Deloitte.

London Borough of Hillingdon

Report to the Audit Committee on the 2010 Audit

8 September 2010

Contents

Executive summary

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 2010 for discussion at the meeting scheduled for 21 Sept 2010. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2010.

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.

	Description
Key findings on audit risks and other matters	We issued our audit plan for the year ended 31 March 2010 on the 12 March 2010. This plan identified the following key financial audit risk areas and documented our approach to testing these areas: • grant income recognition; • pension liability; • property valuations; • bad debt provisions; • valuation of Icelandic investments; and • accounting for local taxes Our audit plan also identified the following two risks to our value for money conclusion: • contract procurement; and • partnership working. A detailed description of each of these audit risks and a summary of the results of our procedures in respect of these risks are documented in Section 1.
Value for money conclusion	Under the Code of Audit Practice, auditors are required to give a 'yes/no' conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in their use of resources. This conclusion is given within our audit report on the Council's Statement of Accounts. We expect to issue an unqualified VFM conclusion in the 31 March 2010 Statement of Accounts.
Other issues	We identified the following other issues within our audit plan and during the course of our audit: • International Financial Reporting Standards; • Faster close; • Cost reduction plan; • Audit Commission announcement; and • Comprehensive Area Assessment. A detailed description of each of these audit risks and a summary of the results of our procedures in respect of these risks are documented in Section 3.

Executive summary (continued)

Audit status	We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan. The matters outstanding at the date of this report include: • post balance sheet events review; • finalisation of audit review procedures; and • receipt of the signed management representation letter (draft included in Appendix 3) We will report to you orally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters. On satisfactory completion of the outstanding matters, we anticipate issuing an unmodified audit opinion.
Accounting policies and financial reporting	As part of our audit, we consider the quality and acceptability of the Council's accounting policies and financial reporting. We have nothing to report in these areas.
Accounting and internal control systems	We have set out in Section 4 our internal control recommendations. Our significant control recommendations relate to the following: • signed contracts with suppliers; • systems training; • property valuation under IFRS; • authorisation of journals; • infrastructure depreciation policy; • finance lease depreciation policy; and • IT related recommendations: – server room access; and – change control process.

1. Key audit risks

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

Grant income recognition	
Background	Accounting for grant income can be complex as the timing of recognition in the accounts will depend on the scheme rules for each grant. In addition, full information on grant entitlement is not necessarily available to officers at the time of closing the accounts and it is therefore common for the accounts to be closed on the basis of estimates which may differ to actual entitlement shown in the claim when it is subsequently prepared. In our 2008/9 report to the Audit Committee dated 22 September 2009 we discussed a specific issue in relation to the Unaccompanied Children's Asylum grant. The Council had recognised income of £2,239k claimed through a special representation bid. We identified this amount as an unadjusted misstatement in our 2008/9 report because there was insufficient certainty as to whether the amount would be received to enable recognition of the income in accordance with the SORP. We agreed with the Council that that funding for future years should only be recognised as income in the accounts if it has been granted before the accounts are signed.
Deloitte response	We have reviewed the design and implementation of controls in place at the Council to mitigate the risk of incorrect grant recognition. We have performed additional detailed testing of grant expenditure for a sample of grants to confirm the expenditure is valid and in accordance with the terms of the grant. We have confirmed receipt of grants to relevant documentary evidence such as remittance advice and grant letter and we have reviewed the accounting treatment of a sample of grants with reference to the requirements of the SORP. The results of our testing were satisfactory with the exception of the Unaccompanied Children's Asylum grant discussed below. We have reviewed the Special Representation Bid in respect of the Unaccompanied Children's Asylum grant and noted that the Council has received approval of this claim and could therefore recognise the income in the financial accounts up to this amount in accordance with the SORP. However, the Council has then recognised an additional £769k income (and related debtor) in excess of this in order to cover 100% of their costs. This has been posted by the directorate finance team based on the historic success of claiming for the full amount of their costs. We understand that corporate finance had not been informed that the amount posted was in excess of the amount approved in the Special Representation Bid. The overstatement of income and debtors of £769k has not been corrected as it is not considered to be material. This adjustment has been included in Appendix 1 as an uncorrected misstatement. In addition, we noted that £2,658k of income in relation to the grant had been misclassified to Adult Social Care. This was corrected by management. We have also identified one other matter from our testing of grant benefit debtors. We noted a difference of £807k between the housing benefit debtor recorded in the Statement of Accounts and the debtor recorded on the housing and council tax benefit grant claim form (BEN01). This has not been corrected by management as it is not considered to be material. For more details on this adjustment plesae refer to Appendix 1.

