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The London Borough of Hillingdon

Report to the Audit Committee on the year ended 31 March 2013 Audit

4 September 2013

Deloitte.

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The Chairman of the Audit Committee
London Borough of Hillingdon
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4 September 2013

Dear Sirs,

We have pleasure in setting out in this document our report to the Audit Committee of the London Borough of Hillingdon ("the Council") for the year ended 31 March 2013. This report covers the principal matters that have arisen from our audit of the Council for the year ended 31 March 2013.

In summary:

- The major issues, which are summarised in the Executive Summary, have now been substantially addressed and our conclusions are set out in this report.
- There are a number of judgemental areas to which we draw your attention in our report which you should consider carefully.
- Our work is largely complete and we are not aware of any circumstances which would cause us to issue a qualified opinion on the accounts or a qualified value for money conclusion.

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

Yours faithfully,

Heather Bygrave

Senior Statutory Auditor

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Executive summary

We have the pleasure in setting out in this document our report to the Audit Committee of the London Borough of Hillingdon on the audit of the Council's financial statements for the year ended 31 March 2013. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2013.

This summary is not intended to be exhaustive but highlights the most significant matters which we would like to bring to your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

Status	Description	Detail
Completion of the audit		
Our audit is largely complete	We have completed our work on the areas of significant risk as identified in our audit plan. We did not identify any additional significant risks. Our outstanding areas are: • Completion of review of events after the reporting period. • Receipt of signed management representation letter. • Completion of Whole of Government Accounts (WGA) consolidation work which will enable certification of financial statements when the audit opinion is signed. • Final completion of internal review procedures.	n/a
Overall view		
We have not identified any matters through our work to date which would prevent us from issuing an unmodified audit opinion on the truth and fairness of the financial statements	We have not identified any matters through our work to date which would prevent us from issuing an unmodified audit opinion on the truth and fairness of the financial statements. The matters that we have taken into account in forming our overall view are described in the following sections of this report. Under the Audit Commission Act 1998, we issue a certificate 'when the audit of the accounts has been concluded'. The issue of the audit certificate marks the closure of the audit and the end of the exercise of the auditor's powers and duties in respect of that audit. The audit certificate can be issued as soon as all the work required to meet auditors' responsibilities under sections 2 and 3 of the Code has been completed. One of our statutory responsibilities is to issue an opinion on the Whole of Government Accounts return. The deadline for the audited return is 5 October. The Audit Commission has been delayed in finalising its instructions to auditors but these are now completed. Whilst we do not need to delay the issue of our opinion on the financial statements for this, we would not be able to issue our certificate until completion of our work and the issue of our opinion on the Whole of Government Accounts return.	n/a

Executive summary (continued)

Overview of risk	Description	Status	Detail

G Risk appropriately addressed

A Risk satisfactorily addressed but with unadjusted errors identified

R Material unresolved matter

Significant audit risks		Status	
There were no significant issues arising from our review of these audit risk areas	In our audit plan we identified a number of significant audit risks. Our findings in respect of those risks are as follows:		Section 1
	1. **Recognition of grant income:** our testing of grants did not identify any significant issues.	G	
	2. **Revaluation of properties:** in the 2012/13 year the Council valued a range of assets including community premises, sports premises, youth centres and investment properties. We concluded that the assumptions used were broadly reasonable but identified one adjustment relating to the use of indices for Council dwellings. In addition, we identified one asset classified as held for sale which we considered to be overstated in value by £0.4m and one asset which was classified as held for sale which we considered to be an asset under construction. Management accepted all of these adjustments and has reflected these changes in the latest draft of the financial statements.	G	
	3. **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 when compared to the Deloitte in-house benchmarks.	G	
	4. **Calculation of the bad debt provision against sundry debts:** 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	
	5. **Recording of capital spend:** we did not identify any issues in our sample testing between the classification of capital and revenue spend.	G	
	6. **Housing Revenue Account ("HRA") self-financing:** the impact of the Localism Act 2011 on statutory mitigations for depreciation on HRA fixed assets was a new accounting requirement for 2012/13. Our testing has identified no material misstatements with respect to the new accounting requirements.	G	
	7. **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. Management has brought to our attention two adjustments: 1) relating to the need for a legal claim provision in the region of £1.0m, which was previously disclosed in the draft accounts presented for audit as a contingent liability. We have reviewed this and agree that an adjustment is required; 2) relating to a receipt of £2.5m in relation to an Icelandic investment which was previously impaired.	G	

Executive summary (continued)

