

Committee: Finance Committee	Date: 10 December 2019
Subject: City's Cash Annual Report and Financial Statements 2018/19 – amended to include a deferred tax liability	Public
Report of: The Chamberlain	For Decision
Report author: Steven Reynolds, Group Accountant	

Summary

The Annual Report and Financial Statements of City's Cash for the year ended 31 March 2019 have been amended to include a deferred tax liability of £14.8m since you last considered them at your meeting on 12 November and are attached at Annex 1 for approval.

At your last meeting, delegated approval was granted to the Chairman and Deputy Chairman to approve City's Cash accounts subject to any observations on those accounts at the forthcoming Audit and Risk Management Committee on 19 November 2019.

Leading up to that meeting, the external auditor, BDO LLP, intended to give an unqualified audit opinion and reported that no material accounting changes were required to the financial statements of either City's Cash or its consolidated subsidiaries. However, on the day of the meeting the external auditor reported that a deferred tax liability of £11.9m (corrected post meeting to £14.8m – paragraph 4 of this report refers) relating to Barking Power Limited (BPL) had been incorrectly omitted from the 2018/19 accounts of both BPL and its parent City's Cash. The deferred tax liability of £14.8m was not included in the draft accounts of BPL, which were submitted to BDO LLP for audit in June 2019. The audit failed to identify the omission, but it was subsequently identified by a separate BDO LLP team providing tax advice to BPL.

The Financial Statements of City's Cash for the year ended 31 March 2019 have since been amended to include this liability and are attached at Annex 1. This adjustment has a net nil impact on the value of City's Cash net assets, which remain unchanged at £2,669.8m as shown in the Consolidated Statement of Financial Position on page 18. A net nil position arises because inclusion of the £14.8m liability is offset by an increase in the value of goodwill as explained in paragraphs 6 to 8 of this report.

The external auditor BDO LLP has submitted a revised Audit Management Report to reflect this adjustment, attached at Annex 2, and intends to give an unqualified audit opinion on the Financial Statements of City's Cash for the year ended 31 March 2019.

Recommendations

The Finance Committee is requested to:

- consider the contents of the revised Audit Management Report issued by BDO LLP (Annex 2);
- approve the amended Annual Report and Financial Statements for City's Cash for the year ended 31 March 2019 (Annex 1); and
- agree that the Financial Statements are signed by the Chairman and Deputy Chairman of the Finance Committee on behalf of the Court of Common Council.

Main Report

Background

1. The Annual Report and Financial Statements of City's Cash for the year ended 31 March 2019 have been amended to include a deferred tax liability of £14.8m since you last considered them at your meeting on 12 November and are attached at Annex 1 for approval.
2. At your last meeting, delegated approval was granted to the Chairman and Deputy Chairman to approve City's Cash accounts subject to any observations on those accounts at the forthcoming Audit and Risk Management Committee on 19 November 2019.
3. Leading up to that meeting, the external auditor, BDO LLP, intended to give an unqualified audit opinion and reported that no material accounting changes were required to the financial statements of either City's Cash or its consolidated subsidiaries. However, on the day of the meeting the external auditor reported that a deferred tax liability of £11.9m (corrected post meeting to £14.8m – paragraph 4 of this report refers) relating to Barking Power Limited (BPL) had been incorrectly omitted from the 2018/19 accounts of both BPL and its parent City's Cash.

Deferred tax liability of £14.8m

4. The deferred tax liability is recognised, as required under FRS102, offsetting the revaluation gain on the land held by BPL. The carrying value (base cost) of BPL land was £17.3m and was revalued to £122.1m at acquisition, resulting in a gain of £104.8m. The tax liability is calculated using the rate applicable to future profits (17%), applied to the value of the revalued land, less the base cost and indexation relevant to the land. The rate of corporation tax applicable to BPL's future profits is 17%, in accordance with a tax rate of 17% in the Finance Bill 2016, which was enacted on 15 September 2016. Following the Audit and Risk Management Committee, the BDO LLP calculation of the deferred tax liability of £11.9m was reviewed by the City and found to be incorrect. The correct sum is £14.8m, which has since been agreed by BDO LLP.

