London Borough of Newham

2009/10 Report to those charged with governance

21 July 2010

Contents

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

The 'Statement of responsibilities of auditors and of audited bodies' issued by the Audit Commission in April 2008 applies to our 2009/10 audit of [name of audited body] under the Code of Audit Practice for Local Government Bodies issued by the Audit Commission in July 2008. A copy of the statement is available from the Chief Executive of [name of 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 expected of the audited body in certain areas. Our reports and management letters are prepared in the context of this Statement and the Code of Audit Practice. 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 2009/10 audit. It sets out:

- matters arising from our audit of the financial statements including the pension fund accounts which we are required to report to you under the Audit Commission's Code of Audit Practice and International Standard on Auditing (UK & Ireland) 260 - "Communication of audit matters with those charged with governance";
- the results of our work under the Code of Audit Practice, to support the Value for Money conclusion; and
- an audit fee update.

Our work during the year was performed in line with the plans that we presented to the Audit Board and Investment and Accounts Committee in February 2010.

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

- Accounting for Private Finance Initiatives (PFI) under IFRIC 12
- Weaknesses identified in the Fixed asset control environment; and
- Control weaknesses identified concerning key reconciliations and the processes in place to manage the Pension Fund

Use of Resources

Following the government announcement that comprehensive area assessment (CAA) is to be abolished, all work on Use of Resources for CAA ceased at the end of May. Therefore, we have not completed this work as planned, but provide an update of our main findings from Use of Resources work completed before the government's announcement.

We ask the Audit Board to:

- Consider the draft management representation letter (Appendix A and confirm you are comfortable with the representations proposed, including those in respect of unadjusted misstatements.

Financial statements

Accounts

We have completed substantially all audit work on the Authority's accounts in line with the Code of Audit Practice and International Standards on Auditing (UK & Ireland), with the exception of:

- The Authority are in the process of finalising the accounting entries for the four PFI schemes that are coming on balance sheet as a result of changes to the 2009/10 Statement of Recognised Practice ('SORP). Following completion of this work we will review the accounting entries to both re-state the prior year figures and account for the in year PFI transactions to ensure that these are accurate.

- In order to gain assurance over the cash, investment and borrowing balances held at the year end we obtain confirmations from the organisations that the funds are invested with and loaned from. We are currently working with management to obtain outstanding confirmations.

- Through review of the accounts we have noted a number of disclosure adjustments that are required to ensure that the accounts are fully compliant with new SORP requirements. We have communicated these to management who are in the process of updating the accounts. Once this has been completed we will review the updated accounts to ensure that all adjustments have been appropriately made.

The draft management representation letter is attached for your consideration in Appendix A.

We anticipate issuing an unqualified audit opinion on the financial statements including the pension fund accounts.

Earlier year end close down timetable

Prior to the audit we agreed a year end timetable with management which included bringing forward the final audit of the Statement of Accounts. We commenced our audit in June 2010 and have now completed the majority of the substantive audit work required. Once the outstanding items detailed above have been resolved we will be in a position to sign the accounts in mid-August, this is compared to September in the prior year.

In order to allow this to occur we have also brought forward the audit of the majority of the grant returns, including NNDR and Housing Benefits. These two claims will both be certified in August compared to September and December respectively in the prior year.

We have worked closely with management to ensure that this new timetable was achievable. During the planning stage of the audit we undertook a detailed reviewed our audit approach and the information that we request. By doing this we were able to significantly reduce the amount of information that individual departments were required to prepare.

We also expanded the scope of audit work performed as part of our interim audit in February / March 2010 and were also able to reduce our on site time during this stage of the audit. During this time we were able to bring forward a number of areas of final audit testing and complete these, including:

- Testing of month 1 to 9 income and expenditure transactions;

- Testing of month 1 to 9 investment and borrowing transactions;

- Testing of month 1 to 9 fixed asset addition and disposal transactions; and

- Review and testing of the 1 April 2009 annual revaluation of housing stock.

We would like to take this opportunity to thank the finance department for their help and assistance during the course of both the interim and final audit, as well as the staff outside finance with whom we've had contact.

Misstatements identified during the audit

There are no misstatements identified during the course of our audit, which remain unadjusted, other than those of a clearly trivial nature. We regard misstatements less than £100,000 as clearly trivial.

We also bring to your attention the significant misstatements set out in Appendix B to this report, which have been corrected by management. We consider you should be aware of these in fulfilling your governance responsibilities.

Accounting Issues

A number of accounting issues were identified and addressed during the audit. The most significant of these issues are set out below:

Accounting for Private Finance Initiatives (PFI)

In 2010/11 Councils will be required to prepare year end financial statements using International Financial Reporting Standards (IFRS). In anticipation of this the 2009 SORP requires Authority's to account for Private Finance Initiatives (PFI) under IFRS in 2009/10.

Previously, under UK GAAP all PFI assets were accounted for off balance sheet. Under IFRS Authority's are required to assess all PFI arrangements under IFRIC 12 *Service Concession Arrangements* to determine whether they meet the requirements to be brought on balance sheet. Where this is the case, the assets associated with the scheme are capitalised on the Authority's balance sheet with a corresponding finance lease creditor also being established. This is considered to be a change in accounting policy and as such is required to be accounted for as a prior period adjustment through the restatement of the 2008/09 figures.

Subsequent annual payments are posted in part to the income and expenditure account, reflecting interest payments made to the PFI operator, and in part to the balance sheet to reduce the finance lease creditor. Additional adjustments ensure that this has no impact on the general fund.

