Government and Public Sector

October 2005

London Borough of Brent

Report on the Audit of the 2004/05 Financial Statements

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October 2005

Ladies and Gentlemen

Report on the audit of the 2004-05 Financial Statements

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

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

Yours faithfully

PricewaterhouseCoopers LLP

Contents

Statement of Responsibilities of Auditors and of Audited Bodies

In April 2000 the Audit Commission issued a revised version of the Statement of Responsibilities of Auditors and 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 audit 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.

I. Introduction

1 The purpose of this report is to comment on the matters that we are required to report on by Statement of Auditing Standard (SAS) 610 "Communication of audit matters to those charged with governance"

2 SAS 610 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.

3 In the case of the London Borough of Brent (the Council) we have agreed with you that these matters would normally be communicated to the Performance and Finance Select Committee. However, we agreed with management to issue a report on our audit of the financial statements to the General Purposes Committee, given that we are due to issue an opinion on the Council's 2004/05 financial statements before 31 October. We will incorporate key messages included in this report in our Annual Audit Letter, and present this separately to the Performance and Finance Select Committee later in the year.

4 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.

5 Those charged with governance should give consideration to the issues contained within this report prior to final approval of the accounts.

6 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; and
- The work to be undertaken by any other firms of auditors, and how we will obtain assurance over the procedures of other auditors; and

- The independence and objectivity of the audit team.

7 These matters have already been communicated to you in our Audit Service Plan and there are no updates to report. In particular, we remain independent within the requirements of ethical and auditing standards.

8 We hope that the members of the General Purposes Committee find the information in this report useful and we will of course be happy to answer any questions that you may have on the contents of this report at the Committee meeting on 27th October 2005.

II. Audit and Accounting Issues

9 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

10 We have substantially completed our audit work and anticipate being able to issue an unqualified audit opinion on the financial statements, within the 31 October deadline.

Unadjusted misstatements

11 SAS 610 requires us to consider with the Committee 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. Where the Council chooses not to adjust the accounts, we include the items in our letter of representation and ask that reasons are provided. This is not required where changes have already been made to the draft accounts during the course of our audit.

12 During the course of our audit, we discussed and agreed a number of adjustments to the accounts. The most significant items were of a technical nature, which did not have an impact on the revenue or net assets position. These included:

- Correction of balance sheet treatment of accumulated depreciation following revaluation. This affected accumulated depreciation of £31.7m relating to Council Dwellings and £28.6m relating to General Fund Land and Buildings;
- Reclassification of £24m premia on debt redemption from long term debtors to reserves;
- Correction to pension fund investments figure of £0.7m, with the compensating entry in Investment Income due. This did not affect fund balances;
- Correction of general fund investments figure of £0.5m due to the inclusion of accrued interest in the value of fixed interest investments. This did not have an impact on the net assets position;
- Adjusting entries required to the balance sheet following the reconciliation of internal debtors and creditors amounting to £0.4m; and
- Adjustment required to the cash balance due to the omission of a Euro account of £0.1m from the schedule of cash balances. This did not affect fund balances.

13 Those adjustments which did affect revenue had a net impact of £0.1m. Though not considered to be material, all adjustments were made and have been suitably reflected in the updated draft of the accounts. There are no unadjusted errors, identified during the course of our audit, which are reflected in the final draft.

Material weaknesses in accounting and internal control systems

14 It is the responsibility of the Council to develop and implement systems of internal financial 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 Council has put adequate arrangements in place to satisfy itself that its systems of internal financial control are both adequate and effective in practice.

15 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 Authority and the controls that are operating at a senior level within the Council; and
- Reviewing the work of Internal Audit and seeking to place reliance upon the work that they have completed in relation to the 2004/05 financial year.

16 As reported to the Performance and Finance Select Committee[1] in June, we concluded that we were unable to adopt a systems-based audit approach, particularly given the lack of integration between the existing three ledger platforms (Unity, Oracle and Epicor). As a result, we agreed with key finance staff and internal audit to follow a largely substantive approach in our audit of the 2004/05 financial statements. We intend to work towards a more efficient, systems-based approach in future years, although the timescales for systems development currently suggest this will not be possible before 2006/07.

17 A planned approach to performing substantive testing at Service Units was discussed and agreed with key finance staff and Internal Audit. As part of the managed audit approach, we seek to place reliance on the work of Internal Audit where appropriate. A reduction in the scope of their work, compared to the prior year, was agreed this year, which necessarily resulted in an increase in the level of detailed testing performed by PricewaterhouseCoopers, particularly at Service Unit level compared to 2003/04.

18 We considered the work performed by Internal Audit, as required by Statement of Auditing Standard 500, and concluded that we were able to place reliance on the work performed by them in relation in relation to the 2004/05 financial year.

