

<b>Committee:</b> Audit and Risk Management Committee Finance Committee	<b>Date:</b> 3 November 2015 17 November 2015
<b>Subject:</b> City's Cash Financial Statements 2014/15	<b>Public</b>
<b>Report of:</b> The Chamberlain	<b>For Decision</b>

### Summary

The Annual Report and Financial Statements for City's Cash for the year ended 31 March 2015 are attached at Annex 1 for approval.

Annex 2 sets out Moore Stephens LLP's Audit Management Report for consideration.

The key points are:

- the Income and Expenditure Account indicates a net surplus of £59.3m was achieved in the year which includes a gain in fair value on non-property investments of £70.6m (***these figures can be seen in the Income and Expenditure Account on page 15***);
- total City's Cash net assets of £2,074.8m, an increase of £214.5m (11.5%) since last year. This favourable movement is largely due to the net surplus of £59.3m above and net gains on property investments of £194.4, partially offset by £41.1m being the City's Cash share of the actuarial loss on the pension fund (***the £214.5m is shown in the Consolidated Statement of Total Recognised Gains and Losses on page 18***);
- the potential contribution of £50m from City's Cash towards the Crossrail Project has been disclosed as a financial commitment in both the annual report (***page 9***) and the notes to the financial statements (***page 57***); and
- a premium of £20m received for a 150 year 'operating' lease has been treated as deferred income, to be released to revenue over the life of the lease. This aspect is consistent with the treatment in City Fund. However, unlike City Fund, City's Cash is not bound by the code of practice on local authority accounting or the Government's capital control arrangements and the funds can therefore be used for any purpose (***paras 7-9 of this report***).

## **Recommendations**

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

- a) consider the contents of Moore Stephens LLP's Audit Management Report; and
- b) recommend approval of the City's Cash Financial Statements for the year ended 31 March 2015 to the Finance Committee.

The **Finance Committee** is requested to:

- a) consider the contents of Moore Stephens LLP's Audit Management Report;
- b) approve the City's Cash Financial Statements for the year ended 31 March 2015 taking account of any observations from the Audit and Risk Management Committee; and
- c) agree that the Financial Statements are signed by the Chairman and Deputy Chairman of the Finance Committee on behalf of the Court of Common Council.

## **Main Report**

### **Introduction**

1. The 2014/15 Financial Statements for City's Cash are attached at Annex 1. The statements are prepared in accordance with United Kingdom Generally Accepted Accounting Practice (UKGAAP).
2. The external auditor, Moore Stephens LLP intends to give an unqualified opinion on the City's Cash Financial Statements and has issued the audit management report set out in Annex 2. The audit management report will be distributed to all Members of the Court of Common Council for information. Representatives from Moore Stephens LLP will be in attendance at the Audit and Risk Management Committee to present their report and to clarify any points or issues.
3. The Audit Review Panel of the Chamberlain's and Bridgemasters' Accounts met on 13 October 2015 to review the processes adopted by Moore Stephens LLP and the Panel intends to certify that those processes were in accordance with the prescribed auditing standards.

### **Non-Property Investments – full year effect of a change in Accounting Treatment on 31 January 2014**

4. As explained in last year's report, four of the six equity funds transferred to pooled investment vehicles on 1 February 2014. Consequently, income generated by those funds remained within those funds to be reinvested, with City's Cash drawing down income as required. As a consequence, incoming

resources within the Income and Expenditure Account now include the gain or loss in fair value of most non-property investments rather than the dividend income.

5. In 2013/14 this change had a part year effect:
  - for the period prior to the accounting change, from 1 April 2013 to 31 January 2014, the Income and Expenditure Account recorded dividend income of £15.4m within incoming resources and, as part of other recognised gains and losses, a net gain on non-property investments of £34.4m; and
  - for the period following the accounting change from 1 February 2014 to 31 March 2014, the Income and Expenditure Account recorded an overall gain in fair value of £1.5m within incoming resources.
6. For 2014/15, this change has a full year effect. The Income and Expenditure Account records a gain in fair value on non-property investments of £70.6m (which is the main reason for the net operating position increasing from a deficit of £10.7m in 2013/14 to a surplus of £44.9m). This accounting change has led to even relatively small movements in the markets from one year to the next producing significant volatility in the amounts to be reported as operating gains or losses in the Income and Expenditure Account.

