AUDIT PANEL			
Report Title	**DRAFT STATEMENT OF ACCOUNTS 2010/11**		
Key Decision	**No**		**Item No. 7**
Ward	**ALL**		
Contributors	**EXECUTIVE DIRECTOR FOR RESOURCES**		
Class	**PART 1**		**Date: 22 JUNE 2011**

1 REASONS FOR URGENCY

1.1 The final quality control checks required on the draft accounts had not quite been completed by the despatch date, but have been completed to enable a supplementary despatch on the terms set out in this report by 16 June 2011. Whilst not ideal this will still enable Members to have several days to review the draft accounts before the meeting, and to ask detailed questions of officers in advance of that meeting if required. The report needs to be despatched now and is therefore urgent as otherwise Members will not have a proper and realistic opportunity to review the draft.

2 SUMMARY AND PURPOSE

2.1 To review the draft Statement of Accounts for 2010/11.

3 EXECUTIVE SUMMARY

3.1 The Council is no longer required by law to obtain elected Members' approval of its draft accounts. However, given the importance of the document, and its complexity, officers are still of the view that it is appropriate to present the draft accounts to the Audit Panel. Accordingly, the draft accounts for 2010/11 are attached as Appendix one to this report.

3.2 The summary of expenditure against budgets for 2010/11, known as the outturn, has already been reported to the Public Accounts Select Committee (on 14 June 2011) and is being reported to the Mayor & Cabinet at the same time as this meeting. The outturn should be read as a background paper to this report.

3.3 This report seeks to highlight the key issues arising from the council's 2010/11 draft accounts, and to explain these in as practical a fashion as possible, given the technical complexity of the accounts (the format of which is essentially prescribed nationally).

4 RECOMMENDATIONS

4.1 To note the report.

5 UNDERSTANDING THE ACCOUNTS AND THEIR PREPARATION

5.1 Preparing the 2010/11 accounts has been challenging for local authorities. Members will be aware that the full application of International Financial Reporting Standards (IFRS) has required officers to undertake significant additional work. It has also had the effect of significantly changing the presentation of the accounts, with the effect that the results for 2009/10 and 2010/11 are not always directly comparable.

5.2 Members will also be aware that the Audit Commission has previously reported Lewisham's preparations for this challenge as "red", highlighting the risks to being able to prepare proper accounts in time as a result of slippage against the original IFRS implementation programme.

5.3 Officers have prepared the draft accounts so as to be able to despatch them to this Panel by 14 June 2011, slightly earlier than was the case in 2009/10. Officers understand that some other authorities have taken advantage of the new provisions of the Accounts and Audit Regulations 2011 to approve their draft accounts rather later, up to the 30 June 2011 deadline.

5.4 It has unfortunately not been possible to finalise the Group Accounts Statement and some notes to the cash flow statement by the date of despatch of this report, although these will available to this Panel before its meeting. The complete draft accounts will therefore be available well in advance of the 30 June 2011 deadline. The Pension Fund accounts have already been presented to the Pensions Investment Committee and made available to the auditor.

5.5 Subject to audit, officers are confident that a professional job has been done in ensuring that the quality of the accounts and supporting working papers is appropriate. This report also indicates areas in which officers, in preparing the accounts, have made what they consider to be reasonable professional judgements as to how certain items should be accounted for. It is possible that an auditor may form a different view on these areas. However, it will be important that Members appreciate, particularly when considering the auditor's later report on the audit, the difference between identified errors (should there be any) and differing interpretations of complex accounting issues where qualified professionals may reasonably come to alternative views.

5.6 The format of local authority accounts is generally agreed to be difficult to understand for those without expert knowledge of the sector's accounting conventions. The document is invariably very long, once all the required disclosures are made, and not easy to interpret. There is little that officers can do about the presentation of the accounts themselves, the format of which is largely prescribed. However, the remainder of this section of the report attempts to set out a summary of the key issues that can be identified in the accounts, and to highlight for Members those areas where officers, in preparing the accounts, have made what they consider to be reasonable and professional accounting judgements in complex areas where alternative interpretations could be applied.

