# London Borough of Hillingdon

# Our Planning Report to the Audit Committee on the year ending 31 March 2013 Audit

27 February 2013

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27 February 2013

Dear Sirs

We have pleasure in setting out in this document our planning report to the audit committee of the London Borough of Hillingdon ("the Council") for the year ending 31 March 2013, for discussion at the meeting scheduled for 12 March 2013. This report covers the principal matters that we will focus on during our audit for the year ending 31 March 2013.

In summary:

- the major issues, and how we plan to address them, are summarised in the Executive Summary;
- the scope of our work is in line with the approach taken for the audit for the year ended 31 March 2012; and
- there are a number of areas where significant management judgement will be required which we draw your attention in our report and which you should consider carefully.

We would like to take this opportunity to thank the management team for their on-going assistance and will be completing more detailed planning work in March and April 2013.

Yours sincerely

Heather Bygrave

Senior Statutory Auditor

# Contents


| | | |
|---|---|---|
| Executive summary | | 1 |
| 1. | Scope of work and approach | 4 |
| 2. | Significant audit risks | 6 |
| 3. | Value for money | 9 |
| 4. | Sector developments | 10 |
| 5. | Responsibility statement | 14 |
| Appendix 1: Prior year uncorrected misstatements including disclosure misstatements | | 15 |
| Appendix 2: Consideration of fraud | | 17 |
| Appendix 3: Audit engagement team | | 19 |
| Appendix 4: Timetable | | 20 |
| Appendix 5: Audit fees | | 21 |

# Executive summary

We have pleasure in setting out in this document details of our proposed audit plan for London Borough of Hillingdon ("the Council") for the year ending 31 March 2013. The Financial Reporting Council ("FRC") has made it clear, in its 'Update for Corporate Committees – November 2010' that it expects Audit Committees to focus activity on assessing and communicating risks and uncertainties and reliance on estimates, assumptions and forecasts. Whilst the FRC report is designed for private and public companies, the messages are equally applicable to governance and Audit Committees in other organisations. This report will describe the work we undertake in order to support this activity.

| Status | Description | Detail |
|---|---|---|
| **Key changes in our audit plan this year** | | |
| **The nature and scope of our planned procedures are similar to those set out in our audit plan for the year ended 31 March 2012** | The nature and scope of our planned procedures are similar to those set out in our audit plan for the year ended 31 March 2012.<br>The principal changes include:<br>• changes to the Housing Revenue Account ("HRA") resulting from the Localism Act 2011, which is considered to be an audit risk in the current year;<br>• the HRA settlement payment no longer being considered a significant audit risk on the basis that this was a one-off transaction in 2011/12; and<br>• accounting for schools' non-current assets no longer being considered a significant audit risk on the basis that there has been no history of error in accounting for these transactions or changes in accounting guidance. | Section 1 |
| **Audit scope** | | |
| **Our work is carried out under the Code of Audit Practice 2010, issued by the Audit Commission** | We conduct our audit in accordance with the Accounts and Audit Regulations 2011 and the Code of Audit Practice 2010 issued by the Audit Commission. Our audit of the statement of accounts is also performed in accordance with International Standards on Auditing (UK and Ireland) as adopted by the UK Auditing Practices Board ("APB").<br>The Code requires that we:<br>• issue an opinion on the financial statements of London Borough of Hillingdon;<br>• satisfy ourselves as to whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources;<br>• consider the completeness of the disclosures in the Annual Governance Statement in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and other work; and<br>• issue an assurance report to the National Audit Office on London Borough of Hillingdon "Whole of Government Accounts" return.<br>For the 2012/13 financial statements, we have estimated materiality of £7.5 million (2011/12: £7.5 million), which is based on prior year outturn. Our preliminary assessment of the level at which we report unadjusted misstatements to the Audit Committee is £375,000. We will also report other adjustments that we consider to be qualitatively material.<br>We will update our assessment during the year end visit based on the final outturn and inform you of any change in our final report. | Section 1 |

