

London Borough of Newham
SAS 610 Report for the 2004-05
accounts – Communication of
relevant audit matters to those
charged with governance

The Members
London Borough of Newham
Town Hall
Barking Road
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London
E6 2RP

October 2005

Ladies and Gentlemen

Statement of Auditing Standard (SAS 610) Report on the Audit of the 2004-05 Accounts

We are pleased to present our report in connection with the audit of the 2004-05 accounts.

We would like to express our thanks to the management and staff at the London Borough of Newham for the assistance given to us during the course of our work.

Yours faithfully

PricewaterhouseCoopers LLP

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I Introduction

1. SAS 610 – “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. In the case of the London Borough of Newham (LBN) we have agreed with you that these matters should be communicated to the Members of the Council.
2. At the time of preparing this document our audit work in respect of the 2004-05 accounts has been substantially completed. Work is outstanding in the following areas:
 - Completion of audit work on the Housing Benefit reconciliation. By October 20th it is expected that this work will be complete.
3. SAS 610 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.
4. With regards to the individual points noted above those charged with governance should give consideration to the issues contained within this report prior to approving the accounts.
5. SAS 610 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 independence and objectivity of the audit team.

These matters have already been communicated to you in our 2004/05 Audit Plan. We are also required to reconfirm the independence and objectivity of the audit team at the final audit stage which we consider below in Section III.

6. We hope that the members of the Council find the information in this report useful. If you have any queries please do not hesitate to contact Peter Flamank from PricewaterhouseCoopers LLP on 0207 213 4346.

II Audit and Accounting Issues

7. We have set out below our comments on each of the matters that we are required to report to you under SAS 610.

Expected modifications to the Audit Report

8. We anticipate issuing an unqualified audit opinion on the 2004/05 financial statements of the London Borough of Newham.

Unadjusted misstatements

9. SAS 610 requires us to consider any misstatements in the draft accounts which management have not corrected, other than those that are “clearly trifling”. The unadjusted misstatements that we report include both factual items and matters involving judgement. We do not report changes that have already been made to the draft accounts during the course of our audit.
10. We are pleased to report that management have adjusted for the majority of the misstatements identified during the course of our audit. We have included a list of unadjusted misstatements in the Appendix to this document.
11. Members are requested to formally consider the unadjusted errors listed in the Appendix and determine whether they wish the accounts to be adjusted. If the errors are not adjusted we will require a written representation from you explaining your reasons for not making the adjustments.

Material weaknesses in the accounting and internal control systems

12. It is the responsibility of the London Borough of Newham to develop and implement systems of internal control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as auditors is to consider whether the London Borough of Newham has put adequate arrangements in place to satisfy itself that its systems of internal financial control are both adequate and effective in practice.
13. We discharged our responsibilities for assessing the adequacy of the Council's systems and internal control through:
- Evaluation of significant systems and associated internal controls to help form our opinion on the Statement of Accounts;
 - Discussions with directors and senior officers to understand the key risks facing the Council and the controls that are operating at a senior level within the Council; and
 - Reviewing the work of Internal Audit and seeking where possible to place reliance upon the work that they have completed during 2004-05.
14. Whilst we have no material weaknesses in the accounting and internal control systems to report, we would like to draw your attention to certain qualitative issues concerning the Council's accounting practices below.

Qualitative aspects of the London Borough of Newham's accounting practices and financial reporting

15. We have brought to your attention, in paragraphs 16 to 27 below, the significant accounting and auditing issues that arose during the course of our audit.

Depreciation of Council Housing Stock

16. In our SAS610 report on the 2003/04 accounts, we reported that the Council had used the Major Repairs Allowance (MRA), an element of the Housing Subsidy received by the Council, as a proxy for the depreciation of the asset values of its Council Housing stock. We reported that to determine if it is a suitable proxy the Council should have undertaken a review of the estimated remaining lives of its housing stock in order to calculate an accurate level of depreciation to be charged to the Housing Revenue Account (HRA).
17. In the 2004/05 the accounts the Council has applied a life of 50 years to depreciate its housing stock based on an estimate from Property Services.

Lender Option Borrower Option loans

18. One of the most prevalent treasury management products currently being sold to local government is the lender's option/borrower's option (LOBO) loan. This family of loans is generally characterised by an initial period (typically two years) of interest rates substantially less than prevailing rates, after which a schedule of higher fixed rates is set out for the next 25-50 years. The lender has an option to increase these scheduled rates at specified reset dates. The authority then has the option to repay the loan, but only on the event of the lender taking up the option to set a higher interest rate. If the lender does not propose to raise the scheduled rates, the authority will be locked into the agreement for the full term. The lender has no option to cancel the loan at any time.
19. Under the provisions of Financial Reporting Standard 4 "Capital Instruments" consideration needs to be given to whether the actual lower interest rate payable should be recognised in the Council's accounts or whether it should be some form of average between the initial lower rate and longer term higher rate. We recommended in our SAS610 report for the 2003/04 accounts that an average should be based upon the probable behaviour of the lending institution.
20. As in the 2002/03 and 2003/04 accounts the Council has accounted on the basis of recognising the actual lower interest rate payable. This has however been adjusted to an average rate in 2004/05 resulting in a additional £1.6m charge to the accounts. At the time of writing the adjustments required to effect this transaction, including the impact on the HRA, are being drafted. In any event the impact of this treatment will be neutral to the accounts over the average life used (approximately 5 years).

