

Committee(s): Audit and Risk Management Committee – For decision Finance Committee – For decision	Date(s): 3 November 2020 10 November 2020
Subject: City's Cash Financial Statements 2019/20	Public
Report of: The Chamberlain	For Decision
Report author: Steven Reynolds, Group Accountant	

Summary

The Annual Report and Financial Statements for City's Cash for the year ended 31 March 2020 are attached at Annex 2 for approval.

The external auditor, BDO LLP is intending to issue an unqualified audit opinion with the inclusion of an 'emphasis of matter' paragraph on the uncertainty relating to property valuations as a result of Covid-19. This is uncontentious and matches judgements we have made on the valuations ourselves. Their report, including recommendations, is attached at Annex 3.

The key points in the financial statements are:

- a net deficit of £2.6m which includes gains in fair value on property investments of £86.9m and a loss on non-property investments of £29.4m due to the impact of the Covid-19 on the financial markets (*these figures can be seen in the Consolidated Statement of Comprehensive Income on page 18*);
- total net assets of £2,675.5m, an increase of £5.7m (0.2%) since last year. The net asset position is after deducting the total pensions liability of £311.1m. This level of assets is necessary to generate the required level of income to fund City Cash services and to support the City's ambitious major projects programme (*the £5.7m is shown in the Consolidated Statement of Changes in Equity on page 20*);
- to support the City's capital programme a £125m bridging loan facility was acquired during 2018/19. This was repaid on 16 September 2019 and replaced by a long-term loan of £450m, of which £250m was received in September 2019 with City's Cash contractually committed to receive the balance of £200m in July 2021 (*page 41 and para 6*);
- financial commitments relating to City's Cash are disclosed in the notes to the financial statements and are summarised as follows:
 1. the potential contribution of £50m from City's Cash towards the Crossrail Project (*page 48, para 8*); and
 2. £2.50m relating to a works contract for the refurbishment of an investment property and £0.5m for tunnel lids at Smithfield Market (*page 48, para 9*); and
- Covid-19 arrived late in the year being reported and the financial impact was largely confined to the fair value loss on non-property investments as noted above.

However, whilst the value of investment properties increased, the valuer has recognised the impact of Covid-19 and reported valuations on the basis of 'material valuation uncertainty' (*accounting policy note g on tangible fixed assets, page 22*).

Recommendations

The Audit and Risk Management Committee is requested to:

- note that the external auditor BDO LLP intends to give an unqualified audit opinion;
- consider the contents of the Audit Management Report issued by BDO LLP; and
- recommend approval of the City's Cash Financial Statements for the year ended 31 March 2020 to the Finance Committee.

The Finance Committee is requested to:

- note that the external auditor BDO LLP intends to give an unqualified audit opinion;
- consider the contents of the Audit Management Report issued by BDO LLP; and
- approve delegated authority for the Chairman and Deputy Chairman of the Finance Committee to approve and sign the City's Cash Financial Statements on behalf of the Court of Common Council, taking account of any observations from the Audit and Risk Management Committee on 3 November.

Main Report

Current Position

1. The 2019/20 Annual Report and Financial Statements for City's Cash are attached at Annex 2 for approval.
2. The external auditor BDO LLP intends to give an unqualified opinion with the inclusion of an 'emphasis of matter' paragraph on the uncertainty relating to property valuations as a result of Covid-19. This is uncontentious and matches judgements we have made on the valuations ourselves. Their report, including recommendations, is attached at Annex 3. We are pleased to report that no material accounting changes were required to the financial statements of either City's Cash or its consolidated subsidiaries and that no material misstatements were identified as reported on page 34. Whilst not material, there were three adjusted items which are listed on page 25, of which two were identified by BDO LLP and one by the City after the draft accounts were submitted. The report notes on pages 28 to 30 that there are some immaterial unadjusted items relating to the consolidated trusts. Ordinarily, even though immaterial, these would be adjusted in their individual financial statements and those of City's Cash but were not due to the late timing of these being identified.
3. The report from BDO LLP notes on page 33 that no significant deficiencies in internal control have been identified. However, the auditor has noted one control observation concerning related party transactions and the City has confirmed that it will review the process for requesting and reporting declarations during 2020/21.

4. The Audit Management Report will be distributed to all Members of the Court of Common Council for information. Representatives from BDO LLP will attend the Audit and Risk Management Committee to present their report and to clarify any points or issues.
5. The Audit Review Panel of the Chamberlain's and Bridgemasters' Accounts met on 23 October 2020 to review the processes adopted by BDO LLP and the Panel intends to certify that those processes were in accordance with the prescribed auditing standards.

New significant items in City's Cash Financial Statements for 2019/20

Loans (page 41)

6. In 2018/19 City's Cash entered into an unsecured bridging loan of £125m as part of an overall borrowing strategy designed to support a sustainable and affordable capital programme (disclosure note 16 on page 39 refers). In August 2019, the City issued debt totally £450m via private placement of which £250m was received in September 2019 and the City is contractually committed to receive the remaining £200m in July 2021. The bridging loan of £125m was repaid in full on 16 September 2019.

