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First Wave Housing Limited

Report to the Directors

Year ended
31 March 2018

Strictly private and confidential

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The Directors
First Wave Housing Limited
Brent Civic Centre
Engineers Way
Wembley
Middlesex
HA9 0FJ

6 July 2018

Dear Sirs

We are pleased to enclose our report to the Directors in respect of our audit of the financial statements for the year ended 31 March 2018.

The primary purpose of this report is to communicate the significant findings arising from our audit to date that are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our Audit Plan, which we submitted to the Directors on 9 May 2018.

We have subsequently reviewed our Audit Plan and concluded that our original risk assessment remains appropriate. The procedures we have performed in response to our assessment of significant audit risks are detailed in the section "Audit approach".

We are in the process of completing our audit work and will update you as to its status as work progresses.

If you have any questions regarding matters in this document please contact Andy Lowe (andy.a.lowe@pwc.com) on 07720 555415 or Hannah Parker on 07706 284727.

Yours sincerely

Andy Lowe
For and on behalf of PricewaterhouseCoopers LLP

Contents

Introduction

Purpose of this report

We set out in this report our significant findings, to date, from our audit of First Wave Housing Limited ('FWH' or the 'Company') financial statements for 2017/2018, together with those matters which auditing standards require us to report to you as 'those charged with governance' of the Company.

We carried out our audit work in line with our 2017/18 Audit Plan that was submitted to you on 9 May 2018. This report details the main conclusions and matters arising from our audit work to date. We would also refer you to our engagement letter dated 2 May 2018.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters.

Status

We have completed the majority of our audit work. The key outstanding matters, where our work has commenced but is not yet finalised, are:

- Review of revised draft financial statements (and the full Annual Report) following our initial detailed comments relating to compliance with FRS 102 and other general presentation matters;
- Review for subsequent events; and
- Finalisation procedures including receipt of the signed annual report and financial statements and letter of representation.

We will inform the Directors if any other key matters arise as we finalise our work.

Key reporting matters

We have worked closely with management throughout the year to ensure that, as far as possible, all potential issues have been identified and resolved prior to the year end.

There are two key reporting matters to bring to you attention.

Going concern

The Directors of the Company must be comfortable that there is sufficient evidence available to them that FWH will continue to be a 'going concern' for at least twelve months from the date the financial statements are approved and signed. This going concern status relates not only to the preparation of the financial statements for the 2017/2018 accounting period but also, from an operational perspective, going forward.

At the date of this report, the Council have resolved to continue with FWH as a housing stock holding vehicle for the foreseeable future with reduced operations, and thus we have concluded that the going concern position is appropriate for the 2017/2018 financial year.

However, the situation will need to be carefully monitored in future reporting periods for any further developments in the Council's plans.

Pension transfer

The London Borough of Brent ('LBB' or the 'Council') decided to terminate the Management Agreement with FWH, with effect from 30 September 2017; but decided that the Company should continue in its own right as First Wave Housing Limited.

All FWH staff have transferred back to LBB under Transfer of Undertakings (TUPE) regulations. This means that the pension scheme deficit (excess of liabilities over assets) that previously existed (£18.5m in 2016/2017) no longer fall on the Company; and has been transferred back to LBB.

Even though the pension liability had transferred to LBB by the balance sheet (31/3/2018) date, there have still been material impacts on the FWH financial statements for this accounting period (1/4/17 to 30/9/17).

These are:

1. The income statement charge in relation to movements in the pension account – such as current service cost, interest cost, expected return on plan assets – for the period 01/04/17 to 30/09/17; and
2. The treatment of the difference between the pension liability and the pension reserve at the date of transition (30/09/17). This difference has been transferred to the revenue reserve (£2.97m).

We therefore requested that FWH obtain an actuarial valuation as at 30 September 2017. Hymans Robertson LLP has prepared this valuation for accounting purposes. Our internal PwC pension specialists have reviewed this, including assessing the reasonableness of the assumptions used. No issues were noted in this review.

