

London Borough of Newham

2006/07 Report to those charged with governance



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Ladies and Gentlemen

2006/07 Report to those charged with governance

We are pleased to present the final version of our report on the results of our audit work for 2006/07. 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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Contents

| Section | Page |
|---|------|
| Executive summary | 4 |
| Financial statements..... | 6 |
| Use of Resources | 11 |
| Audit plans and fee update..... | 13 |
| Appendix A: Audit reports issued in relation to the 2006/07 audit year | 14 |
| Appendix B: Use of Resources conclusion | 15 |
| Appendix C: Summary of unadjusted misstatements (and material adjusted misstatements) | 18 |

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 audit work from our 2006/07 audit of accounts.

It includes 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 on 'Use of Resources' under the Code of Audit Practice, to support our formal conclusion in this area.

Our work during the year was performed in line with the plan that we presented to you in 2006. We have issued 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 and recommendations that we have discussed with you in the course of our work.

Financial Statements

We have now completed our audit of the Council's 2006/07 Financial Statements and we have issued an unqualified opinion upon those. We have

noted several matters that we wish to bring to your attention including:

- The impact of Single Status on the General Fund balance;
- The treatment of the pension deficit attributable to Newham Homes;
- Fixed asset disposals; and
- Financial management in Adults' Services.

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.

We intend to issue an unqualified Use of Resources in relation to the 2006/07 year.

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

This review identified a number of areas of good practice, most notably the Mayor's performance and finance meetings, together with the rigour of the Council's framework for cost effectiveness, and the audit packs prepared by

each service to support the accounts audit.

Some areas for development were also identified, particularly around embedding risk management in corporate business processes, and the need to reinforce compliance with competitive tendering legislation. We also noted that governance arrangements need to be strengthened in situations where procurement is effected through partnership and other relatively novel working arrangements.

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

Financial statements

Accounts

The Council provided a set of accounts, completed to a good standard, to us in accordance with our agreed timetable.

Our audit of the Council's accounts is substantially completed; however, there are a small number of outstanding issues that need to be resolved before we can give our opinion on the financial statements. These issues relate to the resolution of the accounting treatment of the pension deficit attributable to officers that transferred to Newham Homes, the impact of Single Status provisions on the General Fund balance, completion of our audit work in Adults' Services, and the review of the final version of the consolidated accounts.

Accounting Issues

We are required to report to you our view on qualitative aspects of the Council's accounting practices and financial reporting and in that regard 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.

We also bring to your attention the misstatement set out in Appendix C to this report which has been not been corrected by management which we consider you should be aware of in fulfilling your governance responsibilities, together with any adjusted misstatements we consider significant enough to

bring to your attention.

The impact of making a provision for "Single Status" on the General Fund balance

Single Status is the requirement to ensure that local government employees are paid the same for doing the same work or doing comparable jobs and that work of equal value is rewarded equally. The financial implications of Single Status are that authorities will carry out a Local Pay Review to remove discrimination from pay and gradings.

Single Status is a particular issue for 2006/07 audits as a national agreement required Councils to have completed and implemented their Local Pay Review by 31 March 2007. Councils agreed to carry out job evaluation and grading across all jobs to assess how much pay different jobs should attract. Job evaluation involved assessing the skills and responsibilities required to perform particular jobs and then matching these to a scale used consistently across the authority. The Council completed its Local Pay Review by 31 March 2007.

In the accounts presented to the Investment Committee for approval on 29 June 2007, the Council had not included any entries in relation to Single Status. Management made a best estimate of the liability in relation to equal pay claims and the final draft of the accounts was updated accordingly.

This liability has been charged to the Net Cost of Services, but there was no impact on General Fund Balances at 31 March 2007. The Council has adhered to technical guidance from CIPFA and created an Equal Pay

Reserve to reflect the estimated future liability of £18.5m. Charges will be made to the General Fund Balance in future years when payments are actually made to employees. Management anticipate that the majority of the payments will be made in 2007/08.

