

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF TOWER HAMLETS

Issue of audit opinion on the financial statements

In our audit report for the year ended 31 March 2017 issued on 29 September 2017 we reported that, in our opinion, the financial statements:

- gave a true and fair view of the financial position of the Authority as at 31 March 2017 and of its expenditure and income for the year then ended;
- gave a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2017 and the amount and disposition of the fund's assets and liabilities as at 31 March 2017 other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- had been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.

Matters on which we are required to report by exception

In our audit report for the year ended 31 March 2017 issued on 29 September 2017 we had nothing to report in respect of the matters that we are required to report on by exception.

Issue of value for money conclusion

In our audit report for the year ended 31 March 2017 issued on 29 September 2017 we reported a qualified value for money conclusion in the following terms:

Basis for qualified conclusion

In considering whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources we have reviewed the progress made against the findings of the Best Value Inspection of the London Borough of Tower Hamlets Report (the Report) produced by PricewaterhouseCoopers LLP (PwC) for the Department for Communities and Local Government (DCLG) dated 16 October 2014 and published on 4 November 2014, as well as the evidence gathered from our own audit work.

The DCLG instructed PwC to cover specific matters as part of the Best Value Inspection. The report concluded that the Authority had not achieved the best value duty with regard to the following areas:

- The Authority's payment of grants and connected decisions;
- The disposal of property and the granting of leasehold interests; and
- Spending on publicity.

The Report also commented that the Authority's corporate governance arrangements did not appear to be capable of preventing or responding appropriately to failures of the best value duty in the areas highlighted above. Subsequently the Secretary of State for Communities and Local Government appointed independent Commissioners to undertake an executive decision-making role in relation to all grant decisions, and to oversee the work of the Authority in these areas of operation. The Commissioners played a consultative role in the development of plans to deal with weaknesses in the processes for entering into contracts identified in the report, but were not able to issue binding directions to the Authority except in circumstances where they fail to adopt recommendations of the statutory officers.

These matters, taken together with comments within the Mayoral election judgment (as set out in the High Court of Justice, Queen's Bench Division, in the matter of the Representation of the People

Act 1983, and in the matter of a Mayoral election for the London Borough of Tower Hamlets held on 22 May 2014) and other matters raised with us as auditors, indicated that governance processes were not operating effectively for the periods covered by these inspections and judgments.

The Authority developed and published comprehensive action plans including a programme of cultural change (the "BV Action Plans") to address the findings of the reports detailed above. During the course of 2016/17, the Commissioners provided two progress reports to the Secretary of State on the improvements being delivered at the Council, in September 2016 and February 2017.

In their February 2017 letter to the Secretary of State for Communities and Local Government the Commissioners set out their endorsement of the progress that had been made in all areas of the Direction regime. In particular the Commissioners welcomed the Authority's appreciation not only of what has been done, but also what remains to be done to fulfil the expectations for the Directions. The Authority was clear in its February 2017 submission to the Secretary of State for Communities and Local Government that it would take some twelve months to complete the work required. The Authority has developed this work into a Best Value Improvement Plan ("BV Improvement Plan") under five areas: elections; communications; property; grants; and organisational culture.

In March 2017 the Secretary of State for Communities and Local Government decided to end the 2014 Directions and not to extend the appointment of the Commissioners beyond 31 March 2017 in recognition of the Authority's progress. In light of the remaining work, identified in the BV Improvement Plan, the Secretary of State for Communities and Local Government has made three new Directions, in force until 30 September 2018, which require the Authority to set up a Best Value Improvement Board (with cross party and independent membership); submit quarterly progress reports on the BV Improvement Plan to the Secretary of State for Communities and Local Government; and set up an independent review of achievement of the BV Improvement Plan with a report to the Secretary of State for Communities and Local Government by 1 August 2018.

