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London Borough of Hillingdon

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

Report for the meeting on 28 September 2011

Issued on 8 September 2011

Audit Committee 28 September 2011
PART 1 – MEMBERS, PUBLIC & PRESS

Contents

Executive summary

We have pleasure in setting out in this document our report to the Audit Committee for discussion at its scheduled September meeting. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2011.

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

	Description	Detail
Key findings on audit risks and other matters		
We have concluded satisfactorily on each of the key audit risks identified in our audit plan. We did not identify any additional risks in the course of our work.	In our planning report, which was presented to you in February, we outlined our key audit risks. The results of our testing on those risks are summarised below. • Overall, the assumptions used to calculate the liability relating to the London Borough of Hillingdon Pension Fund fall within a reasonable range. • We have concluded that the revaluation of council dwellings and other land and buildings is reasonable and that the Council has accounted for such losses appropriately. However, we have identified a judgemental misstatement relating to the valuation of assets using a depreciated replacement cost methodology. • Our testing of revenue grants did not identify any instances where the recognition criteria had not been correctly considered in the accounting treatment for these grants. • We have identified one judgmental misstatement relating to a provision within sundry debtors. Otherwise our testing concluded that the provisions for sundry debtors were reasonable. In our audit plan, we also identified a number of audit risks arising from transition to the International Financial Reporting Standards (IFRS) based Code. The results of testing on these risks are set out below. • We have proposed a change to the structure of the segmental reporting note following discussions with management and review of information reported internally to management. This change has been accepted and the note has been amended in the latest set of draft financial statements. • We performed specific testing on transitional changes including capital grants, short-term absences accruals, and lease accounting. No issues were identified from our testing.	Section 1
Audit status		
Subject to the clearance of final points, we expect to issue an unmodified audit opinion on the financial statements.	We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan. Details of significant matters outstanding are included at 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 on the fair presentation of the 2010/11 financial statements.	Appendix 3

Executive summary (continued)

Identified misstatements		
Uncorrected judgemental misstatements decrease cost of services by £321k, decrease net assets by £2,923k and decrease unusable reserves by £3,244k.	Audit materiality was £7.8 million (2010 £7.1 million). This exceeds the estimate reported to you in our audit plan which is largely due to differences between budgeted and actual full year gross expenditure. Uncorrected judgemental misstatements decrease cost of services by £321k, decrease net assets by £2,923k and decrease unusable reserves by £3,244k. Additionally, a number of misstatements identified through our work have been corrected and are reflected in the Statement of Accounts to be presented to the Audit Committee in your September meeting. A summary of the uncorrected and corrected misstatements and significant disclosure deficiencies is included in Appendix 1. We will report at the committee if there are any further uncorrected misstatements identified from our review of the updated statement of accounts or from the completion of our remaining audit procedures.	Appendix 1

Value for money conclusion		
We expect to issue an unqualified VFM conclusion.	Based on the work we have performed in respect of criteria specified by the Audit Commission, we expect to issue an unqualified value for money conclusion for the 2010/11 financial year.	Section 2

Accounting and internal control systems		
There are no matters to bring to your attention.	We did not identify any significant deficiencies in the financial reporting systems. However, during the course of our audit we identified a number of control observations, the most significant of which are detailed in Section 3.	Section 3

Independence		
We confirm our independence.	Our reporting requirements in respect of independence matters, including fees, are covered in Appendix 2.	Appendix 2

Management representations		
We have attached our standard representation letter.	A copy of the representation letter to be signed by management responsible for the preparation of the financial statements is included at Appendix 4. Non-standard representations have been highlighted.	Appendix 4

Whole of Government Accounts (WGA) return		
We have completed our procedures.	We have completed our procedures in respect of the WGA and expect to submit the audited return by the deadline of 30 September 2011.	N/A

1. Key audit risks

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

Valuation of pension liability	
The calculation of the pension liability is sensitive to small changes in assumptions. Overall, the assumptions used to calculate the pension liability fall within a reasonable range.	The pension liability was identified as a risk because it is substantial and its calculation is sensitive to comparatively small changes in assumptions made about future changes in salaries, mortality and other key variables. The net liability relating to defined benefit pension schemes for 2010/11 was £248m (£436m 2009/10). There have also been changes announced by the Government including the move from the use of the Retail Price Index (RPI) to the Consumer Price Index (CPI) as the principal measure of inflation. This has resulted in a past service gain being recognised in the Comprehensive Income and Expenditure Statement of £95m. Furthermore, the move to bring the Arms Length Management Operation (ALMO), Hillingdon Homes, back in-house during the year, resulted in some additional complexities for the presentation of the London Borough of Hillingdon Pension Fund liability. Where as in the 2009/10 financial statements the liability relating to Hillingdon Homes was presented separately, its results are now amalgamated with the London Borough of Hillingdon pension fund for the year ended 31 March 2011.
Deloitte response	We considered the arrangements over the engagement of the Council's actuary and concluded that these arrangements were satisfactory. We included our own actuarial experts from our specialist pension team to assist in the review of the assumptions used to calculate the pension liability, the related in-year transactions, and the reasonableness of the resulting accounting entries and disclosure. Our actuaries have concluded that, whilst at the slightly prudent end, the assumptions are within a range that we would expect and have been set in a manner consistent with International Accounting Standard (IAS) 19, the applicable accounting standard. For consistency, we note that we reported the Council as being at the prudent end of the assumptions range in the prior year as well. The effect of the RPI to CPI change is to reduce liabilities. There are two possibilities for accounting for this change in the Comprehensive Income and Expenditure Statement: either as a 'Surplus or Deficit on the Provision of Services' where the reduction is considered to be a change in benefit; or as 'Other Comprehensive Income and Expenditure' representing an 'actuarial gain or loss on pension assets and liabilities' if the reduction in liability is considered to be a change in assumption. CIPFA guidance is that there is a presumption that communications made to staff on a national basis by the government, prior to the UK budget statement, will have established a constructive obligation to continue to increase staff pensions in line with RPI and therefore the change to CPI represents a change in benefit. The financial statements have been prepared on a basis which is consistent with this guidance and so the past service gain has been recognised within non-distributable costs within the Deficit on Provision of Services section. We have included a representation within our draft representation letter at Appendix 4 which states that there has been no local communication worded in such a way that would cause employees to not reasonably infer an expectation that future rises would be based on RPI. On this basis we have concluded that the presentation of this change is appropriate.