# Executive summary (continued)

| Status | Description | Detail |
|---|---|---|
| **Internal controls** | | |
| **We will evaluate the design and test the implementation of key controls relevant to the audit** | To assist us in planning our work, we will evaluate the design and test the implementation of key controls relevant to the audit, including controls which mitigate the significant risks of material misstatement we have identified.<br>We continue to rely on the work of the Council's internal audit function to inform our risk assessment. | Section 1 |
| **Significant audit risks** | | |
| **We summarise the key audit risks identified at this stage** | The significant audit risks which we have identified as part of our overall audit strategy are:<br>1. **Recognition of grant income:** We see this as a continuing audit risk in view of the need for management judgement on recognition of grant income and in determining whether the grant has conditions.<br>2. **Revaluation of properties:** Properties are revalued every 5 years under a rolling programme. The valuation of the Council's property holding of £983,517k (as at 31 March 2012) is sensitive to judgements on key assumptions.<br>3. **Valuation of the pension liability:** This continues to be an audit risk in view of the size of the liability and complexity of judgements in this area. The amount of the net liability at 31 March 2012 was £313,199k.<br>4. **Calculation of the bad debt provision against sundry debts:** This continues to be an audit risk in view of the judgemental nature of provisions.<br>5. **Recording of capital spend:** The council is forecasting capital spend for the year of £56,964k. There is a risk that revenue and capital expenditure may be misclassified.<br>6. **Housing Revenue Account ("HRA") self-financing:** The impact of the Localism Act 2011 on statutory mitigations for depreciation on HRA fixed assets is a new accounting requirement for 2012/13.<br>7. **Management override of key controls:** Our response to this presumed risk will focus on the testing of journals, significant accounting estimates (including those above) and any unusual transactions in the year.<br>8. **Value for money:** Internal audit has identified a number of control deficiencies around housing repairs and construction contracts. We will perform procedures to assess whether this is a significant risk to our value for money conclusion. See section 3 for further discussion on this. | Section 2 |
| **Value for money** | | |
| **We reported a number of findings from our value for money work in 2011/12. We will follow up on these in 2012/13** | In our final report to the Audit Committee for the year ending 31 March 2012, issued on 25 September 2012, we reported findings in the following areas from our value for money work:<br>• capital budgeting and forecasting; and<br>• evidence of achieving savings for the reablement project.<br>We will follow up on both of these areas as part of our 2012/13 work. We will perform a value for money risk assessment exercise in our interim visit. | Section 3 |

# Executive summary (continued)

| Status | Description | Detail |
|---|---|---|
| **Sector developments** | | |
| **The Localism Act 2011 devolves more powers to Councils. The Local Government Finance Act 2012 makes amendments to Council tax support and non-domestic rates** | The Localism Act 2011 received Royal Assent in November 2011 and contains a number of measures that devolve more powers to Councils. The key changes are:<br>• replacing the subsidy method of financing the Housing Revenue Account ("HRA") with a self-financing system;<br>• introducing a new general power of competence; and<br>• abolition of the Standards Board regime.<br>The Local Government Finance Act 2012 contains amendments to two areas of local government finance: council tax support and non-domestic rates.<br>We have highlighted changes to the Code of Practice on Local Authority Accounting in the United Kingdom in Section 4. | Section 4 |
| **Prior year uncorrected misstatements including disclosure misstatements** | | |
| **Prior year uncorrected misstatements reduced cost of services by £1.2m and increased net assets by £1.7m** | We take this opportunity to remind you of the misstatements identified in the prior period. Uncorrected misstatements in 2011/12 reduced cost of services by £1.2 million and increased net assets by £1.7 million.<br>We would also like to remind you of the disclosure misstatements identified in the prior year with a view to addressing these at an early stage of the current year reporting process. | Appendix 1 |
| **Operational features of our audit plan** | | |
| **Our planned audit approach is similar to prior years'** | Appendix 2 sets out our approach to considering fraud in relation to the audit. Appendices 3 and 4 set out our service team and timetable respectively. | Appendices 2, 3 and 4 |
| **Independence and fees** | | |
| **We confirm our independence. Proposed audit fees for 2012/13 are £207,090** | We confirm we are independent of the London Borough of Hillingdon. We will reconfirm our independence and objectivity to the audit committee for the year ending 31 March 2013 in our final report to the audit committee.<br>Our responsibilities and those of the Council are explained in the Audit Commission's publication, 'The responsibilities of Auditors and of Audited Bodies – Local Government' issued March 2010.<br>We propose an audit fee of £207,090 (2011/12: £345,150) for the audit of the Council's financial statements, the assurance report on the whole of government account return and value for money conclusion. This is in line with the scale fee set by the Audit Commission. The 2012/13 scale fees set by the Audit Commission include reductions of up to 40% on 2011/12 fees as a result of savings generated from the outsourcing of the Audit Commission's in-house Audit Practice and internal efficiency savings that the Commission is passing on to audited bodies. Under our new arrangements with the Audit Commission, Deloitte's net re-imbursement for external services provided remains unchanged from those previously agreed. The scale fee reductions do not therefore have an impact on our ability to continue offering a high quality service to you. | Appendix 5 |

# 1. Scope of work and approach

| Key areas of responsibility | |
|---|---|
| | We have four key areas of responsibility under the Audit Commission's Code of Audit Practice: |
| **Financial statements** | We will conduct our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISA (UK and Ireland)") as adopted by the UK Auditing Practices Board ("APB") and the Audit Commission's Code of Audit Practice. The Council will prepare its accounts under the Code of Local Authority Accounting. There are no significant changes in respect of the scope of our work in relation to this area of responsibility. |
| **Annual Governance Statement** | We are required to consider the completeness of the disclosures in the Annual Governance Statement in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and other work. We will also review reports from relevant regulatory bodies and any related action plans developed by the Council. |
| **Value for Money conclusion** | We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources and issue a conclusion on value for money. Our conclusion is given in respect of two criteria:<br>• whether the organisation has proper arrangements in place for securing financial resilience; and<br>• whether the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.<br>In discharging this responsibility, we take into account our work on the Annual Governance Statement and the work of regulators. |
| **Assurance report on the Whole of Government Accounts return** | Whole of Government Accounts (WGA) are commercial-style accounts covering all the public sector and include some 1,700 separate bodies. Auditors appointed by the Audit Commission have a statutory duty under the Code of Audit Practice to review and report on The Council's whole of government accounts return. Our report is issued to the National Audit Office ("NAO") for the purposes of their audit of the Whole of Government Accounts. |

