London Borough of Hillingdon

Annual Audit Letter for the year ended 31 March 2017

October 2017

Ernst & Young LLP

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Contents

Public Sector Audit Appointments Ltd (PSAA) have issued a ‘‘Statement of responsibilities of auditors and audited bodies”. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The “Terms of Appointment (updated 23 February 2017)” issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to London Borough of Hillingdon (the Council) following completion of our audit procedures for the year ended 31 March 2017.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's and Pension Fund's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2017 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception: ► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 27 September 2017.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 28 September 2017.

In January 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken. This will include work completed on Housing Benefits, Housing Capital Receipts and Teacher's Pension.

We would like to take this opportunity to thank the Council and Pension Fund's staff for their assistance during the course of our work.

Maria Grindley

Associate Partner
For and on behalf of Ernst & Young LLP

Purpose

Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report to the 27 September 2017 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued on 16 March 2017 and is conducted in accordance with the National Audit Office's 2016 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2016/17 financial statements, including the pension fund; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council and Pension Fund's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 28 September 2017.

Our detailed findings were reported to the 27 September 2017 Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Management override of controls A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions. For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.	Our testing of journal entries did not identify adjustments which were outside of the normal course of business. All journals tested had an appropriate business rationale. We did not identify any significant unusual transactions. We reviewed accounting estimates for evidence of management bias. We undertook audit procedures on accruals, provisions and prepayments and did not identify any evidence of management override. We performed sample testing on additions to the property, plant and equipment balance and found that these items met the relevant accounting requirements to be capitalised. We performed sample testing on the existence and valuation of prepayments, the completeness and valuation of accruals and completeness of provisions and found no indication of management bias.

Revenue and expenditure recognition Auditing standards also require us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation. We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end. For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.	Our approach focused on: ► reviewing and testing revenue and expenditure recognition policies, to see if they would of themselves lead to over or understatement of amounts; ► reviewing and discussing with management any accounting estimates on revenue or expenditure recognition for evidence of bias. We concentrated on estimates requiring more judgement by management, e.g. IAS 19, Property, Plant and Equipment and accruals; ► developing a testing strategy to test material revenue and expenditure streams. We looked at all material streams individually and completed sample testing tailored for the individual streams (e.g. where higher risk, more testing performed); ► reviewing and testing revenue and expenditure cut-off at the period end date to ensure that transactions were entered in the relevant year (e.g. items were not deferred into the following year to improve the financial position; and ► reviewing and testing a selection of capital additions to ensure that these were correctly capitalised. Our testing did not identify any material misstatements from revenue and expenditure recognition. Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Authority's financial position.
SERCOP Re-Statement Financial statement presentation Amendments have been made to the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the Code) this year, changing the way the financial statements are presented. The new reporting requirements impact the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS). They also include the introduction of the new 'Expenditure and Funding Analysis' note as a result of the 'Telling the Story' review of the presentation of local authority financial statements.	We reviewed the draft expenditure and funding analysis, restated CIES, restated MiRS and associated notes. We have nothing to report from this work.

