

Committee(s):	Date(s):
Audit and Risk Management Committee	8 November 2016
Finance Committee	15 November 2016
Subject: City's Cash Financial Statements 2015/16	Public
Report of: The Chamberlain	For Decision
Report Author: John James, Interim Deputy Financial Services Director	

Summary

The Annual Report and Financial Statements for City's Cash for the year ended 31 March 2016 are attached at Annex 2 for approval.

Moore Stephens LLP is intending to issue an unqualified audit opinion and their report, including recommendations, is attached at Annex 3. The City's action plan to address the audit recommendations is attached at Annex 4.

The main change to the financial statements for the year is that they have been prepared in accordance with Financial Reporting Standard 102 (FRS102) which became effective for accounting periods on or after 1 January 2015. Previously, the financial statements were prepared in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP), now referred to as 'previous UK GAAP' (*para 5 of this report and a transition statement is provided in the notes to the consolidated financial statements on pages 27 to 30*).

The key points in the financial statements are:

- the Consolidated Statement of Comprehensive Income shows that a net surplus of £184.9m was achieved in the year which includes a gain in fair value on property investments of £222.5m and a loss in fair value on non-property investments of £8.4m (*these figures can be seen in the Consolidated Statement of Comprehensive Income on page 15*);

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- City's Cash net assets total £2,329.0m, an increase of £208.4m (9.8%) since last year. This favourable movement is largely due to the net surplus of £184.9m above and £25.3m being the City's Cash share of the actuarial gain on pension funds (*the £208.4m is shown in the Consolidated Statement of Changes in Equity on page 17*);
 - there are two financial commitments relating to City's Cash that are disclosed in the notes to the financial statements:
 1. the potential contribution of £50m from City's Cash towards the Crossrail Project (*page 58*); and
 2. £4m relating to the flood mitigation works to the Hampstead Heath ponds which are being undertaken in accordance with statutory requirements (*page 58*); and
 - a premium of £20.3m was received in 2015/16 for a 150 year operating lease which has been treated as deferred income, to be released to revenue over the life of the lease (*para 6 of this report*).

Recommendations

The Audit and Risk Management Committee is requested to:

- consider the contents of Moore Stephens LLP's Audit Management Report; and
- Recommend approval of the City's Cash Financial Statements for the year ended 31 March 2016 to the Finance Committee.

The Finance Committee is requested to:

- consider the contents of Moore Stephens LLP's Audit Management Report;
- approve the City's Cash Financial Statements for the year ended 31 March 2016 taking account of any observations from the Audit and Risk Management Committee; and
- 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 2015/16 Financial Statements for City's Cash are attached at Annex 2. The statements are prepared in accordance with Financial Reporting Standard 102 (FRS102).
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 3. 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. Moore Stephens report includes recommendations in sections 6 and 7. Some of these recommendations only relate to one entity, whilst some apply to all entities. Four recommendations apply to City's Cash and an action plan to address these is attached at Annex 4.
4. The Audit Review Panel of the Chamberlain's and Bridgemasters' Accounts met on 10 October 2016 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.

Changes to the financial statements - transition to FRS102

5. City's Cash financial statements for the year ended 31 March 2016 have been prepared in accordance with Financial Reporting Standard 102 (FRS102) as issued by the Financial Reporting Council for accounting periods on or after 1 January 2015.

Prior to the adoption of FRS102 City's Cash financial statements were prepared in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP), now referred to as 'previous UK GAAP'. City's Cash last financial statements prepared in accordance with previous UK GAAP were for the year ended 31 March 2015. The date of transition to FRS102 is 1 April 2014.

A transition statement has been included in the accounts on pages 27 to 30, which sets out the changes to funds and net operating surplus/(deficit) as a result of the transition to FRS102. These changes are summarised below:

- a. Lease incentives - FRS102 requires lease incentives, which reduce rental income in the initial years of the lease, to be allocated over the term of the lease.

Previous UK GAAP required lease incentives to be allocated over the shorter of the lease term and the period ending on the date from which it is expected the prevailing market rental will be payable.

This change means that rental income is now 'smoothed' over a generally longer period which, at the transition date of 1 April 2014, led to an increase of £3.7m in the level of accrued rental income. The movement for the year ended 31 March 2015, was a further increase in accrued income of £1.3m.

