

Committees:	Dates:
Audit and Risk Management Committee Finance Committee	20 July 2015 21 July 2015
Subject: City Fund and Pension Funds Financial Statements 2014/15	Public
Report of: The Chamberlain	For Decision

Summary

Attached to this report are the City Fund and Pension Funds Financial Statements for the year ended 31 March 2015. The key points are:

- Total reserves of £1,175.6m, an increase of £130.5m since last year. However, the City is committed to making a £200m contribution to Crossrail which is anticipated to be made in March 2016. A liability has not been recognised in the balance sheet for this sum as the payment is dependent on the fulfilment of a number of conditions. The inclusion of such a liability would reduce the City Fund total reserves to £975.6m. A footnote to this effect has been included on the balance sheet. **(See the Balance Sheet on page 13 and paras. 9 to 13 of this covering report).**
- The £1,175.6m comprises £337.3m in usable reserves and £838.3m in unusable reserves. This net asset position is after having deducted total pension funds liabilities of £1,064.3m.
- The usable reserves of £337.3m have increased by £122.5m from a year earlier primarily due to proceeds from disposals and a revenue surplus for the year, partly offset by the financing of capital expenditure. The reserves are allocated for the funding of the capital programme over the medium term, including the City Fund's £200m contribution to Crossrail, or are earmarked for specific purposes such as for Police, Highways and Housing Revenue Account. **(The £337.3m is shown in the Balance Sheet on page 13 and analysed in more detail in the Movement in Reserves Statement on page 10).**
- The unusable reserves of £838.3m have increased by £8m. The main movements were:
 - revaluation gains on investment and operational properties - £239m;
 - financing of capital expenditure - £54m;
partly offset by:
 - an increase in pension liabilities - £171m (City £53m, Police £118m); and
 - disposals, depreciation and impairments - £114m.**(The £838.3m is shown on the Balance Sheet on page 13 and analysed in more detail in note 27 (page 57) to the financial statements).**
- A net revenue surplus of £12.9m on the City Fund, a better than budget position of £9.2m. **(The £12.9m is shown in the Movement in Reserves Statement on page 10 on the penultimate line of the first column of figures. The comparison to budget is set out in para 5 of this covering report).**

- Deloitte commenced its audit on 8 June. There are a number of items still being reviewed, particularly the treatment of receipts from property transactions, the provision for business rates appeal refunds, and recognition of police grant income. It is anticipated that these reviews will be concluded satisfactorily to enable Deloitte to issue unqualified opinions. Representatives of the auditors will be in attendance at the Audit and Risk Management Committee to present their progress reports which are annexes 2 and 3 to this report.

Recommendations

The **Audit and Risk Management Committee** is requested to:-

- a) consider the contents of Deloitte's management letters;
- b) recommend approval of the City Fund and Pension Funds Financial Statements for the year ended 31 March 2015 to the Finance Committee; and
- c) 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.

The **Finance Committee** is requested to:-

- a) 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 2015; and
- b) 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.

Main Report

Introduction

1. The City Fund and Pension Funds Financial Statements for 2014/15 are set out in Annex 1.
2. The Accounts and Audit Regulations 2011 require the approval and publication of the City Fund and Pension Funds Financial Statements for the year to 31 March 2015 to take place as soon as reasonably practicable, and in any event by 30 September 2015. Approval of each year's financial statements has been delegated by the Court of Common Council to the Finance Committee.

Revenue Position

3. As set out in the table below, the revenue account reveals an overall net surplus for 2014/15 of £12.9m which will be transferred to the City Fund

Unallocated Reserve. This is a better than budget position of £9.2m compared with the anticipated surplus of £3.7m.