5.7 Within the accounts four statements are defined as "core financial statements", which essentially means that they are fundamental to understanding the accounts. A short commentary on each of these is set out below.

Movement in Reserves Statement (MiRS)

5.8 The MiRS shows the movement in the year on the different reserves held by the Council, analysed into 'usable reserves' (i.e. those that can be applied to fund expenditure) and other reserves of a technical nature which cannot be applied to fund expenditure. This is therefore a helpful summary of the resources that the council has available to fund future expenditure and to manage financial risks.

5.9 In the MiRS Members will note that the council's general fund balances remain similar to those held as at 31 March 2010. The Executive Director for Resources has advised that general fund balances of approximately 2.5% of net revenue expenditure are an appropriate and prudent contingency to hold against possible future events. Earmarked reserves are those set aside to pay for future planned expenditure. These include balances required to fund the council's self-insurance account and to meet future commitments under long-term projects, as well as sums set aside to meet anticipated future costs.

5.10 On the face of it earmarked reserves have risen by £6.8m. However, the true underlying position, as disclosed in note seven to the core financial statements, is that the general earmarked reserves (which exclude insurance and schools' balances) have reduced by £2m, reflecting planned use of funds.

Comprehensive Income and Expenditure Statement (CI&ES)

5.11 The CI&ES sets out the total expenditure by the authority in the 2010/11 financial year, some £1.2bn. The format of the CI&ES is completely different to council's management accounts, which present income and expenditure by Directorate. However, a reconciliation between the two is provided by note 24 to the core financial statements, segmental reporting, which discloses net expenditure by directorate in a manner that Members will be familiar with from the Outturn report.

5.12 Comparing 2010/11 with 2009/10 the income and expenditure disclosed by the CI&ES is broadly similar, except that:

- Gross expenditure on Housing services has risen by some £280m. This mostly reflects the technical 'impairment' charge now required, where reductions in the accounting value placed on the authority's housing stock as a result of a change in the valuation basis required to be used are now required to be charged to revenue through the CI&ES. The effect of this change is reversed elsewhere in the accounts, so it has no impact on the authority's available resources.

- Gross expenditure on 'non distributed costs' has reduced by some £130m (to a negative figure of £129m). This largely reflects the change in indexation of pensions from the Retail Price Index (RPI) to the Consumer Price Index (CPI), which has had the effect of reducing the council's likely future pension liabilities. Again, this accounting entry is reversed elsewhere in the statements so that it has no impact on the authority's available resources, although the change in the indexation rate will in the future tend to reduce (all other things being equal) the contributions that the council is in future required to make to the pension fund.

5.13 The other significant change between 2009/10 and 2010/11 disclosed by the CI&ES is a reduction of some £5m in the charge for interest payable. This is principally the result of the transfer during 2010/11 of the 'Chrysalis' stock from council control to London & Quadrant Housing Association (L&Q) and the associated reduction in long-term debt, rather than any reduction in the interest rate charged on long-term debt, where the profile of debt maturity has not allowed any significant opportunities to reduce interest costs.

5.14 Otherwise, the CI&ES discloses a notional deficit of some £177m in the provision of services, after the application of council tax and government grants. This is a notional figure required to be presented this way, and for a more helpful explanation of activities in the year Members may wish to review the Outturn report, which is a background paper to this report.

Balance sheet

5.15 The balance sheet discloses that the 'total equity' of the council has risen to some £0.9bn as at 31 March 2011 compared with some £0.86bn as at March 2010. This is the accounting valuation, and the commentary that follows seeks to explain this in more meaningful terms.

5.16 The accounting value placed on council dwellings has fallen by nearly £200m, as a result of the housing stock revaluation, and the change in valuation basis and Chrysalis transfer referred to above. This accounting value does not reflect the true value of the stock, which would be considerably higher if valued on the basis of either their likely worth under right to buy, or as an asset generating income from rents.

5.17 The accounting value of assets under construction has risen by some £20m. This reflects the current position in delivering the council's multi-year capital programme, with major investment in Deptford, Forest Hill pools, Loampit Vale and other sites part complete as at the year-end. Fuller details are provided in note 15 to the core financial statements.

