Deloitte.

London Borough of Hillingdon

Report to the Audit Committee on the Audit for the year ending 31 March 2011

Planning Report

24 February 2011

Contents

Executive summary

We have pleasure in setting out in this document details of our proposed audit scope for London Borough of Hillingdon for the year ending 31 March 2011.

	Description	Detail
Audit scope	Our audit will be carried out in accordance with the Audit Commission's Code of Audit Practice 2008. Our primary audit responsibilities are also summarised in the "Briefing on Audit Matters" paper which was circulated to you with our 2009/10 audit plan issued in February 2010. In summary, under the Audit Commission's Code of Audit Practice we have responsibilities in two main areas: • the financial statements and the Annual Governance Statement; and • aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources. The Council will need to prepare accounts under International Financial Reporting Standards ("IFRS") for the first time for the year ended 31 March 2011. A number of the key audit risks we have identified below relate to transition issues. The Audit Commission have made changes to the scope of work to be performed on use of resources following the abolition of the Comprehensive Area Assessment and in response to issues facing local authorities in the current funding environment. The work we are required to perform to support our conclusion in this area will focus on the Council's arrangements for securing financial resilience and challenging how it secures economy, efficiency and effectiveness. The audit of the Council's Local Government Pension Scheme is covered by a separate audit plan and will be issued independently.	Page 6
Materiality	Materiality levels are calculated on the basis of gross expenditure. We estimate materiality based on expected results to be £7,295k (2009/10, £7,083k). We will report to the Audit Committee on all individual unadjusted misstatements which are greater than £365k, (2009/10, £354k) or are qualitatively material and in aggregate on all other unadjusted misstatements.	Page 6

Executive summary (continued)

Key audit risks	The key audit risks which we have identified as part of our overall audit strategy are: **1. Valuation of property** The Council has a substantial portfolio amounting to £1,312,743k at 31 March 2010. Properties are normally revalued every five years under a rolling programme. The valuation is sensitive to judgements on key assumptions. **2. Valuation of the gross pension liability** This continues to be an audit risk in view of the size of the liability (£414,519k in the prior year) and complexity of judgements in this area. Recent changes to key actuarial assumptions including the move from the use of the Retail Price Index (RPI) to the Consumer Price Index (CPI) as the principal measure of inflation also need to be considered. **3. Recognition of revenue grant income** Accounting for revenue grants can be complex as the timing of recognition will depend on the scheme rules. **4. Completeness of bad debt provision for sundry debt** The sundry debt balance, which was £24,364k at 31 March 2010, includes a number of sub-categories of debt. The bad debt provisions for sub-categories are based on different judgements and assumptions. There are a number of key differences between the UK GAAP based Statement of Recommended Practice (SORP) and the International Financial Reporting Standards (IFRS) based Code. We have identified the following as IFRS transition risks: **5. IFRS transition risk: accounting for capital grants** The transition to IFRS will require changes to the accounting for capital grants. **6. IFRS transition risk: lease accounting** This is a key difference both in terms of the identification of leasing arrangements and their classification and consequent accounting treatment. **7. IFRS transition risk: holiday pay and other compensated, short-term absences** The Council did not previously make provision for such absences under the SORP. Some authorities have experienced difficulties in capturing information on utilisation of entitlements needed to estimate the accrual. **8. IFRS transition risk: segment reporting** A number of judgements need to be made in identifying reportable segments. The Council will also need to present information in different formats and disclose reconciliations between these.	Page 8

Executive summary (continued)

