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Harrow Council

Report to the Governance, Audit and Risk Management Committee

Accounts opinion audit plan for the 2009/10 accounts

12 March 2010

Contents

Executive summary

We have pleasure in setting out in this document details of our proposed audit scope for Harrow Council ('the Council') for the year ending 31 March 2010.

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 at your meeting in April 2009. In summary, under the Audit Commission's Code of Audit Practice 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. This document deals only with the first of these two responsibilities, i.e. the audit of the financial statements and statement on corporate governance. The second responsibility was dealt with in the fee letter for 2009/10 issued in April 2009. The Council will need to prepare accounts under International Financial Reporting Standards ("IFRS") for the first time for the year ended 31 March 2011. This plan excludes any work we perform on the opening IFRS balance sheet for the comparative period. The audit of the Council's Local Government Pension Scheme is dealt with in a separate audit plan.
Materiality	Materiality levels are calculated on the basis of gross expenditure on services. We estimate materiality based on expected results for the full year to be £4,434k (2009, £4,347k). We will report to the Audit Committee on all unadjusted misstatements greater than £222k (2009, £217k) unless they are qualitatively material.
Key audit risks	The key audit risks which we have identified as part of our overall audit strategy are: 1. **Insurance provision and purchase order accruals:** Due to their judgemental nature, and a history of recorded audit adjustments in respect of these balances, we have identified a risk to their completeness and validity. 2. **Pension liability:** This area is considered to be an audit risk in view of the materiality and complexity of this area, as well as the continuing impact of volatility in the economic environment which impacts on key assumptions in the calculation of the liability. 3. **Property valuations:** this continues to represent a risk in view of the size of the Council's property portfolio and sensitivity of the valuation to changes in assumptions, including volatility of market prices in the current economic environment. 4. **Bad debt provisions:** In previous years we have noted issues with debt recoverability and the calculation of the bad debt provision. In addition, the challenging economic environment and its impact on debt recovery continues to create uncertainties in the estimation of these provisions. 5. **Public Finance Initiative (PFI) transactions and accounting for local taxes:** these are identified as risk areas because these are complex areas and there have been changes to the 2009 SORP which the Council will need to comply with for the first time. 6. **Revenue recognition:** International Standards on Auditing (UK & Ireland) establish a presumption of a risk of fraud in revenue recognition. Historically the most significant area of detected fraud at the Council has been in the area of benefit administration. Therefore over-claim of the benefit subsidy, on the basis of fraudulent benefit claims, has been identified as an audit risk.

Executive summary (continued)

Prior year uncorrected misstatements and disclosure deficiencies	There were no significant uncorrected disclosure deficiencies reported to you in respect of the 2008/9 accounts. There was one unadjusted difference in respect of the 'FRS 17 pension added years' provision. The effect of adjusting for this would have been to increase net assets and credit the income and expenditure account by £1,075k. In addition, there was one unadjusted difference of judgement in the insurance provision. The effect of adjusting for this would have been to increase net assets and credit the income and expenditure account by £237k.
Timetable	The main deadlines remain unchanged at 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 a planning and interim audit visits in February 2010 and our final audit visit from the start of July 2010. We will issue our formal report to the Governance, Audit and Risk Management (GARM) Committee on the audit at their meeting in September 2010. We will issue our audit report as soon as practicable following that meeting. Our detailed timetable is set out in Section 5.
Independence	Deloitte have 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 issued to you in April 2009. We will reconfirm our independence and objectivity to the GARM Committee for the year ending 31 March 2010 in our final report to the GARM.
Fees	As set out in our fee letter for 2009/10 issued in April 2009, we have proposed an audit fee for the audit of the financial statements and the Whole of government Accounts (WGA) return (excluding the audit of the Local Government Pension Scheme) of £263,550 a reduction of 8% against the 2009 fee of £286,085. This fee excludes fees in respect of the audit of the Council's implementation of changes in the SORP in respect of PFI and similar contracts. Details of our fee are included in Appendix 1.
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.

1. Scope of work and approach

Overall scope and approach

We will conduct our 2009/10 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 areas:

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

This document deals with the first of these two areas. Our responsibilities in respect of the second area were explained in our fee letter issued in April 2009. We will conduct that work 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 Statement of Recommended Practice for Local Authorities 2009.

For the 2008/9 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 a spending organisation.

Using this benchmark we estimate that our planning materiality will be £4,434k (2009, £4,347k). This materiality takes into account our knowledge of the Council, our assessment of audit risks and the reporting requirements for the financial statements. In practice there were no circumstances which caused us to vary the standard factor we apply. 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.

Our audit objectives are set out and explained in more detail in our "Briefing on audit matters" document.

Other areas of work which are not covered by this audit plan

As last year, we have prepared a separate audit plan covering the work we carry out in relation to the Local Government Pension Scheme. As a result, this aspect of our work is not covered within this document.

