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London Borough of Hillingdon

Report on the financial statement audit for the year ended 31 March 2012

To be presented at the Audit Committee meeting scheduled on 20 September 2012

Issued on 12 September 2012

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12 September 2012

Dear Sirs

We have pleasure in setting out in this document our report to the audit committee of the London Borough of Hillingdon for the year ended 31 March 2012, for discussion at your meeting scheduled for 20 September 2012. This report covers the principal matters that have arisen from our audit for the year ended 31 March 2012.

In summary:

- The significant risks, which are summarised in the Executive Summary, have been addressed and our conclusions are set out in the report.
- There are a number of judgemental areas to which we draw your attention in our report which you should consider carefully.
- In the absence of unforeseen difficulties, we expect to meet the agreed audit and financial reporting timetable.

We would like to take this opportunity to thank Paul Whaymand and his team for their assistance and co-operation during the course of our audit work.

Heather Bygrave

Senior Statutory Auditor

Contents

Executive summary

Status	Description	Detail
Completion of the audit		
Our audit is largely complete	The status of the audit is as expected at this stage of the timetable agreed in our audit plan. The following are the remaining outstanding areas we are required to complete before we can finalise the audit: • Completion of procedures on the Whole of Government Accounts (WGA) • Completion of internal review procedures • Review of post balance sheet events • Receipt of signed management representation letter	N/A
Significant audit risks		**Status**
We have not identified any material issues through our procedures in respect of the Council's significant audit risks	In our audit plan we identified a number of significant audit risks. Our findings in respect of those risks are as follows:	
	• **Revaluation of properties**: in the 2011/12 year the Council valued a range of assets including community halls, allotments and farms, and assets which had changed status through being completed in the year or were deemed to be surplus to requirements or planned for sale. We considered the process undertaken for the valuation of these assets and reviewed the assumptions used. We concluded that they were reasonable.	G
	• **Valuation of the pension liability**: we considered the assumptions used to calculate the liability relating to the London Borough of Hillingdon Pension Fund to fall within a reasonable range.	G
	• **Recognition of capital and revenue grant income**: our testing of grants identified some instances where the grant recognition criteria had not been correctly applied. The adjustment, which has been accepted and amended by management, resulted in a reclassification of income and expenditure but had no net impact on the net cost of services.	G
	• **Completeness of bad debt provision for sundry debt**: the sundry debt balance includes a number of different sub-categories of debt, each with different methods for calculating the level of provision required. Our testing concluded that overall the level of provision for this balance was reasonable.	G
	• **Housing Revenue Account self-financing settlement payment**: we identified this as a risk because of the size of the settlement (£192m) and the fact that it was a one-off unusual transaction. No issues were noted from our testing.	G
	• **Recording of capital spend**: we identified some inconsistencies in the treatment of capital and revenue spend, particularly with respect to council dwellings. This has resulted in a proposed adjustment of £0.5m which, if corrected, would increase the fixed assets balance but have no net effect on the surplus of the Housing Revenue Account (HRA). As part of this testing we identified another proposed adjustment of £3.3m to reclassify lifts and boilers from the category of council dwellings to plant and equipment. Management has not made these adjustments as it does not consider them to be material but has agreed to adopt a consistent treatment going forward.	A

G Risk appropriately addressed

A Risk satisfactorily addressed but with unadjusted errors identified

R Material unresolved matter

Executive summary (continued)

Status	Description	Detail

Significant audit risks (continued) — Status

We have not identified any material issues through our procedures in respect of the Council's significant audit risks

- **Accounting for schools**: A number of schools changed status in the year which can change the accounting treatment in the financial statements. We paid particular attention to those schools moving from foundation and community status to academy status, and the appropriate accounting treatment of removing fixed assets relating to community schools from the Council's accounts. We did not identify any issues from our testing. — G
- **Management override of key controls**: we are required to assume that all organisations have a risk of management override of controls in accordance with international auditing standards. Our testing in this area focuses on key judgements and other areas where we identify the potential for management override, such as manual journals. We did not identify any significant issues but we highlight to the committee that whilst we consider management's judgements to be reasonable on an individual basis, taken together they are at the more prudent end of a range we consider to be acceptable. More details are included within Section 1. — G

G Risk appropriately addressed | A Risk satisfactorily addressed but with unadjusted errors identified | R Material unresolved matter

Value for money (VFM) conclusion

We are planning to issue an unqualified VFM conclusion	We are required to undertake certain procedures specified by the Audit Commission in order to provide a value for money (VFM) conclusion. Through our procedures we identified two recommendations. We bring these to your attention but highlight that we did not consider the issues to represent a significant risk to our overall conclusion. We plan to issue an unqualified value for money conclusion for the 2011/12 financial year.	Page 11

Risk management and internal control systems

We have identified some minor control observations	We have not identified any risk management and control observations which we consider to be significant. However, we have identified a number of more minor observations which we have included in Section 3 of this report.	Page 15

Identified misstatements and disclosure misstatements

Uncorrected misstatements decrease cost of services by £1.2m	Audit materiality was £7.5m (2010/11 £7.8m). This was updated from the estimate included in our audit plan which was based on the prior year materiality figure because of the limited information available at the time the planning report was prepared. Uncorrected misstatements identified to date decrease net cost of services by £1.2m (2010/11 £0.3m), and increase net assets by £1.7m (2010/11 decrease of £2.9m). Management has concluded that the total impact of the uncorrected misstatements, both individually and in aggregate, is not material in the context of the financial statements taken as a whole. Details of recorded audit adjustments are included in Appendix 1 and a summary of uncorrected misstatements will be attached to the representation letter obtained from the Council.	Page 19

Executive summary (continued)

