

Harrow Council

**Annual Audit Letter to the
Members of the Council
on the 2011 Audit**

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Executive summary

This letter reports our conclusions from our audit of the London Borough of Harrow ("the Council") for financial year 2010/11. The letter's main messages are:

The Council's financial statements	<p>We are pleased to report that we issued an unqualified opinion on the Council's 2010/11 accounts in line with the deadline set by the Audit Commission. Our opinion confirmed that the accounts gave a true and fair view of the Council's financial affairs and of the income and expenditure recorded by the Council. We reported the findings of our audit to the Council's Governance, Audit and Risk Management Committee on 21 September 2011.</p> <p>Updated regulations which govern the preparation audit and publication of the accounts include a new requirement for local authorities to publish the accounts on their website by 30 September. This was not done until 26 October 2011. The Council should make arrangements to secure compliance with this requirement in 2011/12.</p>
Value for money conclusion	<p>We are required to issue a value for money ("VfM") conclusion within our report on the financial statements. From 2010/11 we are required to base our statutory VfM conclusion on two criteria specified by the Audit Commission:</p> <ul style="list-style-type: none">• the organisation has proper arrangements in place for securing the financial resilience; and• the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness. <p>We completed our work in accordance with the Audit Commission guidance.</p> <p>We were able to issue an unqualified value for money opinion and were satisfied that in all significant respects the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011. More details on this issue are included in Section 3 of this report.</p>
The local government pension scheme annual report	<p>We issued an unqualified opinion on information in the Council's 2010/11 pension scheme annual report on 30 September 2011, ahead of the statutory deadline for the publication of this report of 1 December 2011.</p>
Whole of Government Accounts return	<p>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 30 September 2011.</p>
Previous years objection	<p>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 2010/11 accounts (or the 2009/10 and 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.</p>
Grants certification	<p>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. Only 2 grants remain to be certified: HOU01 and PEN05. 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. All grants have been signed off before the deadline and without qualification apart from HOU02 and BEN01 which were qualified as follows:</p> <ul style="list-style-type: none">• HOU02 - 2 of 4 properties tested were included in the wrong category as the recorded floor space was incorrect; and• BEN01 – 7 errors noted where individual cases had not been completed in accordance with DWP requirements (from a sample of 240 cases).

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;
- 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; and
- review and report on the Council’s whole of government accounts return (WGA), issuing a report to the National Audit Office (NAO).

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 2011 on the issues arising from our 2010/11 audit and issued an audit report providing an unqualified opinion on your accounts on 30 September 2011.

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
Pension liability	<p>The liability relating to the pension scheme is substantial and its calculation is sensitive to comparatively small changes in assumptions.</p> <p>The key assumptions are all within the range we have seen adopted by other employers for accounting purposes as at 31 March 2011.</p>
Property valuations	<p>The Council has a substantial portfolio of operational properties which are subject to a 5 year rolling revaluation programme. Ongoing volatility in land and property prices and the complexity underlying the valuations make this a particularly judgemental area.</p> <p>No concerns were noted as a result of this testing, having reviewed the reasonableness of key assumptions.</p>
Revenue recognition	<p>There is a presumed risk of fraud in revenue recognition in all audit work we perform as a result of the requirements of auditing standards. Accounting for grant income can be complex as the timing for recognising income in the accounts will depend on the scheme rules for each grant.</p> <p>We identified a number of errors that were corrected by management.</p>
Capital mis-coding	<p>As a result of the findings in the closing stages of the 2010 financial statement audit in relation to a weakness in the management, control and monitoring of certain capital projects within Children's Services, we performed additional procedures in this area.</p> <p>Our detailed testing has satisfied us that the control environment has been sufficiently improved in the financial year and no further issues arose.</p>
First time implementation of IFRS	<p>The 2011 financial statements are the first presented by the Council under International Financial Reporting Standards (IFRS). Management have had to undertake a number of changes to the previous accounts to meet the requirements of the new Code of Practice.</p> <p>We are satisfied that the financial statements have been prepared in accordance with the new Code of Practice and that accounting policies have been adopted and disclosed in line with those requirements.</p>
Management override of controls	<p>Management may be able override controls that are in place to prevent inaccurate or even fraudulent financial reporting.</p> <p>We have concluded satisfactorily on this area of risk. Our work in this area focused on testing of journals and significant accounting estimates.</p>

2. Financial reporting (continued)

Control observations

Our report to GARMC included ten recommendations for improvements in controls identified in the course of our audit of the statement of accounts, as well as reiterating a number of IT related items that had been raised in the previous year but had not been addressed. Whilst these are lower priority matters, we recommend that officers agree a revised timetable for action and monitor progress against this.

All observations have been reported in detail to management and GARMC.

Misstatements

We identified one uncorrected misstatement which if adjusted would increase the surplus and net assets by £0.7m. Management has concluded that the impact of this uncorrected misstatement is not material in the context of the financial statements taken as a whole.

In addition four “non-trivial” misstatements were identified during the course of our audit and adjusted by management. These misstatements arose through error and none individually exceeded audit materiality and are summarised below:

- The only item impacting the Consolidated Income and Expenditure Statement was a £5.1m overstatement of impairment to the HRA assets. The entry made to reverse this overstatement was matched by a second, equal and opposite entry in the Movement in Reserves Statement such that the effect on useable reserves was neutral;
- A £1.2m overstatement of holiday pay accrual was made as a result of an error in calculation; and
- Two reclassification errors were noted in relation to grant accounting requirements under IFRS.

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

We reported separately to GARMC on 21 September 2011 on our 2010/11 audit. There were no significant issues arising, and our control observations were reported to management and GARMC.