Other Key Findings	Conclusion
Pension disclosures	We challenged the significant movement in the actuarial valuation and found no indication of management bias in this estimate. We reviewed in detail the assumptions used by the actuaries. Barnett Waddingham: We have noted that PWC as part of their central review have reported that the discount rate applied by Barnett Waddingham falls outside the top end of their expected range. Our EY Pensions team agree with this conclusion. In respect of Barnett Waddingham EY Pensions concluded that the methodologies used to derive the discount rate and RPI inflation assumptions are not robust as they do not take adequate account of the duration of the schemes liabilities. In future years this could lead to unacceptable assumptions. Given the size of the Barnett Waddingham element of the Pension Liability this is not considered to be a significant consideration for London Borough of Hillingdon. Hymans Robertson: PWC note that the discount rate and RPI inflation assumptions are determined using a cash flow matching approach to derive 3 separate rates (short, medium and long) with a duration of approximately 15, 20, and 25 years respectively. The use of the nearest duration rather than the actual duration of a particular employer makes the methodology slightly less robust. Our EY Pensions team agrees with the reservations on the actuary's methodology used to derive the discount rates but note that overall other assumptions appear reasonable.
Property valuations	We have assessed and are satisfied with the objectivity of the London Borough of Hillingdon valuers: Wilkes Head and Eve (WHE) and Jones Laing LaSalle (JLL). We have undertaken appropriate audit procedures to verify and critically challenge the basis of valuation adopted by the valuers in relation to the property, plant and equipment, focusing in particular on specialist assets which are valued on a depreciated replacement costs (DRC) basis valued by WHE. We asked our EY internal valuation experts to assist us with providing assurance in this area. EY Property valuations raised a number of questions of WHE on key assumptions applied on DRC valuations. After considering the WHE response and testing a small sample of assets EY property valuation concluded that the assets were fairly stated this year. We will liaise with the finance team to address some of the concerns raised by the EY Property Valuations team on the WHE methodology. This will be important for the 2017/18 valuation.

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £14.286 million (2015/16: £13.192 million), which is 2% of Gross Revenue Expenditure reported in the accounts of £689 million adjusted for any additional lines of Expenditure which area also reported below the line We consider Gross Revenue Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.714 million (2015/16: £0.659 million) in respect of uncorrected audit adjustments

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits
- Related party transactions.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

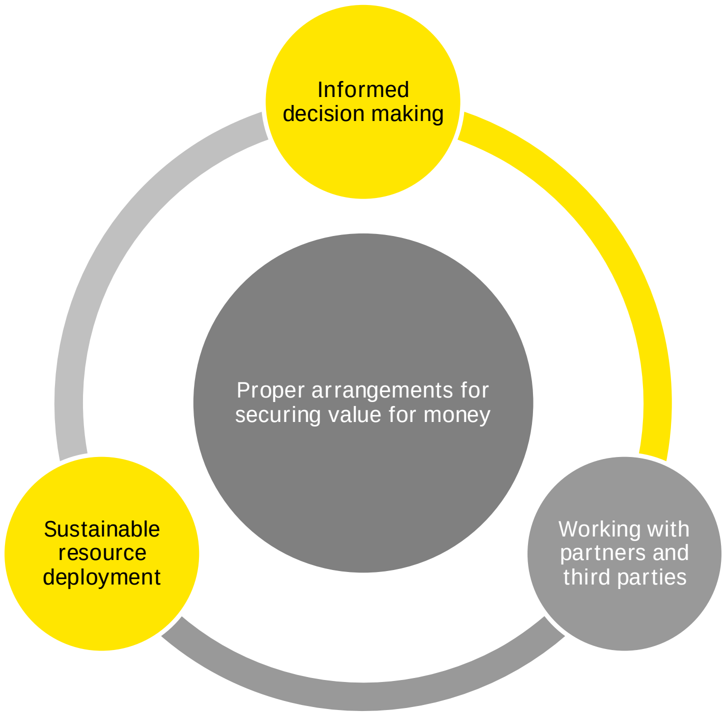
Value for Money

Value for Money

We are required to consider whether the Council has put in place ‘proper arrangements’ to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We did not identify any significant risks in relation to these criteria.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore issued an unqualified value for money conclusion on 28 September 2017.

What are our findings?
London Borough of Hillingdon continues to perform well given the financial challenges they continue to face from austerity. The successful delivery of the Council's Business Improvement Delivery Transformation Programme has enabled London Borough of Hillingdon to manage to continue to deliver for local residents whilst delivering the financial savings necessary year on year. Usable Reserves have remained stable year on year at approximately £180m. Investments and Cash Assets also account for an additional £100m as at end of March 2017. These reserves and balances give the Council a good degree of certainty and security in uncertain times.
The Council has continued its use of internal borrowing where possible to continue to invest in capital initiatives. The borrowing position in year was also significantly improved with a reduction of approximately £48m or 15% of the long term borrowing value having been repaid in year. Furthermore no new debt was entered into in 2016/17.
The next few years will undoubtedly bring further challenges including, but not limited to, a further reduction in core Government grants such as the Revenue Support Grant and New Homes Bonus as well as further continued pressures on social care provision. Other challenges and uncertainty include the proposed retention of NDR which was announced by the then Chancellor at the time George Osborne. Recent performance has highlighted that the Council continues to respond well to the challenges it faces and will need to apply such an aptitude in the coming years as well. The Corporate Risk Register details those risks with the Risk Register being used effectively to manage the risk environment in which the Council operates.

