

London Borough of Newham 2008/09 Annual Audit Letter



The Members
London Borough of Newham
Town Hall
Barking Road
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18 December 2009

Ladies and Gentlemen

We are pleased to present our Annual Audit Letter summarising the results of our 2008/09 audit. We hope that you find this a useful report.

Yours faithfully

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

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

1. Introduction

The purpose of this report

The purpose of this report is to provide a high level summary of the results of the 2008/09 audit work we have undertaken at the London Borough of Newham that is accessible for members and other interested stakeholders.

We have already reported the detailed findings from our audit work to those charged with governance in the following reports:

- Audit opinion for 2008/09 financial statements, dated 29 September 2009, incorporating the conclusion on Use of Resources;
- 2008/09 Report to those charged with Governance (ISA (UK&I) 260), dated 21 September 2009; and
- Report to the Chief Executive following the conclusion of our Use of Resources work, dated 8 October 2009.

The matters reported here are those that we consider are most significant for the Authority. Other recommendations have been reported to the Cabinet and the Audit Panel.

Scope of work

Our audit work is conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

The Authority is responsible for preparing and publishing its financial statements, including the Annual Governance Statement. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As auditors we are responsible for:

- Forming an opinion on the financial statements;
- Reviewing the Authority's Annual Governance Statement;
- Forming a conclusion on the arrangements that the Authority has in place to secure economy, efficiency and effectiveness in its use of resources; and
- Undertaking any other work specified by the Audit Commission.

Our 2008/09 audit work has been undertaken in accordance with the Audit Plan that we issued on 30 May 2008.

2. Audit findings

Accounts

We audited the Authority's accounts in line with approved Auditing Standards and issued an unqualified audit report on 29 September 2009. We identified the following key issues from our audit which were included in our report on the accounts presented to the Audit Committee, as those responsible for governance at the Authority, on 21 September 2009:

Accounting for the year end fixed asset revaluation exercise

At the year end the Council instructed the District Valuer to perform a desktop review of the Council's land and building assets to determine the potential impact of changes to property prices through the performance of a high level, desktop exercise.

The impact of this impairment review was a fall in the value of non-housing assets by £150million and of housing assets by £184million. Of the total £334million fall in asset values, £182million was offset by balances within the revaluation reserve. Therefore, the total accounted for directly through the income and expenditure account was £152million.

However, two issues were noted:

1) In the year a new fixed asset register (AIRS) was implemented. This system records assets on an asset by asset basis and will assist the Council in meeting the more detailed reporting requirements under IFRS. Due to the complexity of the reports from the AIRS system at the year end it had not

been possible to reconcile the impact of the fall in the value of the Council's housing stock to the figures in the revaluation reserve.

2) The impact of the valuation on the revaluation reserve was also not accounted for on an asset by asset basis. It is required that only the revaluation reserve pertaining to an individual asset is used to offset any impairment in that asset's value. The Council need to ensure that the impairment is accounted for on an asset by asset basis through the revaluation reserve and the fixed asset register (AIRS) to ensure that the underlying records supporting the valuation are accurate.

Management is currently working to resolve these issues and we are working closely with them in order to agree appropriate methodologies for their resolution.

Housing Assets - Writing out of accumulated depreciation

It was noted that there was a brought forward accumulated depreciation balance of £162m in the Fixed Asset note (Note 16) to the accounts relating to Council Dwellings. Housing stock is re-valued by the District Valuer on an annual basis on the 1st April. When the updated valuation is accounted for in the balance sheet the accumulated depreciation pertaining to these assets should be written out.

Management have made the required adjustment, which is a technical adjustment only and has no impact on the income and expenditure account.

Accounting for fully depreciated assets

In year a balance of £10million of fully depreciated vehicle, plant and equipment assets was written out of the balance sheet.

Through discussions with management it was determined that there was no certainty as to the nature of these assets, that is, which assets were written out and whether they were still in use. We have reviewed and concur with the accounting treatment adopted by management.

We recommended 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 recommended 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.

We also recommended that a rigorous system of review of the AIRS system be implemented. This will assist the Council in being able to meet the reporting requirements of IFRS from 2010/11, such as component accounting.

Identification and accounting for operating leases

Through review of the operating lease disclosure in the accounts it was identified that the prior year (2007/08) operating lease expenditure figure had been restated from £2million to £239million. Management confirmed that this was due to the identification of a number of operating leases within the Housing directorate which were not disclosed in the past which were identified as part of the IFRS preparatory work.

The impact on the financial statements is a disclosure amendment only. There is no financial impact on the income and expenditure account.

We recommended that management undertake a review and ensure that details of all leases and commercial contracts are collated either at a centralised point or within specified departments within the Council. This will

also ensure that the Council are able to undertake the reviews required for both the implementation and ongoing adoption of IFRS.

