Leeds CITY COUNCIL

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Report of the Director of Resources

Corporate Governance and Audit Committee

Date: 4th July 2012

Subject: The Statement of Accounts 2011/12

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒ No
Is the decision eligible for Call-In?	☐ Yes	☒ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	☐ Yes	☒ No

Summary of main issues

1. The Responsible Financial Officer has certified that the 2011/12 accounts for Leeds City Council are a true and fair view of the Council's financial position. The accounts are fully compliant with proper accounting practice as required by the Accounts & Audit regulations 2011.

2. Overall the Council's net worth has decreased by £474m, primarily due to the following factors:

   § A £400m increase in net pension liabilities mainly due the poor performance of the stock market and the impact of the low bond rates on the discount factor applied to pension liabilities.

   § A £124m (3.7%) reduction in the value of the Council's property, plant and equipment as recognised on the balance sheet. Mainly reflecting the transfer of school assets to Academies and Trusts.

3. Whilst financial reporting under International Financial Reporting Standards provides an overview of all the factors impacting on the financial health of the Council, the amounts actually chargeable to a local authority's council tax and its General Fund reserves are controlled by legislation. In respect of those transactions directly impacting on taxpayers in 2011/12 the Council under spent against the approved budget by £1.5m, resulting in a balance on the General Fund Reserve of £25.4m as at 31st March 2012.

Recommendations

4. Members are asked to:

- § note the 2011/12 Statement of Accounts as certified by the Responsible Financial Officer.
- § Agree to release the accounts for public inspection.

1.0 Purpose of the Report

1.1 The purpose of this report is to present to the Committee the 2011/12 Statement of Accounts for Leeds City Council prior to them being made available for public inspection. 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.

1.2 This report provides a summary analysis of the key financial issues in the accounts; an update on the future accounting issues impacting on the financial statements and an up date on compliance with External Audit recommendations from the audit of the 2010/11 accounts.

2.0 Background Information

2.1 In line with the requirements of the Accounts and Audit Regulations 2011, the Council's annual accounts are certified by the responsible financial officer as a true and fair view of the Council's financial position. Whilst it is no longer a legal requirement for members to formally approve these unaudited accounts before the 30th June, members of this Committee requested that they receive the accounts prior to them being made available for public inspection.

2.2 Subject to Committee's approval, the Council's accounts are to be made available for public inspection for 20 working days commencing 9th July 2012. The final audited accounts and the accompanying external audit report will be presented to Committee for final approval on the 28th September.

3.0 Overall Financial Performance during 2011/12

3.1 Financial Performance of the General Fund

3.1.1 The overall reported outturn to Executive Board on the 20th June 2012, recognised an underspend of £1.5m against an approved budget of £582.2m. The 2011/12 budget represented a major financial challenge for the Council, and the loss of Government Grant plus pressures on spending resulted in the Council needing to identify around £90m of savings. The budget included some difficult and challenging decisions and whilst not all planned savings have been fully achieved, other savings have been identified and additional income secured. Full details of the major variations to the budget are available in the provisional and final outturn reports made to Executive Board on the 16th May and 20th June 2012 respectively.

3.1.2 This reported financial position is governed by statute and represents the amount chargeable to a local authority's council tax and the General Fund reserve. The Council agreed to a budgeted usage of the General Fund reserve of £5.6m. This £1.5m underspend has reduced that required usage to £4.1m, leaving the Council's General Fund Reserve at £25.4m as at the 31st March 2012.

3.1.3 However the published statutory accounts as governed by International Financial Reporting standards takes a much broader view of our financial position and rather than just reflect our performance against the in year budget it also takes into consideration other factors impacting on the Council's long term financial standing.

This is reflected in the Comprehensive Income and Expenditure Statement (CI&E a/c) which recognises both the £1.5m in year underspend and an assessment of any other longer term gains or losses impacting on the Council's assets and liabilities. For 2011/12 the CI&E a/c shows a £474m reduction in the Council's assets and liabilities (£122m reduction in 2010/11). The impact of this reduction is reflected in the Council's balance sheet which shows that the Council's net worth (assets less liabilities) and has fallen from £755m to £281m.