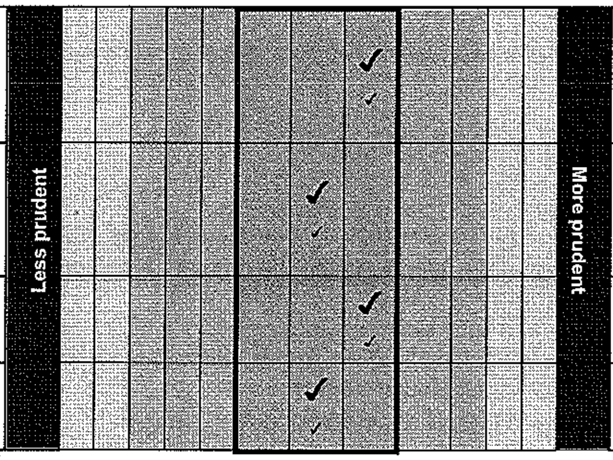
Status	Description	Detail
Value for money (VFM) conclusion		
We expect to issue an unqualified value for money conclusion	One of our responsibilities is to include in our audit report a conclusion on whether the London Borough of Hillingdon has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources - this conclusion is known as "the VFM conclusion". The conclusion is given in relation to two criteria specified by the Audit Commission. On the basis of our work, we confirmed our preliminary assessment that there were no risks which required us to carry out other locally determined work and we propose to issue an unqualified VFM conclusion. However, we have made a recommendation around the current capital budgeting process which is included in Section 3.	Section 2
Risk management and internal control systems		
We did not identify any significant deficiencies in the financial reporting systems	Our audit findings did not identify any significant deficiencies in the financial reporting systems. However, we have identified a number of recommendations which we have identified during the course of our work. We have also provided an update on recommendations raised in 2011/12.	Section 3
Identified misstatements and disclosure misstatements		
Management has adjusted for all misstatements identified and the majority of disclosure deficiencies	Audit materiality was £7.5 million as set out in our Audit Plan. Management has corrected all misstatements identified in the course of our audit. We have also reported to you those disclosure deficiencies which we consider to be significant. Management has adjusted for the majority of these.	Appendix 1
Significant representations		
We will request management representations	A copy of the draft representation letter to be signed on behalf of the London Borough of Hillingdon is included at Appendix 3.	Appendix 3
Independence		
We confirm we comply with APB Revised Ethical Standards for Auditors	Our reporting requirements in respect of independence matters, including fees, are covered in Section 4.	Section 4

1. Significant audit risks

Understanding the subjective judgements and estimates

The table below shows, on a range of acceptable outcomes from less prudent to more prudent, where management's key assumptions and valuations relating to significant estimates lie. We have only included those significant risks which we consider to involve key judgements.

Acceptable range



Pension liability	We have concluded that the assumptions used by the Council's actuary to calculate the pension liability are reasonable. When compared to our own in-house benchmark we consider the assumptions to be slightly prudent but consistent with the prior year.
Asset revaluation	We have identified some process weaknesses in our testing of the valuation of fixed assets and also an adjustment to increase the value of fixed assets based on updated indices. However, overall we consider the assumptions and judgements used to be reasonable.
Sundry debt provisioning	We consider the Council's sundry debt provision to be slightly prudent but materially reasonable and consistent with the prior year.
Management override of controls	We did not identify anything from our testing of journals or review of other estimates or judgements to suggest a prudent or aggressive stance taken by management.

Current year position ✓

Prior year position (if relevant) ✓

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

Grant income recognition

G

We have not identified any errors in our sample testing of the grant income

Accounting for grant income can be complex as the basis for revenue 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 £416m in 2012/13) 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. We have also tested the design and implementation of controls around recognition of grant income and concluded that they are designed and implemented satisfactorily.

Our testing identified no significant issues with the revenue and capital grants included within the sample selected.

1. Significant audit risks (continued)

Revaluation of properties

G●

We identified one adjustment relating to the indexation applied to Council Dwellings, and two adjustments relating to assets held for sale. All adjustments were accepted and corrected by management

The Council's substantial portfolio of assets is subject to a rolling five year revaluation programme. In the 2012/13 year the Council undertook a detailed revaluation of assets with a carrying value of £37.4m, which equates to 3.2% of the £1.2bn carried in the balance sheet value for property, plant and equipment at 31 March 2013. The assets subject to a detailed revaluation in 2012/13 included community premises, sport premises, youth centres and investment properties.

We identified this as a risk because of the size of the property balance in relation to the overall financial statements, and because any valuation is subject to estimates and assumptions.

Deloitte response

We engaged our property specialists Deloitte Real Estate (DRE) to review the assumptions and methodology used to value the different types of land and property. Overall, we concluded that the valuation methods selected, and the way in which those methods were applied, were reasonable. However, we have raised a management recommendation regarding the qualifications of the valuer and the valuations process which is detailed in Section 3.

The Council undertakes a full valuation of council dwellings every five years. In the intervening periods it applies a range of indices as a form of valuation as well as accounting for movements in stock. As in previous years, the Council applied the change in indices to February 2013, as opposed to the year end date of March 2013, because the latter information was not available at the time of preparing the accounts. As part of our testing we considered the potential change in valuation had March data been used; the difference was material and so we proposed an adjustment to increase the value of council dwellings by £6.8m. This adjustment was accepted and changed by management.

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 assets held for sale identified two errors. Our testing identified one property, Rosedale Court Apartments, which was originally classified as held for sale but subsequently confirmed that it was still in the course of construction at year end and so should have been included in this category; this was corrected by management. Secondly, another asset classified as held for sale, Elizabeth Court, was originally recognised in the financial statements at its full market value, despite being marketed for sale at 80% of its market value as part of a first time buyer scheme. Management has also accepted this adjustment and revised the valuation in the latest version of the financial statements.