Status	Description	Detail
Significant representations		
We have included a copy of our representation letter	A copy of the draft representation letter to be signed on behalf of the Council is included at Appendix 3. Non-standard representations have been highlighted.	Page 23
Independence		
We confirm our independence	Our reporting requirements in respect of independence matters, including fees, are covered in Section 4.	Page 17
Reappointment		
We have been appointed as external auditors to the Council for five years from 2012/13	The Audit Commission has confirmed our appointment as external auditors to the London Borough of Hillingdon for five years from 2012/13. This appointment has been under Section 3 of the Audit Commission Act 1998 and was approved by the Audit Commission Board at its meeting on 26 July 2012.	N/A
Scoping of material account balances, classes of transactions and disclosures		
We have identified one account balance which is greater than our planning materiality but for which we consider there to be a remote risk of material misstatement. We have therefore performed limited procedures in respect of this balance.	As part of our procedures we undertake a risk assessment to determine the level of substantive testing required as part of the audit. This assessment involves performing procedures on account balances to assess the risk of material misstatement. Those procedures include: 1. A comparison of the balance to the prior year, obtaining explanations for significant movements and corroborating those explanations to supporting documentary evidence. 2. Reviewing a breakdown of the balance in the current year to identify any items that appear to be unusual. 3. Reviewing our previous audit work in respect of the balance and considering whether there is a history of error. 4. Considering the size of the balance with respect to our planning materiality. Based on these procedures, if we conclude that the risk of material misstatement is remote, we may choose not to perform further substantive audit procedures on that account balance or note to the financial statements. During the 2011/12 audit we identified one balance greater than planning materiality for which we consider the risk of material misstatement to be remote and therefore we have not performed further substantive audit procedures in this area. That account balance was the supervision and management costs in the HRA of £13,962k (2010/11 £15,489k).	N/A

1. Significant audit risks

The results of our audit work on significant audit risks are set out below:

G	Risk appropriately addressed	A	Risk satisfactorily addressed but with unadjusted errors identified	R	Material unresolved matter

Revaluation of properties (A)

We consider the Council's valuation of fixed assets to be reasonable

We have identified a deficiency relating to the disclosure of the revaluation of assets

The Council's substantial portfolio of assets is subject to a rolling five year revaluation programme. In the 2011/12 year the Council undertook a detailed revaluation of assets with a carrying value of £107m, which equates to 9% of the £1,178m carried in the balance sheet value for property, plant and equipment at 31 March 2012. The assets subject to a detailed revaluation in 2011/12 included community halls, allotments and farms as well as those assets which changed status either through being completed in the year, or land and property deemed to be surplus to requirements or planned for sale.

As part of our 2010/11 audit we identified that the Council had not undertaken an annual revaluation of its investment property portfolio, despite this being a requirement of the Code. Investment properties have been subject to revaluation for the year ended 31 March 2012.

In the 2010/11 audit we identified a judgemental misstatement relating to the Council's interpretation of the 'instant build' concept required for assets valued using the depreciated replacement cost (DRC) technique. We note that the Council has revalued the assets concerned in the 2011/12 year and has applied the instant build concept in these valuations.

A detailed revaluation of council dwellings was undertaken in the prior year where a significant impairment was recognised as a result of the change in valuation approach to the existing use value for social dwellings. The Council has considered indices provided by the Land Registry to the housing stock in order to update this valuation for the year ended 31 March 2012.

Deloitte response

We engaged our property specialists Drivers Jonas Deloitte (DJD) to review the assumptions and methodology used to value the different types of land and property. We concluded that the valuation methods selected, and the way in which those methods were applied, was reasonable.

Our testing of the valuation of council dwellings noted that, after consideration, the Council had not applied land registry indices on the basis that the change in value would not have been significant. The Council undertook this assessment using the change in indices from December 2011 to December 2012 as the indices to March 2012 were not available at the balance sheet date. We have considered the potential change to the valuation of dwellings having used indices for the change to March 2012 and do not consider the difference to be material.

Our testing of the interpretation and application of the instant build approach for assets revalued using the DRC technique did not identify any issues.

As part of our testing we also considered whether there was any evidence of impairment to assets which might mean the carrying value of other assets was not appropriate. Our testing did not identify any instances where this was the case.

Our testing of the note for property, plant and equipment identified that it deviates from the Code requirements, specifically in relation to the disclosure of assets which have been revalued and had a balance in the revaluation reserve. Whilst this has no overall impact on the balance sheet, we have identified as a disclosure deficiency in Appendix 1.

1. Significant audit risks (continued)

Valuation of the pension liability

G

We consider the assumptions used to calculate the pension liability for the LBH pension fund to fall within a reasonable range

The determination of the net pension liability was identified as a risk because it is substantial, and its calculation is sensitive to small changes in judgemental assumptions made about future changes in salaries, mortality and other key variables.

The total pension liability recognised in the draft financial statements of £313,199k is comprised of two funds within the Local Government Pension Scheme (LGPS); the London Borough of Hillingdon (LBH) Pension Fund (£310,410k) and the London Pension Fund Authority (LPFA) Pension Fund (£2,789k).

The total net pension liability has increased by £64,753k on the prior year. The main reasons for this are changes in assumptions used, in particular, lower than expected asset returns and a decrease in the discount rate used.

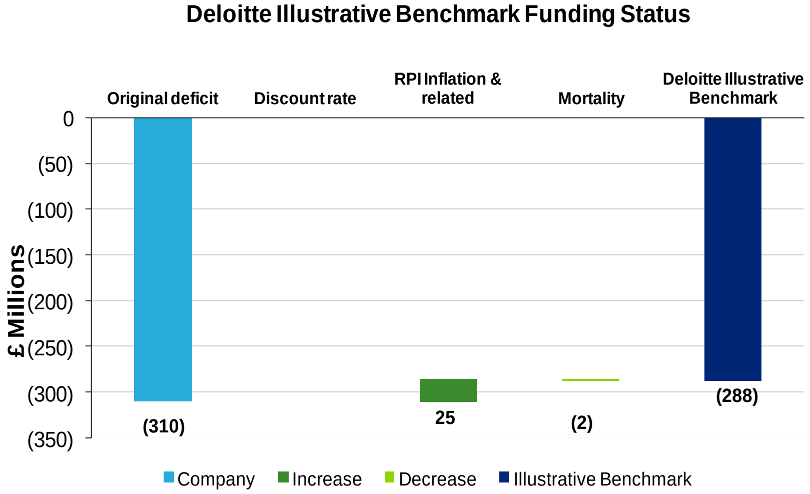
Deloitte response

We considered the Council's arrangements, including the use of actuarial services to calculate the pension liability, to be reasonable. We engaged our own actuarial experts to assist in the review of the assumptions used to calculate the pension liability and the resulting accounting entries and disclosures.

LBH pension fund

Our actuaries have concluded that the assumptions used in the calculation are within a range which we consider to be reasonable, albeit at the more prudent end of that range. We highlight that the assumptions used in the prior year were also at the more prudent end of a range we consider to be reasonable.

The key assumptions used by the Council and the difference compared with the Deloitte illustrative benchmark (our 'house' view) is shown in the chart below.



