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Harrow Council

Annual Audit Letter to the Members of the Council on the 2010 Audit

22 November 2010

Contents

Executive summary

This letter reports our conclusions from our audit of the London Borough of Harrow ("the Council") for financial year 2009/10. The letter's main messages are:

Value for money conclusion	We issued a qualified conclusion on the Council's arrangements for securing value for money during 2009/10. This was issued on 28 October 2010. In undertaking our audit in accordance with the Code of Audit Practice we identified the following: • A weakness in relation to the management, control and monitoring of certain capital projects during the year which has led to a significant overspend which falls mainly after the year end. Our opinion reads as follows: *Having regard to the criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in October 2009, we are satisfied that, in all significant respects, London Borough of Harrow made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010 except for:* • *Managing its risks and maintaining a sound system of internal control.* More details on this issue are included in Section 3 of this report.
The Council's financial statements	We issued an unqualified opinion on the Council's 2009/10 accounts on 28 October, which was after the statutory deadline of 30 September and was deferred to allow management time to progress their investigation into the capital overspend issue outlined above.
The local government pension scheme annual report	We issued an unqualified opinion on information in the Council's 2009/10 pension scheme annual report on 30 September 2010, ahead of the statutory deadline of 1 December 2010 for the publication of this report.
Whole of Government Accounts consolidation return	We provided an unqualified statement of assurance to the National Audit Office on the Council's consolidation return for the purposes of their audit of the Whole of Government Accounts on 28 October 2010.
Previous years objection	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.
Grants certification	We undertake work on grant claims and other returns on behalf of the Audit Commission and provide certificates to grant funders on compliance with aspects of the terms on which funds have been claimed. We will provide a separate, management letter to the Council in the New Year on the outcome of this work, but at this point there are no matters which we consider need to be brought to your attention in respect of claims where our work is complete.
Looking forward	This is a challenging period for local government, the recent Comprehensive Spending Review adding to existing local pressures caused by reductions in income from other sources. We have provided an overview of the audit approach to examining Harrow's response to these challenges in 2011 based on revised guidance from the Audit Commission. We have highlighted two developments which are particularly pertinent to our audit responsibilities, being the abolition of the Audit Commission and the impact of this on future audit arrangements; and the transition to financial reporting under International Financial Reporting Standards from 2010/11.

1. Introduction

The purpose of this letter

The purpose of this Annual Audit Letter ("Letter") is to summarise the key issues arising from the work that we have carried out during the year.

We have addressed this Letter to the members of the Council as it is the responsibility of the members to ensure that proper arrangements are in place for the conduct of its business and that the Council has relevant safeguards and properly accounts for public money.

The Letter will be published on the Audit Commission website at www.audit-commission.gov.uk and should also be posted on the Council's website.

Responsibilities of the Appointed Auditor and the Council and scope of our work

This Letter has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. This is available from www.audit-commission.gov.uk.

We have been appointed as Harrow's independent external auditors by the Audit Commission, the body responsible for appointing auditors to local public bodies in England, including local authorities. As your appointed auditor, we are responsible for planning and carrying out an audit that meets the requirements of the Audit Commission's Code of Audit Practice (the Code). Under the Code, we review and report on:

- the Council's accounts;
- the Council's local government pension scheme annual report; and
- whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources (value for money conclusion) in respect of its local authority functions.

In earlier years we have also been required to assess how well the Council manages and uses its financial resources by providing scored judgements on the Council's arrangements in three specific areas. This was known as the Use of Resources Assessment and formed a component of the Comprehensive Area Assessment (CAA) a performance assessment framework devised and operated by the Audit Commission. In 2010, we commenced, but did not conclude and report on this work, as a result of the abolition of the Comprehensive Area Assessment before we could report on the Use of Resources Assessment work.

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

In addition to our responsibilities under the Code of Audit Practice we are also required to undertake grants certification work on behalf of the Audit Commission.

2. Financial reporting

Key issues arising from the audit of the Council's accounts

We reported separately to the Governance, Audit and Risk Management Committee ("GARMC") in September 2010 on the issues arising from our 2009/10 audit and issued an audit report providing an unqualified opinion on your accounts. We issued this opinion on 28 October 2010, which was after the statutory deadline of 30 September and was deferred to allow management time to progress their investigation into the capital overspend issue.

We raised a control recommendation in respect of the capital overspend issue (see below) and the impact on our VFM conclusion is set out in Section 3. We were able to conclude that the impact of this issue, on the 2009/10 accounts, was not material and issue a "true and fair" audit opinion on the accounts.