Other significant items in City's Cash disclosure notes (pages 21 to 55)

Impact of Covid-19

7. With Covid-19 arriving late in the year being reported, the financial impact is largely confined to a fair value loss of £29.4m on non-property investments. However, whilst the fair value of property investments increased by £86.9m, the valuer has recognised the impact of Covid-19 and reported valuations on the basis of 'material valuation uncertainty' (*accounting policy note g on tangible fixed assets, page 22*).

Financial Commitments (page 48)

8. Contribution to Crossrail - 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). The payment is subject to completion of the works and, due to these being delayed, the timing of the payment has yet to be agreed.
9. Contract commitments – there are contract commitments of £2.5m relating to a works for the refurbishment of an investment property and £0.5m for tunnel lids at Smithfield Market.

Subsequent Events (disclosure note 23 on page 54)

10. Vote to leave the European Union - 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 continues to be kept on this and other implications as events unfold with financial forecasts being refreshed when the picture becomes clearer.

11. Covid-19 – The City of London Corporation has considered the potential impact of the Covid-19 pandemic on the value of investment assets held, future income levels and liquidity and reports that it remains a going concern (*accounting policy note b, going concern, on page 21*). The City considers that it has sufficient resources to meet its needs and will continue to monitor the impact as the pandemic continues. Further details as to how the effects of the pandemic have been managed are provided in the subsequent events note on page 54.

Highlights from the Consolidated Statement of Comprehensive Income

Comparison with Previous Year

12. The Consolidated Statement of Comprehensive Income for the year ending 31 March 2020 shows a net deficit of £3.7m, £63.4m lower than in the previous year, as summarised in the following table. The operating deficit, before gains and losses in the fair value of investments, is £13.0m higher as shown:

	31/3/20 £m	31/3/19 £m	Variance £m
Operating deficit before gains in fair value of investments	(60.1)	(47.1)	(13.0)
Gain in fair value of property investments	86.9	50.1	36.8
(Loss)/Gain in fair value of non-property investments	(29.4)	53.5	(82.9)
Operating (deficit) /surplus	(2.6)	56.5	(59.1)
Profit on sale of fixed assets	2.6	3.4	(0.8)
Loan financing costs	(3.7)	(0.2)	(3.5)
(Deficit)/Surplus for the year	(3.7)	59.7	(63.4)

13. The unfavourable movement in the operating deficit (before gains in fair value of investments) for the year of £13.0m (from £47.1m in the prior year to £60.1m) is largely due to:

- net income relating to property investments reducing by £7.5m, from £47.2m in 2018/19 to £39.7m in 2019/20. This was mainly due to the commencement of amortisation of goodwill held on the purchase of Barking Power Ltd with £3.9m charged in 2019/20, along with the increased cost of works in 2019/20 to facilitate the Markets Consolidation Programme;
- net expenditure on Markets increasing by £5.4m largely due to the cost of works to facilitate the Markets Consolidation Programme;

- net expenditure on education increasing by £5.3m due to spend of £2.0m relating to the business case for the Centre for Music, an increase of £1.9m at GSMD, mostly due to filling various staff vacancies and new appointments to undertake fundraising and marketing, and a Culture Mile Learning Grant of £0.3m; partly offset by
- net expenditure on grants and other activities reducing by £4.3m, due to non-recurrent landlord works for the Museum of London Relocation Programme that were undertaken in 2018/19; and
- net pension scheme costs reducing by £3.4m, from £20.5m in 2018/19 to £17.1m in 2019/20. In 2018/19 there was a non-recurrent increase in losses on settlements and curtailments of £5.8m following the ruling of the Court of Appeal in December 2018 that transitional protections put in place under reforms to both the Judges' and Firefighters' Pension Schemes discriminated against a group of members on the grounds of age. The ruling was applicable to all public sector pension schemes in which the City's Cash employees participate including the LGPS and the Teachers' Pension Scheme and resulted in an increase in the City's Cash pensions liability of £5.8m being recognised in 2018/19. The reduction is partly offset by an increase in pension service costs, which have increased by £2.9m from £20.9m in 2018/19 to £23.8m in 2019/20.

