

<b>Committee(s):</b>	<b>Date(s):</b>
Audit and Risk Management	22 July 2014
Finance	22 July 2014
<b>Subject:</b> City Fund and Pension Funds Financial Statements 2013/14	
<b>Report of:</b> The Chamberlain	<b>Public:</b> For Decision
<b><u>Summary</u></b>	
<p>1. Attached to this report are the City Fund and Pension Funds Financial Statements for the year ended 31 March 2014.</p> <p>2. The key points are:</p> <ul style="list-style-type: none"> <li>• The City Fund Balance Sheet includes, for the first time, an estimated share of the net liability in the City of London Pension Scheme. The estimated City Fund Share is 49% which was £197m at 31 March 2014 (£167m at 31 March 2013). <i>(See paragraph 3 of the explanatory forward and note 46 (on page 87) to the financial statements).</i></li> <li>• Total City Fund net assets of £1,045m, an increase of £85m since last year. The £1,045m comprises £215m in usable reserves and £830m in unusable reserves. This net asset position is after having deducted total pension funds liabilities of £894m. <i>(See the Balance Sheet on page 13 and paras. 16 to 20 of the covering report).</i></li> <li>• The usable reserves of £215m are a reduction of £61m from a year earlier due, primarily, to the purchase of investment properties to generate increased revenue income. These purchases convert usable reserves to unusable reserves. The reserves are allocated for the funding of the capital programme over the medium term, including part of the City Fund's £200m contribution to Crossrail, or are earmarked for specific purposes such as for Police, Highways and Housing Revenue Account. <i>(The £215m is shown in the Balance Sheet on page 13 and analysed in more detail in the Movement in Reserves Statement on page 11).</i></li> <li>• The unusable reserves of £830m have increased by £146m. The main movements were: <ul style="list-style-type: none"> <li>○ revaluation gains on investment and operational properties - £191m;</li> <li>○ financing of capital expenditure including the purchase of investment properties indicated above - £183m;</li> </ul> <i>partly offset by;</i> <ul style="list-style-type: none"> <li>○ an increase in pension liabilities - £120m (City £30m, Police £90m);</li> <li>○ disposals, depreciation and impairments - £93m;</li> </ul> </li> </ul>	

○ an increase on the Collection Fund Adjustment Account - £15m.  
*(The £830m is shown on the Balance Sheet on page 13 and analysed in more detail in note 26 (page 60) to the financial statements).*

- A net deficit of £27.4m on the City Fund, a better than budget position of £3.8m. *(The £27.4m is shown in the Movement in Reserves Statement on page 11 on the penultimate line of the first column of figures. The comparison to budget is set out in para 8 of this covering report).*

3. Deloitte commenced its audit on 9 June and intend to give unqualified opinions on the financial statements. Representatives of the auditors will be in attendance at the Audit and Risk Management Committee to present their management letters which are appended to this report.

### Recommendations

4. The Audit and Risk Management Committee is requested to:-

- consider the contents of Deloitte's management letters;
- recommend approval of the City Fund and Pension Funds Financial Statements for the year ended 31 March 2014 to the Finance Committee; and
- delegate to the Town Clerk, in consultation with the Chairman and Deputy Chairman of the Audit and Risk Management Committee, approval of any material changes to the financial statements required before the signing of the audit opinion by Deloitte which is expected to be by the end of August or early September.

5. The Finance Committee is requested to:-

- consider the resolution from the Audit and Risk Management Committee and, if appropriate, approve the City Fund and Pension Funds Financial Statements for the year ended 31 March 2014; and
- delegate to the Town Clerk, in consultation with the Chairman and Deputy Chairman of the Finance Committee, approval of any material changes to the financial statements required before the signing of the audit opinion by Deloitte which is expected to be by the end of August or early September.

Introduction

6. The City Fund and Pension Funds Financial Statements for 2013/14 are set out in Annex 1.
7. The Accounts and Audit Regulations 2011 further require the approval and publication of the City Fund and Pension Funds Financial Statements for the year to 31 March 2014 to take place as soon as reasonably practicable, and in any event by 30 September 2014. Approval of each year's financial statements has been delegated by the Court of Common Council to the Finance Committee.

Revenue Position

As set out in the table below, the revenue account reveals an overall net deficit for 2013/14 of £27.4m to be funded from the City Fund Unallocated Reserve. This is a better than budget position of £3.8m compared with the anticipated deficit of £31.2m. The deficit reflects the decision to use general revenue reserves to part fund the purchase of investment properties. If this use of reserves is excluded, there is a surplus of £9.3m which compares to a budgeted surplus of £5.4m.