1. Key audit risks (continued)

Pension liability	
Background	The liability relating to the pension scheme is substantial and 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.
Deloitte response	We involved our specialist pensions group within our engagement team to assist in the review of assumptions used to calculate the pension liability and related in-year transactions. Our review has revealed that the assumptions used by the Council in the calculation of the pension liability are within an acceptable range and therefore we do not consider the liability to be materially misstated. If all of the assumptions were set equal to the Deloitte Illustrative Benchmark assumptions, the deficit of £414,519k would decrease to become a deficit of approximately £344,519k. However, this is not intended to imply that the deficit calculated by the actuary is inappropriate. The key assumptions are all within the acceptable range we have seen adopted by other employers for accounting purposes as at 31 March 2010. Based on our procedures we identified that the asset value included in the pension liability at year end is misstated. The Council's actuary quantified the value of this as an overstatement of approximately £600k to the asset value at 31 March 2010. We have confirmed that this is a reasonable assessment of the difference. The asset value included in the accounts presented for audit is estimated using known values at 31 December 2009 and estimated asset returns up to 31 March 2010. The value included in the accounts is based on an estimate because the Council's actuary is not able to obtain asset values from the fund managers in time to value the pension liability at year end. The return from 31 December 2009 to 31 March 2010 was estimated by the Actuary as 6.6%, however the actual asset return over that period has since been confirmed as 6.4%. This has been raised as an uncorrected identified misstatement at Appendix 1.

1. Key audit risks (continued)

Property valuation	
Background	The Council has a substantial portfolio of properties which are subject to a rolling revaluation programme. Some of the properties require the application of specialist valuation assumptions. The 'credit crunch' has affected property values and the Council is not immune to these effects. In 2009/10 the Statement of Accounts presented for audit showed that overall year-end operational and non-operational asset values have decreased by £111,107k to £1,365,320k. Of this £111,107k movement, a downward movement of £182,234k related to impairments, mainly on schools assets which were subject to a full revaluation in 2009/10. The previous valuation was 5 years ago and, from discussion with the Council, we understand that insufficient depreciation on these assets was built into this valuation. Therefore because these assets are relatively old and the fact that the valuation methodology considers current value, a significant reduction in value was recognised to the buildings in 2009/10. The balancing upward movement of £71,127k related to a combination of additions and upward revaluation less depreciation and disposals.
Deloitte response	We have evaluated the Council's arrangements for updating market values, including the operation of its rolling programme of reviews and the qualifications, relevant experience and independence of the Council's internal valuation specialists utilised to carry out valuations. We have reviewed the reasonableness of key assumptions, including the effect on asset valuations from the recent economic and financial market events and we have discussed the assumptions used with our internal valuation specialists from Drivers Jonas Deloitte. The results of our testing were satisfactory.

Bad debt provisions	
Background	In our report to you on the findings from our 2008/9 audit we commented that evidence was limited to support provisions made against certain categories of debt and that available evidence suggested that individual provisions may be either under or over stated. We also discussed how in calculating certain bad debt provisions, adjustments had been made to historical collection experience to reflect the anticipated impact of current economic conditions on future collection rates.
Deloitte response	We have reviewed the Council's methodologies and assumptions used to calculate provisions and the evidence collected by officers to support its approach. Where applicable we have assessed management's consideration of whether provisions appropriately reflect the impact of the current economic conditions by reference to recent collection performance. The results of our testing were satisfactory and we do not consider bad debt provisions to be materially misstated.

1. Key audit risks (continued)

Valuation of Icelandic investments	
Background	The 2008/9 financial statements included an impairment of approximately £5m in relation to Icelandic investments. Changes in the value of the impairment are required to be accounted for in accordance with relevant technical accounting guidance. In 2009/10 £5.3 million has been returned to the Council from Heritable Bank. In applying the latest guidance, the Council has calculated that the impairment held against its Icelandic deposits should be reduced by £0.8 million notional interest for the year, and £0.5 million following revised estimates of the future amounts which will be received from each bank. The remaining carrying amount of the investments in the balance sheet at 31 March 2010 is £11.1m (2008/9: £15.0m).
Deloitte response	We have worked closely with the Council to assess the accounting treatment of this event. We have taken into account the latest CIPFA guidance on how to account for the impairment. In terms of the accounting treatment, we are satisfied that the Council has calculated the amount in accordance with the guidance in all material respects. We have re-performed the calculations undertaken and are satisfied that the impairment has been reflected appropriately in the Statement of Accounts. The ongoing accounting treatment of the impairment beyond 31 March 2010 is subject to a decision by CLG. We understand that the Council challenged the recent decision made by CLG to refuse capitalisation of potential losses and we have reviewed the communication with CLG. We understand that the ongoing treatment will impact on the budget setting process in future years. We will continue to monitor discussions with CLG and the impact this may have in the future.

Accounting for local taxes	
Background	The 2009 SORP provides detailed guidance for the first time on the accounting for local taxes. Whilst the Council's past accounting practice is consistent with industry practice, it differs from the requirements of the new SORP and therefore changes were needed both to current year and prior year information. The 2009 SORP recognises that the billing authority (i.e. the Council) in the case of Council Tax acts as agent for the major precepting bodies (here, the Greater London Authority) and in the case of NNDR, as agent for central government. Past practice has been for billing authorities to account for the full amount of Council Tax and NNDR debtors on their balance sheet. However, given the Council's role as agent in collection, the 2009 SORP now requires that only the Council's share for which it acts as principal is shown on its balance sheet. In practice, this means for the Council that only its share of Council Tax arrears will be shown on the balance sheet.
Deloitte response	We have obtained and reviewed the Council's working papers used to assess the impact of this change and the associated accounting entries and have re-performed the calculations. We have performed detailed sample testing of the balances included in the accounts to supporting documentary evidence. The results of our testing were satisfactory and we have concluded that the accounting entries in the 31 March 2010 Statement of Accounts, in respect of accounting for local taxes, are in accordance with the requirements of SORP 2009.