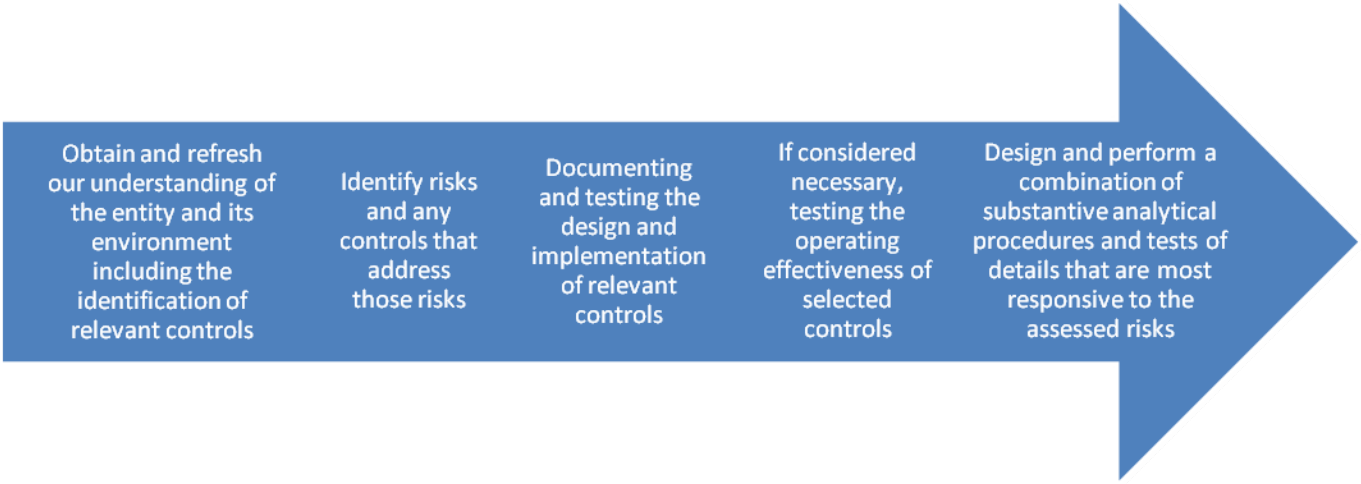
| Working with internal audit | |
|---|---|
| **We will liaise with internal audit in planning our work and utilise their findings in our risk assessment** | We will meet with the internal audit team to plan our combined approach in the year.<br>Following an update of their assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit team, we will review the findings of internal audit and adjust our audit approach as is deemed appropriate. This normally takes a number of forms:<br>• discussion of the work plan for internal audit; and<br>• where internal audit identifies specific material deficiencies in the control environment, we consider adjusting our testing so that the audit risk is covered by our work.<br>We will continue to review all internal audit reports issued during the year and utilise them to assist our risk assessment. |

# 1. Scope of work and approach (continued)

## What audit work do we do on controls?

**We will evaluate the design and implementation of controls relevant to the audit**

As set out in "Briefing on audit matters" circulated to you on 28 February 2012, our risk assessment procedures will include obtaining an understanding of controls considered to be ‘relevant to the audit’. This involves evaluating the design of the controls and determining whether they have been implemented (“D&I”). Our audit approach consists of the following:




We will consider the results of our procedures in respect of the Council’s controls and the extent of any impact our findings have on our substantive audit procedures.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Council, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

## Scoping of material account balances, classes of transactions and disclosures

**We will report to you any significant findings from our scoping work**

We perform an assessment of risk which includes considering the size, composition and qualitative factors relating to account balances, classes of transactions and disclosures. This enables us to determine the scope of further audit procedures to address the risk of material misstatement. We will report to you any significant findings from our scoping work.