19 During our audit of this year's financial statements, we have not identified any material weaknesses in the Authority's internal control systems. We included in Appendix A our internal control findings that have come to our attention during our visit. Our findings are based on the work undertaken and should not be considered to be an exhaustive list of all control weaknesses. We have not sought to repeat observations made by Internal Audit in this Report.

20 We will consider the Council's financial standing, and further consider the Council's internal control environment, in our 2004/05 Joint Audit and Inspection Letter, which we expect to present to the Performance and Finance Select Committee before the end of the current financial year.

Qualitative aspects of the entity's accounting practices and financial reporting

21 We received the first draft of the accounts and pension fund accounts prior to the start of the audit, and these was of a good standard. The accounts, which were approved by the General Purposes Committee on the 12th July, were generally supported by sufficient working papers. This helped to ensure that the audit progressed in line with the timetable agreed with officers.

[1] Reported in our 2004/05 Audit Plan update, which formed part of our 2005/06 Audit Plan.

22 Next year, the requirement for the approval (30 June) and publication (30 September) of the accounts has been brought forward by another month. The preparation of financial statements within this timetable will present a challenge for the finance team, particularly in relation to the collation of schools' financial information. We have started to discuss the preparatory arrangements in place with relevant officers to ensure that suitable arrangements are in place to achieve the deadline. We will consider the arrangements in further detail as part of our 2005/06 audit.

23 The accounts of the Council are prepared using the Statement of Recommended Practice (SORP) 2004 and the Best Value Accounting Code of Practice, issued by the Chartered Institute of Public Finance and Accountancy. All local government organisations must follow the accounting policies specified in these documents. Our audit work has not identified any significant departures from these accounting policies.

24 The SORP currently allows the Council to spread the cost of premia incurred on early redemption of debt over a number of years, i.e. rather than writing off these costs in one year. The SORP will need to be revised in the next two years to adopt Financial Reporting Standard 26, which may result in changes to this treatment. The Council will need to consider the potential impact of any change in accounting requirements for local authorities. A recommendation has been raised at Appendix A, which provides further detail on this matter.

Matters specifically required by other auditing standards to be communicated to those charged with governance

25 There are no such matters which we are required to bring to your attention at this stage.

Any other relevant matters relating to the audit

26 The 2004 SORP contains substantial revisions relating to its requirements for group accounts, designed to provide a fuller picture of the totality of a Council's economic interests and results. The Council will need to consider, against the relevant guidance, whether disclosure of related entities' financial information will be required in its 2005/06 financial statements. If required, this will necessitate preparatory work by finance staff in the forthcoming months.

27 We are in the process of performing our grants audit work in relation to the 2004/05 year. Upon completion of this work, we plan to issue a separate grants audit report to the Council and have undertaken to report any issues with nominated finance staff, including the Deputy Director of Finance, as they arise.

Acknowledgement

28 We would like to thank Council's officers for their assistance and support during our audit of the Statement of Accounts.

Appendix A – Internal Control Report: Final Accounts

Ref	Observation	Risk	Recommendation	Management response
1	**Debt management** Audit work performed at Service Unit level identified some weaknesses in controls and procedures in place for monitoring levels of debt: • The Housing department was unable to provide a breakdown of the Homelessness debtor balance of £1.7m. • We noted that internal audit identified similar issues at Service Units they reviewed, which included Streetcare and Parks Services.	If the Council is unable to justify the inclusion of debtor balances within the Financial Statements these may need to be written off. Poor procedures for monitoring of debt and collection of income may lead to delays in receipt of income or failure to recover debts.	The Council should consider whether sufficient steps are being taken to recover, and account for, older debts. Responsibilities and procedures for debt collection, the write off of debt and bad debt provisions within the devolved finance teams should be reviewed and communicated to officers.	**Management response:** Brent is re-examining its debt recovery strategy. Instructions are issued to all departments before closure of accounts. A Task Group involving members may be established to examine debt recovery and reporting procedures. **Responsibility:** M.Spriggs **Timescale:** 2006 and 2007