	<b>Budget</b>	<b>Actual</b>	<b>Variation (Better) Worse</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Net expenditure on services	150.7	148.5	(2.2)
Investment property purchases	83.0	83.0	0.0
Major revenue works projects	1.7	0.8	(0.9)
Requirement before investment income from the City's Assets	235.4	232.3	(3.1)
Contribution from earmarked reserves to fund the purchase of investment property	(46.4)	(46.4)	0.0
Interest on balances	(4.9)	(5.2)	(0.3)
Estate rent income	(36.0)	(36.8)	(0.8)
City Fund Requirement	148.1	143.9	(4.2)
Financed by:			
Government formula grant	(79.7)	(80.0)	(0.3)
Business Rates Retention Scheme	(14.6)	(14.7)	(0.1)
City offset	(10.5)	(10.5)	0.0
Council tax	(5.6)	(5.6)	0.0
NNDR premium	(6.5)	(5.7)	0.8
<b>Total contribution from reserves</b>	<b>31.2</b>	<b>27.4</b>	<b>(3.8)</b>

8. The better than budget position of £4.2m on the line ‘City Fund Requirement’ can be analysed on a committee basis as follows:

Committee	Budget	Actual	Variation (Better)/Worse		
			Total	Local Risk	Central Risk/Support Services
	£'m	£'m	£'m	£'m	£'m
Barbican Centre	25.5	25.8	0.3	0.0	0.3
Barbican Residential	0.4	0.2	(0.2)	(0.2)	0.0
Community and Children's Services	11.4	10.2	(1.2)	(0.7)	(0.5)
Culture, Heritage and Libraries	20.1	20.2	0.1	0.1	(0.0)
Finance	27.4	26.6	(0.8)	0.6	(1.4)
Licensing	0.2	0.1	(0.1)	(0.1)	0.0
Markets	(0.8)	(0.8)	0.0	(0.2)	0.2
Open Spaces	1.5	1.4	(0.1)	(0.1)	0.0
Planning and Transportation	12.0	11.8	(0.2)	(0.6)	0.4
Police - excluding transfers to/(from) reserves	64.0	62.2	(1.8)	(1.8)	(0.0)
Police - transfers to/(from) reserves	(1.1)	0.7	1.8	1.8	0.0
Policy and Resources	3.8	3.7	(0.1)	(0.1)	0.0
Port Health and Environmental Services	14.3	13.7	(0.6)	(0.4)	(0.2)
Property Investment Board	(30.6)	(31.9)	(1.3)	(0.4)	(0.9)
<b>Total City Fund Requirement</b>	<b>148.1</b>	<b>143.9</b>	<b>(4.2)</b>	<b>(2.1)</b>	<b>(2.1)</b>

The £1.4m reduced requirement against central risk/support services on Finance Committee relates to slippage/rephasing on major revenue repairs, maintenance and improvement projects together with central contingencies not being fully required.

The City Police reduced requirement of £1.8m primarily relates to the rephasing and slippage of certain capital projects, decreasing the level of funding required from revenue.

9. More detailed analyses of the outturn compared to budget are currently being submitted to committees.
10. In accordance with the City's budget management arrangements, requests for the carry forward of City Fund resources totalling £2.1m are being considered by the Chamberlain, in consultation with the Chairman and Deputy Chairman of the Resource Allocation Sub-Committee. The extent to which these carry forwards are agreed, will increase the call on the City Fund Unallocated Reserve in 2014/15. In addition, £0.9m of projects and works programmes have slipped and/or been rephased to 2014/15.

#### Business Rates Retention Scheme

11. In the table above, the income recognised from the new Business Rates Retention Scheme is reported as £14.7m, a marginal increase of £0.1m compared to budget. This sum is taken from a Government return that is completed prior to the commencement of the financial year setting out estimated rates income. Local authorities have no discretion to use a different figure.

12. However, due to the impact of the provision for successful rating appeals on total rates income, the final rates retained will be the lower sum of £13.5m. This is the level below which the City's retained rates share cannot fall (i.e. the safety net). The reduction of £1.2m (£14.7m less £13.5m) will unwind in 2014/15 as local authorities are currently prohibited by statute from including this adjustment in the year of account.

#### NNDR Premium

13. Income from Business Rates income has also reduced due to the provision for successful rating appeals – from £6.5m in the budget to an outturn of £5.7m. Previously, the impact of successful appeals was included in the year they were determined. From 2013/14, a provision has been created to retain consistency with the Rates Retention Scheme.

