

Summary Audit Progress Update

London Borough of Lewisham
Audit 2010/11

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The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

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Summary

The audit of the financial statements is substantially complete. My audit testing has identified further errors, since those reported to the Audit Panel on 20 September 2011 other than those of a clearly trivial nature, and I have reported these to management.

Based upon my work I plan to issue an:

- **unqualified audit opinion,**
- **unqualified conclusion stating that the Council has proper arrangements to secure economy, efficiency and effectiveness in your use of resources,**
- **audit closure certificate.**

1 The purpose of this paper is to provide the Chair of the Audit Panel who has been given delegated responsibility by the Council to represent those charged with governance with a report on progress in delivering my responsibilities as your external auditor. This report provides an update on progress on the audit of the financial statements following the draft Annual Governance Report submitted on 12 September 2011 and included on the Audit Panel's agenda explaining nine agreed amendments to the financial statements. I also presented a further report at the Audit Panel on 20 September 2011 explaining five further agreed amendments to the financial statements. This document does not repeat the findings from the two earlier reports.

2 Since the Audit Panel my team has been carrying out audit work on property plant and equipment and related capital reserves, International Financial Reporting Standards (IFRS) restatement exercise, investments, financial instruments, private finance initiative (PFI) schemes, the cash flow statement, and review and clearance of queries.

3 Since the Audit Panel on 20 September 2011 audit testing has identified further errors, other than those of a clearly trivial nature, and I reported these to management. The agreed amendments to the draft financial statements are detailed below.

Assets held for sale (note 19)

4 An amount of £14,229k was classified as assets held for sale. Following discussions with Officers it was agreed that these items should be disclosed as land and buildings within property, plant and equipment. This adjustment also impacts on the 2009/2010 comparatives. (EX65)

Other gains and losses

5 The Comprehensive Income and Expenditure Statement (CIES) includes 'other gains and losses' of £29,650k. The Council had previously identified an amendment of £(41,537k) relating to the double counting of the overhanging debt grant. The Council has further investigated the remaining balance of £(11,887k) and has reallocated £10,858k to the following headings in the CIES:

- Debit: other gains & losses £10.8m
- Credit: interest payable £1.6m
- Credit: housing services £2.4m
- Credit: Gains/losses on disposal of non current assets £6.8m.

There is a remaining balance of £1m which the Council has not identified. (EX70)

Cash equivalents

6 The 2009/10 restatement figures relating to cash equivalents have been amended by removing items totalling £8,001k of short term investments which were incorrectly classified and treated inconsistently between years. (Ex79)

Leases (note 37)

7 A detailed review of finance leases on dwellings was conducted during the IFRS restatement process. It was agreed that all these were not finance leases as defined by the Code. Therefore the amounts of £565k in 2010/11 and £1,010k in 2009/10 have been removed from the disclosure. (Ex85).

8 In its IFRS restatement exercise for leases the Council incorrectly made adjustments in 2009/10 instead of the balance at 1/4/2009 and also did not recognise a debtor for the finance lease (lessor). The Council has adjusted the accounts to recognise the transaction at 1 April 2009 by increasing the value of investment properties by £422k as well as including a debtor for the amount due as follows £213k 2010/11, £246k 2009/10, £278k at 1 April 2009. (Ex.60, 86, 99,100)

Cash Flow Statement

9 As in previous years the council has continued to have problems producing a timely and accurate cash flow supported by adequate working papers. An updated cash flow was received on 14 October 2011 which has been substantially amended to comply with the Code and provide additional disclosures on investments. Please see the final cash flow in the updated financial statements for amendments. (Ex.91, 123, 127)

Financial Instruments (Note 13a)

10 This note includes an amount of £6.2m described as contract financial liabilities which related to HM Revenue and Customs (HMRC) creditors and £6.1m in financial assets relates to HMRC debtors (VAT). These amounts should not be disclosed as contracted financial assets and liabilities. A note has been added disclosing this matter rather than making the adjustment. (Ex93)

Adjustments between accounting basis and funding basis under regulation.(Note 7)