#### **Treatment of Premiums Received for Long Leases**

7. During the year, the City received a £20m premium for a 150 year lease. As the existing buildings on the site are to be demolished to make way for a new development, the whole of the lease premium has been attributed to land. As land generally has an indefinite life (i.e. the risks and rewards of ownership are shared with the City as lessor) it has been classified as an operating lease and, in accordance with accounting standards, the premium has been treated as deferred income to be released to revenue over the 150 year length of the lease – even though the cash has already been received. The principal here is that although the premium is paid up front, it is ‘earned’ over the life of the lease. In previous years, such premiums have been treated as capital receipts and have not been deferred.
8. Long leases of buildings would normally be treated as finance leases as substantially all the risks and rewards of ownership have usually passed to the lessee. Premiums for such leases would not therefore be deferred.
9. For the City Fund, premiums received for operating leases are required to be treated as unusable reserves as set out in the code of practice on local authority accounting and in accordance with the Government’s capital control arrangements. Although the cash can be used to fund expenditure, doing so incurs ongoing capital financing charges in the revenue account. However, the City’s Cash financial statements are prepared on the basis of UKGAAP (rather than the local authority code) and are not bound by the Government’s capital control arrangements. Consequently the cash can be used without incurring any capital financing costs. The accounting implications of selling leaseholds

instead of freeholds are therefore more significant for City Fund than for City's Cash.

## Consolidated Income and Expenditure Account

### Comparison with Previous Year

10. The Consolidated Income and Expenditure Account for the year ending 31 March 2015 shows a net surplus of £59.3m as summarised in the table below. This represents a positive movement of £65.4m compared to the net deficit of £6.1m in the prior year.

	<b>31/3/15 £m</b>	<b>31/3/14 £m</b>
Net operating deficit before non-property investment gains / income and profits on the sales of fixed assets	(27.7)	(27.6)
Gain in fair value of managed investments (part year impact in 2013/14)	70.6	1.5
Managed investment income (part year impact in 2013/14)	2.0	15.4
Net operating surplus / (deficit)	44.9	(10.7)
Profit on sale of fixed assets	14.3	7.0
Net financing income / (costs) attributable to the pension scheme	0.1	(2.4)
<b>Surplus / (deficit) for the year</b>	<b>59.3</b>	<b>(6.1)</b>

11. Whilst the net operating deficit before non-property investment gains / income and profits on the sale of fixed assets marginally increased by £0.1m to £27.7m (first line in the above table), there were several movements within this net figure:

- an increase of £4.9m in net income from the property investment estate due to a combination of additional rent and lower operating costs;

partly offset by:

- net expenditure on education increased by £2.2m mainly due to a depreciation charge for the Guildhall School's Milton Court facilities; contributions towards projects in the City Academies and Ridriff Primary School; and the development of the City's Education Strategy;
- a net expenditure increase of £1.2m on 'grants and other activities' mainly due to a £0.5m contribution to City Fund towards the refurbishment of the Central Criminal Court and £0.5m towards the establishment and

development of 'New FinTech UK' a not-for-profit organisation which aims to promote and support the financial technology sector;

- an increase in non-property investment fund manager fees, which are performance related, of £0.6m due to the greater return from investments during the year; and
- an increase of £0.5m in net expenditure on city representation due to hosting three visiting heads of state during the year, military events marking the 350<sup>th</sup> anniversary of the Royal Marines and the end of UK combat operations in Afghanistan, and increased repairs and maintenance work at the Mansion House.

### Comparison with Budget

12. The financial statements and the budget are not directly comparable due to differences in the way in which the two documents are constructed. However, compared to a budgeted net deficit of £0.7m, the outturn on a like for like basis is a net surplus of £18.2m, a favourable movement of £18.9m. As indicated in the table below, half of this movement relates to properties being sold in 2014/15 that were forecast to be sold in 2015/16.

City's Cash Outturn 2014/15				
		Budget	Outturn	Variation
		£m	£m	(Better)/Worse £m
1	Net expenditure on services	71.5	65.3	(6.2)
2	Supplementary revenue projects	3.5	2.0	(1.5)
3	Estate rent income	(43.1)	(44.5)	(1.4)
4	Non-property investment income (net)	(19.6)	(19.6)	0.0
5	Interest on balances	(0.2)	(0.5)	(0.3)
6	<b>Operating Deficit</b>	<b>12.1</b>	<b>2.7</b>	<b>(9.4)</b>
7	Profit on asset sales	(11.4)	(20.9)	(9.5)
8	<b>Deficit (Surplus) from (to) reserves</b>	<b>0.7</b>	<b>(18.2)</b>	<b>(18.9)</b>

