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Appendix 2

Harrow Council

Report to the Governance, Audit and Risk Management Committee on the 2010 Audit

Issued on 17 September 2010 for the meeting to be held on 28 September 2010

Contents

Executive summary

Appendix 2

We have pleasure in setting out in this document our report to the Governance, Audit and Risk Management Committee of Harrow Council ("the Council") for the year ended 31 March 2010 for discussion at the meeting scheduled for 28 Sept 2010. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2010.

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

	Description
Key findings on audit risks and other matters	We issued our audit plan for the year ended 31 March 2010 on the 12 March 2010. This plan identified the following key audit risk areas and documented our approach to testing these areas, as well as any other matters that has arisen during the audit: • insurance provision; • purchase order accruals; • pension liability; • property valuations; • bad debt provisions; • public finance initiative finance transactions; • accounting for local taxes; • revenue recognition; • prior year grant claim qualification. A detailed description of each of these audit risks and a summary of the results of our procedures in respect of these risks are documented in Section 2.
Audit status	We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan. The matters outstanding at the date of this report include: • completion of minor audit points; • completion of the BEN01 grant claim; • post balance sheet events review; and • our initial going concern review has not highlighted any significant uncertainty with regards to concern, in the absence of government announcement of policy changes to the contrary. However, we are required to update our review of the going concern assumption to the point of signing the audit opinion. 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.
Identified misstatements	Audit materiality was £5,545k (2009 £4,347k) as set out in our Audit Plan. Identified uncorrected misstatements increase surplus by £929k and net assets by £929k. Management has concluded that the total impact of the uncorrected misstatements, both individually and in aggregate, is not material in the context of the financial statements taken as a whole. Details of the audit adjustments are included in Appendix 1.

Executive summary (continued)

Appendix 2

Accounting and internal control systems	We have set out in Section 2 our internal control recommendations. Our significant control recommendations relate to the following: • Fixed asset additions. • Valuations of fixed assets methodology. • Removal of double counted income and expenditure. • Review of bad debt provision policy. • Journal entries. • Information technology access control points. Together with management, we have noted that in some cases, capitalised costs have been coded to the wrong projects. Whether this is simply a clerical error is not clear at this stage and management are investigating the matter internally. At the time of issuing this document the investigations have not yet been completed, however we do not expect any adjustments to arise from this open item. We have included in section 3 a control recommendation. We will continue to liaise with management up until the meeting on 28 September 2010, where we will report to you our findings and conclusions and any affect on the disclosures made in the financial statements. We are aware that the Health and Safety Executive have served a number of improvement notices in relation to asbestos management. Management are currently performing an inspection and a review of policies and procedure and intend to formalise an action plan to implement any improved policies and procedures. The HSE notices were issued since the mini-actuarial valuation of the insurance provision, however management have confirmed to us that any potential claims would either be successfully defended or be covered by the current insurance policy.

Value for money conclusion	Under the Code of Audit Practice, auditors are required to give a ‘yes/no’ opinion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in their use of resources. This conclusion is given within our audit report on the Council’s Statement of Accounts. Given the scale of the pressures facing public bodies in the current economic climate, the Audit Commission reviewed its work programme for 2010/11 onwards and announced that the CAA was to be abolished. The Audit Commission has been discussing possible options for a new approach to local value for money (VFM) audit work with key national stakeholders. We have been informed that from 2010/11 there will be a new, more targeted and better value approach to the local VFM audit work. We understand that this will be based on a reduced number of reporting criteria specified by the Commission, concentrating on: • securing financial resilience; and • prioritising resources within tighter budgets.

Executive summary (continued)

Appendix 2

Value for money conclusion (continued)	We completed the majority of our Use of Resources (UoR) work this year and we will rely on this work for our VFM conclusion. There will be no published scores this year but we will keep you informed of any future developments as they happen. We will determine a local programme of VFM audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities. We understand that we will no longer be required to make annual scored judgements relating to our local VFM audit work. Instead we will report the results of all the local VFM audit work and the key messages for the audited body in our annual report to those charged with governance and in the annual audit letter. We expect to issue an unqualified VFM opinion in the 31 March 2010 Statement of Accounts. However, as noted on the previous page, management are investigating the coding of capitalised costs to the wrong projects and depending on the conclusion to this work, there may be a bearing on our conclusion.

Accounting policies and financial reporting	As part of our audit, we consider the quality and acceptability of the Council's accounting policies and financial reporting. We have nothing to report in these areas.

Audit Commission announcement	On 13 August 2010, the Secretary of State for Communities and Local Government announced the proposed abolition of the Audit Commission. The proposed abolition will be from March 2012 and the Audit Commission has confirmed that there is no immediate change to your audit arrangements. New audit arrangements are likely to apply from the start of the 2012/13 financial year. Both we and the Audit Commission will keep you informed of further developments.