We issued an unqualified opinion on the pension scheme accounts within the pension scheme annual report on 30 September 2011, in advance of the deadline for this of 1 December 2011.

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 30 September 2011, meeting the deadline set by the NAO.

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.

Update on prior year qualification

As noted above we included a risk in our audit and VFM work in relation to the substantial overspend on a number of capital schemes within the Children's part of the capital programme noted in the closing stages of the prior year audit.

We are satisfied that, since the controls circumvention was noted, management (under the guidance of those charged with governance) have:

- ensured that controls were increased in the short term to prevent ongoing spending and mis-coding;
- put in place a plan to ensure the control environment going forward is improved to address the circumvention that was possible;
- undertaken detailed testing of capital expenditure across the council directorates to ensure that the issue was not more widely spread, and adjusted for any errors (nothing significant noted outside Children's Services);
- taken appropriate action in relation to those involved in the mis-coding; and
- considered the impact that the over-spend had on the value for money of the assets involved.

As a result we are satisfied that our prior year 'except for' qualification to our value for money conclusion in relation to 'managing its risks and maintaining a sound system of internal control' has no impact on the 2010/11 conclusion.

Value for money conclusion

We issued a unqualified conclusion on the Council's arrangements for securing value for money during 2010/11, signed on 30 September 2011. This conclusion addressed both criteria set by the Audit Commission:

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

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.

Code of practice on local authority accounting in the United Kingdom 2011/12

Background The 2011/12 Code is the first annual update of the Code since the International Financial Reporting Standards were adopted as the basis for public sector accounting. The 2011/12 Code clarifies the requirements in a number of areas where uncertainty was identified in the 2010/11 Code and introduces new or amended accounting practices in a number of areas.

Effective date Effective for financial years commencing on or after 1 April 2011.

Pensions

Background Some recent changes to accounting standards will affect some areas of presentation in the financial statements. Most significant for Harrow is that the expected return on assets currently recognised in the comprehensive income and expenditure statement will be replaced with a 'net interest cost', which is calculated by applying a discount rate to the net liability/asset of the scheme. There will also be extended disclosure requirements – which give more disclosure, especially around risks and uncertainty.

Effective date Effective for financial years commencing on or after 1 April 2013.

Consultation - accounting for non-current schools' assets

Background CIPFA/LASAAC have put out to consultation its proposals for developing the 2011/12 Code in relation to non-current schools' assets.

The issue of the accounting treatment of non-current assets used by the different categories of maintained schools has been subject to debate for a number of years, without a firm conclusion being reached. The debate arises because the circumstances of each of the categories of maintained schools, such as ownership and access to economic benefits and service potential are different. The move to IFRS has resulted in authorities and auditors reconsidering the issue.

Effective date Effective for financial years commencing on or after 1 April 2011.

Bribery Act

Background In April 2010, the Bribery Act was passed into law in the UK and was effective from July 2011. Under the provisions of the Act, the enforcement authorities have at their disposal new and more easily applied offences which the Council will need to factor into their risk management processes. Importantly, the Act contains an offence of failing to prevent a bribe being paid on their behalf by an 'associated' person. Associated persons could include not only employees, agents or subsidiaries but a wide group of parties who perform services on behalf of the Council creating a potentially significant risk of liability for the Council under the Act.

The practical impact is that the Council should review their anti-corruption policies to ensure regulatory risk is mitigated.

Effective date Already effective. We understand the Council is already responding to these new requirements.

4. Looking forward (continued)

Code of practice on transport / infrastructure assets

Background	<p>CIPFA has published the Code of practice on transport / infrastructure assets (the Transport Code) which suggests a change in the financial reporting valuation of infrastructure assets. Infrastructure assets are currently valued on a historic cost basis, with the transport Code suggesting a move to a depreciated replacement cost (DRC) based valuation. The transport Code suggests the withdrawal of the current method of historic cost accounting for infrastructure assets from 2012/13.</p> <p>The consultation on the 2012/13 Financial Reporting Code (the financial Code) includes the option for a voluntary disclosure of infrastructure assets on a DRC basis but currently maintains the required historic cost valuation for these assets.</p>
Effective date	Effective for financial years commencing on or after 1 April 2012.

Self-financing for council housing

Background	<p>The reform of council housing was included as a Coalition agreement commitment. Significant changes to the current system are expected with a planned implementation date of April 2012. Currently Councils receive a housing subsidy from government. The Housing subsidy is calculated by the government based on estimated income and spending for each local authority's HRA. The calculation involves a number of assumptions. Where the government's subsidy estimates show that expenditure for a local authority is greater than its income, then a subsidy is paid to the local authority. However, where the government's subsidy estimates show that income is greater than expenditure, then the local authority makes a payment to the government. This calculation changes annually. The new proposals suggest an end to the current subsidy system.</p>
Effective date	A planned implementation date of April 2012

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 within our report to them finalising the 2010/11 audit 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

30 November 2011

Appendix 1: Analysis of professional fees

The professional fees earned by Deloitte in the period from 1 April 2010 to 31 March 2011 were as follows:

	2011 £'000	2010 £'000
Statement of accounts		
- including items in relation to the 2010 audit of a one off nature	282	406
Value for money / Use of resources	80	82
Whole of Government Accounts return	5	5
Pension scheme	35	35
Fees payable in respect of objections received	-	8
Fees payable in respect of the certification of grant claims and returns to the Council	*110	100
	<hr/>	<hr/>
Audit services provided	512	636
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* Our work in respect of the certification of grants for 2010/11 is ongoing and the amount shown above is an estimate only based on the 2009/10 fees. We have regular dialogue with officers to keep them informed of progress for this work. We will issue a letter summarising the results of our work in early 2012 when complete.

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