13. The budget and outturn can also be analysed on a Committee basis as follows:

2014/15 Budget v Outturn - City's Cash Summary by Committee					
Net Expenditure (Income)	Budget Net	Outturn	Variation (Better)/Worse		
			Total	Local Risk	Central Risk/ Support Services
	£m	£m	£m	£m	£m
Culture, Heritage & Libraries	0.1	0.0	(0.1)	(0.2)	0.1
Education Board	0.7	0.6	(0.1)	0.0	(0.1)
Finance	(15.7)	(29.7)	(14.0)	(0.4)	(13.6)
G. P. Committee of Aldermen	3.3	3.2	(0.1)	(0.1)	0.0
Guildhall School of Music and Drama	10.6	11.1	0.5	0.1	0.4
Markets	1.8	0.7	(1.1)	(0.7)	(0.4)
Open Spaces :-					
Open Spaces Directorate	0.0	0.0	0.0	0.0	0.0
Epping Forest and Commons	7.6	7.5	(0.1)	(0.1)	0.0
Hampstead, Queen's Park and Highgate	7.8	7.1	(0.7)	(0.9)	0.2
Bunhill Fields	0.3	0.2	(0.1)	(0.1)	0.0
West Ham Park	1.0	1.0	0.0	0.0	0.0
Planning and Transportation	0.0	0.0	0.0	0.0	0.0
Policy and Resources	12.2	11.4	(0.8)	0.0	(0.8)
Port Health and Environmental Services	0.0	0.0	0.0	(0.1)	0.1
Property Investment Board	(34.2)	(36.3)	(2.1)	(0.2)	(1.9)
Schools :-					
City of London School	1.6	1.6	0.0	0.1	(0.1)
City of London Freeman's School	2.4	2.3	(0.1)	0.0	(0.1)
City of London School for Girls	1.2	1.1	(0.1)	0.0	(0.1)
<b>Deficit (Surplus) from (to) reserves</b>	<b>0.7</b>	<b>(18.2)</b>	<b>(18.9)</b>	<b>(2.6)</b>	<b>(16.3)</b>

14. The main variations were:

- Finance Committee, £14m better:
  - £9.5m profits on the sale of assets – the budget assumed £11.4m profit on the sale of assets whereas the outturn was £20.9m. The increase mainly relates to the sale of a property in 2014/15 that was forecast to be sold in 2015/16 and the sale of another property which was the subject of an earlier than anticipated compulsory purchase order;
  - £1.5m slippage/rephasing of major revenue repairs, maintenance and improvement projects - mainly relating to Guildhall School and Investment Property schemes;
  - £0.9m central support services – a combination of reduced expenditure and the redistributive impact of the latest apportionments;
  - £0.5m increase in contributions received towards capital projects;
  - £0.5m central contingencies and provisions not required;
  - £0.3m increased income from interest earnings due to the average interest rate being higher than anticipated (0.89% compared to 0.75%) and a more beneficial cash flow;
  - £0.3m rebates and lower than anticipated fees on corporate contracts.

- Property Investment Board, £2.1m better – Primarily relates to increased rent income from the City's Cash Property Investment Estate but also a combination of increased income from charges for services and reduced costs.
- Markets Committee, £1.1m better - Savings on employees, repairs and maintenance, energy, and water; projects deferred to 2015/16; and additional income from parking.
- Policy and Resources Committee, £0.8m better – an uncommitted balance on the Policy Initiatives Fund which has been carried forward to 2015/16 and the rephasing of project expenditure.
- Hampstead Heath, Queens Park and Highgate Wood Committee, £0.7m better – some of the projects in the City Surveyor's additional works programme will be completed in 2015/16.

15. In accordance with the City's budget management arrangements, requests for the carry forward of City's Cash resources totalling £3.1m have been agreed by the Chamberlain in consultation with the Chairman and Deputy Chairman of the Resource Allocation Sub-Committee. In addition, £3.3m of projects and works programmes have slipped and/or been rephased to 2014/15. These carry forwards and rephased projects, together with the £9.5m profits on the sales of assets which were received earlier than anticipated, will increase the call on City's Cash reserves in 2015/16.

#### **Consolidated Statement of Total Recognised Gains and losses**

16. As set out in the table below, the recognised gains for the year total £214.5m (31/3/13 – gains of £199.9m).

	<b>31/3/15</b> <b>£m</b>	<b>31/3/14</b> <b>£m</b>
Surplus / (deficit) for the financial year	59.3	(6.1)
Unrealised gains:		
Gain on revaluation of property investments	194.4	196.1
Gain on revaluation of non-property investments	1.9	34.4
Gain/(loss) on defined benefit pension scheme	(41.1)	(24.5)
<b>Net increase in funds</b>	<b>214.5</b>	<b>199.9</b>

## **Consolidated Balance Sheet**

17. City's Cash net assets total £2,074.8m at 31 March 2015 compared to £1,860.3m a year earlier reflecting the £214.5m total gains recognised for the year as set out above.

## **Contribution to Crossrail**

18. The potential contribution of £50m from City's Cash towards the Crossrail Project has been disclosed as a financial commitment in both the annual report and the notes to the financial statements. The reason for this treatment, rather than the inclusion of a long term liability on the balance sheet, is that the arrangement with Crossrail is considered to be an executory contract (i.e. a contract made by two parties in which the terms are set to be fulfilled at a later date - both sides still have duties to perform before it becomes fully executed). Subject to completion of the works, the contributions could be made in two instalments of £25m in 2018 and 2019.

## **Signing of the Financial Statements**

19. The Chairman and Deputy Chairman of the Finance Committee will be requested to sign the financial statements.

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