3.1.4 There are a number of reasons for this fall in net worth and the implications of these changes needs to be understood in order to help stakeholders interpret the Council's financial position. An explanation of the main reasons for this £474m reduction, along with the implications, are as follows:

i) A £400m increase in net pension liabilities resulting in a £1,141m shortfall of assets over liabilities in the Council's pension funding. The main reasons for these increased deficit are:

- The growth in assets was less than predicted;
- A fall in the discount rate applied to the fund liabilities;

A full explanation as to the reasons behind this deterioration in the pensions funding arrangements can be found at Appendix 1.

Whilst recognising that this deterioration is an important indicator as to the estimated financial standing of the Council's net pension liabilities. It needs to be recognised that 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. Accounting standards require the accounts to recognise all measurable potential liabilities but not account for any potential growth in assets. As such, whilst not a worst case scenario, this accounting presentation of the pension deficit does represent a relatively pessimistic view of the fund. Consequently, in order to properly assess the impact of this financial position consideration needs to be given as to the extent to which the expected future returns on assets are sufficient to cover the estimated net liabilities. The Council receives such an assessment from it's actuaries in their review of the Pension Fund. The 2010 full actuarial review concluded that the Pension fund was 93% funded, which equates to a predicted deficit for the whole West Yorkshire Pension Fund of £590m Based on this triennial review, the Council has determined an appropriate level for employer contribution rates with which to move the fund towards a fully funded position over a 22 year recovery period. Actuaries consider a range of long term assumptions when determining the level to which the scheme is funded. Assumptions such as potential asset growth; mortality rates and discount rates are adjusted over a period of time as circumstances change but their affect is "smoothed" over the life of the pension liabilities. The accounts however are an indication of the fund at the 31st March each year and as such are subject to the particular circumstances prevalent at the time. For example stock market "bubbles" and crashes.

It should be noted that this position excludes any potential impact of the recent Government pension proposals.

ii) A £124m (3.7%) reduction in the value of the Council's property, plant and equipment as recognised on the balance sheet. There are three main areas which impact on the carrying value of the Council fixed assets, deterioration in an asset (measured as a depreciation or impairment charge); revaluation of an asset and the sale / disposal of an asset.

In 2011/12, the amount the Council's assets were deemed to have deteriorated through use was largely offset by an increase in asset valuations. The fall in the value of the Council's fixed asset was therefore mainly due to £146m of school buildings and land transferred to Academies and Trusts.

As a result of these changes the value of the Council's property, plant and equipment now stands at £3,351m. Property, plant and equipment represent the main assets of the Council and are the main factor in generating the Council's positive net worth. As with the pensions accounting above, it is important to note that accounting practice is very prescriptive. In the case of the Council's asset base accounting practice requires assets to be valued based on their operational use or historic cost and as such does not reflect the true market value achievable if the Council's assets were sold. So whilst we have seen a drop in the operational value of the Council's long term assets, the overall market value of the Council's assets is considerably higher. In particular it is worth noting that the market value of our Housing stock is around £4.4bn (current social value £1.4bn) and our infrastructure assets are currently only recognised at depreciated historic cost (£570m) when their market value would run into billions of pounds.

iii) A £87m fall in the Council's overall debt. As at 31st March 2012 the Council's overall debt stood at £1,954m. Made up of £172m borrowing repayable on demand or within one year, £1,260m long term borrowing and £522m deferred liabilities (mainly credit arrangements under Private Finance Initiatives and finance leases). The main reason for this reduction in debt is that as part of the new Governments arrangements for ending the current housing subsidy regime, the Government has written off £112m of Housing debt. However this means that in the future the Housing Revenue Account will no longer receive housing subsidy and will be required to fund remaining debt from its own income.

