Report to the Audit and Governance Committee

Report reference: AGC-008-2009/10.
Date of meeting: 22 June 2009.

Epping Forest District Council

Portfolio: **Finance and Economic Development**

Subject: **Statutory Statement of Accounts 2008/09**

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Recommendations/Decisions Required:

That a report be submitted to the Council recommending that the Statutory Statement of Accounts for 2008/09 be adopted.

Executive Summary:

One of the key roles allocated to this Committee is to scrutinise the annual Statutory Statement of Accounts. All Members of the Council will have the opportunity to debate the Accounts at Full Council on 30 June and part of that debate will be to consider the recommendation of this Committee.

To assist Members with their consideration of the Accounts a full report follows together with the Accounts themselves.

Reasons for Proposed Decision:

The consideration of the draft Statutory Statement of Accounts falls within the Terms of Reference of this Committee. Officers have exercised their professional judgement and liaised closely with external experts and the External Auditor to produce the draft Statutory Statement. If Members are satisfied with the content of this report and the verbal responses to any questions raised, they are requested to recommend the draft Statutory Statement of Accounts for adoption by Full Council on 30 June.

Other Options for Action:

The Committee could decide that the accounts should be amended or expanded prior to them being presented to Full Council. Alternatively, the Committee could decide not to discharge this part of its terms of Reference and leave Full Council to scrutinise the Accounts.

Report:

1. The Accounts and Audit Regulations 2003 require Full Council or an Executive Committee to adopt the Council's Statement of Accounts before the end of June. The Council's constitution reserves the adoption of the Accounts to Full Council only. However, prior to Council considering the accounts it is important that they have been subject to robust Member scrutiny. This Committee has scrutinised the Statement of Accounts for the previous two years.

2. The consideration of the Statement of Accounts is contained in the Terms of Reference of this Committee, the relevant parts being:

(h) To review financial statements, including the Council's Statement of Accounts, External Auditor's opinion and reports to members, and monitor management action in response to the issues raised by External Audit.

(i) Review, and challenge where necessary, the actions and judgements of Management, in relation to the Council's Statement of Accounts, paying particular attention to:

- *(i) critical accounting policies and practices, and any changes to them;*
- *(ii) decisions requiring a major element of judgement;*
- *(iii) the extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed;*
- *(iv) significant adjustments resulting from the audit; and*
- *(v) any material weakness in internal control reported by the Internal or External Auditor.*

Changes to the Contents of the Statutory Statement for 2008/09

3. For the last two years this section has started with an explanation of the mechanism for setting the rules that Local Authorities have to follow in producing their accounts. This was necessary as there had been significant changes to the appearance and content of the accounts. Whilst there have been relatively few changes this year, it is worth repeating some of the information for the benefit of the new Members of the Committee and anyone who is coming afresh to these accounts.

4. The Chartered Institute of Public Finance and Accountancy (CIPFA) publishes a Statement of Recommended Practice (SORP) every year that Local Authorities are required to follow in producing their financial statements. Before the SORP is published the Accounting Standards Board (ASB) approves the document. In recent years the ASB has insisted that the SORP moves closer to Generally Agreed Accounting Practices (GAAP), so that public sector financial statements more closely resemble those prepared in the private sector.

5. In previous years the focus of the Statement of Accounts has been the Consolidated Revenue Account, which had the dual role of setting out the authority's financial performance and determining the net expenditure to be charged against council tax in the year. The new statements now required by the SORP disaggregate the Consolidated Revenue Account (and the old Statement of Total Movements on Reserves) to produce a set of statements which each have a single clear objective:

- Income and Expenditure Account – a summary of the resources generated and consumed by the authority in the year.

- Statement of the Movement on the General Fund Balance – a reconciliation showing how the balance of resources generated/consumed in the year links in with the statutory requirements for raising council tax.

- Statement of Total Recognised Gains and Losses – demonstration of how the movement in net worth in the Balance Sheet is identified to the Income and Expenditure Account surplus/deficit and to other unrealised gains and losses.

6. The above are described as core financial statements as all local authorities are required to produce them. There are two other core statements, the Balance Sheet and the Cashflow Statement. The Balance Sheet lists what the Council owns, what is owed to the Council and what the Council owes to others. The Cashflow Statement summarises the movements in assets, liabilities and capital that have taken place during the year and their effect on the Council's holdings of cash. Neither the Balance Sheet nor the Cashflow Statement required direct amendment to comply with the SORP.

Critical accounting policies and practices, and any changes to them

7. This has been a relatively quiet year with few revised requirements in the SORP and no changes being instituted by management. This helps make comparisons with last years accounts easier and a lengthy period of consistency would be welcomed. However, this will not be the case as next year will see changes to comply with International Financial Reporting Standards (IFRS) and work has already commenced on this major project.