2. Value for money conclusion

Under the Code of Audit Practice, auditors are required to give a 'yes/no' conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in their use of resources. This conclusion is given within our audit report on the Council's Statement of Accounts.

We expect to issue an unqualified VFM conclusion in the 31 March 2010 Statement of Accounts. We issued our audit plan for the year ended 31 March 2010 on the 12 March 2010. We have set out below the key audit risk areas that relate to our VFM conclusion which we identified in our audit plan together with a summary of our findings.

Contract procurement	
Background	The Council is a large organisation with various departments and partnership arrangements. All areas of Council operations should comply with certain key policies and procedures. We are aware of issues in relation to procurement at Hillingdon Grid for Learning not having been in accordance with Council policy, and consider this to be part of a wider risk across the Council. If goods and services are not being procured in accordance with Council policy there is a risk that the Council is not achieving value for money on its contracts.
Deloitte response	We have reviewed a sample of single tender contracts awarded in the year with a focus on contracts awarded by Hillingdon Grid for Learning (HGfL). We have checked that the contracts have been awarded in accordance with Council policy and no issues were noted. We have discussed with Internal Audit the recommendations made in December 2009 in relation to HGfL procurement and understand that these have now been implemented. We also reviewed the Council's list of all contracts awarded in the year and checked on a sample basis whether the list of single tender contracts provided to us was complete. Our testing indicated that not all new contracts had been recorded within the procurement system in the year. We understand that contracts not included on the procurement system are likely to be for smaller immaterial amounts. We also understand that a new procurement strategy has been implemented in the year that should reduce the risk of incomplete recording on the procurement system. In addition to our findings above, through our testing of property, plant and equipment we identified that there is not a formal signed contract in place with the construction company working on the Hillingdon House Farm project. This project is valued at approximately £30m. We have set out further details and raised a recommendation in relation to this in Section 4.

2. Value for money conclusion (continued)

Partnership working	
Background	Public agencies in all areas are expected to work effectively with each other in order to provide residents with effective and efficient services. The Council has developed a Sustainable Community Strategy with the Local Strategic Partnership in order to provide a basis for effective partnership working. This requires additional governance, risk management and performance assessment processes to be in place. Additionally an issue with one partner may affect others in the partnership. We considered the performance of the Local Strategic Partnership in 2008/9, and noted that the partnership had achieved a significant number of their targets, accessing additional performance based funding as a result.
Deloitte response	We have reviewed the performance of the significant partnerships within which the Council participates. We have seen no evidence of significant legal claims or penalties in connection with any partnerships and the Council has demonstrated that it aligns priorities and achieves value for money from its partnerships arrangements, for example by the fact that the Council is on course to achieve 90% of the performance Local Area Agreement 2007 stretch reward target.

3. Other issues

We identified the following other issues within our audit plan and during the course of our audit:

International financial reporting standards	
Background	The Council will need to prepare accounts under International Financial Reporting Standards (IFRS) for the first time in 2010/11. This will require 2009/10 accounts to be restated under IFRS to provide the comparative figures in the 2010/11 accounts, which in turn requires the balance sheet as at 31 March 2009 to be restated. We understand that the finance department has invested notable resources in addressing the requirement to convert to IFRS, and ultimately Deloitte will need to review the processes undertaken and restated figures. The Council has appointed external support to assist in this transition. We understand that the Council is currently on track to meet the CIPFA timetable for IFRS convergence. An impact assessment has been completed and the opening balance sheet as at 1 April 2009 has been restated. A skeleton set of IFRS compliant accounts has been drafted and the Council plans to restate the 2009/10 accounts before the end of the calendar year.
Deloitte response	We have liaised regularly with the Council around this issue and have discussed the approach taken towards IFRS convergence. We have discussed the anticipated significant issues around valuation, componentisation, impairment, leases, employee benefits and government and non-government grants. We understand that the Council is on track in meeting its project plan and the Audit Committee has been kept updated and has questioned officers on progress.

Faster close	
Background	Our meetings with the Council's Chief Executive and finance team indicated that the Council would like to have a faster closedown process both for the draft Statement of Accounts approval and the final Statement of Accounts. There is a risk with speeding up the closedown process that errors could be made and not found and rectified. The accounts were approved by the Audit Committee one day earlier in 2009/10 than in the previous year. However, we understand that the internal accounts preparation process was completed earlier than in 2008/9 and that this was achieved through extensive training given to directorate teams during the year. We did not note any impact on the quality of the accounts or supporting work papers which were of a similar high standard to last year and we have received rapid responses to audit queries.
Deloitte response	We have worked with the finance team to support work towards achieving the faster close this year. We have worked closely with the finance team to develop a timetable to sign the final accounts in line with its plan. Looking forward, with the transition to IFRS in 2010/11, we will meet with the finance team in advance of next years audit to ensure that all aspects of the transition are managed efficiently.

