Non-Executive Report of the: **Audit Committee** 14th November 2019	TOWER HAMLETS
Report of: Corporate Director, Resources	**Classification:** Open (Unrestricted)
Statement of Accounts 2018-19 - Progress Update	

Originating Officer(s)	Tim Harlock, Interim Chief Accountant Kevin Bartle, Interim Divisional Director of Finance, Procurement and Audit
Wards affected	All (**All Wards);**

Executive Summary

This report is intended to provide Members with an update on the work to complete the corrections arising from the external audit of the 2018/19 Draft Statement of Accounts.

The report aims to cover the significant areas of challenge, but it should be noted that there is also considerable follow-up work arising, and outstanding, that the external auditor, Deloitte, will need to conclude on.

Recommendations:

The Audit Committee is recommended to:

1. Note the progress made on the points raised by Deloitte in their report to this committee on 23 July; and,
2. Note the emerging matters since that last report.

1. REASONS FOR THE DECISIONS

1.1 The Accounts and Audit Regulations 2015 require that each Local Authority approve its audited financial statements by the statutory deadline of 31st July each year. Since that deadline has been missed it is incumbent upon the Council to have its financial statements signed off as soon as practically possible thereafter.

2. ALTERNATIVE OPTIONS

2.1 The Council produces its Statement of Accounts in line with the relevant guidance and legislation.

2.2 This report is produced to ensure the correct approval process is followed and Members are kept informed of the Council's financial position; as a result no alternative action is considered appropriate.

3. DETAILS OF THE REPORT

3.1 In July, Members received a report from Deloitte detailing matters encountered during their audit of the authority's Statement of Accounts that they wished to highlight. This report will follow that broad outline of matters, incorporating new aspects of enquiry, or requiring correction, within those same main subject themes where possible.

3.2 **Valuation of Property Assets** - Deloitte requested information to support inputs to the valuation of properties and requested explanations of valuation methodology. In the course of producing said response and examining the underlying detail some errors have emerged. Detail by asset class as follows:

Council Dwellings	*No further action anticipated*.
Other Land And Buildings - Schools	In providing the responses to sample testing, it was realised that land valuations had not been performed accurately; officers are in correspondence with the external valuers to correct this. Once figures have been finalised, it is likely that a significant adjustment will be required, and consideration will need to be given as to whether it will be necessary to restate both the opening and closing balance sheets for 2017/18. Furthermore, it should be noted that Deloitte are scrutinising the valuations of the building elements, to ensure that they are consistent with the detail of the "depreciated replacement cost" methodology, which is quite prescriptive and based on the concept of Modern Equivalent Asset. This adjustment will have no impact on General Fund (GF) reserves and balances. *To be scrutinised by Deloitte.*
Other Land And Buildings - Temporary Accommodation	Due to the timing of the revaluation calendar, under which many asset classes are valued as at 1st April 2018, substantial numbers of properties which were purchased for Temporary Accommodation during the year 2018/19 were not valued under the appropriate valuation basis as at the balance sheet date (31

	March 2019). In the draft Statement of Accounts, these new purchases had been included on the balance sheet at their purchase price of £34.7m and not revalued; however, the correct valuation basis is Existing Use Value, and officers have since instructed valuers to value accordingly. The revised figure came back at £23.4m. In addition, some of the properties purchased were undergoing renovation works to bring them up to desired standards, thus rendering them not yet operational. Technically therefore, those particular properties should be classified as Assets Under Construction. The resulting reclassification will be of the value £24.3m. These adjustments would have no impact on GF reserves and balances. *The above is yet to be formally reviewed by Deloitte*.
Infrastructure Assets	In detailed discussion with the Head of Highways, officers have assessed the most appropriate Useful Economic Life (which is used for depreciating assets down) for all constituent elements within this asset class; rather than the current 40 years, 25 years was considered to be a reasonable weighted average for all constituent elements other than tunnels, for which 120 years was deemed appropriate. Had this UEL been applied in 2018/19, it would have resulted in a higher depreciation charge of £7.9m rather than the £3.9m applied. This adjustment will have no impact on GF reserves and balances. The above has been discussed with Deloitte. *Officers are minded not to amend the accounts for this, but to defer adoption of new UELs until 2019/20.*

3.3 **Capital Expenditure -** there are no outstanding queries other than an identified under-accrual of expenditure of £3.4m, which officers will amend for in the next version of the accounts.