8. There are two changes to the accounting policies and practices that are worth highlighting. Firstly, a new phrase appears in this year's accounts with the introduction of "Revenue Expenditure Charged to Capital Under Statute". This relates to expenditure of a capital nature that does not result in the creation of a fixed asset either tangible or intangible. This expenditure was previously know as Deferred Charges and such expenditure was initially classified as capital expenditure but then written off in full to the relevant service heading within the Income and Expenditure Account. Proper practice now is that the expenditure is charged directly to revenue. However, because the financing of this expenditure is from a capital source, it is then reversed out within the Statement of Movement on General Fund Balance and charged against the Capital Adjustment Account. This means that there is no overall effect on the Council Tax or the General Fund. The amount of Revenue Expenditure Charged to Capital Under Statute shown in the Statement of Movement on General Fund Balance for 2008/09 is £1.23 million, relevant comparatives have been restated in the accounts.

9. The second change to highlight is the revaluing of fixed assets prior to disposal. Previously a practice known as "Death Bed" valuing had taken place so that fixed assets were revalued immediately before disposal to limit any gain or loss on disposals. This is no longer regarded as proper practice and has been stopped. The effect can be seen on the Income and Expenditure Account where the gain on disposal of assets is shown as £301,000. This gain arises mostly from the sale of 7 council houses during the year and contrasts to the previous year when the revaluing of the houses prior to disposal meant a gain of only £9,000 was shown from the sale of 28 properties.

10. Despite the general reductions in property values, gains still arise on the disposal of council houses as they are valued in the accounts on the basis of their existing use as social housing (occupied on a secure tenancy). The existing use valuation is 46% of the open market valuation (vacant possession) and the maximum discount on a right to buy sale is £34,000. So taking the example of a property that had an open market valuation of £100,000, it would be recorded as an asset worth £46,000 and sold for £66,000 (assuming the occupier qualified for the maximum discount) and so would give a gain on disposal of £20,000.

Decisions requiring a major element of judgement

11. In preparing a set of accounts at a point in time it is inevitable that some of the information required will not yet be available. The compression of the timetable for the preparation and approval of the accounts, from 30 September to 30 June, has exacerbated this problem. Where an issue is unclear it is far more likely to have been resolved six months after the year end than three. If an actual amount is uncertain an estimate is used. The estimate will be based on the assessment of information available at the time the accounts are closed. When the actual figures are determined any difference is usually accounted for in the following year. If the estimate was wrong by a material amount it would be necessary to consider re-stating the figures, this is extremely rare.

12. The most significant loss shown in the accounts is one of £32 million for the impairment of some of the Council's properties. In order to keep asset values current, assets are revalued on a five-year rolling programme. The exception to this is Housing Revenue Account (HRA) properties that are revalued annually using the Beacon Method, a method that uses examples of a particular type of property and extrapolates for the whole population. This year's revaluation saw a total reduction in gross book value of £139 million, of which £131 million related to HRA dwellings and garages. The valuations were conducted for the

Council by the District Valuer using guidance issued by the Royal Institute of Chartered Surveyors. This exercise clearly requires a major element of judgement and the Council's Estates and Valuation Service check the valuations provided by the District Valuer to ensure that a proper and rigorous process has been followed and that the valuations are reasonable. The reduction in value is significant but needs to be seen in the context of the overall value of fixed assets on the balance sheet of £605 million.

13. Given the size of the values involved it is worth briefly explaining how we get from a reduction in gross book value of £139 million to an impairment loss of £32 million. Firstly, the assets had some depreciation on them so this reduces the gross figure by £10 million to give a net impairment of £129 million. Where an asset has previously had its value increased by a revaluation an amount will have been credited to the Revaluation Reserve. Therefore, when the asset has a downward revaluation the amounts are first debited to the Revaluation Reserve and it is only the amount by which the downward revaluation exceeds the previous positive revaluations that is charged to the Income and Expenditure Account. In this instance £97 million of previous positive revaluations has been eliminated from the Revaluation Reserve to leave the balance of £32 million chargeable to the Income and Expenditure Account.

14. There are no other areas in the Statement of Accounts to bring to Members attention as having required a major element of judgement. Where it has been necessary to exercise judgement in the interpretation of the SORP advice has been sought from CIPFA and staff have liaised closely with both the External Audit Manager and other Essex authorities.

