Coventry City Council

# Public report

Audit & Procurement Committee 22 June 2015

**Name of Cabinet Member:**
Strategic Finance and Resources (Councillor Gannon)

**Director Approving Submission of the report:**
Executive Director of Resources

**Ward(s) affected:**
All

**Title:**
Unaudited 2014/15 Statement of Accounts

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**Is this a key decision?**
No

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**Executive Summary:**
The purpose of this report is to give Audit and Procurement Committee the opportunity to review the 2014/15 Statement of Accounts and raise any points that need to be addressed prior to their formal approval in August 2015. The Accounts and Audit Regulations 2011 allow local authorities the discretion to use an Audit Committee or equivalent as the sole body for approval of these Statements and this path was adopted at Coventry in 2011.

**Recommendations:**
Audit and Procurement Committee is recommended to review and comment on as appropriate, the 2014/15 Statement of Accounts.

**List of Appendices included:**
The Statement of Accounts is appended in its entirety.

**Other useful background papers:** Final Accounts Working papers – 3rd Floor Christchurch House

**Has it been or will it be considered by Scrutiny?:** The Audit and Procurement Committee will consider the Statement.

**Has it been or will it be considered by any other Council Committee, Advisory Panel or other body?:** No

**Will this report go to Council?:** No

**Report title:**
Unaudited 2014/15 Statement of Accounts

## 1. Context (or background)

This report presents the 2014/15 Statement of Accounts (SoA). The Council is required by law to produce this document and it is prescribed heavily by regulation. It is presented in draft format within this report to give the Audit and Procurement Committee the opportunity to review and comment on it. It is also subject to audit currently by the Council's external auditors, Grant Thornton. It will be brought back to Audit and Procurement Committee for formal approval in August 2015 reflecting any changes recommended by Grant Thornton and agreed by the Executive Director of Resources. This process reflects changes to reporting requirements made by the Accounts and Audit Regulations 2011 which allow local authorities the discretion to use an Audit Committee or equivalent as the sole body for approval of these Statements.

## 2. Options considered and recommended proposal

2.1 Given the highly technical, heavily prescribed and retrospective nature of the Statement of Accounts there are no options to consider. The Audit and Procurement Committee is recommended to review the draft statements, make any comments as appropriate prior to final approval in September and take note of any issues that could affect the Committee's governance role going forward. The paragraphs below explain the key aspects of the Statement.

2.2 In approving the recommendation, it is important that the Audit and Procurement Committee should, as a minimum, seek explanations and gain assurance that sufficient explanation is provided for the differences between the City Council's management accounts and statutory Statement of Accounts.

2.3 In terms of the financial aspects of the Statement of Accounts, the Committee should be aware that the Council's accounts are presented in line with International Financial Reporting Standards (IFRS), introduced for local government in 2010/11. The Council is required to include the following financial statements within the Statement of Accounts document as follows (references relate to the appended Statement):

- Comprehensive Income and Expenditure Account (SoA section 2.2) - This shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation. Authorities raise taxation to cover expenditure but this is different to the accounting cost which reflects notional changes in the value of the Council's assets and liabilities.
- Movement in Reserves Statement (SoA section 2.3) - This shows reserve movements analysed into two broad categories. Usable Reserves are those that can be applied to fund expenditure or reduce local taxation and Unusable Reserves include those that hold unrealised gains and losses (for example the Revaluation Reserve), where amounts would only become available to provide services if the assets are sold; and reserves that hold timing differences between the Council's accounting basis and funding basis
- Balance Sheet (SoA section 2.4) - This shows the value of the assets and liabilities recognised by the authority. The net assets of the authority (assets less liabilities) are matched by the reserves held by the authority.
- Cash Flow Statement (SoA section 2.5) – This shows the changes in cash and cash equivalents of the authority during the reporting period. The statement shows how the authority generates and uses cash and cash equivalents by classifying cash flows as operating, investing and financing activities. The amount of net cash flows arising

from operating activities show the extent to which the operations of the authority are funded by way of taxation and grant income or from the recipients of services provided by the authority.

- The Collection Fund (SoA section 2.6) - This account shows how much Council Tax and National Non-Domestic Rates (business rates) are collected within the City. It shows how much has been transferred to the Income and Expenditure Account to pay for Council Services and how much has been paid to the Police and Fire Authorities. The difference between these two amounts is then a surplus or a deficit which is carried forward in the following financial year. For 2014/15 there is surplus carried forward of £2.8m for Council Tax and a deficit carried forward of £3.3m for Business Rates. Provision has been made to absorb the Business Rates deficit.
- Group Accounts (section 4) ~ These statements consolidate the City Council's accounts with those companies considered to be part of our group. For 2014/15 those companies are North Coventry Holdings Ltd, Coventry North Regeneration, and Coventry and Solihull Waste Disposal Company. In October 2014 the Council sold its interest in Arena Coventry Ltd and therefore ACL’s transactions have been included in the Group Accounts up to the end of September 2014 and will form no further part in the Group Accounts in the future.