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council’s annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2016/17 financial statements from member of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

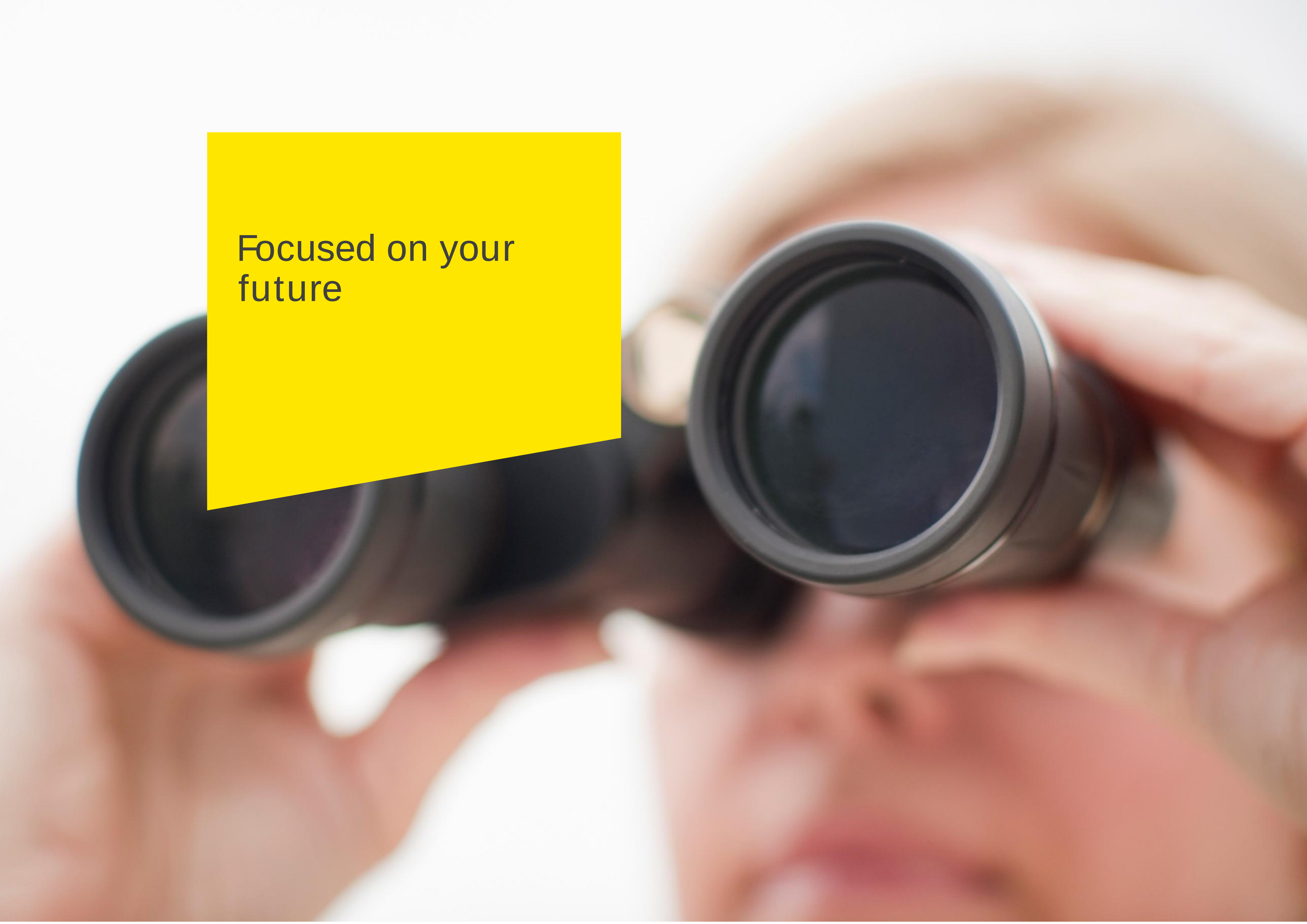
Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 27 September 2017. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