Newham has four PFI schemes, as follows:

- Cumberland School;
- The Three schools scheme, incorporating Kingsford, Plaistow and Kaizen schools;
- Forest Gate Housing PFI; and
- Canning Town Housing PFI

Management has undertaken a review of these schemes and confirmed that they are all required to come on balance sheet in 2009/10 under the terms of IFRIC 12.

The Council has commissioned external consultants to prepare financial models to support each scheme. Newham have subsequently undertaken an exercise to determine the appropriate adjustments required to bring the fixed assets on balance sheet and make the corresponding entries.

The impact of the PFI schemes coming on balance sheet is an increase in the Council's fixed asset base of £65 million (£20 million relating to Housing assets and £45 million to school assets) and a corresponding finance lease creditor balance of £67 million.

Through the audit work performed, the following issues have been identified at the year end:

1. All adjustments to the financial statements as a result of the PFI schemes coming on balance sheet have been posted in the 2009/10 financial year. Due to the adjustment being treated as a change in accounting policy it is necessary to account for it as a prior period adjustment by restating the 2008/09 financial statement figures.

2. Through review of the information provided by consultants it has been noted that the opening finance lease creditor balances for each scheme is incorrect. Consequently the opening finance lease creditor in the financial statements is overstated by £3.8 million.

We have worked closely with management throughout the restatement process and have developed a detailed understanding of the four PFI schemes. Management are currently working to resolve the issues identified above to ensure that the correct figures are posted to restate the prior year figures and to reflect the transactions in 2009/10.

Recommendation

We recommend that following the completion of the audit and certification of the accounts, that management liaise with their consultants to gain a detailed understanding of the work that has been undertaken to model each of the PFI schemes to ensure that the accounting treatment for the schemes is correct in future accounting periods.

We will continue to work closely with management to support them through this complex transition.

Fixed Asset Control Environment

We have identified a number of issues within capital which we have discussed with management over the course of the audit. These have been summarised below:

- **Duplicate Assets:** At the start of the 2009/10 financial year the District Valuer performed a valuation over the Authority's Housing stock. They also performed a desk top review over all non housing assets. Through performing this review a number of assets were identified which were duplicated on the Fixed Asset register. Management have undertaken an additional review of all assets to ensure that all instances of duplication have been identified. A total of 43 duplicate properties were identified with a total value of £30,697k.

  Recommendation

  The Authority is involved in a number of regeneration projects. Due to the current economic climate there is a risk that these projects will not develop as move forward as anticipated and that additional demands for social housing will arise. It is therefore possible that further properties that are currently classified as surplus assets on the Authority's balance sheet will be used as rented accommodation and there is a risk that these will also be added as duplicate assets onto the fixed asset register.

  We recommend that management undertake a review of the processes in place concerning the transfer of surplus assets to housing assets to ensure that where this occurs the appropriate accounting entries are applied.

- **Accounting for Fully Depreciated Assets:** At the start of the audit it was communicated to the audit team that £5 million of fully depreciated assets had been identified in the fixed asset register. Through discussions with management it was confirmed that, whilst it is possible to obtain a list of the individual assets that make up this balance, it is not known whether these assets continue to be in use. In the prior year a balance of £10 million of fully depreciated assets were written off and the same issue was reported.

  Recommendation

We recommend that management undertake a fixed asset verification exercise in the forthcoming year in order to ensure the existence of assets recorded on the fixed asset register and therefore the accuracy of management and financial information provided by the system. We recommend that following this a fixed asset verification process is implemented to ensure that finance is informed of obsolete assets and the movement of assets around the Council.

- **Allocation of the 2008/09 year end valuation:** In the prior year the Authority undertook an impairment review over all fixed assets which resulted in a total impairment of £334 million. Of this £182 million of the impairment was off set by balances from the revaluation reserve. Whilst the impairment was reflected in the 2008/09 accounts, it was not posted to the fixed asset register until following the year end.

The impairment impacting on housing assets has been allocated by spreading the total impairments figure evenly across all housing assets. Non housing assets are re-valued using a 5 year rolling programme whereby 20% of the non housing stock is valued each year. The impairment was allocated in full to 20% of the non-housing stock only. This method has resulted in significant swings in the value of a small number of assets.

On the 1 April 2009 the Council undertook a full desktop valuation of all housing and non-housing assets. This has been accounted for in the fixed asset register on an asset by asset basis.

Recommendation

We recommend that all future revaluations are recorded in the asset register using this method to ensure that the supporting information underlying the financial statements is accurate.

In the prior year a new fixed asset register (AIRS) was implemented to allow for better recording and reporting of the Authority’s capital programme. The system allows assets to be recorded on an asset by asset basis which will assist the Council in meeting the more detailed reporting requirements of IFRS. To ensure that the full advantages of a system with more sophisticated functionality can be achieved management must ensure that the information recorded on the system is of a high quality and that there is a system of regular review in place to identify and resolve errors.

We understand that management are in the process of recruiting an additional staff member into the capital team and that this role will focus on ensuring that the full functionality of the AIRS system is understood to enable the capital team to exploit the system to its fully potential.

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. These are set out below.

Preparation and review of key reconciliations

As part of the audit we examine and test where appropriate all reconciliations between the general ledger and key financial systems. Through review of the year end Collection Fund and Bank reconciliation it was noted that, whilst these reconciliations are performed on both a regular and timely basis, the reconciliations are not formally evidenced as prepared and reviewed.

Through review of the year end reconciliation between the NNDR system and the general ledger it was noted that there is an unexplained reconciling balance of £26,000. As a result of changes in NNDR regulations a number of software upgrades have been made to the NNDR system over the course of the year which has resulted in this difference. Management have contacted Civica, their software provider, to determine the nature of this issue and resolve it.

