Leeds CITY COUNCIL

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Report of the Director of Resources

Corporate Governance and Audit Committee

Date: 30th June 2010

Subject: The Statement of Accounts 2009/10

Electoral Wards Affected:	**Specific Implications For:**
	Equality and Diversity ☐
☐ Ward Members consulted (referred to in report)	Community Cohesion ☐
	Narrowing the Gap ☐

1.0 Purpose of the Report

1.1 The purpose of this report is to introduce the 2009/10 Statement of Accounts for Leeds City Council for approval. The Statement of Accounts is included with the agenda as a separate booklet for members of the Committee and is published on the Council's intranet site. Anyone else wishing to obtain a copy of the Statement of Accounts should contact the committee clerk named on the front of the agenda.

2.0 Background Information

2.1 The Accounts and Audit Regulations 2003 require the annual accounts to be submitted for approval by the Council or a committee of the Council. There is also a requirement for the accounts to be signed and dated by the Chair of the Committee at which the approval was given. The terms of reference of the Corporate Governance and Audit Committee include dealing with matters relating to the accounts.

2.2 After approval by members, the Authority's accounts are to be made be available for public inspection for 20 working days commencing 1st July 2010. The external audit of the approved accounts is due to commence on the 12th July 2010 and upon completion, the auditors will submit their report to this Committee which is scheduled to be at the end of September.

3.0 Main Issues

3.1 The aim of this report is to provide a summary analysis of the accounts to aid members in their understanding of the main financial issues. The report is split into three areas:

- A summary of both the Council's in year financial performance and the financial position as at 31st March 2010.
- An update on the accounting issues impacting on the financial statements.

- An update on the Council's response to external audit issues raised in 2008/09.

Members should note that the accounts include a foreword by the Director of Resources which provides further interpretation of the accounts.

3.2 A Summary of the Council's Financial Position

The following summary of the financial performance of the Council covers:

- The Council's overall performance;
- The performance of statutory ring fenced accounts; and
- The performance of the Group.

3.2.1 **The Council's Overall Financial Performance:**

3.2.1.1 **Financial performance for the year:** For 2009/10 the Council's Income and Expenditure Account (I&E a/c) shows a deficit for the year of £212.2m (£645.3m in 2008/09), this deficit is then adjusted to reflect any statutory overrides to accounting practice in order to produce a reported financial position which directly impacts on Council Tax payers. For 2009/10 the statutory overrides amounted to a credit to the I&E a/c of £209.0m, producing a final reported financial deficit for the Council of £3.2m (compared to a deficit of £0.8m in 2008/09). For further details on the impact of statutory overrides see para. 3.3.2 below.

The Council's approved budget for 2009/10 was £556.8m, the final reported outturn deficit of £3.2m therefore represents an overspend of 0.6%. This overspend reflects both the impact of the economic downturn on income levels and the continuing financial pressures on Adult's and Children's Services. The full details of the outturn variations to the approved budget are available in the Executive Board report of the 22nd June 2010.

The published accounts for 2008/09 showed a balance on the General Fund Reserve of £16.1m. However, due to the decision to change the Council's accounting policy in respect of the interest cost (see para 3.3.3 below) a prior period adjustment is required which increases the opening position for the General Fund Reserve to £19.3m. After taking into account the in year deficit of £3.2m, the General Fund Reserve stood at £16.1m as at 31st March 2010. In view of the present uncertain economic circumstances the Executive Board accepted that it was appropriate that the Council maintained this higher level of reserves.

3.2.1.2 **Financial Position at the end of the Year:**

Overall the value of the Council's assets net of liabilities has fallen by £961m. The main movements on the balance sheet which has resulted in this fall in the value of the Council's net worth are as follows:

- Reduction in long term assets £31m. Including the recognition of new PFI expenditure, the capital expenditure for the year was £350m, £42.7m less than the latest approved estimate. This £350m of capital expenditure increases the carrying value of the Council's long term assets on the Balance Sheet. The carrying value of the Council's assets are then adjusted for the impact of factors such as depreciation, impairment and any disposals charged in year, resulting in this net overall fall in the carrying value of the Council's long term assets.