# 2. Significant audit risks

Based upon our initial assessment and following discussion with management, we will concentrate specific effort on the significant audit risks set out below.

| Recognition of grant income | | Deloitte response |
|---|---|---|
| **Evaluating compliance with grant terms and conditions can involve significant judgement** | We have identified an audit risk in relation to grant income. This is because, for those grants with conditions attached, income should only be recognised when such conditions have been met. Determining if there are conditions attached to a grant, and if these conditions have been met, can involve significant management judgement. In the prior year revenue grant income amounted to £431,097k and capital grant and contributions income amounted to £40,364k. | We will carry out detailed testing of grant income to check that recognition of income properly reflects the grant scheme rules, that entitlement is in agreement with the draft or final grant claim and that the grant control account balance has been properly reconciled. |

| Revaluation of properties | | Deloitte response |
|---|---|---|
| **The valuation of property is sensitive to judgements on key assumptions** | The Council has a substantial portfolio of property, amounting to £983,517k at 31 March 2012, which is subject to a rolling revaluation programme. The Council has recorded significant gains and losses as a result of property revaluations over the last three years. We have identified this as a risk because of the significant value of the asset base and the fact that valuations are sensitive to judgements on key assumptions.<br><br>We understand the assets to be revalued in the current year include community buildings, sports clubs, youth centres and mortuaries. | We will consider the qualifications, expertise and independence of the Council's valuation expert and the instructions and sources of information provided to the expert.<br><br>We will evaluate the arrangements in place around the property valuation as part of our interim audit.<br><br>We will use our internal valuation specialists, Deloitte Real Estate, to review and challenge the appropriateness of the assumptions used by the Council in valuing their property. |

| Valuation of pension liability | | Deloitte response |
|---|---|---|
| **The valuation of the pension liability continues to be an audit risk in view of the complexity of the judgements and sensitivity of the valuation to small changes in individual assumptions** | The net liability relating to the pension scheme is substantial, amounting to £313,199k at 31 March 2012, so its calculation is sensitive to comparatively small changes in assumptions made about future changes in salaries, price and pensions, mortality and other key variables. Some of these assumptions draw on market prices and other economic indices and these have become more volatile during the current economic environment. | We will consider the qualifications, expertise and independence of the actuary engaged by the Council and the instructions and sources of information provided to the actuary.<br><br>We will include a specialist from our team of actuaries in our engagement team to assist in the review and challenge of assumptions used to calculate the pension liability and related in year transactions and the reasonableness of the resulting accounting entries. |

# 2. Significant audit risks (continued)

| Calculation of the bad debt provision against sundry debtors | | Deloitte response |
|---|---|---|
| **This continues to be a key audit risk in view of different judgements and assumptions used in calculating the provision for the various sub-categories of sundry debt** | The sundry debt balance (referred to Other entities and individuals debtor in the financial statements), which was £20,091k gross of provision at 31 March 2012, includes a number of different sub-categories of debt, all of which have different methodologies for calculating the level of provision required. The provision against sundry debts totalled £10,519k at 31 March 2012. Provisions are inherently judgemental. | We will challenge management's methodologies and assumptions used to calculate the sundry debt provision and the evidence to support the approach. We will consider whether provisions appropriately reflect the impact of the current economic conditions by reference to recent collection performance and trends. |

| Recording of capital spend | | Deloitte response |
|---|---|---|
| **The Council is forecasting a significant amount of capital spend in 2012/13. Judgements are required in the classification of expenditure** | The Council is forecasting significant capital spend in 2011/12 with the month 7 forecast outturn showing a general fund capital programme of £56,964k and HRA capital programme of £4,666k. Classification of expenditure requires management judgement on whether it is capital or revenue in nature.<br><br>In the previous year, we identified several inconsistencies of treatment with expenditure relating to council dwellings and other assets in the housing revenue account. We recommended that management performs an assessment of revenue and capital expenditure at the time it is incurred, rather than as a year end exercise. | We will perform detailed testing on expenditure coded as fixed asset additions to capital assets in the year to confirm the expenditure has been treated correctly. Where the addition replaces another asset, we will test that the other asset has been appropriately disposed of through the fixed asset register. We will also perform detailed testing on repairs and maintenance accounts to identify any capital expenditure that has been incorrectly treated as revenue. |

| Housing Revenue Account (HRA) self-financing | | Deloitte response |
|---|---|---|
| **The Localism Act 2011 replaces the subsidy method of financing the Housing Revenue Account with a system of self-financing** | In the year ending 31 March 2012, the Council made an HRA self-financing settlement payment of £191,571k, which will allow it to retain surpluses on the HRA account going forward. As a result, all HRA revenue and capital expenditure is expected to be funded from existing resources meaning that rent collection, depreciation and impairment of HRA assets have a real impact on the HRA surplus or deficit.<br><br>There are transitional arrangements in place for a 5 year period that allow the Council to mitigate the impact of depreciation or impairment of HRA dwellings by reducing the impact of a portion of depreciation on the bottom line.<br><br>This is a new requirement in the current year and there is a risk that the impact of depreciation and impairment of HRA properties is understated; therefore it is considered a significant audit risk. | We will understand and challenge the estimate that management has made for depreciation of HRA properties. We will test the entries posted by management to mitigate the impact of depreciation and impairment charges to verify that they are in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 Guidance Notes and Item 8 Determination. |

# 2. Significant audit risks (continued)

| Management override of key controls | | Deloitte response |
|---|---|---|
| **We will focus on the testing of journals, significant accounting estimates, and any unusual transactions in the year** | International Standards on Auditing require auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports. | Our work will focus on the testing of journals, significant accounting estimates and any unusual transactions, including those with related parties.<br>We have considered significant accounting estimates and management judgement as significant audit risks above. |

# 3. Value for money

We are required to satisfy ourselves that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources and issue a conclusion on value for money. Our conclusion is based on two specified reporting criteria, which is consistent with prior year. These criteria are:

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

We meet this requirement by:

- reviewing the annual governance statement;
- reviewing the results of the work of other relevant regulatory bodies or inspectorates, to consider whether there is any impact on our responsibilities at the Council; and
- undertaking other local risk-based work as appropriate, or any work mandated by the Commission.