We have considered the extent to which the Authority's BV Action Plans were implemented during 2016/17. The reports submitted to the Authority's Cabinet meetings in September 2016 and March 2017 clearly show that while progress was meaningful, there remain a significant number of actions that were not completed within 2016/17. Whilst we note the progress made further time is required to fully implement and embed the improvements required under the BV Improvement Plan.

An Ofsted inspection undertaken in January and February 2017, which reported in April 2017, rated the Authority's services for children in need of help and protection, children looked after and care leavers and the local safeguarding children board inadequate overall with some features requiring improvement. The Ofsted report raised concerns in relation to poor frontline practice and ineffective, complacent and sometimes resistant management practices which enabled non-compliance with basic standards (including legal requirements) and in some cases left children at risk of harm. The report also highlighted the need for stronger leadership, management and governance to ensure there is robust performance management and scrutiny of children's social care.

The Authority has established a Children's Services Improvement Board led by an Independent Chair and an Improvement Plan was submitted to the Department for Education in July 2017. Ofsted will be carrying out quarterly monitoring visits to ensure that its recommendations are being robustly addressed.

In October 2015, in relation to our audit for the year ended 31 March 2014, we raised a recommendation under section 11(3) of the Audit Commission Act 1998 that the Authority should undertake a detailed review of its governance processes to satisfy itself that they were appropriate and operating effectively. This reflected our view that the Authority needed to ensure that its governance processes were appropriate in a wider sense for the Authority as a whole and as part of its programme of cultural change and not just the areas referred to in the BV Inspection report. This governance review is being undertaken in conjunction with the other actions currently being undertaken including the programme of cultural change. We are satisfied that the issues referred to have been incorporated into the Authority's BV Implementation Plan relating to organisational culture.

Having considered the findings and conclusions of the above inspections together with the results of our audit work, we have concluded that the Authority did not have proper arrangements in place to meet the requirements of the sub-criteria relating to 'informed decision making' and 'working with partners and other third parties'.

Qualified conclusion

On the basis of our work, having regard to the guidance issued by the Comptroller and Auditor General in November 2016, with the exception of the matters reported in the basis for qualified conclusion paragraph above, we are satisfied that, in all significant respects, London Borough of Tower Hamlets put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

Certificate

In our report dated 29 September 2017, we explained that we could not formally conclude the audit on that date until consideration of a matter brought to our attention by a local authority elector under the Local Audit and Accountability Act 2014 relating to the year ending 31 March 2017 had been duly considered.

In addition, we reported that had not completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack.

We have now completed this work.

Formal recommendation

As part of the work undertaken we have issued a formal recommendation to the Council under Schedule 7 of the Local Audit and Accountability Act 2014:

- We recommend that the Council should commission a detailed independent review of the operation of the Private Finance Initiative (PFI) contracts to satisfy itself that they are appropriate and operating effectively and that the results are reported to a Council public meeting by 30 November 2019. This should include consideration of:
 - health, safety and welfare issues;
 - the day-to-day quality of the PFI contract operation; and
 - actions taken to address the lessons to be learned (set out in the 'Learning the Lessons' paper to Corporate Director of Resources, dated November 2018, relating to the Grouped Schools PFI contract material document).

Restatement of 2016/17 financial statements

The Council has made adjustments to restate figures previously reported in 2017/18 in its 2018/19 financial statements. The Council has further noted that the impact of some of these adjustments would also have impacted the 2016/17 financial statements.

The three that we consider to be material adjustments are explained below. The impact on the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement – Usable Reserves, Balance Sheet, and Cashflow Statement are outlined in the tables that are annexed to this certificate.

- **Property Plant and Equipment Adjustments**
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.
- **Leaseholder contributions**
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. An exercise of catch-up billing was put in place. However, as 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) and these are now adjusted for in the accounts.
- **Community Infrastructure Levy (CIL)**
It was identified that final details in the planning process were causing delays in the raising of invoices for the CIL. 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. For 2016/17 the impact is to increase debtors by £9.4 million and increase CIL Receipts in the Capital Grants Unapplied Reserve by £9.4 million.

