

# London Borough of Newham 2005/06 Report to those charged with governance



The Audit Board  
London Borough of Newham  
East Ham Town Hall  
London  
E6 2RP

September 2006

Ladies and Gentlemen

**2005/06 Report to those charged with governance**

We are pleased to present our report on the results of our audit work for 2005/06. We hope that the information contained in this report provides a useful source of reference for members.

Yours faithfully

PricewaterhouseCoopers LLP

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**Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies**

*In March 2005 the Audit Commission issued a revised version of the ‘Statement of responsibilities of auditors and of audited bodies’. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.*

# Executive summary

## The purpose of this report

This report summarises the results of our 2005/06 audit of the London Borough of Newham.

It covers the issues arising from our audit of the financial statements and those issues which we are formally required to report to you under the Audit Commission's Code of Audit Practice and International Standard of Auditing (UK & Ireland) (ISA(UK&I)) 260 - "Communication of audit matters with those charged with governance".

It also includes the results of the work we have undertaken under the Code of Audit Practice in forming our opinion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Our work during the year was performed in line with the plan that we presented to you in March 2005. We have issued [or plan to issue] a number of reports during the audit year, detailing the findings from our work and making recommendations for improvement, where appropriate. A list of these reports is included at Appendix A to this letter.

We have set out below the most important issues that have arisen during the course of our work.

## Financial Statements

We have now significantly completed our audit of the Authority's 2005/06 Financial Statements. We have noted several matters that we wish to bring to

your attention including:

- The accounting treatment of Local Space;
- The treatment of the pension deficit attributable to Newham Homes;
- Financial management in the Public Realm and Crime and Anti Social Behaviour services;
- Financial management in the Youth Offending Team and Mental Health cost centres; and,
- The impact of rule changes in the Local Government Pension Scheme.

These matters have been set out in more detail within the Audit of Financial Statements section of this report.

## Use of Resources

Under the new Audit Commission Code of Practice, we are required to give an opinion on the Council's use of resources. This annual assessment evaluates how well the Council manages and uses its financial resources.

[Use of Resources opinion to be inserted here]

This opinion has been arrived at following an assessment of the Authority against a set of criteria issued by the Audit Commission.

This review identified a number of areas of good practice, most notably the regular quarterly performance monitoring process and strategy meetings undertaken personally by the Executive Mayor.

Some areas for development were also identified, particularly around risk management, value for money, and incorporating the Council's joint plans agreed with partners and other stakeholders in the medium-term financial strategy.

The findings from this review have been summarised in the Use of Resources section of this letter.

# Financial statements

## Formal communication of relevant audit matters to those charged with governance (ISA 260 Report)

ISA 260 - "Communication of audit matters to those charged with governance" requires us to communicate relevant matters relating to the audit of the financial statements to those charged with governance of the entity, sufficiently promptly to enable them to take appropriate action. We have agreed with you that these matters should be communicated to the members of the Audit Board through this letter.

ISA 260 specifically requires us to communicate the following matters to those charged with governance:

- Expected modifications to the auditors' report;
- Unadjusted misstatements;
- Material weaknesses in the accounting and internal control systems identified during the audit;
- Views about the qualitative aspects of the entity's accounting practices and financial reporting;
- Matters specifically required by other auditing standards to be communicated to those charged with governance; and
- Any other relevant matters relating to the audit.

The table below details how each of these requirements have been met and where they are reported in this letter.

ISA 260 Requirement	Where Reported
Expected modifications to the auditors' report	None
Unadjusted misstatements	Appendix B
Material weaknesses in the accounting and internal control systems identified during the audit	Accounting practices section
Views about the qualitative aspects of the entity's accounting practices and financial reporting	Accounting practices section
Matters specifically required by other ISAs (UK and Ireland) to be communicated to those charged with governance	None
Any other relevant matters relating to the audit.	None

ISA 260 also requires us to communicate with those charged with governance regarding:

- The concept of materiality and its connection to our audit approach;
- Our approach in addressing the risk of material misstatement;
- Our approach to the assessment of, and reliance on, internal controls;

- Intended reliance on the work of internal audit;
- The work to be undertaken by any other firms of auditors, and how we will obtain assurance over the procedures of other auditors; and
- The independence and objectivity of the audit team.

These matters have already been communicated to you in the audit service plan and we have no changes to report to you. In particular we remain independent within the requirements of ethical and auditing standards.

