

Annual Audit Letter

December 2005



# Annual Audit Letter

**East London Waste Authority**

**Audit 2004-2005**

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As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we ensure that public services are good value for money and that public money is properly spent.

### **Status of our reports to the Authority**

Our reports are prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Reports are prepared by appointed auditors and addressed to members or officers. They 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.

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# Contents

<b>Key messages</b>	<b>4</b>
The accounts	4
Financial aspects of corporate governance	4
Performance management	4
Action needed by the Authority	4
<b>Accounts</b>	<b>5</b>
Matters arising from the final accounts audit	5
Report to those with responsibility for governance in the Authority	5
<b>Financial aspects of corporate governance</b>	<b>6</b>
Financial standing	6
Systems of internal financial control	7
Standards of financial conduct and the prevention and detection of fraud and corruption	8
Legality of financial transactions	8
<b>Performance management</b>	<b>9</b>
Best value performance plan	9
<b>Future audit work</b>	<b>10</b>
<b>Closing remarks</b>	<b>11</b>
Availability of this letter	11
<b>Appendix 1 – Background to this letter</b>	<b>12</b>
The purpose of this letter	12
Audit objectives	12
<b>Appendix 2 – Audit reports issued</b>	<b>14</b>
<b>Appendix 3 – Audit fee</b>	<b>15</b>

## Key messages

### The accounts

- 1 We gave an unqualified opinion on the Authority's accounts on 31 October 2005.

### Financial aspects of corporate governance

- 2 The Authority's financial position is sound. It should formalise its risk assessment process to determine a target level of general reserves and communicate this to members. Underspends against budget have occurred due to lower than forecast levels of waste tonnage. The Authority should continue to work closely with Shanks to review the reasonableness of future waste estimates.
- 3 We can continue to place reliance on the work of Internal Audit. Risk management processes are developing.
- 4 Internal Audit has agreed a number of recommendations with the Authority to strengthen the anti-fraud and corruption control environment.
- 5 The Authority's overall arrangements to ensure the legality of financial transactions are adequate.

### Performance management

- 6 We issued our statutory report on the Authority's best value performance plan (BVPP) on 30 November 2005. It contained no recommendations.

### Action needed by the Authority

- 7 The Authority should:
  - continue to review the level of reserves on an ongoing basis and ensure that the target level is supported by a robust risk assessment which is communicated to members;
  - ensure that officers continue to work with Shanks to manage the inherent volatility in the forecasting of waste tonnage; and
  - monitor the progress made in implementing Internal Audit's recommendations to strengthen the anti-fraud and corruption control environment and contract monitoring arrangements.

## Accounts

- 8 We gave an unqualified opinion on the Authority's accounts on 31 October 2005.

### Matters arising from the final accounts audit

- 9 Members approved the Authority's financial statements on 18 July 2005.
- 10 The working papers provided to support the accounts were generally adequate, although we did experience some delays in securing complete responses to audit queries.
- 11 Our audit identified one amendment to the statements. The draft accounts included expenditure of £412,000 in respect of tonnage mileage payments. However, this represented the budget for that item of expenditure as some of the invoices from constituent councils in respect of these amounts had not been received at the time the financial statements were prepared. Taking into account the invoices received subsequently, expenditure on tonnage mileage incurred by the constituent councils totalled £703,000. The impact of the amendment was to reduce the surplus by £292,000 to £3,695,000. The Authority needs to ensure that the councils issue their invoices for tonnage mileage payments more promptly to assist financial monitoring and the preparation of the financial statements.
- 12 We identified other minor presentational amendments to the draft accounts which were agreed with officers.
- 13 We note that the Authority is in the process of securing a valuation for the four closed landfill sites. Once obtained, this will need to be incorporated into the 2005/06 financial statements.

### Report to those with responsibility for governance in the Authority

- 14 Statement of Auditing Standard (SAS) 610 'Reporting to those charged with governance', requires auditors to report certain matters before they give an opinion on the financial statements. We reported to the Authority on 17 October 2005 that there were no matters arising from our audit that needed to be brought to members' attention under SAS 610. We subsequently issued an unqualified opinion on the Authority's accounts on 31 October 2005. At the same time, we issued our certificate on the 2004/05 audit.