1. Key audit risks and other matters

Appendix 2

The results of our audit work on key audit risks and other matters identified during the audit are set out below:

Insurance provision	
Background	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 identified this as a risk for the 2009/10 audit. In 2010 the Council commissioned an external 'mini' actuarial valuation of its insurance fund, which rolled-forward the results of the previous full valuation at 31 March 2008 with more recently available data. The insurance provision included in the 31 March 2010 Statement of Accounts was £5,161k.
Deloitte response	We have reviewed the Council's actuarial report on the insurance provision and we have tested the assumptions used by the actuary in the calculation of the fund liability. The actuary performed their work as at September 2009 however their conclusion of the level of fund liability required took account of expected claims between September and the year end, providing £700k, using historical claim rates as the basis. We note that the actuary recommended a reserve is held totalling £5.1m including a surplus of £400k being retained by the Council despite the future claims payments for 31 March 2010 being estimated to be £4,700k. Taking account of the volume of judgement and estimation around this balance we have raised this surplus amount as a likely misstatement. All other testing results were satisfactory and we do not consider the insurance provision to be materially misstated.

1. Key audit risks and other matters (continued)

Appendix 2

Purchase order accrual	
Background	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 (£14,321k in 2010). 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 was identified as a risk for the 2009/10 audit.
Deloitte response	We have reviewed the design and implementation of management controls to mitigate this risk and have performed additional substantive audit procedures in respect of this balance. The results of our design and implementation review and our audit procedures were satisfactory and we do not consider the purchase order accrual to be materiality misstated in 2009/10. We are satisfied that management have satisfactorily addressed the issues arising in the previous year.

1. Key audit risks and other matters (continued)

Pension liability	
Background	The liability relating to the pension scheme is substantial and its calculation is sensitive to comparatively small changes in assumptions made about future changes in salaries, price and pensions, mortality and other key variables. Some of these assumptions draw on market prices and other economic indices and these have become more volatile during the current economic environment.
Deloitte response	We include our specialist pensions group within our engagement team to assist in the review of assumptions used to calculate the pension liability and related in-year transactions. Our review has revealed that the assumptions used by the Council in the calculation of the pension liability are within an acceptable range and therefore we do not consider the liability to be materially misstated. If all of the assumptions were set equal to the Deloitte Illustrative Benchmark assumptions – and after taking account of the re-stated lower asset value, the reported deficit of approx £346m would decrease to become a deficit of c. £288m. However, this is not intended to imply that the deficit calculated by the actuary is inappropriate. The key assumptions are all within the range we have seen adopted by other employers for accounting purposes as at 31 March 2010. We did however identify the following issues: • Within the FRS17 disclosure in the statement of accounts, salary increases are noted as 1.5% above inflation. We have asked management to consider if this is an appropriate disclosure to make in the statement of accounts given the current public spending pressures. • The assets of the fund were overstated in the actuary's calculations by £6,158k and this amount has been adjusted in the Statement of Accounts by management. This impacts the balance sheet and the statement of recognised gains and losses, as well as the asset split disclosed in the notes of the statement of accounts. This arose as a result of the actuaries methodology (that was consistent with previous years) being affected by the volatile markets – the expected return for the final quarter of the year to 31 March 2010 was assumed to be 7.7% by the actuary, however the actual return (determined post year-end) was 6.2%, hence the overstatement. • Consistent with the previous year when the item was raised by us but not adjusted, we note that there was a double counting of the teachers added years (CAYS) provision which is within employee provisions as well as being within the FRS17 liability in the Statement of Accounts. The value of this provision is £1,069k, a reduction of £9k from the prior year. We recommended that the CAYS provision was released to the General Fund. Management has posted this adjustment to the Statement of Accounts and created an ear-marked reserve to reflect the cash commitment that the council has to pay the contributions, but to ensure no balance sheet double counting of the provision.