### **Audit opinion**

[As of 1 September 2006 the audit has not been completed. The audit opinion will be inserted here upon completion of the audit].

### **Unadjusted misstatements**

[Confirmation of any unadjusted misstatements for us to bring to the attention of members to be inserted here. As of 1 September 2006 there are no issues to bring to your attention].

We set out in Appendix B to this report those misstatements which have been corrected by management but which we consider you should be aware of in fulfilling your governance responsibilities [this section to be populated following completion of the audit. As of 1 September 2006 there are no issues to bring to your attention].

### **Accounting practices**

We are also required to report to you our view on qualitative aspects of the Authority's accounting practices and financial reporting and have set out below our observations on key issues affecting the Council.

Although we identified no material weaknesses in the accounting and internal control systems during the audit, we report the most significant audit issues in this section of the report.

### **Local Space**

The Statement of Recommended Practice (SORP) 2005/06 requires, for the first time, that Councils consolidate entities over which they exert control into their Statement of Accounts.

In February 2006 the Council set up Local Space Limited, a Charitable Registered Social Landlord, incorporated under the Industrial & Providential Society Act 1985. As part of our audit we have considered whether Local Space Ltd should be consolidated into the Council's Statement of Accounts.

We have concluded that as Local Space Limited has charitable status this is sufficient to take it outside the scope of group accounts, because the existence of objects with wholly charitable purposes theoretically remove the opportunity for another party to claim to control or influence the company. There is no other evidence that the Council has powers to exert dominant influence over Local Space Limited.

### **Newham Homes – pension liability**

The Council transferred its Housing Management functions to an arms length management organisation (ALMO) called Newham Homes on 1 December 2005. The Council has been considering how to treat the pension liability relating to those staff that transferred from the Council to the ALMO.

Under Financial Reporting Standard 17: Retirement Benefits (FRS17), an actuary should be engaged to calculate the pension liability payable to employees in future years. Any shortfall in funding is recorded in the balance sheet as a pension liability. As at 1 December 2005, the pension liability relating those staff that transferred from the Council to the ALMO was £19.0m.

[To be updated with the final agreed position between the Council, the ALMO and PwC. PwC will talk to this item at the Audit Board].

### **Financial management in the Public Realm service**

During the course of the audit we have noted several issues concerning financial management in the Public Realm service.

- The service incurred an overspend of £1.4m in 2005/06, although management were aware of the overspend at an early stage in the year. The majority of this was due to an overspend on Street Cleansing;
- Changes in the structure of the service and a lack of permanent staff have hindered effective budget management during the year; and,
- We noted that a significant number of journals, which are supported by poor audit trails, had been raised by the service, rather than using regular transaction posting mechanisms. Such practices create a higher risk of error or misstatement.

#### **Financial management in the Crime and Anti-Social Behaviour service**

During the course of the audit we have noted several issues concerning financial management in the Crime and Anti-Social Behaviour service. We recognise that these issues constitute a 'backward-look' and that financial management in the service is improving.

- The service incurred an overspend of £1.4m in 2005/06. This was largely due to an overspend on the CCTV control room of £1.2m and budget setting weaknesses after the service was disaggregated from the Environment directorate;
- Following an investigation led by an independent external investigator into procurement practices in the service, five members of the management team left the Council; and,
- As a consequence of these departures there was a significant knowledge gap in the service; the new Crime and Anti-Social Behaviour management team tasked with improving resource management have therefore had the challenge of understanding precisely what the issues were in the service before they have been able to address them.

If not addressed, the issues in the Public Realm and Crime and Anti-Social Behaviour services could limit the Council's ability to understand its financial position as a corporate body, and could potentially deny it the opportunity to focus resources on corporate priorities as effectively as they could be.

Management are aware of these issues, significant resources have been mobilised to help address them and action plans are in place to improve financial management in these services in 2006/07. We will continue to monitor progress against these action plans as part of the interim work for our audit of the 2006/07 Statement of Accounts in January – March 2007.

#### **Financial management – Mental Health and Youth Offending Team cost centres**

Whilst financial management in Social Services has improved significantly in recent years, we draw to your attention two areas where the Council has incurred significant overspends in 2005/06.