No other matters have come to our attention since 29 September 2017 that would have a material impact on the financial statements on which we gave an unqualified opinion, or a significant impact on our qualified value for money conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness and value for money conclusion.

We certify that we have completed the audit of the financial statements of the London Borough of Tower Hamlets in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice.

Andrew Cardoza for and on behalf of KPMG LLP
Statutory Auditor
Chartered Accountants
One Snowhill, Snow Hill Queensway, Birmingham, B4 6GH, UK

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Effect on the Comprehensive Income and Expenditure Statement 2016/17

All values in £'000s	Previously stated 2016/17	PPE revaluations	Leaseholder contributions	CIL	Restated 2016/17
Gross Expenditure					
Children's Services	554,767				554,767
Health, Adults and Communities	168,107				168,107
Place	141,027				141,027
Governance	12,256				12,256
Local Authority Housing (HRA)	64,209				64,209
Resources	294,998				294,998
Corporate Cost and Central Items	14,388				14,388
Total Gross Expenditure	1,249,752	-	-	-	1,249,752
Gross Income					
Children's Services	(439,884)				(439,884)
Health, Adults and Communities	(64,494)				(64,494)
Place	(74,304)				(74,304)
Governance	(2,473)				(2,473)
Local Authority Housing (HRA)	(91,545)				(91,545)
Resources	(275,378)				(275,378)
Corporate Cost and Central Items	(745)				(745)
Total Gross Income	(948,823)	-	-	-	(948,823)
NET COST OF SERVICES	300,929	-	-	-	300,929
Other Operating Expenditure	(38,985)				(38,985)
Financing and Investment Income and Expenditure	26,422				26,422
Taxation and Non-Specific Grant Income	(351,174)		(2,615)	(2,283)	(356,072)
(SURPLUS) OR DEFICIT ON THE PROVISION OF SERVICES	(62,808)	-	(2,615)	(2,283)	(67,706)
Other Comprehensive Income and Expenditure					
(Surplus)/Deficit on revaluation of non-current assets	(82,645)	(6,989)			(89,634)
Actuarial (gains) or losses on pension assets and liabilities	91,986				91,986
OTHER COMPREHENSIVE INCOME AND EXPENDITURE	9,341	(6,989)	-	-	2,352
TOTAL COMPREHENSIVE INCOME AND EXPENDITURE	(53,467)	(6,989)	(2,615)	(2,283)	(65,354)

ANNEX

Effect on the Movement in Reserves Statement 2016/17 – Usable Reserves

All values in £'000s	As previously stated	PPE revaluations	Leaseholder contributions	CIL	Restated
Balance as at 31 March 2016	(409,784)	-	(21,492)	(7,130)	(438,406)
(Surplus) or Deficit on the Provision of Services	(62,808)	-	(2,615)	(2,283)	(67,706)
<u>Reversal of items debited or credited to the Comprehensive I&E</u>					
Charges for depreciation and impairment of non-current assets	(39,199)				(39,199)
Revaluation losses on PPE	11,795				11,795
Capital grants and contributions applied	31,591				31,591
Revenue expenditure funded from capital under statute	(12,674)				(12,674)
Amounts of non-current assets written off on disposal or sale as part of the gain/loss on disposal to the CIES	(37,651)				(37,651)
<u>Inclusion of items not debited or credited to the Comprehensive Income & Expenditure Statement</u>					
Capital expenditure charged against the General Fund and HRA balances	7,600				7,600
All Other Adjustments	32,643				32,643
Total Adjustments between accounting basis and funding basis under regulations	(5,895)	-	-	-	(5,895)
(Increase) or Decrease for year	(68,703)	-	(2,615)	(2,283)	(73,601)
BALANCE AS AT 31 MARCH 2017	(478,487)	-	(24,107)	(9,413)	(512,007)