11 This note has been subject to substantial changes with 23 of the figures being amended. Please see the final note 7 in the updated financial statements for amendments. (Ex96) (Ex98) (Ex109) (Ex129)

Housing rents aged analysis (Note 17d)

12 The aged analysis of the housing rents debtors has been corrected.

Group accounts

13 On consolidation the loan of £11,916k to Catford Regeneration Partnership Ltd was eliminated against investment property instead of long term debtors in the 2009/10 comparatives.
(Ex97)

Private finance initiative schemes

14 The draft financial statements required a number of amendments in relation to the private finance initiative schemes:

- Downham - reversal of capitalisation and impairment £143k.
- Brockley - to apply the prepayment to the deferred liability immediately instead of over the life of the scheme £2,000k.
- Grouped Schools - to correct treatment of the PFI liability £184k.
- Northbrook / Trinity - to correct overstated journal £1,636K.
- Northbrook / Trinity - to correct the split between land and buildings £3,600k.

Within the Brockley PFI scheme, part of the health centre is leased to Lewisham Primary Care Trust. The lease of £367k per year had not been disclosed. (Ex104)

Capital adjustment account (Note 24b)

15 Expenditure charged against the general fund and the housing revenue account line is understated by £5,377k and the statutory provision for the financing of capital investment line is overstated by £5,377k (Ex112).

Investments

16 The Council incorrectly classified investments maturing in 2011/12 as long term and therefore understated current assets by £17,857k. (Ex115).

Financial instruments (note 13)

17 The Council incorrectly disclosed £25,593k (£29,126k in 2009/10) of 'available-for-sale financial assets' as loans and receivables at amortised cost. (Ex117).

18 The balance for loans and receivables excluded cash of £2,644 (£1,419 in 2009/10) (Ex 118).

Capital expenditure and financing (Note 36)

19 Revenue expenditure funded from capital under statute was understated by £3,942k. (Ex120)

Related party transactions, (note 35)

20 The Council has added a few disclosures regarding related party transactions, to include previously omitted items. (Ex124)

Revaluation reserve

21 The Council identified an error relating to prior periods when they reviewed the balances within the revaluation reserve for 2010/11. The error relates to debit balances relating to previous impairments that were incorrectly charged to the revaluation reserve instead of the CIES. In the draft financial statements the Council incorrectly amended the accounts as an in year transaction of £58,447k. Under IAS8 and the Code the Council should have accounted for the prior period error by restating the prior period financial statements in the year the transactions arose. Therefore the Council has removed the £58,447k transaction from 2010/11 and restated the relevant 2009/10 comparatives (£51,992k) and the balance at 1 April 2001 by £6,525k. (Ex 126)

Property, plant and equipment (Note10)

22 Capital expenditure of £17,069k was incorrectly included in transfers rather than additions. (Ex 119)

23 There was a difference of £1,619k between the Impairments Revaluation Reserve figure £15,505k in the property plant and equipment note and the corresponding entry in Note 24 a) revaluation reserve £17,124k. (Ex128)

24 Existence testing of properties identified an asset that the Council had sold in year but was still including as an asset. Further work by the Council identified similar properties with a value of £693k. These have been removed from land and buildings. (Ex131)

Uncertainties

25 I have identified the following uncertainties during the course of my audit of the financial statements:

- The Brockley PFI Service Charge of £6m has been charged to Supervision and Management, part of this amount is incorrectly classified and should be classified as Repairs and Maintenance. The Council will undertake a review of the PFI service charge during 11/12 with a view to correctly classifying the amount in future years. (Ex108)
- In note 7 the line shown as 'other adjustments' is a balancing figure used by the Council to reconcile the movements within the financial statements. The amount is a net amount of £344k. (EX113/3)
- There is no listing from schools to support this capitalised expenditure of £1.7m relating to devolved formula capital. As a result there has been no componentisation. I can not verify whether this expenditure meets the Council's accounting policy for recognition of property, plant and equipment. (Ex130)

Pension Fund

26 During the audit the Council revised note 4 (income from investments) to agree the breakdown of income to the custodian report. There remained however a discrepancy of £101k between the total income on the custodian report and the total income disclosed within note 4. The Council has not adjusted for this discrepancy in the accounts.