3. Other issues (continued)

Cost reduction plan	
Background	The economic downturn has led to unprecedented pressure on public spending. Income across the Council from various sources is expected to decrease significantly over the coming years. In addition, Hillingdon has committed itself to no increase in Council Tax in 2010/11, having already frozen Council Tax in 2009/10. We are aware of a comprehensive process of service review and redesign which is underway at the Council. Delivery of efficiency plans and realisation of savings will become more important now that 2009/10 has ended and 2010/11 begins. The outturn in 2009/10 was £186.8m which was an under spend of £5m compared to budget. The current medium term financial plan indicates the need to make savings of approximately £47m by April 2014 which is 15% of gross spend on controllable budgets. We understand that the Council expects £43m of these savings to be delivered through the Business Improvement Delivery (BID) plan with £4.4m of this savings target due to be delivered in 2010/11. There is an operational risk in implementing cost reduction that there could be a decline in public service.
Deloitte response	We have discussed the Council's BID plans with management and we will continue to work closely with the Council during the year to pre-empt any issues with respect to the accounts. We will need to consider how the Council has accounted for change, for example accounting for any restructuring costs, as we plan our audit for 2010/11. During the audit we have not identified any issues that materially impact the 2009/10 Statement of Accounts.

Audit Commission announcement	
Background	On 13 August 2010, the Secretary of State for Communities and Local Government announced the proposed abolition of the Audit Commission. The proposed abolition will be from March 2012 and the Audit Commission has confirmed that there is no immediate change to your audit arrangements. New audit arrangements are likely to apply from the start of the 2012/13 financial year.
Deloitte response	Both we and the Audit Commission will keep you informed of further developments. Included within our 2009/10 fee was the amount of £66k for Use of Resources and data quality work. In May 2010 the new government announced that they would abolish CAA. The Audit Commission has been discussing possible options for a new approach to local value for money (VFM) audit work with key national stakeholders. We have been informed that from 2010/11 there will be a new, more targeted and better value approach to the local VFM audit work. We understand that this will be based on a reduced number of reporting criteria specified by the Commission. We would therefore expect a variation on this fee in our 2010/11 audit plan. We will keep the Council informed of further developments in respect of the VFM requirements.

3. Other issues (continued)

Comprehensive area assessment	
Background	This was to be the second year of the Comprehensive Area Assessment (CAA). The Council did well in the 2008/9 CAA, being awarded ‘Three – Performing Well’, also being awarded a ‘Green Flag’ in relation to partnership working to support unaccompanied asylum seeking children. In May 2010 the new government announced that they would abolish CAA. The Audit Commission has been discussing possible options for a new approach to local value for money (VFM) audit work with key national stakeholders. We have been informed that from 2010/11 there will be a new, more targeted and better value approach to the local VFM audit work. We understand that this will be based on a reduced number of reporting criteria specified by the Commission, concentrating on: - securing financial resilience; and - prioritising resources within tighter budgets.
Deloitte response	We have completed most of our Use of Resources (UoR) work this year and we are relying on that work for our VFM conclusion (see Section 2 for further details on our VFM conclusion). In respect of the CAA and our Use of Resources work, there will be no published scores this year. Following the recent announcement in respect of the abolition of the Audit Commission in August 2010, we will ensure that we keep the Council informed of further developments and the impact those changes may have on the audit work we perform.

4. Accounting and internal control systems

Control observation

During the course of our audit we identified a number of control observations, the most significant of which are detailed below, together with our assessment of priority:

High – immediate action required
Medium – action required within 6 months
Low – action required within 1 year

Signed contracts with suppliers	
Observation	The Hillingdon House Farm project does not have a formal signed contract in place with the construction company, although the project is valued at approximately £30m. Management relies on the letter of intent and will complete the contract with the supplier once construction is finished. We understand that it is standard practice within the construction industry that signed contracts are not always in place. However, the lack of a formal agreement puts the council at risk of suffering losses since there is no legal recourse in the event of the counterparty reneging on the agreement. In this instance the asset had already been constructed and therefore if it were found to not meet the Council's requirements, there is the risk that no amendments would be enforceable.
Recommendation	We understand that the Council's Legal department was involved in the project consultation and had input regarding the form of the letter of intent. We understand that construction beginning without a formal signed contract is not unusual in the industry. Nevertheless, we recommend that contracts are obtained for all high-value projects with sign off on the contract not possible without prior approval from the legal department. We understand that Internal Audit have conducted extensive work on procurement during 2009/10 but that there are outstanding recommendations from this work. We understand that the Internal Audit work plan for 2010/11 includes plans to undertake focused work on specific contracts. We recommend that the Council prioritise finalising recommendations from 2009/10 and any new recommendations that may arise from Internal Audit work on contracts in 2010/11.