Through review of the year end payroll reconciliation it was also noted that one of the directorates had been coding non payroll costs to payroll codes during the 2009/10 financial year. This had the impact of inflating the year end payroll figures by £200 million. Management have reviewed the reconciliation and it has been amended to reflect to actual year end payroll costs figure.

These reconciliations are considered to be a key control for our audit work to ensure that the information on stand alone systems is correctly transferred onto the general ledger. Their timely preparation and review also provides assurance that the reconciliations are being prepared and reviewed on a timely basis and that there is a rigorous review process which ensures that reconciling items are appropriate and that significant monthly and year on year variances are challenged and understood by management.

Recommendation

We recommend that the policies and procedures concerning these reconciliations are reviewed and a process of evidencing of the timely preparation and review of the reconciliations is implemented.

Monitoring and review of back office activities within Pension Fund Pooled Investment Vehicles (PIVs)

Included within the Scheme's investments are Pooled Investment Vehicles (PIVs) and Property. These funds are managed fund of funds. This is considered to be a riskier investment due to the lack of an immediately tradeable value for the funds, meaning reliance is placed on the fund manager's determination of the value.

The funds also often have a 31 December year end, compared to the 31 March year end of the Authority. The figures in the accounts are therefore based on unaudited quarterly valuations at the year end date.
As part of our audit work we have obtained the final audited financial statements for the funds and compared them to the unaudited quarterly valuations to ensure that the valuation of the investments reported in the accounts is accurate.

Recommendation

We recommend that management implement this process within the Authority to ensure that the value of investments in the financial statements is supported by more robust supporting information.

Review of Pension Fund Internal control (FRAG 21/SAS 70/AAF 01/06) reports

We reviewed whether the Council had obtained the SAS 70 reports which summarise the controls and procedures in place at their alternative investment service provider, in the determination of unit values.

We found that the Council had received a number of the internal control reports they did not however have all of the reports at the time of our audit

Recommendation

We recommend that the Council request all internal controls reports from all providers and review the Fund Managers' internal controls reports to ensure that there are no exceptions within the control environment which would put the Council's monies at risk.

The internal controls reports are audited every year by appointed auditors, consequently the Council should review the reports on the annual basis to ensure that there have not been any deficiencies noted in the controls.

In addition when the Council tender for a new Fund Manger we recommend that they ensure that the internal controls report is reviewed as part of the tender process.

The Council should review the fund managers who produce neither audited financial statements nor internal control reports to ensure that they are satisfied that they have enough assurance of their internal control environment at the Fund Manager.

Accounting practices

We are also required to report to you our view on qualitative aspects of the Authority's accounting practices and financial reporting. The financial statements were prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2009 (the SORP). We consider the following to be key issues affecting the Authority.

Pensions estimate

One of the most material estimates included in the accounts is for pension liabilities in respect of employees who are members of the London Borough of Newham pension scheme. The scheme is administered by the London Borough of Newham. The net pensions liability at the balance sheet date is £756.5 million. This liability has increased from £393.4 million in the prior year.

The Authority is not required to recover this deficit immediately, but it is an important factor in the assessment of future employer's pension contributions.

A full actuarial valuation for the scheme was last undertaken in 2007. Management are currently consulting with the actuaries to obtain a new valuation of the Pension Fund as at the 31 March 2010 for use in the 2010/11 financial statements. Current indications are that an increased level of employer contributions may be needed across the sector to make up scheme shortfalls. The extent of any contributions increase will depend on the magnitude of the shortfall and the period over which it is recovered. Decisions concerning the recovery period should take into account prudence and the likelihood that longer recovery periods will increase the real cost to the scheme and employer.

We have reviewed the reasonableness of the assumptions underlying the pension liability in the accounts in accordance with ISA (UK&I) 540 'Audit of accounting estimates'. Overall we are comfortable with the net effect of the assumptions adopted.

As consulting actuary to the Audit Commission, PwC meets all the local government scheme actuaries annually to gain an understanding of the methodology and assumptions they use. The table below sets out the principal assumptions used by your actuary in 2009/10 and 2008/09.

	2009/10	2008/09
FRS 17 Assumptions		
Discount Rate	5.5%	7.1%
Inflation rate	3.9%	3.3%
Rate of salary increase	5.7%	5.1%
Returns on assets		
Equities	8.0%	7.5%
Government Bonds	4.5%	4.0%
Corporate Bonds	5.5%	6.0%
Property	5.5%	6.5%
Cash	3.0%	0.5%

Typical assumptions used by actuaries for local government pension schemes are shown below.

	Hewitt	Barnett Waddingham	Hymans Robertson	Mercer
FRS 17 Assumptions				
Discount Rate	5.50%	5.50%	5.50%	5.60% - 5.70%
Inflation rate	3.80% - 3.90%	3.90%	3.80%	3.30% - 3.50%
Rate of salary increase	5.30% - 5.40%	4.90% - 5.90%	5.30%	4.55% - 4.75%
Returns on assets				
Equities	8.00%	6.50% - 8.00%	7.80%	7.50%
Government Bonds	4.50%	4.50%	5.00%	4.50%
Corporate Bonds	5.50%	5.50%	5.00%	5.20%
Property	8.50%	5.50% - 7.00%	5.80%	6.50%
Cash	0.70%	3.00%	4.80%	0.50%

It is important that management understand and appropriately influence the assumptions underpinning the net pension liability.

The Authority also participates in the Teachers' Pension Scheme, which is a multi-employer defined benefit scheme where the individual employers' share of the assets and liabilities of the scheme cannot be identified. Therefore, the Authority accounts for this scheme as a defined contribution scheme under FRS 17 'Retirement benefits'. It recognises contributions payable for the year in the income and expenditure account but does not include a pension liability in the balance sheet for benefits earned by Authority employees.