5.18 'Surplus assets not held for sale' are valued at £30.5m. This is a somewhat unhelpful description. Under IFRS assets can only be classed as held for sale under very tightly defined conditions, essentially that there is a significant likelihood that they will shortly be sold. Given the current uncertainties in the property market this means that a number of assets that the council has declared surplus to requirements cannot meet this strict accounting test, albeit that officers are seeking to dispose of them in accordance with council policy. Assets held for sale are valued at £14.2m.

5.19 There are changes throughout the balance sheet, comparing 2009/10 with 2010/11 to the value of long and short term investments, cash and cash equivalents. The net impact of these changes is broadly neutral, reflecting changes in classification between assets within these categories rather than substantive changes to the council's overall holdings.

5.20 Long-term borrowing has reduced by some £41m, essentially as a result of the Chrysalis stock transfer referred to above.

5.21 Overall, the balance sheet discloses an authority with current assets in excess of current liabilities, and with reasonable and prudent balances available to fund its future spending plans. Were this not to be the case Members would be rightly concerned as to the council's ability to meet its financial obligations over the 2011/12 year. The liability in respect of future pensions has reduced by some £307m, principally as a result of the change in indexation referred to above.

Cash flow statement

5.22 The Cash Flow Statement shows the changes in cash and cash equivalents of the Council during the 2010/11 financial year. This statement is typically more valuable to understanding the financial health of private companies and other organisations that depend on sales in order to avoid financial failure. Given that most local authority funding comes either from government grants, or from local property taxation where there is reasonable certainty of future payments that cash flow is less important to understanding the business of a local authority.

5.23 Members' attention is also drawn to the following financial statements, which although not technically defined as "core financial statements" are nonetheless highly important to understanding key aspects of local authority services and financing.

- The Housing Revenue Account (HRA) which presents the financial transactions relating to the provision of council housing; and

- The Collection Fund which presents a summary of the collection of council tax and national non domestic rates.

5.24 The accounts also provide substantial detail by way of notes and other statements. Members, according to their judgement, may be interested in any of these, but possibly those most helpful to understanding the financial position of the authority disclosed by the accounts are:

- Notes 16 and 20 to the core financial statements, which disclose the debtors to and creditors of the council as at 31 March 2011

- Note 21 to the core financial statements, which discloses the provisions against likely future events held by the authority

- Note seven to the core financial statements, which discloses the level of earmarked revenue reserves and the purposes for which these are held.

5.25 The format of the accounts is essentially prescribed. As a result the document is extremely long and detailed. Members may have questions that they wish to pose to officers on points of detail. Appropriately qualified officers will attend the meeting and make their best endeavours to answer these. However, given the level of detail contained in the accounts it is likely that some questions of detail may not be capable of being answered at the meeting. If Members are minded to ask questions on points of detail they are respectfully requested to submit them in advance to Richard.lambeth@lewisham.gov.uk , ideally at least 24 hours before the meeting, in order to facilitate this.

6 ISSUES FOR THE ATTENTION OF MEMBERS

6.1 in constructing the accounts the officers concerned have applied professional judgements in the areas set out below. Officers believe that these are the correct judgements to apply, but acknowledge that with the introduction of IFRS these are areas where alternative decisions might have been made, as the appropriate treatment is at least capable of significant professional debate. It is possible that the auditors may, during the course of their audit work, come to a different view, and as a result may recommend a different treatment.

6.2 Members are reminded that should such a situation subsequently arise, they should bear in mind the complexities resulting from the introduction of IFRS, the scope for differing opinions between appropriately qualified professionals and to consider, in the event that it proves necessary, the difference between errors by council officers and different judgements that may have been reached had the Audit Commission been responsible for preparing the council's accounts.

6.3 The significant accounting judgements made by officers in preparing the accounts, where alternative treatments might have been appropriate, are set out below.

6.4 Where future funding is uncertain, IFRS requires that consideration is given to 'impairing' (i.e. reducing) the value of assets that might be affected, for example if services were forced to close as a result. Although future government funding is less certain than may have been the case in previous years officers are of the view that there is sufficient certainty as regards funding in 2011/12 and to a large extent 2012/13 that such impairments are unnecessary.