## Financial aspects of corporate governance

### Financial standing

- 15 The Authority's financial position is sound. It should formalise its risk assessment process to determine a target level of general reserves and communicate this to members. Underspends against budget have occurred due to lower than forecast levels of waste tonnage. The Authority should continue to work closely with Shanks to review the reasonableness of future waste estimates.
- 16 The Authority set an operational revenue budget of £28.4 million for 2004/05. The audited net expenditure for the year was £25.7 million, representing an underspend of £2.7 million (9.5 per cent). The factors contributing to the underspend were:
  - lower than forecast waste volumes;
  - additional income from commercial waste charges and bank interest; and
  - anticipated new regulations and other initiatives for which the Authority had built contingencies into the budget did not occur during the year.
- 17 The surplus of £2.7 million has been appropriated to the general revenue reserve. At 31 March 2005, this reserve totalled £7.1 million, equal to 24 per cent of the net revenue budget for 2005/06.
- 18 As part of its risk management process, the Authority has prepared an analysis detailing the operational risks, the likelihood that the event will happen and the potential cost if that risk is realised. This analysis should be used to inform a target level for the general reserve, which should be communicated to and approved by members. In doing so, consideration also needs to be given to the earmarked revenue reserves held by the Authority. As the Authority operates within a dynamic environment, the risk assessment will need to be reviewed on a regular basis to ensure that the level of reserves remains appropriate.
- 19 The Authority maintains an earmarked revenue reserve, the PFI Contract Reserve. This reserve was established to smooth the impact of annual increases in the Integrated Waste Management Services (IWMS) contract costs and consequently, limit year-on-year increases in the levy that funds those costs. At 31 March 2005, this reserve totalled £7.9 million. The Authority also plans to utilise general reserves to limit the annual increase in the levy when there is a large year-on-year increase in the contract costs.

- 20 The annual IWMS contract cost is determined by the levels of waste tonnage. In the previous two financial years, and continuing into 2005/06, the actual waste collected has been less than forecast, as detailed in Table 1.

**Table 1 Waste tonnage**

Forecast waste compared to waste collected and impact on annual contract costs

Year	Forecast tonnage	Outturn tonnage	Difference tonnage	Difference %	Difference £
2003/04	568,000	518,000	50,000	8.8%	2.4m
2004/05	553,400	517,000	36,400	6.6%	2.3m
2005/06	527,700	493,000 (estimated)	34,700	6.6%	

*Source: Authority papers*

- 21 The forecasts for waste tonnage are agreed with Shanks before the start of the financial year. Table 1 demonstrates that there is an inherent volatility in predicting the levels of waste tonnage. The Authority needs to continue to work closely with Shanks to review future estimates in light of previous experience. Any revisions to the forecast waste should then be built into the profile of contract costs for financial planning purposes.

## Systems of internal financial control

- 22 We can continue to place reliance on the work of Internal Audit. Risk management processes are developing.
- 23 As in previous years, we reviewed a sample of Internal Audit's files and found that they complied with relevant professional standards. We continue to be able to place reliance upon Internal Audit's work.
- 24 During the year, progress has been made in formalising the approach to risk management. This has been supported by the delivery of specialist training to officers. The major risks facing the Authority have been considered and priorities and mitigating actions have been assigned to these risks. This was reported to Management Board in June 2005 and processes are being established for reporting risk management to the Authority. Work is currently underway to produce a comprehensive risk strategy and risk register.

## Standards of financial conduct and the prevention and detection of fraud and corruption

- 25 Internal Audit has agreed a number of recommendations with the Authority to strengthen the anti-fraud and corruption control environment.
- 26 During the year, Internal Audit completed an anti-fraud review at the Authority. They concluded that the most significant financial risk facing the Authority is within the IWMS contract as payments to Shanks are based on information provided by Shanks. To address this risk, Internal Audit has recommended that the Authority undertakes detailed monitoring of information provided by the contractor and co-ordinates this review with representatives from the four constituent councils.
- 27 In previous years, the Authority has applied the anti-fraud and corruption policies of the constituent councils, in particular, the London Borough of Redbridge. In line with good practice, Internal Audit recommended that the Authority develop its own policies and procedures, including:
  - an anti-fraud and corruption strategy;
  - a fraud response plan; and
  - a 'whistleblowing' policy.
- 28 We understand that these documents are currently being drafted.

## Legality of financial transactions

- 29 The Authority's overall arrangements to ensure the legality of financial transactions are adequate.
- 30 We reviewed the Authority's overall arrangements to ensure the legality of transactions with financial consequences and we did not identify any areas of concern.
- 31 The Authority monitors closely developments in European Union and UK waste legislation. The operational and financial impact of pending legislation is considered and where deemed appropriate, contingencies to address such developments are built in to the budget-setting process.

## Performance management

- 32 We issued our statutory report on the Authority's best value performance plan on 30 November 2005. It contained no recommendations.
- 33 The Authority's services are delivered through a 25-year Integrated Waste Management Service (IWMS) contract with Shanks Waste Services Ltd. Therefore, performance management is primarily delivered through the client monitoring role.
- 34 During the year, Internal Audit reviewed the information system operated by Shanks that is used to generate data for contract monitoring. They concluded that while the system had sound operating controls, there was a need for the Authority to review the information and reports generated by the system to ensure that it meets its needs and enables the client management role to be performed effectively.

## Best value performance plan

- 35 The Authority published its best value performance plan (BVPP) by the deadline of 30 June 2005. We assess the extent to which the BVPP complies with statutory requirements as to its content and distribution. The 2005/06 plan was compliant with statutory requirements in all significant respects. We issued our statutory report on the BVPP on 30 November 2005 and it contained no recommendations.
- 36 The BVPP includes seven environment best value performance indicators (BVPIs). We reviewed the Authority's processes for compiling these indicators and found them to be satisfactory. Our audit did not include any reservations on the BVPIs disclosed in the BVPP.