Value for Money in the Use of Resources

Work performed

We have performed work to conclude on the Authority's arrangements for achieving economy, efficiency and effectiveness in its use of resources.

Our work to support our Value for Money conclusion comprised the following elements:

- Work performed on the key lines of enquiry (KLoEs) specified by the Audit Commission as underpinning the Value for Money conclusion. This includes Use of Resources assessment work undertaken to the end of May, and

- Review of the Annual Governance Statement

Value for Money Conclusion

Under the Code of Audit Practice we are required to provide a conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources. The conclusion is based on the adequacy of the Authority's arrangements to meet criteria issued by the Audit Commission. Since 2008/09, selected Key Lines of Enquiry (KLOEs) have formed the criteria for the Value for Money conclusion. These are listed in Appendix C.

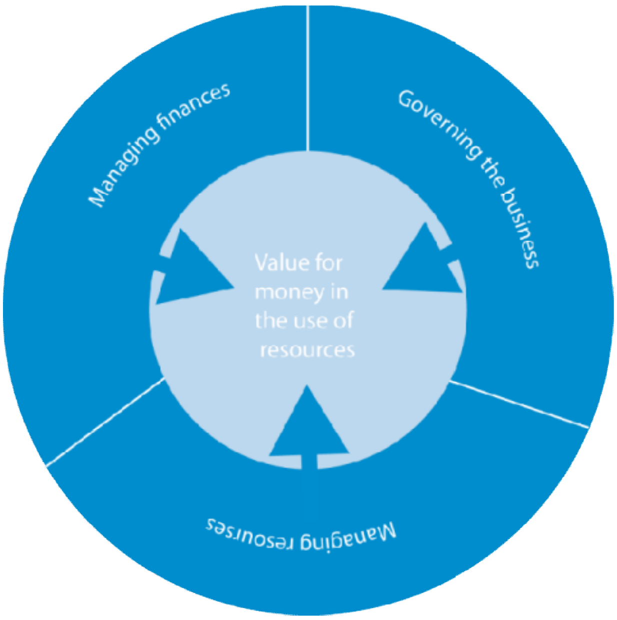
We intend to issue an unqualified value for money conclusion.

Use of resources

In May this year, the government announced its intention to abolish comprehensive area assessment (CAA). Shortly afterwards, we were instructed by the Audit Commission to halt all work on the Use of Resources assessment.

Therefore we cannot report Use of Resources scores, as this work was not completed. However, we do provide an update based on the work we had undertaken to the point work ceased. The work undertaken has also informed our Value for Money conclusion.

The Use of Resources assessment reviewed the Authority's arrangements against the specified KLOEs for the Authority (Appendix C). These are grouped into three themes, which form the Use of Resources framework. This is illustrated below. The assessment focussed on the Authority's achievements, outputs and outcomes, rather than the Authority's processes.



By the end of May we had undertaken work as follows:

- Undertaken discussions with management in order to:
    - discuss the changes to the 2009/10 Use of Resources process as communicated by the Audit Commission and discussed the most appropriate method in which to perform the required work for 2009/10;
    - gain an updated understanding of the process adopted by the Authority to prepare the self assessment against each of the KLoEs;
    - gain an understanding of the key changes that the Authority has implemented over the course of the year and the KLoEs that this related to;
    - discuss the self assessment documents prepared by the Authority against each of the KLoEs.
- Reviewed the following documents:
    - the self assessment documents prepared by the Authority for all of the KLoEs;
    - minutes from the meetings undertaken throughout the financial year;
    - key documents supporting the self assessment prepared. This included the Corporate Plan and final budget books

We have reported our initial findings to management and will include these in a separate report.

Local Authorities are required to produce an Annual Governance Statement (AGS), which is consistent with guidance issued by CIPFA / SOLACE: ‘Delivering Good Governance in Local Government’. The AGS was included in the financial statements.

CIPFA recently issued a statement on The Role of the Chief Financial Officer in Local Government 2010 , which makes recommendations about:

- the Chief Finance Officer's position in an authority's leadership,
- their involvement in and ability to influence key business decisions
- their responsibility for promotion of good financial management,
- their role in leading and directing a finance function which is resourced to be fit for purpose, and
- the qualifications and experience required of a Chief Finance Officer.

The recommendations of the statement are expected to be consolidated into the CIPFA/Solace Framework "Delivering Good Governance in Local Governance" over the next year. In the meantime, CIPFA has recommended a voluntary "comply or explain" approach in the 2009/10 AGS. This means the AGS is expected to include either:

- a confirmation that the authority's financial management arrangements conform to the CIPFA Statement, or
- an explanation of why they do not and how the authority delivers the same impact.

The Authority has included this in the AGS. As auditors, we are not required to report on this aspect of the AGS for 2009/10.

We reviewed the AGS to consider whether it complied with the CIPFA / SOLACE ‘Delivering Good Governance in Local Government’ framework 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.

Current and future developments

We provide regular accounting and technical updates for the Authority through annual training events and our periodic accounting publication for local government ‘Authority on Accounting’.

Set out below is an overview of significant new and emerging accounting and reporting developments in local government.

International Financial Reporting Standards (IFRS) implementation for 2010/11 accounts

The adoption of International Financial Reporting Standards (IFRS) represents a significant change in financial reporting in the UK public sector. The process has already started for local authorities, as this year’s SORP adopted the new accounting arrangements for PFI and service concessions, while previous SORPs have adopted IFRS style accounting for financial instruments.