4. Accounting and internal control systems

Signed contracts with suppliers (continued)	
Management response	The decision to proceed with construction based on a letter of intent was not taken lightly. It was a considered decision to proceed rather than accept a significant delay to the project with likely cost consequences. The procurement of contracts for this particular scheme was managed by the Major Construction Project team within delegated powers in 2005/6. The decision was taken at a high level with full agreement from the Council's Legal department and external consultants Atkins. The form of the letter of intent was agreed by the Legal department. The Council has not accepted the absence of a signed contract. It has made strenuous and continuous efforts throughout to achieve an agreed and signed contract, which is now close to completion. Management believes that the Council still has legal recourse in this situation. Construction work proceeding without a signed contract is by no means unusual in the industry. The Courts assume an implied contract in a standard form, based on the Tender Documents and the letter of intent, and in many respects similar to the contract that would otherwise be in place. However management does accept that contractual arrangements and change controls are essential to ensure the Council's interests are properly protected. To this end new control procedures, including contract signoff, are being implemented within the Major Construction Project team and across the Council generally.
Priority:	High
Owner:	Norman Benn, MCP

Systems training	
Observation	We noted that a new system (ControCC) was implemented in Education & Children's Services in the year. The implementation of this system had some initial problems in relation to the timely payment of invoices and allocation of these payments. In addition we noted that some immaterial client accounts were not validated in the system leading to an understatement of claimable days in relation to the Asylum Seekers Grant.
Recommendation	We recommend that where the Council is implementing a new system, full staff training on all areas of functionality should be given as a priority in advance of the date the system goes live.
Management response	The Council does currently ensure staff training takes place prior to the introduction of new systems and has, in recent years, invested resources into providing specialist training facilities to accommodate this. However, the Council will endeavour to improve the quality of such training. Recent organisational changes within ICT have enabled the introduction of specific ICT Business Partners for each directorate who work collectively with the business areas, the project managers and the Learning Development teams to ensure that appropriate training is built into any IT systems implementation prior to going live.
Priority:	Medium
Owner:	Louise Bateman, ICT Business Partner for F&R and DCEO

4. Accounting and internal control systems (continued)

Property valuation under IFRS	
Observation	No issues were noted from our work on property valuations for the year ended 31 March 2010. We have begun discussions with the Council in relation to the audit work that will be required for the restatement of the IFRS opening balance sheet and comparative figures. We understand that it is the Council's intention to 'roll-forward' the 31 March 2010 valuation for this purpose. In preparation for this piece of work our internal valuation specialists from Drivers Jonas Deloitte have noted that there was limited evidence of the full application of the guidance set-out in RICS Valuation Information Paper 10. Specifically there was no explicit confirmation that assets being valued using a Depreciated Replacement Cost (DRC) approach were valued using a Modern Equivalent Asset (MEA) approach. In all cases the conclusion was that the asset was operating at capacity and that therefore no alternative asset was relevant. Whilst this is appropriate under the SORP, for the IFRS restatement exercise we would expect explicit mention of an MEA valuation approach based on decisions informed by discussions with the Council's in-house departments.
Recommendation	We recommend that the valuation team include discussions with the relevant directorate early in the process. This will allow a robust assessment of whether an alternative asset could produce the same required outputs for a lower build cost. This should be evidenced in the valuation file. This will ensure the Council's assets are appropriately valued in accordance with IFRS.
Management response	Management accepts the recommendation but notes the following: The Asset rolling programme for revaluations was carried out against the background of the 'Schools Organisation Plan' the 'Hillingdon Children and Families Trust Plan' and the Primary Capital Programme. Hillingdon is experiencing considerable school places pressures and has a major school expansion programme underway. Hence the assumption that school assets are operating at capacity and no alternative use was relevant is indeed valid and therefore a MEA valuation would not be appropriate for these specific assets at this time. Furthermore if reduction in school sizes were to take place, such as the removal of temporary classrooms, this would be picked up as adjustments to valuations as and when such changes take place. In future the Education department can be specifically surveyed to identify potential surplus capacity for each school which would impact on a MEA valuation.
Priority:	Medium
Owner:	Virginia de Mattos RICS, Corporate Property

4. Accounting and internal control systems (continued)

Authorisation of journals	
Observation	Currently there is not a consistent, formalised procedure for approval of journals. Many employees do have all their journals reviewed by a colleague or manager, although unless a signed hard copy of the journal has been kept on file there is no evidence of this approval. Some staff do not routinely have their journals approved or reviewed, as they work on a specific area such as the pension scheme or collection fund. In these cases they work alone and do not have a manager in their department, so it is not seen as effective to send journals for approval as staff in other departments would not understand what they were approving. The lack of approval or authorisation could result in incorrect or fraudulent postings being posted to the system.
Recommendation	We recommend that all journals should be approved before being posted. We understand that the journal system is intended to be updated this year, with a new automated approval process which would provide a clear audit trail. Until this becomes operational, we recommend keeping hard copies of journals which can be signed and put on file, or an alternative may be for the reviewer to send an email to the preparer when their journal has been approved, as evidence of the review. This is especially important if there is a chance of the roll-out of the new system being pushed back again to 2011.
Management response	A new journal approval system is now developed and virtually ready to roll out and planned to become operational in September 2010. Significant progress has been made by the Council in relation to this system and all journal posters have now been assigned an approver. Templates have been created and end testing for the new system is complete. The new system obliges approvers to view any journals before approval and this should prove to be a considerable improvement on previous systems that allowed approvers to approve without reviewing the journals
Priority:	Low
Owner:	Harry Lawson, Corporate Finance