3.2 Financial Performance of Statutory Ring Fenced Accounts:

3.2.1 Housing Revenue Account (HRA)

3.2.1.1 The overall reported outturn to Executive Board on the 20th June 2012 recognised, after movements to and from earmarked reserves, an underspend against the approved budget of £1.4m. Full details of the major variations to the budget are available in the provisional outturn report made to Executive Board on the 16th May.

3.2.1.2 However, like with the Council's Comprehensive Income and expenditure account, the HRA Income and Expenditure account (HRA I&E a/c) reflects a much broader view of the HRA's financial position. The HRA I&E a/c shows a £58m contribution to the Council' overall net worth. Other than the £1.4m underspend against the approved budget, the main reasons for this surplus are:

- The £112m repayment of long term debt under the governments arrangements for ending the current housing subsidy regime;
- A £67m fall in the value of Council Houses reflecting the current condition of the housing market.

3.2.1.3 Overall the HRA reserves stand at £25.3m as at 31st March 2012 (£20.1m in 2011). £5.9m 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. Of the £19.4m earmarked HRA reserves, £12.5m 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 Collection Fund

3.2.2.1 The Collection Fund for 2011/12 generated a deficit of £0.1m (£0.8m deficit 2010/11). This leaves the collection fund with negative reserves (£1.0m) as at 31st March 2012. 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.

3.3 A Statement of Financial Resilience as at 31st March 2012

3.3.1 Taking into account the explanation as to the changes in the Council's net worth as explained in para 3.4 above, the following is a summary of the Council's overall financial resilience:

i) Whilst the net pensions deficit has risen to £1,141m it should be recognised that there is a regular independent process of review to ensure that the long term funding of the fund remains viable. Over the last few years there have been a number of significant increases and decreases to the pension deficit, many of which have reflected the particular short term state of the stock or bond markets. However it has been recognised that there are a number of long term factors such as mortality rates and long term predicted growth on investments which have significantly impacted on the ongoing cost of the fund. These have been partly offset by recent changes to the pension scheme and will be further affected by the proposed changes to the scheme benefits.

   The fund will continue to be closely monitored and appropriate actions taken based on each triennial actuarial review. Any such actions are fully incorporated into the Council's Medium Term Financial Plan.

ii) The ration of the Council's debt to long term fixed assets currently stands at 56% (57% in 2010/11). The Council considers this as a sustainable level of debt and in proportion to its significant fixed asset base. The Council's has an approved Treasury management policy (as agreed by the Executive Board on the 10th February 2012) which follows CIPFA's Treasury Management Code of Practice and sets acceptable levels of borrowing, interest rate risk exposure and investment limits in order to minimise risk and ensure the Council's debt finance costs are affordable.

iii) Despite the significant pressures on Local Government Finances the Council has been able to underspend it's in year budget by £1.5m. The Council maintains a financial risk register detailing the main risk and any potential consequences. The risk register considers any existing controls to mitigate against the risk, the value in monetary terms of the risk, review dates and progress towards managing the risk within existing resources. The register is prepared before the start of each financial year and is monitored on a regular basis.

iv) The Council maintains a minimum level of general reserves, as determined by a risk based reserves strategy, with which to meet any short term financial issues. The current level of the General Reserve stands at £25.4m and in addition the Council also has a further £31.5m of non ring fenced earmarked reserves set aside to fund specific future costs.

v) The Council's accounts reflect any potential losses which are deemed sufficiently certain to be accrued. However there are a number of potential liabilities which cannot be estimated or are considered sufficiently uncertain which have therefore been excluded from the accounts. Such potential liabilities are disclosed as a note to the accounts so stakeholders can consider their potential impact if they became due.

3.4 Group

3.4.1 Arms Length Management Organisations (ALMOs)

3.4.1.1 Collectively the three ALMOs showed a combined provisional deficit of £17.3m for 2011/12. Compared to a surplus of £37.8m in 2010/11. The final figures for each ALMO will be available for Committee along with the associated Group accounts.