The IFRS-based Code of Practice on Local Authority Accounting (the IFRS-based Code), will complete the transition process and applies to local authority accounts from 1 April 2010. As well as preparing the 2010/11 accounts under the IFRS-based Code, authorities must restate their balance sheet at the point at which the Code is adopted (1 April 2009), and present restated comparatives for 2008/09.

The format of the financial statement will change, with the Income and Expenditure Account and Statement of Total Recognised Gains and Losses being combined to form a new Comprehensive Income and Expenditure Statement. In addition, the Statement of Movement on the General Fund Balance will be replaced by the new Movement in Reserves Statement.

As well as these changes to the format of statements, there will be significantly increased levels of disclosure in the notes to the account and certain items may be brought onto the balance sheet for the first time.

You should not under estimate the challenge of the impact of adopting IFRS. The Authority has undertaken a significant amount of work in preparation of this change including:

- Implementing an IFRS Steering group to oversee and monitor the restatement process;
- Bringing their PFI assets on balance sheet in the 2009/10 financial statements (IFRIC 12);
- Commencing the process of restating the opening balance sheet at 1 April 2009;
- An exercise to identify and review all significant contracts for the purpose of identifying embedded derivatives (IAS 32, IAS 39, IFRS 7);
- An exercise to identify and review all leases for the purpose of reviewing their classification under IFRS and the potential impact on the financial statements (IAS 17); and
- Reviewing the specific requirements under IFRS for accounting for employee benefits (IAS 19)

Should you require assistance in the IFRS transition process please contact Philip Cliftlands.

CIPFA /SOLACE review of Delivering Good Governance in Local Governance Framework

CIPFA has issued an Application Note to Delivering Good Governance in Local Government as an addendum to the CIPFA /SOLACE Governance Framework Delivering Good Governance in Local Government. The guidance builds on the Statement on the role of the Chief Financial Officer in Local Government published by CIPFA. The Statement recommends that the CFO should be a member of the leadership team, with a status at least equivalent to other members. It sets out the key features of the role that CIPFA expects the CFO to play as well as outlining the skills and personal attributes required for successful performance.

The Application Note is intended to be a temporary measure that will operate for the financial years 2009/10 and 2010/11 during which time CIPFA aims to carry out a full review of the CIPFA/SOLACE Framework including consultation.

CIPFA consultation: Statement on the role of the Head of Internal Audit in public service organisations

CIPFA's consultation on the draft Statement on the role of the Head of Internal Audit in public service organisations close[s/d] on 10 September. The statement is intended to raise the profile and clarify the role of the Head of Internal Audit (HIA). It sets out best practice for HIAs to aspire to and for Audit Committees and others to measure internal audit against. The proposed principles-based framework is intended to apply to all HIAs in the UK, irrespective of the particular part of the public services in which they work. The Statement draws on the best practice and regulatory requirements in public services, as well as the requirements of CIPFA, other professional accountancy bodies' and the Institute of Internal Auditors' codes of ethics and professional standards.

CLG consultation on the future of council housing

In March 2010, the Department for Communities issued a prospectus "Council Housing - A Real Future". This contains proposals for putting the HRA on a self-funding basis that will involve the abolition of HRA Subsidy. Instead, authorities would fund their expenditure from rental income. The mechanism that will ensure equity between authorities is a reallocation of housing debt, based on an assessment of the level whose servicing will be affordable from individual HRAs. It will be crucial to get the opening debt figure correct if the HRA is to achieve the break-even target effectively.

There is no target implementation date for the proposals. However, authorities have been encouraged to consider the new skills and capacity they might need for the new arrangements and to test the opening debt figure proposed for them. The consultation exercise is being endorsed by the new Government (although without any commitment to the views expressed in the consultation document).

Capital finance regulation changes

Amendments made in 2010 to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 have effect for 2010/11 as follows:

- The regulation allowing authorities to defer the revenue impact of Equal Pay back payments until cash is paid has been extended from 31 March 2011 to 31 March 2013.
- Purchase of shares in the Local Authorities' Property Fund (LAPF) can no longer be regarded as capital expenditure.
- Capital receipts may now be used to:
  - finance costs of disposals for non-housing disposals, up to a maximum of 4% of the capital receipts generated, and
  - to settle obligations arising on the disposal of an asset in relation to agreements made at the time the asset was acquired.

Government spending review

The Government has published details of reductions to individual local authority grant allocations for 2010-11, which will contribute £1.166bn of local government savings in 2010/11. The changes include measures to remove ring fencing of certain grant streams. The grant reductions are part of a total of £6.2bn cross government savings in 2010/11 intended to tackle the UK's deficit in order to restore confidence in the economy and support the recovery. At the same time the government has committed to freezing levels of council tax for 2010/11.

The distribution and level of grants from 2011-12 onwards will be considered in the autumn Spending Review with further cuts and removal of ring fencing expected.

Carbon reduction commitment (CRC)

This mandatory emissions trading scheme started in April 2010. It aims to promote energy efficiency and help reduce carbon emissions. It is UK-wide, covering large businesses and public sector organisations. Authorities with an annual spend of more than £400,000 - 500,000 on electricity each year are likely to be in the scope of CRC.

All participants must monitor energy use and file an annual return with the Environment Agency which sets out their energy usage. They will then have to purchase allowances from the Government to use energy in the following year. The Government will compare the energy efficiency of each participant by ranking them in a published league table. The monies collected through the sale of allowances will then be returned to the participants, but with those who perform better in the league table receiving a bonus and those who perform badly suffering a penalty. Consequently there will be a cash flow impact for all participants, but both a reputational risk (via their standing in the league table) and financial downside for the poor performers.