1. Key audit risks (continued)

Valuation of property	
We focused our work on the valuation of council dwellings and certain other land and buildings. We concluded that the valuation was reasonable except for the inclusion of finance costs in the valuation of buildings using the depreciated replacement cost methodology.	The Council has a substantial portfolio of properties which is subject to a rolling revaluation programme. For the year ended 31 March 2011 the Council has revalued its council dwellings and certain other land and buildings. We identified these valuations as a key audit risk because of the size of the balance in relation to the financial statements as a whole and because some properties require the application of specialist valuation assumptions. The carrying value of council dwellings at 31 March 2011 has fallen by £200m compared to the prior year valuation. However, this revaluation loss was largely due to a decision made by the Department for Communities and Local Government (DCLG) to change the factor used for calculating the existing use value for social housing from 37% to 25%, rather than a significant change in the market value of such dwellings.
Deloitte response	We have considered the approach and methodology of the external valuers and whether the stated valuation assumptions were well reasoned and supported by appropriate evidence. We engaged our property experts, Drivers Jonas Deloitte, to assist us in the assessment of valuations. For council dwellings, we have concluded that the valuation was reasonable. For the valuation of other land and buildings we identified one issue resulting from the process undertaken. The 2010/11 Code states "where Depreciated Replacement Cost (DRC) is used as the valuation methodology, authorities should use the 'instant build' approach at the valuation date". Specific reference to this was made in LAAP 88 which did not define instant build but did state that the concept of instant build means the need to remove finance costs from a valuation. From discussions with our internal valuation experts and with the Council, we have established that under the new methodology, an instant build approach would mean valuing relevant assets on the basis of current build costs; in practice this might mean using historic build costs and then accounting for changes in build costs to the date of valuation. The Council has not taken this approach but has used historic build costs and added finance costs of 6.75%. Therefore the potential error is the difference between inflationary build costs and the finance cost used by the Council. The capitalisation of finance costs amounts to £4.1m of the revalued assets. As building inflation costs change over time, it is not possible to quantify the actual misstatement in relation to this issue unless each asset valued is reviewed. The Council has not proposed to undertake an exercise to identify the actual inflationary build costs that should be included for this year's financial statements on the basis that to do so accurately will take some time and there is a low risk that the amount would be material. However, management has agreed to undertake such an exercise for these assets in the 2011/12 financial year. Therefore, whilst acknowledging that this will be at the upper level of the actual error, we have proposed a judgemental misstatement of £4.1m within fixed assets to remove the finance cost capitilisation. This is recorded in Appendix 1. In Section 3, we have identified a control observation relating to the documentation of considerations around valuation methodologies.

1. Key audit risks (continued)

Completeness of bad debt provision for sundry debt

Bad debt provisions are an area of focus due to their judgemental nature. Our testing identified a potential misstatement for the housing benefit overpayment provision.

The sundry debt provision was identified as a risk because the sundry debt balance comprises of a number of 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.

The make-up of the sundry debtor balance is shown in the table below:

	Gross debtor £'000	Provision £'000	Net debtor £'0 00
Other sundry debts	11,821	(2,685)	9,136
Housing benefit overpayments	7,658	(6,359)	1,299
Housing revenue account	1,043	(738)	305
Council tax and NNDR	884	(770)	114
Prepayments	2,596	-	2,596
Total sundry debtor	**24,002**	**(10,552)**	**13,450**

Deloitte response

Of a gross debt of £24m, £10.5m has been provided for, leaving the Council with a maximum potential exposure of £13.5m at 31 March 2011. Our risk was specifically addressed towards the completeness of the bad debt provision for sundry debt but as part of our work we have considered the level of the provision as a whole, including an assessment of whether the provision appears to be higher than we would expect.

The Council's methods for calculating provisions are different for each sub-category of debt, but all have been calculated using the same processes as the previous year. The general approach adopted by the Council when assessing the level of provision required is to analyse the make-up of sub-categories of debt and then apply provisions based on perceived risk. Whilst the logic for this approach does not appear unreasonable, with the exception of Council tax debtors, officers have not supported this through reference to recent experience of recovery of debt.