Acknowledgements

We would like to thank Ian Rooney and Paul Keegan, alongside the wider finance department, for the help and assistance provided to us during the course of our audit.

Audit approach

Response to our risk assessment

We raised a number of risks in our Audit Plan where we detailed work we would be carrying out as part of our audit procedures.

We performed procedures at the year end to address each of these risks and assess whether the financial statements are free from material misstatement.

We provide an update of the work performed below. Risks are categorised as follows:

●	*Significant*	Risk of material misstatement due to the likelihood, nature and magnitude of the balance or transaction. These require specific focus in the year.
●	*Elevated*	Although not considered significant, the nature of the balance/area requires specific consideration.
●	*Normal*	We perform standard audit procedures to address normal risks in all other material financial statement line items (these other risks are not detailed in this report).

<table>
<tr><th>Risk</th><th>Significant / elevated risk</th><th>Reason for risk identification</th><th>Audit response</th></tr>
<tr><td>Significant risk
Risk of management override of controls</td><td>●</td><td>ISA (UK) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk that management may override controls in order to manipulate the financial statements.</td><td>We reviewed the appropriateness of manual journals processed during the year and targeted our testing on a risk basis, specifically:
• Journals containing specific words;
• Material journals;
• Round sum journals;
• Journals posted at the weekend;
• Journals posted during the financial statement preparation period; and
• Automated journals

We reviewed and challenged key assumptions and judgments made by management in producing the financial statements including:
• Those relating to the assumptions of the actuary in the context of the pensions provision;
• Provisions made for doubtful debts;
• Assumptions made in the valuation and impairment of properties (see work performed over elevated risk below); and
• Accruals for expenses incurred but not invoiced.

We have also performed cut-off testing post year end for revenue, expenditure and credit note review.

We note that management have updated their methodology in regards to the provision for doubtful accounts.

<u>Provisions for doubtful debts less than one year in arrears</u>
The following point was raised in prior years. Although the provision for doubtful debt is not specifically a significant risk to the financial statements, as a provision it carries an inherent risk of manipulation. As such it has been subject to challenge by audit.
The previous policy was to provide in full for:
• Rentals outstanding from all ‘former’ tenants; and
• Rentals overdue by a year from ‘current’ tenants.</td></tr>
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We recommended that management monitor, on a regular basis, the adequacy of the provision policy (in accordance with FRS102); based on historical data of debt write-offs within FWH. In particular, we challenged management as to whether amounts outstanding between 3 and 12 months should be provided for.
In 2017/2018 management have updated their bad debt provision to bring this in line with the methodology used by the London Borough of Brent. The new policy is to provide for:

100% of rentals outstanding from all ‘former’ tenants;
100% of rentals overdue >1 year from ‘current’ tenants;
60% of rentals overdue 6-12 months from ‘current’ tenants;
30% of rentals overdue 3-6 months from ‘current’ tenants; and
15% of rentals overdue 0-3 month from ‘current’ tenants.

The outstanding rent profile as at 31 March 2018 is as follows:
<table>
<tr><td>Rent due from former tenants</td><td>£165k (£165k provided for)</td></tr>
<tr><td>Rent due >1 year from current tenants</td><td>£112k (£112k provided for)</td></tr>
<tr><td>Rent due 6-12 months current tenants</td><td>£81k (£49k provided for)</td></tr>
<tr><td>Rent due 3-6 months current tenants</td><td>£75k (£48k provided for)</td></tr>
<tr><td>Rent due 0-3 months current tenants</td><td>£187k (£28k provided for)</td></tr>
</table>
We note that the new methodology is more prudent and is based on historical data of debt write-offs within the Council. The new methodology is also in line with the Council’s methodology.
We have no other matters to report in this area.
</td>
</tr>
<tr>
<td>Significant risk
Risk of fraud in revenue recognition</td>
<td></td>
<td>Under ISA (UK) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. The risk of fraud has been considered for each of the revenue streams recognised as follows:</td>
<td>We considered the accounting policies adopted by the Company and have tested income to the appropriate level in accordance with our audit procedures, designed to identify any material misstatement.</td>
</tr>
</table>