1. Key audit risks and other matters (continued)

Appendix 2

Property valuation	
Background	The Council has a substantial portfolio of properties which are subject to a rolling revaluation programme. Some of the properties require the application of specialist valuation assumptions. The ‘credit crunch’ has affected property values and the Council is not immune to these effects. In the first draft of the 2008/9 Statement of Accounts, the HRA Council Dwellings 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 the Statement of Accounts presented for audit showed the following movements: For the General Fund, 20% of the portfolio was revalued as at 1 April 2009 in line with the 5 year rolling programme and and a desk top review taken of the remaining 80%. The HRA portfolio was valued in line with the 5 year rolling programme. The full council dwellings portfolio was uplifted by 8.67% to follow the improvement in Harrow property prices using the Land Registry house price index. At 1 April 2009 the certified valuation has been reduced from that in place at 31 March 2009 by 15% as a result of 2009 year to date movements in the index. Operational land and buildings show a net reduction in value of £178m. The key source of reduction is a lowering of the land value, with the land that schools are on reducing to £900,000 per acre in this valuation. Upward revaluations totalling c£8.8m arose - typically as a result of extensions, rent reviews and changed income streams rather than indicative of market uplift. The majority of the value of non-operational property is Assets Under Construction (£59m) and does not require revaluation. The net decrease of £8.4m arose mainly from a few properties, as a result of the deterioration in land values in the period.
Deloitte response	We have evaluated the Council’s arrangements for updating market values, including the operation of its rolling programme of reviews and the qualifications, relevant experience and independence of specialists utilised to carry out valuations. We have reviewed the reasonableness of key assumptions, including the effect on asset valuations from the recent economic and financial market events and we have discussed the assumptions used with our internal valuation specialists from Drivers Jonas Deloitte. Management noted an error in the HRA valuation, which resulted from the desktop exercise carried out by the Harrow Finance team in respect of market movements between the valuation at 1 April 2009 and the market value as at 31 March 2010 – the upward revaluation was overstated by £49m and the adjustment was posted. No further issues arose from our consideration of the assumptions driving these valuations. The results of our testing were satisfactory and we do not consider the property valuations to be materially misstated. A number of control recommendations have been made and are set out in Section 2.

1. Key audit risks and other matters (continued)

Appendix 2

Bad debt provisions	
Background	In our report to you on the findings from our 2008/9 audit we commented that evidence was limited to support provisions made against certain categories of debt and that available evidence suggested that individual provisions may be either under or over stated. We also discussed how in calculating certain bad debt provisions, adjustments had been made to historical collection experience to reflect the anticipated impact of current economic conditions on future collection rates.
Deloitte response	We have reviewed the Council's methodologies and assumptions used to calculate provisions and the evidence collected by officers to support its approach. Where applicable we have assessed management's consideration of whether provisions appropriately reflect the impact of the current economic conditions by reference to recent collection performance and trends in performance. Bad debt provisions are based on estimates and management judgement in the assessment of the recoverability of those debts. We understand that management considers the bad debt provisions to be appropriate with consideration of the current economic environment. We have performed a review of the recoverability of the prior year debt balance during 2009/10. Based on the percentage of debt held at 31 March 2009 that has been recovered during 2009/10 we have projected an estimate of the amount of debt held at 31 March 2010 that could be expected to be recovered in the future. The results of our review suggest that the bad debt provisions for council tax arrears and housing benefits may be overstated by £1,291k and £748k respectively. These amounts are shown on our summary of misstatements table in Appendix 1. These amounts are below our calculated materiality level and are differences in estimate rather than known factual misstatements.

1. Key audit risks and other matters (continued)

Public finance initiative finance transactions	
Background	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. 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. The Council has three PFI schemes: • Special schools: 2 new schools for pupils with learning difficulties and the refurbishment of a third school. All schools were fully operational since February 2006. • Neighbourhood Resource Centres: 3 such centres are provided under a Local Improvement Finance Trust (LIFT) initiative, they become operational in June 2009 for a contract of 25 years. • Sancroft Hall: a residential and day care facility. The contract ends in 2024 and at the end of the contract the provider retains the assets. The contract is therefore not treated as a Service Concession Arrangement under IFRIC 12 and is treated as an operating lease, having also not met the requirements of an operating lease under SSAP 21. As a result of applying IFRIC 12 in the current year, schools and NRC have been accounted for on balance sheet, including a prior year adjustment in relation to schools due to them being operational in the previous year.
Deloitte response	We have reviewed the report completed by the Council's external advisor and have engaged with our internal PFI specialists to assess the more complex aspects of these transactions. Based on our procedures we have concluded that the Council's accounting treatment is appropriate and in line with SORP 2009. We have noted that the total value at 31 March 2010 of assets in relation to NRC and schools that management have capitalised is £3.1m lower than the asset value suggested in the 'operator' model that was used to agree the terms of the PFI arrangement with the third party providers. We have raised a control recommendation in relation to this as well as a proposed adjustment as a number of the costs that have not been capitalised do meet the FRS15 asset recognition criteria. We have also considered Sancroft Hall in respect of IAS 17 which will apply for financial year to 31 March 2011 and consider it will remain an operating lease under the IFRS. We note that the contractual arrangements make no comments around the final ownership of the asset. Whilst it is unusual for a service concession not to set this out, typically in these cases, the asset will rest with who currently owns it (i.e. the operator), at the end of the contract.