2.4 The Statement of Accounts must ensure that any surplus or deficit that arises within the financial year is equal to the change in the net value of the authority's assets and liabilities and the change in the value of its equity. For 2014/15 the Council is reporting a £113 million deficit within its Comprehensive Income and Expenditure Statement. This deficit is matched by a decrease in the value of the Balance Sheet and the same decrease reflected in the level of (useable plus unusable) reserves in the Movement in Reserves Statement.

2.5 The CIES deficit referred to above does not reflect the genuine position of the Council's General Fund, for which a £2.2m overspend has been reported in the Revenue and Capital Outturn Report on the Audit and Procurement Committee agenda today. The headline differences between the Income and Expenditure Account and the General Fund is explained below. These are also incorporated, along with a range of smaller changes, in the table that follows:

- The key reason for the deficit relates to the Council’s pensions deficit position worsening by £120 million, as a result largely of the decrease in the discount rate from 4.4% to 3.2%. This rate is used by the actuary to discount the expected cost of future pensions to current values. The lower the rate used the higher the calculated cost of liabilities.
- There are a number of asset related adjustments: Revaluation of assets is undertaken on a five yearly rolling programme. Revaluations in 2014/15 have led to a £65m reduction in asset values. This can be explained largely by the 2014/15 process incorporating school valuations as one group during the year, such that the trend of declining values for other asset groups in recent years is now reflected in the schools grouping. In addition, under IFRS the value of assets has to be split into several individual components necessitating assessments of the value of each component part of each asset. This work has continued in 2014/15 and as a consequence £37m of asset value has been derecognised and removed from the balance sheet.
- Notwithstanding the asset based explanations above, the large Capital Programme undertaken by the Council in 2014/15 has led to additions to the Programme of £82m. In total, the overall value of the Council’s asset base has remained relatively constant in the year.

2.6 These circumstances within the Statement have not affected the Council's cash flows of income and expenditure in 2014/15. Instead they are either events that will never result in a reduced level of income or increased need to spend or at worst will only do so many years in the future. For this reason they do not form part of the management accounts which reflect a more current (and statutorily based) view of the need to spend and to finance this spend through grants, taxation and charges. The differences between the Statement of Account and management accounts are shown in the table below.

| | **£000** | **£000** |
|---|---|---|
| **Deficit Shown in Comprehensive Income & Expenditure Account (CIES)** | | **112,954** |
| <u>Less changes that made the CIES worse than the management accounts</u> | | |
| Asset related adjustments including the rate that our assets go down in value over their lifetime due to wear and tear (depreciation) and any charges reflecting extra-ordinary one-off reductions in the value of our assets (impairment, revaluation and de-recognition). | (74,524) | |
| Items such as external schemes (e.g. Nuckle) that the Council funds from capital resources not revenue which do not result in the creation of new asset value for the Council. | (25,269) | |
| The difference between a calculated whole-life cost of pensions and the pension contributions paid by the Council in the year. The pensions' deficit position has gone up this year due in large part to a change in the discount rate from 4.4% to 3.2%. | (120,180) | |
| **Sub-Total – changes that made the CIES worse than the management accounts** | | **(219,973)** |
| <u>Add changes that made the CIES better than the management accounts</u> | | |
| Capital grants and other capital funding that is reflected in the CIES but not in the management accounts. | 80,498 | |
| A charge for the amount that we need to put aside to repay debt in the future, peculiar to local authorities, referred to as the minimum revenue provision. This is reflected in the management accounts but not the CIES | 14,117 | |
| An increase in the overall value of reserves which is reflected in the CIES but not in the management accounts | 6,145 | |

| | | |
|---|---|---|
| Capital expenditure charged against the management accounts, sometimes known as revenue contribution to capital outlay. | 6,917 | |
| All Other Items | 1,510 | |
| **Sub-Total – changes that made the CIES better than the management accounts** | | **109,187** |
| **Surplus Shown in Outturn Report** | | **2,168** |

2.7 There is one further material items that has affected the Council's accounts. As a result of a change in accounting policy the assets for voluntary controlled and foundation schools have been brought onto the Council's balance sheet. This has increased the opening balance sheet value by £43m.

## 3. Results of consultation undertaken

3.1 Given the nature of the report no consultation has been undertaken.

## 4. Timetable for implementing this decision

4.1 Forthcoming regulations are expected to shorten the timescale for completing local authority accounts from financial year 2017/18 onwards. These will require the draft accounts to be prepared by 31st May (currently 30th June) and the final audited Statement to be approved by 31st July (currently 30th September). As a result the Council is taking measures to bring forward its accounting timetable. It is anticipated that this year's statement will be signed off by Audit Committee on 3rd August 2015 once it has been audited by Grant Thornton. Any material changes to it will be reported to Audit and Procurement Committee at that time.