	Budget £m	Actual £m	Variation (Better) Worse £m
Net expenditure on services	148.7	142.8	(5.9)
Major revenue works projects and capital expenditure financed from revenue	2.4	1.4	(1.0)
Requirement before investment income from the City's Assets	151.1	144.2	(6.9)
Interest on balances	(2.5)	(4.1)	(1.6)
Estate rent income	(41.6)	(42.5)	(0.9)
City Fund Requirement	107.0	97.6	(9.4)
Financed by:			
Government formula grant	(72.6)	(72.6)	0.0
Business Rates Retention Scheme	(15.0)	(15.2)	(0.2)
City offset	(10.8)	(10.7)	0.1
Council tax	(5.8)	(5.8)	0.0
City premium	(6.5)	(6.2)	0.3
Net surplus transferred to unallocated reserve	(3.7)	(12.9)	(9.2)

4. The better than budget position of £9.4m on the line 'City Fund Requirement' can be analysed on a committee basis as follows:

2014/15 Budget v Outturn - City Fund Summary by Committee					
Net Expenditure (Income)	Budget	Provisional	Variation (Better)/Worse		
	Net	Outturn	Total	Local Risk	Central Risk/Support Services
	£m	£m	£m	£m	£m
Barbican Centre	25.3	25.2	(0.1)	(0.2)	0.1
Barbican Residential	0.8	0.3	(0.5)	(0.1)	(0.4)
Community and Children's Services	11.8	12.1	0.3	(0.3)	0.6
Culture Heritage and Libraries	20.7	20.5	(0.2)	(0.4)	0.2
Finance	(8.1)	(14.0)	(5.9)	(0.1)	(5.8)
Licensing	0.2	0.1	(0.1)	0.0	(0.1)
Markets	(0.8)	(0.8)	0.0	0.0	0.0
Open Spaces	1.5	1.5	0.0	0.0	0.0
Planning and Transportation	12.6	11.9	(0.7)	(1.2)	0.5
Police - excluding transfers from reserve	67.5	64.9	(2.6)	(1.7)	(0.9)
Police - transfers from reserve	(7.1)	(4.5)	2.6	1.7	0.9
Policy and Resources	3.8	3.8	0.0	(0.1)	0.1
Port Health and Environmental Services	14.8	13.8	(1.0)	(0.8)	(0.2)
Property Investment Board	(36.0)	(37.2)	(1.2)	(0.3)	(0.9)
City Fund requirement to be met from government grants, local taxation and transfers to/(from) reserves.	107.0	97.6	(9.4)	(3.5)	(5.9)

The £5.8m reduced requirement against central risk/support services on Finance Committee relates to slippage/rephasing on major revenue repairs, maintenance and improvement projects; increased income from interest earnings; central contingencies and provisions not being required in full; rebates and lower than anticipated fees on corporate contracts; and a lower apportionment of support service costs.

The City Police reduced requirement of £2.6m primarily relates to a combination of slippage on the capital programme and lower net operating costs. Consequently, the net contribution required from police reserves was reduced from £7.1m to £4.5m.

5. More detailed analyses of the outturn compared to budget are currently being submitted to committees.
6. In accordance with the City's budget management arrangements, requests for the carry forward of City Fund resources totalling £2.2m 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 2015/16. In addition, £2.3m of projects and works programmes have slipped and/or been rephased to 2015/16.

NNDR Premium

7. Income from the Business Rates Premium has reduced from £6.5m in the budget to an outturn of £6.2m. This is due to an increase in the provision for outstanding rating appeals.

Capital Position

8. The approved capital budget for 2014/15 totalled £56.9m. Actual capital expenditure during the year was £45.6m. This reduction of £11.3m compared to budget was mainly due to slippage and/or rephasing of expenditure on a number of schemes, primarily relating to housing dwellings, investment properties and streetscene projects.

Balance Sheet

9. The Consolidated Balance Sheet indicates that the City Fund's total net assets increased by £130.5m (or 12%) to £1,175.6m from £1,045.1m a year earlier. The main reasons for this increase are set out below.

	2014/15	
	£m	£m
Long-Term Assets		
Net unrealised gain on revaluation of investment properties	130.0	
Net unrealised gain on revaluation of other fixed assets	108.8	
Acquisitions	53.8	
Disposals (net book value)	(91.5)	
Depreciation, impairment and amortisation	(22.4)	
Reduction in long-term non-property investments	(7.9)	
Reduction in long-term debtors	(0.6)	
Sub-Total Increase in Long-Term Assets		170.2
Increase in short-term investments		184.0
Increase in cash and cash equivalents		26.1
Increase in current liabilities (mainly business rates related)		(82.7)
Increase in Pension liabilities		(170.6)
Increase in other net assets		3.5
Increase in net assets		130.5