1. Key audit risks and other matters (continued)

Appendix 2

Accounting for local taxes	
Background	The 2009 SORP provides detailed guidance for the first time on the accounting for local taxes. Whilst the Council's past accounting practice is consistent with industry practice, it differs to the requirements of the new SORP and therefore changes were needed both to current year and prior year information. The 2009 SORP recognises that the billing authority (i.e. 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.
Deloitte response	We have obtained and reviewed the Council's work papers used to assess the impact of this change and the associated accounting entries. We have performed detailed sample testing of the balances included in the accounts to supporting documentary evidence. The results of our testing were satisfactory and we have concluded that the accounting entries in the 31 March 2010 Statement of Accounts, in respect of accounting for local taxes, are in accordance with the requirements of SORP 2009.

Revenue recognition	
Background	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. Therefore over-claiming of benefit subsidy on the basis of fraudulent benefit claims has been identified as being a key audit risk.
Deloitte response	We tested the operating effectiveness of controls in place at the Council for detection of benefit fraud and performed additional detailed substantive testing of benefit claims. No issues were identified.

Prior year grant claims qualification	
Background	In the prior year we issued a qualified opinion with regards to the audit of the BEN01 grant claim. This was issued after the GARM meeting in the prior year. We identified that the housing benefit grant income claim for 2008/9 was overstated by £6.5m, due to expenditure paid in 2009/10 being included in the 2008/9 claim. There was a nil impact of on the general fund as both income and expenditure is overstated, thus no adjustment was proposed. The 2009/10 grant income and expenditure is then understated by the same amount, but there is a nil impact on the general fund thus no adjustment has been proposed. Following the qualification, additional testing was performed by the council, as requested by the Department of Work & Pensions (DWP). As a result of the qualification, the council is required to do additional testing in the current year on the qualified areas identified in the prior year.
Deloitte response	The testing of the BEN01 grant claim is currently in progress, thus no final opinion has been issued. However, the testing is materially complete, and we have assurance that the statement of accounts is not materially misstated.

2. Accounting and internal control systems

Appendix 2

Control observations

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

We have adopted a grading system for the management recommendations:

- Grade 1 High level of importance: recommendations that are of such significance that they require attention at a senior level within the Council.
- Grade 2 Medium level of importance: Recommendations which we consider are important and should be reviewed over the next three months; and
- Grade 3 recommendations are those of lesser importance which can be looked at over the course of the 2010/11 financial year.

Miscoding of capital expenditure	
Observation	It was noted from our testing of assets under construction that expenditure had been incorrectly coded to the wrong project. The costs are valid capital expenditure thus additions are not materially misstated. Miscoding of expenditure will have an impact on the percentage completion of the asset under construction and will distort any reviews of actual costs against budgets. There is a risk that assets which have gone over budget will not be identified due to the costs being posted to another project. This can cause funding issues when any additional orders incurred to complete such projects are subsequently raised. Should there be any special conditions or ring fencing in relation to the funding of any of these projects, repayment and similar risks would need to be considered.
Recommendation	All journals should contain supporting evidence allowing the reviewer to quickly identify which project the costs should be coded to. Any additional expenditure outside of what has been budgeted or specification should be appropriately reviewed and authorised. Staff should be regularly reminded of the importance of coding costs correctly and the implications that miscoding can have. Budget holders should review in detail the costs which have been allocated to projects.
Management response	Agreed
Timeframe:	Immediate
Grade:	1
Owner:	Divisional Director of Finance and Procurement

2. Accounting and internal control systems (continued)

Appendix 2

Journal entries	
Observation	Through our testing we identified that some journals were not supported by sufficient documentary evidence, as only SAP breakdowns were attached. This can make it harder to check validity of journals and hence a manager review before posting may not be meaningful.
Recommendation	Ensure sufficient supporting documentation is attached to the journals, such as invoices, and supporting calculations. If not attached manually, a link to the shared drive should be provided on the journal to aid review.
Management response	Agreed
Timeframe:	Ongoing
Grade:	2
Owner:	Finance Business Partner – Financial Accounting, Treasury and Pension Fund.

Capitalisation of proposal costs	
Observation	When performing testing on additions, we identified that proposal costs of £47k had been capitalised during the year, relating to a development of a cost model to be used in the proposal request. This is not in line with the SORP which requires all costs of option appraisal to be expensed. We requested management to review additions during the year and quantify any similar costs that has been capitalised. Management has identified £219k of set up costs that were capitalised during the year. We have proposed an adjustment for this amount.
Recommendation	It is recommended that proposal costs incurred should not be capitalised as outlined in the SORP. Budget holders should be informed of the type of costs that can be capitalised and an appropriate review should be done by Finance to ensure appropriate capitalisation of costs.
Management response	Agreed
Timeframe:	Ongoing
Grade:	2
Owner:	Divisional Director of Finance and Procurement

