Report to the Audit and Governance Committee

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Epping Forest District Council

Portfolio: Finance and Economic Development

Subject: Statutory Statement of Accounts 2010/11

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Recommendations/Decisions Required:

That a report be submitted to the Council recommending that the Statutory Statement of Accounts for 2010/11 be adopted.

Executive Summary:
The previous meeting of this Committee received a report outlining the changes to the annual Statutory Statement of Accounts in order to comply with the requirements of International Financial Reporting Standards (IFRS). That report also informed Members of the change implemented by the Accounting and Audit Regulations 2011 which removed the requirement for the accounts to be scrutinised by this Committee and approved by Council prior to the audit.

It is anticipated that the audit will be completed shortly and that the Statutory Statement of Accounts will be presented to Council on 27 September. There is a separate report elsewhere on the agenda that sets out the key findings of the audit.

Even though the timing of the review has changed, this Committee still has a role in scrutinising the annual Statutory Statement of Accounts. All Members of the Council will have the opportunity to debate the Accounts at Full Council on 27 September and part of that debate will be to consider the recommendation of this Committee.

To assist Members with their consideration of the Accounts a 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 Statutory Statement of Accounts. If Members are satisfied with the content of this report and the verbal responses to any questions raised, they are requested to recommend the Statutory Statement of Accounts for adoption by Full Council on 27 September.

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 require Full Council or an Executive Committee to adopt the Council's Statement of Accounts before the end of September. 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 Member scrutiny. This Committee has scrutinised the Statement of Accounts for the previous four 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 2010/11

3. Given the size and significance of the changes necessary to comply with the requirements of IFRS it is worth repeating some of the information from the previous report referred to above.

4. The Income and Expenditure Account which, as its name suggests, recorded the in year income and expenditure and the Statement of Total Recognised Gains and Losses (STRGL) which recorded other gains and losses have been replaced by the Comprehensive Income and Expenditure Statement (CIES). This is intended to bring together all gains and losses during the year and report them in one statement. The total at the bottom of the CIES is therefore equivalent to the total that would have previously been recorded at the bottom of the STRGL.

5. The Statement of Movement on General Fund Balance was a statement that reconciled the surplus or deficit on the Income and Expenditure Account to the amount to be added to or taken from the General Fund Balance as a result of the year's activities. This statement now forms part of the Movement in Reserves Statement, which tracks all movements on all reserves in the bottom half of the Balance Sheet. There is still a requirement for a note detailing all of the items to be reversed out to get from the surplus or deficit on the CIES to the General Fund Balance but this now includes even more items than before and is referred to as "Adjustments between accounting and funding bases under regulations".

6. The Balance Sheet is the statement of net worth, the balance representing the net value of the Councils assets. Whilst there are presentational changes within the statement, the statement itself looks broadly similar. The Cashflow Statement is still in existence but is now in a more summarised form. The statement now reports the movement on cash and cash equivalents. The category described as cash will contain some items that would previously not have been reported as cash hence the totals on the comparatives will not match those shown in the 2009/10 Statutory Statements.

7. There have been a number of changes to the notes to be included in the statement with some additional notes, some changes in content and some no longer required. A detailed listing of the notes and changes was discussed at the last meeting of the Committee and that list has not been re-produced with this report.

Critical accounting policies and practices, and any changes to them

8. The most significant change in terms of value and the impact on the Balance Sheet is one that is unrelated to IFRS. To reflect the reduction in value caused by the existence of secure tenants, Council housing has a vacant possession value calculated which is then reduced by a factor to get to an existing use for social housing valuation. This factor is determined by the Government and then issued in guidance as a figure to be applied by all housing authorities. In the 2009/10 accounts the vacant possession value was multiplied by 46% and in 2010/11 this has been reduced to 39%. This change has had the effect of reducing the value of council dwellings and garages on the Balance Sheet by £100 million. The amount shown on the CIES under “Exceptional Items” as “Change in Discount Factor” is only £77 million as £23 million has been charged to the Revaluation Reserve against previous upward revaluations.

9. The largest change to fixed asset accounting introduced by IFRS is componentisation. Historically large assets have been treated as single whole items and a single rate of depreciation has been applied. Now when an asset is revalued or a component replaced or created significance tests are done to see if an item needs to be separately accounted for and depreciated. This is to ensure that the depreciation charge accurately reflects the differing useful lives of components. The value of plant and equipment within council dwellings and the Loughton Leisure Centre have been identified as significant and componentisation has been applied to them.

10. The treatment relating to Capital Grants and Other Contributions has been changed under IFRS. Previous practice to amortise Capital Grants over the same period as the depreciation charged relating to the asset in question has been discontinued. Where a grant or contribution has been received the first consideration is whether there is a condition attached to the receipt of that grant. Where there is no condition or the condition is met then the income is recognised in the CIES. This income must then be reversed out within the Movement in Reserves Statement. If the related expenditure has been incurred the reversal is to the Capital Adjustment Account, if the expenditure has not been incurred the reversal is to the Capital Grants Unapplied Account.