Accounting for changes to FRS 17 – Pension Costs

In the financial year FRS 17 “Retirement Benefits” was amended so that quoted investments and unit trusts are now valued at their bid price, rather than their mid price. This is considered to be a change in accounting policy and the Council disclosed this in the notes to the accounts. As a change of accounting policy it is necessary to determine whether the financial impact is sufficient to warrant a prior period adjustment. The net impact on the pension fund was £382,000, consisting of a reduction of the year end pension surplus of by £1.04million and a reduction in the value of investments of £658,000. It was considered that this impact was not sufficient to warrant a prior period adjustment.

We concurred with management’s conclusion and the treatment of the adjustment in the accounts.

Accounting for Impairments to Icelandic Bank Deposits

In November 2008 when the Landsbanki and Glitnir Icelandic banks went into administration, the Council held £7m of investments, £2million and £5million respectively. Treasury management undertook a review of the required impairment to these investments at year end. The impact was a total impairment of £949,000. We reviewed the work undertaken by management to ensure its consistency with the CIPFA LAAP Bulletin, number 82 issued in May 2009 and the SORP and we concurred with management’s treatment of the impairment and the investments in the financial statements.

Use of Resources

The Audit Commission requires us to assess the overall arrangements that the Authority has in place in the following three areas:

- Managing finances
- Governing the business.

- Managing Resources.

We evaluated the arrangements against criteria set by the Audit Commission in underlying Key Lines of Enquiry (KLoE) and reached a score for each based on the following:

- 1 Failure to meet minimum requirements – inadequate performance;
- 2 Meets only minimum requirements –performs adequately
- 3 Exceeds minimum requirements –performs well; or
- 4 Significantly exceeds requirements – performs excellently.

The scores for these KLoEs then determine the overall score for each area, using rules issued by the Commission. The Commission in turn then determines an overall score for the Authority.

Managing Finances

We have scored the KLoEs for managing finances reporting as follows:

Key Line of Enquiry		Score
1.1	The Authority plans its finances effectively to deliver its strategic priorities and to secure sound financial health	3
1.2	The Authority has a sound understanding of its costs and performance and achieves efficiencies in its activities	3
1.3	The Authority's financial reporting is timely, reliable and meets the needs of internal users, stakeholders and local people	3

The Borough has a strong understanding of its costs, with an improving commitment to financial and performance management. The Borough assesses whole life costs and undertakes benchmarking to gain a thorough understanding of its costs. There is a medium term financial strategy that is clearly linked to the Borough's corporate priorities and mayors' promises.

The Borough promotes a culture of transparency about its financial performance and position. Financial and corporate planning incorporates engagement with the community and stakeholders through initiatives such as Newham Compact, Newham Youth Council and the Young Mayor programme.

Budget monitoring and forecasting is relevant, reliable and understandable. The Star Chamber process identified a number of efficiency savings which are currently being reinvested in-line with the corporate priorities. There is an ongoing focus on service improvement via the Service Boards that provide a rigorous challenge on both spend and performance targets. High cost areas are identified and targeted, with monthly reporting focusing on these areas.

There is a good level of internal scrutiny to ensure finances are managed effectively in-line with corporate priorities. The Borough regularly consults with residents and stakeholders to ensure reporting of financial matters meet their needs. The result is sound reports which are fit for purpose, enabling residents and stakeholders to make informed decisions.

Governing the business

We have scored the KLoEs for governing the business as:

Key Line of Enquiry		Score
2.1	The Authority commissions and procures quality services and supplies, tailored to local needs, to deliver sustainable outcomes and value for money.	3
2.2	The Authority produces relevant and reliable data and information to support decision making and manage performance	3
2.3	The Authority promotes and demonstrates the principles and values of good governance	3
2.4	The Authority manages its risks and maintains a sound system of internal control	3

The Procurement Strategy is committed to delivering value for money through local strategic partnerships. The joint commissioning team focuses on ensuring resident's needs are met through partnerships, in addition to a number of surveys which are

undertaken to understand commissioning and procurement needs. Service users are represented on partnership boards as well as wider user groups. The Chief Executive has initiated a number of service design reviews to identify efficiencies and savings, including back office functions as a result of the move to Building 1000.

Data quality is governed by the corporate data quality framework. This ensures data quality remains high, with good use of performance indicators to drive improvement and identify potential for increased efficiency. The Borough adopts the industry best practice guide for data quality and is accredited for connection to the GCSx network.

Governance arrangements are supported by a robust structure, which imposes corporate ownership. The Newham Partnership Board has expanded membership to ensure all business sectors are well represented. The Newham Compact joint agreement also supports strong governance through partnership arrangements.

There is a strong commitment to risk management, which is integrated into the Borough's Corporate Plan as well as both directorate and service planning processes. There is a zero tolerance to fraud, with a suite of counter fraud policies and strategies which are reviewed annually. Internal control is sound, with internal audit having a risk based approach.

The audit board provide adequate scrutiny and assurance over the operations of the Borough, with membership widely drawn to ensure elected members have links with other parts of the Borough's governance arrangements. This ensures a consistent and clear approach to internal control across the Borough.