2. Accounting and internal control systems (continued)

Appendix 2

Fixed asset additions	
Observation	It was noted by the Harrow finance team during reconciliation of fixed asset additions that £4.9m of assets were previously created or identified on the fixed asset listing held by the valuations team but were not included on the fixed asset register held by the finance department. Through subsequent investigations it was noted that a number of the assets were previously included within the value of other assets recognised in the accounts and the valuations team had subsequently separated these assets out and had given them individual values. Examples include pavilions located on Harrow parks, previously included within the park, which had been individually valued in 09/10 and shown as separate assets. We note that it is the current policy to bring additions and assets under construction into use at the cost incurred in acquiring the asset, only revaluing the asset in the following year. Where bringing an asset into use increases its market value – i.e. on a modern equivalent asset valuation basis – the asset value at cost may be misstated. Current year additions testing identified other land and buildings worth £53,000 acquired but not accrued in the prior year. This is not a reportable balance and no further errors of this nature were noted from further work in this area. Our unrecorded liability testing in the current year did not highlight a similar error at the 2010 year end
Recommendation	Reconcile the two separate asset registers, each year to ensure completeness, this should be performed by one individual and reviewed by another. The finance team should also be informed of all assets “created” by valuations team e.g. where previously there was one asset which was then split into several assets. This should then be reviewed by the finance team and included on the finance fixed asset register. In the course of preparing the year end results, consider on a line by line basis all assets not already re-valued to consider whether their cost is materially different to their market value following the SORP guidelines, either individually or in aggregate. Put in place a formal process to identify accrued additions to fixed assets to ensure these are accounted for in fixed assets, despite invoices not being received by corporate finance.
Management response	Agreed
Timeframe:	12 months
Grade:	3
Owner:	Finance Business Partner – Financial Accounting, Treasury and Pension Fund.

2. Accounting and internal control systems (continued)

Appendix 2

Assets under construction	
Observation	It was identified that £22.4m of cost included in assets under construction at year end (relating to sixth form blocks in schools) were operational at year end. These have been reclassified in the accounts (the estimated depreciation on these assets is immaterial).
Recommendation	Review assets under construction on a regular basis to ensure appropriate classification and to ensure depreciation is charged from the point the assets become operational. Regular meetings with project managers will assist in identifying completed projects.
Management response	Agreed
Timeframe:	31 March 2011
Grade:	3
Owner:	Finance Business Partner – Financial Accounting, Treasury and Pension Fund.

Property valuations	
Observation	Whilst there is good evidence that the valuations have been carried out in line with RICS guidance, there is scope for closer adherence to the VIP 10 guidance – for example a modern equivalent asset approach to depreciated replacement cost valuations. As a case-study for specialised property such as a school the valuation would involve dialogue between the valuers and the education department around capacity.
Recommendation	We intend to involve our specialist in our audit planning for the 2011 financial year and discussions around process and detail included with assumptions reached will be discussed at this point. In our work we have looked ahead to the 2010/11 Statement of Accounts. Two points arise that may be of interest, initially in the 1 April 2010 certified valuation and then for the financial statements: • The CIPFA IFRS Code of Practice will apply. This includes some changes to the required terminology around valuations which will need to be incorporated into the March 2011 statement of accounts and any valuation team working papers that discuss/summarise the approach. • Under the new code, it is expected that operational assets will be valued on an 'instant build' basis that does not include finance costs. Under the current guidance, such costs are included within the valuations.
Management response	Agreed
Timeframe:	Already actioned for 2010/11 accounts
Grade:	3
Owner:	Head of Corporate Estate

2. Accounting and internal control systems (continued)

Appendix 2

Private Finance Initiative (PFI) accounting under IFRIC 12	
Observation	As a result of a change in accounting policy and the requirement to reflect IFRIC 12 in the financial statements, contracts in place with third parties to provide facilities have been reviewed to consider if they should be accounted for as on balance sheet assets. The council has engaged the services of Grant Thornton to assist in these considerations. The third party finance provider (the 'operator') prepared a model for the length of the construction period, Grant Thornton have then prepared a model to be incorporated into the financial statements. In the course of our work, undertaken by our PFI Consulting team, it was noted that the value of the assets capitalised in relation to these PFI projects for Neighbourhood Resource Centres and Schools was £19.9m, which was £3.1m below the forecast asset values that are found in the operator models. Management have assisted us in obtaining from Grant Thornton the breakdown of costs that have not been capitalised in the model that has been used to drive the journals posted in the accounts. We note that costs such as insurance, site supervision and inspections, due diligence and legal fees have not been capitalised, whilst they do meet the asset recognition criteria under both FRS15 and the SORP. A cumulative adjustment has been proposed accordingly to increase fixed assets by this amount and credit the income and expenditure account that has been over-charged since the start of the contracts.
Recommendation	Management should review in detail any assumptions made by third parties and ensure they concur. Management should ensure that, whilst the complexity of these PFI projects requires a detailed model, they review the recognition criteria to ensure that it is in line with the council's accounting policies. The nature of this error is such that the forecast asset is of a lower value to the asset that has been capitalised and as such it is likely that the council is reporting paying a larger finance or service cost than is truly being paid.
Management response	Agreed
Timeframe:	12 months
Grade:	3
Owner:	Finance Business Partner – Financial Accounting, Treasury and Pension Fund.