In Adult Services, the Mental Health budget is run on the Council's behalf by the Mental Health Trust (MHT). There is a Section 31 agreement between the organisations that states that all significant cost variations have to be agreed by both the Council and the MHT. In 2005/06 the Mental Health Care Packages and Placements cost centre overspent by £1.5m as a result of a breakdown of management and monitoring procedures in the MHT. The overspend was not authorised by the Council.

Following the departure of the original Assistant Director for Mental Health, the MHT deferred the appointment of a replacement. During this period, the costs of residential placements rose as managers in the service initiated mental health contracts without appropriate review by senior management as there was no panel in place to review decisions against the Council's criteria.

Following the appointment of a new Assistant Director at the MHT, a management action plan has been introduced for 2006/07 focusing on reducing the costs of mental health placements. In the Mayor's budget strategy for 2006/07 this service benefited from £0.7m additional resources to ease service pressures. Early indications in 2006/07 are that there may be a further unauthorised overspend of between £300k and £400k.

We understand that the Council has informed the MHT that this is unacceptable, that there is no authority to overspend and they must return to equilibrium in 2006/07. In the interim, all delegated authorisation for expenditure within MHT teams has been removed and new expenditure is restricted to emergency items. The Council and the MHT have agreed to

meet in September 2006 to review forecast expenditure. We will monitor progress against this action plan as part of the interim work for our audit of the 2006/07 Statement of Accounts in January – March 2007.

In Children's Services, the Youth Offending Team (YOT) cost centres have overspent by £1.0m in 2005/06, largely due to agency staff costs. YOT management were made aware from budgetary control reports of indications of an overspend early in the financial year. The scale of the overspend only became apparent after the end of the year.

Management's action plan for 2006/07 includes centralising control of the YOT cost centres. Regular meetings are taking place between YOT management and Finance officers to ensure that the action plan is within budget. We will monitor progress against this action plan as part of the interim work for our audit of the 2006/07 Statement of Accounts in January – March 2007.

Despite these overspends, the overall position for Social Services in 2005/06 was an underspend of £0.4m.

#### ***Commutation of retirement benefits***

Changes to the Local Government Pension Scheme from 1 April 2006 mean that Officers who retire can opt to increase their lump sum retirement grant by reducing their annual pension entitlement. The change has been set deliberately with the intention that it will benefit the pension scheme. Thus, if a retiree takes up the option, the overall value of their retirement benefits is projected to fall. Taking up the option would therefore give the Council a pension gain and reduce the pension liability on the balance sheet.

Councils should engage their actuaries to consider the quantity and quality of evidence that would allow them to make a reliable estimate and to give a view as to whether such information is likely to be available before the publication date of the accounts.

The Council has obtained a confirmation from its actuary that at this point in time there is not enough evidence for the actuary to form an opinion as to the impact of the rule change to the pension liability. No adjustments have been made to the accounts.

#### ***Internal Audit***

We have maintained a good working relationship with the Council's internal audit service during 2005/06.

As part of our wider assessment of the Council's control environment we are required to review the internal audit arrangements. We have reviewed the 2005/06 Internal Audit plan and, where applicable to our audit approach, individual audit reports.

Internal Audit have undertaken the flowcharting of the accounts payable systems at the Council. ISAs require that external auditors flowchart all complex material systems, and we intend to rely on the work completed by Internal Audit in this respect.

This work is nearly complete and will inform our 2006/07 audit approach.

#### ***Standards of Financial Conduct and the Prevention and Detection of Fraud and Corruption***

[To be updated following testing of fraud cases in the Housing and Council Tax Benefit claim. A verbal update will be given at the Audit Board.]

#### ***Legality of Financial Transactions and Elector's Questions***

We have in the period received several Elector's Questions, whose content we summarise below.

#### ***Housing service investigation***

We have been presented with a number of questions regarding procurement practices within the Council's Housing service. These are currently the subject of an investigation, and until such time that the outcome of the investigation is finalised, we are unable to comment further.

#### ***Queen's Market***

We are liaising with Officers to determine the legality of the transactions relating to the Queen's Market redevelopment, following a question from an elector on this issue. [To be updated following completion of work in this area].

### **Newham Magazine**

We have received a question on the content Mayor's Annual Report in the Newham Magazine, which is now the subject of legal action, until such time that the outcome of that action is finalised, we are unable to comment further.

### **Canning Town regeneration scheme**

We received a question on the Canning Town regeneration scheme. This issue has been resolved satisfactorily, and at this point in time there are no matters that require to be reported to Members.