		• The majority of the Company's revenue is received via the management fee with the Council. The Council pays the management fee on a monthly basis. • In addition to the management fee, the Company generates revenue from other services including repairs administration, decent homes administration, and other charges to the Council and third parties. There is a risk that, for these revenue streams, the accounting policies the Company adopts, or the accounting treatment of the revenue transactions, may lead to revenue not being recognised in accordance with accounting standards. This is particularly relevant around year end in how management may manipulate the accounting policy for income recognition.	We also performed additional testing over: • Income transactions posted to the ledger between the period 1 March 2018 and 30 April 2018; and We also reviewed income transactions recorded through the Company's bank statement in April 2018. **We have no matters to report in this area.**
Significant risk Going concern	●	There is ongoing uncertainty around the HRA and level of funding to be provided to local government in the future. The possibility of local authorities delivering the services currently provided by ALMOs with a view to reduce running costs is currently under consideration. We are aware that the Company is in regular dialogue with Brent Council about the future shape and structure of its business. Currently the Company is under a performance review assessment which will shape its future structure, scope and potentially existence as a separate entity from the Council.	We have obtained an update on the understanding of the going concern positon of FWH at year end, through discussions with management and review of Brent Council documents. We have identified the following: • The Council intend to keep FWH running as a housing stock holding vehicle for the foreseeable future, as currently it would be logistically inefficient to transfer the housing stock either back to the Council or to a third party; and • The Council have guaranteed the debts of FWH in the letter of representation sent to PwC. **We believe the going concern basis is appropriate and have no matters to report in this area.**
Elevated risk Valuation and impairment of property assets	●	The current economic environment continues to have a significant impact on the housing sector. Recent government policy changes in relation to housing sector funding and benefits also presents significant challenges to the current business model of housing associations. Specifically for FWH, there is a risk that the valuations for completed schemes such as the	We have performed the following procedures: • Obtained valuation data directly from FWH's independent valuers (Jones Lang Lasalle) to confirm the accuracy and completeness of information presented in the financial statements; • Inquired of management on impairment assessments; and

		Settled Homes Initiative scheme may be less than the build cost, resulting in impairment charges.	• Performed reasonableness checks on the assumptions used by management in deriving the present value using discounted cash flow analysis; using our own in-house property valuation specialists to assist. **We have no matters to report in this area.**
Elevated risk Component accounting		It is a requirement of the Housing SORP that components of housing property assets should be accounted separately where the depreciation charge for separate components have a material impact on the financial statements. In the prior year, management's assessment of the impact of component accounting on the financial statements was not material. Management will need to assess the impact of component accounting in the current year to ensure that there is no material impact to the financial statements.	The following procedure was performed: • Reviewed management's estimation of the cumulative impact of not applying component accounting and ensured that it is not material to the financial statements. • Re-performed the calculation to confirm appropriateness of treatment. **We have no matters to report in this area.**

Risk of fraud and independence

Fraud

International Standards on Auditing (UK) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

We found in our work to date no instances of fraud to report to the Directors.

Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, attitudes and rationalisation.

Responsibility of the Directors

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of antifraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

Independence

Our policy to ensure independence, integrity and objectivity of PwC and the audit team was set out in our Audit Plan. We have included below our independence assessment which confirms our independence in accordance with International Standard on Auditing (UK) 260 (Revised) *"Communication with those charged with governance"*, UK Ethical Standard 1 (Revised) *"Integrity, objectivity and independence"* and UK Ethical Standard 5 (Revised) *"Non-audit services provided to audited entities"* issued by the UK Auditing Practices Board.

We have complied with APB Ethical Standards and, in our professional judgment, we are independent and our objectivity is not compromised. We have not identified any business or personal relationships between PwC and the Company that we consider to bear on our objectivity and independence as external auditors.

Internal financial controls

Summary of internal financial control deficiencies

Management are responsible for developing and implementing systems of internal financial control and to put in place appropriate arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the financial statements.