Prior year uncorrected misstatements	The cumulative effect of uncorrected misstatements identified in the 2009/10 audit would have resulted in a £38k credit to the income and expenditure account and a £562k decrease in net assets. These misstatements related to: • Pension asset values - the difference between estimated and actual. • Asylum seekers grant - recognition of direct cost recovery. • Housing and Benefit subsidy debtor provision - potential overstatement.	N/A
Timetable	The main deadlines remain unchanged with 30 June for draft accounts and 30 September for the audit opinion. We will carry out the work on the accounts audit in two main visits. We will carry out our planning and interim audit visit in March 2011 and our final audit visit from the start of July 2011. We will issue our formal report to the Audit Committee on the audit at their meeting in September 2011. We will issue our audit report as soon as practicable following that meeting. We also expect the audit deadline for the Whole of Government return to be close to 30 September 2011.	Page 16
Independence	Deloitte has developed important safeguards and procedures in order to ensure our independence and objectivity. These are set out in the "Independence policies and procedures" section of our Briefing on audit matters document issued in February 2010. We will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2011 in our final report to the Audit Committee.	N/A
Fees	Our proposed fee for the 2010/11 audit (excluding the audit of the pension scheme annual report and fees in connection with the certification of grant claims and including fees in respect of the statement of accounts, the value for money conclusion and the whole of government accounts return) is £359,155 (2009/10, £367,500). This is in line with the Audit Commission's scale rates. The reduction reflects scope changes which are discussed further in Section 2. We note that an element of the proposed fee takes account of the additional requirements of the first year implementation of International Financial Reporting Standards. The audit of the Council's Local Government Pension Scheme is covered by a separate audit plan and will be issued independently. Details covering expected grant fees will also be communicated separately.	Page 18
Matters for those charged with governance	We have communicated to you separately in our publication entitled "Briefing on audit matters" those additional items which we are required to report upon in accordance with International Standards on Auditing (UK & Ireland). We will report to you at the final audit stage any matters arising in relation to those requirements.	Publication provided separately.

1. Scope of work and approach

Overall scope and approach

We will conduct our 2010/11 audit in accordance with the Audit Commission's Code of Audit Practice 2008 and other guidance issued by the Audit Commission.

We have responsibilities in two main areas:

- the financial statements and the Statement on Corporate Governance; and
- aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are also asked to provide an assurance statement on the Council's consolidation pack for Whole of Government Accounts purposes and to carry out procedures under instruction from the Audit Commission to certify grant claims and other returns on behalf of the Audit Commission.

Financial statements and statement on corporate governance

We will conduct our work on the accounts in accordance with International Standards on Auditing (UK and Ireland) ("ISA plus") as adopted by the UK Auditing Practices Board ("APB"). The audit opinion on the accounts we intend to issue will reflect the financial reporting framework adopted by the Council, being the Code of Practice on Local Authority Accounting ("the Code") which is based on International Financial Reporting Standards ("IFRS"). This is a change from last year when the accounts were required to be prepared in accordance with the Statement of Recommended Practice for Local Authorities 2009 (the "Local Government SORP" or the "SORP") which was based on generally accepted accounting practice in the United Kingdom ("UK GAAP").

For the 2010/11 financial statements, we will use the latest estimates of gross expenditure on services as the benchmark for our materiality assessment as this benchmark is deemed to be a critical component of the financial statements for the Council. We have determined a preliminary materiality of £7,295k (2009/10 £7,083k). This figure takes into account our knowledge of the entity, our assessment of audit risks and the reporting requirements for the financial statements. The concept of materiality and its application to the audit approach are set out in our Briefing on audit matters document.

The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

1. Scope of work and approach (continued)

Value for money conclusion

The Audit Commission has advised that in 2011 there will be a new approach to value for money (VFM) work at bodies previously subject to a use of resources (UoR) assessment.

For 2010/11, the auditors' statutory VFM conclusion will be based on the following two criteria:

Specified criteria for auditors' VFM conclusion	Focus of the criteria for 2011
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.

The extent of the work required will be determined by our VFM risk assessment. We will continue to discuss with officers the detailed approach to the work as the Audit Commission's guidance is published.

Whole of Government Accounts consolidation pack

Whole of Government Accounts (WGA) are commercial-style accounts covering all the public sector and include some 1,700 separate bodies. Auditors appointed by the Audit Commission have a statutory duty under the Code of Audit Practice to review and report on the Council's whole of government accounts return. Our report is issued to the National Audit Office ("NAO") for the purposes of their audit of the Whole of Government Accounts.