- Overall debt stands at £1,459m (£1,434m in 2008/09) made up of long term borrowing £1,334m (£1,286 in 2008/09) and borrowing repayable on demand or within one year of £125m (£147m in 2008/09).

  The level of overall debt has increased by £25m from 2008/09 and reflects £108m of long term debt repaid during the year of which £88m was prematurely repaid, continuing the policy to move debt between long and short term dependent on the market rates. In addition, in order to meet the funding requirements of the 2009/10 capital programme, £150m of new long term loans were taken, all at favourable rates. £17m of this new long term borrowing was used to replace less favourable short term debt.

  In the 2008/09 the Council borrowed £15m in advance of need and loaned out as an investment at favourable rates. In 2009/10 this is required to fund the capital programme and this returning sum is reflected in the fall in investments.

  Full details of the Council's Treasury Management activities for the year will be available in the Treasury Management report to Executive Board on the 21st July 2010.

- The amount owed by the Authority for the financial year but not yet paid (current creditors) increased by £29m. The overall carrying value of the Council's creditors is made up of amounts outstanding to the Government and other public bodies of £40m; group entities of £13m; receipts in advance of £118m and individuals and private organisations of £88m. The main reason for the increase in creditors is a reflection of the additional monies the Council has received in advance of the provision of services or capital works compared to 2008/09. This money is held on the balance sheet as a creditor, reflecting the fact that if the work is not undertaken the money will be returned. If the work or service is provided this funding will be matched against the expenditure in the year it is incurred. In respect of creditor payments to individuals and business it is the Council aim to pay such creditors within 30 days and the Council's prompt payment statistics shown an improvement from 2008/09.

- For 2009/10 one of the most significant areas which has impacted on the Council's balance sheet has been in respect of pension liabilities. As at the 31st March 2010 the net pensions liability under FRS 17 stood at £1,473m, an increase in the net liability of £758m from last year. The main factors which have contributed to this increase are:

  - The future pension liabilities held on the balance sheet are discounted back to current prices. Every year these pension liabilities become one year closer to being paid and the accounts therefore reflect the unraveling of one more year of this discount. Consequently the level of pension liabilities rises each year and for 2009/10 this increase amounted to £135m.
  - In addition, the discount rate used for the liabilities is based on the AA Corporate Bond rate. The volatility of the financial markets over the last few years has produced significant variations in this rate. The current financial markets have seen a significant fall in the bond rate with a resulting increase in the current value of the funds pension liabilities of £1,068m.
  - The value of the council's pension fund assets has risen by £450m mainly due to the good performance of the stock markets over the last year.

  The overall deficit on the fund represents the difference between the value of the Authority's pension fund assets at 31st March 2010 and the estimated present value of the future pension payments to which it was committed at that date. These pensions liabilities will be paid out over a period of many years, during which time the assets will continue to generate returns towards funding them. The extent to which the expected future returns on assets are sufficient to cover the estimated net liabilities was considered by the actuaries in their full actuarial review of the Pension Fund, carried out as at 31st March 2007. This concluded that the Pension fund was 90% funded, and set contribution rates for the next three years which are designed to move the fund towards a fully funded position. The final contribution level for the Council remains uncertain with the next full actuarial review due in the current year and the potential impact of the Governments emergency budget.

- The Council recognises the amounts due under PFI and finance leases as deferred liabilities on the Balance Sheet. As at 31st March 2010 the Council's deferred liabilities have increased by £102m, mainly reflecting additional liabilities on new PFI schemes in 2009/10.

3.2.2 **Ring Fenced Accounts:**

3.2.2.1 **Schools:** The outturn on the Individual Schools' Budget for the year was £3.3m lower than estimated. This unspent budget has been transferred to school reserves leaving available balances at 31st March 2010 of £17.1m. Net borrowing and repayment from the reserve for VER (£1.7m) and Building Schools for the Future / PFI (£4.8m) reduces these reserves to £10.6m on the balance sheet (£7.4m 2008/09).