FRS17 and the Newham Homes Pension Liability

Financial Reporting Standard 17: Retirement Benefits (FRS17) requires that Councils record a pension liability in their accounts to reflect their commitment to pay pensions to retired employees in future years. A matching pension reserve ensures that there is no impact on the Net Worth of the Council. Similarly, charges to the Income & Expenditure account required by FRS17 are reversed out in the Statement of Movement on the General Fund Balance to ensure there is no impact on Council taxpayers. These accounting regulations can only be applied to the period of tenure of officers who were, or who currently are, directly employed by the Council.

The Council transferred its Housing Management functions to the Arms Length Management Organisation (ALMO), called Newham Homes, on 1 December 2005. As at 31 March 2006, the pension liability relating those staff that transferred from the Council to the ALMO was £19.0m.

It was determined for the Council's and ALMO's 2005/06 accounts that the ALMO would record this liability in its accounts as a pension liability, with a matching long term debtor due from the Council. The Council recorded a pension liability in its accounts, matched by an equal entry to the Pension Reserve. This treatment has also been adopted for the Council's 2006/07 accounts, wherein the estimated pension liability relating to those staff that transferred from the Council to the ALMO has reduced to £14.0m.

The Council instructed the actuary to calculate a more accurate assessment of the actuarial liability relating to staff that transferred to the ALMO, as between pre and post transfer. The actuary calculated that a surplus of £725k arose post transfer.

There is currently limited prescription as to how any post transfer liability should be accounted for as between the Council and the ALMO. To the extent that this surplus relates to an appreciation in value of investments in the scheme, it follows that this would be attributable to the Council. To the

extent that it relates to employer contributions in excess of the amounts required, the surplus would be attributable to the ALMO.

Newham Homes is currently discussing with its auditors a methodology for calculating the post transfer surplus that is attributable to the ALMO. As the amount has not yet been quantified, we are unable to specify the unadjusted misstatement in the Council's accounts. We do not believe that the adjustment, if any, would be material to the Council and would not impact on the General Fund balance.

Fixed Asset Disposals

We noted that two assets with a combined sale price of £950k were disposed of during 2006/07. These assets had not been recorded on the Council's fixed asset register in the first instance.

Furthermore, we also noted that two assets that had been disposed of in 2002/03, with a combined value of £360k, were only accounted for as disposals in the 2006/07 accounts.

We understand that there may be other items similarly recorded in fixed assets that have been disposed of previously, although the net financial impact on the Council is unlikely to be material since the asset values are only recorded in the Gross Book Value and Accumulated Depreciation lines in Note 19 to the accounts.

We recommend that as part of the anticipated changes to the SORP in 2007/08 a review should be undertaken of the Council's fixed assets to ensure that the fixed asset register and accounting records are complete and accurate.

Management have explained that the Council's Corporate Land Registration Project, carried out in conjunction with the Land Registry, will enable the Council to voluntarily register all its land ownership ahead of official registration in 2012. The project is being managed on a phased basis and should identify any sites not currently included in the Council's asset register. Once identified, additional sites will be valued by Property Services and included within the asset register. The project will also enable comparison of data to identify whether any assets currently included on the Corporate asset

register are no longer in the Council's ownership.

Financial management – Adults Services

In 2006/07 Adults Services incurred an overspend of £1.1m. This was largely caused by invoices amounting to £1.3m received during 2006/07 that related to services received in 2005/06 but not accrued. The Carefirst system, which records cases dealt with by Adults Services, had not been appropriately updated during the year by case officers, which meant that finance officers had incomplete information with which to estimate year-end accruals.

In 2007/08 management has implemented a new performance management system to ensure that care assessments are input onto Carefirst within 48 hours of an assessment being performed. Furthermore, care packages are not supposed to be authorised until Carefirst has been appropriately updated. A review of the Adults' contracts team is to be undertaken. Reporting mechanisms are now in place to log disputed invoices encountered by the invoicing team.

Systems of internal control

We are required to report to you any material weaknesses in the accounting and internal control systems identified during the audit. We have not identified any material weaknesses.

As part of our interim audit, our IT auditors performed an assessment of the general IT controls in place at the Council. Whilst very few new issues have been noted this year, and none of which were deemed high risk, little progress has been made in addressing the issues raised last year.

We have also set out below details of the more significant control weaknesses that we have identified as part of our audit.