In evaluating the reasonableness of the provisions, we have considered the potential exposure where the net debtor is significant. We have also considered the extent to which the provision estimated at 31 March 2010 differed to the amounts actually utilised in the current year. Our findings are noted below.

The table above shows that the largest area of exposure is within other sundry debts. £5.7m of this exposure relates to Corporate and Finance debts where investigation noted that 90% of the outstanding debt is less than 1 year old and has a historic cash collection rate of 91% based on 2009/10 debt. £2m of the other sundry debt exposure relates to social service debt which has a historic cash collection based on 2009/10 of 81% but has had some change in the ageing of the debts in the current year. Based on this work we have concluded that, in terms of completeness, the provisions for sundry debt are not unreasonable.

Our work on the housing benefit overpayment identified that the provision may be overstated. The Council's current policy is to provide for 100% of overpayment debt with former tenants. However, our review of historic cash collection identified that, on average, 27% of debts were recovered per annum from 2008/9 and 2009/10 indicating that the current provision of 100% is not appropriate. As a result we have identified a judgemental misstatement of £1.2m. Management have stated that the economic downturn is likely to result in an increase in residents owing money in relation to housing benefit and this will increase the risk in underrecovery, however, they have agreed to look at the methodology and appropriateness of this provision in 2011/12. This potential error in included in our schedule at Appendix 1.

Aside from the judgemental misstatement identified, we have concluded that the amount of the provision for sundry debt is not unreasonable. A representation covering the reasonableness of the bad debt provision is included in Appendix 4.

1. Key audit risks (continued)

Recognition of revenue grant income

The timing for the recognition of grant income will depend on the scheme rules for each grant. Our testing found no material issues.

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. This risk was identified as a result of changes to the IFRS based Code and due to the relaxation of restrictions on use for a number of grants received by the Council.

Under the Statement of Recommended Practice (SORP) 2009, income from revenue grants was recognised in the income and expenditure account to match the expenditure to which the grant was expected to contribute. Where the revenue grant was not ring-fenced to a particular purpose or period, income was recognised immediately. Under the IFRS based Code, income from grants is recognised in the Comprehensive Income and Expenditure Statement as soon as all conditions are met.

Deloitte response

We performed detailed testing on a sample of revenue grants by reviewing correspondence attached to specific grants and comparing with the Council's accounting treatment. This included reviewing revenue grants recognised in 2009/10 and 2008/09. Our testing did not identify any instances where the recognition criteria had been determined incorrectly or where treatment would change under the Code.

Presumed risk of management override of controls

Recently amended audit guidance includes a presumed risk of management override of key controls

New International Standards on Auditing (ISAs) have been issued which apply to accounting periods ending on or after 15 December 2010. These 'clarified' ISAs impose some new requirements on auditors, one of which is the presumed risk of management override of control, which cannot be rebutted by the auditor.

Our audit work is designed to test the potential risk of management override of controls. Our work focussed on the testing of manual journals, significant accounting estimates and any unusual transactions, including those with related parties.

Deloitte response

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

Key areas of accounting estimates are included as separate risks, notably:

- valuation of pension liability;
- valuation of fixed assets; and
- completeness of bad debt provisions.

Our testing of these risks are reported to you in this section. We did not identify any bias from management in preparing these estimates.We did not identify any transactions where the business rationale was not clear.

We did identify one area that was not perceived to be a risk of material misstatement, but is an area of judgement by management. The Council does not currently recognise the whole of income receivable in relation to the BEN01 grant on the basis that it includes potential impairment losses relating to errors in the claim where the Department for Work and Pensions (DWP) could clawback grant funding. We have reviewed the basis for this adjustment and considered in the context of our grant audit of the BEN01 claim. Our testing of this claim to date has identified that it does contain certain errors, which whilst immaterial from the perspective of our audit, do indicate the possibility of clawback of funds. Therefore, we have concluded that this position is not unreasonable and concluded satisfactorily on this risk. The results of our testing of grant claims will be reported separately to the Audit Committee.

1. Key audit risks (continued)

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, which require restatement of 1 April 2009 and 31 March 2010 balances.

IFRS transition risk: segment reporting	
A change has been made to the initial segmental reporting note included in the first draft of the financial statements presented for audit. **We consider the revised note to be appropriate.**	Under the Code, a new note to the accounts is required. The Council was required to disclose a segmental analysis of income and expenditure, with segments reflecting the structure of financial information used for internal management reporting. In addition to reporting the results of its segments, the Council was required to disclosure additional information included in a subjective analysis of total income and expenditure, and a reconciliation from segmental information presented to the Comprehensive Income and Expenditure Statement.
Deloitte response	We have reviewed the rationale adopted by the Council regarding its reportable segments and performed detailed testing on the balances disclosed. As a result of our discussions with management, the Council has amended the structure of the note since the initial draft of the financial statements presented for audit, so that the table of reportable segments now reconciles directly to the Outturn report for 2010/11 which is reported to the Cabinet. We consider this to be appropriate because it is the outturn report which is closest to the definition in the Code which states the internal reporting considered should be 'the most commonly used within the authority when considering the allocation of financial resources.' Management has agreed with this change and the adjustment has been reflected in the latest version of the financial statements.