The chart shows that the discount rate and mortality rates are in line with our benchmark where as the Council's RPI inflation and related measures are slightly more prudent which is the result of a difference in the rate of CPI inflation rate used.

LPFA pension fund

Our actuaries have undertaken a high level review of the assumptions used in calculating the LPFA net pension liability and concluded that the assumptions for discount rate, inflation, increase in payment and deferment are not within the range that they consider to be reasonable for a fund with an estimated duration of 3 years. If the assumptions were changed to be within our illustrative benchmark, our actuaries estimate that the net liability would increase by £350k. This has not been included in our schedule of unadjusted errors as it is below our clearly trivial level of £391k.

We have therefore concluded that the total net pension liability, incorporating both funds, is not materially misstated.

1. Significant audit risks (continued)

Recognition of capital and revenue grant income	G
We identified some errors which resulted in reclassifications of grants within the comprehensive income and expenditure account	Accounting for grant income can be complex as the basis for recognition in the accounts will depend on the scheme rules for each grant. This risk was identified because grant income is a material income stream to the Council (revenue and capital grants amounted to over £471m in 2011/12) and there is an element of professional judgement in determining whether certain grants have conditions or restrictions attached and whether those conditions or restrictions have been discharged.
Deloitte response	We performed detailed testing on a sample of revenue and capital grants by reviewing correspondence attached to specific grants and comparing with the Council's accounting treatment. Our testing identified two errors which, if corrected, would have an equal and opposite effect on income and expenditure but would have no net impact on the net cost of services. The first of these (amounting to £2,728k) was where a grant was ring-fenced and so should have been allocated to a particular directorate on the face of the comprehensive income and expenditure statement (Adult social Care in this case) but was instead incorrectly classified as a non-specific grant. The second (£442k) was where a condition was present within three grants but the disclosure in the comprehensive income and expenditure statement was incorrect; the Council correctly recognised a creditor for the amount unspent at the end of the year, but the other side of this entry was posted as expenditure. The correct entry would have been to reverse the recognition of income which had not yet been spent. These adjustments have been corrected by management. Additional testing was performed to identify whether further errors of this type were present and none were identified. We also identified two disclosure deficiencies relating to grants which have been corrected by management relating to disaggregation of the Dedicated Schools Grant (DSG) and to show an additional in-year adjustment to the DSG grant. Other than the issues noted above, our testing was satisfactory.

Housing Revenue Account self-financing settlement payment	G
We did not identify any issues from our testing of the HRA self financing settlement	On 28 March 2012 the Council made a one-off payment of £192m to central government as part of the move towards self-financing of Council housing stock. The Council has funded this payment through loans from the Public Works Loan Board (PWLB). We identified this as a risk because of the size of the balances involved and that it was an unusual transaction.
Deloitte response	Guidance on accounting for this transaction was provided in Local Authority Accounting Panel ("LAAP") bulletin number 92 from CIPFA. We tested the entries posted by the Council and confirmed that they were in accordance with LAAP 92. We also agreed the amount to the Department for Communities and Local Government's ("DCLG") publication, The Housing Revenue Account Self-financing Determinations. No issues were identified from our testing. We have tested the disclosure of the loans entered into in the year and consider the disclosure to be appropriate.

1. Significant audit risks (continued)

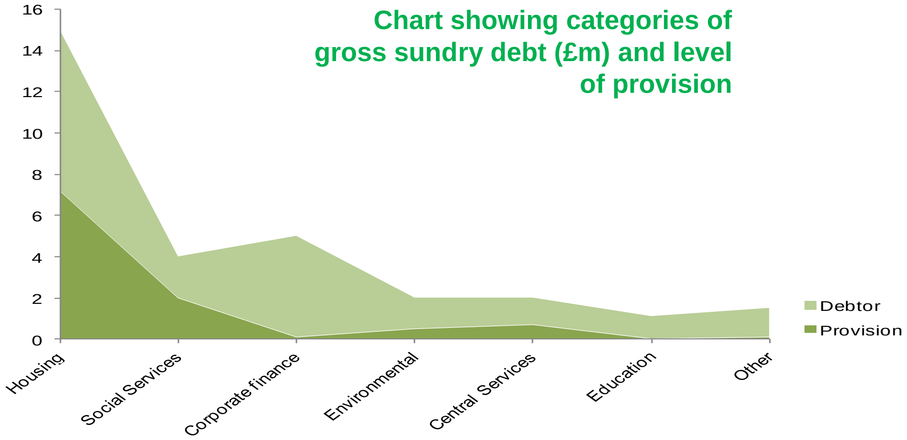
Completeness of bad debt provision for sundry debt

G

We consider the level of bad debt provision for sundry debt to be materially accurate

The sundry debt provision was identified as a significant risk because it comprises of different types of debt, each of which have different methodologies for calculating the level of provision required. Provisions are judgemental by nature but should be based on sound assumptions and methodology.

The total sundry debtors balance at 31 March 2012 of £26m includes a prepayment balance of £1.4m. As our significant risk was concerned with the level of provision for this category of debt, we have omitted prepayments from our analysis and so will refer to a gross debtor of £24.6m. The corresponding balance for the prior year is £21.5m.



Deloitte response

Within sundry debtors there are two types of debt (housing and social services) which attract significant provisions, as the Council deems these debts to have a higher risk of recovery. We tested the reasonableness of these two types of debt provisions by reviewing the cash recovery of 2010/11 debt and comparing to the level of provision held in the prior and current year. Along with information obtained from testing the recoverability and cash recovery of current year debtors, we have used this information to gauge whether we consider the level of provision to be materially reasonable.

The 2011/12 gross balance for housing and social services debt is £14.4m with a provision of £9.3m. If prior year cash recovery rates were to remain the same, we would expect a provision of £8.0m, a difference of £1.3m when compared to the current year provision. Therefore, we consider the provision for housing benefit and social care debt to be prudent, but also materially reasonable based on historic cash recovery rates.

Other sundry debtors include other commercial debts within directorates and some small debts relating to council tax and NNDR costs of collection. The total of these debts for 2011/12 is £10.3m with a provision of £1.3m. This debtor balance includes a VAT debtor of £4.4m which we have seen evidence of being settled post year end. The remaining balances are provided for based on age of debt and/or perceived risk of recovery. Removing the VAT debtor (on the basis that this was settled shortly after year end and is not a balance we would expect to be provided for), leaves a revised gross debtor of £5.9m against which there is a provision of £1.3m. We did not identify any issues from testing this debt and do not consider the remaining provision, or the exposure to present a risk of material misstatement.