Included below are areas we have considered to date in respect of this requirement. We will update you further following our interim procedures in March and April 2013.

### Monitoring and control of construction contracts

**Internal Audit has identified control deficiencies at the Council in monitoring housing repair and construction contracts**

Internal audit has identified a number of control deficiencies in monitoring housing repairs and construction contracts. The Council's 2011/12 Annual Governance Statement also reported a significant governance issue around the monitoring and control of construction contracts.

There is a risk that if controls are not designed and implemented correctly, the Council will not be achieving value for money for procurement of construction contracts.

We will perform procedures to assess whether this is a significant risk to our value for money conclusion as part of our interim visit in March and April 2013. We will then discuss and agree the scope and cost of any additional procedures required as a result of this assessment.

### Capital budgeting and forecasting

**Significant variances between capital budgets, forecast and outturn were identified in 2011/12**

Final recorded capital expenditure for the 2011/12 financial year was £49m, which was £16m lower that the revised budget and £45m lower than the original budget.

We recommended in 2011/12 that management 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.

We understand that at month 7, forecast outturn on 2012/13 General Fund Capital Programme is £57m, a variance of £46m against a revised budget of £103m. The main reason is down to re-phasing of Primary Schools Expansion project, which accounts for £27m of the difference. For the period 2012 – 2015, we understand the forecast underspend to be much lower at £5m.

We will test those projects that show a significant variance of actual spend against initial forecast to understand if the initial forecast was inaccurate.

### Evidence of achieving savings

**We will select a sample of savings projects to agree to support that savings have been made**

During 2011/12 we identified one project, RE1 Reablement, where it was difficult to support savings of £1,278k that were recorded as being achieved. We raised a recommendation that at the planning stage for savings projects, details of how savings will be tracked and measured should be considered.

As part of our work to support our value for money conclusion in 2012/13, we will test a sample of projects where savings have been recorded as being achieved and obtain support that savings have been made.

# 4. Sector developments

## Localism Act 2011

**The Localism Act 2011 devolves more powers to Councils**

**Self-financing the housing revenue account ("HRA")**

The Localism Act 2011 replaced the previous subsidy method of financing the HRA with a system of self-financing. The Council made a one off payment in 2011/12 of £192m to central government so that it can retain the surpluses made on the HRA going forward.

From 2012/13 authorities will no longer receive housing subsidy or Major Repairs Allowance (MRA) income. Instead the Council will be expected to fund all HRA revenue and capital expenditure from existing resources.

The impact on depreciation and impairments to HRA property has been considered a significant risk within Section 2.

**General power of competence**

The previous well-being powers of local authorities, contained in section 2 of the Local Government Act 2001, and have been replaced by a new 'general power of competence' in the Localism Act 2011.

The general power of competence enables local authorities to do anything which an individual can do, unless other legislation specifically prevents it. Councils may use the power to do things for a commercial purpose, although they must do so through a company. Applying the new power is still subject to legal interpretation and advice. The general power may facilitate new income generation schemes and new ways of providing and funding services, such as joint working arrangements.

**Governance, scrutiny and standards**

Changes to the Council's arrangements for governance, scrutiny and standards have been introduced by the Localism Act 2011. The Act abolishes: the requirement for councils to adopt a national code of conduct; the requirement to have a standards committee that oversees the behaviour of councillors and receives complaints; and the Standards Board for England, the central body set up to regulate standards committees.

All councils now have a duty to 'promote and maintain high standards of conduct by members and co-opted member of the authority'. Each council must:

- develop a local code of conduct dealing with the conduct of members and co-opted members of the authority;
- maintain and publish a register of interests; and
- appoint at least one independent person to act as an adviser to the council on any allegations it may be considering and to members who may be the subject of the allegation(s).

Members who fail to comply with the requirement to register interests will now be committing a criminal offence. The Council itself must decide what action to take if it finds that a member has failed to comply with the Code.

# 4. Sector developments (continued)

## Local Government Finance Act 2012

**The Local Government Finance Act 2012 contains amendments to council tax support and non-domestic rates**

### Council tax support

The Local Government Finance Act 2012 includes provisions designated to localise council tax support. Council tax benefit will disappear and individual local authorities will be responsible for preparing their own council tax reduction ("CTR") schemes. The current system means that central government reimburses the Council for all correctly awarded council tax benefit. Going forward, it is intended that the source of funding for each authority's CTR scheme will be the proportion of business rates retained by authority.