# Use of Resources

## Work performed

Under the new Audit Commission Code of Practice, we are required to give an opinion on the Council's use of resources. This annual assessment evaluates how well the Council manages and uses its financial resources. It focuses on the importance of having sound and strategic financial management to ensure that resources are available to support the council's priorities and improve services. The questions on which the judgments are based are broad and strategic in their nature and reflect the impact of financial arrangements as well as the adequacy of those arrangements. It has five themes covering:

- Use of Resources assessment for CPA:
  - Financial Reporting
  - Financial Management
  - Financial Standing
  - Internal Control
  - Value for Money
- Mandatory Data Quality Review work
- Review of the Statement on Internal control

- Audit of the Best Value Performance Plan

## Use of Resources Conclusion

In reaching our conclusions, we will be building on the work undertaken in the previous year as well as our cumulative audit knowledge of the Council. Our understanding is informed further by the Council's own self assessments, which are used as the basis for detailed interviews with senior officers and members.

Last year, the Council's scores were as follows:

Element	Assessment
Financial reporting	2 out of 4
Financial management	3 out of 4
Financial standing	4 out of 4
Internal control	2 out of 4
Value for money	3 out of 4
<b>Overall</b>	<b>3 out of 4</b>

Under the Audit Commission's definition a score of 3 represents a council that is consistently above the minimum requirements and performing well.

This year there is an increased focus on the extent to which the elements of each theme, as set out in the Audit Commission's Key Lines of Enquiry

document are embedded and operating effectively. We have already received the Council's self assessments and have undertaken some of the interviews with officers and members. We are still in the course of gathering our evidence and at this stage, are not in a position to provide members with an interim judgment.

In recognition of the earlier deadline for issuing an opinion on the financial statements, the deadline set by the Audit Commission for completing the fieldwork at London Boroughs has been extended to 23 October (previously 30 September). We will report our opinions and any significant matters arising at that time. These will be set out in a report to the Executive Director of Resources, as well as being summarised in the Audit Memorandum produced by the Audit Commission – both of which will be presented to the Audit Board later in the year.

### **Data Quality work**

We undertook a review of data quality management arrangements in accordance with the audit guide published by the Audit Commission in June 2006. The review assessed the Council's arrangements for securing data quality in 5 areas: Leadership and Governance, Policies and Procedures, Systems and Processes, People & Skills and Data Use.

Our review concluded that the council's arrangements meet at least minimum requirements (level 2 or above) against all of the key lines of enquiry (KLOEs) and are particularly strong (level 4) on Data Use. Our key recommendations relate to the need for the Council to make more explicit its strategic commitment and objectives for data quality and to formalise existing data quality procedures and processes. These should inform a data quality policy which is disseminated to staff across the organisation.

Our final overall score for data quality will be confirmed following satisfactory completion of stage 3 (spot checks) on a sample of selected performance indicators. Stage 3 is due to be completed in early September 2006.

### **Statement on Internal Control**

The Accounts and Audit Regulations 2003 include a requirement that the statement of accounts prepared by a local authority in England should contain a Statement on Internal Control (SIC). This statement refers to the full range of internal controls, rather than being limited to financial controls. It requires the Council to conduct an annual review of the effectiveness of the

system of internal control, which provides the evidence to support the SIC.

The SIC discloses whether the Authority has had risk management and review processes in place for the whole of the period 1 April 2005 to the date on which the accounts are signed.

We reviewed the SIC to consider whether it complied with the CIPFA guidance and whether it is misleading or inconsistent with other information known to us from our audit work. [To be updated following discussion of PwC comments on the SIC]

### **Best Value Performance Plan**

Our work on the 2005/06 Best Value Performance Plan (BVPP), issued by the Authority in June 2005, resulted in an unqualified opinion. Our audit of the 2004/05 Best Value Performance Indicators (BVPIs) published within the BVPP amended only one indicator (BV183a) but placed no reservations on any of the BVPIs.

We did, however, place a reservation on one of the CPA indicators selected for audit by the Audit Commission (Public Library Service Standards on stock PLS5). Our audit report on the BVPP was issued in December 2005. Our work on the 2006/07 BVPP forms part of our 2006/07 audit work.

# Audit fee update

## Audit fees update for 2005/06

We reported our fee proposals as part of the Audit Plan for 2005/06.

We varied our fees because of the introduction of audit requirements for the 'Whole of Government Accounts' (WGA) and International Standards on Auditing (ISAs).