Network user access weaknesses

There are three issues relating to access to the Council's computer network. Collectively, we deem these to be significant:

- There is no authorised list of personnel that can approve the set up of new users on the Council network. Online request forms are

accessible by all Council Officers. Support Centre Officers set up new user accounts based on the information submitted.

- There are no checks to ensure that users' access is changed when their roles and responsibilities change. Services are expected to inform the System Support team of any transfers.
- Checks for inactive user accounts are only performed intermittently. In addition, a leaver's form is not always completed to support the removal of user access rights.

Without a set of clearly defined and documented user administration procedures there is a risk that users will be granted an inappropriate level of access to the Council's systems, or that their access may not be adequately removed when they leave the Council, which could lead to financial loss.

Management have plans in place to address these issues in September 2007.

Disaster Recovery and Business Continuity

During our review of prior year recommendations raised by our IT auditors, we noted that there is still no comprehensive, documented disaster recovery plan to ensure the effective restoration of all computer systems in the event of an emergency situation. Without an adequately documented and tested Disaster Recovery and Business Continuity Plan the council may not be able to sufficiently recover from a disaster in a timely manner.

We recommend that a comprehensive disaster recovery plan be developed to help ensure that the computer systems can be effectively restored in the event of an emergency. The plan should encompass the main computer systems that are used to process key transactions, and any other systems that are critical to the operation of the Council.

Management have reported to us that a comprehensive disaster recovery plan is now in place along with an "interim" external disaster recovery contract through an external supplier. We will assess the adequacy of these arrangements as part of our interim audit for the 2007/08 accounts.

Interface between the MIS2 system and the general ledger

During the course of our audit we noted that whilst there is a central reconciliation between the MIS2 debtors system and the general ledger, two issues arose relating to the interface between the MIS2 debtors system and

the general ledger.

- There is an imbalance between MIS2 and the general ledger relating to overpayments of Housing Benefits. The balance is £5.5m on MIS2, compared to £7.0m on the general ledger.
- There had been no reconciliation between the MIS2 ledger for right-to-buy leaseholder debtors and the general ledger. The balance on MIS2 is £151k higher than the general ledger. We also noted that the debtors comprise balances in excess of 5 years old, with no indication that these balances are still recoverable.

Whilst we were satisfied in both of these instances that the Council's bad debt provision adequately covers these debts, we recommend that management ensure that these differences are resolved promptly.

Contracts register

International Standards on Auditing (ISA) require us, as external auditors, to review all significant contracts the Council has entered into and consider if there are any implications for our audit work. We noted that as at February 2007 there was insufficient centralised information to assess the entire scope of the Council's existing contracts, information is fragmented and the Council has an ongoing project to ensure that records of significant contracts are complete and available centrally. This project is being led by Strategic Procurement.

Whilst we have been able to address the ISA requirements by reviewing Cabinet minutes to identify significant contracts, we recommend that the Council should ensure that its project to identify all significant contracts is completed, and that arrangements to keep the register up to date are fully embedded.

For both audit purposes and to ensure effective contract monitoring by the Council, we recommend that the Council should ensure that its project to identify all significant contracts is completed, and that arrangements to keep the register up to date are fully embedded.

Accounting practices - Changes to the treatment of enhancement

expenditure in the 2007/08 SORP

The 2007/08 SORP will include formal clarification of the treatment of enhancement expenditure.

In 2006/07 the Council included £42.9m of enhancement expenditure on Council Dwellings in its accounts that was then written off the Fixed Asset Restatement Account, on the basis that the value of the enhanced asset has not increased by the amount of the expenditure.

The 2007/08 SORP will clarify that enhancement expenditure should be added to the value of the relevant fixed asset and only written off to the extent that there is evidence that an impairment review might be needed and that review results in a devaluation of the asset.

Whilst we do not propose any adjustments to the 2006/07 accounts, the Council should prepare to make the required accounting entries in its 2007/08 accounts.

Internal Audit

We have maintained a good working relationship with the Council's internal audit service during 2006/07.

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 2006/07 Internal Audit plan and, where applicable to our audit approach, individual audit reports.