#### Capital Position

14. The approved capital budget for 2013/14 totalled £190.5m. Actual capital expenditure during the year was £183.7m. This reduction of £6.8m compared to budget was mainly due to slippage and/or rephasing of expenditure on a number of schemes, primarily relating to investment properties and streetscene projects.

#### Balance Sheet

15. The Consolidated Balance Sheet indicates that the City Fund's total net assets increased by £85.1m (or 9%) to £1,045.1m from £960.0m a year earlier. The main reasons for this increase are set out on the following page.

	2013/14	
	£m	£m
Long Term Assets		
Net unrealised gain on revaluation of investment properties	105.9	
Net unrealised gain on revaluation of other fixed assets	85.0	
Acquisitions	183.3	
Disposals	(72.2)	
Depreciation, impairment and amortisation	(20.6)	
Reduction in long term non-property investments	(42.5)	
Reduction in long term debtors	(5.0)	
Sub-Total LongTerm Assets		233.9
Increase in Pension liabilities		(119.5)
Decrease in short term investments		(13.6)
Increase in capital grants and contributions received in advance		(7.3)
Net increase in NNDR and Council Tax liabilities		(7.5)
Increase in other net liabilities		(0.9)
<b>Increase in net assets</b>		<b>85.1</b>

16. This increase in net assets of £85.1m is reflected in the following movements in usable and unusable reserves.

	2013/14 £m	2012/13 £m	(Increase)/ Decrease £m
Usable reserves			
Revenue	128.9	182.2	53.3
Capital	85.9	93.7	7.8
Sub-total usable reserves	214.8	275.9	61.1
Unusable reserves	830.3	684.1	(146.2)
<b>Total reserves</b>	<b>1,045.1</b>	<b>960.0</b>	<b>(85.1)</b>

17. The £53.3m decrease in usable revenue reserves primarily relates to the part funding of the purchase of investment properties. The £7.8m decrease in usable capital reserves is the result of sums applied to finance capital expenditure partly offset by proceeds from disposals during the year.

18. Although usable reserves are a relatively healthy £214.8m they are already committed over the medium term. They are required for the funding of the capital programme including part of the City Fund's £200m contribution to Crossrail and also include sums earmarked, either by

statute or as agreed for Members, for specific purposes such as Highways, the Housing Revenue Account and the Police. It is not sustainable for the reserves to fund the potential annual revenue deficits being forecast over the medium term as a result of increasing Government grant cuts and these deficits are therefore being addressed by the Service Based Review.

19. The main movements included within the overall net increase of £146.2m in unusable reserves are as follows:
- revaluation gains on investment and operational properties - £190.9m;
  - financing of capital expenditure including the purchase of investment properties indicated above - £183.3m;
- partly offset by;*
- an increase in pension liabilities - £119.5m (City £29.3m, Police £90m, Judges £0.2m);
  - disposals, depreciation and impairments - £92.8m;
  - an increase in the deficit on the Collection Fund Adjustment Account - £15.4m. This account manages the differences arising from the recognition of National Non Domestic Rates and Council Tax income as it falls due from tax payers compared with the statutory arrangements for paying amounts to the City Fund from the Collection Fund.

### Crossrail

20. The City of London Corporation has agreed with Government that £200m will be provided from City Fund towards the costs of constructing Crossrail. The payment of this amount is dependent on the fulfilment of a number of conditions, primarily the completion of certain works in relation to Crossrail stations. Whilst it is anticipated that the conditions will be met, there is still 2 years to go before the relevant works are due to be completed. A liability has not therefore been recognised in the financial statements pending fulfilment of the conditions. At this stage it is anticipated that the contribution will be made in 2016. The financing strategy for the contribution is based on the accumulation of annual rental income from specific investment properties and capital receipts from the sale of assets. The City Surveyor is in the process of identifying the properties that it would be most advantageous to sell – both in terms of potential proceeds and the overall City Fund Estate strategy.

### Pension Liabilities

21. The City Fund's total net assets of £1,045.1m are after having deducted net pension liabilities totalling £893.7m (City £196.7m, Police £695.2m,

Judges £1.8m). The comparator for 31 March 2013 is £774.2m (City £167.4m, Police £605.2m, Judges £1.6m). The liabilities arise from applying the requirements of International Accounting Standard (IAS) 19. This accounting standard is complex, but is based on the principle that an organisation should recognise liabilities for pension benefits as they are earned, even if the payment of such benefits will be many years into the future. The estimated net liabilities are calculated by independent actuaries, Barnett Waddingham.

#### *City of London Pension Scheme*

- 22.** City of London staff, excluding police officers, teachers and judges, are eligible to join the Local Government Pension Scheme – a statutory scheme administered in accordance with Government regulations.
  
