

COMMITTEE Audit Committee	DATE 21 st September 2010	CLASSIFICATION Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Chris Naylor - Director of Resources		TITLE: Annual Governance Report 2009/10		
ORIGINATING OFFICER(S): Alan Finch – Service Head, Corporate Finance		Ward(s) affected: All		

Special Circumstances and Reasons for Urgency

- The report was unavailable for public inspection within the standard timescales set out in the Authority's Constitution, because of the continuation of discussions between the Council and its Auditors regarding items of account which it had been anticipated would be completed in time for publication of the agenda for this meeting of the Audit Committee.
- The Corporate Director of Resources recommends that committee note the findings of the annual governance report for 2009/10 to allow the auditors to provide their audit opinion by the statutory deadline of 30th September 2010.

1. SUMMARY

- 1.1 This report presents the Authority's draft Annual Governance Report for 2009/10. Their report is attached to this covering report. As the audit is continuing at the time this report was prepared, the auditors will provide any updates at the meeting. A separate report is prepared for the pension fund, this is also attached.
- 1.2. The findings of the report is that an unqualified audit opinion is expected to be provided and adequate arrangements to secure value for money have been achieved, though there are some internal control concerns that the auditors wish to bring to Member's attention. This report expands officer's comments that have been included within appendix 6 of the audit report.

2. RECOMMENDATIONS

Audit Committee is recommended to:-

- 2.1 Note the draft Annual Governance Reports for 2009/10 for both the Statement of Accounts and Pension Fund, in particular consider and agree the points on page 5 of the respective reports.
- 2.2 Note that if the auditor identifies any further significant issues, then they will bring them to the attention of members. The chief finance officer will also brief members of the committee and, if necessary, prepare a formal report to the next meeting of the committee.

LOCAL GOVERNMENT ACT, 1972 (SECTION 100A)
LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"

*Name and telephone number of holder and
address where open to inspection*

Draft Statement of Accounts 2009/10 – LB Tower Hamlets

Alan Finch (Tel 0207 364 4915)

3. BACKGROUND

Each year, the external auditors conduct a review of the draft financial statements before issuing an opinion on the robustness of the accounts. An unqualified opinion indicates that the accounts give a true and fair view and that there are no major issues that bring in question the integrity of the accounts. The auditors are required to provide their opinion by 30th September 2010.

4. ANNUAL GOVERNANCE REPORT

- 4.1 The auditors have almost completed their audit and expect to provide an unqualified opinion on the Statement of Accounts and Pension Fund. Their report outlines some matters that they wish to bring to the attention of members as part of the review of the financial statements – they outline these in paragraphs 9 to 12 of their main report. Some changes to the draft accounts have been made, these have required little change to the council's reported income and expenditure account and net worth on the balance sheet – usable reserves have been unchanged from the draft accounts, so have not changed the council's usable resources. Officer's comments are included within appendix 6 of the auditor's main report and appendix 3 of the pension report, however further information is provided below:

Financial Statements Audit

- 4.2. **Tower Hamlets Homes (THH) pension costs guarantee** (paragraph 9 and 11 of audit report). Following the creation of the ALMO, the council has included THH's pension fund deficit within the Council's group accounts. However as the pension deficit increased from £125,000 to £19.3 million in 2009/10 due to changes in actuarial assumptions on the increase in future pensions payable and investment returns on assets, a review of the accounting treatment has been conducted. As the Council is responsible for paying the ALMO's pension contributions through a management fee and for ensuring future pensions are funded, officers have added the £19.3million pension deficit within the Council's balance sheet under the FRS17 rules to ensure the pension liability is treated consistently. The accounting treatment of this does not affect the financial standing of the Council at 31st March 2010, as the future pension contributions to meet this deficit will be budgeted for in the future. It should be noted that there are a number of major assumptions built into the deficit calculations that result in major swings in deficit figures from year to year, so the £19 million deficit may not become payable – actual investment returns or forecast pension increases may be more favourable over time from the perspective of the pension fund.
- 4.3 The auditors have asked for the post ALMO creation pension deficit of £1.3 million to be treated differently by creating a £1.3 million provision from usable HRA reserves. In effect this would reduce the Council's usable resources as a result of having an ALMO rather than providing the services in-house, therefore officers do not believe it is appropriate to create the provision under FRS12 rather than FRS17. Officers have liaised with a number of other councils on the accounting treatment of ALMO pension deficits, some larger