Internal Audit have undertaken a follow up of their previous work in the payroll function, ensuring that the processes and controls flowcharted in 2005 are still in place and are operating effectively.

No significant issues were noted and this work informed our 2006/07 audit approach.

Other matters

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

Canning Town PFI

We have been presented with two questions relating to the Council's proposals regarding the Canning Town PFI. These questions have been resolved satisfactorily, and there are no issues we need to raise with Members.

Resolution of 2005/06 Question - Queen's Road Market

During the period we responded to the questions that an elector had raised during 2005/06 regarding the legality of the Council's plans in relation to the Queen's Road Market redevelopment. We concluded that the Council had acted appropriately, in accordance with legal requirements.

Use of Resources

Work performed

In accordance with the Code of Audit Practice, we have performed work to conclude on the Council's arrangements for achieving economy, efficiency and effectiveness in its use of resources. Our work to support our conclusion comprised the following elements:

- 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 2006/07

Under the Code of Audit Practice we are required to provide a conclusion on

the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. This conclusion is reached by assessing the Council's arrangements against a set of criteria issued by the Audit Commission. Our conclusion is based on the use of resources assessment undertaken in September 2006 as part of the CPA process and updated as necessary, our Local Government data quality work, and other information that came to our attention during the course of our audit work.

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

| Element | Assessment |
|----------------------|-------------------|
| Financial reporting | 4 out of 4 |
| Financial management | 3 out of 4 |
| Financial standing | 4 out of 4 |
| Internal control | 3 out of 4 |
| Value for money | 3 out of 4 |
| Overall | 4 out of 4 |

Pending our work to confirm that arrangements have not deteriorated since 31 March 2007, we intend to issue an unqualified use of resources conclusion in the 2006/07 accounts.

Details of our conclusion for each of the criteria specified by the Code of Practice are set out in Appendix B.

Use of Resources Conclusion 2007/08

We have already received the Council's self assessments for 2007 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.

We remind members that our conclusion on the Financial Reporting element of the 2007/08 Use of Resources assessment will relate to the audit work we are currently undertaking on the 2006/07 accounts.

We will report our opinions and any significant matters arising to the December Audit Board. These will also be set out in a report to the Executive Director of Resources, as well as being summarised in the Audit Letter produced by the Audit Commission – both of which will be presented to the Audit Board later in the year.

Data Quality work

Last year we completed a review of data quality across the Council and awarded an overall score of 3 - performing well, against the Audit Commission's Key Lines of Enquiry for management arrangements. We also found that all the performance indicators tested were fairly stated.

The timescale for the data quality review has been extended this year and work is currently underway on the assessment of management arrangements. A self assessment and supporting evidence has been provided and follow up work is ongoing. We will be considering the progress that has been made on the recommendations we made last year, along with key improvements to Council systems against a set of slightly amended Key Lines of Enquiry. Data testing is scheduled to start at the beginning of September. We have selected a set of performance indicators to be tested from the revised list provided by the Audit Commission.

We will be producing a separate report to set out the findings of our data quality review which will be completed in the autumn.

Statement on Internal Control

Local Authorities are required to produce a Statement on Internal Control (SIC) which is consistent with guidance issued by CIPFA / SOLACE. The

SIC was included in the financial statements.

We reviewed the SIC to consider whether it complied with the CIPFA / SOLACE guidance and whether it is misleading or inconsistent with other information known to us from our audit work. We found no areas of concern to report in this context.

Best Value Performance Plan

Our work on the 2006/07 Best Value Performance Plan (BVPP), issued by the Council in 2006, resulted in an unqualified opinion. Our audit report on the BVPP was issued in December 2006.

Our audit of the 2005/06 Best Value Performance Indicators (BVPIs) published within the BVPP amended three indicators out of nine tested, but placed no reservations on any of the BVPIs.

Our work on the 2007/08 BVPP forms part of our 2007/08 audit work.

Audit plans and fee update

Audit Plan 2006/07

We issued our Audit Plan for 2006/07 and presented it to Members in 2006.

We have performed appropriate reporting procedures for each of the risks identified in our Audit Plan of 2006/07. In this report we comment only on those areas where we believe we need to communicate with those charged with governance.