We have summarised below our audit areas of focus as identified at the planning stage and the outcomes from our testing in these areas.

Area of focus	Outcome of our work
Insurance provision	In prior years we identified misstatements in this area. In 2010 the Council commissioned an external "desktop review" 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. We identified a £0.4m overstatement which was not adjusted by management.
Purchase order accrual	Control weaknesses were identified in the prior year resulting in adjustments being processed. In 2009/10, the results of our procedures were satisfactory and we are satisfied that management have addressed the issues arising in the previous year.
Pension liability	The liability relating to the pension scheme is substantial and its calculation is sensitive to comparatively small changes in assumptions. The key assumptions are all within the range we have seen adopted by other employers for accounting purposes as at 31 March 2010. The assets of the fund were overstated in the actuary's calculations by £6.2m and this amount has been adjusted. In addition, we noted that there was a double counting of the teachers added years provision (£1.1m) which management has also adjusted.
Property valuation	In prior years we identified misstatements in this area. Management noted an error in the HRA valuation which was overstated by £49m and posted the adjustment. No further issues arose from our consideration of the assumptions driving these valuations. A number of control recommendations have been made around fixed assets.
Bad debt provisions	In prior years we identified misstatements in this area. We understand that management considers the bad debt provisions to be appropriate with consideration of the current economic environment. The results of our work around recoverability of debts suggest that the bad debt provisions for council tax arrears and housing benefits may be overstated by £1.3m and £0.8m respectively but are within a reasonable range.
Accounting for PFI and similar contracts	Changes in rules for the accounting for service concessions let under PFI contracts had the effect of bringing 2 special schools and 3 Neighbourhood Resource Centres on to the Council's balance sheet for the first time. Based on our procedures we have concluded that the Council's accounting treatment is appropriate and in line with the 2009 SORP. We proposed an adjustment of £3.1m in respect of costs since the inception of the contracts that have not been capitalised but do meet the FRS15 recognition criteria.
Accounting for local taxes	The 2009 SORP introduced changed accounting and presentational requirements for local taxes to better reflect the position which the billing authority has as agent for the collection of other preceptors' shares of Council Tax and for the collection of National Non Domestic Rates (NNDR). The results of our procedures were satisfactory and we have concluded that the accounting entries are in accordance with the 2009 SORP.
Revenue recognition	We identified over-claiming of benefit subsidy on the basis of fraudulent benefit claims as a key audit risk. No issues were identified.
Prior year grant claims qualification	In the prior year we issued a qualified opinion on the benefit subsidy grant claim. Although no opinion on this claim has yet been issued, we have obtained assurance that the statement of accounts is not materially misstated.

2. Financial reporting (continued)

Control observations

Our report to GARMC included twelve recommendations for improvements in controls identified in the course of our audit of the statement of accounts. One item was classified as high priority, five as medium priority and six as lower priority.

The observation classified as high priority is in relation to the miscoding of capital expenditure and has in part led to the qualified value for money conclusion. The whole control observation from our ISA 260 report to GARMC is reproduced below. Other observations have already been reported in detail to management and GARMC.

Since we issued our ISA 260 report, management have progressed with their investigation into the capital overspend issue. We have not updated our recommendation in the light of any further findings identified by management as part of their investigation.

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. Other projects may be underfunded if expenditure has been inappropriately allocated. 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 commitment 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. Corporate finance should perform a monthly review of the budgets and the reviewer should be independent of those approving and coding the expenditure.

2. Financial reporting (continued)

Misstatements

We identified six uncorrected misstatements which if adjusted would increase the surplus and net assets by £0.5m. 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.

In addition seven "non-trifling" misstatements were identified during the course of our audit as follows:

- The upward revaluation of the HRA assets was overstated by £49m;
- Operational assets of £22.4m were incorrectly included in assets under construction;
- Pension assets and liabilities were overstated by £6.2m;
- Contributions for unfunded benefits of £2.9m had not been debited to the Statement of Movement on the General Fund balance;
- The pension added years provision was overstated by £1.1m;
- Depreciation on council dwellings was overstated by £0.4m; and
- Gain on disposal of fixed assets has been overstated by £0.1m.

The above items were adjusted by management.

Key issues arising from the audit of the pension scheme accounts within the pension scheme annual report

We reported separately to GARMC on 28 September 2010 on our 2009/10 audit. There were no significant issues arising, but we made control recommendations in the following areas:

- Non compliance with the Statement of Investment Principles;
- Requirement for a pension fund bank account; and
- Regular review of the fund managers' internal control reports.