- b. Lease incentives - as the valuation of investment properties is partly based on future rental income (see change noted at 1 above), a corresponding reduction was made to the value of investment properties reflecting that a lower level of income will be recognised in later years.
- c. Holiday pay accruals – previous UK GAAP had no specific requirement to make accruals for employee entitlement to paid holiday leave not yet taken as at the year end. FRS102 explicitly requires accruals to be made for holiday pay as the employees earn the right to the paid leave. The initial provision recognised at the date of transition, 1 April 2014, was for the holiday entitlement arising in the year which was due but not taken (£0.8m). The movement in the provision for the year ended 31 March 2015 was also recognised as an effect of transition (nil movement).
- d. Deferred income – under previous UK GAAP grants and contributions relating to fixed assets were treated as deferred income and released to the, then titled, Consolidated Income and Expenditure Account over the expected useful lives of the assets concerned. FRS102 requires such income to now be recognised in the year of receipt where specific conditionality has not been applied by the grantor. Previously deferred income recognised at the transition date of 1 April 2014 was £66.8m, with a further adjustment of £6.4m in the year ended 31 March 2015.
- e. Teachers' Pension Scheme – a number of employees working at the schools supported by City's Cash participate in the Teachers' Pension Scheme. Although the Scheme is a defined benefit plan, previous UK GAAP allowed the Scheme to be treated as a defined

contribution scheme with the pension cost being the amount of contribution actually paid. However, FRS102 requires the employer to also account for the deficit contributions and set up a reserve to meet future deficit contributions. The Teachers' Pension Scheme deficit recognised at the transition date of 1 April was £1.7m, which increased by £12.1m to £13.8m as at 31 March 2015.

Significant items

Premium received for a long lease

6. During the year, the City entered into a series of property transactions to facilitate the lease and redevelopment of a site in the Eastern City Cluster for which it received a premium of £20.3m. As the existing buildings on the site are to be demolished to make way for a new development, the receipt of £20.3m was deemed to be wholly attributable to the underlying 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 FRS102, the premium has been treated as deferred income to be released to revenue over the 150 year length of the lease.

Contribution to Crossrail

7. 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 equal instalments of £25m in 2018/19 and 2019/20.

Subsequent Event – vote to leave the European Union

8. As stated in the annual report and the notes to the financial statements, there are risks to City's Cash from the vote to leave the EU. In particular, the future levels of demand for office accommodation in the City and surrounding areas and the consequential impacts on rent incomes. A close watching brief will be kept on this and other implications as events unfold during the coming months with financial forecasts being refreshed if and when the picture becomes clearer.

Key highlights from the financial statements

Consolidated Statement of Comprehensive Income

Comparison with Previous Year

9. The Consolidated Statement of Comprehensive Income for the year ending 31 March 2016 shows a net surplus of £184.9m as summarised in the following table. The surplus is £62.4m lower than in the previous year, whilst the operating deficit, before gains and losses in the fair value of investments, is £4m higher as shown:

	31/3/16 £m	31/3/15 £m
Operating surplus/(deficit) before gain/(loss) in fair value of investments	(28.4)	(24.4)
Gain in fair value of property investments	222.5	186.7
Gain/(loss)/ in fair value of non-property investments	(8.4)	70.6
Operating surplus	185.7	232.9
Profit on sale of fixed assets	7.5	14.3
Net financing income / (costs) attributable to the pension schemes	(8.3)	0.1
Surplus for the year	184.9	247.3

10. The unfavourable movement in the operating surplus of £47.2m (from £232.9m in the prior year to £185.7m) is largely due to:
- the gain in fair value on non-property investments reducing by £79.0m, from a gain of £70.6m in 2014/15 moving to a loss of £8.4m in 2015/16, due to less favourable market conditions;
 - an increase of £4.5m in net pension scheme costs mainly due to a rise in current service costs of £3.8m (from £12.1m in 2014/15 to £15.9m in 2015/16). In addition, there was an increase in losses on settlements and curtailments of £0.8m (from £0.1m in 2014/15 to £0.9m in 2015/16). This was due to an increase in the number of former employees being entitled to unreduced early retirement benefits;

partly offset by:

- the gain in fair value from property investments increasing by £35.8m (from a gain of £186.7m in 2014/15 to a gain of £222.5m in 2015/16);
- net expenditure on education decreasing by £0.9m mainly due to fee increases at the City's three fee paying schools; and
- lower costs at Smithfield Market (£1.0m). Savings include lower energy charges as a result of the fall in the price of oil, a planned reduction in repairs and maintenance, insurance cost savings from a review of buildings requiring cover, employee cost savings as part of planned service levels and increases in income from rents, filming and parking.

Comparison with Budget

11. 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 £0.1m as detailed in Annex 1, the outturn on a like for like basis is a net surplus of £8.1m, a favourable movement of £8.2m.
12. The budget and outturn can also be analysed on a Committee basis as shown in Annex 1.
13. The net £8.2m better than budget position comprises:
 - £3.1m slippage/rephasing of major revenue repairs, maintenance and improvement projects – mainly relating to Guildhall School and match funding contributions to Crossrail Art Works.
 - £1.5m surplus on cash limited local risk budgets, comprising:
 - £1.7m of savings across Chief Officers local risk budgets (excluding GSMD – see below);
 - £0.6m better than budget on the City Surveyor's Additional Works Programme; and

* the budget includes the draw-down from non-property investments, whereas the Consolidated Statement of Comprehensive Income (CSoCI) does not as this is a transfer between investments and cash, however, the CSoCI includes the movements in fair value of investments but the budget does not account for such movements in the market value of assets. The budget also does not include accounting adjustments for holiday pay accruals and pension scheme actuarial gains or losses.