2. Accounting and internal control systems (continued)

Appendix 2

Removal of double counted income and expenditure	
Observation	It was noted from our income testing that the gross income and expenditure for Housing Services had been overstated by £1.8m. This was due to the double counting of recharges which had not been removed.
Recommendation	The procedure for identifying and removing all double counted entries from the ledger as part of the year-end closedown should be circulated to all finance teams. The adjustments to remove the double counting should be prepared by one individual and reviewed by their manager. Once collated these should then be reviewed by corporate finance before preparing the draft statement of accounts.
Management response	Agreed.
Timeframe:	12 months.
Grade:	3
Owner:	Finance Business Partner – Financial Accounting, Treasury and Pension Fund.

Review of bad debt provision policy	
Observation	Our audit testing of bad debt provisions in respect of housing benefit overpayments and council tax debtors highlighted that the current bad debt provision policy is extremely prudent. Our projections of future cash receipts based on previous rates of cash recovery suggested that the provisions are overly prudent, and the policy should be revised so that a lower proportion of debt is provided for. We have proposed an adjustment for the overstatement of the provision for council tax arrears of £1,290k, and provision for housing benefits of £748k.
Recommendation	Review the bad debt provision policy in respect of both council tax and housing benefit overpayment debtors to reduce the level of the provision in order to ensure that the provision is not materially overstated in future years.
Management response	The council is in the process of writing off some Housing Benefit Overpayment debts, this will be reviewed again at March 2011. It is anticipated that the effect of the current economic climate on irrecoverable debts may have an impact on the Council Tax bad debt provision once all the collection processes are exhausted.
Timeframe:	March 2011
Grade:	3
Owner:	Divisional Director – Collections and Housing Benefit

2. Accounting and internal control systems (continued)

Appendix 2

The following 3 recommendations arose from the work performed by our IT colleagues in Spring 2010:

SAP User Access Levels	
Observation	Whilst conducting testing over SAP BASIS user access levels at Harrow we were unable to identify whether users access levels were appropriate for users job roles. This is due to the fact that there is seemingly a gap between the technical knowledge provided by the SAP BASIS support supplied by Capita and the business knowledge contained within the shared services team at Harrow in relation to BASIS access levels required for certain job roles. This means that there is currently no one group who can identify whether users current level of access for the Basis team is appropriate given their job roles. The business and IT should have an understanding between them as to what system access is appropriate for the Basis support team. Not having this understanding can lead to users being set up on the system with access levels which are not in line with their job roles, potentially leading to segregation of duties issues where users have inappropriate system access.
Recommendation	Carry out a full user access review – refer to point 5 above. This will be beneficial in determining if user's access level is in line with their job roles. In addition going forward a matrix could be developed listing the various job roles within Harrow and the access level in SAP associated with these job roles. This could then be used in the future when new joiners are set up on SAP to ensure that users are set up with system access levels appropriate for their given job roles.
Management response	The operation of the SAP user access functionality for Harrow staff is operated by the SAP support team. They do understand how the system works and operate it in accordance with the scheme of delegation. The SAP role catalogue defines the breakdown of roles against types of users. Variations to the standard scheme for employees require authorisation by directors. In the case of the Capita support staff using BASIS, the Council will seek to agree a user access agreement for 3rd party access and review this quarterly.
Timeframe:	4 months
Grade:	2
Owner:	Corporate finance