ANNEX

Effect on the Closing Balance Sheet as at 31 March 2017

All values in £'000s	31 March 2017	PPE revaluations	Leaseholder contributions	CIL	Restated 31 March 2017
Long term assets					
Property, Plant & Equipment	2,275,180	442,700			2,717,880
Heritage assets	9,929				9,929
Total Long-term assets	2,285,109	442,700			2,727,809
Current assets					
Investments	315,517				315,517
Debtors	80,487		17,984	9,411	107,882
Cash and Cash Equivalents	184,299				184,299
Total Current assets	580,303	-	17,984	9,411	607,698
Current liabilities					
Borrowing	(3,533)				(3,533)
Creditors	(154,154)				(154,154)
Provisions	(4,855)				(4,855)
Total Current liabilities	(162,542)	-	-	-	(162,542)
Long Term liabilities					
Provisions	(7,173)				(7,173)
Borrowing	(84,966)				(84,966)
Liability related to defined benefit pension schemes	(619,122)				(619,122)
Capital grants receipts in advance	(83,120)		6,123		(76,997)
Deferred liabilities	(63,871)				(63,871)
Deferred Income - Receipt in Advance	(1,205)				(1,205)
Total Long term liabilities	(859,457)	-	6,123	-	(853,334)
NET ASSETS	1,843,413	442,700	24,107	9,411	2,319,631
Usable Reserves					
General Fund	(31,740)				(31,740)
Housing Revenue Account	(39,079)				(39,079)
Earmarked reserves	(134,619)				(134,619)
Schools reserves	(24,714)				(24,714)
Capital Receipts Reserve	(156,848)				(156,848)
Capital Grants Unapplied	(82,030)		(24,107)	(9,411)	(115,548)
Major Repairs Reserve	(9,459)				(9,459)
Total Usable Reserves	(478,489)	-	(24,107)	(9,411)	(512,007)
Unusable Reserves					
Revaluation Reserve	(464,596)	(444,124)			(908,720)
Capital Adjustment Account	(1,525,680)	1,424			(1,524,256)
Pensions Reserve	619,122				619,122
Other reserves	6,230				6,230
Total Unusable Reserves	(1,364,924)	(442,700)	-	-	(1,807,624)
TOTAL RESERVES	(1,843,413)	(442,700)	(24,107)	(9,411)	(2,319,631)

ANNEX

Effect on the Cash Flow and notes

All values in £'000s	As previously stated 2016/17	PPE revaluations	Leaseholder contributions	CIL	Restated 2016/17
Net surplus or (deficit) on the provision of services	62,808	-	2,615	2,283	67,706
Adjustments to surplus or deficit on the provision of services for noncash movements					
Depreciation	39,199				39,199
Impairment and downward valuations	(11,795)				(11,795)
Adjustments for effective interest rates	2,849				2,849
Increase/(decrease) in creditors	(50,850)				(50,850)
(Increase)/decrease in debtors	16,732				16,732
Movement in pension liability	10,541				10,541
Contributions to/(from) provisions	2,329				2,329
Carrying amount of non-current assets and non-current assets held for sale, sold or derecognised	37,651				37,651
Total adjustments	62,491	-	-	-	62,491
Adjustments for items included in the net surplus or deficit on the provision of services that are investing and financing activities					
Proceeds from the sale of property, plant and equipment, investment property and intangible assets	(12,082)				(12,082)
Any other items for which the cash effects are investing or financing cash flows	(80,133)		(2,615)	(2,283)	(85,031)
Total adjustments	(92,215)	-	(2,615)	(2,283)	(97,113)
Net Cash flows from operating activities	33,084	-	-	-	33,084
Net Cash flows from Investing Activities	(8,570)	-	-	-	(8,570)
Net Cash flows from Financing Activities	(928)	-	-	-	(928)
Net increase or (decrease) in cash and cash equivalents	23,586	-	-	-	23,586
Cash and cash equivalents at the beginning of the reporting period	160,712	-	-	-	160,712
Cash and cash equivalents at the end of the reporting period	184,298	-	-	-	184,298