2. Key audit risks

Based upon our initial assessment, we will concentrate specific effort on the significant audit risks set out below:

Valuation of property	
Properties are normally revalued every five years under a rolling programme. The valuation is sensitive to judgements on key assumptions	The Council has a substantial portfolio of properties, amounting to £1,312,743k at 31 March 2010, which is subject to a rolling revaluation programme. Some of the properties require the application of specialist valuation assumptions. The credit crunch has affected property values, generally, and the Council has recorded gains and losses over the last three years. We understand the Council will be valuing Council Dwellings and Community assets in the current year as well as a number of completed buildings.
Deloitte response	We will evaluate the Council's arrangements for updating market values and the qualifications, relevant experience and independence of specialists utilised to carry out valuations and review the reasonableness of key assumptions. The accounting treatment for impairment/revaluation losses under the Code differs to past practice under the SORP, with all impairment losses on re-valued assets to be recognised in the Revaluation Reserve up to the amount in the Reserve for each respective asset. We will check compliance with the Code in this respect, including any restatement of prior period amounts.

Valuation of the gross pension liability	
This continues to be an audit risk in view of the size of the liability and the complexity of judgements in this area	The pension 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. There have also been changes announced by the Government to the key assumptions which need to be considered including the move from the use of the Retail Price Index (RPI) to the Consumer Price Index (CPI) as the principal measure of inflation.
Deloitte response	We will consider the qualifications, relevant expertise and independence of the actuary engaged by the Council and the instructions and sources of information provided to the actuary. We will include a specialist from our team of actuaries within our engagement team to assist in the review of assumptions used to calculate the pension liability and related in year transactions and the reasonableness of the resulting accounting entries.

Recognition of revenue grant income	
Grant income should be recognised based on the scheme rules	Accounting for grant income can be complex as the timing for recognising income in the accounts will depend on the scheme rules for each grant. A number of revenue grants which previously had restrictions on use have now been relaxed and so there is a risk that these revised scheme rules have not been taken into account in terms of accounting treatment.
Deloitte response	We will carry out extended testing to check that recognition of income properly reflects the grant scheme rules, that entitlement is in agreement with the draft or final grant claim and that the grant control account balance has been properly reconciled.

2. Key audit risks (continued)

Completeness of bad debt provisions for sundry debt	
Provisions continue to be an area of focus due to their judgemental nature	The sundry debts balance, which was £24,364k at 31 March 2010, includes a number of different sub-categories of debt, all of which have different methodologies for calculating the level of provision required. By nature, provisions are judgemental but should be based on sound assumptions and robust methodologies.
Deloitte response	We will review the Council's methodologies and assumptions used to calculate the sundry debt provision and the evidence collected by officers to support its approach. We will consider whether provisions appropriately reflect the impact of the current economic conditions by reference to recent collection performance and trends.

The risks noted below represent key differences between the UK GAAP based Statement of Recommended Practice (SORP) and the International Financial Reporting Standards (IFRS) based Code in place for the current financial year. We have already performed some testing on this transition and will report to the Audit Committee when our procedures are complete.

We have identified the following as IFRS transition risks where we will perform specific testing:

IFRS transition risk: accounting for capital grants	
The transition to IFRS will require changes to the accounting for capital grants	The Code sets out changes to the accounting for grants and contributions related to capital expenditure. As part of the restatement to International Financial Reporting Standards (IFRS) exercise, Management will need to undertake a review of grants and contributions unapplied at 1 April 2009, together with grants received but not applied subsequently, to ascertain whether there are any conditions attached to the grant or contribution.
Deloitte response	We will review documentation relating to the process carried out by the Council to review grant offer letters and related records and arrangements over the preparation and review of journals needed to restate the opening balance sheet and comparative information. We will test an extended sample of grants and contributions to check they have been accounted for in accordance with the Code.

IFRS transition risk: lease accounting	
This is a key area of difference between the SORP and the new IFRS based Code – both in terms of the identification of leasing arrangements and their classification and consequent accounting treatment	The 2009 SORP amended the previous accounting requirements for the Private Finance Initiative (PFI) and similar contracts to come into line with IFRS in 2009/10. This year, with full IFRS implementation, the Council is required to review its leases against IFRS criteria and assess whether they should be categorised as operating or finance leases and account for them accordingly.
Deloitte response	We will review documentation prepared by officers which shows how they have concluded whether leases are classified as operating or finance leases. We will review accounting analysis papers on the accounting treatment for leases identified.