The first annual reporting year is April 2010 – March 2011 and the first sale of allowances will take place in April 2011 – March 2012. Organisations that are required to participate fully in the scheme will need to consider how to account for the purchase of allowances, the obligation to deliver allowances and the receipt of revenue recycling payments. If you require assistance with getting to grips with the CRC scheme please contact Philip Cliftlands.

Clarity International Standards on Auditing (UK & Ireland)

The Auditing Practices Board (APB) has issued 33 clarity ISAs (UK &I), based on the IAASB's clarity International Standards on Auditing (ISAs), effective for audits of financial statements for periods ending on or after 15 December 2010.

A number of the standards have been completely revised and new requirements have been introduced. There are approximately one-third more explicit requirements applying to entity audits and extra new requirements that apply to group audits, with about half of the total increase resulting from clarification of the existing standards, and about half relating to new requirements designed to improve audit quality and, consequently, financial reporting.

The actual impact on cost of audits will depend on a variety of factors such as the effectiveness of current execution; the size and complexity of the entity; and how effectively we can work with you to obtain any additional information needed to enable us to perform the required procedures.

The UK Bribery Bill

The UK Government introduced the Bribery Bill into the House of Lords on 19 November 2009. The Bill seeks to enhance the UK's anti-bribery legislation, which is widely perceived as out of date and has been subject to serious criticism internationally.

The Bill replaces previous offences with a general bribery offence and a specific offence relating to bribery of foreign public officials (both of which are applicable to individuals and UK-registered companies). It also introduces the specific corporate offence of failing to prevent bribery, which is designed to make companies and other corporate bodies responsible for bribery committed on their behalf. The key potential liability relates to failure to prevent active bribery for and on behalf of the corporate body by its employees, agents or subsidiaries. Corporate bodies found to have committed any bribery offence could face unlimited fines, while individuals could face a maximum 10 year prison sentence and/or an unlimited fine

Audit plans and fee update

Audit Plan

We issued our Audit Plan for 2009/10 and presented it to Members on 8 February 2010. We also issued our Audit Plan for the pension fund accounts and presented it to the Investment and Accounts Committee on 11 February 2010.

Other than curtailment of CAA Use of Resources work in May 2010, the plans have not been changed in any significant respect.

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 2009/10

We reported our audit fee proposals in the fee letter issued in April 2009 and updated this in our Audit Plan.

Our actual fees were in line with our proposals.

Our fees charged were:

	2009/10 Outturn £	2009/10 Fee £
Financial Statements (main authority accounts) (pension fund accounts)	336,150 35,000	336,150 38,500
Use of Resources/ VFM conclusion	143,775	143,775
Total audit fee	**514,925**	**518,425**

Our fee for the certification of grant claims is based on the amount of time required to complete individual grant claims at standard hourly rates. We are in the process of undertaking the grants audit work and will discuss and agree this with the Executive Director of Resources and his team.

We have completed substantially all audit work on the Authority's accounts in line with the Code of Audit Practice and International Standards on Auditing (UK & Ireland), with the exception of those items detailed above (see Executive Summary). Once we have completed these areas of work we anticipate issuing an unqualified audit opinion on the financial statements including the pension fund accounts.

Appendix A: Draft management representation letter

(Appointment letterhead)

[Date]

To PricewaterhouseCoopers LLP
80 Strand
London
WC2R 0AF

This representation letter is provided in connection with your audit of the consolidated financial statements of the London Borough of Newham for the year ended 31 March 2010. The authority is responsible for preparing consolidated financial statements in respect of itself and its subsidiary undertakings (together "the group").

Your audit is conducted for the purpose of expressing an opinion as to whether the financial statements of the authority and the group give a true and fair view of the state of affairs of the authority and the group as at 31 March 2010, of the income and expenditure and cash flows of the group for the year then ended and of the financial transactions of the pension fund during the year ended 31 March 2010, and the amount and disposition at that date of the fund's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year, and have been properly prepared in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009.

My responsibilities as Executive Director of Resources for preparing the financial statements are set out in the Statement of Responsibilities for the Statement of Accounts. I am also responsible for the administration of the financial affairs of the authority. I also acknowledge that I am responsible for making accurate representations to you.

I confirm that the following representations are made on the basis of enquiries of other chief officers and members of the London Borough of Newham with relevant knowledge and experience and, where appropriate, of inspection of supporting documentation, to satisfy myself that I can properly make each of the following representations to you.

I confirm, to the best of my knowledge and belief and having made the appropriate enquiries, the following representations:

Accounting records

I have taken all the steps that I ought to have taken in order to make myself aware of any relevant audit information and to establish that you (the authority's auditors) are aware of that information, including that:

- All the accounting records, whether for the purposes of financial reporting or any other purpose, have been made available to you for the purposes of your audit and all the transactions undertaken by the authority and the group have been properly reflected and recorded in the accounting records.
- All other records and related information which might affect the fair presentation of, or necessary disclosure in, the financial statements, including minutes of the Cabinet, Audit Board and Investment and Accounts Committee and relevant management meetings, have been made available to you and no such information has been withheld.

So far as I am aware, there is no relevant audit information of which you are unaware.

Accounting policies

I confirm that I have reviewed the authority’s and the group’s accounting policies and estimation techniques and, having regard to the possible alternative policies and techniques, the accounting policies and estimation techniques selected for use in the preparation of the financial statements are the most appropriate to give a true and fair view for the authority's and the group’s particular circumstances, as required by the Code of Practice on Local Authority Accounting in the United Kingdom 2009**.**

Related party transactions

I confirm that authority has disclosed all related party transactions relevant to the authority and the group and that I am not aware of any other such matters required to be disclosed in the financial statements under the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2009.

Employee benefits

I confirm that the authority has made you aware of all employee benefit schemes in which employees of the authority and the group participate.

