



The Audit Findings for First Wave Housing Limited

Year ended 31 March 2021

15 September 2021

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15 September 2021

To the Board of Directors

Audit Findings for First Wave Housing Limited for the year ended 31 March 2021

This Audit Findings presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260. Its contents have been discussed with management.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

We encourage you to read our transparency report which sets out how the firm complies with the requirements of the Audit Firm Governance Code and the steps we have taken to drive audit quality by reference to the Audit Quality Framework. The report includes information on the firm's processes and practices for quality control, for ensuring independence and objectivity, for partner remuneration, our governance, our international network arrangements and our core values, amongst other things. This report is available at www.grantthornton.co.uk/about-us/transparency-report/.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Joanne Love

Partner
For Grant Thornton UK LLP

Chartered Accountants

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Status of the audit and opinion

Our work is substantially complete and there are currently no matters of which we are aware that would require modification of our audit opinion, subject to the outstanding matters detailed below.



Updated management paper on Granville remedial work including considerations detailed on page 6-7.
Minor sample items or queries from fieldwork.
Final tax specialist review of deferred and current taxation balances and charge.
Final review of updated financial statements.
Receipt of legal confirmation from internal legal team.

All conclusions in this report are subject to final internal quality control reviews, which may result in additional queries or requests.

Status

- Likely to result in material adjustment or significant change to disclosures within the financial statements
- Potential to result in material adjustment or significant change to disclosures within the financial statements
- Not considered likely to result in material adjustment or change to disclosures within the financial statements

Our anticipated audit report opinion will be unmodified

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Observations in respect of significant risks

Risks identified in our Audit Plan

Commentary

1

Improper revenue recognition

- Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue

Our procedures included but were not limited to:

- Review and testing of revenue recognition policies;
- Performing a walkthrough to confirm our understanding of the processes and controls through which the business initiates, records, processes and reports revenue transactions;
- Performing substantive analytical review based on prior year revenue and reflecting changes in property numbers and annual rent increases; and
- Agreeing a sample of the rental income to the supporting rent agreements.

We did not identify any misstatements and control deficiencies in relation to revenue recognition.

2

Management override of controls

- Under ISA 240 (UK) there is a presumed risk that the risk of management over-ride of controls is present in all entities

The work performed by the auditor consisted of:

- Reviewing accounting estimates, judgements and decisions made by management. We have tested the valuation of properties as a significant risk – see page 6; and
- Testing journal entries using audit data analytics to identify potentially unusual transactions. The data analytics performed a series of automated tests, looking for characteristics which may potentially indicate increased risk, for example material profit impact, blank descriptions, or infrequent postings.

We found no misstatements or control points relating to journals testing.

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Observations in respect of significant risks (continued)

Risks identified in our Audit Plan

Commentary

3

Valuation of social housing properties and valuation of investment properties

As a matter of accounting policy, the company holds its housing properties at valuation. This is measured on an existing use for social housing basis. The investment properties are also held at valuation on an open market basis. Both require significant judgement and there is a risk that these revaluation measurements are materially misstated.

During planning, it has also been brought to our attention that significant remedial works are required for a significant portion of the social housing stock of First Wave Housing. Initial cost estimates have been calculated at approximately £18m on housing stock with a carrying value of £12m at 31 March 2021. Management must therefore review the accounting treatment for these works.

Valuation of property portfolio:

Our work consisted of:

- Obtaining copies of the valuations prepared by management's expert and agreeing to the financial statements;
- Using an internal expert employed by Grant Thornton to assess the assumptions, inputs, and methods used by management's expert;
- Considering the credentials and independence of the valuers;
- Discussing with the valuers their key assumptions and documenting the challenge and corroborating evidence; and
- Testing the three disposals to underlying documentation to ensure it was appropriate to recognise the disposals in the current year.

We found no misstatements in relation to valuation..