Ref	Observation	Risk	Recommendation	Management response
2	**Intangible assets** The SORP requires separate disclosure of intangible assets in local authority accounts. However, the Council's fixed asset system does not signify these items separately. No intangible assets have been identified in the accounts.	Intangible assets may exist, but not be separately identified as required by the 2004 SORP.	The Council should seek to identify all assets that comply with the definition of intangible assets and make full and compliant disclosures for the 2005/06 accounts. If the Council is unable to demonstrate compliance with the SORP, this will require narrative disclosure in the accounts.	**Management response:** The fixed asset register and supporting information will be interrogated in order to identify existing intangible assets. These are expected to be minimal. The notes of guidance issued to services will require intangible assets to be declared on closing. **Responsibility:** M.Peart **Timescale:** Early 2006
3.	**Management Information on PWLB Loans** Our work on Long Term Borrowing identified five errors in the management information obtained from the Council's Loans Management System. These errors related to maturity date, interest rate and, in one case, the identity of the lender.	Inaccurate management information relating to loans could lead to late repayment of the loan. No such late payments were identified in the course of the audit. These errors did not impact on the 2004/05 financial statements.	The Council should continue to ensure that working papers are provided for the audit which are accurate and up to date. Training and assistance should be provided to officers to ensure that working papers and management information are satisfactory	**Management response:** The records have been corrected. **Responsibility:** M.Spriggs **Timescale:** Completed
4.	**Accounting for premia on premature debt redemption** The Council currently spreads the £24m cost of these items over a number of years. This treatment is in line with the current version of the SORP. However, the SORP will need to be revised in the next two years to adopt Financial Reporting Standard 26, which may result in a change to the current treatment.	It is possible that the Accounting Standards Board will require the SORP to take a less generous line on the spreading of premiums. However, convergence will not necessarily mean that the full sum will have to be expensed - it is possible that the government will bring in statutory support for the current treatment, or that some other method of avoiding charging these costs to revenue will be developed. We understand that CIPFA is certainly aware of the impact if all unamortised premiums had to be written off upon the implementation of the new FRSs, possibly in 2006/07.	The Council needs to be part of the national debate and consider how it would deal with any changes required in accounting treatment, particularly if there is likely to be an impact on revenue balances.	**Management response:** We are aware of the potential issue, but expect action by either CIPFA or ODPM to facilitate future restructurings and avoid a large charge – the premia will be reduced to £18m by 2007/08 - to one year. Our treasury adviser has raised this issue with CIPFA and ODPM. Brent will be writing to both bodies. **Responsibility:** M.Spriggs **Timescale:** End of November

Ref	Observation	Risk	Recommendation	Management response
5.	**Documentation of debt restructuring** In order to justify spreading the costs of debt redemption premia, the SORP guidance requires that documentation is produced to explain the overall economic effect of the restructuring. The Council currently produce a memo which gives brief details of the restructuring but which is not in full compliance with the guidance, which requires information on: • The loan to be replaced; • The expected life of the replacement loans; • The overall commercial effect including the treatment of premia and discounts; and • The reasoning behind the restructure.	Although the information produced by the Council was deemed to be sufficient for audit purposes, this could be improved to achieve greater compliance with the SORP guidance. This could help to address any risks around insufficient high level review of restructuring of debt, which could lead to inappropriate accounting treatment of similar items in the future.	Documentation should be produced in the case of a restructure which complies with the SORP guidance. This should be authorised in accordance with the Councils Treasury Management procedures.	**Management response:** Previous debt restructurings have been documented to detail both policy aspects and costs / benefits of change. Debt restructuring activity is reported to members as part of the Treasury Management Annual Report. However, the documentation will be improved in line with the SORP guidance. **Responsibility:** M.Spriggs **Timescale:** All future restructurings

Ref	Observation	Risk	Recommendation	Management response
6.	**Pensions deficit recovery period** Following discussions with the actuary, the Council has decided that they will recover the deficit on the pension fund over 25 years. Our understanding is that 20 years is a more common, and potentially more prudent, period for local authorities to adopt, particularly when viewed against the private sector where on average even the most soundly based schemes believe that the maximum period should lie in the range 12-14 years.	The current accounting arrangements may not be fully prudent. We have not proposed an adjustment to the 2004/05 accounts in relation to this matter, however, due to a combination of materiality and the difficulty in deciding what a more appropriate period would be.	The Council should consider monitoring the situation and be prepared to shorten the implementation period if circumstances warrant it. The FRS 17 information disclosed within the financial statements will provide an annual indication of the likely change of the deficit.	**Management response:** The poor investment returns for the period 2000 – 2003 have increased fund deficits at a time when contribution rates were already rising to cover previous deficits, pensioner longevity and falling gilt yields. The actuary, Hewitts, has proposed a 25 year recovery period for a number of clients, partly as a result of large deficits and partly because the return and inflation assumptions used have been quite severe. The recovery period will be reviewed at the next Actuarial Valuation (2007) when conditions may be more favourable. The comparison with the private sector does not take into consideration the differing legal framework between private and public sector funds, the security of public sector employers in underwriting the scheme, and the ODPM advice to use longer recovery periods to allow time to reform the scheme. However, there is no power to change the Actuarial Certificate between Valuations. **Responsibility:** M.Spriggs **Timescale:** 2007