IFRS transition risk: accounting for capital grants	
The transition to IFRS required changes to the accounting for capital grants. **No material issues were identified from testing.**	The transition to IFRS requires changes to 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 IFRS, officers were required 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. The Council has restated the 2009/10 and 2008/09 balances to reflect changes to accounting for capital grants.
Deloitte response	We reviewed the work performed by officers to assess and restate entries made in relation to capital grants arising from transition to the Code. We also performed detailed testing on a sample of capital grants by reviewing correspondence attached to specific grants and comparing with the accounting treatment. Our testing did not identify any issues and so we have concluded the treatment of capital grants is satisfactory.

1. Key audit risks (continued)

IFRS transition risk: lease accounting	
There has been a change in the identification of leasing arrangements and their classification and consequent accounting treatment. No material issues were identified from testing.	The IFRS based Code includes different criteria regarding the classification of leases. This risk was identified because the Council was required to review its leases retrospectively against IFRS criteria and assess whether they should be categorised as operating or finance leases and account for them accordingly. This requirement did not extend to lease-type Private Finance Initiatives as changes resulting from IFRS were fully implemented in 2009/10 as an amendment to the 2009/10 SORP.
Deloitte response	We have reviewed documentation prepared by officers which shows how they have concluded whether leases are classified as operating or finance. We have then performed detailed testing on a sample of these leases to form an independent conclusion. We have not identified any issues from our testing.

IFRS transition risk: holiday pay and other compensated, short-term absences	
An accrual for short-term absences has been made in the financial statements for the first time. Our testing has not identified any material issues.	The Council has made provision for compensated, short-term absences such as annual leave and flexitime for the first time as required by the Code. For council employees, the Council has used data from its Resource Link payroll system as the basis for this accrual. For school term-time employees, the Council has calculated the accrual using specific CIPFA guidance.
Deloitte response	We have tested the calculations for the prior year and current year accrual and the report obtained from the payroll system. For school term-time employees we recalculated the accruals using CIPFA guidance and agreed source data to appropriate evidence. We have not identified any issues from our testing.

2. Value for money conclusion

For the 2010/11 year the Audit Commission introduced a new approach to value for money (VFM) work at bodies previously subject to a use of resources (UOR) assessment.

Our VFM conclusion is based on the following criteria:

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

Based on the criteria specified by the Audit Commission and the work we have performed against those criteria, we expect to issue an unqualified value for money conclusion for the 2010/11 financial year.

Without affecting our value for money conclusion, from our work we have identified the following recommendations:

Publication of a summary strategic plan	
Description	The Council is undergoing a significant period of change, both with a revised internal structure and plans to meet challenging savings targets. We have seen evidence of the plans behind such changes but there is no overall Council strategic plan in place which brings together the key strategic priorities of the Council and shows how the changes being made align themselves to this plan and the priorities of the Council.
Recommendation	The Council should consider creating a strategic summary for residents and staff which is available on the Hillingdon Council website. The document could discuss the Council's key strategic priorities in the short and medium term and how these priorities are being managed in the context of significant change. It is considered that such a document would be helpful to users to understand the context of these changes and how difficult decisions are being made to balance key priorities.
Management response	Each year, in the autumn edition of Hillingdon People, the Council includes an article summarising the Council's annual accounts and explaining to residents how their money has been spent. Resident's value this publication as the most effective means of communication from the council. As part of this year's article we will be explaining how the Council manages to maintain services the residents have said they want, how they are achieving their stated priorities and how this is being done within the context of delivering significant savings and undergoing a major transformation of the Council. Hillingdon People is also published on the Council's web site.
Timeframe:	October / November 2011
Owner:	Nancy Leroux, Senior Service Manager Corporate Finance

Proposed amendment to annual governance statement	
Description	On review of internal audit reports we identified some cases where control weaknesses had been identified in capital project management and creditors. We understand that control improvements have been implemented in the year to address these weaknesses. The draft annual governance statement makes some reference to control improvements being made but does not specifically link to these areas.
Recommendation	To add more detail to the annual governance statement to discuss these control weaknesses and the specific changes made to address them. This would make the statement more explicit and show that weaknesses are addressed.
Management response	The annual governance statement has been updated to include further detail on these issues. The revised version will be included in the final accounts.
Timeframe:	Completed
Owner:	Helen Taylor, Head of Internal Audit and Enforcement

3. Accounting and internal control systems

Control observations

During the course of our audit we identified a number of control observations, the most significant of which are detailed below.

Ageing of housing benefit overpayments provision	
Description	We understand that the Northgate system, which is used to calculate and monitor housing benefit overpayments debts, does not have the functionality to report on the ageing or cash recovery of debtors. This results in a limitation of the information available to management when determining the appropriate level of provision for housing benefit debts and could limit a more efficient approach to identifying debts perceived to be of a higher risk.
Recommendation	Management may wish to enquire into the possibility of creating ageing and cash recovery reports if they would be useful for debt collection purposes.
Management response	This would be useful if Northgate are able to produce such a report as part of the standard suite of reports providing it can be done with minimal effort. If a significant level of resources is needed to produce such report(s) then it is unlikely to be worthwhile as the nature of such debts as well as housing benefit regulations reduce the significance of the age of debtor as an indicator of the likelihood of recovery. The financial status of the debtor can mean that some relatively new debt can be difficult to recover but the reverse can also be true.
Timeframe:	April 2012
Owner:	Maqsood Sheikh