1. Significant audit risks (continued)

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 £373.3m is comprised of two funds within the Local Government Pension Scheme (LGPS); the London Borough of Hillingdon (LBH) Pension Fund (£370.1m) and the London Pension Fund Authority (LPFA) Pension Fund (£3.2m).

The total net pension liability has increased by £60.1m on the prior year. The main movements within this overall net increase are a higher than expected return on assets, which is more than offset by a reduction in the discount rate applied to liabilities.

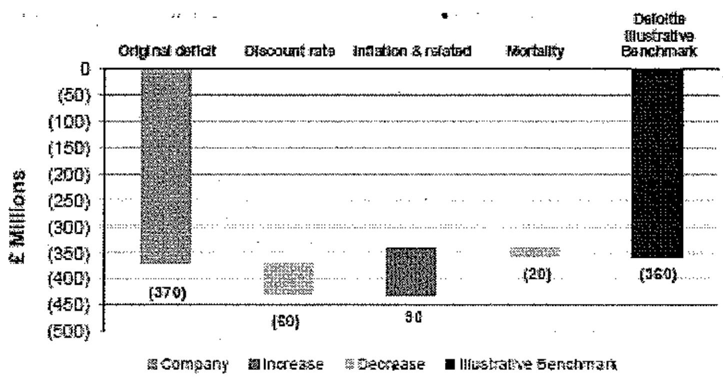
Deloitte response

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. Our actuaries did not undertake a high level review of the assumptions used in calculating the LPFA net pension liability due to the size of the liability being immaterial.

Our actuaries have concluded that the assumptions used in the calculation are near the middle of a range which we consider to be reasonable. We highlight that the assumptions used in the prior year were also considered to be reasonable.

Whilst we consider the Council's overall assumptions, and therefore the net pension liability, to be materially reasonable, for illustrative purposes we have shown below the difference in individual assumptions between the Council's approach and our own 'in house' benchmarks.

Deloitte Illustrative Benchmark Funded Status



1. Significant audit risks (continued)

Calculation of the bad debt provision against sundry debts

G●

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

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

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 2011/12 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.

	Gross balance £'000	Provision £'000	*Net balance £'000*
Total Sundry Debt	**21.4**	**11.1**	**10.3**
Housing and Social services debt	14.5	9.7	4.8
Other	6.9	1.4	5.5

The 2012/13 gross balance for housing and social services debt is £14.5m with a provision of £9.7m. If prior year cash recovery rates were to remain the same, we would expect a provision of £9.4m, a difference of £0.3m 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 historical 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 2012/13 is £6.9m with a provision of £1.4m. We have tested the significant risk over the provision and consider that the provision is reasonable based on the change in the level of the council debt from the prior year.

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

1. Significant audit risks (continued)

Recording of capital spend	
G● **Our sample testing over the recording of capital spend identified no material errors**	The Council has had significant capital spend during 2012/13 of £49m (2011/12: £54m). This is less than the planned capital spend of £89m. Classification of expenditure requires management judgement on whether it is capital or revenue in nature.
Deloitte response	In the prior year our testing identified several inconsistencies of treatment with expenditure relating to council dwellings and the housing revenue account. As a result, we recommended that management undertook an exercise to determine whether certain categories of spend should be treated as capital or revenue. A detailed review of capital expenditure was performed by management in the 2012/13 year and adjustments made prior to the audit visit. In the current year we tested the risk of misclassification of capital expenditure in three ways: • sample testing of repairs and maintenance expenditure which had been classified as revenue; • sample testing of capital additions within fixed assets; and • sample testing of the disposal of any replacement assets. No issues were found in our testing this year with regards to the classification of capital and revenue spend.

1. Significant audit risks (continued)

Housing Revenue Account (HRA) self-financing settlement payment

G●

We did not identify any issues from our testing of the HRA self-financing settlement

In the year ending 31 March 2012, the Council made an HRA self-financing settlement payment of £191.6m 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.

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. The Council has made the decision not to use these transitional arrangements, as the depreciation calculated by the Council for the current year is broadly in line with the prior year Major Repairs Allowance.

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.

Deloitte response

We have reviewed the estimate on the depreciation charge of HRA properties to verify that it is in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 Guidance Notes and Item 8 Determination.

We have noted that there has been no split of land and buildings for the purpose of calculating depreciation. Management's opinion is that removing the value of the land would have a negligible effect on the depreciation charge as the land can only be used for social housing and therefore has a reduced market value.

In the prior year, the amount used for depreciation was a formula calculation based on what the Council considered was the correct amount to put to reserves to maintain the housing stock. This value was described as the Major Repairs Allowance. In the current year, as a result of the new requirements, a true figure for depreciation has been used as calculated using SORP guidelines. This calculation is materially similar to the prior year MRA "proxy" depreciation calculation. If the land value was removed from the depreciation calculation, it would reduce the depreciation value for the current year and would make the prior year and current year values incomparable.

Under the new guidelines, if land was removed from the depreciation calculation and the depreciation value was lower, a voluntary revenue provision could be made to the Major Repairs Allowance to include the amounts which the HRA think are reasonable to maintain the housing stock.

Therefore, we concur with management's judgement that the depreciation value as calculated in the current year in not materially misstated.