Ref	Observation	Risk	Recommendation	Management response
7.	**Bank reconciliation (Pensions)** In the course of our audit work on the Pension Fund we noted that the bank reconciliation for the Superannuation Account was not supported by working papers. These are produced for management review but not held on file.	Lack of adequate audit trails mean that we cannot audit bank reconciliations in sufficient detail. Errors may exist in the year end figure, but not be identified through audit. This example was isolated to the Pension Fund.	Written procedures for those preparing bank reconciliations should require sufficient audit trails to be in place to enable testing to be performed at year end, if required. In particular, working papers should be kept for the Pensions bank accounts to show the list of outstanding payments and receipts for each reconciliation.	**Management response: T**he reconciliation has previously relied on a summary of outstanding payments and receipts rather than produce a detailed list each month. The detailed list will be produced on request, and will be added to the file. **Responsibility:** M.Spriggs **Timescale:** Implemented
8.	**Group Accounts** In preparation for the 2005/06 Financial Statements, the Council is in the process of identifying those entities which may require to be consolidated into the Financial Statements.	This is a SORP requirement for all Councils in 2005/06. Preparations are required in advance to enable alignment of accounting policies and to ensure that we can audit the consolidation.	The Council should formally: • Determine the range of its interests; • Decide whether these interests are relevant for group accounts; • Classify the relevant interests; and • Consider whether the Council is exempt from preparing group accounts on the basis of materiality.	**Management response:** Work is ongoing to ensure that the Council can meet group accounting requirements for the 2005/2006 accounts. Service Areas were asked whether they had any relevant interests in the summer. **Responsibility:** M.Gray **Timescale:** Early 2006

Ref	Observation	Risk	Recommendation	Management response
9.	**Protocol for Reporting to the Pensions Regulator.** The Pensions Act 2004 came into force from 6 April 2005. Among other things, the Act imposes a duty on the Authority and other employers to report breaches of applicable law which are likely to be of material significance to the Pensions Regulator. In the course of our work on the Pension Fund, it was found that there was no official procedure for reporting any such breaches, if they arise.	The Authority could face civil or criminal penalties for breaching the law or failing to report breaches applicable law which are likely to be of material significance to the Pensions Regulator.	The Council should have a written procedure with the following features: • A clear process for referral to the appropriate level of seniority at which decisions can be made on whether to report to the Pensions regulator; • An established procedure for dealing with difficult cases such as a 'Regulator Committee'; • A timeframe for the procedure to take place that is appropriate to the breach and allows the report to be made as soon as reasonably practicable; • A system to record breaches even if they are not reported to the Pensions Regulator.	**Management response:** This responsibility has been existence for a number of years. When, very exceptionally, an employer has been perceived to be in (usually minor) breach of their duties, they have been contacted to remind them of the sanctions available. This has been successful. However, a protocol will be written to cover these exceptional occurrences. **Responsibility:** M.Spriggs **Timescale:** November

Ref	Observation	Risk	Recommendation	Management response
10.	**Council Tax Benefits subsidy and Single Person Discounts** The Department of Work and Pensions (DWP) requires that, where a benefit claim is received against a full council tax liability and on the face of it a single person discount could apply, authorities should take follow up action and either apply the discount where appropriate or otherwise be able to justify not having done so. We are in the process of conducting work on the Council's subsidy claim, which we are required to audit by 31 December. From our initial testing, we identified 2 out of 15 cases where the discount had not been applied, where it potentially could have been.	Where the discount has not been applied in line with the DWP's requirements, there is a potential impact on subsidy, though it may be that the overall impact would be reduced by changes to the Council's overall allocation of funding. The impact of this potential issue is dependant on the Department of Work and Pensions' response to grants report, due to be issued by 31 December 2005. We would need to consider the reaction of the DWP to our qualification letter before concluding on this matter. However, there is no basis for proposing an adjustment to the accounts, at this stage.	This matter will be included in our grants report to the Department of Work and Pensions, as appropriate. In the interim, the Council should review its treatment of single persons to ensure that subsidy is not affected.	The council has mechanisms in place for identifying persons recorded as single on the benefits system and awarding Single persons discount or investigating the appropriateness of this. Benefit assessors have system access that allows them to apply discounts where appropriate and this is agreed policy with Capita. An annual single person's discount review is also carried out on by the Council's contractor – Capita – this includes identification of Single persons on the benefit system as well as cross referencing with other systems such as the electoral register. With regard to the 2 cases identified –one was followed up by contact with the charge payer and the other was a terminated claim. These explanations have been sent to PwC and we are awaiting further testing by them.