Bank housekeeping arrangements	
Description	Our bank confirmation letter from HSBC identified that an unlimited multilateral guarantee was still held between Hillingdon Council and Hillingdon Homes Ltd. Such an agreement would now be redundant as Hillingdon Homes was amalgamated back into the Council in the 2010/11 year. The confirmation letter also identified a bank account that was open but when discussed with management, we understand that management believed this account was closed.
Recommendation	Management should regularly review banking arrangements to ensure that any open bank accounts are regularly reconciled to the ledger and that any other additional agreements are removed when the related contractual relationship has ended. In the instance of the two issues identified above, we understand that the Council has now contacted the bank to close the bank account concerned and remove the guarantee.
Management response	The guarantee was required for the first six months of the financial year 2010/11. HSBC were informed at the time that Hillingdon Homes had ceased to be a legal entity. The paperwork has now been updated by HSBC. All bank accounts are reconciled to the ledger on a monthly basis. The bank account referred above was opened several years ago and had never been used. The account has now been closed by HSBC.
Timeframe:	August 2011
Owner:	Annette Reeves

3. Accounting and internal control systems (continued)

Consideration of modern equivalent asset valuation basis for fixed assets	
Description	We raised a control observation in the our report on the 2009/10 audit which recommended that where the Council is valuing assets under the depreciated replacement cost (DRC) methodology, there should be explicit reference to whether or not a modern equivalent asset (MEA) basis had been applied. Where appropriate, the MEA basis of DRC is to be used for all assets; this means consideration of the replacement cost of an existing asset if new materials were to be used or potentially a different site. Our review of detailed valuation papers, and discussion with the valuers, has identified that an MEA basis has been adopted However, we did not see detailed commentary that documented the thought process in arriving at this valuation.
Recommendation	Whilst our testing has not identified any issues with the valuation process undertaken by the Council, given the complexities of this area, we suggest robust documentation of valuation approach is used.
Management response	Management agree to review the documentation process for future revaluations to ensure that the methodology is clear and followed.
Timeframe:	April 2012
Owner:	Virginia De Matos

Land registry housekeeping	
Description	Our testing of fixed assets identified a property, Lapwing site at Heathrow, which is still being shown as the property of the London Borough of Hounslow, despite being transferred to Hillingdon over 10 years ago.
Recommendation	Management should contact the Land registry to effect this change and ensure that the same process is followed for any other sites of this type.
Management response	The legal department have been instructed to begin the process of transferring the title into Hillingdon's ownership.
Timeframe:	December 2011
Owner:	Boe Williams Obasi

3. Accounting and internal control systems (continued)

Valuation of investment properties	
Description	Under the IFRS based Code, investment properties are required to be revalued on an annual basis. However the Council did not revalue their investment properties during the 2010/11 financial year. Whist the investment property balance is not material; the Code explicitly requires annual valuations for these properties.
Recommendation	Management should perform annual revaluations on the Council's investment properties to comply with the Code of Practice.
Management response	The Council holds few Investment properties and these would normally be valued during the usual five year revaluation cycle. The Code now requires annual valuations for which the Council will undertake in 2012.
Timeframe:	April 2012
Owner:	Virginia De Matos

Calculation of homecare accrual	
Description	The homecare accrual, which forms part of sundry creditors, was calculated using a system generated report which had a number of faults including issues where more than one provider was used for an individual's care package. Although the accrual was not materially misstated, there is a risk that using the system generated report in the future can lead to a misstated accrual.
Recommendation	Management should review the controls around the production of the report and aim to rectify these. In addition to this, a review of the report should be performed after it has been generated to assess if correct.
Management response	Management agree with the recommendation. The report is due to be reviewed and will be tested prior to being used to accrue expenditure for 2011/12.
Timeframe:	April 2012
Owner:	Sheila Congram

Schools balances	
Description	The returns which are received from schools, providing the Council with financial information, do not include an analysis of payroll costs such as national insurance and employer's pension contributions. One effect of this is that the Council's Whole of Government Accounts (WGA) return does not include employers' national insurance contributions for schools when this data is requested.
Recommendation	To include more detail on schools returns to enable national insurance and pension costs to be split from salary costs. We also recommend that the school returns include details of the school staff full time equivalents for the period.
Management response	Management agree to review the school returns requirements to ensure the capture of all required data as part of the year end process. This may require additional review of the Scheme for Financing Schools.
Timeframe:	April 2012
Owner:	Peter Malewicz

4. Other matters for communication

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

Independence	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised. If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this.
Fees and Non-audit services	An analysis of professional fees earned by Deloitte and non-audit services performed in the period from 1 April 2010 to 31 March 2011 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" issued in February 2010 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. There were no areas where we needed to adjust our audit approach as a result.
Written representations	A copy of the representation letter to be signed on behalf of Council has been attached at Appendix 4. Non-standard representations have been highlighted.
Note on electronic publication	If you publish or distribute your statement of accounts electronically, you are responsible for ensuring that any such publication properly presents the annual report and any report by us thereon and for the controls over, and security of, the website. You are also responsible for establishing and controlling the process for electronically distributing such reports. ISA (UK and Ireland) 720 and APB Bulletin 2001/1 set out the procedures auditors follow before electronic distribution of their reports. In order that we can carry out these procedures you will provide us with a copy of the financial information in electronic form before it is published. You agree that you will obtain our written consent to any electronic publication including the use of our name or our report(s) before it occurs. We reserve the right to withhold consent to electronic publication if we are not able to satisfactorily perform the procedures set out in the Bulletin.