Letter of representation

27 Please can you approve the letters of representation, provided with this report, on behalf of the Council before I issue my opinion and conclusion. Can you also review the unadjusted misstatement to the financial statements and if you decided not to amend please tell me why in the representation letters.

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Core Financial Statements

CASH FLOW STATEMENT

This consolidated statement summarises the inflows and outflows of cash arising from transactions with third parties for both revenue and capital purposes. It has been prepared using the "Direct" method.

| 2009/10 Restated £000 | | 2010/11 | |
|-----------------------------|--|-----------|------------------|
| | | £000 | £000 |
| | OPERATING ACTIVITIES | | |
| | Cash Inflows | | |
| (72,142) | Council Tax income | (72,354) | |
| (147,203) | NDR received from ratepayers and national pool | (160,962) | |
| (556,665) | Government grants | (607,128) | |
| (42,992) | Rent received from council housing | (40,063) | |
| (40,386) | Cash received for goods and services | (39,446) | |
| (5,008) | Interest received | (2,336) | |
| 0 | Dividends received | 0 | |
| (11,640) | Other operating cash receipts | (8,480) | |
| (876,036) | | | (930,769) |
| | Cash Outflows | | |
| 345,386 | Cash paid to and on behalf of employees | 343,266 | |
| 130,473 | Housing benefit paid out | 153,617 | |
| 1,772 | Precepts and Levies | 1,787 | |
| 0 | Contribution to Capital Receipts Pool | 483 | |
| 19,737 | Interest paid | 19,593 | |
| 368,578 | Other operating cash payments | 361,103 | |
| 865,946 | | | 879,849 |
| (10,090) | Net Cash Flow from Operating Activities | | (50,920) |
| | INVESTING ACTIVITIES | | |
| | Cash Outflows | | |
| 38,314 | Purchase of property, plant, equipment and investment properties | 48,301 | |
| 7,291 | Revenue Expenditure Funded from Capital Under Statute | 3,942 | |
| 788 | PFI Prepayments | 3,342 | |
| 11,981 | Long-Term Debtors | (12) | |
| 58,374 | | | 55,573 |
| | Cash Inflows | | |
| (8,525) | Sale of property, plant, equipment and investment properties | (19,679) | |
| (33,748) | Capital grants and other capital cash received | (22,576) | |
| (42,273) | | | (42,255) |
| | Net Cash Flows | | |
| (83,931) | Net increase in short term investments | 30,617 | |
| 0 | Net increase in long term investments | 16,092 | |
| 3,728 | Net increase in other liquid resources | 3,234 | |
| (80,203) | | | 49,943 |
| (64,102) | Net Cash Flow from Investing Activities | | 63,261 |
| | FINANCING ACTIVITIES | | |
| | Cash Inflows | | |
| (30,000) | New loans raised | 0 | |
| (250,268) | New short term borrowing | (38,685) | |
| (280,268) | | | (38,685) |
| | Cash Outflows | | |
| 250,391 | Repayments of short and long term borrowing | 43,685 | |
| 250,391 | | | 43,685 |
| (29,877) | Net Cash Flow from Financing Activities | | 5,000 |
| (104,069) | NET (INCREASE)/DECREASE IN CASH AND CASH EQUIVALENTS | | 17,341 |
| (41,537) | CASH AND CASH EQUIVALENTS - BEGINNING OF THE PERIOD | | (145,606) |
| (145,606) | CASH AND CASH EQUIVALENTS - END OF THE PERIOD | | (128,265) |

Core Financial Statements

CASH FLOW STATEMENT

This consolidated statement summarises the inflows and outflows of cash arising from transactions with third parties for both revenue and capital purposes. It has been prepared using the "Direct" method.

