

Item No: 8.1	Classification: Open	Date: 20 October 2004	Meeting Name: Council Assembly
Report Title:		Report on the final audited accounts for the year 2003/04	
Ward(s) or Group affected:		All	
From:		Finance Director	

RECOMMENDATIONS

1. The Council Assembly approves the amended Accounts for the year ended 31 March 2004 (Appendix A) and notes the amendments to the Accounts for the year ended 31 March 2004 detailed in the recommendations below and in Appendix B.
2. That the Mayor, as presiding Member at the meeting of the Council Assembly, signs the Accounts, to indicate that the Accounts have been received and approved by the Council Assembly.
3. The Council Assembly notes the change in the reported valuation of Southwark's Housing Stock of £1,960 million as detailed in paragraphs 10 to 13, which has been prepared and approved by external professional valuers and accountants.
4. The Council Assembly notes the change in value of Other Property of £1.306 million as detailed in paragraphs 15 to 17.
5. The Council Assembly notes and agrees the amendment to the description of the balance of £10.652 million in note 15.6 of the Accounts for the year ended 31 March 2004 from its current title of Capital Expenditure Reserve to Modernisation, Service and Operational Improvement Reserve.
6. The Council Assembly notes and agrees the addition of £1.014 million to the Modernisation, Service and Operational Improvement Reserve as detailed in paragraphs 21 to 23.
7. The Council Assembly notes the report of the external auditors (Appendix C) and the response of Officers to the items raised set out in Appendix D.

BACKGROUND INFORMATION

8. Each year, the Chief Financial Officer prepares annual Accounts, signs them and presents them to the Council Assembly for approval. The 2003/04 Accounts were presented by the previous Chief Financial Officer to the Council Assembly on 21 July 2004. The financial statements are then audited by external auditors and the audited Accounts presented to the Council Assembly together with a report on amendments.

Four significant changes to the 2003/04 Accounts and a number of presentational and clarification amendments are necessary in order that the Accounts can be finalised and an unqualified audit opinion provided by the external auditor.

9. The completion of audit fieldwork results in the external auditor producing a report on governance matters, commonly called the SAS610 report (Appendix C). This highlights the key control and governance issues that they wish to bring to the Council's attention together with the draft of their audit opinion on the 2003/04 Accounts. Council officers have also provided their response to the matters identified (Appendix D).

HOUSING STOCK VALUATION

10. Southwark's housing stock, described as Council dwellings in the Consolidated Balance Sheet presented to Council Assembly on 21 July 2004, should be valued each year in accordance with standard accounting principles. The methodology for this valuation is provided in guidance from CIPFA and the Royal Institute of Chartered Surveyors (RICS). The process will arrive at a value described as Existing Use Value for Social Housing (EUV-SH), which recognises the reserved usage of these assets and the consequent impact on their valuation. In its simplest terms, the valuation requires an assessment of the vacant possession value of the housing portfolio and then a reduction of this amount by a percentage as set out in the guidance (currently 53%).
11. Unfortunately, the valuation methodology used by Southwark's valuation department was not in accordance with the regulations, and so the Balance Sheet valuations for Housing Stock as presented in the accounts for 2002/03 and 2003/04 are very significantly overstated. The Finance Director commissioned an exercise by outside consultants (Ernst & Young and FPD Savills) that has advised us of the appropriate valuation methodology and produced a value for the 2003/04 Accounts and restated 2002/03 comparative figures.
12. The pre-audit Accounts showed the value for Council dwellings to be £4,699 million at 31 March 2004. The Accounts have been restated in line with the above report to show a closing value for 2003/04 of £2,739 million. The reduction in value of £1,960 million is made up of £336 million from restating the 2002/03 Accounts and £1,624 million in 2003/04.
13. The valuation is purely an accounting exercise and does not produce any cash balances, does not affect the rate or valuation basis for council tax or housing rents, nor result in any usable reserves. All that happens with the revaluation amount is that it is added to the Balance Sheet Fixed Asset amount for this category and to an offsetting technical accounting reserve called Fixed Asset Restatement Reserve (see note 15.1 page 37 of the 2003/04 Accounts).
14. Clearly, the internal controls over the process for the revaluation of fixed assets did not operate sufficiently to ensure the correct value for Council dwellings was presented in the Accounts. In future, formal certification will be required from the Property Division, confirming that all control procedures have been adhered to, as well as providing documentary evidence to this effect.

CHANGE IN VALUE OF OTHER PROPERTY

- 15.** Southwark has two asset registers – one used by Property and Regeneration to monitor and control the stock and status of all assets and one by Finance to manage the financial data held in support for the Accounts. The Property register contains assets that will not be shown as Fixed Assets in our Accounts (e.g. wayleave rights for which we receive an annual rent) but we have found that there are other differences between the two registers that require correction. These are being identified in an exercise started during 2003/04 and continuing this year with corrections due to be made by 31 March 2005. However, the Council sold assets valued at £3.363 million during 2003/04 that were not recorded in the Finance asset register and also not in the Accounts. It is therefore necessary for the Accounts to be amended so as first record them as a Fixed Asset and then show them as sold.
- 16.** In addition, assets with a book value of £1.306 million were sold during 2003/04 but not removed from the Finance asset register and hence the Accounts. This correction has now been made.
- 17.** These changes are largely presentational and affect Fixed Assets (Note 1 page 30 of the Accounts) and the Fixed Asset Restatement Reserve (Note 15.1 page 37 of the Accounts). Cash receipts had already been properly recorded so these amendments do not produce any cash balances, do not affect the rate or valuation basis for council tax or result in any usable reserves. The control issues over Asset Systems used in Southwark are discussed more fully in the auditor's SAS 610 report (Appendix C) and addressed in Southwark's response (Appendix D).