Valuation of land

21. The Council's de minimis for the valuation of land is 0.25 hectares, and the de minimis for the capitalization of an asset is £25,000. We have challenged whether there are pieces of land under 0.25 hectares that would, if valued, breach the de minimis. The Council has been unable to provide robust evidence that this is not the case. Whilst the value of land recorded in the accounts is likely to be understated, the extent of this is not expected to be material.
22. The Council is in the process of a land registry database review, and the results of this piece of work should be used to compile the 2005/06 accounts to ensure the completeness of asset values in the balance sheet.

Capitalisation of asbestos removal

23. The Council has capitalized asbestos removal costs to the value of £300k. Financial Reporting Standard 15: Tangible Fixed Assets (FRS15) requires that subsequent expenditure on fixed assets is charged to revenue if the expenditure maintains the asset at its previously assessed value, as is the probable case in this instance.

24. The amount of asbestos removal work capitalised has not been adjusted in the 2004/05 accounts (and is therefore recorded within the Appendix Summary of Unadjusted Differences) pending clarification during 2005/06 as to the nature of the asbestos removal work and the extent to which a provision should be created in respect of future work.

Interest cost calculation

25. Financial Reporting Standard 17: Retirement Benefits (FRS17) requires that authorities engage actuaries to calculate the pension liability recorded in the balance sheet and the charges to the Consolidated Revenue Account (CRA).
26. In 2004/05, the discount rate assumption used to calculate the pension liability changed from 6.5% to 5.4%. Our interpretation of the CIPFA Guidance on this matter is that the new discount rate should be used to restate the pension liability at 1 April 2004 for the purposes of calculating the interest charge to the CRA.
27. We summarise below the adjustment that would have been made to the 2004/05 accounts had our methodology been used, recognising that the overall net pension liability and impact upon Council tax payers is unaffected. We have agreed with management that this item does not require inclusion in our summary of unadjusted differences, but is included here for information:

	As per LBN Actuaries £m	As per PwC recalculation £m
Pension Liability at 1 April 2004	276.1	276.1
Interest Cost	8.2	16.0
Other items required by FRS 17	(9.5)	(9.5)
Actuarial Gains/ (Losses)	102.3	94.5
Net Pension Liability at 31 March 2005	377.1	377.1

III Independence

28. We are required to reconfirm the independence and objectivity of the audit team at the final audit stage, and have considered whether adequate arrangements are in place to safeguard the objectivity and independence of the audit team, including PwC partners and staff.
29. All staff involved in the audit have confirmed their independence in line with the requirements of SAS240: *'Quality control for audit work'*.
30. We report to you work we have undertaken at LBN outside of the scope of the Code of Audit Practice and whether it has effected our independence. During the year 2004-05, PwC have carried out the following work at LBN:
 - In the Cashfinder project we were engaged to identify and verify overpayments to suppliers including duplicate or other erroneous payments to suppliers, outstanding credits due from suppliers and other overpayments to suppliers. This work was completed in November 2004.
31. The fee for this work was within the de minimis level set by the Audit Commission. We can confirm that, in our professional judgement, the firm is independent within the meaning of regulatory and professional requirements and the objectivity of the audit engagement partner and audit staff has not been impaired.

Appendix – Summary of Unadjusted Differences

The following table details the misstatements identified during our audit that have not been adjusted by management: We are required to report such unadjusted differences to those charged with governance to confirm their approval of the decision not to adjust.

Description	Housing Revenue Account		Balance Sheet		Reason for non-adjustment
	DR £k	CR £k	DR £k	CR £k	
Asbestos removal work has been capitalised when it is probable that the works carried out cannot be classified as capital expenditure	300			300	Management has undertaken to investigate the nature of the asbestos removal works and in this context would prefer not to adjust until such investigations are complete.
The calculation for the bad debt provision for housing rents performed by the Housing department was different to that recorded in the accounts	103			103	Management are satisfied that the provision in the accounts adequately provides for the Council's rent arrears.
TOTAL	403			403	

The net unadjusted misstatement to the HRA is an overstatement of income of £403k. The net unadjusted misstatement to the balance sheet is an overstatement of net assets of £403k.

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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