	6,123	-7%	Yes	Yes	Yes
Increase in Capital Grants Unapplied	Balance Sheet	- 82,030	- 24,107	29%	Yes	Yes	Yes
Increase in taxation and non-specific grant income	CIES	- 351,174	- 2,615	1%	Yes	Yes	Yes

Commentary

- Billing leaseholders for their share of the costs of major works on housing blocks had fallen behind. This was due in particular to the expanded programme of Decent Homes, and the need to obtain final completion information from contractors. So, whilst at the time of accounts preparation the amounts may not have been finalised, LBTH should have been able to calculate an estimate of the leaseholder contributions that needed to be accrued for.
- Consequently, at 31 March 2017, £18.0 million of contributions should have been accrued for, and a further £6.1 million should have been recognised (rather than held as receipt in advance).
- The small increase in CIES income is because the works were largely done before 31 March 2016. So main recognition of income would, in effect, have been accounted for prior to 2016/17. However, as not actually billed the balances remain on the Balance Sheet in 2016/17 and 2017/18.

Conclusion

The amounts involved are material and there is a material impact on usable reserves, so suggests this is a material adjustment that would need to be referred to in the KPMG concluding certificate.

Community Infrastructure Levy (CIL)

Extract from LBTH 2018/19 financial statements:

It was identified that final details in the planning process were causing delays in the raising of invoices for the Community Infrastructure Levy. Whilst some payments on account for initial instalments had been received, the full debt had not formally been raised in the accounts. The additional income has now been correctly recognised in the balance at the end of 2017/18, increasing debtors by £10.2 million (£9.4 million in 16/17), reducing payments in advance by £1.6 million and increasing CIL Receipts in the Capital Grants Unapplied Reserve by £11.8 million (£9.4 million in 16/17).

Summary	Primary statement affected	Value in primary statement (£000s)	Value of change (£000s)	Percentage change	Approach agreed	Value agreed	Accounting agreed
Increase in short-term debtors	Balance Sheet	80,487	9,411	12%	Yes	Yes	Yes
Increase in Capital Grants Unapplied	Balance Sheet	- 82,030	- 9,411	11%	Yes	Yes	Yes
Increase in taxation and non-specific grant income	CIES	- 351,174	- 2,283	1%	Yes	Yes	Yes

Commentary

- Raising debt not currently in accounts (£9.4m) in respect of the Community Infrastructure Levy.
- The Council was significantly behind on invoicing, even when work had been completed and officers knowing that costs needed to be claimed from developers.

Conclusion

Although not material on its own, not referring to this adjustment would lead to the total value of unadjusted issues that would impact materially on revenue reserves ie the list of unadjusted amendments would have a material impact on usable reserves if this matter relating to CIL were not to be treated as a PPA. As such the CIL adjustment is referred to in the concluding certificate.

Appendices

Appendix 1: Draft certificate 2017/18

See separate document.

Appendix 2: Draft certificate 2016/17

See separate document.