4. Accounting and internal control systems (continued)

Infrastructure depreciation policy	
Observation	As part of the transition to IFRS, there is an increasing focus on component accounting in fixed assets. Currently the depreciation policy on infrastructure assets is to use a standard useful life of 40 years. This asset category includes all roads, resurfacing projects and street furniture which will all have different life spans. For example, the tarmac of a road and its underlying layers may be replaced at very differing intervals.
Recommendation	We recommend the Council consider reviewing the depreciation policies in respect of infrastructure.
Management response	Management accepts this recommendation and will liaise with Infrastructure managers to enable categorisation of works.
Priority:	Low
Owner:	Andy Evans, Head of Finance PE&CS

Finance lease depreciation policy	
Observation	Finance leases are currently depreciated on an annuity basis with a charge being made equal to the principal part of the lease payment due in the financial year. This results in lower charges in earlier years and higher charges in later years than would be the case using straight line depreciation. All other assets are depreciated on a straight line basis. In the case of the Barnhill Community School PFI scheme and the vehicles held on finance leases, we would not expect the benefits extracted from the assets to follow this annuity profile. In the case of the Barnhill school, all other schools are depreciated on a straight line basis which is considered to reflect the consumption of economic benefits. In the case of vehicles, we would expect the consumption of economic benefits (i.e. loss of value) to be higher in earlier years rather than lower. The impact of this difference in treatment is trifling in the current year as a result of the immaterial nature of such schemes but could be significant if the Council initiates high value finance leases in the future.
Recommendation	The Council may wish to consider reviewing its depreciation policies in respect of finance leases including PFI schemes. This review should assess whether the policy appropriately reflects the consumption of economic benefits.
Management response	Management accepts the recommendation and will undertake such a review. Barnhill is valued at amortised cost of the principal part of the original PFI contract. As such, an annuity basis depreciation is felt to be appropriate and in line with the corresponding strategy of establishing a sinking fund thus recognising increased consumption in later years. However, the consumption of economic benefit of vehicles may well be better reflected by another depreciation method but the amounts involved are fairly small and hence differences between the methods would be highly immaterial.
Priority:	Low
Owner:	Harry Lawson, Corporate Finance

4. Accounting and internal control systems (continued)

IT related recommendations are as follows:

Server Room Access	
Observation	Of the 32 access cards which were granted access to the server room at Hillingdon, 18 were not required to be in circulation and could be revoked without affecting server room support. In addition, security guards were found to be 'clocking out' on server room doors, preventing accurate review of access violation attempts. Access reviews of logs are not in place, and the process for gaining access through facilities is not formalised. The 18 exceptions identified above are more a housekeeping issue as they were all confirmed to be members of IT or fire wardens / security. When users are clocking out using the card access system this means that Hillingdon staff are not able to build up a true picture of the number of inappropriate attempts to gain access to the server room. In addition it makes any process of reviewing the audit logs more difficult.
Recommendation	We recommend that management carry out the following: - review users who have access cards to the server rooms and remove any considered not necessary for individuals to carry out their job roles; - ensure that security staff are not using the access system as a means of clocking in and out; and - implement a periodic review of user access to the server room to ensure that only appropriate individuals are gaining access.
Management response	Approval is now required from either the Head or two assistant heads of ICT, for any new or revised access request. All generic accounts have been removed and there is a procedure to review all access rights once a quarter to maintain appropriate levels of access. An agreement has been in place (since 1 April 2010) for any non-ICT access rights to be properly policed to ensure appropriate use only of the access privileges and the Head of Facilities Management has been asked to instruct security guards to stop misusing this system, and has subsequently confirmed that this has stopped.
Priority:	Low
Owner:	Agreed and implemented

4. Accounting and internal control systems (continued)

Change Control Process	
Observation	Changes carried out by Northgate did not always have test material retained or approval documented on the RFC (Request For change form) which is raised in relation to each change. Whilst approval was found to be appropriate through review of email trails this was not documented on the RFC. Where approval and testing is not clearly captured there is a risk that unauthorised changes and changes which have not been fully tested may be loaded into the production environment. This can lead to system instability and system downtime where inappropriate changes may be loaded into production.
Recommendation	We recommend that management complete the current RFC form and ensure that approval and testing information is captured on it.
Management response	A new change request process has been developed using the Council's call management system, LANDesk, in partnership with Hillingdon application managers (piloted in April 2010). This ensures that each manager is responsible for changes requested to their system and has the functionality to store testing documentation. Approval of the change is a mandatory step in this process and can only come from the application manager for each system.
Priority:	Low
Owner:	Agreed and implemented