We therefore conclude that the level of provision for sundry debt is materially reasonable.

1. Significant audit risks (continued)

Recording of capital spend

A

We identified an adjustment of £0.5m which has not been corrected by management

We identified a risk around the recording of capital and revenue expenditure because capital expenditure is significant and there is an element of interpretation in determining what constitutes revenue and capital expenditure.

In 2011/12 the Council spent £46.8m on new assets, of which £8m was on council dwellings.

Deloitte response

We tested the risk of misclassification of capital expenditure in two ways:

1. sample testing of repairs and maintenance expenditure which had been classified as revenue; and
2. sample testing of capital additions within fixed assets.

Our testing identified several inconsistencies of treatment with expenditure relating to council dwellings and the housing revenue account: one example being lifts where some spend had been treated as capital but other as revenue.

We requested that management undertake an exercise to determine whether certain categories of spend should be treated as capital or revenue, and as a result of this exercise, to determine whether an adjustment might be required.

Management performed this work, which we reviewed and sample tested for accuracy. The outcome is a proposed adjustment of £494k which, if accepted, would increase the fixed asset balance but have no net impact on the housing revenue account surplus. Management has not made this adjustment on the grounds that it is not material.

As part of this testing, another error was identified relating to the classification of specific assets. The Council currently categorises expenditure on lifts and replacement boilers under the fixed asset category of council dwellings. We consider that these particular assets would be separate components to the Council dwellings that they form part of, and, as such, would be more suitably categorised as plant and equipment. This would mean that they would have separate useful economic lives and be valued at historic cost rather than the current council dwellings basis of a moderated existing use value.

Management has not made this adjustment in the current year as it does not consider it to be material but has agreed to consider this difference in classification going forward.

1. Significant audit risks (continued)

Accounting for schools	G
We consider the Council's accounting treatment relating to the changing status of schools to be appropriate	We identified a risk relating to the changing status of schools, notably those moving from community and foundation status to academy status, and the appropriate accounting treatment for such schools in the Council's accounts. Only one school moved from community status to academy status (the Willows school) during the financial year. Part of this arrangement involves the schools signing a 125 year lease for the school land and property. The Council previously recognised community school assets on the balance sheet and so has treated this as a fixed asset disposal in the accounts resulting in a loss on disposal of £2.7m. Two further community schools changed to academy status after the balance sheet date. These have been disclosed in the notes to the accounts as a non-adjusting event after the balance sheet date. 13 foundation schools moved to academy status in the year. Foundation schools' assets are not held on the Council's balance sheet and so there was no disposal to recognise. However, we did see the effect of the foundation school change with a fall in DSG grant income and non-pay and pay expenditure.
Deloitte response	We reviewed the Council's treatment of all categories of schools and considered against available CIPFA guidance. We obtained the Council's listing and categorisation of schools and corroborated the completeness of this listing by agreeing to independent sources such as Edubase. We consider the Council's treatment of the Willows school lease to be appropriate based on the guidance available. We also agree with the treatment and disclosure, of community schools that have changed to academy status after year end, as a non-adjusting event.

1. Significant audit risks (continued)

Management override of key controls

We consider some of managements judgements to be prudent

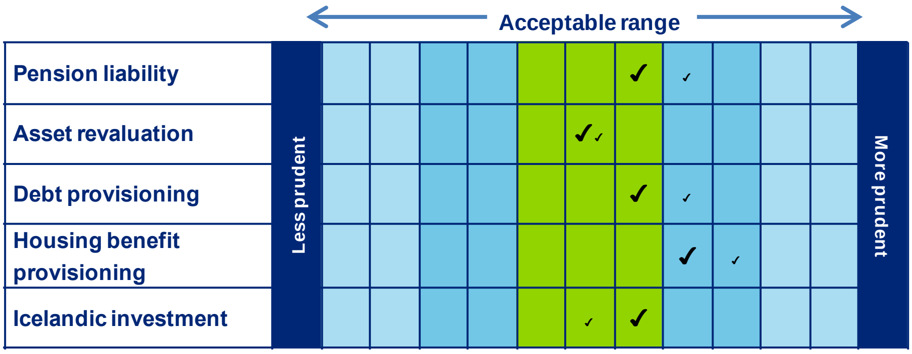
International standards on auditing require us to presume a significant risk in relation to manual override of key controls. Our audit work is designed to test the manual override of key controls and the significant estimates and judgements used by management.

Deloitte response

In testing journals, we made use of computer assisted audit techniques to analyse the whole population of journals and to identify those which had features which can be indicators of fraud. We tested these journals and did not identify any issues to report to you.

Key accounting judgements have been reported in this document as separate significant risks, notably the valuation of fixed assets, the valuation of the pension liability and the bad debt provision estimate. Our testing concluded satisfactorily in each of these individual areas.

However, we do highlight to the committee that taken together, the Council does show consistent examples of prudence in its application of judgement as can be seen in the table below:



✓ Current year ✓ Prior year

We have included the housing benefit provision in the table above because we have identified this as a misstatement in Appendix 1 on the basis that we do not consider it to meet the accounting definition of a provision.

We have also included the Council's treatment of Icelandic investments in the table; the 2011/12 year LAAP Bulletin 82 v6 highlighted expected improvements to recovery rates of investments in certain Icelandic banks, including those held by the authority. Application of those recovery rates would have reduced the level of impairment the Council has applied to investments held. The Council has chosen not to apply these rates on the basis of current economic uncertainty within the eurozone, foreign currency exchange rates and fluctuating asset values. We consider the Council's approach to be prudent but within an acceptable range.

Aside from the housing benefit provision, which we have identified as a judgemental misstatement in Appendix 1, we consider management's application of judgements to be materially reasonable and did not identify any instances where the business rationale was not clear.

2. Value for money conclusion

Our value for money conclusion is based on the following criteria:

- the organisation has proper arrangements in place for securing financial resilience; and
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

We have performed procedures to meet the criteria noted above using guidance from the Audit Commission.