5. Future developments

For reference, the following developments are likely to have an impact the financial statements of the Council.

Changes to the 2011/12 Code	
Background	The 2011/12 Code includes a number of key accounting changes. We have listed some of the potentially significant changes below. • The requirements of FRS 30 Heritage Assets are adopted, with all heritage assets identified to be carried at valuation if possible, and disclosed. We note that the Council has already considered the potential impact of this change and concluded that at this stage no heritage assets are held. • Additional disclosures are required in respect of remuneration and exit packages. Specifically, there is a requirement to disclose the number and cost of exit packages agreed. • Various legislative changes, including regulations mitigating the impact of the transition to IFRS and the remuneration reporting requirements. • Clarification of requirements in a number of areas where uncertainty was identified in the 2010/11 Code.
Potential impact on Hillingdon	Regarding heritage assets, the Council has conducted an exercise to identify potential heritage assets and has concluded that it does not currently hold any assets which fall in to this category. The Council should be aware of any potential new heritage assets and account for valuation and disclosures appropriately. In the 2010/11 draft financial statements the Council has disclosed compensation paid to senior employees. The 2011/12 Code requires further disclosure in this area for exit packages, which includes compulsory and voluntary redundancy, ex-gratia payments and other departure costs.
Effective date	The Council is required to account for these changes from1 April 2011.

Code of practice on transport / infrastructure assets	
Background	CIPFA has published the Code of practice on transport / infrastructure assets (the transport Code) which suggests a change in the financial reporting valuation of infrastructure assets. Infrastructure assets are currently valued on a historic cost basis, with the transport Code suggesting a move to a depreciated replacement cost (DRC) based valuation. The transport Code suggests the withdrawal of the current method of historic cost accounting for infrastructure assets from 2012/13. The consultation on the 2012/13 Financial Reporting Code (the financial Code) includes the option for a voluntary disclosure of infrastructure assets on a DRC basis but currently maintains the required historic cost valuation for these assets.
Potential impact on Hillingdon	The financial Code remains the primary accounting source for the Council when preparing the financial statements. The 2011/12 financial Code states that the current historic cost valuation basis will be maintained for the next financial year and so there is no proposed impact for this period. Additionally, the consultation on the 2012/13 Code is only suggesting an additional voluntary disclosure for infrastructure assets under a DRC basis. However, considering the carrying value of infrastructure assets on the current historic cost basis at 31 March 2011 of £147m, if a change in valuation is adopted in future financial Codes, the impact could be significant for the Council.
Effective date	The consultation on the 2012/13 financial Code suggests an additional voluntary disclosure is required for that year end. We recommend the Council monitors this area for potential future changes.

5. Future developments (continued)

Self-financing for council housing	
Background	The reform of council housing subsidy system was included as a Coalition agreement commitment. Significant changes to the current system are expected with a planned implementation date of April 2012. Currently central government determine an amount deemed necessary for each council to maintain its housing stock on an annual basis. Council's then either receive a housing subsidy from government or pay excess rents to the Housing pool (negative subsidy). The Housing subsidy is calculated by the government based on estimated income and spending for each local authority's HRA. The calculation involves a number of assumptions. Where the government's subsidy estimates show that expenditure for a local authority is greater than its income, then a subsidy is paid to the local authority. However, where the government's subsidy estimates show that income is greater than expenditure, then the local authority makes a payment to the government. This calculation changes annually. The new proposals suggest an end to the current subsidy system moving to a self-financing system after redistribution of current national housing debt.
Potential impact on Hillingdon	We understand that a baseline subsidy valuation will be undertaken from which the government will determine the opening valuation of council dwellings with the new valuation being based on assumptions about each local authority's income and need to spend over 30 years. There will be a readjustment of each local authority's housing debt. If the re-valuation is lower than the amount of housing debt which is currently supported through the housing revenue account subsidy system, Government will pay the difference. If the valuation is higher than the debt supported by Housing Revenue Account subsidy, the local authority will be required to pay Government the difference. Management has provided information based on draft figures produced by DCLG which indicate that Hillingdon will be required to pay £172m to government and in return will keep £15m (rising to £25m) annually in negative subsidy. This represents a doubling of Council debt and will require separation of HRA and general fund pools of debt.
Effective date	28 March 2012

Consultation - accounting for non-current schools' assets	
Background	CIPFA/LASAAC has issued a consultation on proposals for developing the 2011/12 Code in relation to non-current schools' assets. The issue of the accounting treatment of non-current assets used by the different categories of maintained schools has been subject to debate for a number of years, without a firm conclusion being reached. The debate arises because the circumstances of each of the categories of maintained schools, such as ownership and access to economic benefits and service potential, are different. The move to IFRS has resulted in authorities and auditors reconsidering the issue.
Potential impact on Hillingdon	CIPFA/LASAAC's proposals are: • recognition or otherwise of all maintained schools on local authority balance sheets will require a subjective analysis of the indicators of control of the assets; • it is likely that for foundation and voluntary aided schools the non-current assets are not assets of the authority; • the case for voluntary controlled and community schools is less clear and CIPFA / LASAAC's preliminary view is that voluntary controlled schools appear not to be the assets of the authority whilst community schools appear to be the assets of the authority; and • the proposed interpretation may require some local authorities to change their accounting policy for one or more of the categories of schools, and this interpretation would need to be applied retrospectively.
Effective date	Effective for financial years commencing on or after 1 April 2011