| 2009/10 Restated £000 | 2010/11 | |
|-----------------------------|--|-----------|
| | £000 | £000 |
| | (930,769) | |
| | OPERATING ACTIVITIES | |
| | Cash Inflows | |
| (72,142) | Taxation - council tax income | (72,354) |
| (147,203) | NNDR received from national pool | (160,962) |
| (556,665) | Government grants | (607,128) |
| (42,992) | Rent received from council housing | (40,063) |
| (40,386) | Cash received for goods and services | (39,446) |
| (5,008) | Interest received | (2,336) |
| 0 | Dividends received | 0 |
| (11,640) | Other operating cash receipts | (8,480) |
| (876,036) | | |
| | Cash Outflows | |
| 345,386 | Cash paid to and on behalf of employees | 343,266 |
| 130,473 | Housing benefit paid out | 153,617 |
| 1,772 | Precepts and Levies | 1,787 |
| 0 | Contribution to Capital Receipts Pool | 483 |
| 19,737 | Interest paid | 19,593 |
| 325,067 | Cash paid to suppliers of goods and services | 310,551 |
| 39,228 | Other operating cash payments | 45,649 |
| 861,663 | | 874,946 |
| (14,373) | Net Cash Flow from Operating Activities | (55,823) |
| | INVESTING ACTIVITIES | |
| | Cash Outflows | |
| 38,314 | Purchase of property, plant, equipment and investment properties | 48,301 |
| 7,291 | Revenue Expenditure Funded from Capital Under Statute | 3,942 |
| 788 | PFI Prepayments | 3,342 |
| 11,981 | Long-Term Debtors | (12) |
| 202,924 | Purchase of short-term and long-term investments | 184,871 |
| 261,298 | | 240,444 |
| | Cash Inflows | |
| (8,525) | Sale of property, plant, equipment and investment properties | (19,679) |
| (33,748) | Capital grants and other capital cash received | (22,576) |
| (278,854) | Proceeds from short-term and long-term investments | (146,163) |
| (321,127) | | (188,418) |
| (59,829) | Net Cash Flow from Investing Activities | 52,026 |
| | FINANCING ACTIVITIES | |
| | Cash Inflows | |
| (30,000) | New long term borrowing | 0 |
| (250,268) | New short term borrowing | (38,685) |
| (280,268) | | (38,685) |
| | Cash Outflows | |
| 4,283 | Cash payments for reduction of outstanding liability relating to finance leases and on-balance sheet PFI contracts | 4,903 |
| 250,391 | Repayments of short and long term borrowing | 43,685 |
| 3,728 | Other payments for financing activities | 3,234 |
| 258,402 | | 51,822 |
| (21,866) | Net Cash Flow from Financing Activities | 13,137 |
| (96,068) | NET (INCREASE)/DECREASE IN CASH AND CASH EQUIVALENTS | 9,340 |
| (41,537) | CASH AND CASH EQUIVALENTS - BEGINNING OF THE PERIOD | (137,605) |
| (137,605) | CASH AND CASH EQUIVALENTS - END OF THE PERIOD | (128,265) |