2. Key audit risks (continued)

IFRS transition risk: holiday pay and other compensated, short-term absences	
The Council did not previously make provision for such absences under the SORP. Some authorities have experienced difficulties in capturing information on utilisation of entitlements needed to estimate the accrual	Under the Code, the Council will need to make provision for the first time for compensated, short-term absences such as annual leave and flexitime. This will require the Council to determine the amount and value of individuals' entitlement accrued up to the 31 March each year which has not been used by that date. A number of authorities have experienced difficulties in capturing data needed to estimate the accrual.
Deloitte response	We will consider the systems used to collect data to support the calculation. We will also test other assumptions used in the calculation.

IFRS transition risk: segment reporting	
A number of judgements need to be made in identifying reportable segments. The Council will also need to present information in different formats and disclose reconciliations between these	Under the Code, the Council will need to disclose an analysis of income and expenditure for each reportable segment (a subjective analysis), with segments drawn up to reflect the structure of financial information reported internally to the "chief operating decision maker". The Council will also need to disclose: • a reconciliation between the internal segmental reporting analysis (the subjective analysis) and the net cost of services in the Comprehensive Income and Expenditure Statement, analysed under the Best Value Accounting Code of Practice (BVACOP); • a reconciliation between the internal segmental reporting analysis and total income and expenditure; and • an analysis of assets and liabilities by reportable segment, where this information is reported regularly to the "chief operating decision maker". Under the SORP 2009, the Council was not required to prepare a subjective analysis within the statutory accounts, but was required to do so in its reporting to the Treasury for Whole of Government Accounts purposes.
Deloitte response	We will focus our work on reviewing the Council's rationale for the reportable segments it has identified and the reconciliation between the different analyses of its income and expenditure which it is required to prepare and disclose.

3. Consideration of fraud

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

ISA (UK and Ireland) 240 – 'The auditor's responsibilities relating to fraud in an audit of financial statements' requires us to document an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in Hillingdon Council and the internal control that management has established to mitigate these risks.

We will make inquiries of management, internal audit and others within the Council as appropriate, regarding their knowledge of any actual, suspected or alleged fraud affecting the group. In addition we are required to discuss the following with the Responsible Financial Officer ("RFO") and Audit Committee:

1. Whether the RFO and Audit Committee have knowledge of any fraud, alleged or suspected fraud?

2. The role that the RFO and Audit Committee exercises in oversight of:

   - Hillingdon Council's assessment of the risks of fraud; and

   - the design and implementation of internal control to prevent and detect fraud?

3. The RFO and Audit Committee's assessment of the risk that the financial statements may be materially misstated as a result of fraud.

We will be seeking representations in this area from the RFO in due course.

3. Consideration of fraud (continued)

Management override of controls

In addition to the procedures above we are required to design and perform audit procedures to respond to the risk of management's override of controls which will include:

- Having understood and evaluated the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, test the appropriateness of a sample of such entries and adjustments. We will utilise our computer audit specialists to extract a report of journals posted in 2010/11 and to analyse this information using computer audit techniques to identify journals with features which may be indicative of fraud.
- A review of accounting estimates for biases that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of management. We will also perform a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements.

We will focus on impairment allowances against balances with customers and outstanding statutory charges; and obtain an understanding of the business rationale of significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the Council and its environment.

We are also required to presume that there are risks of fraud in revenue recognition and conduct our audit testing accordingly (unless the presumption is rebutted). For further information see Key audit risks in section 2.

4. Internal control

Obtaining an understanding of internal control relevant to the audit

As set out in "Briefing on audit matters" circulated to you as part of our prior year audit plan issued in February 2010 for controls considered to be ‘relevant to the audit’ we are required to evaluate the design of the controls and determine whether they have been implemented (“D & I”).