5. Future developments (continued)

Consultation: proposals for business rates retention	
Background	A consultation covering the retention of business rates has been issued by DCLG. Currently, business rates are collected on a local basis and repatriated to central government. Funds are then reallocated to local authorities on the basis on the local government finance settlement. The consultation introduces proposals to enable local authorities to retain more of locally collected business rates. Various control measures are discussed within the consultation such as setting a baseline position and introducing tariffs or top-ups based on business rate yield. Proposals are also made for options to implement the concept of Tax Increment Financing, where a local authority could borrow for capital projects against future predicted increases in business rate growth, provided they can afford to service the borrowing costs out of revenue resources.
Potential impact on Hillingdon	Management has stated that due to the large size of Hillingdon's business rate tax base there are potentially significant financial gains for Hillingdon from this proposal. However, at this stage of the consultation, there are many unknowns in the design of this scheme and until they can be clarified they are as yet unable to assess the impact on Hillingdon.
Effective date	1 April 2014

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 in this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.

This report should be read in conjunction with the "Briefing on audit matters" circulated to you in February 2010 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 Council and this report is not necessarily a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

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

Deloitte LLP

Chartered Accountants

St Albans
8 September 2011

Appendix 1: Audit adjustments

Uncorrected misstatements

The following uncorrected judgemental misstatements were identified during the course of our audit. They have not been corrected by management. As stated in our Planning report, we only report to you misstatements that are not clearly trivial, which is greater than £392,000.

		Charge / (credit) to current year Comprehensive Income and Expenditure Statement	Increase/ (decrease) in Net assets	Decrease/ (increase) Reserves
		£'000	£'000	£'0 00
Judgemental misstatements				
Fixed assets instant build	[1]	839	(4,083)	3,244
Housing benefit overpayment provision	[2]	(1,160)	1,160	
Total		(321)	(2,923)	3,244

[1] This adjustment relates to the capitalisation of finance costs for assets revalued under the DRC method. It is discussed further in Section 1 under Valuation of property.

[2] The Council currently provides for 100% of housing benefit overpayment debt relating to former tenants. From work we have performed we have seen that in the last 2 years the Council has, on average, recovered 27% of debt per annum and so we estimate the provision is overstated by this amount.

Appendix 1: Audit adjustments (continued)

Corrected audit adjustments

The following misstatements have been corrected by management in the latest draft financial statements.

		Charge/ (credit) to current year Comprehensive Income and Expenditure Statement £'000	Increase/ (decrease) in Net assets £'000	Decrease/ (increase) Reserves £'0 00
Factual misstatements				
Disclosure of VAT	[1]			
Government department creditors		-	(2,355)	-
Government department debtors		-	2,355	-
Disclosure of Past Service Gain	[2]			
Non distributable expenditure		(95,470)	-	-
Non distributable income		95,470	-	-
Housing rents reclassification	[3]			
Housing rents debtor		-	857	-
Sundry creditors		-	(857)	-
Section 106 Creditors reclassification	[4]			
Long term creditors		-	(10,053)	-
Capital grants in advance		-	10,053	-
Total		-	-	-

[1] The Council had disclosed VAT payable and receivable on a gross basis (in debtors and creditors). However, as the net position is settled with HMRC, we consider that only the net amount should be presented in the balance sheet.

[2] The past service gain relating to the change from the use of the Retail Price Index (RPI) to the Consumer Price Index (CPI) had been appropriately recognised in the Statement of Comprehensive Income and Expenditure but as income rather than expenditure. Given that this gain effectively reverses expenditure previously incurred, it is more appropriate to recognise it in the expenditure column of the Statement of Comprehensive Income and Expenditure.

[3] Testing identified credit balances within housing rents debtors. These credits relate to rents received in advance and rent overpayments which are due to be refunded and so they should be reclassified as creditors.

[4] To reclassify Section 106 receipts from long-term creditors to capital grants in advance where monies received relate to capital projects where funding has been received but conditions have not yet been met.

Appendix 1: Audit adjustments (continued)

Disclosure deficiencies

During the course of our audit we have discussed a number of disclosure changes with management. Auditing standards require us to highlight significant disclosure deficiencies to enable audit committees to evaluate the impact of those matters on the financial statements. In the tables below we have included what we consider to be the significant corrected and uncorrected disclosure deficiencies that we have identified.