The Council will need to prepare accounts under International Financial Reporting Standards (IFRS) for the first time in 2010/11. We have discussed with officers bringing forward aspects of our work on the IFRS opening balances at 1 April 2009 to the early part of 2010. We will agree a timetable and fee for this work with you. This plan excludes any work which we will carry out on the opening IFRS balance sheet as this will form part of our 2010/11 accounts audit plan.

We also carry out work on behalf of the Audit Commission in respect of the certification of grant schemes. This was discussed in our April 2009 fee letter.

2. Key audit risks

Based upon our initial assessment, we will concentrate specific audit effort in 2009/10 on the following areas:

Insurance provision	
Risk & Response	The Council obtained an actuarial valuation of its insurance provision for the 2007/8 accounts. In 2008/9 management calculated the provision based on a combination of the expected value of claims on the system at year end, and rolling forward the actuarial valuation from 2007/8 for new claims and payments made. During the 2008/9 audit we reviewed the Council's calculation of the provision and identified that the calculated insurance provision was £237k less than the amount included in the Statement of Accounts. We reported this in September 2009 as an unadjusted likely misstatement. The insurance provision is a judgemental provision: the claims registered on the system may be repudiated; settled for more or less than the reserve; or may require significant legal costs. Due to the judgemental nature of this balance, and the identification of a likely misstatement in the prior year, we have identified this as a risk for the 2009/10 audit. We will review managements calculations and supporting evidence for the insurance provision included in the 2009/10 accounts.

Purchase order accrual	
Risk & Response	For the 2008/9 accounts, management performed a review of the goods receipt and invoice receipt (GRIR) account and identified both revenue (£2,000k) and capital (£1,400k) items that should not be included as liabilities in the Statement of Accounts. These amounts were corrected by management and the amended balance included in the 2008/9 accounts in respect of GRIR was £10,781k. We performed detailed substantive testing on a sample of items that remained in the GRIR as a liability in the 2008/9 Statement of Accounts, and assessed whether the liability was valid. Internal audit identified, and we corroborated, that £232k of the GRIR account balance included within the Statement of Accounts presented for audit, was invalid and we proposed an adjustment for this amount. This misstatement was adjusted by management. In 2008/9, through our audit procedures, we also identified a similar control weakness in respect of the accrual for 'Outstanding Commitments on Framework I for Care Homes'. We concluded that the accrual for 'Outstanding Commitments on Framework I for Care Homes' was also overstated by £233k. This misstatement was adjusted by management. Given the control weaknesses identified in the prior year and the identification of audit adjustments in these balances, the completeness and validity of this balance will continue to be a risk for the 2009/10 audit. We will review the design and implementation of management controls to mitigate this risk and will perform additional substantive audit procedures in respect of this balance.

2. Key audit risks (continued)

Pension liability	
Risk & Response	The liability relating to the pension scheme is substantial and its calculation is sensitive to comparatively small changes in assumptions made about future changes in salaries, price and pensions, mortality and other key variables. Some of these assumptions draw on market prices and other economic indices and these have become more volatile during the current economic environment. 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 manager from our specialist pensions group within our engagement team to assist in the review of assumptions used to calculate the pension liability and related in year transactions and the reasonableness of the resulting accounting entries.

Property valuations	
Risk & Response	The Council has a substantial portfolio of properties which are subject to a rolling revaluation programme. Some of the properties require the application of specialist valuation assumptions. The credit crunch has affected property values, generally, and the Council is not immune to these effects. In the first draft of the 2008/9 Statement of Accounts the HRA Council Dwelling valuation had not been updated to reflect the economic environment, which had had a detrimental impact on property values. This was adjusted by the Council and an impairment totalling £38,708k was recorded in the I&E, with the remainder of the adjustment, £18,001k, being accounted for as a downward revaluation which reduced the fixed asset balance and the revaluation reserve having no I&E impact. In 2009/10 we will evaluate the Council's arrangements for updating market values, including the operation of its rolling programme of reviews and the qualifications, relevant experience and independence of specialists utilised to carry out valuations and review the reasonableness of key assumptions, including the effect on asset valuations from the recent economic and financial market events.

Bad debt provisions	
Risk & Response	In our report to you on the findings from our 2008/9 audit we commented that evidence was limited to support provisions made against certain categories of debt and that available evidence suggested that individual provisions may be either under or over stated. We also discussed how in calculating certain bad debt provisions, adjustments had been made to historical collection experience to reflect the anticipated impact of current economic conditions on future collection rates. We will review the Council's methodologies and assumptions used to calculate provisions and the evidence collected by officers to support its approach. Where appropriate, we will consider whether provisions appropriately reflect the impact of the current economic conditions by reference to recent collection performance and trends in performance.