## Future audit work

- 37 The statutory requirements governing our audit work are contained in:
- the Audit Commission Act 1998; and
  - the Code of Audit Practice (the Code).
- 38 The Code has been revised with effect from 1 April 2005. Further details are included in our Audit Plan which was agreed with the Authority on 17 October 2005. The key changes include:
- the requirement to draw a positive conclusion regarding the Authority's arrangements for ensuring value for money in its use of resources; and
  - a clearer focus on overall financial and performance management arrangements.

## Closing remarks

- 39 This letter has been discussed and agreed with the Finance Director. A copy of the letter will be presented at the Authority meeting on 6 February 2006.
- 40 I would like to take this opportunity to express my appreciation for the assistance and co-operation provided during the course of the audit. Our aim is to deliver a high standard of audit that makes a practical and positive contribution and which supports the Authority's own agenda. We recognise the value of your co-operation and support.

## Availability of this letter

- 41 This letter will be published on the Audit Commission's website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk) and a copy should also be placed on the Authority's website.

Jon Hayes  
District Auditor  
December 2005

## Appendix 1 – Background to this letter

### The purpose of this letter

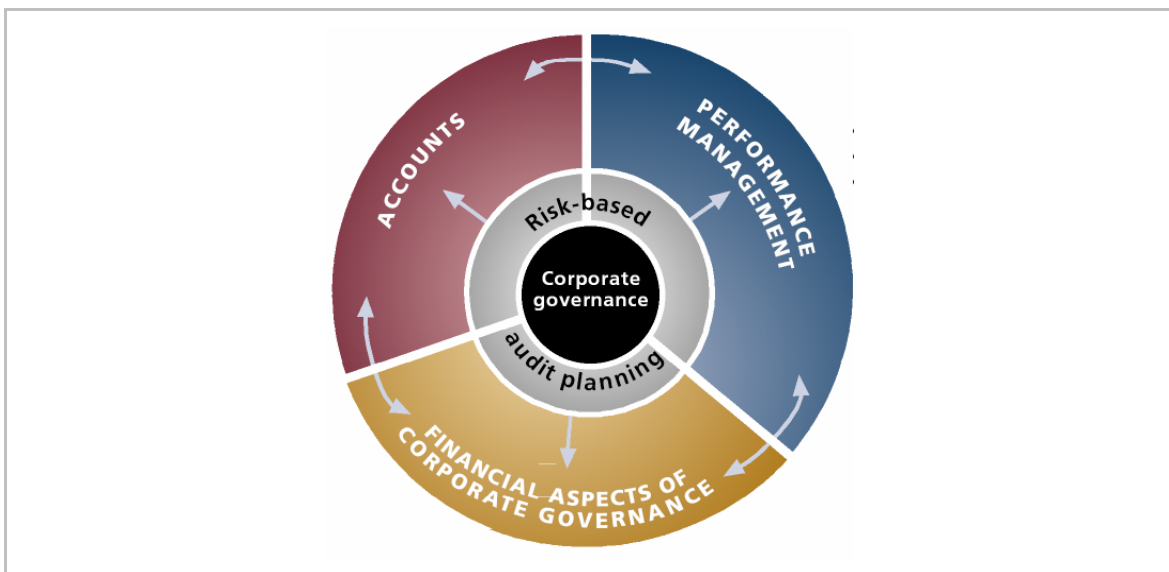
- 42 This Annual Audit Letter summarises the conclusions and significant issues arising from our 2004/05 audit of the Authority, together with our comments on other current issues.
- 43 More detail can be found in the separate reports we have issued this year which are listed in Appendix 2 for information. These reports have been discussed and agreed with officers.
- 44 The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.
- 45 Appendix 3 provides information about the fee charged for our audit.

### Audit objectives

- 46 Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on the significant risks that are relevant to our audit responsibilities.
- 47 Figure 1 illustrates our responsibilities under the Code.

**Figure 1 Code of Audit Practice**

Code of practice responsibilities



- 48 Central to our audit are your corporate governance arrangements. Our audit is then structured around three elements as shown below.

### **Accounts**

- Opinion.

### **Financial aspects of corporate governance**

- Financial standing.
- Systems of internal financial control.
- Standards of financial conduct and the prevention and detection of fraud and corruption.
- Legality of transactions.

### **Performance management**

- Performance information.
- Best value performance plan.

## Appendix 2 – Audit reports issued

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**Table 2**

<b>Report title</b>	<b>Date issued</b>
Audit Plan 2004/05	May 2004
Report to Those Charged with Governance on the Financial Statements 2004/05 (SAS 610)	October 2005
Final Accounts Action Plan	November 2005
Best Value Performance Plan Statutory Report	November 2005
Annual Audit Letter	December 2005

## Appendix 3 – Audit fee

**Table 3**     **Audit fee update**

<b>Audit area</b>	<b>Plan 2004/05</b>	<b>Actual 2004/05</b>
Accounts	£14,500	£14,500
Financial aspects of corporate governance	£4,500	£4,500
Performance	£9,000	£9,000
<b>Total</b>	<b>£28,000</b>	<b>£28,000</b>