6.5 Under IFRS different tests apply as to whether leases should be classified as finance or operating leases. Officers have conducted a thorough review of the council's leases and made judgements accordingly, but the complex nature of some leases, which can include aspects of finance and operating leases, means that other judgements as to classification could reasonably have been reached. Officers are of the view that the work that has been done is sufficient that any changes that may be required by an auditor forming another judgements are unlikely to be material.

6.6 Major contracts have also been reviewed to see if they contain aspects of a lease of equipment, in which case a different IFRS accounting treatment of them would have been required. Officers are of the view that the main contracts where this might be held to apply are for the provision of ICT services and photocopiers, and have reviewed these carefully. On balance this review has shown that they are not lease contracts, but it is a fine and complex judgement and another professional could come to a different view.

6.7 The classification rules for 'non current assets' under IFRS (previously known as fixed assets) have also changed, requiring officers to make a series of judgements as to the correct classification to apply. Had different judgements been reached then different values would have been placed on the assets and different depreciation charges would have applied, but these would not have had a material impact on the accounts.

6.8 IFRS also introduces different rules for the classification of government grants that have been received and where conditions exist as to how this money is to be used. In theory in this position the money may subsequently need to be repaid, if for example the council fails to meet those conditions. This has always been the case in practice, but IFRS requires different classifications of government grants according to the nature of the conditions that apply to them. The effect of the judgements applied here has been to transfer sums from receipts in advance to earmarked reserves, and in the event that an auditor formed a different view these transfers, which do not impact on the council's total available resources, might need to be reversed in whole or in part.

6.9 Also, throughout the accounts, there are areas where officers have been required to make judgements about possible future events. These include issues such as judging the amounts of the debts due to it that may ultimately not be paid and more technical issues such as the actuarial assumptions to apply to value future pension liabilities. Officers have always had to make such judgements in constructing the accounts, although in some cases the factors to be considered in making these judgements have changed as a result of the implementation of IFRS.

6.10 Finally, Members' attention is drawn in particular to the accounting treatment for the indemnity granted to Lewisham Homes in respect of pensions costs. This indemnity was agreed by the council when Lewisham Homes was established, and the accounting for it has been a matter of concern to the auditors in recent years, and has been reported to Members as such.

6.11 Officers have discussed this closely with the Audit Commission, and presented what they consider to be sound and well-reasoned arguments as to why the treatment they initially adopted in previous years was and remains correct. Members will recall that in last year's audit the matter was raised, and that officers agreed to amend the accounts in the manner proposed by the Audit Commission, in order to avoid a qualification on the accounts being issued.

6.12 Officers have therefore continued with this treatment, albeit that they consider it to be wrong and distorting to the financial statements. As at the date of despatch of the accounts the Audit Commission has not provided officers with written explanations from their Technical Advisory service, to whom the matter has been referred, as to why officers' preferred treatment is incorrect, although we understand that it should be received shortly.

7 FINANCIAL IMPLICATIONS

7.1 The accounts are a financial document, and present a picture of the council's activities in 2010/11 and its assets and liabilities as at 31 March 2011. However, there are no financial implications directly arising from the Panel considering the draft accounts.

8 LEGAL IMPLICATIONS

8.1 Regulation 8(2) of the Accounts and Audit Regulations 2011 (the Regulations) means that local authorities are no longer required to obtain elected Members' approval of their draft accounts. Regulation 8(3)(b) does require local authorities to have elected Members, by way either of a duly constituted committee or by the Full Council, to approve the final accounts, having considered the auditor's report thereon.

8.2 The Regulations do require that the draft accounts are approved for issue by 30 June following the year end by the Responsible Finance Officer under s151 of the 1972 Act. In Lewisham, that officer is the Executive Director for Resources.

9 OTHER IMPLICATIONS

9.1 There are no direct equalities, environmental or crime and disorder implications arising from this report.

APPENDICES

Appendix 1 – Draft Statement of Accounts 2010/11

BACKGROUND PAPERS

Outturn report 2010/11 (PAC 14 June 2011, M&C 22 June 2011)

For further information on this report please contact:
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