5. Other matters for communication

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

Independence	We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised. If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this. If the Audit Committee wishes to discuss matters relating to our independence, we would be happy to arrange this.
Non-audit services	We are not aware of any inconsistencies between APB Revised Ethical Standards for Auditors and the company's policy for the supply of non audit services or of any apparent breach of that policy An analysis of professional fees earned by Deloitte in the period from 1 April 2009 to 31 March 2010 is included in Appendix 2.
International Standards on Auditing (UK and Ireland)	We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.
Liaison with internal audit	The audit team, following an assessment of the independence and competence of the internal audit department, reviewed the findings of internal audit and adjusted our assessment of risk as appropriate. No issues were noted from these procedures.
Written representations	A copy of the representation letter to be signed on behalf of the Council has been included within Appendix 3.

6. 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 in September 2008 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 Audit Committee and this report is not necessarily a comprehensive statement of all weaknesses 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
8 September 2010

Appendix 1: Audit adjustments

Uncorrected misstatements

The following uncorrected misstatements were identified during the course of our review:

		Credit/ (charge) to current year income and expenditure £'000	Increase/ (decrease) in net assets £'000	Increase/ (decrease) in pension reserve deficit £'000	Increase/ (decrease) in change in general fund £'000
Factual misstatements					
Pension liability	[1]	-	(600)	600	-
Judgemental misstatements					
Asylum seekers grant	[2]	(769)	(769)	-	(769)
Housing and council tax benefit	[3]	807	807	-	807
Total		38	(562)	600	38

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

[1] The pension asset values at 31 March 2010 were estimated using the known asset value at 31 December 2009 and estimated asset returns up to 31 March 2010. The return from 31 December 2009 to 31 March 2010 was estimated by the Actuary as 6.6%, however the actual asset return over that period has since been confirmed as 6.4%. The Actuary has estimated that the assets have been overstated by approximately £600k.

[2] The Special Representation bid for further funding for service provided to asylum seekers has been approved and the Council has recognised all of the income in relation to this grant . However, the Council has recognised an additional £769k of income (and related debtor) in excess of this in order to cover 100% of its direct costs since these have always historically been recovered. This is in excess of the amount approved in the Special Representation Bid and therefore an adjustment has been proposed to reflect that a greater degree of certainty is required before funding should be recognised.

[3] The housing and council tax benefit grant claim (BEN01) indicates the net amount due to the Council relating to housing and council tax benefit subsidy from the Department of Work & Pensions (DWP). In the Statement of Accounts the Council has recognised a lower debtor amount than that which is shown in the grant claim form to provide for the possibility of DWP claw back of the subsidy. We are not aware of any history of such claw back and the claim form is considered to represent the Council's best estimate of the subsidy debtor. An adjustment of £807k has been proposed to reflect that a greater level of certainty is required before such a provision is recognised. The Council does not consider this to be a material adjustment.

Recorded audit adjustments

There were no recorded audit adjustments identified during the course of our review.

Appendix 1: Audit adjustments (continued)

Disclosure deficiencies

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 consider require consideration by the committee.

Disclosure		Source of disclosure requirement	Quantitative or qualitative consideration
Net assets of Hillingdon Homes	[1]	SORP	£1,494k

[1] The SORP requires the disclosure of the net assets and results of operation for related companies of the Council. The Council has not included this disclosure in the accounts as, due to the required accounting treatment for the indemnity given by the Council to Hillingdon Homes in respect of FRS 17 losses, it would result in inconsistency between the two sets of accounts. The Council does not consider this to be a material disclosure deficiency.

Appendix 2: Analysis of professional fees

The professional fees earned by Deloitte in the period from 1 April 2009 to 31 March 2010 are as follows:

	2010 £'000	2009 £'000
Statement of accounts	302	302
Use of Resources and data quality	66	66
Whole of Government accounts (WGA)	6	6
Pension fund	38	38
Grant claims and returns	137	138
Total fees for audit services provided to the Council	549	550

Included within our 2009/10 fee was the amount of £66k for Use of Resources and data quality work. In May 2010 the new government announced that they would abolish CAA. The Audit Commission has been discussing possible options for a new approach to local value for money (VFM) audit work with key national stakeholders. We have been informed that from 2010/11 there will be a new, more targeted and better value approach to the local VFM audit work. We understand that this will be based on a reduced number of reporting criteria specified by the Commission. We would therefore expect a variation on this fee in our 2010/11 audit plan. We will keep the Council informed of further developments in respect of the VFM requirements.

No fees have been earned from non-audit services during the year. At the date of this report no future services have been contracted for or written proposals submitted.