Corrected disclosure deficiencies

The following disclosure deficiencies have been corrected by management:

Disclosure	Detail
Capital grant creditors	A misclassification was identified in the creditors note between sundry creditors and government department creditors as a result of a capital grants reclassification being misallocated. This amounted to £8.4m in 2009/10 and £4.2m in 2008/09. The disclosures have subsequently been corrected.
Segmental reporting	This adjustment has been discussed in detail in section 1. We suggested the Council should present segmental data based on their outturn report, which is the most commonly used reporting document when considering the allocation of financial resources. Management has agreed with this change and the adjustment has been reflected in the latest version of the financial statements.
Cash flow statement	The Code allows two methods of deriving cash flow balances, the direct or indirect method. The initial draft of the financial statements included both the direct and indirect method. Our testing identified difficulties obtaining evidence supporting the direct method. However, the Code's suggested approach is the indirect method and so we have suggested that the Council includes only this note. This has been agreed by management and reflected in the latest draft of the financial statements.
Financial instruments: receivables provision, payables presentation and ageing of investments	Financial receivables (debtors) were originally presented on a gross basis when there is a requirement to be shown net of their associated provision in the financial instruments notes. Additionally, the initial draft of the financial statements included showing deferred income as a financial liability when it does not meet the appropriate criteria. Both adjustments have been accepted by management and adjusted in the financial statements. Additionally, the ageing analysis of investments in UK banks was initially incorrect. It has now been corrected by management.

Uncorrected disclosure deficiencies

The following disclosure deficiencies have been identified through our audit procedures but have not been corrected by management:

Disclosure	Detail
Financial Instruments: ageing of assets	There is a requirement to provide an analysis of assets which are past due but not impaired. This requirement includes a need to disclose the ageing of such assets. This is relevant to debtors where an ageing analysis is considered to be appropriate. The Council has not made this adjustment on the basis that it would be onerous to prepare and that some debtors systems cannot currently produce an aged debt analysis.
Revaluation losses disclosure	The Code requires a table of revaluation losses over the preceding five years to be presented in the notes to the accounts. The Council has not made this adjustment as it considers the current narrative to be reasonable.

Appendix 2: Analysis of professional fees

The professional fees earned by Deloitte in respect of the period 1 April 2010 to 31 March 2011 are as follows:

	2011 £'000	2010 £'000
Fees payable in respect the Council	359	368
Fees payable in respect of the certification of grants	155*	155
Fees payable in respect of the pension scheme	37	38
Total fees payable in respect of our role as appointed auditor	551***	561
DJD contract monitoring project**	-	-
Total non-audit fees payable	-	-

* Our work in respect of the certification of grants for 2010/11 is ongoing and the amount shown above is an estimate only based on the 2009/10 fees. We have regular dialogue with officers to keep them informed of progress for this work.

** In our audit plan presented to you in February 2011 we highlighted that one of our divisions, Drivers Jonas Deloitte, submitted a proposal to the Council to monitor the delivery of a building contract for the expansion of six primary schools. We have since been informed that Drivers Jonas Deloitte was successful in this proposal and that work has now started. However, this work had not started at 31 March and the Council has not incurred any charges to date relating to this project.

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

*** The fees disclosed above do not reconcile directly to the audit fees disclosed in the financial statements. The audit fees disclosed in the financial statements exclude pension scheme costs noted above but include £20k of costs which related to the 2009/10 audit but were invoiced in the 2010/11 financial year.

Appendix 3: Audit status

Our audit, conducted in accordance with our Audit Plan presented to you at your meeting in February 2011 is ongoing and is subject to the satisfactory completion of the matters set out below:

- Finalisation of internal review procedures.
- Closedown of certain audit procedures in non risk areas. This includes:
    - Receipt of remaining bank confirmations for schools.
- Representation letter (as attached at Appendix 4).
- Update of post balance sheet events review including value for money and going concern conclusion.

Appendix 4: Draft management representation letter

This representation letter is provided in connection with your audit of the financial statements of the London Borough of Hillingdon for the year ended 31 March 2011 for the purpose of expressing an opinion as to whether the financial statements present fairly the financial position of London Borough of Hillingdon at 31 March 2011 and of the results of its operations, other comprehensive income and expenditure and its cash flows for the year then ended in accordance with the applicable accounting framework and Accounts and Audit Regulations 2003 (as amended).

We acknowledge our responsibilities for preparing the financial statements for the London Borough of Hillingdon ("the local authority") which present fairly the results for the period and for making accurate representations to you. For the avoidance of doubt, references to the local authority should be taken as applying equally to the London Borough of Hillingdon Pension Scheme and references to the financial statements of the local authority, includes information in those financial statements dealing with the London Borough of Hillingdon Pension Scheme.

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

Financial statements

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

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

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

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

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

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

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

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

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

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

11. Except as disclosed in the Statement of Accounts, as at 31 March 2011 there were no significant capital commitments contracted for by the local authority.

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

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

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

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

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

17. We have not provided information to current and former staff of the Council prior to 1 April 2010 which would give rise to an expectation other than that pensions would rise in line with the Retail Price Index. As a result we confirm our view that the reduction in the liability arising from the change to the Consumer Price Index is properly accounted for as a change in benefits.*

18. We acknowledge our responsibilities for the following in relation to the adoption of IFRS:
    (a) analysing the impact of the introduction of IFRS on the business;
    (b) developing plans to mitigate the effects identified by this analysis; and
    (c) assessing any impact of the introduction of IFRS on the appropriateness of adopting the going concern basis in preparing the financial statements (and preparation of relevant disclosures).

Information provided

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

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

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

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

23. 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.

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

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

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

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

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

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

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

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

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

Yours faithfully

Signed on behalf of the London Borough of Hillingdon

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* denotes a non-standard representation.