5. The liability should have been included in the draft accounts of BPL, which were submitted to BDO LLP for audit in June 2019, and then consolidated in the accounts of its parent body City's Cash. The audits of both BPL and City's Cash failed to identify the omission, but it was subsequently identified by a separate BDO LLP team providing tax advice to BPL. The City was first notified of this omission by BDO LLP on 19 November, the day of the Audit and Risk Management Committee.

Impact of including the liability in City's Cash consolidated accounts

6. BPL's accounts are consolidated into those of City's Cash and inclusion of BPL's deferred tax liability of £14.8m has reduced the value of BPL's net assets on acquisition in City's Cash accounts, with a corresponding increase in the value of goodwill, from £24.5m to £39.3m. These values have been updated in the supporting disclosure Note 21 titled 'Business Purchases' on page 46, Annex 1, and the before and after positions are shown in the following table.

Note 21 - Business purchases <i>Amended to recognise the deferred tax liability of £14.8m</i>	BEFORE 2018/19 Fair Value £m	AFTER 2018/19 Fair Value £m	CHANGE 2018/19 Fair Value £m
Land	122.1	122.1	-
Property, plant and equipment	1.6	1.6	-
Debtors	0.3	0.3	-
Cash	0.5	0.5	-
Creditors	(0.5)	(0.5)	-
Provisions for liabilities	(18.0)	(32.8)	(14.8)
Total net assets	106.0	91.2	(14.8)
Goodwill	24.5	39.3	14.8
Total consideration	130.5	130.5	-

7. Inclusion of the liability has not resulted in any changes to City's Cash Consolidated Statement of Comprehensive Income.
8. However, it has changed two lines in the Consolidated Statement of Financial Position (Annex 1, page 18). The first is an increase in 'Intangible assets' of £14.8m to £39.5m, relating to the increase in goodwill. The second change is an increase in 'Provisions for liabilities' of £14.8m to £35.9m, relating to inclusion of the deferred tax liability. Because these two changes net to nil, total net assets remain unchanged in City's Cash Consolidated Statement of Financial Position at £2,669.8m as at 31 March 2019.

When will the tax become payable?

9. If BPL sold the land directly, to an unrelated buyer, then the liability would become payable. However, if the land is transferred to the Corporation prior to BPL being liquidated, the tax cost would not arise. This transfer should be able to be done on a tax-free basis on the assumption that BPL and the Corporation form a chargeable gains group. The City's tax advisor states that they have not validated this assumption formally yet, but given that BPL is a share capital company and the Corporation is the sole shareholder, then he would expect the grouping requirements to be met.
10. If the land was transferred to the Corporation and subsequently found to be unsuitable and had to be sold, no tax arises as the seller would be the Corporation.

BDO Audit Management Report

11. The external auditor BDO LLP has submitted an updated Audit Management Report, attached at Annex 2, to reflect the adjustment to include the deferred tax liability of £14.8m (page 6, third bullet point, and page 15, second to last bullet point, refers) and intends to give an unqualified audit opinion on the Financial Statements of City's Cash for the year ended 31 March 2019.

Approval of the Financial Statements

12. It is recommended that the Finance Committee approve and sign the revised Financial Statements of City's Cash on behalf of the Court of Common Council.

Lessons for the future

13. Following omission of the deferred tax liability from BPL's accounts, the closing process and related working papers have been reviewed at the City to avoid a repetition in the future. In addition, following BDO's first year auditing BPL and City's Cash, several improvements are currently being pursued with our auditor to ensure an efficient and thorough audit in the future.

Annexes

- Annex 1 – Annual Report and Financial Statements of City's Cash (revised)
- Annex 2 – BDO LLP Audit Management Report (revised)

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