than THH, none have reduced usable reserves by creating FRS12 provisions. **Officers disagree with recommendation R1 and the accounts have not been adjusted in line with audit recommendations.**

- 4.4. **Financial instruments note** (paragraph 10). It was identified that some non statutory debtors, creditors and cash had not been included within the financial instruments notes. As these items were correctly incorporated within the council's balance sheet, this is a disclosure amendment to the notes – the balance sheet contained these items. The 2008/09 note has been restated to also include the equivalent balances. **Officers have incorporated recommendation R3 and a review of disclosures will be conducted for the 2010/11 accounts.**
- 4.5. **Property Revaluation/Impairment** - officers had disclosed revaluation changes to fixed assets the same way as previous years in grouping together increases in values and falls in values (impairments) – note this type of impairment is different from an impairment of an asset's value from the use or permanent fall in value (i.e. as a result of fire damage). However the auditors have requested that the increases and decreases in fixed assets are shown separately to be SORP compliant. Officers have made this change, though believe that page 168 of the SORP guidance notes supports the initial treatment in that impairments as a result of a formal valuation are included as part of revaluations. The guidance notes are more detailed but have a lower standing than the SORP. **This amendment does not change the financial position of the council, so have implemented recommendation R2.**
- 4.6 **Fixed asset additions** (paragraph 11). Following a review by Property Services, a number of properties were identified that should have been added to the balance sheet. As these were identified late in the financial year, after the annual valuation had been conducted, it was not possible for Property Services to arrange full valuations in time for the preparation of the draft accounts. The auditors raised concerns that the exclusion of these assets would materially affect the balance sheet, so Property Services provided some approximate valuations based on their knowledge of the buildings (without inspecting them) to demonstrate the value of these assets was around £4.5 million. As these valuations are estimated and the assets only represent 0.2% of the council's £2.1 billion of fixed assets, the assets have not been included within the accounts – exclusion does not materially impact upon the financial statements. Proper valuations will be conducted in 2010/11 as part of the accounts preparation.
- 4.7 **Finance lease review** (paragraph 11) – as part of implementing IFRS, the council has undertaken a review of leases to ensure that they are accounted for in line with IFRS requirements. As part of this review three equipment leases were identified. The accounting rules require that if a lessee takes ownership of an asset at the end of the contract, the lease is for practically all of the asset's life or if the net present value of lease rentals equates to almost the original value of the asset, then the assets should be shown on the lessee's (the Council) balance sheet. As the value of the assets leased is only £143,000 (£188,000 including future rentals due), exclusion does not have a material impact upon the financial statements.

Internal Controls

- 4.8 **Internal Control Concerns** - the auditors have highlighted four internal control issues within their report (paragraph 13). They are as follows:
- 4.9 **Journal review** – an incorrect journal for £113.48 was discovered by the auditors. This journal had been corrected by officers so did not mean that the accounts were incorrect, however officers who process journals will be reminded to ensure that checks of journals are conducted. **Officers agree with recommendation R4.**
- 4.10 **Bank reconciliations** – some schools completed their bank reconciliations on the last day before the Easter break (26th March 2010), this meant that the bank reconciliations did not include some cheques that cleared in the latter part of March. Schools officers did this so not to delay closedown work. The value of these transactions across the eight schools was around £160,000. The reconciliations for April 2010 would have reconciled these movements. **Officers agree recommendation R11.** Staff absence caused a period where the Council's main bank account was not formally reconciled, however internal audit obtained assurance on the process from controls within banking software when controls were audited.
- 4.11 **Payroll data amendments** – the auditors have identified an error in pension contribution deductions in one case. The member of staff who made the incorrect adjustment has been identified. The Payroll Manager has arranged for monthly reports to be generated to highlight errors in pension contribution rates. **Recommendation R5 has been implemented.**
- 4.12 **System reconciliations** – managers who are responsible for overseeing reconciliations will be asked to evidence their reviews on the reconciliations. In addition, service continuity arrangements will be put into place – other banking software conducts reconciliations – this enabled internal audit to place reliance on the systems of control even whilst the main bank reconciliation was not conducted. **Officers agree recommendation R6.**