3.4.2 Other Group entities

3.4.2.1 The definition of group entities changed in 2010/11, leading to an expansion in the number of entities now accounted for under the Council's Group accounts. Along with the ALMOs, the following entities are now included and their results consolidated into the group accounts:

Leeds Grand Theatre, Belle Isle Tenant Management Organisation, Leeds groundwork trust, Marketing Leeds Ltd, Green Leeds Ltd, Craft Centre and Design Gallery Limited and all material bequests and trusts managed by the Council.

In addition the Group Accounts also includes the residual company for Education Leeds which is in the process of being wound up.

Of the above entities the only financial results which materially impact on the Council's accounts are:

- £1.8m deficit in respect of Education Leeds reflecting the transfer of the companies reserves to the Council. The corresponding income was recognised in the Council's Income & Expenditure Account and therefore has a neutral impact on the Council's Group accounts.
- A £1.5m bequest made to the Leeds City Art Gallery to "purchase an object of beauty such as a period piece of solid silver".

3.4.3 Impact of the Group entities on the overall financial position

3.4.3.1 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 (£34m). The majority of these reserves are held by the ALMOs and are still provisional at this stage

3.4.3.2 It should be noted that whilst the Group Accounts do show the full scale of the Council's financial activities, those that are the most financially significant are in-fact limited companies and as such the Council would only be required to contribute a nominal sum if any of them are wound up.

4.0 Accounting Issues Impacting on the Financial Statements

4.1 The only significant change to accounting practice for 2011/12 is a requirement for heritage assets to be valued and recognised on a separate line in the council's balance sheet. Whilst the Council owns a large number of heritage assets only those deemed to have a significant value have been disclosed on the balance sheet. The Council also has a number of heritage assets which it uses in the provision of services. These assets therefore remain disclosed as operational assets. The requirement to account for heritage assets has increased the value of the Council's balance sheet by £42m.

5.0 External Audit Issues

5.1 In September 2011, KPMG reported back to this Committee its main audit findings in respect of the 2010/11 accounts and any recommendations or risks for the following years accounts. For 2011/12 KPMG identified no key risks or recommendations.

5.2 As stated in paragraph 2.2 above, any relevant matters arising from the audit of the 2011/12 accounts are reported back to this Committee in September.

6.0 Corporate Considerations

6.1 Consultation and Engagement

6.1.1 This is a factual report Director of Resources on the financial accounts of the Council for 2011/12 and consequently no public, Ward Member or Councillor consultation or engagement has been sought.

6.2 Equality and Diversity / Cohesion and Integration

6.2.1 This report does not highlight any issue regarding equality, diversity, cohesion and integration.

6.3 Council Policies and City Priorities

6.3.1 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.

6.3.2 As required by the Accounts and Audit Regulations 2011, 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.

6.4 Resources and Value for Money

6.4.1 This is a factual report of the Director of Resources on the financial accounts of the Council for 2011/12. There are no additional financial or value for money implications..

6.5 Legal Implications, Access to Information and Call In

6.5.1 The Accounts are required to be certified as a true and fair view of the Council's financial position by the Responsible Financial Officer before the end of June. This report does not require a key decision and is therefore not subject to call-in.

6.6 Risk Management

6.6.1 The Council's external auditors provide a risk assessment on the accounts process as part of their interim audit as reported to this Committee. Processes officers have put in place to mitigate these risks are included within the audit report.

7.0 Conclusions

7.1 The Council continues to face significant financial pressures due to the current economic climate. However through good governance and effective financial management the Council remains in a strong financial position. For 2011/12 the Council has achieved the challenging savings target whilst maintaining appropriate levels of reserves..

7.2 Whilst the Council's net worth has fallen this is primarily down to the impact of the recession on the pension fund deficit and takes no account of future growth on pension assets nor the impact of the agreed proposals on changes to the scheme.

The pensions deficit is subject to regular reviews by external experts who advise the Council on the required actions to maintain the financial viability of the scheme over an appropriate 22 year recovery period.