We undertook a risk assessment to identify potential risks to the value for money conclusion. From this work we identified two potential risks which we investigated further. These potential risks, and our conclusions as to why we did not consider them to be significant risks to our value for money conclusion, are noted below:

- Capital forecasting: we identified that capital budgeting and forecasting included several significant variances during the year. We considered this to indicate a potential risk of weaknesses in financial controls. Our work did not identify any significant weaknesses in the capital control procedures but did highlight that management should consider reviewing the forecasting process to ensure more accurate reporting. We have identified a recommendation in this area below.
- Control over construction projects: we identified this as a potential risk on the basis that there are governance issues highlighted in the Council's draft Annual Governance Statement relating to construction projects. Our investigations into these matters concluded that management were taking steps to address capital procurement and capital reporting issues and so proper arrangements were in place.
- Classification of revenue and capital spend: our testing of repairs and maintenance revenue expenditure and fixed asset additions identified inconsistency of treatment. The details of these errors are further described in section 1 but we considered that this could present a potential VFM risk as it could be suggestive of weak internal controls. Our work identified a limited number of categories of assets which had been inconsistently treated. The proposed adjustment was not material and we have made a control recommendation to management which has been accepted. On this basis we did not consider it to be a significant risk to our value for money conclusion.

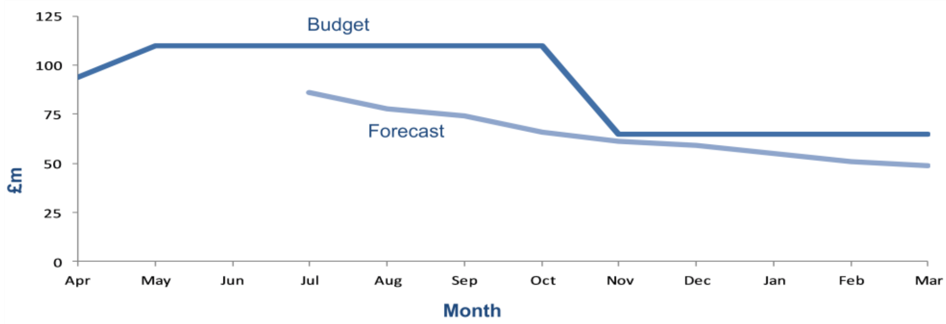
On the following page we have identified two recommendations from our value for money work. We do not consider these matters to present a material issue with respect to our value for money conclusion.

2. Value for money conclusion (continued)

Capital budgeting and forecasting

Description

During the 2011/12 year, the Council's capital budget was amended twice. Forecast expenditure (the expected expenditure for the whole financial year) reduced consistently each month. Final recorded capital expenditure for the 2011/12 financial year was £49m, which is £16m lower than the revised budget and £45m lower than the original budget. This is summarised in the chart below:



The chart above shows that budgeted spend, and forecast spend, which should be based on more recent information, is not being achieved.

Recommendation

We understand that the nature of the Council's capital plans means that projects can span over a period of greater than one year and so there will always be some variation between actual and budgeted spend. However, we recommend that the Council reviews the capital budgeting and forecasting process with an aim to achieving more accurate forecasting.

If the Council is unable to plan or forecast capital spend accurately then future significant variances could occur that mean either resources are not adequate, or that service delivery is impacted by failure to deliver capital projects within time limits.

Management response

The Capital budget is set in February and adjusted in month two for re-phased amounts following the previous year's outturn. It is re-phased again once more certainty around timing and scope are ascertained. The programme contains two very large programmes (Primary School Places and Supported Housing) that are constantly evolving in line with requirement projections and hence re-phasing of budgets into following years is inevitable and often desirable. In addition the budget contains many schemes that are Programmes of Works or items of a contingent nature for which the Council would aim to minimise expenditure. Stringent controls are in place for the release of capital and all monitoring is undertaken on a 'whole' project basis over at least three years and not just focussed on the current financial year.

2. Value for money conclusion (continued)

Evidence of achieving savings for Reablement project	
Description	As part of our value for money procedures, we selected two of the largest individual savings projects for review. We focused specifically on evidencing the source and detail of savings plans and saving achievements. For one of the projects selected, RE1 Reablement, the planned saving for the 2011/12 year was £1,278k and this amount was recorded as being achieved. We understand that this is a cross-cutting project which involves a number of sub-divisions, and that the Reablement project as a whole is larger than the specific project we selected. However, there was only limited evidence available to support the achieved savings and most of this was indirect. To illustrate this, we have provided more information on the evidence provided to support the savings and why we consider its use to be of only limited use:

Evidence provided by management	Deloitte response
Analysis showing actual and expected numbers of residential and nursing starters and leavers from 2008/9 to 2012/13.	This information shows an overall net reduction of clients in the system when comparing 2010/11 data with 2011/12 data. However, this is not triangulated with financial information, nor does it show how many starters and leavers were in the original savings plan.
Adult social care outturn did not call on the entire contingency included in the budget showing that some savings must have been achieved.	This shows that the full amount of the contingency was not required for adult social care. However, the fact that the contingency was required suggests that the initial adult social care budget was not met. It is not clear how much the RE1 Reablement project contributed towards this position.
Analysis of Reablement cost centre codes which shows year on year expenditure falling.	This information shows evidence of a trend in actual spend year-on-year. However, it is not clear how much of this trend is all or partly due to the RE1 Reablement project or any other pressures.

	Our testing of another large project did not identify any issues around clarity of savings.
Recommendation	Taken as a whole, we can see how management has concluded that this saving was achieved. However, we consider the evidence provided to be more circumstantial than a clear and direct quantification of savings achieved. Going forward we recommend that at the planning stage of projects the Council considers the detail of exactly how the achievement of savings will be tracked and measured during and at the completion stage of projects. Reviewers of project plans should challenge those preparing them by asking how success or failure will be measured and how other related pressures can be distinguished.
Management response	The specific savings initiative examined here is one of the most complex savings proposals within the Council's savings plans. Work is being undertaken within Finance to put in place measures to better understand all savings proposals to enable better tracking of both savings and wider benefits. Following a review of existing Social Care finance models work has commenced on developing revised models which will enable the impact of initiatives such as Reablement to be better captured and quantified. It is planned, that once developed, the methodology used to build these models will be adapted for use across the council for all demand led budgets.

3. Risk management and internal control systems

Our audit approach in relation to internal control was set out in our 'Briefing on audit matters' and our planning report circulated to you on 28 February 2012.

Key controls over significant risks

In Section 1 we discussed the identified significant audit risks. For each significant audit risk, we have assessed the design and implementation of internal controls in each of those areas. Our findings are set out below.