Contractual arrangements/agreements

All contractual arrangements (including side-letters to agreements) entered into by the authority or the group with third parties have been properly reflected in the accounting records or, where material (or potentially material) to the financial statements, have been disclosed to you.

Laws and regulations

I am not aware of any instances of actual or potential breaches of or non-compliance with laws and regulations which provide a legal framework within which the authority and the group conducts its business and which are central to the authority’s and the group’s ability to conduct its business or that could have a material effect on the financial statements.

I am not aware of any irregularities, or allegations of irregularities including fraud, involving members, management or employees who have a significant role in the accounting and internal control systems, or that could have a material effect on the financial statements.

The pension fund has not made any reports to the Pensions Regulator nor am I aware of any such reports having been made by any of our advisors. I confirm that I am not aware of any late contributions or breaches of the payment schedule/schedule of contributions that have arisen which I considered were not required to be reported to the Pensions Regulator. I also confirm that I am not aware of any other matters which have arisen that would require a report to the Pensions Regulator.

There have been no other communications with the Pensions Regulator or other regulatory bodies during the year or subsequently concerning matters of non-compliance with any legal duty.

Assets and liabilities

- The authority and the group has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

- In my opinion, on realisation in the ordinary course of the business the current assets in the balance sheet are expected to produce no less than the net book amounts at which they are stated.

- We have no plans or intentions that will result in any excess or obsolete stock, and no stock is stated at an amount in excess of net realisable value.

- The authority and the group has satisfactory title to all assets and there are no liens or encumbrances on the authority's and the groups assets, except for those that are disclosed in the financial statements.

- I confirm that we have carried out impairment reviews appropriately, including an assessment of when such reviews are required, where they are not mandatory. I confirm that we have used the appropriate assumptions with those reviews.

- Details of all financial instruments, including derivatives, entered into during the year have been made available to you. Any such instruments open at the year end have been properly valued and that valuation incorporated into the financial statements. When appropriate, open positions in off-balance sheet financial instruments have also been properly disclosed in the financial statements.

- I confirm that all significant assumptions made in relation to fair value measurement and disclosures are reasonable and appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the authority and the group where relevant to the fair value measurements or disclosures.

Fraud

I acknowledge responsibility for the design and implementation of internal control to prevent and detect fraud.

I have disclosed to you:

i) the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud
ii) my knowledge of fraud or suspected fraud affecting the authority and the group involving:
  - members
  - management
  - employees who have significant roles in internal control, or
  - others where the fraud could have a material effect on the financial statements;

iii) my knowledge of any allegations of fraud, or suspected fraud, affecting the authority's and the group's financial statements communicated by members, employees, former employees, analysts, regulators or others.

Minimum Revenue Provision

The London Borough of Newham has determined a prudent amount of revenue provision for the year under the Prudential Framework, including any voluntary sums over and above the Minimum Revenue Provision;

Misstatements detected during the audit

I acknowledge my responsibility for the design and implementation of internal control to prevent and detect error.

I confirm that the financial statements are free from material misstatement, including omissions.

I confirm that the reason why the misstatements that you have brought to the attention of the Audit Board, in the attachment to this letter have not been adjusted in the financial statements is as follows:

Those charged with governance believe their effect both individually and in aggregate is not material to the truth and fairness of the financial statements either taken as a whole or in connection with the ability properly to assess the performance and/or the financial position of the authority and the group.

Financial Instruments

All embedded derivatives have been identified and appropriately accounted for under the Code of Practice on Local Authority Accounting in the United Kingdom 2009.

Where we have designated hedging relationships of either firm commitments or highly probable forecast transactions, we confirm that our plans and intentions are such that these relationships qualify as genuine hedge arrangements.

Where we have assigned fair values to financial instruments, we confirm that the valuation techniques, the inputs to those techniques and assumptions that have been made are appropriate, and reflect market conditions at the balance sheet date, and are in line with the business environment in which we operate.

Where we have reclassified financial assets out of the categories of fair value through profit or loss or available for sale in the year we confirm that the group has the intention and ability to hold the assets for the foreseeable future or until maturity.

Retirement benefits

All retirement benefits that authority and the group is committed to providing, including any arrangements that are statutory, contractual or implicit in authority's and the group's actions, wherever they arise, whether funded or unfunded, approved or unapproved, have been identified and accounted for and/or disclosed.

All settlements and curtailments in respect of retirement benefit schemes have been identified and properly accounted for.

The following actuarial assumptions underlying the valuation of retirement benefit scheme liabilities are consistent with my knowledge of the business and in my view would lead to the best estimate of the future cash flows that will arise under the scheme liabilities:

Assumption	2009/10 %	Assumptions for Return on Assets	2009/10 %
Rate of inflation	3.9	Equities	8.0
Salary increases	5.7	Bonds	4.6
Pension increases	3.9	Properties	5.5
Discount on scheme liabilities	5.5	Cash	3.0

The authority participates in the Teachers' Pension Scheme that is a defined benefit scheme. We confirm that authority's share of the underlying assets and liabilities of this scheme can not be identified and as a consequence the scheme has been accounted for as a defined contribution scheme.

Premiums and discounts

We confirm that we are satisfied that appropriate treasury advice was taken at the time of the debt restructuring in 2007/08 and that having considered the issues raised by PwC we are satisfied that the Council has acted in accordance with the Regulations and applicable guidance. We are satisfied that the Council has acted reasonably, taking into account the Treasury Management advice received, the application of the regulations and the circumstances which gave rise to the decision to restructure.

We acknowledge our duty under the 2003 Regulations to consider the debits and credits made to revenue in respect of premiums and discounts is an annual one and that the decisions taken in respect of 2007/08 will need to be refreshed in subsequent years.