## 5. Comments from Executive Director of Resources

5.1 Financial implications

The Statement is a heavily prescribed, highly technical and very detailed document and it is no exaggeration to say that even experienced finance professionals find it difficult to understand some of the more complex areas of the Statement. For this reason, a report of this nature can only summarise the key aspects of the Statement and its implications for the Council. In reality, the 2014/15 Revenue and Capital Outturn Report which contains the end of year position of the Council's management accounts is a more representative summary of the Council's in-year financial performance.

The Statement of Accounts provides a retrospective record of the Council's financial position on an accounting basis and it does not in itself have any specific financial implications for the Council. However, there are two material areas of analysis contained within the Statement that require further explanation – the pensions liability and the threat of future negative equity.

Long-term trends have witnessed a significant worsening of the Council's Pension liabilities over time. In general, this means that the contributions and other income flows into the pension fund are not sufficient to meet the calculated cost of future outflows (the payment of pension benefits) from the fund. Action has been taken to reform local government pensions on a national level with the introduction of a revised Local Government Pension Scheme from 1st April 2014. In addition, employer contributions have been increased across all West Midlands authorities to pay for the past service cost of pensions and in Coventry's case these were built into the 2014/15 Budget. Whether or not these measures will redress the overall pension deficit over the medium to long term, other factors are always likely to cause year on year volatility which makes it difficult to assess any long-term trends in the early years. Nevertheless, the significantly worsened position of the Council's pension deficit described above, albeit that this is the result largely of factors outside of the Council's control, represents a continued worrying trend. The next triennial review of the Council's pension position is due for 31st March 2016 and will influence the revised employer pension contributions that will be payable from 2017/18. Based on the current position, the Council will once again come under pressure to increase its budgeted pension contributions.

In recent years, the Audit and Procurement Committee has been briefed on the possibility that the value of the Council's Balance Sheet (or its net worth) will become a negative figure in the future, indicating that the Council, based on the way the accounts are required to be presented by regulations, will be judged to have a position of negative equity (it will owe more than it owns). In the main this trend is based on the risk that the pension deficit described above increases, that more schools will become Academies and no longer be part of the Council's asset base and that further impairments to the value of other Council assets could occur. Based on the current balance sheets of councils around the country it is anticipated that a number of others will face the same issue, not least due to the fact that the causes in Coventry are all part of national trends.

It is important to understand that it is untenable for a position of negative equity to be maintained over the long-term. Given that the Council's pension deficit represents the over-riding reason for the threat of negative equity it is has become essential that this position is addressed by the local government community and its pensions authorities. There has already been an increased focus on the issue in terms of national regulations and the local actions of the West Midlands Pension Fund at a local level. However, the Council has made an assessment that it maintains a robust position of going concern based on the long-term funding streams available to local government and the facility for it to take a long-term view on managing its pensions' deficit.

It is also worth making the point that changes to accounting regulations will, from 2016/17, increase massively the value of highways assets included within the local authority accounts. For Coventry, the strong likelihood is that we know already that this will add multiple millions of pounds to the Council's balance sheet. Whilst this will (from 2016/17) remove the threat of negative equity, it in no way diminishes the need to resolve the pensions issues described above.

5.2 Legal implications

The Council is required by legislation to complete a draft Statement signed by the Chief Financial Officer by 30th June and to approve and publish audited accounts by 30th September in line with the Accounts and Audit Regulations 2011. The Audit and Procurement Committee approves the accounts on behalf of the Council.

**6. Other implications**

**6.1 How will this contribute to achievement of the Council's key objectives / corporate priorities (corporate plan/scorecard) / organisational blueprint / Local Area Agreement (or Coventry Sustainable Community Strategy)?**

The Statement of Accounts contributes to the Council's key objectives as one of the measures by which to judge whether the Council is using its resources effectively and that its performance is well managed.

**6.2 How is risk being managed?**
There is a detailed timetable for compiling the Statement of Accounts.

**6.3 What is the impact on the organisation?**
No specific impact.

**6.4 Equalities / EIA**
No specific implications.

**6.5 Implications for (or impact on) the environment**
None.

**6.6 Implications for partner organisations?**
None.

**Report author(s):**

**Name and job title: Paul Jennings, Finance Manager (Corporate Finance)**

**Directorate: Finance and Legal Services**

**Tel and email contact: 02476833753 paul.jennings@coventry.gov.uk**

Enquiries should be directed to the above person.

| **Contributor/approver name** | **Title** | **Directorate or organisation** | **Date doc sent out** | **Date response received or approved** |
|---|---|---|---|---|
| **Contributors:** | | | | |
| Michelle Rose | Governance Services Officer | Resources | 11/6/15 | 11/6/15 |
| **Names of approvers for submission:** (officers and members) | | | | |
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