11. Where a condition is not met the income must be recognised in the Capital Grants Received in Advance Account. If in a future accounting period the condition is met, at that point the grant income is recognised in the CIES and reversed out in the Movement in Reserves Statement as before. If there is no prospect of the conditions being met the grant monies are held as a Creditor until such as time as repayment can be made. Where the only condition attached to a grant is that it must be spent on a particular asset or used for a particular purpose then the condition is assumed to be met only when expenditure actually occurs.

Decisions requiring a major element of judgement

12. 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. 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.

13. Two of the additional notes required by IFRS are relevant here, note 3 "Critical judgements in applying accounting policies" and note 4 "Assumptions made about the future and other major sources of estimation uncertainty". The key critical judgement highlighted in note 3 is that the Council does not currently need to close facilities or significantly reduce levels of service provision. If this were not the case it would be necessary to consider any assets that would be affected and any consequent impairment of their values.

14. Three areas are covered by note 4, these are firstly property, plant and equipment, secondly pensions liability and finally arrears. The assumption made on property, plant and equipment is that assets will continue to be maintained so as to maximize their useful lives. If this were not to be the case additional depreciation would need to be charged. In reviewing arrears an estimate has to be made to allow for bad debts and, whilst a prudent view is taken in making this calculation, if the economic climate were to worsen significantly the charge to the CIES would increase.

15. In these reports in previous years I have commented on the movement in the pension liability in the next section, as it could be seen as an unusual transaction. However, the significant reduction in the liability this year has made clear the element of judgement exercised by the actuary in establishing the pension figures. The largest creditor on the Balance Sheet is the Council's liability to the pension fund. The Balance Sheet shows that the pension liability for the Council has reduced in the year from £56.5 million to £46.3 million. The value of the scheme assets has increased during the year and the projected liabilities have reduced by even more. The main factor in reducing the schemes liabilities has been the changes in the benefits available under the scheme. These changes have created a "Past Service Gain" which is shown on the CIES as part of the "Exceptional Items", with the gain being split between the General Fund £5.3 million and the Housing Revenue Account (HRA) £2.5 million.

16. The following table is included to illustrate how the overall deficit has fluctuated over time, in part due to changes in asset values but also due to the judgements made by the scheme actuary (Mercer).

	2010/11 £'m	2009/10 £'m	2008/09 £'m	2007/08 £'m	2006/07 £'m
Liabilities	(130.1)	(139.2)	(102.3)	(120.4)	(111.2)
Assets	83.8	82.7	60.8	76.9	82.4
Deficit	(46.3)	(56.5)	(41.5)	(43.5)	(28.8)

17. 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 2011. It does not mean that this full liability will have to be paid over to the pension fund in the near future.

18. 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 Code of Practice advice has been sought from CIPFA and staff have liaised closely with both the External Audit Manager and other Essex authorities.

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

19. Where a transaction has been separately disclosed as an Exceptional Item it clearly needs to be mentioned in this section. Last year the Council received a substantial VAT refund relating to over declared VAT and interest on output tax charged on supplies of sporting services between 1 January 1990 and 31 March 1994. A number of authorities across the country made similar claims and Members may have seen them described in

the press as “Fleming Claims”. The claim produced a net benefit of £1.2 million. This year a further net refund of £0.7 million has been agreed in relation to sports tuition for the periods from 1 January 1978 to 31 December 1989 and 1 April to 31 July 1994.

20. One very large transaction has taken place that has not affected the Balance Sheet or the main fixed assets note, as these show the aggregate position on the different funds. The consultation document on self-financing for the Housing Revenue Account (HRA) highlighted that assets not related to the landlord function should be held in the General Fund (GF) and not the HRA. Having considered this issue, Council decided on 2 November 2010 to transfer all of the commercial properties held within the HRA to the GF. The value of the assets transferred was £16.5 million and more details are provided in the notes to the HRA.

21. Another unusual item is the Council’s investments that are currently held as part of the administration of the Heritable Bank. The accounts reflect the view of the administrators, Ernst & Young, at the year end, which was a return to creditors of 85p in the £. The latest update has increased the projected to return to between 86p and 90p. If the amounts impaired prove to be excessive adjustments will be made in subsequent sets of accounts.

22. 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. 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.

23. Since 2005/06 the Council has applied each year to the Secretary of State for capitalisation directions. Full directions had been obtained for all years other than 2006/07 when directions were issued for only 57% of the amounts requested. However, the amounts capitalised in 2010/11 were restricted to 38% of the amounts applied for, leaving the amounts capitalised as £451,000 (£644,000 in 2009/10) General Fund and £211,000 (£302,000 in 2009/10) Housing Revenue Account.

Significant adjustments resulting from the audit

24. It is always hoped that there will be no significant adjustments arising from the audit. However, given the additional complexity and detail of IFRS the possibility of a significant adjustment cannot be ruled out. Any significant adjustments that are made to the Statement of Accounts will be reported to this Committee.

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

25. 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 2010/11. 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 September and as part of the overall governance framework the Accounts should be subject to Member scrutiny prior to their approval.

Safer, Cleaner and Greener Implications:

There are no environmental implications.

Consultation Undertaken:
None.

Background Papers:
Previous reports on IFRS to this Committee, 15 November 2010, 4 April 2011 and 23 June 2011.

Impact Assessments:
There are no equalities or risk management impacts.