In addition schools also have extended school reserves of £4.2m (up from £3.9m in 2008/09). Extended school activity is an initiative to make greater use of school facilities to provide wider community access and provide extended services such as quality childcare, study support activities and parenting support. Such activities are expected to broadly break-even in the medium term and any net surplus or deficit is carried forward to the following financial year.

3.2.2.2 **Housing Revenue Account (HRA):** The HRA Income & Expenditure account shows a surplus for the year of £67m. The main reason for this surplus is the reversal of part of the 2008/09 impairment charge as housing prices begin to recover (see para 3.3.2 below). After taking account of statutory overrides, the final position on this account amounted to a deficit of £0.1m. After net transfers from earmarked reserves of £1.0m as approved by the Executive Board on the 22nd June 2010, the HRA had a surplus of £0.9m which was added to the HRA general reserve. A full explanation as to the main variations to budgets contained within these figures is available in the Financial Performance Outturn report presented to the Executive Board on the 22nd June 2010.

Overall the HRA reserves stand at £18.1m as at 31st March 2010 (£18.8m as at 31st March 2009). £4.6m of this sum represents the HRA general reserve; this is deemed to be a prudent level based on the Council's risk based reserves strategy. A further 10.9m is being held to fund the future costs of the Swarcliffe PFI scheme. Full details of the all the HRA reserves are shown in the Statement of Accounts.

3.2.2.3 **Collection Fund:** The Collection Fund for 2009/10 generated a deficit of £0.8m (£0.5m surplus 2008/09). This leaves the collection fund in a balanced position with no available reserves as at 31st March 2010 (£0.8m at 31st March 2009). There is no requirement to hold a balance on the Collection Fund reserve but any positive or negative balance must be taken into account when calculating the council tax for the following year.

3.2.3 **Group:**

3.2.3.1 **Arms Length Management Organisations (ALMOs):** Collectively the three ALMOs showed a surplus position for 2009/10 of £8.7m (£7.0m deficit in 2008/09). The detailed performance figures for each individual ALMO are available in the Statement of Accounts under the Group Accounts section.

The net assets held by the companies to fund the pensions deficit now stand at £37.9m (£22.1m in 2008/09). As at 31st March 2010, the net pension liability for the three ALMOs stood at £41.3m (£11.2m in 2008/09), producing a net liabilities (negative reserves) for the companies of £3.4m (£10.9m positive reserves in 2008/09). The main reasons for this increase in pension liabilities are the same as for the Council (see para. 3.2.1.2 above).

3.2.3.2 **Education Leeds:** This Council subsidiary made a net operating deficit of £2.4m for 2009/10 (£2.4m deficit in 2008/09). This large deficit mainly reflects the impact of pension liabilities which, unlike Local Government, impact on the Income & Expenditure account. After taking account of the revenue impact of the pensions liability the company made an operating deficit of £0.4m (£0.1m deficit in 2008/09).

The net assets (reserves) held by the company to fund the pensions deficit now stands at £2.6m (£3.2m in 2008/09). As at 31st March 2010, the net pension liability for Education Leeds stood at £64.9m (£22.1m in 2008/09), producing a net liabilities for the company of £62.3m (£18.9m in 2008/09). The main reasons for this increase in pension liabilities are the same as for the Council (see para. 3.2.1.2 above).

A strategic review of the Council's provision of Children's Services was considered at the Executive Board on the 10th March 2010. The Committee agreed that to enable the Council to develop an integrated and more holistic approach to the delivery of children's services the contract with Education Leeds would be terminated on the 31st March 2011. The termination of the contract will lead to the Education Leeds staff being transferred back to the Council along with the assets and liabilities of the company.

3.2.3.3 **Impact of the Group entities on the overall financial position:** Whilst it should be recognised that the Group entities do not represent a major part of the Council's activities, the Group Accounts do show that they hold a significant level of reserves (£37m). The major reason behind these levels of reserves is to contribute to the pension deficits of the ALMOs (£37.9m).