Notes to the Core Financial Statements

| 2010/11 | Usable Reserves | | | | | | Movement in Unusable Reserves £'000 |
|--|-------------------------------------|--------------------------------------|--|---|--------------------------------------|---|--|
| | General Fund Balance £'000 | Earmarked GF Reserves £'000 | Housing Revenue Account £'000 | Capital Receipts Reserve £'000 | Major Repairs Reserve £'000 | Capital Grants Unapplied £'000 | |
| Adjustments primarily involving the Capital Adjustment Account: | | | | | | | |
| Reversal of items credited or debited to the Comprehensive Income and Expenditure Statement: | | | | | | | |
| Charges for depreciation and impairment of non-current assets | 76,534 | | 343,317 | | | | (419,851) |
| Revaluation losses on Property, Plant and Equipment | | | | | | | |
| Movements in the market value of Investment Properties | 94 | | | | | | (94) |
| Capital grants and contributions applied | (75,238) | | (41,537) | | | 1,120 | 115,655 |
| Revenue expenditure funded from capital under statute | 3,942 | | | | | | (3,942) |
| Amounts of non-current assets written off on disposal or sale as part of the gain / loss on disposal to the Comprehensive Income and Expenditure Statement | 1,822 | | (1,047) | 13,135 | | | 775 |
| Insertion of items not debited or credited to the Comprehensive Income and Expenditure Statement: | | | | | | | |
| Statutory provision for the financing of capital investment | (7,202) | | (3,078) | | | | 10,280 |
| Voluntary provision above MRP | (1,959) | | | | | | 1,959 |
| Capital expenditure charged against the General Fund and HRA balances | (1,689) | | | | | | 1,689 |
| Adjustments primarily involving the Capital Grants Unapplied Account: | | | | | | | |
| Capital Grants and contributions unapplied credited to the Comprehensive Income and Expenditure Statement | | | | | | | |
| Application of grants to capital financing transferred to the Capital Adjustment Account | | | | | | | |
| Adjustments primarily involving the Capital Receipts Reserve: | | | | | | | |
| Transfer of cash sale proceeds credited as part of the gain / loss on disposal to the Comprehensive Income and Expenditure Statement | | | | | | | |
| Use of the Capital Receipts Reserve to finance new capital expenditure | | | | | | | |
| Contribution from the Capital Receipts Reserve towards administrative costs of non-current asset disposals | | | | | | | |
| Contribution from the Capital Receipts Reserve to finance the payments to the Government capital receipts pool | | | | | | | |
| | 688 | | | (688) | | | 0 |
| Transfer from Deferred Capital Receipts Reserve upon receipt of cash | | | | | | | |
| Adjustments primarily involving the Major Repairs Reserve: | | | | | | | |
| Reversal of Major Repairs Allowance credited to the HRA | | | | | | | |
| | | | (19,004) | | 19,004 | | 0 |
| Use of the Major Repairs Reserve to finance new capital expenditure | | | | | | | |
| | | | 1,627 | | (1,627) | | 0 |

Notes to the Core Financial Statements

| 2010/11 Continued | Usable Reserves | | | | | | Movement in Unusable Reserves £'000 |
|---|-------------------------------------|--------------------------------------|--|---|--------------------------------------|---|--|
| | General Fund Balance £'000 | Earmarked GF Reserves £'000 | Housing Revenue Account £'000 | Capital Receipts Reserve £'000 | Major Repairs Reserve £'000 | Capital Grants Unapplied £'000 | |
| Adjustments primarily involving the Financial Instruments Adjustment Account: Amount by which finance costs charged to the Comprehensive Income and Expenditure Statement are different from finance costs chargeable in the year in accordance with statutory requirements | 10,062 | | (1,601) | | | | (8,461) |
| Adjustments primarily involving the Pensions Reserve: Reversal of items relating to retirement benefits debited or credited to the Comprehensive Income and Expenditure Statement | (85,598) | | 154 | | | | 85,444 |
| Employer's pensions contributions and direct payments to pensioners payable in the year | (30,385) | | (177) | | | | 30,562 |
| Adjustments primarily involving the Collection Fund Adjustment Account: Amount by which Council Tax income credited to the Comprehensive Income and Expenditure Statement is different from Council Tax income calculated for the year in accordance with statutory requirements | 3 | | | | | | (3) |
| Adjustments primarily involving the Accumulated Absences Account: Amount by which officer remuneration charged to the Comprehensive Income and Expenditure Statement on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements | (820) | | | | | | 820 |
| Other Adjustments | 1,284 | | (1,627) | | | | (14,342) |
| Total Adjustments | (108,462) | 0 | 277,027 | 12,447 | 17,377 | 1,120 | (199,509) |