Council controls in operation	Deloitte procedures on controls	
Revaluation of properties The valuation of assets is undertaken in-house by the Council's internal valuer. The Council's corporate finance team reviews the valuations and challenges unexpected movements.	We have considered the competence of the in-house valuer and corroborated the role that corporate finance plays in reviewing the valuations that take place.	G
Valuation of the gross pension liability The Council engages actuaries to value the pension liability. Corporate finance engages with the actuary to discuss and challenge the assumptions being made.	We have considered the competence of the actuarial support and corroborated the role that Corporate finance plays in reviewing the assumptions and valuations that take place.	G
Recognition of capital and revenue grant income Specific training is provided to staff regarding grant accounting to ensure appropriate treatment. Grant treatment is reviewed by Corporate Finance.	We obtained evidence of management review and corroborated that training is provided to staff.	G
Bad debt provision for sundry debt Provisions are calculated according to type of debt. Provisions are calculated by directorates. They are then reviewed by the head accountant within that directorate before being reviewed centrally by corporate finance.	We reviewed the bad debt provision working papers to identify whether these procedures were in operation.	G
Housing Revenue Account settlement The HRA settlement, and financing, was discussed at Council and Cabinet level. Management have reviewed the LAAP bulletin to ensure appropriate treatment.	We corroborated management's awareness of the LAAP bulletin and saw evidence of consideration at Council and Cabinet level.	G
Recording of capital spend Several checks are in place around capital requisitioning and reporting including detailed monthly reviews at directorate level.	We did not identify issues in application from our planning, but did identify some inconsistencies in treatment from our detailed testing and have included a recommendation for improvement on the following page.	A
Accounting for schools Management has set out how it accounts for each type of school. It also has a record of when schools are expected to change status. The proposed treatment is reviewed by Corporate Finance.	We reviewed the schools listing provided by management and corroborated to independent sources. We reviewed management's proposed treatment.	G
Management override of controls Management is aware of key controls and judgements and has detailed these in the accounting policies. Hierarchical controls are in place with journals.	We considered the key judgements highlighted by management and tested the design and implementation of controls around manual journals.	G

G No issues noted   Y Satisfactory – minor observations only   A Requires improvement   R Significant improvement required

3. Risk management and internal control systems (continued)

Risk management and control observations

In addition to the recommendations provided in relation to our value for money conclusion, we also identified a number of control observations, the most significant of which are detailed below.

Revenue and capital expenditure classification	
Description	Our testing identified several examples of inconsistent treatment of capital and revenue expenditure, particularly relating to council dwellings. We understand that inconsistencies occurred because of a lack of clarity around what the Council interprets as revenue and capital expenditure and potentially because of the volume of transactions being transferred.
Recommendation	The Council undertook an analysis of specific categories of assets to determine whether they should be recognised as revenue or capital expenditure. We recommend that this analysis be developed further and distributed to relevant accountants and estates staff to use as a practical guide when expenditure is incurred. Furthermore, we recommend that the assessment of revenue and capital expenditure is undertaken at the time the expenditure is recorded, rather than as a year-end exercise.
Management response	Management accepts this recommendation but notes significant ‘grey areas’ around works to Council dwellings. The valuation process of these assets (25% Social Housing) and the resource accounting treatment for the Major Repairs Allowance (MRA) further confounds such categorisation with the latter giving rise to the need for a year end exercise. Management have drawn up and agreed a general set of principles to apply to expenditure to determine its correct treatment. It should be noted that regardless of revenue or capital categorisation, both are financed in year from revenue resources.
Timeframe:	March 2013
Owner:	Maqsood Sheikh

3. Risk management and internal control systems (continued)

Depreciation policy for infrastructure assets	
Description	The infrastructure category of property, plant and equipment includes a range of assets such as road foundations, road surfacing, street lighting and bridges. The Council adopts a policy of depreciating all infrastructure assets over a period of 40 years regardless of the type of asset. The different types of asset within this category will have different useful economic lives and so a blanket depreciation policy of 40 years is not as accurate as it could be. We note that we have performed procedures from which we have concluded that the current treatment does not materially misstate this balance. We highlight that plans are underway to change the way in which infrastructure assets are valued with CIPFA having published a Code of Practice on Transport Infrastructure assets. This Code of Practice has not yet been adopted into the IFRS based Code although information on the Council's valuation under this new guidance has been prepared and is submitted to central government through the Whole of Government Accounts (WGA) return.
Recommendation	We recommend that management categorises the different infrastructure assets and selects appropriate useful economic lives over which to depreciate them.
Management response	Management acknowledges the rather simplistic depreciation policy currently in use for infrastructure but notes that the only balances held represent historical cost of works that have been capitalised i.e. such values do not represent a replacement cost valuation and it would therefore be impossible to categorise in detail the historic values held. The introduction of the Code will provide a basis for valuation. Management will then adopt a depreciation policy in line with this.
Timeframe:	On introduction of the Infrastructure Code
Owner:	Harry Lawson

4. Other matters for communication

As part of our obligations under International Standards on Auditing (UK & Ireland), we are required to report to you on the matters listed below.

Independence confirmation	
We confirm our independence	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised. If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this.

Fees	
Our audit fee for the year ended 31 March 2012 was £345,150	Our audit fee for the year ended 31 March 2012 was £345,150 (2010/11 £359,155). This fee covers the audit of the accounts, the assurance report on the whole of government accounts (WGA) and the procedures we are required to perform to reach our value for money conclusion. This fee is in line with the scale fee set by the Audit Commission. It excludes the fee for the audit of the local government pension scheme, which is communicated to you as part of a separate report. It also excludes fees for the certification of grant claims. Our procedures in respect of grants are ongoing but we have provided information on costs incurred to date in Appendix 2.

Non-audit services	
We have provided some non-audit services to the Council in 2011/12 but do not consider this to compromise our independence as auditors	In our audit plan issued to you on 28 February 2012 we reported that one of our divisions, Drivers Jonas Deloitte, was successful in its proposal to monitor the delivery of a building contract for the expansion of six primary schools. The total fees payable for 2011/12 in relation to this work was £242,231. Of this, £177,808 was retained by Drivers Jonas Deloitte, with £64,423 being paid to subcontractors. We do not consider this to compromise our independence as external auditors to the Council. We have also received approval from the Audit Commission to undertake this work.

Liaison with internal audit	
Our review of internal audit work did not identify any areas where we need to adjust our approach	Following an assessment of the independence and competence of the internal audit department, we reviewed the findings of internal audit. There were no areas where we needed to adjust our audit approach as a result.