Granville Blocks – refurbishment costs:

A number of issues have been identified at the Granville blocks including water penetration and the use of hazardous materials in the construction that represent a fire risk. Ridge and Partners have been commissioned to survey the block identify the issues and set out remediation proposals and cost estimates. The total cost for the works is estimated at £18m, however the value of the properties in the JLL valuation (with the special assumption that these works have been completed) is £12m. In the initial accounting paper, management had proposed reducing the carrying value of the property portfolio by £18m. However, this would result in "negative assets" of £6m netting off against other housing properties. This is inappropriate and not the correct presentation under FRS 102 or the Housing SORP.

We requested management prepare a paper considering how the facts and circumstances outlined above should be assessed against the criteria within FRS 102, in respect of both the carrying value of the properties and the requirement to recognised any provision.

Specifically in respect of the provision, management were asked to consider the following criteria set out within FRS 102:

Section 21 of FRS 102 requires three criteria to be met in order for a provision to be recognised which are:

- (a) the entity has an obligation at the reporting date as a result of a past event;
- (b) it is probable (that is, more likely than not) that the entity will be required to transfer economic benefits in settlement; and
- (c) the amount of the obligation can be estimated reliably.

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Observations in respect of significant risks (continued)

Risks identified in our Audit Plan

Commentary

3

Valuation of social housing properties and valuation of investment properties

Within their paper management concluded that FWH does have a legal obligation. We considered the basis on which management had reached this conclusion and also consulted with our technical specialists. On the basis of the fact pattern set out by management and as understood by the audit team, we do not agree with management's assessment. Specifically, we note that a distinction must be made between a legally enforceable obligation and a requirement to incur future operating costs. Whilst the laws and regulations quoted by management within their paper impose a series of responsibilities on a housing provider, they do not mandate a specific course of action. Furthermore, many of the requirements are on-going and the costs associated with the remediation works should not be treated differently to any other on-going maintenance cost.

In respect of the carrying value of housing properties, as noted above, FWH applies a policy of revaluation. In accordance with the Housing SORP, the basis of valuation adopted is EUV-SH (Existing Use Value – Social Housing). This uses a discounted cashflow model to derive a valuation. Therefore, it is appropriate that future costs are included within the cashflows. We therefore, concur with management, that the carrying value of the Granville Blocks as at 31 March 2021 is £nil. This was initially presented by management as an impairment, however, as this relates to a movement in the EUV-SH, should be shown as a revaluation movement in the Statement of Comprehensive Income. We are awaiting the final management paper to document their final considerations, as well as financial statements updated to reflect that there is a £12.5m downwards revaluation and no provision or impairment to be recognised.

[Our conclusion on the appropriateness of the position taken by management remains subject to obtaining final documentation.]

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Observations in respect of other risks

Risks identified in our Audit Plan

Commentary

1

Housing property existence

There is a potential risk that housing properties do not exist or are not owned by the entity at year-end.

Our procedures included:

- Verifying the existence of a sample of properties to land registry documentation;
- Testing the disposals in the year to supporting documentation; and
- Reviewing the disclosures within the financial statements.

We continue to recommend that the company adopts component accounting to align its policies and results with the Housing SORP. We have reviewed management's assessment that the financial impact is not material for the current year and concur with their assessment.

2

Administrative expenses and corresponding liabilities

There is a potential risk that expenditure is incorrectly recognised.

Our procedures included:

- Updating our understanding of the processes and controls applicable to the allocation of expenditure;
- Selecting a sample of items and agreeing to supporting documentation to ensure they are correctly classified. We have reconciled costs recharged from the Council to the SLA and quarterly invoices; and
- Confirmed the closing creditor balance for amounts owed to the London Borough of Brent.

3

Debt

There is the potential risk that debt and interest balances are not complete at year-end.

Our procedures included:

- Confirming the loan balance with London Borough of Brent and recalculating interest payments due; and
- Reviewing interest payments and relevant calculations prepared by management to ensure they are in accordance with the loan agreements.

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Observations in respect of other risks (continued)

Going concern commentary

Management's assessment process

Management have produced a detailed business plan and budget, which included a 5 year financial forecast.

They have used this to model their expected cashflows and profit for the going concern period (12 months from the expected date of signing).

COVID-19 resulted in increasing uncertainty in the economy and management are monitoring any impact on the rents received each month.