We have verified that the depreciation and impairment charges are in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 Guidance Notes and Item 8 Determination and have not noted any material misstatements.

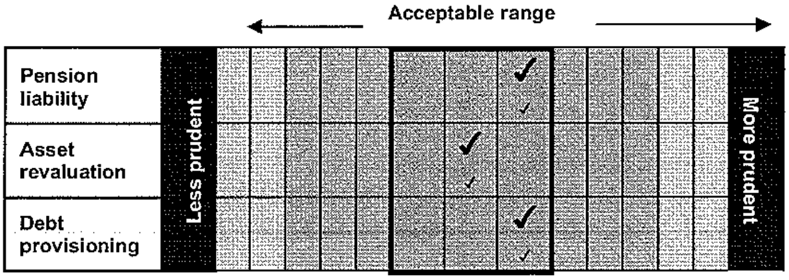
1. Significant audit risks (continued)

Management override of controls

We consider some of management's judgements to be at the more prudent end of an acceptable range.

Deloitte response

International Standards on Auditing include a presumption of a risk of management override of key controls which cannot be rebutted by the auditor. This recognises that management may be able override controls that are in place to prevent inaccurate or even fraudulent financial reporting.



Current year position ✓ *Prior year position (if relevant)* ✓

Our work focused on testing of journals, significant accounting estimates and any unusual transactions, including those with related parties. 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 could be indicators of possible fraud and to focus our testing on these. We did not identify any issues from the work carried out.

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. From the table above, we highlight to the committee that the Council application of judgement in all areas is within the acceptable range.

During our testing, management brought to our attention two post year end updates relating to accounting estimates which gave rise to the potential need to adjust the accounts.

The first was in relation to an adjustment to provisions relating to a claim which was previously disclosed as a contingent liability. The reason for this proposed change was the result of an employment tribunal which ruled against the Council in relation to the termination of a contract with a supplier in October 2012. We held discussions with the Council's in-house legal team and concluded that we considered this ruling to represent an adjusting event after the reporting period, and so recognition as a provision would be appropriate. The estimate of settling these claims has been assessed at £1m by the in-house legal team and so we agreed with management that this change should be made to the draft financial statements.

The second was in relation to an unexpected dividend that was received in August 2013 from a previously impaired Icelandic investment. We have reviewed the receipt of the dividend and reviewed management's recalculation of the necessary impairment over the investment, taking into account the percentage of the investment now received. A reduction in the impairment of £1.3m has been made and we agreed with management that this change should be made to the draft financial statements.

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

Scope of our work

Under the Code of Audit Practice 2010 we are required to include in our audit report a conclusion on whether the London Borough of Hillingdon has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources - this conclusion is known as "the VFM conclusion".

Our conclusion is given in relation to two criteria:

Specified criteria for auditors' VFM conclusion	Focus of the criteria for 2013
The organisation has proper arrangements in place for securing financial resilience.	The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.	The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Approach to our work

We draw sources of assurance relating to our VFM responsibilities from:

- The audited body's system of internal control as reported on in its Annual Governance Statement..
- The results of the work of the Commission, other inspectorates and review agencies to the extent that the results come to our attention and have an impact on the our responsibilities.
- Any work mandated by the Commission – of which there was none in 2012/13.
- Any other locally determined risk-based VFM work that auditors consider necessary to discharge their responsibilities.

Risk assessment

Our preliminary assessment identified a number of potential risks in relation to our VFM, which we reported in our audit plan. These related to:

- The monitoring and control of construction contracts.
- Capital budgeting and forecasting.
- Evidence of achieving savings.

In our audit plan we said we would undertake a wider risk analysis but also pay specific attention to these areas. We have done this and reported our findings below.

Monitoring and control of construction contracts

We identified this as a potential risk because Internal Audit identified a number of control deficiencies in monitoring housing repairs and construction contracts, because the 2011/12 Annual Governance Statement reported a significant governance issue around the monitoring and control of construction contracts, and because of allegations made by an MP in Parliament during the 2012/13 financial year.

Our testing included reviewing subsequent internal audit reports and investigation papers relating to construction contracts. It also extended to reviewing other internal audit reports on other areas of contract management. We also met with the Head of Procurement to discuss issues raised in these reports and his plans for addressing weaknesses identified.

2. Value for money conclusion (continued)

Monitoring and control of construction contracts (continued)

During the audit we also became aware of the Council being found liable by an employment tribunal for employment costs relating to the termination of a contract held with a contractor for housing maintenance. The estimated cost of settlement is £1m, which has been recognised as a provision by the Council. Given that this was another example of contractual issues relating to construction / maintenance, we requested some further assurance from management that they were not aware of any further matters of this type, and assurances around planned improvements to contractual monitoring controls.

We found that management recognised the need for improvement of controls around all aspects of contract management at the Council and could demonstrate actions that were taking place to address these issues. Considering progress, and that the contracts where issues were noted were not material, we concluded that this was not a significant risk to our VFM opinion.

Capital budgeting and forecasting

We raised a recommendation as part of our 2011/12 audit regarding capital budgeting and the need for this to be more accurate in order to be meaningful as a tool to measure the risk of potential non-delivery. As a result, we revisited this area this year.