2. Accounting and internal control systems (continued)

Appendix 2

User Access Administration – Starters and Leavers Process	
Observation	For the user access administration process we noted that there were a number of areas for improvement: **Starters** • There are a number of different processes/forms in place to approve and assign the access of new joiners to key financial applications. • Not all starters were found to go through the starters' process, therefore no supporting documentation and approval could be located. **Leavers** • Of the sample of leavers we tested, a number of users were not removed from SAP or IWorld. • There is a pervasive weakness with the leavers process as not all leavers are communicated to HR or IS for leavers for certain agencies. **Transfers** • Not all additional access requests are documented. Where there is no end-to-end process in place to cover the user access administration approval and assigning of action over all systems there is a pervasive risk that users may not have the correct access for their job role. If the access is inappropriately high this could lead to segregation of duties conflicts and the ability to bypass automated and manual controls. Where access is too low or incorrect, this may lead to inefficiencies in the user to be able to perform their job function.
Recommendation	Management should review the access management process to include: • A single access request form for all new/additional/removal access requests covering all users on systems. • Centralised review of approval given. A process to ensure all leavers are recorded and action taken to remove their access in a timely manner.
Management response	**Revenues and Benefits** Starters - In Revenues and Benefits there is a process in place for new users. Work has been started to enable a single form to be used by Harrow IT Services and Revenues and Benefits admin support staff. The process has been updated in the mean time and spreadsheets and documentation have always been available. Leavers – Management teams should notify the admin support staff when a user leaves and the user list is reviewed on a quarterly basis to capture any gaps, or failure of notification, in the process. Admin support staff will notify Harrow IT services of leavers, so the account can be disabled/deleted. Transfers – Changes to access rights generally come by email from managers in the Revenues and Benefits areas. A change will be made to the procedure, so that these requests are saved in the appropriate place, giving a documentary audit trail. Staff have regular performance reviews and any issues with access rights would be identified and addressed through this process. **SAP: t**here are weaknesses in the current process, primarily in relation to agency staff. A review will be undertaken following the ITO.
Timeframe:	12 Months
Grade:	2
Owner:	Corporate finance

2. Accounting and internal control systems (continued)

Appendix 2

Audit logging	
Observation	Through review of the audit logging configurations on the financially relevant applications, databases and operating systems there were two varying levels of logging in place:- • No logging active (for example on SAP) • Logging was active but this was not reviewed (for example on IWorld) Where an appropriate level of auditing is not enabled or reviewed, changes to key data and key tables are not recorded and cannot be reviewed if required. There is also a risk that key security violations may go unnoticed.
Recommendation	Review the requirement to audit key actions and security violations within each system based on criticality. Where audit logging is enabled these logs should be reviewed by the appropriate level of management and any unusual activities should be recorded and investigated.
Management response	**SAP** The audit logging is switched on for all SAP systems (BW,ECC,SRM,CRM). There are however difficulties using the reports available due to the volume of data contained and a review will be undertaken.
Timeframe:	12 months
Grade:	2
Owner:	Corporate finance

3. Other matters for communication

Appendix 2

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

Independence	We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised. If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this. If the audit committee wishes to discuss matters relating to our independence, we would be happy to arrange this.
Non-audit services	We are not aware of any inconsistencies between APB Revised Ethical Standards for Auditors and the Council's policy for the supply of non audit services or of any apparent breach of that policy An analysis of professional fees earned by Deloitte in the period from 1 April 2009 to 31 March 2010 is included in Appendix 2.
International Standards on Auditing (UK and Ireland)	We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.
Liaison with internal audit	The audit team, following an assessment of the independence and competence of the internal audit department, reviewed the findings of internal audit and adjusted our assessment of risk as appropriate. No issues were noted from these procedures.
Written representations	A copy of the representation letter to be signed on behalf of the Council will be circulated separately.
Whole of government accounts return (WGA)	We have commenced our procedures in respect of the WGA and we expect to complete our review by 1 October 2010 to meet the national deadline.
Audit certificate	When our audit is complete we are required to certify the closure of the audit. As at the date of this report, we are unable to certify the 2009/10 accounts (or the 2008/09 accounts) due to ongoing correspondence with a local elector relating to an objection against credit card fees on parking and traffic penalty charges in relation to the 2008/09 accounts. We are yet to receive any objections to the 2009/10 accounts.

4. Responsibility statement

Appendix 2

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 at your meeting 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 the Audit Committee and this report is not necessarily a comprehensive statement of all weaknesses which may exist in internal control or of all improvements which may be made.

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

Deloitte LLP

Chartered Accountants

St. Albans

Appendix 1: Audit adjustments

Appendix 2

Uncorrected misstatements

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

		Credit/ (charge) to current year income statement £'000	Increase/ (decrease) in net assets £'000	Increase/ (decrease) in prior year retained earnings £'000	Increase/ (decrease) in turnover £'000
Factual misstatements					
Proposal costs	[1]	(219)	(219)	-	-
PFI capitalisation of costs	[2]	-	-	-	-
Judgemental misstatements					
Overstatement of insurance provision	[3]	400	400	-	-
Overstatement of council tax bad debt provision	[4]	-	-	-	-
Overstatement of housing benefit provision	[5]	748	748	-	-
Total		929	929	-	-

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

[1] Through our testing of fixed asset additions, we identified £47k of proposal costs that had been capitalised. This is not line with the SORP which requires proposal costs to be recognised in the I&E. A review of additions by management identified £219k of proposal costs had been capitalised during the year. We have proposed an adjustment for this to be expensed.