It should be noted that whilst the Group Accounts show the full scale of the Council's financial activities the ALMO's are limited companies and as such the Council would only be required to contribute £1 if any of them are wound up. The Council does however, act as guarantor for Education Leeds' admittance to the West Yorkshire Pension Fund. Consequently, on termination of the Education Leeds contract, an assessment of the outstanding pensions liability for the company will be made by the Council's actuary and the resulting pension liabilities and assets of the company will be transferred to the Council.

3.3 Accounting Issues Impacting on the Financial Statements:

3.3.1 **Changes to Accounting Practice:** The accounting practice governing Local Authority accounts has undergone significant changes over the last few years with the aim of harmonising the accounting requirements of the public sector with those of the private sector who are still subject to UK accounting standards. The success of this harmonisation programme means that the Council and it's auditors are required to sign off the 2009/10 accounts as a "true and fair view" rather than "presents fairly". The "true and fair view" opinion is seen by many, in particular the private sector, as a higher level of accounting compliance.

However even as Local Authorities became compliant with UK accounting Standards, large private sector companies were required to move to compliance with International Financial Reporting Standards (IFRSs). As originally reported to members of this Committee on the 23rd April 2008, the 2007 Budget announcement stated that all Government bodies would also be required to publish their 2010/11 accounts under IFRSs. A further report to this Committee in March 2010, updated members on the progress towards this IFRS implementation and highlighted the requirement for early adoption in 2009/10 of IFRS based accounting practice for PFI transactions.

The 2009/10 accounts now reflect IFRS based accounting practice in respect of PFI schemes, resulting in the recognition of the assets on the Council's balance sheet along with the associated deferred liabilities. Adoption of IFRS based accounting practice requires the recognition of the transactions from the date the schemes started. Consequently for those PFI schemes which commenced before the 31st March 2009, a prior year adjustment has been made to the comparator figures in the I&E a/c and the Balance Sheet. Therefore the current year only reflects any in year transactions for these older schemes, along with those for any new schemes.

The other major change to the accounting practice for 2009/10 is in respect of the Collection Fund Account. Previously the accounts of the Police and Fire Services only recognised the precept paid by the Council in their accounts. This change to accounting practice recognises that the collection of Council Tax is in substance an agency arrangement and consequently the Police and Fire Services should show their proportion of Council Tax debtors in their accounts. The overall impact of this change only affects the carrying value of accruals recognised on the Council's Balance Sheet. As this is a change in accounting policy it impacts, not just on the current year, but on 2008/09 as a prior year adjustment.

3.3.2 **Impact of the statutory overrides on the Council's Income & Expenditure Account (I&E a/c):** As stated in para 3.2.1.1 above, the Council's I&E a/c shows a deficit of £212.2m. The two main reasons for this reported deficit are as follows:

As in previous years, proper accounting practice requires the Council to make a depreciation charge to revenue for the use of fixed assets. This charge provides an indication as to the cost the Council will have to incur, through borrowing and repairs and maintenance budgets, in order to maintain the standard of our buildings and other assets. Under statute this revenue charge is reversed and replaced by a Minimum Revenue Provision (MRP). The MRP charge is the minimum amount which it is considered prudent to set aside to repay debt. The depreciation charge for 2009/10 was £143m (£148m in 2008/09), off set by £25m MRP (£24m in 2008/09).

Also under proper accounting practice, if there is any indication that an asset is either being used up, or its value is falling, faster than currently recognised by the rate of depreciation then an impairment charge is made. Normally such impairment charges reflect the reduction in the value of an asset from an incident such as a fire or due to demolition. In 2008/09 the recession had a significant impact on the value of some of the Council's assets, in particular the value of the Council's housing stock fell by around 17% (£389m). In 2009/10 further impairment reviews have been undertaken to ascertain if asset values have continued to fall or whether in some areas the values have begun to recover. Overall the carrying value of the Council's assets was impaired by £280m in 2009/10, reflecting a variety of factors, including demolitions and a general fall in value. This impairment cost has been partly offset by a recovery in house prices which has led to a rise in the value of the authority's council houses of £126m.