We understand that the Council has agreed a scheme and that this will in place from 1 April 2013. This will impact the accounts for the year ending 31 March 2014.

### Non domestic rates

The provisions allow the Secretary of State to move money around by deciding how much of the non-domestic rate income collected by the Council should be retained by the Council, paid to central government and paid out by central government to local authorities for local government purposes. This will impact the accounts for the year ending 31 March 2014.

CIPFA will use the 2013/14 Code update to cover the accounting implications of these changes.

## Code of Practice on Local Authority Accounting in United Kingdom 2012/13

**Changes introduced by the Code 2012/13 are not significant**

### Housing Revenue Account ("HRA")

The impacts of the changes to the HRA due to the Localism Act 2011 have been discussed in more detail above and in the significant risks section (Section 2).

### Carbon Reduction Commitment ("CRC") scheme

As the obligation to meet CRC responsibilities arises during 2012/13, the obligation should be accounted for at 31 March 2013. Where any allowances are purchased prospectively (i.e. in respect of 2013/14), authorities will need to account for the allowances as assets. This is clarification of the guidance in relating to the CRC provision. We established in the prior year that the provision is not material; therefore we do not consider this to be significant audit risk of material misstatement.

### Exit packages

The 2012/13 Code guidance notes provide extended guidance on the disclosure requirements for exit packages. This clarifies that legal, contractual or constructive obligations at year end should be included in the disclosure of exit packages. The guidance notes also recommend that the exit package disclosure is amalgamated with the requirements in relation to the disclosure of termination benefits. The value of exit packages has historically not been material; therefore we do not consider this to be significant audit risk of material misstatement.

### Accounting for non-current schools' assets

The CIPFA/LASAAC board is still considering the accounting for non-current schools' assets. It intends to issue guidance to authorities to improve the consistency of the accounting for these assets and a potential accounting treatment was consulted on as part of the 2013/14 code. Since CIPFA/LASAAC is not able to issue guidance for 2012/13, the situation remains the same as for the 2012/13 year. There is no change in guidance and no issues were noted from testing in the prior; therefore accounting for schools' non-current assets is not considered a significant audit risk.

# 4. Sector developments (continued)

## Code of Practice on Local Authority Accounting in United Kingdom 2013/14

**A number of changes are proposed by the 2013/14 Code**

**IFRS 13: Fair value accounting**

The 2013/14 Code will introduce the requirements of IFRS 13 *Fair Value Measurement* as adapted for public sector circumstances. Non-financial non-profit generating assets are taken out of the scope of this standard and will be carried at a ‘public sector valuation’, which is presumed to reflect the assets’ service potential.

As a result of the adaption the Council would not be required to measure property, plant and equipment in accordance with IFRS 13; however in order to meet the disclosure requirements of the standard the Code makes it necessary for authorities to consider which level of the fair value hierarchy the valuation technique they have used will apply.

The Council will need to ensure that the valuer is made aware of the introduction of IFRS 13 and the Code’s adaption of it. Where the change is expected to be material to the accounts, the Council will need to disclose in its 2012/13 financial statements:

- the title of the new or amended standard;
- the nature of the change of accounting policy;
- the date at which the change of accounting policy is required; and
- a discussion of the impact that initial application of the IFRS is expected to have on the financial statements.

**Other amendments**

Other changes include:

- amendments to the Comprehensive Income and Expenditure Statement as a result of the June 2011 amendments to IAS 1 *Presentation of Financial Statements*;
- amendments to IAS 19 *Employee Benefits* including changes to definitions and terminology, changes to the recognition requirements and clarification of the disclosure requirements;
- a number of clarifications and augmentations of the provision of the Code as a result of the CIPFA/LASAAC IFRS post implementation review;
- amendments to IAS 12 *Income Taxes*;
- new definitions and clarification for service concession arrangements that are assets under construction or intangible assets;
- clarification on the treatment of overdrafts; and
- amendments to IFRS 7 *Financial Instruments: Disclosures* requiring information that will enable users to evaluate the potential effect of netting arrangements.

As discussed above, a change to accounting for non-current school assets is currently being consulted on.

# 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 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 on 28 February 2012 and sets out those audit matters of governance interest which have come to our attention during the planning of our audit to date. Our audit is not designed to identify all matters that may be relevant to the members and our final report on the audit will not necessarily be 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 the Audit Committee, 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**

Chartered Accountants
St Albans

27 February 2013

# Appendix 1: Prior year uncorrected misstatements including disclosure misstatements

### Uncorrected misstatements

We are required to communicate to you the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. The following uncorrected misstatements were identified during the course of our prior year audit:

| | | Charge/ (credit) to current year income and expenditure statement £'000 | Increase/ (decrease) in net assets £'000 | Decrease/ (increase) in unusable reserves £'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 | - |
| **Total** | | (1,162) | 1,656 | (494) |

We obtained written representations from management confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the financial statements taken as a whole, no adjustments were 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 proposed that it was released.