We recommended that management should prepare a breakdown of the budgeted 2012/13 capital spend by project and compare that with the actual outturn spend for the year. Management performed this review and this showed an original budget of £89m, which was revised up to £101m in May, compared to actual outturn spend of £45m, which is significantly less than both original and revised budget. We focussed on the two most significant areas of underspend which were the schools programme and the supported housing programme. Regarding schools, management agreed that improvements could be made to the phasing and monitoring of school expenditure, and that the school programme project team had been developed in recent years, but stated that the noted underspend to budget had not, to date, resulted in a detrimental effect on services such as provision of school places. With the supported housing programme, we understand a detailed review is currently underway to reassess this area of capital spend. This capital programme plays a key part in the delivery of the Council's revenue savings programme and so is important that it is delivered.

We found no evidence that the underspend of capital budgets has had a detrimental effect on the provision of Council services. Our key finding was that there are still opportunities to improve the budgeting and monitoring of capital spend and so we have made this recommendation in Section 3.

Evidence of achieving savings

Our 2011/12 report identified some areas for improvement regarding clarity around the tracking of savings made, with particular emphasis on the Reablement savings project, which is one of the major savings projects in the Council's plan. Working with the Council's corporate finance team, we reviewed this area again in the 2012/13 year. Regarding the Reablement project we found some improvements had been made but in some areas it was still difficult to link the planned saving to the overall outcome for some component parts of the overall programme. However, we have seen that management are aware of this and taking active steps to improve this in the 2013/14 year. Given that this area of risk has already been identified by the Council, and we can see evidence of progress, we concluded it was not a material risk to our VFM conclusion.

Overall conclusion

On the basis of the work detailed above, and supplemented by more general enquiries such as reviewing the matters reported in the Annual Governance Statement, and other matters which came to our attention, we concluded that there were no significant risks which required us to carry out further work and we propose to issue an unqualified VFM conclusion.

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 in February 2012.

Risk management and control observations

We have identified a number of control observations, the most significant of which are detailed below. We have grouped the recommendations into those in relation to the finance function and those in relation to the wider business.

Finance Function

Accuracy check of data submitted to the Actuary	
Description	In 2012/13 the Council outsourced the administration of its Pension scheme to Capita. Capita are also responsible for sending data to the scheme's actuary, without the involvement of management. There were a number of errors in their submission in 2012/13, although these were not material.
Deloitte response	We recommend that management put controls in place to check that the data sent to the actuary is accurate before it is submitted.
Management response	Whilst the submission of data to the actuary is part of the contract with Capita Employee Benefits, processes will be changed going forward to ensure that all data will be submitted through the in house Pensions Team who will undertake a review of the data before final submission to the actuary.
Timeframe	Revised process now in place, to ensure IAS 19 data for schools this autumn is checked prior to submission.
Owner	Nancy Leroux, Deputy Director Strategic Finance

3. Risk management and control systems (continued)

Journal codings	
Description	As part of our testing over the management override of controls, we undertake a risk-based approach to test journals. A number of the journals we were directed to test were picked up as a result of the journal heading containing the word 'correction' or 'error'. Our testing identified a number of journals which were originally posted to incorrect accounts and further journals were made to correct these.
Deloitte response	Whilst we acknowledge that the controls within the Council are picking up these miscodings, we recommend refresher training is considered for all staff and for new joiners involved with posting. This will encourage journals to be posted correctly in the first instance and will reduce the risk of miscodings not being identified and making journal entries more efficient by making 'right first time'.
Management response	'Back to Basics' training for all accountants will be part of the work plan for the coming year, which will include training on getting things correct first time, with the aim of reducing the number of journals posted. As part of this training, accountants will be reminded of the need to post journals correctly in the first instance. Once training is completed, regular reviews of journals will be undertaken to ensure procedures are followed correctly.
Timeframe	Winter 2013
Owner	Nancy Leroux, Deputy Director Strategic Finance

3. Risk management and control systems (continued)

Property valuation technique	
Description	Our testing of asset valuations identified a number of areas where improvements could be made. Firstly, we identified that, whilst the Council's valuers are registered with the Royal Institute of Chartered Surveyors (RICS), they are not Registered Valuers. The Registered Valuer scheme was introduced in 2011 and is compulsory for all surveyors who undertake valuations. Secondly, our detailed review of asset valuations identified some areas where the 20 minimum requirements of a Red Book valuation report were not complied with. We highlight that these were largely documentation points such as a statement over the valuation approach. The Code also notes that best practice is for the Valuer to agree formal terms of engagement when undertaking this work; this was also not in place. Finally, our detailed review identified some areas where the assumptions used by the valuer were not clearly documented and could only be understood through discussions. There were some cases where our independent valuers did not agree with the assumptions made by the Council's valuer, although these differences were not material.
Deloitte response	We recommend: • The Council's valuers enrol in the Registered Valuer scheme; • The documentation of valuation reports is improved and the valuation process formalised; • The Council considers the portfolio of assets requiring valuation and engage • specialist support where appropriate.
Management response	1. Registered Valuer Scheme - We were advised by the RICS registration monitoring section that registration would be optional if the valuations undertaken were exempt under PS1.2. We took the view that as the valuations provided are 'internal valuations' neither in the public domain or relied on by third parties that they were technically exempt. However the Council may choose to enrol the appropriate valuers in the Registered Valuer scheme to cover any valuations which may become public and to comply with the auditors' recommendation. 2. Valuation Documentation - It is noted that the documentation of individual valuations could be improved on individual valuation files though background information is documented generally. It is noted that 'Terms of Engagement' are recommended to be agreed and standard terms of engagement are being drawn up for the current financial year. With respect to the independent valuers not agreeing with assumptions in some cases, it is not uncommon in the valuation process to find that valuers' opinions are often different. As current staff have a high level of experience and local knowledge, we are confident that our valuations are appropriate for their purpose. The Council may choose to appoint independent valuers in some cases though the benefit of this over relying on internal valuations would have to be weighed against the additional costs involved.
Timeframe	March 2014
Owner	David Murnaghan, Deputy Director Asset Management

