LONDON BOROUGH OF CROYDON

REPORT:		**AUDIT AND GOVERNANCE COMMITTEE**
DATE OF DECISION		**20 April 2023**
REPORT TITLE:		**Update on the Accounts preparation of 2022-23 and prior years accounts**
CORPORATE DIRECTOR / DIRECTOR:		**Jane West** **Corporate Director of Resources and Section 151 Officer**
LEAD OFFICER:		**Allister Bannin, Director of Finance (Deputy S151 Officer)** **Ian Geary, Interim Head of Corporate Finance**
LEAD MEMBER:		**Councillor Jason Cummings, Cabinet Member for Finance**
DECISION TAKER:		**N/A**
AUTHORITY TO TAKE DECISION:		**N/A**
KEY DECISION?	**No**	**REASON: N/A**
CONTAINS EXEMPT INFORMATION?	**No**	**Public**
WARDS AFFECTED:		**All**

1 SUMMARY OF REPORT

1.1 This report provides an update on the work required to close the 2022-23 and prior years accounts. In particular it updates ongoing considerations to be finalised for the accounting treatment of arrangements with Croydon Affordable Homes and Croydon Affordable Tenures.

2 RECOMMENDATIONS

The Audit and Governance Committee is recommended to:

2.1 Note the ongoing work to close the 2022-23 and prior year accounts.

2.2 Note the ongoing considerations in relation to the accounting treatment of arrangements with Croydon Affordable Homes and Croydon Affordable Tenures.

3 BACKGROUND AND DETAILS

2022-23 Financial Year

3.1 The closure of the 2022-23 financial year is underway, with service areas reviewing the outturn position, and identifying any accruals or adjustments that are required to establish the correct amount of income and expenditure for the year.

3.2 The first stage of the production of accounts is to establish and review the provisional outturn against revenue and capital budgets for both the General Fund and Housing Revenue Account (HRA). The provisional outturn will be reviewed by directorate senior management and the Corporate Management Team, prior to being presented to Cabinet by July.

3.3 The second stage to produce the accounts is the calculation and addition of technical accounting entries required by various accounting standards. Accounting basis entries are typically transferred to a non-useable reserve and include revaluation gains/losses on property, retirement benefit costs calculated under IAS19 and timing differences relating to the Collection Fund (Council Tax and Business Rates).

3.4 The Council cannot publish its 2022-23 financial accounts until these accounting entries are calculated and completed. For example, the accounting transactions that relate to fixed assets (land and property) require the use of a fixed asset register to be calculated. The council's software provider of it's asset register can only make available three open financial years at one time. As the 2019-20, 2020-21 and 2021-22 financial years are all still currently open for adjustments, there will not be capacity to start calculating 2022-23 accounting entries until the 2019-20 accounts are concluded. It is expected this will be completed by the end of June, meaning the 2022-23 accounts would be available from the end of July 2023 at the earliest.

3.5 It must also be noted that the completion of the 2022-23 financial accounts is dependent on the resolution of queries raised to date (or to come) by the external audits of the prior year accounts. This includes the treatment of Croydon Affordable Homes / Croydon Affordable Tenures (please refer to further details below) as well as other queries which may be raised during the audits of 2020-21 and 2021-22.

3.6 The Department for Levelling Up, Homes and Communities (DLUHC) have consulted on a statutory deadline for the production of accounts of May 2023, which would revert back to the deadline in force for the 2017-18 and 2018-19 financial years (prior to the extended deadlines due to the Covid pandemic). The council would not be able to achieve an earlier deadline, but would publish the required statutory notice of delay in the production of accounts by the end of May if required.

Croydon Affordable Homes / Croydon Affordable Tenures

3.7 The accounting treatment of Croydon Affordable Homes and Croydon Affordable Tenures (CAH/CAT) has been under review as part of the 2019-20 audit by the Council's external auditor Grant Thornton.

3.8 As background, the Council leased 344 dwellings to the two entities on 80 years long leases (with an option to break at 40 years), in return for an upfront lease premium of £111.8m. CAH/CAT were able to pay this to the Council because they had received two sources of funding:

- a grant of Right to Buy receipts from the council for the provision of affordable housing, (£33.51m)
- The sale of the future income stream of the 344 properties to two external funders, in return for an upfront amount (£71.135m).

This was initially facilitated by loans from the council to CAH/CAT (£79.034m), which were repaid upon transfer apart from a residual balance (£8.125m) being repaid over the 40 year life of the leases.

3.9 The council had made the judgement that the long lease of the 344 dwellings was a finance lease, where substantially all the risks and rewards incidental to ownership were transferred to the CAH/CAT Limited Liability Partnerships (LLPs). This approach resulted in the disposal of the assets from the Council's accounts. The finance leases also resulted in a capital receipt to the Council (£111.8m), which was subsequently spent on both capital expenditure (£38.721m) and revenue transformation expenditure (£73.079m) allowable under the flexible capital receipts regime.