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

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

Liaison with internal audit

We have agreed with the Council’s Chief Internal Auditor, that in the coming year, the external auditors will liaise with the Council’s internal audit function on a constructive and complementary basis to maximise our combined effectiveness and eliminate duplication of effort. This co-ordination will enable us to derive full benefit from the group’s internal audit functions, their systems documentation and risk identification during the planning of the external audit.

The audit team, following an assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function, review the findings of internal audit and adjust the audit approach as is deemed appropriate. This normally takes a number of forms:

- discussion of the work plan for internal audit; and
- where internal audit identifies specific material deficiencies in the control environment, we consider adjusting our testing so that the audit risk is covered by our work.

5. Timetable

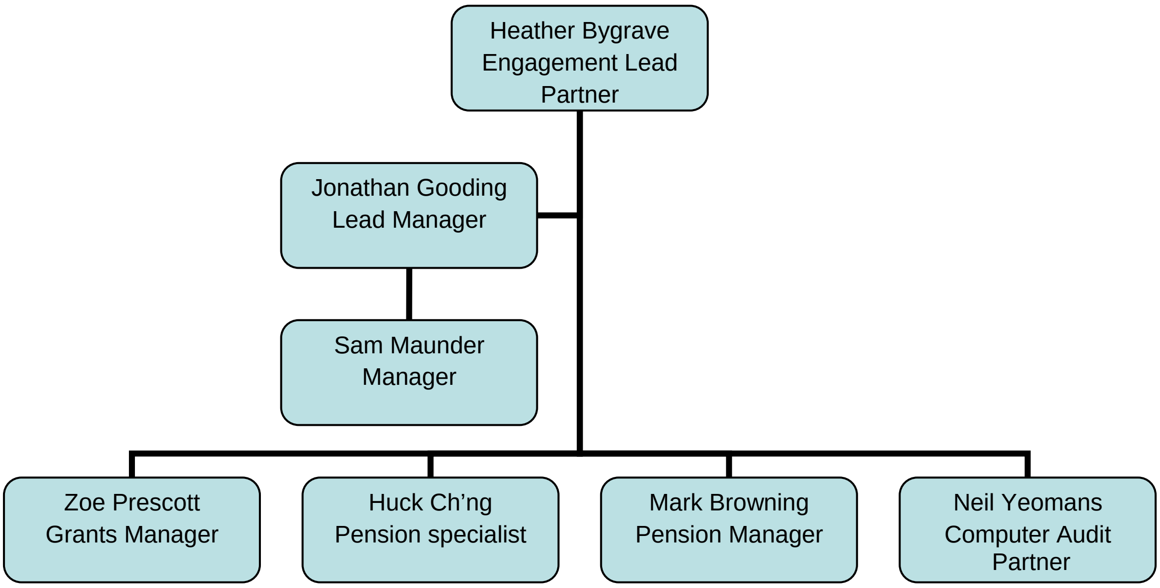
Set out below is the approximate expected timing of our reporting and communication with the Audit Committee.

Planning	Pre year end work	VFM conclusion	Year end fieldwork	Reporting	Post reporting
Meetings with management to: • confirm risk assessment; and management response and • agree on key judgemental accounting issues. Audit plan presentation Agreement of audit fees Early discussion on areas to improve financial statements and financial accounts and audit process	Discussion of key business risks Review audit trail behind IFRS transition process and audit of restatement of comparative information Update understanding of systems and controls, including IT systems Review relevant internal audit work Review of interim financial information for preliminary analytical review purposes Early work on financial statements, including testing of capital expenditure; testing of repairs and maintenance and supervision and management expenses	Performance of procedures specified by the Audit Commission	Performance of substantive testing Performance of specified procedures in relation to the audit of the WGA consolidation pack Audit issues meetings	Review of financial statements Final Audit Committee meeting Issuance of audit report on financial statements Issuance of Value for money conclusion Issuance of assurance report on WGA consolidation pack	Audit feedback Presentation of controls letters of recommendations Issue of annual audit letter and presentation to the Audit Committee
Dec 2010-Jan 2011	Jan-Mar 2011	Feb-April 2011	July-Sept 2011	Sept 2011	Nov 2011-Jan 2012

Ongoing communication and feedback

6. Client service team

We set out below our audit engagement team.