3.4 **Pension Liabilities and Lump-Sum Payment to Pension Fund** - there are several points of challenge:

Assumptions feeding into the actuary's IAS 19 report	The key assumption under scrutiny was the assumed rate of salary increases, at 2.3%. Officers have concluded that, although lower than many other authorities, this assumption is not inconsistent with experience in recent years or internal planning assumptions, and is therefore a reasonable estimate. *No further action anticipated.*
Estimated pension assets	Although there is inconsistency of figures between

being c£28m higher than the Council's share of the assets as disclosed in the Pension Fund accounts	the main accounts and the Pension Fund accounts, after checking with Hymans Robertson (the Council's Actuary), officers have concluded that this has arisen from the IAS 19 report not being based on actual data as at 31 March 2019 (unlike the Pension Fund accounts). Explanation provided by the actuary has been shared with Deloitte. *Officers await Deloitte's view on this matter.*
The Council paid a lump-sum "up front" of £43.4m to the Pension Fund in 2017/18, rather than three separate payments of £15m over the three years 2017/18, 2018/19 and 2019/20.	The required payment profile was specified in the "rates and adjustments certificate", and according to a detailed reading of the legislation this is indeed how monies should have been paid over. Clarification on this matter was provided by legal counsel, who also added that if challenged it seemed highly unlikely that a court would grant any relief as it was of an entirely technical nature, being primarily an administrative issue. It should be noted that the then Chief Accountant was in communication with the actuary over this matter, and also presented a report for approval of this decision to the Pensions Committee on 21 September 2017. *Officers await Deloitte's view on this matter.*
Unfunded Liabilities	Outside of the Tower Hamlets Local Government Pension Scheme there is an unfunded liability which had not been assessed within the draft accounts (as required by the CIPFA Code). This arose from discretionary awards upon retirement made to teachers over several decades – where the Council continues to pay a top-up element of pension each month (ie that element which the accrued contributions previously paid to the Teachers' Pension Fund does not provide for). *This liability has been assessed as £9.4m and will be included within the balance sheet of the revised accounts. (It has no impact on the GF reserves and balances as presented in the accounts).*

3.5 **Collection Fund-related items** – in Deloitte's report of 23 July, they mentioned release of a creditor balance of £20m and the challenge with respect to the (low) level of provision against appeals made by business ratepayers:

Creditor balance of £20m	Officers have investigated the history of this creditor balance, and have reviewed previous years to ascertain its history (on a "most likely" scenario, as we do not have complete records). It appears that errors were made on a consistent basis over a number of years prior to 2013 in the calculation and

	journaling of the bad debt provision, thus giving rise to an erroneous surplus in the Collection Fund. In 2013 this erroneous surplus was credited to the Council's own balance sheet as creditor, whereas the correct treatment would have been to leave it within the Collection Fund. In 2018/19 this surplus was taken to revenue codes, and subsequently a proportion to reserves. *Officers have concluded that the correct treatment is to reverse the whole £20m back to the Collection Fund.* *Officers are finalising the detailed working papers before presenting to Deloitte.*
Low level of provision against appeals to rateable values	Officers have performed benchmarking against other London authorities by way of assessing provision as a percentage of total rateable value. The total provision of the Tower Hamlets Collection Fund was found to be a complete outlier, at 0.2%, whereas the broad range of consensus was within the range 2-6%, with overall average at 4%. *The Council will top up the provision to ensure it falls inside that generally accepted range. The overall impact to the Council's accounts is still being assessed and officers are finalising the detailed working papers before presenting to Deloitte.*

3.6 **Implementation of IFRS 9 and IFRS 15** - although officers do not expect there to be noticeable impact, if any, arising from the implementation of these new reporting standards, there is a need to provide working papers such that Deloitte can scrutinise the assessment made. Officers will work to improve the level of working papers.

3.7 **Other financial reporting matters** - there are several elements that Deloitte made observation on; these will be incorporated in the next version of the accounts, including:

- Accounting policies
- Critical accounting judgments
- Cash flow statement
- Elimination of internal recharges
- Narrative report

3.8 Further points of significant activity (emerging matters that have come into sharper focus since the last report) - these are detailed below:

Review of revenue accruals	Testing of an initial sample of accruals items identified an unacceptably high level of error was identified (in particular several of the items accrued for should not have been). Officers agreed with Deloitte to perform an extensive