We issued an unqualified opinion on the pension scheme accounts within the pension scheme annual report on 30 September 2010, in advance of the deadline for this of 1 December 2010.

Whole of Government Accounts

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

We were able to issue an unqualified report on the consistency of the Council's consolidation return with the statutory accounts and the policies governing the preparation of the return. Our opinion was issued on 28 October 2010, which was beyond the deadline of 1 October 2010 for auditors to report on the return to the NAO. This was deferred to allow management time to progress their investigation into the capital overspend issue outlined above.

3. Value for money conclusion

The scope of our work

We are required to issue a conclusion on whether we are satisfied that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources in respect of its local authority functions. This is known as the value for money conclusion.

Issue identified

At the end of August 2010, management identified that the Council had a substantial overspend on a number of capital schemes within the Children's part of the capital programme. The issue stemmed from an initial concern about miscoding between schemes highlighted as part of our audit. In addition, it also became clear to management that there were a number of outstanding invoices that were not on the system and therefore could not be paid.

Management commissioned an investigation which was ongoing at 30 September 2010, the statutory deadline for signing the Statement of Accounts, so our opinions and conclusions were deferred to allow management time to progress their investigation.

The key findings identified by management to date include:

- An overspend of £7.9m had occurred, £1.3m of this being before the year end, the remainder in the post balance sheet period;
- Internal controls had not operated effectively in this area; and
- No evidence was identified to indicate fraud for personal gain or that any political pressure was applied to increase the specification/cost of the projects.

The Council has informed us that it intends to submit a report to both Cabinet and GARMC outlining what happened; how the Council responded; the financial impact (in year and ongoing); the action that will be taken to deal with any control weaknesses; and how the implementation of recommendations will be monitored.

Value for money conclusion

We issued a qualified conclusion on the Council's arrangements for securing value for money during 2009/10. This was signed on 28 October 2010.

In undertaking our audit in accordance with the Code of Audit Practice we identified the following:

- A weakness in relation to the management, control and monitoring of certain capital projects during the year which has led to a significant overspend which falls mainly after the year end.

Our value for money conclusion is as follows:

"Having regard to the criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in October 2009, we are satisfied that, in all significant respects, London Borough of Harrow made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2010 except for:

- *Managing its risks and maintaining a sound system of internal control."*

Management also updated the Annual Governance Statement to include the following:

"It has become clear that there is a more serious weakness in relation to the management and control of certain capital projects. In order to address this situation a management investigation has been commissioned and corrective measures are being put in place in the meantime. The investigation will result in a number of recommendations to improve project management, internal control and monitoring in relation to the capital programme."

4. Looking forward

This is a challenging period for local government on a number of fronts. The outcome of the recent Comprehensive Spending Review will add to existing local pressures. We have commented in this section on the changes which have been made to the scope of our work in 2011 to respond to this changed environment.

Value for money conclusion work in 2011

The Audit Commission has advised that in 2011 the auditors' statutory VFM conclusion will be based on the following two criteria specified by the Commission:

Specified criteria for auditors' VFM conclusion	Focus of the criteria for 2011
The organisation has proper arrangements in place for securing financial resilience.	The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.	The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We will discuss with officers the detailed approach to the work as part of our detailed 2010/11 audit planning.

Preparations for the implementation of International Financial Reporting Standards from 2010/11

In 2010/11, the Council will need to prepare its accounts for the first time under International Financial Reporting Standards (IFRS). The Council has reported to GARMC in the past and has set itself a timetable for restating its balance sheet and income and expenditure account for 2009/10 under IFRS by 31 December 2010. The Council will need to adhere to this timetable and to prepare full proforma financial statements, with full comparative information, by early in the New Year.

Abolition of the Audit Commission

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.

5. 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 GARMC at the 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 Harrow 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 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

22 November 2010

Appendix 1: 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	80	110
Whole of Government Accounts (WGA)	5	5
Pension scheme	37	38
Fees payable in respect of objections received	8	7
Fees payable in respect of the audit of PFI and other contracts	22	-
Fees payable in respect of the audit of the capital overspend issue	23	-
Fees payable in respect of the certification of grant claims and returns of the Council	105	110
Total fees for audit services provided to the Council	539	552

Our work on the certification of grants is ongoing and the amount shown above is an estimate only.

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

	2010 £'000	2009 £'000
IFRS Transition Project	15	-
Use of resources workshop	5	-
Total fees for non-audit services provided to the Council	20	-

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