3. Risk management and control systems (continued)

Capital Budgeting	
Description	As part of our 2011/12 Value For Money (VFM) procedures we identified significant variances between the capital budget and actual capital spend, and recommended that the Council reviews this process. As part of our VFM procedures for 2012/13, we revisited this area. We found that the actual capital spend of £45m was £44m less than the original capital budget of £89m. One of the major purposes of monitoring capital spend is to measure whether projects are delivered on time and within planned resources. We consider that the current capital process of capital budgeting and monitoring, and the way this is presented to Cabinet, is limited in achieving this.
Deloitte response	We recommend the Council reviews its current capital budgeting and monitoring process, and the presentation of this to Cabinet. The aim of the review should be to design a capital monitoring system which is risk-focussed and will highlight where projects are not progressing against agreed milestones or where non delivery will have a detrimental impact on services. Where actual spend is significantly different to budgeted spend, commentary should be provided detailing why projects are not on track and the mitigating actions being undertaken to address this.
Management response	Whilst we acknowledge that there have been delays in the completion of some projects within the Schools Capital Programme against the original plan, we can confirm that these delays have had no impact on the delivery and opening of those schools in time to meet demand. Hillingdon are delivering one of the largest school build programmes across London and when the capital programme was set last year much of the planning was at an early stage, resulting in the programme developing as the year progressed. Additionally, budgets are set for a financial year, whereas the schools programme is delivered to meet the start of academic years, meaning the profile of spend over a financial year will not be directly linked to project milestones. However, all budget monitoring processes are under review and are being revised during the first half of the 2013/14 year. As part of the review, the format of capital budget monitoring reports will be improved to make more relevant and to take more account of the risks contained within projects.
Timeframe	October 2013
Owner	Andy Evans, Deputy Director Operational Finance

3. Risk management and control systems (continued)

The Wider Business Functions

Audit Committee terms of reference	
Description	Through attendance at recent Audit Committee meetings we are aware of changes made to the Council constitution, specifically the decision to remove the Audit Committee's ability to 'invite relevant Heads of Service, Corporate Directors and Cabinet Members to answer questions on the implementation of outstanding audit recommendations where satisfactory assurance levels have not been received.' We would like to draw the Council's attention to the CIPFA publication *Audit Committees: Practical guidance for local authorities.* Whilst this guidance is not mandatory, it is the single publication that we are aware of which specifically provides guidance on how audit committees should operate in local authorities. Regarding the specific issue right of access the publication states *"the Committee should have the right to call any other officers or agencies of the Council as required".*
Deloitte response	We recommend the Council reviews the CIPFA publication Audit Committees: Practical guidance for local authorities and considers the specific guidance around right of access to individuals. The publication also offers wider guidance, including a checklist on the effectiveness of the Audit Committee which could be considered.
Management response	We note the recommendation and will consider this as part of our 2013/14 review of the effectiveness of the Audit Committee, currently scheduled for March to May 2014.
Timeframe	May 2014
Owner	Paul Whaymand, Corporate Director of Finance

3. Risk management and control systems (continued)

NFI – process formalisation	
Description	The Council participates in the National Fraud Initiative (NFI), a national data matching exercise designed to identify potential cases of fraud across public sector bodies. As part of a review of the Council's progress with the NFI process, we identified some areas for improvement around formalising the approach to NFI at the Council, and ensuring that the NFI lead has a method of obtaining regular progress updates.
Deloitte response	We recommend that: • the key contact for NFI requests regular (monthly) updates from other NFI leads within the Council in order for them to monitor and report on overall progress; and • the formal strategy document for NFI is refreshed to include resources allocated to the NFI process, a project plan with expected milestones to monitor progress, and a section detailed expected outcomes.
Management response	The Council's participation in the NFI has in the past sat with the Head of Internal Audit, but is now in the process of being handed over to the Corporate Fraud Team which falls under the Deputy Director of ICT, Highways and Business Services. We agree that more work could be done to co-ordinate the NFI process across the Council and this will be addressed and introduced for the next data matching exercise in 2014/15. Internal Audit is in the process of completing the data matching exercise for 2012/13. We will also give consideration to updating our current strategy in relation to NFI work at Hillingdon.
Timeframe	Any counter fraud work that has sat with Internal Audit in the past is gradually being handed over to the Corporate Fraud Team. The handover process will have been completed in time for the Corporate Fraud Team to take responsibility for the next NFI data matching exercise due in 2014/15 (April 2014).
Owner	Steve Palmer, Deputy Director of ICT, Highways and Business Services / Garry Coote, Corporate Fraud Manager