- 23.** Previously, the City Fund's share of the estimated net deficit on the City of London Pension Scheme had not been included in the balance sheet. This exclusion arose because the estimated net deficit is the responsibility of the City of London as a whole, as one employer, rather than the specific responsibility of any of its three funds. Thus the City Fund does not have an exclusive relationship with the City of London Pension Fund and the portion of the Pension Fund relating to City of London employee members engaged on City Fund activities is not separately identifiable. Consequently, in accordance with IAS 19, the pension arrangements have been treated as a defined contribution scheme in the City Fund accounts. This meant that only the employer's contributions to the scheme have previously been included in the accounts as they become payable.
  
- 24.** However, although the Pension Fund net deficit cannot be attributed precisely between the City Fund, City's Cash and Bridge House Estates, it is now considered that an apportionment of that deficit and inclusion in the respective balance sheets presents a fairer view of the funds' financial positions than if the deficit were to continue to be excluded. Accordingly an apportionment has been made which is based on employer's annual contributions to the fund.
  
- 25.** Amounts included for 2012/13 have also been restated from those published last year to include the City Fund's estimated proportion of the net Pension Fund deficit. The total net deficit in the City of London Pension Fund was £402m at 31 March 2014 (2012/13: £342m). The City Fund's estimated proportion of this deficit is £196.7m or 49% (2012/13:



£167.4m or 49%).

26. Pension fund deficits (or surpluses) are relatively sensitive to movements in the underlying assumptions. The main reasons for the increase in the City of London Pension Fund deficit are a reduction in the discount rate used for calculating the present day value of future payments from the fund - with a decrease in the rate resulting in higher liabilities and vice-versa together with an increase in longevity; partly offset by an increase in the fund's assets.
27. The employer's pension contribution rate is considered and determined by the Finance Committee following each triennial valuation (updated by any subsequent interim valuations) and is a separate issue from the IAS19 calculations. The triennial valuation considers the period over which the pension deficit should be recovered through employer's contributions and the City Corporation is consulted on the assumptions used by the actuary for these valuations. Following the triennial valuation as at 31 March 2013 the Finance Committee agreed to leave the employer's contribution rate at 17.5%.

#### *City Police Pension Schemes*

28. The Police Pension Scheme is a statutory scheme as specified by police regulations. The scheme is unfunded (i.e. the scheme has no assets - unlike the Local Government Pension Fund which has both assets and liabilities). The deficit in the City Police Pension Scheme at 31 March 2014 was £695.2m, an increase of £90m since last year. The main reasons for the increase in the deficit are a decrease in the discount rate used to value liabilities, an increase in longevity and experience losses (differences between actual events as they have turned out and the assumptions made at the previous actuarial valuation).
29. The City of London Corporation in its capacity as Police Authority pays an employer's contribution of 24.2% of pensionable pay for all serving police officers into the Police Pension Fund Account. If there is insufficient money in the Police Pension Fund Account to meet all expenditure commitments in any particular year, the Home Office will fund the deficit. In practice therefore the significant balance sheet liability of £695.2m relating to benefits earned but to be paid in the future, will be covered by future employee contributions and receipt of Home Office grant monies.

### Audit Opinion and Letter

30. Deloitte commenced its audit on 9 June and intends to give unqualified opinions on the City Fund and Pension Funds Financial Statements subject to clarification of any residual points and to issue its 2013/14 management letters for the City Fund and Pension Fund as set out in Annexes 2 and 3 respectively. Representatives from Deloitte will be in attendance at the Audit and Risk Management Committee to present their reports and to clarify any points or issues.

### Subsequent Adjustments to the Accounts

31. Deloitte is expecting to sign its audit opinion by the end of August or early September. Should any material adjustments to the financial statements be required before that position is reached, it is recommended that authority to approve such amendments should be delegated to the Town Clerk in consultation with the Chairmen and Deputy Chairmen of the Audit and Risk Management and Finance Committees.

### Publication of the Statement of Accounts

32. As soon as reasonably possible after the conclusion of the audit, and in any event by 30 September 2014, the City is required to publish the 2013/14 City Fund and Pension Fund Financial Statements including the Audit Opinion on its website. Copies of the published statements will be placed in the Members' Reading Room and will be available from my office. The final management letters from Deloitte on its audit will be presented to the Court of Common Council for information.

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Annex 1: Statement of Accounts for the City Fund and the Pension Funds

Annex 2: Deloitte's City Fund Management Letter

Annex 3: Deloitte's Pension Fund Management Letter