partly offset by:

- £0.8m deficit on Guildhall School of Music and Drama – the combined impact of a number of budget pressures including target savings not being achieved, higher energy bills, a shortfall in student enrolment and additional expenditure on setting up regional music centres for young musicians. PA Consulting is currently undertaking a review of the School's operating model and is due to report in the autumn. In addition, the GSMD has been awarded a further grant of £4m per annum for 5 years from September 2016.
- £2.0m central contingencies and provisions not required;
- £1.2m reduced net expenditure on central support services;
- £0.5m profit on the disposal of assets – the budget assumed £7.3m profit whereas the outturn was £7.8m. The increase mainly relates to a number of minor receipts including rights of light compensation and building licences which were uncertain when preparing the budget; and
- £0.9m of other net reductions in operating costs across services.

partly offset by:

- £1.0m net reduction in deferred income released to revenue in 2015/16. This is a technical accounting adjustment relating to the implementation of Financial Reporting Standard 102;
14. In accordance with the City's budget management arrangements, requests for the carry forward of City's Cash resources totalling £2.1m have been agreed by the Chamberlain in consultation with the Chairman and Deputy Chairman of the Resource Allocation Sub-Committee. In addition, £3.1m of projects and works programmes have slipped and/or been rephased to 2016/17. These carry forwards and rephased projects will increase the call on City's Cash reserves in 2016/17.

Consolidated Statement of Changes in Equity

As set out in the following table, the recognised gains for the year total £208.4m (for year ended 31 March 2015 – gains of £196.0m).

	31/3/16	31/3/15
	£m	£m
Surplus for the financial year	184.9	247.3
Unrealised gains/(losses):		
(Loss)/gain on revaluation of non-property investments	(1.8)	1.9
Actuarial gain/(loss) on defined benefit pension schemes	25.3	(53.2)
Net increase in funds	208.4	196.0

Consolidated Statement of Financial Position

15. City's Cash net assets total £2,329.0m at 31 March 2016 compared to £2,120.6m a year earlier reflecting the £208.4m total gain recognised for the year as set out above.

Approval of the Financial Statements

16. The Chairman and Deputy Chairman of the Finance Committee will be requested to approve and sign the financial statements on behalf of the Court of Common Council.

Annexes

Annex 1 – City's Cash - comparison of outturn with budget

Annex 2 – Annual Report and Financial Statements of City's Cash

Annex 3 – Moore Stephens Audit Management Report (*Please see also BHE 2015/16 – Annex 5*)

Annex 4 – Action plan to address Moore Stephens recommendations

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ANNEX 1

City's Cash - Comparison with Budget

City's Cash Outturn 2015/16			
	Budget	Outturn	Variation Better/ (Worse)
	£m	£m	£m
1. Net expenditure on services	(74.5)	(69.8)	4.7
2. Supplementary revenue projects	(3.4)	(0.3)	3.1
3. Estate rent income	48.4	48.3	(0.1)
4. Non-property investment income (net)	21.8	21.8	0.0
5. Interest on balances	0.3	0.3	0.0
6. Operating deficit	(7.4)	0.3	7.7
7. Profit on asset sales	7.3	7.8	0.5
8. (Deficit) Surplus (from) to reserves	(0.1)	8.1	8.2

City's Cash - Comparison with Budget on a Committee Basis

2015/16 Budget v Outturn – City's Cash Summary by Committee					
Committee	Budget Net	Outturn	Variation Better / (Worse)		
			Total	Local Risk	Central Risk/ Support Services
	£m	£m	£m	£m	£m
Culture, Heritage & Libraries	(0.3)	(0.3)	0.0	0.0	0.0
Education Board	(1.1)	(1.0)	0.1	0.0	0.1
Finance	10.8	15.0	4.2	0.2	4.0
G.P Committee of Aldermen	(3.3)	(3.1)	0.2	0.1	0.1
Guildhall School of Music and Drama	(10.8)	(11.7)	(0.9)	(0.8)	(0.1)
Markets	(1.2)	0.0	1.2	1.0	0.2
Open Spaces :-					
Open Spaces Directorate	0.0	0.0	0.0	0.1	(0.1)
Epping Forest and Commons	(7.5)	(7.2)	0.3	0.2	0.1
Hampstead, Queen's Park and Highgate	(7.7)	(7.4)	0.3	0.2	0.1
Bunhill Fields	(0.2)	(0.2)	0.0	0.0	0.0
West Ham Park	(1.3)	(1.2)	0.1	0.0	0.1
Policy and Resources	(13.2)	(12.0)	1.2	0.1	1.1
Property Investment Board	39.5	41.0	1.5	0.5	1.0
Schools :-					
City of London School	(1.4)	(1.5)	(0.1)	(0.1)	0.0
City of London Freeman's School	(1.8)	(1.7)	0.1	0.0	0.1
City of London School for Girls	(0.6)	(0.6)	0.0	0.0	0.0
(Deficit) Surplus (from) to reserves	(0.1)	8.1	8.2	1.5	6.7