In addition, First Wave Housing are seeking to finance the £18m of remedial works required on properties (see pages 6-7) and this is a key assumption when considering the going concern status of the entity.

Auditor commentary

Our work has consisted of:

- Reviewing management's forecasts and budgets and comparing to the audited results for the current year;
- Reviewing the impact of COVID-19 on the rental income collected during the current year and any impact on the forecast period to date;
- Reviewing the sensitivities produced by management and considering their adequacy; and
- Testing the mathematical accuracy of the forecasts.

We have noted that the Company is reliant on the continued funding and support of the London Borough of Brent (for example the SLA and debt agreement). We have therefore requested that management obtain a letter of support from the London Borough of Brent, which we have obtained and reviewed.

The key assumption within the going concern period is how the £18m of remedial works will be funded, as this is £18m of cash costs outside of the normal course of business which will be incurred within 2 years of the balance sheet date.

[Our conclusion in this area is subject to receiving the final letter of support from the London Borough of Brent.]

Other communication requirements

	Issue	Commentary
1	Matters in relation to fraud	<ul style="list-style-type: none">We have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit procedure.
2	Matters in relation to related parties	<ul style="list-style-type: none">We are not aware of any related parties or related party transactions which have not been disclosed.
3	Matters in relation to laws and regulations	<ul style="list-style-type: none">We are not aware of any significant incidences of non-compliance with laws and regulations.
4	Written representations	<ul style="list-style-type: none">We will request a letter of representation from the Board to be signed on the date of signing.Specific representations will include:<ul style="list-style-type: none">The going concern forecasts provided are the most up to date and include all material relevant facts and circumstances.The judgements and estimates included in the final Granville accounting paper represent the most up to date and accurate view of the Board.
5	Confirmation requests from third parties	<ul style="list-style-type: none"><i>We are awaiting confirmation of bank balances from RBS.</i><i>We will require a copy of the letter of support provided by the London Borough of Brent to the Directors of the Company.</i>
6	Disclosures	<ul style="list-style-type: none">We have provided feedback on the draft financial statements and are awaiting updated accounts. Final disclosures to amend include the taxation note, the presentation of the downwards revaluation on the Granville blocks, and disclosures relating to the £18.5m of costs for remedial works (subject to mitigating actions such as stock transfer).

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Internal controls

Assessment

Issue and risk

Recommendations

<p>1</p> <p>●</p>	<p>Accounting policies and judgements</p> <p>There are certain judgements within the financial statements which have a material financial impact on the results of the Company. Within the current year this includes the treatment of Granville refurbishment costs. The original accounting paper provided included a negative asset, and no considerations of the SORP and FRS 102 requirements for the write-down of property assets or the recognition of provisions. The original paper proposed recognizing a negative asset of £6m which would offset the carrying value of other properties. This is not an appropriate recognition of the facts and costs. This indicates the paper had not been through an appropriate internal review process. There is a risk that if accounting judgements are not reviewed internally and appropriately concluded on that material errors will be posted to the financial statements.</p> <p>Similarly, it was noted in the prior year that there were multiple iterations of the financial statements due to errors or inconsistencies. There is a risk that financial statements will have material errors including omissions if internal review processes are not completed.</p>
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We recommend that all material judgements, estimates, and accounting policies are discussed internally, formally documented, and reviewed by senior finance staff before being implemented.

We also recommend that financial statements go through internal review by senior finance staff before being provided to the Board and Audit team, to ensure the process is as efficient as possible.

Management response

Fixed asset accounting – This was a highly unusual transaction on which management sort advice from GT at the account planning stage. Approaches were reviewed by senior management prior to submission to GT. Engagement with Auditors highlighted the need for input from the GT technical team and this advice took longer to receive than anticipated. When received a final amendment to the accounts was required as a result of the technical teams advice. Our legal advisors have advised that it is a legal obligation to carry out the works and therefore we presented this as a provision in the accounts accordingly. However, we accept the argument, following a GT internal technical review, that this shouldn't be recognised as a provision as FWH could dispose of the assets