Other Financial Statement Observations

- 4.13 **Financial Statement review** - the timescale for preparing the financial statements has been reduced in recent years to three months (the timescale for completing the audit has remained unchanged). Officers plan to review the closedown timetable to ensure there is additional time to review the accounts prior to submission to Audit Committee in 2011. This will also provide more time to prepare audit working papers before the commencement of the audit to **comply with recommendation R7.**
- 4.14 **Amendments to draft accounts** – appendix 2. The auditors have listed changes made to the accounts. None of these change the usable reserves of the accounts as any changes to the Income and Expenditure account also result in an equal and opposite change to the Statement of Movement in General Fund balance.
- 4.15 **Response to audit queries** – the auditors have acknowledged that changes to audit guidance has meant they have changed their approach to auditing balance sheet items, this has required additional, historical information to be

obtained from system reports. The auditors have also increased the depth of testing as a result of these reports not being available. Officers will ensure that this information for the 2010/11 accounts is obtained from systems at the balance sheet date, thus ensuring it is available at the start of the audit. The auditors did acknowledge at the start of the audit that working papers were better than previous years, though there have been problems in obtaining some historic reconciliation data from systems. **Officers will meet with the auditors following the conclusion of the audit to discuss how processes can be improved for the future as per recommendation R8.**

- 4.16 **Approval of Accounts** - the auditors have noted that the Council's draft Statement of Accounts was not approved by the 30th June 2010. **Recommendation R9 is that the financial statements are approved by 30th June in future years.**
- 4.17 **Councillor related party declarations** – nine Councillors had not returned related party declarations. Member Services will send reminders for 2010/11 to **comply with recommendation R10.**

Pension Fund Audit

- 4.18 **Pension Fund report** – The auditor's pension fund AGS is also enclosed. The six audit recommendations included in appendix 3 of the report are covered within the audit of the council's main statement of accounts. Recommendation 3 relates to a change in pension contribution rates.
- 4.19 Attached to the pension report is the auditor's annual fee letter for the pension fund.

5. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 5.1 The comments of the chief financial officer are incorporated within this report of which he is the author.

6. RISK MANAGEMENT

- 6.1 There are no specific risk management implications.

7. CONCURRENT REPORT OF THE CHIEF LEGAL OFFICER

- 7.1. This report presents the annual governance report, which deals with the results of the 2009/2010 audit. The Council's accounts are required to be audited pursuant to the Audit Commission Act 1998. The Accounts and Audit Regulations 2003 set out further detailed requirements concerning the preparation of a statement of accounts. The consideration of the annual governance report is one of the functions of the Audit Committee under the Council's Constitution.

8. ONE TOWER HAMLETS CONSIDERATIONS

- 8.1 The Statement of Accounts is a single statement of the financial position of the whole Council which is potentially of interest to all individuals and organisations which have dealings with the Council.
- 8.2. The statements are published on the Council's website both in draft and in audited form. Interested parties had the right to inspect the accounts during the audit and local electors have the right to question the auditor.

9. ANTI-POVERTY CONSIDERATIONS

- 9.1 There are no specific anti-poverty implications arising out of this report.

10. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT (SAGE)

- 10.1 There are no SAGE implications arising out of this report.