

AUDIT PANEL

Report Title	External Auditor's report on the 2010/11 accounts		
Key Decision	No	Item No.	3
Ward	ALL		
Contributors	EXECUTIVE DIRECTOR of RESOURCES		
Class		Date:	20 September 2011

1 PURPOSE

- 1.1 The purpose of this report is to present to the Audit Panel the external auditor's report (The Annual Governance Report or AGR) on the audit of the council's 2010/11 accounts. The AGR is attached to this report, and sets out:

"...the findings from the 2010/11 audit...the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources."

- 1.2 In other words, the AGR sets out the matters arising from the audit that, in the opinion of the external auditor, are of sufficient significance to warrant discussion with Members.
- 1.3 This covering report also sets out officers' views on the matters raised by the external auditor.

2 EXECUTIVE SUMMARY

- 2.1 The audit is not complete as at the date of despatch. However, at that date the external auditor anticipates that:

"...subject to completion of outstanding audit areas...I plan to issue an unqualified opinion on the financial statements..." and that

"I plan to issue a conclusion that the council's arrangements for securing economy, efficiency and effectiveness in the use of resources are adequate."

- 2.2 The external auditor raises a number of matters for Members to consider. In some cases officers accept that errors were made in the draft statements, although it is important to note that these principally relate to detailed disclosure requirements. In other cases officers disagree with the emphasis of the auditor's report. Discussions between officers and the auditors on earlier drafts of the report have resolved some issues, but on others it has not been possible to reach agreement. The reasons for these disagreements are set out in this covering report.

2.3 The District Auditor and appropriate members of her team, and senior council officers, will attend the meeting to answer questions as appropriate.

2.4 The external auditor recommends that Members:

- *“Take note of the adjustments to the financial statements which are set out in this report (i.e. the AGR)*
- *Review unadjusted misstatements to the financial statements and if you decide not to amend please tell me why in the representation letter*
- *Approve the letter of representation, provided alongside this report, on behalf of the council before I issue my opinion and conclusion*
- *Agree your response to the proposed action plan.”*

2.5 Under the council’s constitution these matters will be for council to determine. At the council meeting Members will be recommended to note the AGR and to delegate authority to the Executive Director of Resources and the Chair of the Audit Panel to complete these actions as appropriate. The comments of the Audit Panel arising from this meeting will be communicated to council on 21 September 2011.

3. RECOMMENDATIONS

3.1 The Audit Panel are recommended to note the AGR and the covering officer report, to ask questions as appropriate and to agree the comments that they wish to be relayed to Council.

4. POLICY CONTEXT

4.1 Completing the audit of the council’s accounts and receiving the auditor’s report thereon contributes directly to the council’s tenth corporate priority:

- **Inspiring efficiency, effectiveness and equity:** ensuring efficiency and equity in the delivery of excellent services to meet the needs of the community.

5. DETAIL

5.1 The audit is not complete at the point of despatch of this report. However, it is well advanced and the external auditor plans *“to issue an unqualified opinion on the financial statements”* subject of course to no other issues arising that cannot be resolved. Good working relationships between officers and the audit staff have been developed through regular meetings and remain strong. In some cases officers disagree with the auditor’s findings or interpretations, but because of the good working relationships in place these disagreements have not impeded the progress of the audit.

5.2 This section of the report details those parts of the AGR where officers disagree with the emphasis in the auditor’s comments, and sets out officers’ reasons for this. Absence of comment means that the findings reported by the external auditor are accepted. In some cases the external auditor’s findings are accepted, but additional contextual information is provided for the benefit of Members. References are given by the page numbers of the external auditor’s report, rather

than the pagination of the agenda papers, as the latter are, naturally, not available at the time of despatch.