Audit fees update for 2006/07

We reported our fee proposals as part of the Audit Plan for 2006/07.

Our actual fees were in line with our proposals.

Our fees charged were:

| | 2006/07 Outturn | 2006/07 Fee proposal |
|------------------|-----------------|----------------------|
| Accounts | £300,000 | £300,000 |
| Use of Resources | £130,000 | £130,000 |
| Total | £430,000 | £430,000 |

The total fee of £430,000 is subject to the successful completion of the financial statements audit and the assumptions set out in the 2006/07 Joint Audit and Inspection Plan still being met.

The outturn fees for 2005/06 were £285,000 (Accounts) and £110,000 (Use of Resources).

Appendix A: Audit reports issued in relation to the 2006/07 audit year

| Report title | Date issued/ to be issued |
|---|---------------------------|
| Audit Plan | <i>July 2006</i> |
| Report on the Best Value Performance Plan | <i>December 2006</i> |
| Report on Data Quality arrangements | <i>December 2006</i> |
| Use of Resources opinion and report | <i>January 2007</i> |
| Report on the 2006/07 financial statements to those charged with governance (ISA 260) | <i>September 2007</i> |
| Internal Control Report | <i>October 2007</i> |

Appendix B: 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.

These code criteria are linked to the CPA and Data Quality Review Key Lines of Enquiry (KLoEs). 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 |
| 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 | Adequate |
| 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 | Adequate |
| 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 Stage 1]/ [Police Data Quality Review | 3 | Adequate |

| Code Criteria | Description | Associated KLoE | CPA Score | Use of Resources Conclusion |
|---------------|--|--|-----------|-----------------------------|
| | | Work/ [Informed by relevant FRA data quality review work] | | |
| 5 | The body has put in place arrangements to maintain a sound system of internal control | 4.2 | 2 | Adequate |
| 6 | The body has put in place arrangements to manage its significant business risks. | 4.1 | 3 | Adequate |
| 7 | The body has put in place arrangements to manage and improve value for money. | 5.2 | 3 | Adequate |
| 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 | 4 | Adequate |
| 9 | The body has put in place arrangements to ensure that its spending matches its available resources. | 3.1 | 4 | Adequate |
| 10 | The body has put in place arrangements for managing performance against budgets. | 2.2 | 3 | Adequate |

| Code Criteria | Description | Associated KLoE | CPA Score | Use of Resources Conclusion |
|---------------|--|-----------------|-----------|-----------------------------|
| 11 | The body has put in place arrangements for the management of its asset base. | 2.3 | 3 | Adequate |
| 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 | 3 | Adequate |

Appendix C: Summary of material adjusted misstatements

Management have adjusted all of the errors we noted during our audit of the accounts. We bring to your attention below those items that management have adjusted in the final draft of the accounts, but which we deem to be significant enough to bring to your attention.

| Adjusted Misstatement | Income and Expenditure Account | | Balance Sheet | |
|--|---|--------------------------------------|---|------------------------------------|
| | Dr £'000 | Cr £'000 | Dr £'000 | Cr £'000 |
| Department for Work and Pensions (DWP) debtor for which insufficient evidence of recoverability has been provided. Management have elected to match the write-off of the debtor with a write-back from a bad debt provision that relates to Housing Repairs. | Housing and Public Protection 765 | Housing and Public Protection 765 | Bad Debt Provision 765 | Debtors 765 |
| Inclusion in the Housing depreciation charge of assets that were transferred out of the Council as part of the Canning Town PFI. | Statement of movement on the HRA balance 1,609 | Housing Revenue Account 1,609 | Fixed Assets – Council Dwellings 1,609 | Capital Financing Account 1,609 |

| Adjusted Misstatement | Income and Expenditure Account | | Balance Sheet | |
|-------------------------------------|--|---|-----------------------------|----------------------|
| | Dr £'000 | Cr £'000 | Dr £'000 | Cr £'000 |
| Provision charged for Single Status | Allocation across the Net Cost of Services 18,493 | Statement of Movement on General Fund Balance 18,493 | Equal Pay Reserve 18,493 | Provisions 18,493 |
| Net effect | 20,867 | 1 20,867 | 20,867 | 20,867 |

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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