3. Risk management and control systems (continued)

Mail archives and back ups	
Description	With the implementation of Google Apps for e-mails, at present the organisation does not have mail archives and back-ups. There is a risk that in the absence of employee e-mail back-ups, if a specific email needs to be found for an internal investigation or in response to litigation, it may not be discoverable.
Deloitte response	We recommend that management considers implementing an e-mail archiving and back-up solution according to an agreed data retention schedule, to minimise the risk that data is lost.
Management response	An email archive facility is now in place known as Google Vault.
Timeframe	Already implemented.
Owner	Steve Palmer, Deputy Director ICT & Business Services / Shirley Clipp, Senior Service Manager - ICT

3. Risk management and control systems (continued)

We also provide below an update on relevant observations made in the prior year.

Revenue and capital expenditure classification	
Prior year observation	Our testing identified several examples of inconsistent treatment of capital and revenue expenditure, especially in relation to council dwellings. The Council undertook an analysis of specific categories of assets to determine whether they should be recognised as revenue or capital expenditure.
Current year update	Management has implemented part of our recommendation and has drawn up and agreed a general set of principles to apply to expenditure to determine its correct treatment.

Depreciation policy for infrastructure assets	
Prior year observation	There are many different types of asset within the infrastructure category, such as road foundations, road surfacing, street lighting and bridges. We noted that the Council adopted a policy of depreciating all infrastructure assets over a period of 40 years, regardless of the type of asset, which we observed was not as accurate as it could be.
Current year update	Plans are underway to change the way in which infrastructure assets are valued. CIPFA published a Code of Practice on Transport Infrastructure assets. This Code of Practice has not yet been adopted into the IFRS based Code. However, Council valuations of their infrastructure are made and submitted for the purpose of filling in their WGA returns.

4. Independence

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

Confirmation	
We confirm we comply with APB Revised Ethical Standards for Auditors	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.

<table>
<tr><th colspan="2">Non-audit services</th></tr>
<tr><td>We confirm that our independence is not compromised by our provision of non-audit services</td><td>In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors, the Audit Commission's additional instructions in relation to independence and non-audit services provided.
We apply the following safeguards to eliminate identified threats to independence or reduce them to an acceptable level are as follows:
<table>
<tr><th>Service provided</th><th>Consideration of threats to independence</th><th>Safeguards applied</th></tr>
<tr><td>Advice provided by Deloitte Real Estate in relation to lease advisory work</td><td>Potential threats to self-review and management threat</td><td>Non audit work is carried out by partners and staff who have no involvement in the audit.</td></tr>
</table>
</td></tr>
</table>

Fees	
The level of non-audit fees is within appropriate guidelines	An analysis of professional fees earned by Deloitte in the year from 1 April 2012 to 31 March 2013 is included in Appendix 2.

5. Responsibility statement

This report should be read in conjunction with the "Briefing on audit matters" circulated to you in 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 board 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 the London Borough of Hillingdon 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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

Deloitte LLP.

Deloitte LLP

Chartered Accountants

St Albans

4 September 2013

Appendix 1: Audit adjustments

Unrecorded audit adjustments

All identified misstatements were corrected by management.

Recorded audit adjustments

We report all individual identified recorded audit adjustments in excess of £375,000 and other identified misstatements in aggregate adjusted by management in the table below.

		Charge / (credit) to current year Comprehensive Income and Expenditure Statement £'000	Increase/ (decrease) in Net assets £'000	Decrease/ (increase) in unusable Reserves £'000
<u>Factual misstatements</u>				
Collection Fund adjustment	1			
- Income from business rate payers		10,842	-	-
- Payment to national pool		(10,842)	-	-
Right to buy adjustment	2			
- Debtors owed from Government		-	(3,169)	-
- Creditors owed to Government		-	3,169	-
<u>Judgemental misstatements</u>				
Valuation Indices	3			
- Fixed assets		-	6,763	-
- HRA revaluation reserve		-	-	(6,763)
Reclassification of Rosedale Court	4			
- Assets under construction		-	1,560	-
- Revaluation reserve		-	-	690
- Assets held for sale		-	(2,250)	-
Adjustment to Elizabeth Court	5			
- Revaluation reserve			-	420
- Assets held for sale		-	(420)	-
		-	5,653	(5,653)

1 This represents an error in the draft financial statements which double-counted the effect of rates received in relation to Crossrail. The adjustment has an equal and opposite effect on income and expenditure.

2 The Council had originally recorded a Creditor in the draft financial statements in relation to a payment due to Government. It was subsequently agreed that this payment did not need to be made and so the Creditor should have been reversed. It was instead posted as a debtor. This adjustment removes both the Debtor and Creditor.