The I&E a/c (which includes the Housing Revenue Account) has been charged with the net impact of these changes to impairment. Any potential loss through impairment would only be realised if the asset was sold and as with Council Houses in 2009/10 any future upward revaluation of assets results in a reversal of the impairment entry. Consequently the Government introduced legislation which requires Local Authorities to reverse such impairment charges in the year they incur in order to prevent a disproportionate burden on current taxpayers.

Full details of all the statutory overrides impacting on the Council's I&E account are shown in the accompanying Statement of Accounts (see note 8.1 the Statement of Movement on the General Fund Balance).

3.3.3 **Impact of changes to the Council's accounting policies:** Other than due to national changes in accounting practice, it is rare that authorities change there accounting policies. However, under current accounting practice, Councils have an option as to whether they capitalise interest costs on debt associated with assets under construction. The purpose behind this option is that upfront interest costs do not become prohibitive when authorities are building assets over a long period. If the interest is capitalised then the cost will be incurred when the asset becomes operational. As the Council has a number of assets under construction, with significant interest cost, the decision was made to exercise the option in 2009/10. This decision resulted in a £0.6m saving on the in year cost of debt. As this decision is a change in accounting policy it is a requirement of accounting practice that comparator figures for the preceding period are also adjusted. With the agreement of KPMG, this prior period adjustment has resulted in further capitalisation of interest of £3.1m which had previously been charged to revenue. Consequently, as at the 31st March 2009 the carrying value of the General Reserve was amended and stood at £19.2m, with a corresponding increase in the carrying value of the Council's debt.

3.4 External Audit Issues

3.4.1 In September 2009, KPMG reported back to this Committee it's main audit findings in respect of the 2008/09 accounts. In this report, KPMG informed members of just one area of concern, namely, the need for a robust plan to remedy the deficit position on the Building Regulation charges account.

3.4.2 KPMG's Interim Report, which was presented to this Committee on the 23rd June, noted that the Council had informed KPMG that it had a plan in place which it hoped would address this deficit. However, as the Building Control Account is no longer required in the Statement of Accounts, KPMG no longer propose to follow up this issue.

3.4.3 KPMG's Interim Audit report also highlighted a number of key risks for the 2009/10 accounts process, along with officers management responses. In compiling these accounts officers have continued to address the issues identified, specifically:

- PFI and similar schemes have been accounted for under International Financial Reporting Standards.
- The accounts have been reviewed by senior officers to improve the process of quality assurance.

- Bad debt provisions and the ability for bodies to repay Council loans have been reviewed to take account of the current financial climate.

3.4.4 As stated in paragraph 2.2 above, any relevant matters arising from the audit of the 2009/10 accounts are reported back to this Committee in September.

4.0 Implications for Council Policy and Governance

4.1 The Statement of Accounts is an audited publication which provides all stakeholders with the confidence that public money has been properly accounted for and that the financial standing of the Council is on a secure basis.

4.2 As required by the Accounts and Audit Regulations 2003, the accounts are to be made available for public inspection for twenty working days. Local electors and taxpayers have the right to look through the accounts and supporting documentation. They also have the right to object to the accounts and question the auditors.

5.0 Legal and Resource Implications

5.1 The Accounts are required to be approved by the Council or committee of the Council before the end of June. This is a factual report of the Director of Resources on the financial accounts of the Council for 2009/10. There are no additional legal or financial implications.

6.0 Recommendations

6.1 Members are asked to approve the 2009/10 Statement of Accounts and the Chair to acknowledge the approval on behalf of the Committee by signing the appropriate section within the Statement of Responsibilities on page 1 of the accounts.

<u>Background Documents</u>

2009/10 Statement of Accounts (separately distributed to members at the Corporate Governance and Audit Committee on the 23rd June 2010 – Copies available on 23rd June – please contact Phil Garnett 0113 395 1632).

KPMG ISA 260 Report 2008/09

KPMG Interim Report 2009/10

The Code of Practice on Local Authority Accounting in the United Kingdom 2009

Corporate Governance and Audit Reports on International Financial Reporting Standards (23rd April 2008 & 17th March 2010)

Executive Board report (22nd June 2010): Financial Performance – Outturn 2009/10