# Appendix 1: Prior year uncorrected misstatements including disclosure misstatements (continued)

## Disclosure misstatements

Auditing standards require us to highlight significant disclosure deficiencies to enable audit committees to evaluate the impact of those matters on the financial statements.  The table below highlights those areas of disclosure that we considered required consideration by the committee in the prior year:

| Disclosure | Detail |
|---|---|
| **Housing benefit provision** | The Council included a provision relating to housing benefit. This is included in the table of uncorrected misstatements on the previous page. As management did not intend to adjust for this proposed misstatement we considered it necessary to highlight that the 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 did not make 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 the revaluation of assets and the effect of these revaluations on accumulated depreciation and the revaluation reserve. The presence of these errors meant that it was 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 highlighted that this has no overall impact on the balance sheet. Management did not adjust 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 had not been disclosed by the Council. We considered this to meet the definition of a heritage asset as it is a 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. |

We obtained written representations from management confirming that after considering all these disclosure deficiencies, both individually and in aggregate, in the context of the consolidated financial statements taken as a whole, no adjustments were required.

# Appendix 2: Consideration of fraud

## Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

## Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

## Fraud inquiries

We will make the following inquiries regarding fraud:

| Management | Internal Audit | The Audit Committee |
|---|---|---|
| Management's assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments.<br>Management's process for identifying and responding to the risks of fraud in the entity.<br>Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.<br>Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.<br>Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity. | Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. | How the Audit Committee exercises oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.<br>Whether the Audit Committee has knowledge of any actual, suspected or alleged fraud affecting the entity. |

# Appendix 2: Consideration of fraud (continued)

We will make inquiries of others within the Council as appropriate. We will also inquire into matters arising from your whistle blowing procedures.

## Concerns

As set out in Section 2 above we have identified the risk of fraud in grant income recognition, and management override of controls, as significant audit risks for your organisation.

## Representations

We will ask for you and management to make the following representations towards the end of the audit process:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- 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.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:

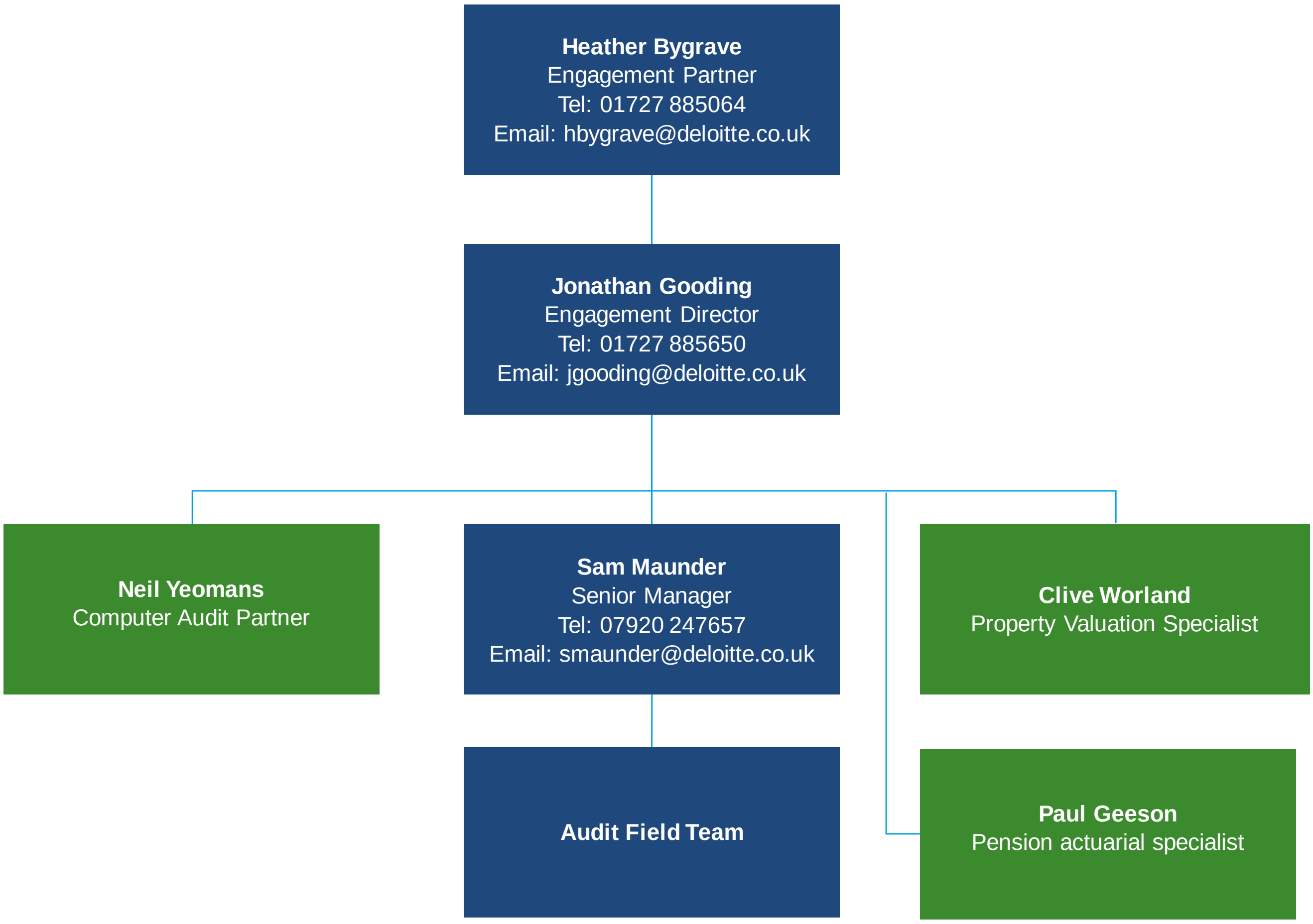
  (i) management;