Appendix 3: Management representation letter

Deloitte LLP
3 Victoria Square
Victoria Street
St Albans
AL1 3XT

Our Ref: GM/JLG/10 Date: September 2010

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of the London Borough of Hillingdon ("the council") for the year ended 31 March 2010 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the London Borough of Hillingdon as of 31 March 2010 and of the results of its operations, other recognised gains and losses and its cash flows for the year then ended in accordance with applicable accounting framework.

We acknowledge our responsibilities for preparing financial statements for the council which give a true and fair view and for making accurate representations to you.

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

1. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all council and relevant committee meetings, have been made available to you.

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

3. 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.

4. We are not aware of any significant facts relating to any frauds or suspected frauds affecting the council involving:
   (i). management;
   (ii). members of the council;
   (iii). employees who have significant roles in internal control; or
   (iv). others where the fraud could have a material effect on the financial statements.

5. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the council's financial statements communicated by employees, former employees, analysts, regulators or others.

6. We are not aware of any actual or possible instances of non-compliance with laws and regulations, the effects of which should be considered when preparing financial statements.

7. We have considered the uncorrected misstatements and disclosure deficiencies detailed in the appendix to this letter. We believe that no adjustment is required to be made in respect of any of these items as they are individually and in aggregate immaterial having regard to the financial statements taken as a whole.

8. Where required, the value at which assets and liabilities are recorded in the balance sheet is, in the opinion of the directors, the fair value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the council. Any significant changes in those values since the balance sheet date have been disclosed to you.

9. We confirm the completeness of the information provided regarding the identification of related parties, and the adequacy of related party disclosures in the financial statements.
   We have made enquiries of any key managers or other individuals who are in a position to influence, or who are accountable for the stewardship of the council and confirm that we have disclosed in the financial statements all transactions relevant to the council and we are not aware of any other such matters required to be disclosed in the financial statements, whether under FRS8 "Related party disclosures" or other requirements.

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

11. We have considered all claims against the council and on the basis of legal advice have provided for the amount. No other claims in connection with litigation have been or are expected to be received.

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

13. Other than those described in Note 40 to the financial statements, there have been no events subsequent to 31 March 2010 which require adjustment of or disclosure in the financial statements or notes thereto.

14. There have been no irregularities involving members or employees who have a significant role in the accounting or internal control systems or that could have a material effect on the financial statements.

15. The council has satisfactory title to all assets and there are no liens or encumbrances on the council's assets.

16. We recognise that we are responsible for ensuring that the statement of accounts as published on the website properly presents the financial information and your auditor's report and for the controls over, and security of, the website. We also recognise that we are responsible for establishing and controlling the process for electronically distributing annual reports and other information.

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.

18. We confirm that the methodology used by management to estimate the increase in value to fixed assets as a result of expenditure on those assets represents the best estimate of the value added.

19. All known material liabilities have been properly included in the statement of accounts and all material contingent liabilities have been disclosed.

20. We have adhered to guidance and used this to calculate the impact of any impairment on our investments, and have disclosed these fully in the statement of accounts.

21. We confirm that the provision in respect of Equal pay has been calculated to include all potential future claims and are satisfied that no liability exists prior to July 2003.

22. We confirm that the dilapidation provision has been calculated to take into consideration all expected future costs associated with the Annington Homes lease.

23. We confirm that the provision for doubtful debts in relation to council tax is appropriate.

24. We confirm that we consider an adjustment to decrease income by £0.8 million relating to the Asylum Seekers Grant is inappropriate based upon our belief that funding will be secured. We believe there is no need to adjust the provision due to:

- The immateriality of this in respect of the financial statements;
- The previous historic record of achieving the funding through the Special Representation process in relation to these direct costs; and
- The amount being sought not being dissimilar to 2008/09 and therefore there has not been an unexpected increase in 2009/10 that we are seeking to claim.

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

Christopher Neale
Director of Finance and Resources
Signed on behalf of the London Borough of Hillingdon

APPENDIX 1 SCHEDULE OF UNCORRECTED MISSTATEMENTS

Description	Assets DR / (CR) £'000	Liabilities DR / CR) £'000	Equity DR / (CR) £'000	Income Statement DR / (CR) £'000
Being the overstatement of the pension scheme assets leading to understatement of DB liability				
Dr Pension reserve			600	
Cr Liabilities relating to DB pension scheme		(600)		
Being adjustment for Asylum Seeker Grant income recognised more than specified in grant letter				
Dr Education & Children's Services Income				769
Cr Government department debtors	(769)			
Being adjustment for housing & council tax benefit subsidy to bring the debtor in line with the grant claim form				
Dr Housing & council tax benefit debtor	807			
Cr Other housing services				(807)

APPENDIX 2 DISCLOSURE DEFICIENCIES

#	Disclosure title	Description of the deficiency and explanation of why not adjusted	Amount (if applicable) £'000
Note 1 on p72	Group accounts	SORP requires disclosure of net assets and results of operation for related companies of the authority. Due to the required accounting treatment for the indemnity given by the authority to Hillingdon Homes in respect of FRS 17 losses, such disclosure would be inconsistent with the Hillingdon Homes accounts.	1,494

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