3.10 The judgement about the arrangement being a finance lease is now under consideration to be changed, due to the following factors:

- The Council will regain the properties at the end of the lease period, and the LLPs have no option to purchase them
- If the break clause was exercised, 40 years is not the majority of the overall life period of the assets being leased, given a proportion of the assets are land and also HRA dwellings are depreciated up to 80 years
- The lease payments may not amount to substantially all of the assets' fair value

CIPFA guidance states that if none of the above tests are satisfied, then a finance lease treatment cannot be used. Furthermore, there are other factors that could suggest the Council has retained the risk and rewards of ownership:

- The Council has retained nomination rights.
- Rent levels are controlled within an "affordable" range set out in the contract terms.
- The Council has guaranteed repayment of income to the funders, protecting the LLP from some of the commercial risks associated with property ownership.

3.11 Paragraph 3.10 could suggest the lease should be accounted for as an operating lease, which is revenue in nature rather than a capital disposal. However, it is also necessary to consider the overall substance of the arrangements, and not just their form.

3.12 This involves examining further tests set out in the CIPFA accounting code of practice:

- Does the seller enjoy substantially the same rights to the dwellings as before the arrangement?
- Is the primary reason to achieve a particular tax result, and not to convey the right of use?
- Is an option to repurchase the assets included on terms that make it almost certain?

3.13 Because of the way the series of leases involved in these arrangements interact, it is apparent that the transfers between the Council and the LLPs largely cancel out, and what remains in substance is the tenants paying rent to the Council, which the Council is transferring to the funders (Canada Life and Legal & General, whom provided upfront funding in return for income over the lease periods). An option being considered is that the arrangement could be viewed as a passthrough arrangement, where the Council has raised financing but retained economic control of the dwellings.

3.14 A passthrough arrangement means the leases by the Council are cancelled out when presenting the accounting position. This change would result in recognising the 344 properties back into the council's accounts as Council assets, as if they had not been sold. This would be accompanied by revaluations and depreciation calculations as required by standard accounting practices.

3.15 However, a key outcome of presenting the leases as a passthrough arrangement is that no capital receipt is generated. With the capital receipt being removed, this sum cannot be used to finance revenue expenditure under the flexible use of capital receipts regime during the period 2017-18 to 2019-20. Expenditure of £73.079m was funded in this way and would instead need to be funded from capitalisation direction, as the Council had no alternative method of funding this expenditure.

3.16 It would also result in a sum of £38.721m capital expenditure (the non transformation part) being funded from borrowing, instead of capital receipts. Both of these changes would require additional Minimum Revenue Provision (MRP) to be charged to the General Fund in the period 2018-19 onwards, to repay this borrowing. Note: this is not new borrowing in the cash sense: but internal borrowing that reflects the gap between capital expenditure incurred and capital resources available to finance it.

3.17 The loan financing from the third party funders (Canada Life and Legal & General) to CAH/CAT would be recognised as loan financing obtained directly by the Council (so show as Council debt rather than CAH/CAT debt).

3.18 Loans from the Council to CAH/CAT would be consolidated and therefore not show in the Council's accounts.

3.19 It could also result in the grant of right to buy receipts to CAH/CAT to be reversed. The council could account for this money as if it had directly used the Right to Buy funds for the initial acquisition of the 344 dwellings, instead of being funded from a combination of borrowing and capital receipts.

3.20 Communication with DLUHC would be required before the Council ultimately decides on the accounting treatment, as it could result in our accounting of right to buy receipts being different than previously reported to DLUHC.

3.21 Please note that the finalisation of the accounts is dependent on agreeing the correct accounting treatment for the accounting substance of the CAH/CAT arrangements. This is different to the legal form of the arrangements which do not change. This is likely to require professional external legal and accounting advice as well as discussions with DLUHC.

3.22 It should also be noted that although the first transfer of dwellings to CAH and CAT took place during the 2017-18 and 2018-19 financial years, the audits for both of those financial years have been concluded and therefore the accounts for those financial years will not be re-opened. Instead the impact of any potential changes to accounting treatment would only affect the prior year comparator (2018-19) in the 2019-20 accounts (this would include a substantial explanation of any prior period adjustment).

<u>Other changes to the 2019-20 accounts</u>

3.23 The 2019-20 audit is largely completed, and the adjustments set out below are likely to be made:

- The cost of the Fairfield Halls development of £62.6m as at 31 March 2020 reflected as additional Council capital expenditure instead of a loan to Brick By Brick.
- The Council's investment in the Resonance Fund shown at Fair Value rather than historical cost, increasing the value by £2m.
- A number of non-material errors to reduce overall error in the 2019-20 statements.
- Corrections identified through the Opening the Books work (detail below).