Managing resources

We have scored the KLoEs for managing resources as:

Key Line of Enquiry		Score
3.1	The Authority makes effective use of natural resources.	2
3.2	The Authority manages its assets effectively to help deliver its strategic priorities and service needs.	3
3.3	The Authority plans, organises and develops its workforce effectively to support the achievement of its strategic priorities	n/a

Note: KLoE 3.1/3.2/3.3 is/are not a specified KLoE(s) for 2008/09 for Single Tier and

County Councils/District Councils/ Police Authorities/ Fire Authorities

The Borough has established processes to manage its use of natural resources and is developing action plans to improve performance.

The Sustainability Programme Board, which oversees the Carbon Management Project Team, was established to ensure projects are delivered with sustainability objectives. The Borough has an Energy Efficiency Team who promotes and monitors energy efficiency and reductions, and discharges all local authority responsibilities in these areas.

Positive outcomes from initiatives and programs for the use of natural resources to date are limited. Reductions in carbon emissions are yet to be measured due to baselines not been available for comparative data. The Borough is ensuring that the performance management of initiatives is in place.

As part of their Corporate Accommodation Strategy and a policy and performance review, the Borough has based their office at Building 1000, Royal Docks. This has rationalised their front and back office operations, with some 2,500 staff moving into the purpose built building, which will show a reduction in its consumption of natural resources and address environmental pressures from the Borough's output.

The Borough has a sound asset management governance structure, with work streams reporting to the Property Board. The Corporate Accommodation Strategy outlines major consolidation and rationalisation of back office operations. The Borough is jointly procuring office accommodation with Newham Primary Care Trust. Additionally, the Borough plans to use a library as a local service centre combining the traditional library with a council 'one stop shop' for council services.

The Borough is actively developing strategies, initiatives and programs to maximise the efficient use of natural resources, and efficiently manage its assets. The Borough is also engaging external expertise and key partners to ensure its use of resources improves in the future. This needs to be regarded as a key priority. The Newham Board will need to act as the catalyst to achieve their targets.

Conclusion on Use of Resources

We were also required to issue a conclusion on the adequacy of the Authority's arrangements for ensuring economy, efficiency and effectiveness

in its use of resources.

We issued an unqualified conclusion on the Authority's arrangements for its Use of Resources on 29 September 2009.

Annual Governance Statement

Local Authorities are required to produce an Annual Governance Statement (AGS) which is included in the financial statements.

We reviewed the AGS to consider whether it complied with the relevant guidance and whether it is misleading or inconsistent with other information known to us from our audit work. We found no areas in terms of the content of the statement.

3. Matters affecting future accounting periods

Transition to International Financial Reporting Standards (IFRS)

There are proposed changes to the basis of financial reporting which are being introduced across the public sector. This will apply to accounting periods starting on or after 1 April 2010. Due to the requirements to have comparative information for the first set of full IFRS accounts the effective date of the transition is 1 April 2009. The Council will need to be aware of the amendments to accounting treatments and disclosures for assets and transactions that will be required to comply with IFRS from this date.

In advance of full adoption, the 2009 SORP adopts IFRS accounting principles for PFI schemes and similar service concession arrangements. Under IFRS there is an expectation that more of these types of schemes will be accounted for as “on balance sheet”, in contrast with current practice under UK GAAP and the SORP, where many schemes are predominately accounted for as “off balance sheet”.

The Authority will need to ensure that it has a good grasp of the changes to accounting requirements and that it has robust plans in place to enable collection and processing of the information needed to comply with the new requirements.

In our experience the key features of a successful IFRS conversion project have proven to be:

- Completed impact analysis and comprehensive conversion plans;

- The commitment of key stakeholders in the organisation;
- Operational steering and technical groups;
- Cabinet/audit committee oversight;
- Regular progress reporting against the plan;
- The necessary project management resources; and
- Appropriate and timely training for all members and officers with IFRS involvement.

4. Summary of control recommendations

Page	Recommendation	Management Response
1.	<p>Pension fund reconciliation</p> <p>We recommend that a regular reconciliation process be re-instated to ensure that the information in the custodian reports agree to that in the Fund Manager reports.</p> <p>The reconciliation should be reviewed by a separate member of staff and evidenced as both prepared and reviewed (signed and dated).</p>	Management response to be confirmed
2	<p>Pension fund bank account</p> <p>We recommend that the pension fund cash balances be held in a separate bank account to the main Council cash balances.</p>	The pension fund cash balances will be held in a separate bank account to the main Council cash balances. The Council are currently implementing a separate bank account to be in place by 2009/10 year end.
3	<p>Collection Fund reconciliation</p> <p>We recommend that management undertake a review of the Collection Fund Reconciliation and write out all aged reconciling items.</p> <p>We also recommend that this becomes a regular annual process to ensure that aging reconciling items are reviewed and resolved in a timely basis.</p>	Management have agreed to the recommendation. The reconciliation will be reviewed in order to remove those aged reconciling items.

In the event that, pursuant to a request which 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. London Borough of Newham agrees to pay due regard to any representations which PwC may make in connection with such disclosure and London Borough of Newham shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, 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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