Notes to the Core Financial Statements

| 2010/11 | Usable Reserves | | | | | | Movement in Unusable Reserves £'000 |
|--|-------------------------------------|--------------------------------------|--|---|--------------------------------------|---|--|
| | General Fund Balance £'000 | Earmarked GF Reserves £'000 | Housing Revenue Account £'000 | Capital Receipts Reserve £'000 | Major Repairs Reserve £'000 | Capital Grants Unapplied £'000 | |
| Adjustments primarily involving the Capital Adjustment Account: | | | | | | | |
| Reversal of items credited or debited to the Comprehensive Income and Expenditure Statement: | | | | | | | |
| Charges for depreciation and impairment of non-current assets | 73,728 | | 341,581 | | | | (415,309) |
| Revaluation losses on Property, Plant and Equipment | | | | | | | |
| Movements in the market value of Investment Properties | 94 | | | | | | (94) |
| Capital grants and contributions applied | (23,801) | | (41,537) | | | | 65,338 |
| Revenue expenditure funded from capital under statute | 3,942 | | | | | | (3,942) |
| Amounts of non-current assets written off on disposal or sale as part of the gain / loss on disposal to the Comprehensive Income and Expenditure Statement | 890 | | (6,943) | | | | 6,053 |
| Insertion of items not debited or credited to the Comprehensive Income and Expenditure Statement: | | | | | | | |
| Statutory provision for the financing of capital investment | (9,160) | | (3,078) | | | | 12,238 |
| Voluntary provision above MRP | | | | | | | |
| Capital expenditure charged against the General Fund and HRA balances | (1,689) | | | | | | 1,689 |
| Adjustments primarily involving the Capital Grants Unapplied Account: | | | | | | | |
| Capital Grants and contributions unapplied credited to the Comprehensive Income and Expenditure Statement | | | | | | 1,120 | (1,120) |
| Application of grants to capital financing transferred to the Capital Adjustment Account | | | | | | | |
| Adjustments primarily involving the Capital Receipts Reserve: | | | | | | | |
| Transfer of cash sale proceeds credited as part of the gain / loss on disposal to the Comprehensive Income and Expenditure Statement | | | | 25,054 | | | (25,054) |
| Use of the Capital Receipts Reserve to finance new capital expenditure | | | | (11,919) | | | 11,919 |
| Contribution from the Capital Receipts Reserve towards administrative costs of non-current asset disposals | | | | | | | |
| Contribution from the Capital Receipts Reserve to finance the payments to the Government capital receipts pool | 688 | | | (688) | | | 0 |
| Transfer from Deferred Capital Receipts Reserve upon receipt of cash | | | | | | | |
| Adjustments primarily involving the Major Repairs Reserve: | | | | | | | |
| Reversal of Major Repairs Allowance credited to the HRA | | | (13,670) | | 13,670 | | 0 |
| Difference between Major Repairs Allowance and HRA depreciation | | | (5,335) | | 5,335 | | 0 |
| Use of the Major Repairs Reserve to finance new capital expenditure | | | 1,627 | | (1,627) | | 0 |

Revised

Notes to the Core Financial Statements

| 2010/11 Continued | Usable Reserves | | | | | | Movement in Unusable Reserves £'000 |
|---|-------------------------------|--------------------------------|----------------------------------|-----------------------------------|--------------------------------|-----------------------------------|--|
| | General Fund Balance £'000 | Earmarked GF Reserves £'000 | Housing Revenue Account £'000 | Capital Receipts Reserve £'000 | Major Repairs Reserve £'000 | Capital Grants Unapplied £'000 | |
| Adjustments primarily involving the Financial Instruments Adjustment Account: Amount by which finance costs charged to the Comprehensive Income and Expenditure Statement are different from finance costs chargeable in the year in accordance with statutory requirements | (1,439) | | (1,601) | | | | 3,040 |
| Adjustments primarily involving the Pensions Reserve: Reversal of items relating to retirement benefits debited or credited to the Comprehensive Income and Expenditure Statement | (85,598) | | 154 | | | | 85,444 |
| Employer's pensions contributions and direct payments to pensioners payable in the year | (30,385) | | (177) | | | | 30,562 |
| Adjustments primarily involving the Collection Fund Adjustment Account: Amount by which Council Tax income credited to the Comprehensive Income and Expenditure Statement is different from Council Tax income calculated for the year in accordance with statutory requirements | 3 | | | | | | (3) |
| Adjustments primarily involving the Accumulated Absences Account: Amount by which officer remuneration charged to the Comprehensive Income and Expenditure Statement on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements | (820) | | | | | | 820 |
| Other Adjustments | 1,283 | | (1,627) | | | | 344 |
| Total Adjustments | (72,264) | 0 | 269,394 | 12,447 | 17,378 | 1,120 | (228,075) |