Appendix 1: Audit adjustments (continued)

3 The Council revalues its Council dwelling each year using the house price index from land registry website. In keeping with previous years, the Council had used the February 2013 index information as we understand this was the only available information available at the time of preparing the financial statements. The data available for March 2013 shows an increase in the indexation movement which would have a significant impact on the overall balance. Given that the Council prepares its accounts to 31 March we have suggested this change is reflected.

4 The Council has classified Rosedale Court apartments as Assets held for Sale at the year end. However, from our testing, we do not consider that the apartments should have been classified as held for sale as at the year end. At the time of testing, the site was noted to have just been completed and therefore ready for sale.

5 The Council has valued Elizabeth Court apartments at the full value. However, through our testing we have noted that these are due to be sold for 80% of market value. This has been announced and therefore as the information is in the public domain, the value of the apartments in the accounts should be disclosed at the lower value.

Disclosure deficiencies

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
Disclosure of useful economic lives	Our testing of accounting policies has noted that the disclosure of useful lives of the different asset classes gives discrete values. From our testing we know that assets with different lengths of UEL are grouped together. We recommend that the disclosure should list the UELs in ranges, ranging from the shortest to the longest asset life in the respective category. Management has made this adjustment.
Net interest expense in the cash flow	We noted that an amount for net interest expense had been included within the Services line of the cash flow. As per the Code, this should be removed and included under the heading Adjustments for items included in the net surplus or deficit on the provision of services that are investing or financing activities. The balance is £10,524k for the current year and £5,933k for the prior year. Management has made this adjustment.
Carrying amount of non-current assets sold	We noted that the value against this in the cash flow was actually the cost of non-current assets sold rather than the carrying value. Management has made the adjustment to change this to the carrying value.
External audit costs	In the note to the accounts, fees payable for the certification of grant claims and returns shows the fees for external audit on a cash basis. We note that this should be disclosed on an accruals basis. The effect for the current year is immaterial at £115k. Management has not adjusted for this.

Appendix 2: Independence – fees charged during the year

The professional fees earned by Deloitte in respect of the period 1 April 2012 to 31 March 2013 are as follows:

	2013 £'000	2012 £'000
Fees payable in respect of our work under the Code of Audit Practice in respect of the London Borough of Hillingdon's annual accounts, assurance report on the Whole of Government accounts and the value for money conclusion	207.1	345.2
Fees payable for the audit of the London Borough of Hillingdon's pension scheme annual report	21.0	36.5
	228.1	381.7
Fees payable for the certification of grant claims (Note 1)	90.2	120.0
Total fees payable in respect of our role as Appointed Auditor	318.3	501.7
Non audit fees		
Deloitte Real Estate contract monitoring engagement (Note 2)	157.1*	177.8

Note 1: Our work in respect of 2012/13 is ongoing and the amount shown above is an estimate only. The 2012-13 scale fees that the Audit Commission has set 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 fees receivable in respect of private and voluntary funds and in respect of the local government pension scheme are dealt with in separate reports to this meeting of the Audit and Risk Management Committee.

Note 2: In our audit plan issued to you on 27 February 2013 we reported that one of our divisions, Deloitte Real Estate, was successful in its proposal to monitor the delivery of a building contract for the expansion of six primary schools. 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.

* The draft financial statements show a fee in respect of £349k for 2012/13. The reason for the difference is two-fold: firstly, the fee shown above is the net figure excluding subcontractor fees, plus some timing differences of invoices.

Appendix 3: Management 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 2013 for the purpose of expressing an opinion as to whether the financial statements present fairly the financial position of the London Borough of Hillingdon at 31 March 2013 and of the results of its operations, other comprehensive income and expenditure and its cash flows for the year then ended in accordance with applicable accounting framework and Accounts and Audit Regulations 2010.

We acknowledge our responsibilities for preparing financial statements for the London Borough of Hillingdon ("the local authority") which present fairly and for making accurate representations to you. For the avoidance of doubt, references to the local authority should be taken as applying equally to the London Borough of Hillingdon Pension Scheme and references to the financial statements of the local authority, includes information in those financial statements dealing with 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 do not intend to liquidate the Council or cease trading as we consider we have realistic alternatives to doing so. 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 are immaterial, both individually and in aggregate, to the financial statements as a whole. The uncorrected misstatements and disclosures are included in an appendix to this report.

8. Our reasons for not making the adjustments set out in the attached summary are due to the size of adjustments found.

9. 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.

10. The assumptions appropriately reflect our intent and ability to carry out specific courses of action on behalf of the entity where relevant to the accounting estimates and disclosures.

11. The disclosures related to accounting estimates under the entity's applicable financial reporting framework are complete and appropriate.

12. We confirm that there is no best estimate regarding the timing of the crystallisation of the provisions and that we are happy that all provisions are recorded as being due in more than one years time.

13. There have been no subsequent events that require adjustment to the accounting estimates and disclosures included in the financial statements.

14. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and have disclosed in Note 40 to the financial statements all guarantees that we have given to third parties.

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

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

17. 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.

Information provided

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

19. All minutes of member and management 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 entity's related parties and all the related party relationships and transactions of which we are aware.

27. No claims in connection with litigation have been or are expected to be received.

28. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent.

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

30. 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.

31. We have evaluated whether the restrictions, terms or conditions on grants have been fulfilled with and deferred income to the extent that they have not.

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