7.3 The Council's debt is subject to strong governance arrangements based on CIPFA's Treasury Management Code of Practice. Current debt levels remain sustainable and the related risks are subject to stringent controls as agreed within the Council's Treasury Management Policy. The affordability of the Council's debt is a key consideration in the Council's medium term financial planning arrangements.

8.0 Recommendations

8.1 Members are asked to note the 2011/12 Statement of Accounts as certified by the responsible financial officer.

8.2 Agree to release the accounts for public inspection.

9.0 Background documents[1]

2011/12 Statement of Accounts.

KPMG ISA 260 Report 2010/11

The Code of Practice on Local Authority Accounting in the United Kingdom 2011

Executive Board report (20th June 2012): Financial Performance - Outturn Financial year ended 31st March 2012

Executive Board report (16th May 2012): Provisional Outturn Financial year ended 31st March 2012

Corporate Governance and Audit Committee report: Treasury management Governance Framework (23rd January 2012)

[1] The background documents listed in this section are available for inspection on request for a period of four years following the date of the relevant meeting. Accordingly this list does not include documents containing exempt or confidential information, or any published works. Requests to inspect any background documents should be submitted to the report author.

Appendix 1.

Factors impacting on the Pension deficit in 2011/12

For 2011/12 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 2012 the net pensions liability under IAS 19 stood at £1,141m, an increase in the net liability of £400m from last year. The main factors which have contributed to this decrease 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 unravelling of one more year of this discount. Consequently the level of pension liabilities rises each year and for 2011/12 this increase amounted to £149m.
- For 2011/12 there have been a number of changes to the actuarial assumptions, one of the biggest of these has been the discount rate used to adjust future pension liabilities to current costs 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 fall in the bond rate (5.4% to 4.8%) so reducing the discount applied to future liabilities. This and other minor changes to assumptions has lead to a £220m increase in the expected liabilities of the fund.
- The value of the council's pension fund assets has risen by only £36m mainly due to the poor performance of the stock markets over the last year.
- The Council now recognises the £31m net pension liabilities transferred from Education Leeds.

The main differences between the pensions deficit as calculated in the accounts and that calculated in the actuarial review.

Under the accounting standard (IAS 19) the Council must determine the future cost of the pension liability earned to date by it's employees. In order to do this, the Council's actuaries estimate the how long they expect the officers in the scheme are expected to live and their anticipated rise in salary (pay awards, increments etc.). The level of future pensions is then inflated (now based on CPI) to calculate the likely future liabilities the Council faces under the scheme. This is broadly the same approach as followed in the actuarial review. The only real difference will be slight changes to some of the assumptions used due to the timing of the assessments.

In order to include this projected future pensions liability in the accounts it needs to be discounted back to current prices. The discount rate used is determined by the accounting standard. This is currently the yield on corporate and government bonds as at the reporting year end. In theory this discount rate is expected to be stable over the long term and represents the time value of money. Due to the exceptional economic situation over the last few years there has been some fluctuations in this discount rate but it is expected to be relatively stable over the long term. The actuarial review also discounts future pension liabilities but for this calculation the actuaries are not restricted to the yield on bond rates but instead choose a rate which they believe is more applicable for bodies in the West Yorkshire Pension Scheme. They therefore apply a higher discount rate based on expected returns on the pension fund's assets and the long term financial standing of the Councils in the scheme. Accordingly, the actuarial review produces a lower level of future pension liabilities (at current prices) than that used in the accounts.

In respect of the fund's assets to pay for these liabilities, accounting practice only allows the Council's accounts to include them at their current value. Any expected future growth in these assets remains uncertain and the prudent approach in accounting practice is that organisations can only included gains on investments when the gains are certain. Consequently the accounts are always likely to show the pension fund in deficit as the viability of a scheme will always depend on asset growth. In comparison the actuarial review assesses the long term viability of the fund and therefore assumes that the assets will grow in order to meet future liabilities. Consequently the value of the fund's assets in the actuarial review are much greater than those in the accounts. It is therefore the actuarial review which helps determine the employer contribution rates required to meet any projected deficit.