[2] £3.1m of capitalisable costs have not been treated as fixed assets. The effect is on a cumulative basis since the inception of the contracts and accordingly the I&E impact is the current year is immaterial and has not been calculated.

[3] The actuary who performed the valuation of the insurance provision has recommended a surplus provision of £400k to be prudent. The council has included this in the insurance provision, which is an overprovision, thus we have proposed for this to be reversed.

[4] Through our testing of council tax bad debt provision, we have estimated a likely overprovision of £1,291k based on projected cash recovery. This adjustment will be credited to the Collection Fund rather than the main I&E of the council. Thus, this will impact the carried forward surplus on the Collection Fund. This will then be credited to the main I&E as part of the Income from Council Tax movement. Under the new SORP accounting for local taxes guidelines, the Collection Fund surplus for the year that it recognised in the main I&E is then taken out in the Statement of Movement of the General Fund balance. Thus, there is a nil impact on the general fund balance for this adjustment.

[5] Through our testing of housing benefit debt provision, we have estimated a likely overprovision of £748k based on projected cash recovery.

Appendix 1: Audit adjustments (continued)

Appendix 2

Recorded audit adjustments

We report all individual identified recorded audit adjustments in excess of £222,000 and other identified misstatements in aggregate adjusted by management below:

[1] An adjustment has been posted to transfer the pension added years provision included within the Statement of Accounts of £1.1m to earmarked reserves. When FRS 17 was implemented the actuary's valuation of the deficit included the added years element of the liability. Therefore the separate provision included on the balance sheet should have been released.

[2] An understatement of the FRS 17 pension liability was identified, due to the actuary using known values at 31 December 2009 and estimating the returns on assets for Q4. The return was estimated at 7.7% but was actually since been confirmed as being 6.2%. Asset values were overstated by £6.2m, and pension liability was understated by the same amount.

[3] The upwards revaluation initially calculated by management was overstated by £49m due to an error in the revaluation calculation. An adjustment was posted to reduce the upwards revaluation by £49m.

[4] An adjustment was proposed to account for the depreciation on council dwellings, upon reversal of the prior year impairment, as required by the SORP. The impact of this adjustment was to decrease the current year charge to the HRA by £0.4m, and to decrease the Statement of movement on the HRA balance by the same amount.

[5] Through our testing of physical verification of assets under construction, we identified approximately £22.4m of assets under construction relating to sixth form blocks in schools, which were operational during the year. Thus, the assets need to be transferred to land and buildings at year end.

[6] Through our testing of the Statement of Recognised Gains and Losses (STRGL), we identified that contributions for unfunded benefits of £2.9m had not yet been debited to the Statement of Movement on the General Fund balance. The impact of this adjustment was to reduce the deficit for the year, and reduce the General Fund balance for the year.

[7] Through our testing of the STRGL, we identified that the gains on disposal of fixed assets has been overstated by £0.1m. This was due to an error in the calculation of gains. The gains on disposal should be the difference between receipts and net book value of disposals, which is £1.8m, but management had initially calculated it as £1.9m. The impact of this adjustment was to reduce the gains on disposal in the I&E and increase the debit to the Statement of Movement on the General Fund balance.

Appendix 1: Audit adjustments (continued)

Disclosure deficiencies

Auditing standards require us to highlight significant disclosure deficiencies to enable audit committees to evaluate the impact of those matters on the financial statements. The table below highlights those areas of disclosure that we consider require consideration by the committee.

Disclosure	Source of disclosure requirement	Quantitative or qualitative consideration
The foreword (3.2.2) to the accounts refers to £96m of capital spend compared to the fixed asset note (7.15) referring to £99m of additions. The difference arises from 'additions' of assets previously owned, but not held on the balance sheet. This has been discussed in the ISA260 report.	-	Quantitative
In the prior period, Coroners Court amounts were treated as levies, however in the current year, in line with BVACOP, the current and prior year amounts have been classified within net cost of services, as disclosed in appendix 10.2 rather than in note 7.2, levies.	-	Quantitative

Appendix 2: Analysis of professional fees

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

	2010 £'000	2009 £'000
Statement of Accounts	259	282
Use of resources and Data Quality	111	110
Whole of Government Accounts (WGA)	5	5
Fees payable in respect of the certification of grant claims and returns of the Council	90	110
Total fees for audit services provided to the Council	465	507

At the date of the Audit Committee meeting no future services have been contracted for or written proposals submitted.

In addition to the above audit fees, the Council has commissioned Deloitte to conduct the following:

	2010 £'000	2009 £'000
IFRS Transition Project	15	-
Total fees for non-audit services provided to the Council	15	-

Appendix 2

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