- 5.3 Before detailing the points on which officers disagree with the external auditor it is important to note that the audit has identified errors in the draft statements of account. Officers regret these and will consider whether any year-end processes should be amended for next year. However, it is important to note that there are no findings from the external auditor that would, if amended, cause the resources available to the council as at 31 March 2011 to change, and hence that there are no findings that would cause any different decisions to have been made. Similarly, there are no findings that, if amended for, would cause reported performance for the 2010/11 year to change in any way relevant for decision making. Where errors have been identified they are generally concerned with detailed disclosure of technical matters, or in the technical accounting treatment of items that, under statutory requirements for local government accounting, have no impact on any 'bottom line' figure relevant for decision making.

Matters on which officers dispute aspects of the external auditor's findings

- 5.4 On page 11 of the AGR the external auditor states that:

"My audit identified a number of typographical errors, rounding and casting errors...trivial inconsistencies between notes to the financial statements, which management have chosen not to amend."

- 5.5 Officers disagree with this finding. Even if it were factually correct (which is not agreed) officers disagree that it is a matter of sufficient significance to report publicly in this way, especially given that the auditor acknowledges that the number of errors is not significant. The detailed review of the draft statements carried out by the external auditor, with their annotations, is attached as Appendix One to this report.
- 5.6 The external auditor contends that in a number of places the financial statements do not cast correctly, due to rounding errors. Different professionally qualified accountants might have different professional views as to whether figures in the accounts should be disclosed to the correct nearest £'000 or amended fractionally in order that the face of the statements arithmetically cast correctly. Officers are of the opinion that this is an entirely trivial matter.
- 5.7 However in constructing the statements one view or the other needs to be adopted, and officers chose the former, partly as a professional judgement but also because it is simpler. The external auditor takes the view, in effect, that if they were preparing the statements themselves, they would have taken the alternative approach, which would be to amend one of the constituent figures by £1,000 in order that the particular element of the statements appeared to cast correctly. This would then create other cross-referencing or similar errors, and so take considerable officer time to amend for.
- 5.8 The accounts disclose that the council spent around £1.2bn in 2010/11, and had gross assets of approximately £1.75bn as at 31 March 2011. Officers consider that rounding differences of £1,000 within an organisation this size are not important.

- 5.9 Officers accept that in some isolated cases this review by the external auditor has identified trivial errors in cross-referencing in the accounts and other similar matters. These will be corrected in the final statements. However, the external auditor recommends that:

“The council should include appropriate quality control procedures in the final accounts closedown process.”

- 5.10 Officers believe that the quality control checks already operating are appropriate. If more officer time were diverted to these it would take focus away from controlling and reducing costs. Officers believe that their current assessment of the relative importance of these competing priorities is correct, and so recommend that Members do not accept this recommendation.

- 5.11 The external auditor identifies in Appendix 3 of the AGR (pages 23 and 24) *“unadjusted misstatements to the financial statements”*. The external auditor recommends that Members *“Consider whether the financial statements should be amended to reflect the unadjusted errors...”*

- 5.12 Officers recommend that these errors are not adjusted. It is common ground between officers and the external auditors that these are errors. However, they are not material to the financial statements. Adjusting for them would have no impact on the resources available to the council, as the correct figures were brought into all relevant reports to Members on resource allocation where appropriate. Adjusting for them would not impact on any relevant performance figure for the 2010/11 accounts.

- 5.13 In understanding this point Members should note that the balance sheet reflects a precise point in time, i.e. 31 March 2011. Around this date there will, almost inevitably in any large and complex organisation such as Lewisham, be transactions that are treated one way for pragmatic reasons. These errors have already been adjusted for in 2011/12 as part of normal business.

- 5.14 Accordingly, Members are recommended to:

“Agree not to amend the misstatement identified in Appendix 3 to the AGR, and to authorise the Executive Director of Resources and the Chair of the Audit Panel to sign a letter of representation to the external auditors accordingly.”

Matters where officers agree with the external auditor’s findings, but consider it appropriate to provide further contextual or other information

- 5.15 The external auditor identifies (page 6 of the AGR) an error of £41.5m in respect of capital grants and contributions. The error is acknowledged and regretted. However, it is important that Members understand that this was in respect of a technical accounting entry the effect of which is automatically reversed elsewhere in the statements, as the external auditor acknowledges.