  (ii) employees who have significant roles in internal control; or

  (iii) others where the fraud could have a material effect on the financial statements.
- 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.

# Appendix 3: Audit engagement team

We set out below our audit engagement team.  We manage our audit on a basis that is consistent with prior year and which draws on the expertise of our local government industry group and relevant specialists within the firm.



# Appendix 4: Timetable

Set out below is the approximate expected timing of our reporting and communication with management and those charged with governance.

| Planning | Interim audit | Year end fieldwork | Reporting | Post reporting |
|---|---|---|---|---|
| Planning meetings to:<br>• confirm risk assessment; and management response;<br>• agree on key judgemental accounting issues; and<br>• agree the audit plan | Update discussions of key audit and business risks and testing of controls to mitigate significant audit risks<br><br>Review of relevant internal audit work<br><br>Document and test design and implementation of key controls<br><br>Update understanding of systems, controls and developments in the business<br><br>Performance of work in support of value for money conclusion | Performance of substantive testing<br><br>Finalisation of work in support of value for money conclusion<br><br>Review of annual accounts<br><br>Audit issues meeting<br><br>Work to support assurance statement on WGA return | Final Audit Committee Meeting<br><br>Issuance of:<br>• audit report and opinion;<br>• value for money conclusion; and<br>• limited assurance opinion on WGA return | Audit feedback meeting<br><br>Issue of annual audit letter |
| February 2013 | March – April 2013 | June – August 2013 | August – Sept 2013 | Sept – October 2013 |

**Ongoing communication and feedback**

# Appendix 5: Audit fees

The indicative fee for the audit of the London Borough of Hillingdon for 2012/13, excluding the audit of the pension scheme and certification of claims and returns, is £207,090 (exclusive of VAT), which compares to the fee of £345,150 for 2011/12.

The 2012/13 scale fees set by the Audit Commission include reductions of up to 40% on 2011/12 fees. These result from savings generated from the outsourcing of the Audit Commission's in-house Audit Practice and internal efficiency savings that the Commission is passing on to audited bodies. Under our new arrangements with the Audit Commission, Deloitte's net re-imbursement for external services provided remains unchanged from those previously agreed. The scale fee reductions do not therefore have an impact on our ability to continue offering a high quality service to you.

The fee excludes:

- fees for the certification of grant claims. For 2012/13, the Audit Commission has replaced the previous schedule of hourly rates with a composite fee for certification work for each body. The composite indicative fee which the Audit Commission has set for 2012/13 is £90,200. This is based on the actual certification fees for 2010/11 adjusted to reflect the fact that a number of schemes will no longer require auditor certification, and incorporating a 40% reduction (similar to the 40% reduction in the audit fee described above). The fee is based on assumptions on the grants requiring certification, the scope of work required and the availability of good quality working papers to support the claims. Total fees charged for the certification of grant claims in 2011/12 was £115,399;
- the fee for the audit of the pension scheme annual report, which is discussed in a separate audit plan;
- any work in relation to providing any specific accounting or other views. Given the uncertainty of timing and input required, we will agree the scope of work and associated fee with you when you request the opinion;
- any additional work required to address questions and objections raised by local government electors which, due to uncertainty of timing and resource required, will be agreed separately;
- any work requested by you that we may agree to undertake. Each piece of work will be separately negotiated and a detailed project specification agreed with you; and
- value added tax which will be charged at the prevailing rate.

We have also assumed that:

- Internal Audit undertakes appropriate work on all systems, and good quality working papers and records will be provided by the agreed start date for the planning audit visit;
- good quality draft of the financial statements, together with good quality working papers and records to support the financial statements, will be provided by the agreed start date for the final audit visit; and
- good quality working papers will be available by the deadline for submission of the WGA return to auditors to support the WGA return.

One of our divisions, Drivers Jonas Deloitte, was successful in 2011/12 with 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 sub-contractors.

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. We will provide details of the amount of non-audit fees invoiced in 2012/13 in our final committee paper.