<u>The extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed</u>

15. The impairment mentioned above is an unusual transaction as in recent times asset values have been rising rather than falling. This transaction has significantly affected the financial statements as the Income and Expenditure Account shows that a deficit of £5.5 million in 2007/08 has increased to £40.4 million for 2008/09. If the impairment is discounted a more comparable figure of £7.8 million is arrived at. Once all of the amounts that we are required to charge to the Income and Expenditure Account are removed to get back to the basis on which the Council Tax is set, the results for the two years are very similar, with just over £700,000 being added to the General Fund Balance in both years.

16. Another unusual item is the Council's investments that are currently held as part of the administration of the Heritable Bank. This Committee has already considered how the investments were made and the Council's Treasury Management Policy. The aspect that is unusual is the passing of an amendment to the capital financing regulations to encourage the deferment of the impact of investment impairments to 2010/11.

17. The creditor progress report issued by the Heritable administrators (Ernst & Young) on 17 April 2009 projected a return to creditors of 80p in the £. Therefore, the accounts include an impairment based on recovering 80p in the £. In normal circumstances the impairment would be charged to the Income and Expenditure Account and impact on the General Fund Balance. However, in view of the overall uncertainty about the timing and ultimate levels of recovery from the various administrations, the Government has encouraged authorities to postpone until 2010-11 the impact on budget calculations of the impairments. It is also possible that the further amendment regulations may be issued that either allow these impairments to be capitalised or accounted for in some way that will not impact on the Council Tax.

18. The figure shown in the Income and Expenditure Account is a total impairment of the potential loss of both interest and principal of £794,000. The Statement of Movement on the General Fund Balance then shows £711,000 being added back to leave only £83,000 charged to the General Fund Balance for 2008/09. This amount represents the interest lost between the date of administration, 7 October, and the year end, 31 March. The remaining £711,000 is described as Financial Instruments on the Balance Sheet and is shown as a

negative reserve. How this is dealt with in subsequent periods will depend on what further regulations the Government issue and the ultimate level of recoveries from the administration.

19. A transaction that requires the approval of the Secretary of State must be seen as unusual, even though it is in line with Council policy. Prior to the last triennial valuation of the Pension Fund the Council had anticipated an increase in the deficit on the fund and a corresponding increase in contributions being required from employers to fund it. In order to fund these additional contributions £2.5 million was moved from the Usable Capital Receipts Reserve to a Pension Deficit Reserve with the intention of applying to the Secretary of State for capitalisation directions. Pension contributions would normally be treated as revenue expenditure but where a particular item would have a severe impact on the revenue account local authorities are able to seek authority from the Secretary of State to treat the expenditure as capital and meet it from capital resources rather than revenue.

20. Since 2005/06 the Council has applied each year to the Secretary of State for capitalisation directions. Full directions have been obtained for 2005/06, 2007/08 and 2008/09 although in 2006/07 directions were issued for only 57% of the amounts requested. The amounts capitalised in the 2008/09 accounts are £663,000 (£680,000 in 2007/08) General Fund and £310,000 (£319,000 in 2007/08) Housing Revenue Account (HRA).

21. The largest creditor on the Balance Sheet is the Council's liabilities to the pension fund. The Balance Sheet shows that the pension liability for the Council has decreased in the year from £43.4 million to £41.5 million. Even though the recession has seen the assets of the scheme fall 20% in value, changes in the actuarial assumptions used have reduced the projected liabilities by slightly more. The scheme actuary (Mercer) has advised that the assumptions used as at 31 March 2009 are less conservative than those used as at 31 March 2008, driven by the yields on corporate bonds rising and inflation expectations falling during the year. The inclusion of this amount in the Balance Sheet shows the extent of the authority's liability if the pension fund was to close on 31 March 2009. It does not mean that this full liability will have to be paid over to the pension fund in the near future.

Significant adjustments resulting from the audit

22. It is always hoped that there will be no significant adjustments arising from the audit. However, given the issues outlined above the possibility of a significant adjustment cannot be ruled out. Any adjustments that are made to the draft Statement of Accounts will be reported back to this Committee.

23. The difficulties in producing such a complex Statement of Accounts in a short period of time have already been mentioned above. The accounts that follow are complete but are subject to an ongoing checking process and Members will be advised of any amendments at the meeting.

Any material weakness in internal control reported by the Internal or External Auditor

24. To date no material weaknesses have been reported, if any such weaknesses are discovered they will also be reported to this Committee.

Resource Implications:

The Accounts set out the resource implications of the Authorities activities for 2008/09. The recommendation of the Accounts to Full Council does not in itself have any resource implications.

Legal and Governance Implications:

Full Council must approve the Accounts before the end of June and as part of the overall governance framework the Accounts should be subject to robust Member scrutiny prior to their approval.

Safer, Cleaner and Greener Implications:

There are no environmental implications.

Consultation Undertaken:

None.

Background Papers:

None.

Impact Assessments:

There are no equalities or risk management impacts.