Financial statements - Accounts have been reviewed in the 20-21 accounts process prior to submission to GT. The review focusses on material items and it is not practical or efficient to review all cross casting or presentational matters until the preparation of the final version of the accounts

"The purpose of an audit is for the auditor to express an opinion on the financial statements. Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance." (ISA (UK) 265)

Assessment
 ● Significant deficiency – risk of significant misstatement
 ● Deficiency – risk of inconsequential misstatement

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Internal controls – review of issues raised in prior year

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
<p>① X</p>	<p>Application of Component Accounting The Statement of Recommended Practice (SORP) which is applied by the Company requires the application of component accounting. That is a property should not be considered as a single asset but split between its material components. i.e. land, structure, roof, kitchen, bathroom, etc. Management undertook an exercise sometime ago and determined that the impact of not applying such a policy was not material to the financial statements. Over time, the cumulative impact will become material.</p>	<p>Management have prepared a current year assessment of applying component accounting and we concur with their assessment that the difference is immaterial. However, we continue to recommend that component accounting is applied going forwards to ensure compliance with the SORP. We understand management plans to apply this going forwards.</p>

Assessment
 ✓ Action completed
 X Not yet addressed

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Misstatements

We have not identified any misstatements above our reporting threshold in the work performed to date. We will update this when our work is finalised, including work on the adjustments in respect of the required works at Granville.

Independence, ethics, and fees

Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements.

Fees

The table below sets out the total fees for audit for the current financial year (net of VAT). There are no non-audit services for the Company.

<u>Company</u>	<u>£</u>
Audit of First Wave Housing Limited	29,500

The fees disclosed in the financial statements should be updated to the current year audit fees (net of VAT). Currently they are stated as £26k.

The financial statements should also be updated to make clear the fees paid to your tax advisors are not paid to Grant Thornton. Currently they are listed under Auditor's Remuneration, but this is inappropriate as the tax computations are not performed by Grant Thornton.

None of the above services were provided on a contingent fee basis.

For the purposes of our audit we have made enquiries of all Grant Thornton teams within the Grant Thornton International Limited network member firms providing services to First Wave Housing Limited. The table summarises all non-audit services which were identified. In addition, we have identified services performed in respect of group entities including the London Borough of Brent and i4B Holding Limited. The fees to these entities are communicated within the Audit Findings Reports of the relevant entity.

This covers all services provided by us and our network to the company, its directors and senior management and its affiliates, and other services provided to other known connected parties that may reasonably be thought to bear on our integrity, objectivity or independence. (ES 1.69)

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Communication of audit matters with those charged with governance

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, form, timing and expected general content of communications including significant risks and Key Audit Matters	•	
Confirmation of independence and objectivity	•	•
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
Significant matters in relation to going concern	•	•
Matters in relation to the group audit, including: Scope of work on components, involvement of group auditors in component audits, concerns over quality of component auditors' work, limitations of scope on the group audit, fraud or suspected fraud	•	•
Views about the qualitative aspects of the Group's accounting and financial reporting practices including accounting policies, accounting estimates and financial statement disclosures		•
Significant findings from the audit		•
Significant matters and issue arising during the audit and written representations that have been sought		•
Significant difficulties encountered during the audit		•
Significant deficiencies in internal control identified during the audit		•
Significant matters arising in connection with related parties		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
Non-compliance with laws and regulations		•
Unadjusted misstatements and material disclosure omissions		•
Expected modifications to the auditor's report, or emphasis of matter		•

ISA (UK) 260, as well as other ISAs (UK), prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table here.

This document, the Audit Findings, outlines those key issues, findings and other matters arising from the audit, which we consider should be communicated in writing rather than orally, together with an explanation as to how these have been resolved.

Respective responsibilities

As auditor we are responsible for performing the audit in accordance with ISAs (UK), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance.

The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Distribution of this Audit Findings report

Whilst we seek to **ensure** our audit findings are distributed to those individuals charged with governance, as a minimum a requirement exists for our findings to be distributed to all the company directors and those members of senior management with significant operational and strategic responsibilities. We are grateful for your specific consideration and onward distribution of our report, to those charged with governance.

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