Single Status

The London Borough of Newham has determined a prudent application of the statutory provisions for the neutralisation of the impact of Single Status provisions on the General Fund balance.

Taxation

I have complied with UK taxation requirements and have brought to account all liabilities for taxation due to the relevant tax authorities whether in respect of direct tax or any indirect taxes. I am not aware of any non-compliance that would give rise to additional liabilities by way of penalty or interest.

In particular:

- In connection with any tax accounting requirements, I am satisfied that our systems are capable of identifying all material tax liabilities and transactions subject to tax and have maintained all documents and records required to be kept by the relevant tax authorities in accordance with UK law or in accordance with any agreement reached with such authorities.
- I have submitted all returns and made all payments that were required to be made (within the relevant time limits) to the relevant tax authorities including any return requiring us to disclose any tax planning transactions that have been undertaken the authority's benefit or for the group's benefit or any other party's benefit.
- I am not aware of any taxation, penalties or interest that are yet to be assessed relating to either the authority or the group or any associated company for whose taxation liabilities the authority may be responsible.

Pension fund assets and liabilities

All known assets and liabilities (other than liabilities to pay pensions and benefits after the end of the year) including contingent liabilities, as at the 31 March 2010, have been taken into account or referred to in the financial statements.

Details of all financial instruments, including derivatives, entered into during the year have been made available to you. Any such instruments open at the 31 March 2010 have been properly valued and that valuation incorporated into the financial statements.

The pension fund has satisfactory title to all assets and there are no liens or encumbrances on the pension fund's assets.

The value at which assets and liabilities are recorded in the net assets statement is, in the opinion of the authority, the market value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the pension fund. Any significant changes in those values since the date of the financial statements have been disclosed to you.

Pension fund registered status

I confirm that the London Borough of Newham Pension Fund is a Registered Pension Scheme. We are not aware of any reason why the tax status of the scheme should change.

Bank accounts

I confirm that we have disclosed all bank accounts to you including those that are maintained in respect of the pension fund.

Subsequent events

There have been no circumstances or events subsequent to the period end which require adjustment of or disclosure in the financial statements or in the notes thereto.

As minuted by the Audit Board at its meeting on 21 July 2010.

......................………........….. ....

(Executive Director of Resources) Date

For and on behalf of ……………………………………........................

Appendix B: Summary of material adjusted misstatements

We identified the following material misstatements during our audit which management have corrected, but which we consider should be communicated to you to assist you in fulfilling your governance responsibilities:

Accounting for Private Finance Initiatives (PFI)

Accounting for the prior period adjustment

In anticipation of the move to Authorities preparing financial statements under IFRS in 2010/11 under the 2009 SORP Authorities are required to assess all PFI arrangements under IFRIC 12 *Service Concession Arrangements* to determine if they should be accounted for on balance sheet.

Management has undertaken a review of the Authority's four PFI schemes and confirmed that under IFRS they are required to come on balance sheet. This is considered to be a change in accounting policy and as such is required to be accounted for as a prior period adjustment through the restatement of the 2008/09 figures.

Through review of the financial statements it has been identified that a prior period adjustment has not been undertaken and that all PFI entries have been posted in the 2009/10 financial year.

Management are currently reviewing this treatment and undertaking an exercise to restate the prior year figures and prepare the prior year adjustment disclosures necessary to ensure that the financial statements comply with SORP requirements.

Calculation of the finance lease creditor

The Authority has commissioned external consultants firm to prepare financial models to support each of the four PFI schemes. Newham have subsequently undertaken an exercise to determine the appropriate adjustments required to bring the fixed assets on balance sheet and make the corresponding entries.

Through review of the information provided by the consultants it has been identified that the opening finance lease creditor balances for each scheme has been incorrectly calculated. Consequently the opening finance lease creditor in the financial statements is overstated by £3.8 million.

Appendix C: Value for Money conclusion criteria

The Audit Commission publishes Code of Practice criteria on which auditors are required to reach a conclusion on the adequacy of an audited body's arrangements for economy, efficiency and effectiveness in its use of resources. The criteria are linked to Key Lines of Enquiry (KLoEs). The Commission specifies which KLOEs will form the 'relevant criteria' for the VFM conclusion for each type of body each year. The table below shows the KLoEs specified for the conclusion in 2009/10 and 2008/09.

Managing Finances

Key Lines of Enquiry		Specified in 2009/10	Specified in 2008/09
1.1	Does the organisation plan its finances effectively to deliver its strategic priorities and secure sound financial health?	✓	✓
1.2	Does the organisation have a sound understanding of its costs and performance and achieve efficiencies in its activities?	✓	✓
1.3	Is the organisation's financial reporting timely, reliable and does it meet the needs of internal users, stakeholders and local people?	✓	✓

Governing the Business

Key Lines of Enquiry		Specified in 2009/10	Specified in 2008/09
2.1	Does the organisation commission and procure quality services and supplies, tailored to local needs, to deliver sustainable outcomes and value for money?	✓	✓
2.2	Does the organisation produce relevant and reliable data and information to support decision making and manage performance?	✓	✓
2.3	Does the organisation promote and demonstrate the principles and values of good governance?	✓	✓
2.4	Does the organisation manage its risks and maintain a sound system of internal control?	✓	✓

Managing Resources

Key Lines of Enquiry		Specified in 2009/10	Specified in 2008/09
3.1	Is the organisation making effective use of natural resources?	✗	✓
3.2	Does the organisation manage its assets effectively to help deliver its strategic priorities and service needs?	✓	✓
3.3	Does the organisation plan, organise and develop its workforce effectively to support the achievement of its strategic priorities?	✓	✗

pwc.com