<u>Opening the books</u>

3.24 The Opening the Books report presented to the previous Audit & Governance Committee (2 March 2023) set out a series of reviews by an external accountancy specialist containing 76 recommendations for the council to implement. It was agreed for this Committee to monitor the Council's progress in implementing them.

3.25 Amongst strategic and process recommendations, some specific areas of historical inaccuracy were identified, which will also affect the restatement of accounts for the periods 2019-20, 2020-21 and 2021-22. These were:

- Recharging of costs from the General Fund to the Housing Revenue Account
- Recharging of costs from the General Fund to capital schemes
- The level of impairment set aside for debts (bad debt provision, now known as loss allowance)

3.26 Work is underway on all three of the items listed above and the adverse impact on the Council's general fund has already been agreed to be funded through the capitalisation directions granted by DLUHC.

4 ALTERNATIVE OPTIONS CONSIDERED

N/A

5 CONSULTATION

None.

7. CONTRIBUTION TO COUNCIL PRIORITIES

The publication and audit of the Council's financial accounts aligns with the Mayor's core outcome of balancing the Council's books, and provides transparency and accountability to residents.

8. IMPLICATIONS

8.1 FINANCIAL IMPLICATIONS

8.1.1 This is a noting report to update on the work to be carried out on the 2022-23 and prior years' financial accounts. Potential financial implications are highlighted throughout the report and the final impacts will be updated once each year's accounts are finalised.

Approved by: Allister Bannin, Director of Finance (for Corporate Director of Finance)

8.2 LEGAL IMPLICATIONS

8.2.1 Under Section 3 of the Local Audit and Accountability Act 2014, the authority must keep adequate accounting records, and must prepare a statement of accounts in respect of each financial year. Regulation 7 of the Accounts and Audit Regulations 2015 requires the authority's statement of accounts to be prepared in accordance with those Regulations and proper practices in relation to accounts.

8.2.2 The terms of reference of Audit and Governance Committee include "oversee the financial reporting and annual governance processes" and "to review the annual statement of accounts and specifically to consider whether appropriate accounting policies and the CIPFA Financial Management Code have been followed, and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the Council".

8.2.3 The authority is of course, also under a general duty “to make arrangements for the proper administration of their financial affairs” under Section 151 of the Local Government Act 1972. In addition, keeping adequate accounting records, and following proper practices in relation to accounts may impact on the authority’s ability to deliver its functions in a manner which promotes economy, efficiency and effectiveness, and therefore the consideration of this report also seeks to demonstrate the authority’s compliance with its Best Value Duty under the Local Government Act 1999.

Comments approved by the Head of Litigation & Corporate Law on behalf of the Director of Legal Services and Monitoring Officer (Date 06/04/2023)

8.3 EQUALITIES IMPLICATIONS

8.3.1 Under the Public Sector Equality Duty of the Equality Act 2010, decision makers must evidence consideration of any potential impacts of proposals on groups who share the protected characteristics, before decisions are taken. This includes any decisions relating to how authorities act as employers; how they develop, evaluate and review policies; how they design, deliver and evaluate services, and also how they commission and procure services from others.

8.3.2 Section 149 of the Act requires public bodies to have due regard to the need to:

- eliminate unlawful discrimination, harassment, victimisation and any other conduct prohibited by the Act;
- advance equality of opportunity between people who share a protected characteristic and people who do not share it; and
- foster good relations between people who share a protected characteristic and people who do not share it.

8.3.3 Protected characteristics defined by law include race and ethnicity, disability, sex, gender reassignment, age, sexual orientation, pregnancy and maternity, and religion or belief.

8.3.4 Having due regard means there is a requirement to consciously address the three tenets of the Equality Duty within decision-making processes. By law, assessments must contain sufficient information to enable the local authority to show it has paid ‘due regard’ to the equalities duties; and identified methods for mitigating or avoiding adverse impact on people sharing protected characteristics. Where a decision is likely to result in detrimental impact on any group with a protected characteristic it must be justified objectively.

8.3.5 There are no immediate direct Equalities implications identified within this report. Equalities will need to remain a consideration, as the council seeks to discharge the recommendations referred to in the report at Section 3.24 above.

Approved by: Barbara Grant on behalf of Denise McCausland – Equality Programme Manager

8.4 HUMAN RESOURCES IMPLICATIONS

8.4.1 There are no immediate workforce implications arising from the recommendations in this report. Should any matters arise these will be dealt with under the Council's appropriate HR policies and procedures.

Approved by: Gillian Bevan, Head of HR Resources and Assistant Chief Executives on behalf of Dean Shoesmith, Chief People Officer.

9. APPENDICES

None.

10. BACKGROUND DOCUMENTS

None.