Written representations	
We have attached a copy of the proposed management representation letter to this report	A copy of the representation letter to be signed on behalf of the Council has been attached at Appendix 3. Non-standard representations have been highlighted.

5. Responsibility statement

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body and in this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.

This report should be read in conjunction with the "Briefing on audit matters" circulated to you as an appendix to our audit plan issued on 28 February 2012 and sets out those audit matters of governance interest which came to our attention during the audit. Our audit was not designed to identify all matters that may be relevant to the Council and this report is not necessarily a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

This report has been prepared for Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

Deloitte LLP.

Deloitte LLP

Chartered Accountants

St Albans
12 September 2012

Appendix 1: Audit adjustments

Uncorrected misstatements

The following uncorrected misstatements have been identified up to the date of this report:

		Charge / (credit) to current year Comprehensive Income and Expenditure Statement	Increase/ (decrease) in Net assets	Decrease/ (increase) in Unusable Reserves
		£'000	£'000	£'000
Judgemental misstatements				
Net effect of capital / revenue expenditure misclassification (HRA)	**1**	-	494	(494)
Reclassification of capital expenditure	**2**			
- Council dwellings		-	(3,282)	-
- Plant and equipment		-	3,282	-
Housing benefit provision	**3**	(1,162)	1,162	-
		(1,162)	1,656	(494)

We will obtain written representations from management confirming that, after considering all unadjusted items, both individually and in aggregate, in the context of the consolidated financial statements taken as a whole, no adjustments are required.

1 & 2 Testing identified several inconsistencies in recording capital and revenue expenditure. The reserves balance affected would be the Capital Adjustment Account. Further details are included in our reporting on significant risks in Section 1.

3 The Council has recognised a provision against a potential clawback relating to the housing benefit grant. We do not consider this to meet the required criteria for a provision and so have proposed that it is released.

We only report to you uncorrected misstatements that are not clearly trivial. We have identified our clearly trivial level as £391,000.

Appendix 1: Audit adjustments (continued)

Recorded audit adjustments

We report all individual identified recorded audit adjustments in excess of £391,000 and other identified misstatements in aggregate adjusted by management in the table below.

General fund

		Charge / (credit) to current year Comprehensive Income and Expenditure Statement £'000	Increase/ (decrease) in Net assets £'000	Decrease/ (increase) Reserves £'0 00
Factual misstatements				
Reclassification of debtor balances	**1**			
- Government departments debtors		-	5,979	-
- Sundry debtors		-	(5,979)	-
Reclassification of grants	**2**			
- Government ringfenced grants		(2,286)	-	-
- Taxation and non-specific grant income		2,728	-	-
- Cost of services		(442)	-	-
Reclassification of creditors				
- Sundry creditors	**1**	-	1,646	-
- Government department creditors		-	(1,646)	-
		-	-	-

1 Testing identified classification errors within debtors and creditors.

2 Testing identified classification errors within grants. This is discussed further in our significant risks at Section1.

Appendix 1: Audit adjustments (continued)

Recorded audit adjustments (continued)

Collection fund

		Charge / (credit) to current year Collection fund	Increase/ (decrease) in Net assets	Decrease/ (increase) Reserves
		£'000	£'000	£'0 00
Factual misstatements				
Timing of information for income from business ratepayers				
- Income collectable from business ratepayers	**1**	1,349	-	-
- Business rates expenditure		(1,349)	-	-
		-	-	-

1 This adjustment arose as a result of the timing difference between the preparation of the accounts and the final NNDR 3 grant return. The date that the Collection Fund is prepared for the draft financial statements is before the date of the final submission of the NNDR 3 claim. At the time of preparing the accounts the Council used the best estimate available at the time. With the benefit of hindsight we have identified that this figure changed in the final return and so management have reflected this.

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable audit committees to evaluate the impact of those matters on the financial statements. The table below highlights those areas, up to the date of this report, which we have concluded are not material but would like to bring to the attention of the audit committee.

Disclosure	Detail
Housing benefit provision	The Council has included a provision relating to housing benefit. We have included this in the table of uncorrected misstatements on the previous page. As management does not intend to adjust for this proposed misstatement we consider it necessary to highlight that the current disclosure suggests that there was no opening provision at the beginning of the year. There was an opening provision but in the prior year this was included within creditors and not provisions. The Council has not made this adjustment.
Disclosure of assets in the property, plant and equipment note	Our testing of the note for property, plant and equipment identified some errors in the recording of revaluation of assets and the effect of these revaluations on accumulated depreciation and the revaluation reserve. The presence of these errors means that is that it is not possible to reconcile the property, plant and equipment note to other notes in the accounts such as the movements in the revaluation reserve or the note covering revaluation losses. We highlight that this has no overall impact on the balance sheet. Management has not adjusted this but has agreed to review this in the 2012/13 financial year.
Heritage assets	Our testing of the completeness of the new requirement to identify and disclose heritage assets identified one asset, a Norman mound, which has not been disclosed by the Council. We consider this to meet the definition of a heritage asset as it is a historical tangible asset which is held and maintained principally for its contribution to knowledge and culture. The Code recognises that where heritage assets have not been recently purchased or capitalised, and a valuation cannot be obtained at a cost which is commensurate with the benefits to the users of the financial statements, the asset should not be recognised in the Council's balance sheet. However, a description of the asset should be disclosed in the notes to the Council's financial statements. The Council has not disclosed this asset in the note covering heritage assets on the basis that this disclosure is not material.

Appendix 2: Fees charged during the period

The professional fees earned by Deloitte in the period from 1 April 2011 to 31 March 2012 are as follows:

	2011/12 £	2010/11 £
Fees payable to the auditor for the audit of the London Borough of Hillingdon's annual accounts, assurance report on the whole of government return and value for money conclusion	345,150	359,155
Fees payable to the auditor for the audit of the London Borough of Hillingdon's pension scheme annual report	36,500	36,500
	381,650	395,655
Fees payable to the auditor for the certification of grant claims (**Note 1**)	120,000*	210,071
Total fees for audit services (excluding VAT) (Note 3)	501,650	605,726
Non-audit fees:		
Drivers Jonas Deloitte contract monitoring engagement (**Note 2**)	177,808	-

Note 1* Our fees for grant certification work are billed on the basis of time spent by different grades of staff using scale fees advised by the Audit Commission. The level of fees charged in a given year is dependent on the grant schemes falling within the audit requirement, the scope of procedures agreed between the Audit Commission and the grant paying body, the quality of working papers provided to us and the timeliness with which audit queries are resolved. Our work in respect of the certification of grants for 2011/12 is ongoing and the amount shown above is based on the work we have completed to date and our best estimate of the work we are still yet to perform. We have regular dialogue with officers to keep them informed of progress for this work.