In accordance with ISA (UK) 265 we are required to communicate significant deficiencies in internal control to the Directors. These deficiencies were identified from our interim and year end procedures. We have also provided an update of issues raised in our prior year report in the table below.

No new issues in connection with internal financial controls have been identified during the course of our work.

Update on prior year recommendations

We reviewed management's implementation of recommendations made in our prior year report to the Directors in respect of 2016/2017.

We have summarised the response and provided our evaluation, based on the audit work we have undertaken in respect of internal controls this year.

Finding	Recommendation	Audit Follow-up	Status
Bank account In reviewing our external bank confirmation received from RBS we noticed one bank account which did not have a corresponding general ledger account. Whilst this account had a nil balance, if money were to be paid into the account this would not be recorded in the ledger and not reconciled to the ledger.	We recommend that the bank account is set up with a general ledger account, or, as it is not an operational bank account, the account is closed immediately.	**Not updated –** although the account continues to have a nil balance and was unused, the risk remains that any income or expenditure in this account would not be reconciled to the ledger as there is no dedicated TB code.	**Open**
Rent accounts receivable reconciliation We reviewed the rental accounts reconciliation as part of our testing over the rent receivable balance, and noted the following points: • The reconciling items are not listed out which does not make it clear what reconciling items require follow up. Through discussion with management it is clear that this is a new process as of September 2016, and that once in operation for a full year it should be easier to identify individual items; and There are delays in matching cash received to the rental accounts. Through discussion with management it is clear that the delays are often caused by the Council not identifying unmatched cash receipts in a timely manner.	We recommend the following: • Reconciling items at the year-end are listed out in a clear manner and investigated promptly to resolve the differences; and FWH should work with the Council to ensure that a timely review of unmatched cash receipts occurs and is clearly documented in line with the above recommendation.	**Not updated –** the reconciliation continues to list out the bulk differences between cash received on Northgate v5 and the General Ledger due to the difficulty in matching the bulk income received from the Council to specific tenants.	**Open**

Financial statements and audit process

The preparation of the financial statements is a key process in the stewardship of the group and one which should be performed on a timely basis.

The dashboard below summarises our qualitative view of management's performance regarding preparedness of the financial statements and the audit.

Key

● (red)	Significant impact on our audit process	● (yellow)	Moderate impact on our audit process	● (green)	No impact on our audit process

Assessment

Quality of financial statements and accounting records	● (green)
Readiness for transactional audit	● (green)
Response to queries and information requests throughout fieldwork	● (green)
Availability of staff	● (green)

Quality of financial statements and accounting records

- The quality and completeness of the first draft financial statements was to a reasonable standard. We received first draft financial statements prior to the start of the audit.

Readiness for transactional audit

- We were provided with comprehensive working papers supporting the figures in the financial statements on the first day of the audit.

Response to queries and information requests throughout fieldwork

- Finance staff worked hard to assist us during the audit and were quick in responding to our queries.

Availability of staff

- Key finance staff were available during the audit.
- Finance staff worked hard to assist us during the audit.

We would like to thank all involved for their time and assistance.

Appendices

Appendix I: Summary of uncorrected and corrected misstatements

This section contains details of any unadjusted errors which management do not consider material in the context of the financial statements as a whole. We are obliged to bring to your attention errors found during the course of the audit that have not been corrected, unless they are 'clearly trivial'. It was agreed with the Directors in May 2018 that we are to report all proposed audit adjustments which management have not elected to change with a value greater than £40,300. Our overall materiality was £806,900.

Errors are those identified as at the date of issue of this report. If additional items are identified between the date of this report and the signing of our audit report we will communicate these to you in due course.

Those charged with governance, the Directors, are requested formally to consider the uncorrected misstatements and to determine whether they concur with management's view that these are not material and that the financial statements should not be amended. If the misstatements are not amended, we will require a written representation from you explaining your reasons.

At the time of this report there are no uncorrected misstatements to report to you. Additionally, there are no corrected misstatements which exceed the above reporting threshold.