Heather Bygrave has replaced Gus Miah as Engagement Lead Partner. Heather has been introduced to the Audit Committee at the meeting in December 2010. Heather has also met with responsible officers and the core finance team.

7. 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 February 2010 and sets out those audit matters of governance interest which have come to our attention during the planning of our audit to date. Our audit is not designed to identify all matters that may be relevant to Members and our final report on the audit will not necessarily be a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Members of the London Borough of Hillingdon, 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

24 February 2011

Appendix 1: Analysis of professional fees

We summarise below our proposed audit fees as discussed with management, including details of any scope changes:

£	Audit of financial statements	2009/10 VFM conclusion and 2010/11 use of resources work for the CAA (abolished)	2010/11 value for money conclusi on	WGA	Total	Pension scheme
2009/10	302,000	60,000	-	5,500	**367,500**	38,000
2010/11	**324,000	-	29,655	5,500	**359,155**	36,500

Note 1 - The Audit Commission publishes a work programme and scales of fees. The scale fee represents the Commission's best estimate of the fee required to complete an audit where the audited body has no significant audit risks and the audited body has in place a sound control environment that ensures the auditor is provided with complete and materially accurate financial statements with supporting working papers within agreed timeframes. The scale fee for Hillingdon Council (excluding pension scheme audit), based on gross cost of services in 2009/10, uplifted for an assumed inflation rate of 1.5% in 2010/11, is £383,500. Our proposed fee is lower than that expected by the Audit Commission.

Note 2** - An increment has been added in respect of the implementation of International Financial Reporting Standards is based on the Audit Commission's recommended uplift of 6% of the total audit fee. We note that the Audit Commission has undertaken to pay you a subsidy towards the cost of the increment in respect of IFRS.

Note 3 – In line with the Audit Commission's recommendation we have not made any adjustment to the fee for inflation.

Note 4 - In setting the fee at this level, we have assumed that the general level of risk in relation to the audit of the financial statements is not significantly different from that identified in respect of 2009/10.

Note 5 - In setting the audit fee we have assumed:

- you will inform us of significant developments impacting on our audit;
- there are no additional audit risks to those set out in section 2 of this report;
- Internal Audit meets the appropriate professional standards and undertakes the audits set out in their agreed plan with testing covering the whole of the financial year;
- management will provide good quality working papers and records to support the financial statements by the agreed start date for the audit;
- management will provide draft financial statements for the agreed start date of the audit which are complete and of a good standard;

Appendix 1: Analysis of professional fees (continued)

- management will provide the draft pension scheme annual report by the agreed start date for the accounts audit to enable the work on that to be carried out contemporaneously with the audit work on the pension scheme information in the statement of accounts;
- management will provide a consolidation pack for WGA purposes which audit trail for mapping to the statutory accounts and is properly prepared in accordance with Treasury guidance;
- management will provide requested information within three working days unless indicated that the request is more complex or time consuming;
- management will provide prompt responses to draft reports;
- management will provide a detailed commentary on status of recommendations together with supporting documentation and
- a self assessment will be prepared for the use of resources assessment, including compilation of supporting documentation.

Where these requirements are not met or our assumptions change, we may be required to undertake additional work which is likely to result in an increased audit fee.

Note 6 - Our fee in respect of use of resources/value for money conclusion represents fees for the work we expect to carry out to support our 2010/11 value for money conclusion during the current financial year. We have not identified any significant risks in relation to our value for money conclusion.

Note 7 - The fee for the audit of the pension scheme reflects the Audit Commission's fee scale in respect of 2010/11, uplifted for additional risk.

Note 8 - Our fee charged in respect of the certification of claims and returns will be based on the time spent on each claim using the fee rates applicable to the certification of grant claims and published by the Audit Commission for different levels of staff. We will provide an estimate once the composition of the grants programme for 2010/11 is known.

Note 9 – Drivers Jonas Deloitte has submitted a proposal to the Council to monitor the delivery of a building contract for the expansion of six primary schools. If successful in this proposal, we do not consider this to compromise our independence as external auditors to the Council. We have written to the Audit Commission to request approval to undertake this work.