10. This increase in net assets of £130.5m is reflected in the following movements in usable and unusable reserves.

	2014/15 £m	2013/14 £m	(Increase)/ Decrease £m
Usable reserves			
Revenue	139.5	128.9	(10.6)
Capital	197.8	85.9	(111.9)
Sub-total usable reserves	337.3	214.8	(122.5)
Unusable reserves	838.3	830.3	(8.0)
Total reserves	1,175.6	1,045.1	(130.5)

11. The £10.6m increase in usable revenue reserves primarily relates to the transfer of £12.9m to the unallocated reserve (paragraph 3) and a £0.8m increase in the HRA reserve, partly offset by a reduction of £3.2m in earmarked reserves. The £111.9m increase in usable capital reserves is the proceeds from disposals during the year partly offset by the financing of capital expenditure.
12. Although usable reserves are a relatively healthy £337.3m they are already committed over the medium term. They are required for the funding of the capital programme including the City Fund's £200m contribution to Crossrail and also include sums earmarked, either by statute or as agreed by 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.

13. The main movements included within the overall net increase of £8m in unusable reserves are as follows:

- revaluation gains on investment and operational properties - £239m;
- financing of capital expenditure - £54m;

partly offset by:

- an increase in pension liabilities - £171m (City £53m, Police £118m); and
- disposals, depreciation and impairments - £114m.

Crossrail

14. 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 relating to the completion of certain works. It is anticipated that these conditions will be met in 2016. A liability has not been recognised in the financial statements pending fulfilment of the conditions. However, a footnote has been included on the balance sheet to indicate that the total reserves are before taking account of the £200m commitment to Crossrail. 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. It is anticipated that sufficient useable reserves will be available to fund the contribution.

Pension Liabilities

15. The City Fund's total net assets of £1,175.6m are after having deducted net pension liabilities totalling £1064.3m (City £249.1m, Police £813.2m, Judges £2m). The comparator for 31 March 2014 is £893.7m (City £196.7m, Police £695.2m, Judges £1.8m). 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

16. 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.

17. Although the Pension Fund net deficit cannot be attributed precisely between the City Fund, City's Cash and Bridge House Estates, 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 excluded. Accordingly an apportionment has been made which is based on employer's annual contributions to the fund.

18. The total net deficit in the City of London Pension Fund was £498.2m at 31 March 2015 (31 March 2014: £402m). The City Fund's estimated proportion of this deficit is £249.1m or 50% (31 March 2014: £196.7m or 49%).
19. Pension fund deficits (or surpluses) are relatively sensitive to movements in the underlying assumptions. The main reason for the increase in the City of London Pension Fund deficit is 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; partly offset by an increase in the fund's assets and reductions in the assumptions for salary and pension increases and inflation. The discount rate is required by regulations to be based on market yields on high quality corporate bonds.
20. The employer's pension contribution rate is a separate issue from the IAS19 calculations. It is considered and determined by the Finance Committee following each triennial valuation (updated by any subsequent interim valuations). 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% to recover the pension fund deficit over a period of 20 years.

City of London Police Pension Schemes

21. 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 2015 was £813.2m, an increase of £118m since last year. The main reasons for the increase in the deficit are the decrease in the discount rate used to value liabilities and an increase in longevity, partly offset by a reduction in the assumptions for salary and pension increases and inflation.
22. 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 £813.2m relating to benefits earned but to be paid in the future, will be covered by future contributions (employees' and employer's) and receipt of Home Office grant monies.

Audit Opinion and Letter

23. Deloitte commenced its audit on 8 June. There are a number of items still being reviewed, particularly the treatment of receipts from property transactions, the provision for business rates appeal refunds, and recognition of police grant income. These items are set out on pages 7, 12 and 13 of Deloitte's progress report on its audit of the City Fund (Annex 2). It is anticipated that these reviews will be concluded satisfactorily to enable Deloitte to issue unqualified opinions. Deloitte's draft report on the City of London Pension Fund is also set out in Annex 3. 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

24. 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

25. As soon as reasonably possible after the conclusion of the audit, and in any event by 30 September 2015, the City is required to publish the 2014/15 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.

Dr. Peter Kane
Chamberlain

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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