2. Key audit risks (continued)

Public Finance Initiative (PFI) transactions	
Risk & Response	The 2009 SORP amends the previous accounting requirements for the Private Finance Initiative (PFI) and similar contracts to bring into line with International Financial Reporting Standards (IFRS). As well as contracts entered into from 1 April 2009, the requirements apply in respect of PFI and similar contracts existing at 31 March 2009 and prior period adjustments will be needed for these. It is expected that the PFI properties used to deliver the PFI services which are currently 'off Balance Sheet' will generally be required to be recognised on local authorities' Balance Sheets along with a liability for the financing provided by the PFI operator. Regulations or statutory guidance to mitigate any impacts on authorities' funding positions either have been, or are in the process of being, put in place. We understand the Council has located relevant documentation for its existing PFI schemes and engaged advisers to assist officers in evaluating the accounting treatment, restating opening balances and preparing the necessary journals for the current year. We will utilise our specialists in this area as part of our team to assist in the more complex aspects of this work.

Accounting for local taxes	
Risk & Response	The 2009 SORP provides detailed guidance for the first time on the accounting for local taxes. Whilst the Council's past accounting practice is consistent with industry practice, it differs to the requirements of the new SORP and we therefore anticipate that changes will be needed both to current year and prior year information. The 2009 SORP recognises that the billing authority (i.e. Harrow Council) in the case of Council Tax acts as agent for the major precepting bodies (here, the Greater London Authority) and in the case of NNDR, as agent for central government. Past practice has been for billing authorities to account for the full amount of Council Tax and NNDR debtors on their balance sheet. However, given the billing authorities role as agent in collection, the 2009 SORP now requires that only the Council's share for which it acts as principal is shown on its balance sheet. In practice, this means for the Council that only its share of Council Tax arrears will be shown on the balance sheet. We will test to check that changes have been made in line with the requirements of the 2009 SORP.

Revenue recognition	
Risk & Response	International Standards on Auditing establish a presumption of a risk of fraud in revenue recognition. Historically the most significant area of detected fraud at the Council has been in the area of benefit administration. Over-claim of benefit subsidy on the basis of fraudulent benefit claims has been identified as being a key audit risk. We will test the design and implementation of controls in place at the Council for detection of benefit fraud and will perform additional detailed substantive testing of benefit claims.

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 responsibility to consider 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 Harrow 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 Council. In addition we are required to discuss the following with the GARM Committee:

1. Whether the GARM Committee has knowledge of any fraud, alleged or suspected fraud?
2. The role that the audit committee exercises in oversight of:
    a. Harrow Council's assessment of the risks of fraud; and
    b. the design and implementation of internal control to prevent and detect fraud?
3. The GARM 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 Director of Finance in due course.

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;
- 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; and
- understanding the business rationale for 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). (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 for your meeting in April 2009, 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 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 Council'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;
- specific reliance is placed in certain areas (as we expect our approach to be largely or fully substantive (see above), we expect this aspect of reliance to be limited);
- 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; and
- review of any fraud investigations to determine their potential effect on our work.

5. Timetable

Set out below is the approximate expected timing of our audit work, reporting and communication with management and the GARM committee:

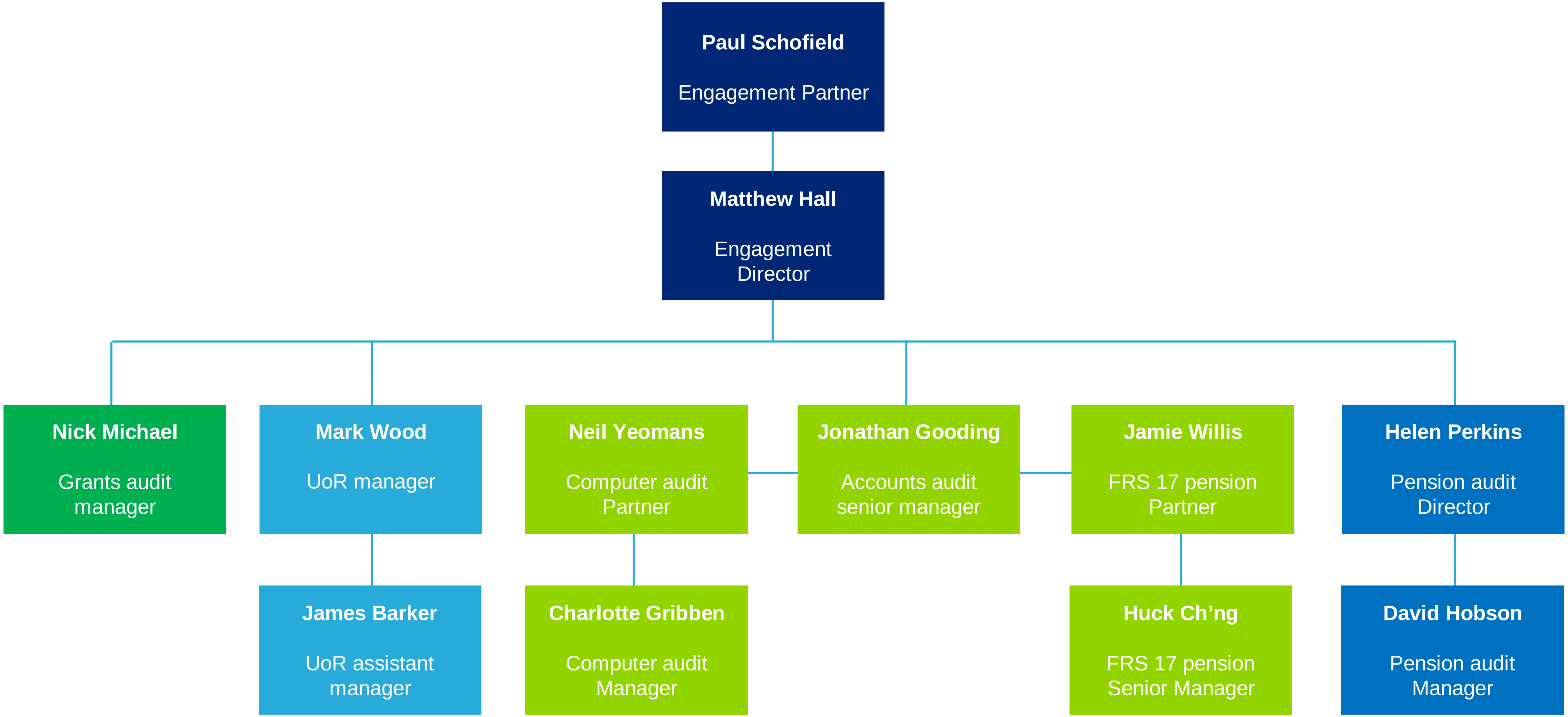
		2010										
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Management	Prepare plan based on discussions with management		■	■								
	Early discussion of Council's approach to risks areas		■	■								
	Performance of detailed planning and controls work*			■								
	Feedback on outcome of interim procedures					■						
	Audit fieldwork/audit issues meetings**							■	■	■		
	Preparation of our report on the 2009/10 audit									■		
	Whole of Government Accounts work									■		
GARM committee	Audit plan				■							
	Report to the GARM committee on the 2009/10 accounts									■		

* We will carry out tests of general computer controls in a separate interim visit which has still to be scheduled, but expect this to be in March 2010. In addition we carried out a planning and interim audit visit in the two weeks from 22 February 2010. During this time we looked at aspects of our planning including documentation of our understanding of any changes in accounting systems; tests of capital expenditure using information at an interim date; and performance of work on risk areas where indicated in Section 2.

** Our final audit visit is scheduled from 5 July 2010, but we have a limited presence during the week commencing 28 June 2010 to inspect the Council's working paper files and to raise initial queries or requests for additional information. We will issue our formal report to the GARM Committee on the audit at their meeting in September 2010. We will issue our audit report as soon as practicable following that meeting.

6. Client service team

Paul Schofield will continue to lead the audit. He and the other key members of the team are shown below.



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 April 2009 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 members and this report is not necessarily a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Members of Harrow 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
12 March 2010

Appendix 1: Analysis of professional fees

We summarise below our proposed audit fees as discussed with management:

	Accounts £	Whole of government accounts £	Total £
2008/9 audit fee	281,585	4,500	286,085
Inflation (1.25%)	3,520	50	3,570
Reassessment of level of audit risk	(26,105)	-	(26,105)
2009/10 audit fee	**259,000**	**4,550**	**263,550**

In addition to the fees set out above, due to changes in the SORP which will impact on the 2009/10 financial statements, we are required to perform additional procedures in respect of the Council's accounting for PFI schemes and similar contracts. We are currently assessing the scope of this requirement and are in discussions with the Audit Commission. Our current estimate of the fee for these procedures in 2009/10 is £30,000.

In addition to the fees for the audit of Harrow Council under the Code of Audit Practice, we also carry out work in relation to the certification of grant claims on behalf of the Audit Commission. Our fees are billed on the basis of time spent by different grades of staff using scale fees advised by the Audit Commission. The level of fees charged in a given year is dependent on the grant schemes falling within the audit requirement, the scope of procedures agreed between the Audit Commission and the grant paying body and the quality of working papers provided to us and timeliness with which audit queries are resolved. Our current estimate of fees for 2009/10 is £85,000 (£100,000 for 2008/9).

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;
- 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 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.

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