Our fees charged were:

	2005/06 Fee proposal	2005/06 Fee outturn
Accounts	£270,000	£285,000*
Use of Resources	£110,000	£110,000
<b>Total</b>	<b>£380,000</b>	<b>£395,000</b>

\* The extra fee of £15,000 is dependent on the Council producing adequate working papers for us to complete our audit obligations with regard to the Whole of Government Accounts, which we estimate will cost £4,000, and the introduction of ISAs, which have significantly increased the amount of audit

work we have undertaken during 2005-06 and we estimate will cost £11,000.

The total fee of £285,000 is subject to the successful completion of the financial statements audit and the assumptions set out in the 2005/06 Joint Audit and Inspection Plan still being met.

The outturn fees for 2004/05 were £270,000 (Accounts) and £93,000 (Use of Resources).

# Appendix A: Audit reports issued in relation to the 2005/06 audit year

Report title	Date issued/ to be issued
Audit Plan	<i>July 2005</i>
Report on the Best Value Performance Plan	<i>December 2005</i>
Report on the 2005/06 financial statements to those charged with governance (ISA 260)	<i>September 2006</i>
Use of Resources opinion and report	<i>October 2006</i>
Internal Control Report	<i>October 2006</i>

# Appendix B: Summary of unadjusted misstatements

At the time of drafting this report we have not identified any errors during our audit of the financial statements that have not been adjusted by management.

[To be updated following completion of our audit work]

# Appendix C: Use of Resources conclusion

The Audit Commission has published 12 Code of Practice criteria on which auditors will be required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its Use of Resources.

In forming a conclusion in respect of Code Criteria 1-3, we have taken into account the most recent corporate assessment. In forming a conclusion in respect of Code Criteria 4, we have taken into account work undertaken on the 2005-06 BVPP and BVPIs. In addition, any other work on data quality, including work on the 2006-07 BVPP and BVPIs undertaken prior to the finalisation of the UoR Conclusion has been taken into account when forming the Use of Resources Conclusion. In forming a conclusion in respect of Code Criteria 5-12, we have taken into account the work we undertook in August – October 2005 using the Audit Commission's Key Lines of Enquiry (KLoEs), which is summarised in the Use of Resources section of this report. A score of Level 2 or higher under the KLoEs will result in an assessment of adequate for the purposes of the Code criteria. The Code criteria and the linked KLoEs are shown in the table below:

Code Criteria	Description	Associated KLoE	CPA Score	Use of Resources Conclusion
1	The body has put in place arrangements for setting, reviewing and implementing its strategic and operational objectives.	N/A	N/A	Adequate/ Inadequate
2	The body has put in place channels of communication with service users and other stakeholders including partners, and there are monitoring arrangements to ensure that key messages about services are taken into account.	N/A	N/A	
3	The body has put in place arrangements for monitoring and scrutiny of performance, to identify potential variances against strategic objectives, standards and targets, for taking action where necessary, and reporting to members.	N/A	N/A	
4	The body has put in place arrangements to monitor the quality of its published performance information, and to report the results to members.	LG DQ KLoEs		

Code Criteria	Description	Associated KLoE	CPA Score	Use of Resources Conclusion
5	The body has put in place arrangements to maintain a sound system of internal control	4.2		
6	The body has put in place arrangements to manage its significant business risks.	4.1		
7	The body has put in place arrangements to manage and improve value for money.	5.2		
8	The body has put in place a medium-term financial strategy, budgets and a capital programme that are soundly based and designed to deliver its strategic priorities.	2.1		
9	The body has put in place arrangements to ensure that its spending matches its available resources.	3.1		
10	The body has put in place arrangements for managing performance against budgets.	2.2		
11	The body has put in place arrangements for the management of its asset base.	2.3		
12	The body has put in place arrangements that are designed to promote and ensure probity and propriety in the conduct of its business.	4.3		

[To be completed after we have concluded our Use of Resources work]

# Appendix D: Summary of recommendations

Page	Recommendation	Management Response	Target Implementation Date

[This section will be completed following the conclusion of our Use of Resources work]

*In the event that, pursuant to a request which the London Borough of Newham has received under the Freedom of Information Act 2000, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. The London Borough of Newham agrees to pay due regard to any representations which PwC may make in connection with such disclosure and the London Borough of Newham shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, the London Borough of Newham discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.*

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