Note 2 In our audit plan issued to you on 28 February 2012 we reported that one of our divisions, Drivers Jonas Deloitte, was successful in its proposal to monitor the delivery of a building contract for the expansion of six primary schools. The total fees payable for 2011/12 in relation to this work was £242,231. Of this, £177,808 was retained by Drivers Jonas Deloitte, with £64,423 being paid to subcontractors.

We do not consider this to compromise our independence as external auditor to the Council and we have also received approval from the Audit Commission to undertake this work.

Note 3 The draft financial statements for the year ended 31 March 2012 report external audit fees of £348k and fees payable for grant claims of £185k to report total external audit costs of £533k. This differs to the total reported above for three reasons; firstly, the Council has not included the external audit cost of the pension fund (£36.5k) as this is borne by the pension fund itself and so disclosed separately; secondly, the Council included an estimate of grant fees at the time of preparing the financial statements which is £65k higher than the estimate we have included above which is based on more up-to-date information; and finally, the Council's fees for external audit reported in the notes to the accounts are £3k higher than we have reported above due to coding of invoices. We do not consider the total difference to be material to the accounts.

Appendix 3: Draft representation letter

This representation letter is provided in connection with your audit of the financial statements of the London Borough of Hillingdon for the year ended 31 March 2012 for the purpose of expressing an opinion as to whether the financial statements present fairly the financial position of London Borough of Hillingdon at 31 March 2012 and of the results of its operations, other comprehensive income and expenditure and its cash flows for the year then ended in accordance with the applicable accounting framework and Accounts and Audit Regulations 2003 (as amended).

We acknowledge our responsibilities for preparing the financial statements for the London Borough of Hillingdon ("the local authority") which present fairly the results for the period and for making accurate representations to you. For the avoidance of doubt the representations made in this letter apply to the financial statements of the local authority. Those financial statements include the London Borough of Hillingdon Pension Scheme Financial Statements. Therefore this letter applies equally to both the financial statements of the London Borough of Hillingdon and the financial statements of the London Borough of Hillingdon Pension Scheme.

We confirm, to the best of our knowledge and belief, the following representations.

Financial statements

1. We understand and have fulfilled our responsibilities for the preparation of the financial statements in accordance with the applicable financial reporting framework and the Accounts and Audit Regulations 2003 (as amended) which give a true and fair view.

2. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

3. The measurement processes, including related assumptions and models used to determine accounting estimates in the context of the applicable financial reporting framework are appropriate and have been applied consistently.

4. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of IAS24 "Related party disclosures".

5. All events subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment of or disclosure have been adjusted or disclosed.

6. We confirm that the financial statements have been prepared on the going concern basis. We are not aware of any material uncertainties related to events or conditions that may cast significant doubt upon the Council's ability to continue as a going concern. We confirm the completeness of the information provided regarding events and conditions relating to going concern at the date of approval of the financial statements, including our plans for future actions.

7. The effects of uncorrected misstatements and disclosure deficiencies reported in Appendix 1 are immaterial, both individually and in aggregate, to the financial statements as a whole.

8. We are not aware of events or changes in circumstances occurring during the period which indicates that the carrying amount of fixed assets or may not be recoverable.

9. The methods and assumptions used to determine fair values in the context of the applicable financial reporting framework are appropriate and have been applied consistently.

10. We have reconsidered the remaining useful lives of the infrastructure assets and confirm that the present rates of depreciation are appropriate to amortise the cost less residual value over the remaining useful lives.*

Appendix 3: Draft representation letter (continued)

11. Except as disclosed in the Statement of Accounts, as at 31 March 2012 there were no significant capital commitments contracted for by the local authority.

12. We confirm that in our opinion the bad debt provision policy currently in place reflects our best estimate and is considered to be adequate but not excessive.*

13. We consider that our current policy for depreciation of fixed assets takes into account the guidance in the Code regarding componentisation of assets.*

14. We consider that our categorisation of fixed assets is materially reasonable.*

15. We confirm that the disclosures made in the Statement of Accounts in respect of Heritage assets represent a complete disclosure of the existence of assets which fall within the scope of Heritage assets under The Code of Practice on Local Authority Accounting in the United Kingdom 2011-12, and our most accurate available information on the valuation of these assets.*

16. The annual governance statement is representative, to the best of our knowledge, of the activities and performance of the local authority in the financial year.

17. We consider the organisation has proper arrangements in place for securing financial resilience and for challenging how it secures economy, efficiency and effectiveness.

Information provided

18. We have provided you with all relevant information and access.

19. All minutes of member and officers meetings during and since the financial year have been made available to you.

20. All transactions have been recorded and are reflected in the financial statements and the underlying accounting records.

21. We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

22. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

23. We are not aware of any fraud or suspected fraud that affects the entity and involves:
    (i). management;
    (ii). employees who have significant roles in internal control; or
    (iii). others where the fraud could have a material effect on the financial statements.

24. We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

25. We are not aware of any instances of non-compliance, or suspected non-compliance, with laws, regulations, and contractual agreements whose effects should be considered when preparing financial statements

26. We have disclosed to you the identity of the Council's related parties and all the related party relationships and transactions of which we are aware.

Appendix 3: Draft representation letter (continued)

27. We have considered all claims against the Council and on the basis of legal advice have provided for the amount. No other claims in connection with litigation have been or are expected to be received. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.

28. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.

29. We are not aware of any events or changes in circumstances occurring during the period which indicate that the carrying value of fixed assets may not be recoverable.

30. We confirm that:
    - all retirement benefits and schemes, including UK, foreign, funded or unfunded, approved or unapproved, contractual or implicit have been identified and properly accounted for;
    - all settlements and curtailments have been identified and properly accounted for;
    - all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
    - the actuarial assumptions underlying the valuation of the scheme liabilities (including the discount rate used) accord with the directors' best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the business;
    - the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology; and
    - the amounts included in the financial statements derived from the work of the actuary are appropriate.

We confirm that the above representations are made on the basis of adequate enquiries of management and staff (and where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

Signed on behalf of the London Borough of Hillingdon

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* denotes a non-standard representation.