AMENDMENT OF DESIGNATION OF SPECIFIC RESERVE

- 18.** Specific revenue reserves have been created in past years as part of Southwark's prudent financial management strategy as detailed in note 15.6 of the 2003/04 Accounts. One of these is described as Capital Expenditure Reserve and had a balance of £10.652 million at 31 March 2004 (pre audit). The rationale for this balance is to fund one-off expenditure for multi year projects of various descriptions that are designed to modernise and improve the service levels and operational efficiency of Southwark's activities.
- 19.** In discussions with the external auditors, and from other external advice received, we are advised that this balance could be more appropriately described to reflect the funding intention that it was set up for.
- 20.** The reserve designated as Capital Expenditure Reserve should therefore be reclassified as Modernisation, Service and Operational Improvement Reserve to more accurately reflect its intended use. The presentation of the final audited Accounts for 2003/04 will include this amendment but we are seeking early approval of this change so as to allow the Executive to allocate expenditure against the balance as part of their budget allocation deliberations.

ADDITION TO MODERNISATION, SERVICE AND OPERATIONAL IMPROVEMENT RESERVE

- 21.**In 1992/93 the Government paid off a proportion of Council debt which earned revenue subsidies from the Government. The Government then issued incorrect guidance on adjusting the calculation of annual debt and financing charges as a result of the debt repayment and the loss of subsidy. External audit has been correcting the calculation nationally, a separate exercise from the audit of the Accounts. The 2003/04 Accounts presented on 21 July corrected the position in the Council's favour. A further review during the audit of the Accounts identified an additional £0.807 million for the Council. This amendment has enabled a reclassification of this credit balance previously held in the capital financing reserve (see note 15.2 page 38 to the Accounts) to usable general reserves.
- 22.**The review has also identified an incorrect debit balance of £0.116 million that has historically been reported in stock, and previously unreconciled credit cash balances of £0.323 million that have now been reconciled. The net credit balance of £0.207 million can now be transferred to usable general reserves.
- 23.**It is appropriate that, since these are one-off items, they should be added to the Modernisation, Service and Operational Improvement Reserve. The addition of these items, total £1.014 million, to the reserve increase the reserve from £10.652 million (paragraph 17 above) to £11.666 million (Note 15.6 page 40 of the Accounts).

SUPPLEMENTARY ADVICE FROM THE BOROUGH SOLICITOR AND SECRETARY

- 24.**The Accounts and Audit Regulations 2003 place obligations on the Council to ensure its financial management is adequate and effective and complies with proper practice. Regulation 5 of those regulations provides that the Finance Director (s151 Officer) shall determine on behalf of the body, its accounting records, including the form of accounts and supporting accounting records; and accounting control systems. That officer shall ensure that the accounting control systems determined by him are observed and that the accounting records of the body are maintained in accordance with proper practices. It appears that revaluing the Housing Stock is an act that is being undertaken by the Finance Director in order to comply with his statutory obligations to comply with proper accounting practice.
- 25.**Council Assembly approved the designation of the Capital Expenditure Reserve when it approved the budget on 18 February 2004. The title for the reserve did not make it clear as to what the reserve would be used for. As the intended purpose of the Reserve has now been clarified, and in line with proper accounting practices, the Reserve should be redesignated. As approving the budget is within Council Assembly's remit, similarly redesignating a Reserve as being for the purpose of Modernisation, Service and Operational Improvements is a decision that should be taken by Council Assembly. This enables the Executive to then draw down on the reserve within the Budget framework.

REASONS FOR URGENCY

26. The Council's external auditors have a statutory duty to provide an opinion on the 2003/04 Accounts by 30 November 2004. Since there are material amendments to the Accounts, it is necessary for the Council Assembly to approve the amended Accounts as part of the sign-off procedures. It is also considered best practice to provide the Council Assembly with the external auditor's report on governance matters as part of this approval process. There is no Council Assembly in November to receive these items.

REASONS FOR LATENESS

27. It has not been possible to finalise the fieldwork necessary to complete the audit of the 2003/04 Accounts until after the date for distribution of reports for the Council Assembly on 20 October. An interim note was issued within the first distribution highlighting the matters to be considered. This report contains fuller details.

Background Papers	Held At	Contact
2003/04 Accounts	Town Hall, Peckham Road, London. SE5 8UB	Finance Director 020 7525 7180

Audit Trail

Lead Officer	Stephen Bishop, Finance Director	
Report Author	Stephen Bishop, Finance Director	
Version	Final	
Dated	14 October 2004	
Key Decision?	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments included
Borough Solicitor & Secretary	Y	Y
Executive Member	Y	Y
Date final report sent to Constitutional Support Services	14 October 2004	

Appendices attached –

- Appendix A Statement of Accounts 2003/04
- Appendix B List of changes to the Accounts since 21st July 2004
- Appendix C District Auditor's SAS 610 report
- Appendix D Response on issues raised in the SAS 610 report