- 5.16 It arose because a system report was misunderstood to exclude certain technical transactions, when in fact it included them. This should not have happened. However, the quality control checks on the accounts were designed to focus on those areas where errors would impact materially on the reported performance for 2010/11 or on the resources available for future expenditure. These quality control

checks were successful, as no issues relating to these figures have been reported by the external auditor. These quality checks were, intentionally given resource constraints, 'light touch' on technical entries that are automatically reversed elsewhere in the statements.

- 5.17 This does not excuse a substantial error, which officers regret. Nonetheless, the context behind it is, in officers' view, important for Members' understanding of the accounts and the auditor's report thereon.
- 5.18 On page 9 of the AGR (and repeated elsewhere in the document) the external auditor comments on the implementation of the new asset register as regards the asset class of 'property, plant and equipment'. Officers do not dispute that the implementation of this system was problematic and delayed. However, the system has now been implemented, and works in accordance with requirements. Officers accept that early in the audit process they could and should have communicated more clearly to the auditors, but it is important that Members understand that there is no fundamental weakness in the system.
- 5.19 The external auditor also identifies an error of £11.9m in respect of the consolidation of the loan between itself and Catford Regeneration Partnership Ltd (CRPL). This error is in the comparative figures for 2009/10, rather than 2010/11, and therefore reflects a previously unidentified error in last year's audited accounts, which, having now identified it, the auditor wishes to be corrected.
- 5.20 For clarity, the council's accounts are correct; the auditor does not dispute this. Subject to their separate audit the accounts of CRPL are also correct. In producing the group accounts, for the council and all its legal subsidiaries, including CRPL, this transaction should have been eliminated, as the loan to CRPL is necessarily matched by CRPL's debt to the council. This consolidation was overlooked in 2009/10, in error, but has no impact relevant performance figures reported to Members, or on the resources available to the council.
- 5.21 On page 8 of the AGR the external auditor correctly states that the disclosure of the financial close reached in respect of SPV4 of the Building Schools for the Future Programme was not made in note 38 to the accounts. The correct disclosure was made in notes 28 and 35. Officers do not dispute that it was an error that the additional disclosure required by The Code was not made in note 38, but consider it important to stress that this was an oversight only of detailed disclosure requirements; in other words that the substance of the transaction was understood, and that appropriate disclosures were included elsewhere in the statements.

6 FINANCIAL IMPLICATIONS

- 6.1 There are no direct financial implications in agreeing the recommendations in this report.
- 6.2 The cost of external audit services in respect of 2010/11 was £559,000, including the cost of the audit of the accounts, the certification of grant claims and returns and other external audit services.

7 LEGAL IMPLICATIONS

- 7.1 Regulation 8 of the Accounts and Audit (England) Regulations 2011 requires authorities to publish its Statement of Accounts after the external audit is concluded no later than 30 September. The approval of the audited Statement of Accounts by Council on 21 September 2011 will satisfy this statutory requirement.
- 7.2 It is the role of the Audit Panel to receive, review and where appropriate advise and make recommendations to the Council in relation to the external auditor's opinion and report to Members, and to monitor management action in response to issues raised by external audit.

8 EQUALITIES IMPLICATIONS

- 8.1 There are no equalities implications in this report.

9 Consultation

- 9.1 The draft accounts have been published, and local electors have been able to exercise their rights to ask questions of the auditor in respect of them, and to inspect accounting records.

10 ENVIRONMENTAL IMPLICATIONS

- 10.1 There are no environmental implications in this report.

11 CRIME AND DISORDER IMPLICATIONS

- 11.1 There are no crime and disorder implications arising from this report.

12 BACKGROUND PAPERS

None

Appendices

- 1 Annotated version of draft accounts (by the external auditor)
- 2 Annual Governance Report by the external auditor

For further information on this report please contact:

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