	reviewing exercise of the accruals raised, with a view to amending where significant error had occurred. *This exercise is ongoing, though drawing close to conclusion, and anticipates an increase on the revenue outturn in excess of £2m.*
Accrual for leaseholder contributions to the costs of major works on housing properties	Where major works are undertaken on blocks of housing, the costs that are attributable to leaseholders are billed to them. In recent years this billing has fallen behind, in particular due to the expanded programme of Decent Homes, and the need to obtain final completion from contractors. Tower Hamlets Homes has been pro-actively implementing an exercise of catch-up billing; nevertheless, it has been estimated that as at 31 March 2019, £15m of contributions should have been accrued for. *Officers are finalising the detailed working papers before presenting to Deloitte.*
Loss allowance for bad debt for the above ("bad debt provision" in pre-IFRS 9 terminology)	Currently there is no loss allowance set aside against leaseholder contributions for major works. Although recovery processes as implemented by THH appear to be reasonably robust, and the level of write-offs in recent years has certainly reduced markedly in recent years, it is unlikely that a gross debtor of c£35m should have nil loss allowance for bad debt. Officers continue to test and consider what an appropriate level might be. *Officers are finalising the detailed working papers before presenting to Deloitte.*
Receipts in Advance	In particular in the area of Community Infrastructure Levy, the Council has not been accounting on a full accruals basis. Income should be recognised in the accounts upon "commencement of development"; in practice the raising of the invoices sometimes gets delayed for sound practical and operational reasons due to delays in getting finalisation of details (eg architects' drawings illustrating relevant floorspace), and, conversely, sometimes monies get paid ahead of time. Officers are performing thorough assessment of CIL billing, and eligible schemes, and will ensure robustness in the stated RIA and accruals figures. (Unfortunately, the CIL billing system does not facilitate this exercise with system reports, and so this has turned into a time-consuming manual exercise). *Officers are finalising the detailed working papers before presenting to Deloitte.*
Grants accounting – "grants with conditions"	In technical accounting terminology, "with conditions" is interpreted to mean unspent grant monies are

	subject to active recovery processes by the donating government department – and therefore should be shown as creditors on the balance sheet. In practice, most grants are simply “ring-fenced” (despite the voluminous stipulations provided by donating departments), meaning that unspent monies should be recognised as income in-year, and then lodged on the balance sheet as earmarked reserves. Officer assessment indicates that about £7m will need to be reclassified in this way (resulting in an increase in earmarked reserves of said amount, although this should not be viewed as “new resource”, rather “re-badged resource”.). *Approach has been agreed with Deloitte.*
Grants accounting – debtor balances	A debtor should be set up where the Council is owed monies that relate to that particular financial year (eg a government department has only paid 3 instalments by 31 March out of the 4 quarterly payments due, thus leaving one instalment due for the year). However, for Dedicated Schools Grant and PFI credits, debtors were set up even where all monies due had been paid in-year. Clearing these debits to revenue will result in a reduction of £5.9m on the General Fund balances and reserves. *Approach has been agreed with Deloitte.*

4. EQUALITIES IMPLICATIONS

4.1 There are no direct equalities implications within this report.

5. OTHER STATUTORY IMPLICATION

5.1 VALUE FOR MONEY CONCLUSION

Deloitte will report on the Council’s arrangements for securing economy, efficiency and effectiveness in its use of resources as part of its audit report on the Statement of Accounts.

6. COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 The Statement of Accounts is being restated so as to take account of the significant errors found to date.

7. COMMENTS OF LEGAL SERVICES

7.1 The Council is required to prepare a statement of accounts in accordance with the Accounts and Audit Regulations 2015. The statement must include statements about the housing revenue account (setting out prescribed particulars) and each and every other fund in relation to which the Council has a statutory function to keep a separate account. The statement must include notes demonstrating that Dedicated Schools Grant has been deployed in accordance with regulations; of the number of employees in each £5,000 salary bracket starting at £50,000, not including senior employees; and of the remuneration and the Council's contribution to pension for each senior employee.

7.2 The Accounts and Audit Regulations 2015 specify a procedure for signing, approval and publication of a statement of accounts. The chief finance officer is required to sign and date the statement of accounts by 31 May each year, certifying that it presents a true and fair view of the Council's financial position at the end of the relevant financial year and of the Council's income and expenditure for the year. The Audit Committee must approve the statement of accounts by 31 July each year and the statement must be signed by the chair of the meeting at which the accounts were approved. The statement of the accounts must be published by 31 July along with any certificate, opinion or report issued or given by the Local Auditor under the Local Audit and Accountability Act 2014.

7.3 As indicated in the report, it is consistent with good practice for the committee to see the statement of accounts at an early stage, given that it will be asked to approve the accounts upon completion of the audit.

7.4 The Council has a duty under the Local Government Act 1999 to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness. This is referred to as the Council's best value duty. The Annual Financial Report for 2018-19 will go towards demonstrating that the Council is meeting this duty.

7.5 When making decisions, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who do not (the public sector equality duty). There are no direct equality implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report

Annual Financial Reports 2018-19, presented to Audit Committee on 23 July 2019

Appendices

None

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report
List any background documents not already in the public domain including officer contact information.

- NONE

Officer contact details for documents:

- Tim Harlock, Interim Chief Accountant (ext. 6791)