Movements in fair value of investments

14. As shown in the table, the gain in fair value from property investments increased by £36.8m, from a gain of £50.1m in 2018/19 to £86.9m, largely due to the inclusion of two new developments in 2019/20 totalling £36.9m. These developments were the Grafton Street Hotel Scheme (£36m) and Crowndean House (£0.9m).
15. The table also shows a loss in the fair value of non-property investments of £29.4m, a movement of £82.9m compared to the gain of £53.5m in 2018/19. This arose as January to March 2020 was a period of exceptional volatility for financial markets as the emergence of the Coronavirus (COVID-19) pandemic led to widespread economic and social disruption. In particular, financial markets undertook a large fall over this time which impacted on the fair value of non-property investments held by City's Cash. These investments have recovered significantly in value since the reporting date as financial markets have rallied. As at 30 September 2020, non-property investments are estimated to be valued at £889.1m, an increase of £131.6m compared to the value of £757.6m as at 31 March 2020.
16. After the operating deficit of £2.6m (2018/19: surplus of £56.5m) it can be seen in the table that there was a profit on disposal of fixed assets of £2.6m (2018/19: profit of £3.4m) and loan financing costs of £3.7m (2018/19: £0.2m). This increase is due to loan interest being payable for the whole of 2019/20, whereas it was only payable for part of the prior year from when the bridging loan finance was taken out in March 2019.

Comparison with Budget

17. 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 £43.0m as detailed in Annex 1, the outturn on a like for like basis is a net deficit of £44.7m, an unfavourable movement of £1.7m.

* 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.

18. The budget and outturn are also analysed on a Committee basis in Annex 1.

19. The net £1.7m worse than budget position is largely due to additional costs on major project SRP's of £13.6m partly offset by several other smaller items including central contingences not being fully required (£5.0m), repairs and maintenance programmes slippage (£3.7m) and higher investment income (£2.0m).

20. In accordance with the City's budget management arrangements, requests for the carry forward of City's Cash local risk resources totalling £349k have been agreed by the Chamberlain in consultation with the Chairman and Deputy Chairman of the Resource Allocation Sub-Committee. In addition, £3.7m of projects and works programmes have slipped and/or been re-phased to 2020/21. These carry forwards and re-phased projects will increase the call on reserves in 2020/21.

Consolidated Statement of Financial Position

21. City's Cash net assets total £2,675.5m at 31 March 2020 compared to £2,669.8m a year earlier reflecting the £5.7m total gain recognised for the year as set out in the following table. This level of assets is necessary to generate the required level of income to fund City Cash services and to support the City's ambitious major projects programme.

Changes in Equity	31/3/20 £m	31/3/19 £m	Variance £m
(Deficit)/Surplus for the financial year	(3.7)	59.7	(63.4)
Unrealised gains/(losses):			
Loss on revaluation of non-property investments	(9.3)	(0.2)	(9.1)
Actuarial gain/(loss) on defined benefit pension schemes	18.7	(1.2)	19.9
Net increase in funds	5.7	58.3	(52.6)

Approval of the Financial Statements

22. It is recommended that the Finance Committee approve delegated authority for the Chairman and Deputy Chairman of the Finance Committee to approve and sign the financial statements on behalf of the Court of Common Council, taking account of any observations from the Audit and Risk Management Committee on 3 November.

Annexes

- Annex 1 – City's Cash – comparison of outturn with budget
- Annex 2 – Annual Report and Financial Statements of City's Cash
- Annex 3 – BDO LLP Audit Management Report (includes the audit of the City's trusts)

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

City's Cash Outturn 2019/20			
	Budget	Outturn	Variation Better/ (Worse)
	£m	£m	£m
1. Net expenditure on services	(102.0)	(91.7)	10.3
2. Supplementary revenue projects	(3.7)	(16.4)	(12.7)
3. Estate rent income	61.2	61.3	0.1
4. Non-property investment income (net)	1.2	2.0	0.8
5. Interest on balances	0.3	0.1	(0.2)
8. (Deficit) Surplus (from) to reserves	(43.0)	(44.7)	(1.7)

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

2019/20 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	(0.7)	(0.7)	-	-	-
Education Board	(3.0)	(2.9)	0.1	0.1	-
Finance	(27.6)	(22.2)	5.4	0.3	5.1
G.P Committee of Aldermen	(4.4)	(4.5)	(0.1)	(0.2)	0.1
Guildhall School of Music and Drama	(13.5)	(12.2)	1.3	1.3	-
Markets	(1.0)	(0.8)	0.2	0.4	(0.2)
Open Spaces :-					
Open Spaces Directorate	-	-	-	0.1	(0.1)
Epping Forest and Commons	(9.5)	(8.3)	1.2	0.9	0.3
Hampstead, Queen's Park and Highgate	(8.8)	(7.7)	1.1	1.0	0.1
Bunhill Fields	(0.3)	(0.3)	-	-	-
West Ham Park	(1.5)	(1.3)	0.2	0.1	0.1
Policy and Resources	(21.6)	(31.1)	(9.5)	(0.2)	(9.3)
Property Investment Board	53.2	51.7	(1.5)	-	(1.5)
Schools :-					
City of London School	(1.8)	(1.8)	-	-	-
City of London Freeman's School	(1.7)	(1.8)	(0.1)	(0.1)	-
City of London School for Girls	(0.8)	(0.8)	-	-	-
(Deficit) Surplus (from) to reserves	(43.0)	(44.7)	(1.7)	3.7	(5.4)