Our audit did not identify any controls issues to bring to the attention of the Audit Committee.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Accounting and Regulatory Updates

Area	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: • How financial assets are classified and measured • How the impairment of financial assets are calculated • Financial hedge accounting • The disclosure requirements for financial assets. Transitional arrangements are included within the accounting standard, however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be and whether any accounting statutory overrides will be introduced to mitigate any impact.	Although some initial thoughts on the approach to adopting IFRS 9 have been issued by CIPFA, until the Code is issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Council will have to: • Reclassify existing financial instrument assets • Remeasure and recalculate potential impairments of those assets; and • Prepare additional disclosure notes for material items The Council is awaiting clarification of the exact requirements before investing time in the above work.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: • Leases; • Financial instruments; • Insurance contracts; and • for local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. There are transitional arrangements within the standard; however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be.	As with IFRS 9, some initial thoughts on the approach to adopting IFRS 15 have been issued by CIPFA. However, until the Code is issued there remains some uncertainty. However, what is clear is that for all material income sources from customers the Council will have to: • Disaggregate revenue into appropriate categories • Identify relevant performance obligations and allocate income to each • Summarise significant judgements The Council is awaiting clarification of the exact requirements before investing time in the above work.

Area	Issue	Impact
IFRS 16 Leases	IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease in a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard, although as the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be or whether any statutory overrides will be introduced.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to classify all of its leases and therefore must ensure that all lease arrangements are fully documented. The Council is has yet to commence work in this area due to the timing of implementation.
Earlier deadline for production and audit of the financial statements from 2017/18	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.	These changes provide challenges for both the preparers and the auditors of the financial statements. To prepare for this change the Council will need to take a number of steps as outlined below: • Critically review and amend the closedown process to achieve draft accounts production by 31st May for 2017/18; • Brought forward the commissioning and production of key externally provided information such as IAS 19 pension information, asset valuations; • Provided training to departmental finance staff regarding the requirements and implications of earlier closedown; • Re-ordered tasks from year-end to monthly/quarterly timing, reducing year-end pressure; • Established and agreed working materiality amounts with auditor As auditors, nationally we have:

Area	Issue	Impact
		• Issued a thought piece on early closedown • As part of the strategic Alliance with CIPFA jointly presented accounts closedown workshops across England, Scotland and Wales • Presented at CIPFA early closedown events and on the subject at the Local Government Accounting Conferences in July 2017 Locally we will: Have regular discussions through the year on the Council's proposals to bring forward the closedown timetable and agree on areas where early work can be completed.

Appendix A

Audit Fees

Appendix A Audit Fees

Our fee for 2016/17 fee is in line with the scale fee set by the PSAA and reported in our 16th March 2017 Audit Plan.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work	£157,268	£157,268	£157,268	£157,268
Total Audit Fee – Certification of claims and returns –	£TBC*	£28,725	£28,725	£24,445
Total Audit Fee – Fee for correspondence with members of the public	£1,444	£0	£0	£0

*We are currently completing our work on this area and will report our findings to the December 2017 Audit Committee. The final fee will depend on the number of errors identified as part of the work.

** We received correspondence from a member of the public which we needed to work through. In line with the protocols in place with the PSAA the additional fee will need to be formally approved by the PSAA before we can raise an invoice for this amount. We have notified officers of this amount.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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ED None

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