

Committees:	Dates:
Audit and Risk Management Committee	18 July 2016
Finance Committee	19 July 2016
Subject:	Public
City Fund and Pension Funds Financial Statements 2015/16	
Report of:	For Decision
The Chamberlain	
Report author:	
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Summary

Attached to this report are the City Fund and Pension Funds Financial Statements for the year ended 31 March 2016.

The key points are:

- Total reserves of £1,555.9m, an increase of £374.9m since last year. However, the City is committed to making a £200m contribution to Crossrail which is anticipated to be made in March 2017. 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 £1,355.9m. **(See the Balance Sheet on page 17 and paras. 10 to 15 of this covering report).**
- The £1,555.9m comprises £258.5m in usable reserves and £1297.4m in unusable reserves. This net asset position is after having deducted total pension funds liabilities of £1,017.1m (a reduction in liabilities of £47m on the previous year)
- The usable reserves of £258.5m have increased by a net £22.3m from a year earlier comprising £35.3m in capital reserves partly offset by a reduction of £13m in revenue reserves. The usable reserves are required 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 the Housing Revenue Account. **(The £258.5m is shown in the Balance Sheet on page 17 and analysed in more detail in the Movement in Reserves Statement on page 13).**
- The unusable reserves of £1,297.4m have increased by £352.6m. The main movements were:
 - revaluation gains on investment and operational properties - £284m;
 - financing of capital expenditure - £41m;
 - deferred capital receipts - £2m;
 - collection fund adjustment account - £31m;
 - a decrease in pension liabilities - £47m (City £9m, Police £38m)
 Partly offset by:
 - disposals, depreciation and impairments - £52m.**(The £1,294.7m is shown on the Balance Sheet on page 17 and analysed in more detail in note 27 (page 60) to the financial statements).**

- There was a net revenue surplus for the year of £0.8m compared to a budgeted deficit of £14.5m, a better than budget position of £15.3m. *(The £0.8m is shown in the Movement in Reserves Statement on page 13 on the penultimate line of the first column of figures. The comparison to budget is set out in paras. 3 to 6 of this covering report).*
- BDO commenced its audit on 8 June. There are a number of items still being reviewed, particularly investment property valuations, the business rates retention scheme and the pension fund. It is anticipated that these reviews will be concluded satisfactorily to enable BDO 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 BDO's progress reports;
- b) recommend approval of the City Fund and Pension Funds Financial Statements for the year ended 31 March 2016 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 BDO - 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 2016; 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 BDO - 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 2015/16 are set out in Annex 1.
2. The Accounts and Audit Regulations 2015 require the approval and publication of the City Fund and Pension Funds Financial Statements for the year to 31 March 2016 to take place as soon as reasonably practicable, and in any event by 30 September 2016. 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 2015/16 of £0.8m which will be transferred to the City Fund Unallocated Reserve. This is a better than budget position of £15.3m compared with the anticipated surplus of £14.5m.

	Budget	Actual	Variation
	£m	£m	(Better) Worse
			£m
Net expenditure on services	141.9	133.7	(8.2)
Property Investments funded from Revenue Reserves	9.1	9.2	0.1
City Police - Action Fraud	4.7	4.7	0.0
Cylical Works Programme and capital expenditure financed from revenue	6.0	3.9	(2.1)
Requirement before investment income from the City's Assets	161.7	151.5	(10.2)
Interest on balances	(2.9)	(4.7)	(1.8)
Estate rent income	(40.9)	(42.9)	(2.0)
City Fund Requirement	117.9	103.9	(14.0)
Financed by:			
Government formula grant	(79.9)	(80.8)	(0.9)
City offset	(10.9)	(10.9)	0.0
Council tax	(6.1)	(6.1)	0.0
City premium	(6.5)	(6.9)	(0.4)
Net (surplus)/deficit transferred (to)/from unallocated reserve	14.5	(0.8)	(15.3)

4. The better than budget position of £14m on the line 'City Fund Requirement' can be analysed on a committee basis as follows:

Net Expenditure (Income)	Budget	Provisional	Variation (Better)/Worse		
	Net	Outturn	Total	Local	Central
				Risk	Risk/ Support Services
	£m	£m	£m	£m	£m
Barbican Centre	25.7	23.4	(2.3)	(0.8)	(1.5)
Barbican Residential	3.0	3.0	0.0	0.1	(0.1)
Community and Children's Services	11.8	11.8	0.0	(0.3)	0.3
Culture Heritage and Libraries	20.9	20.3	(0.6)	(0.1)	(0.5)
Finance	(4.5)	(10.4)	(5.9)	(0.2)	(5.7)
Licensing	0.0	0.0	0.0	0.0	0.0
Markets	(0.6)	(0.7)	(0.1)	0.0	(0.1)
Open Spaces	1.6	1.5	(0.1)	(0.1)	0.0
Planning and Transportation	13.1	12.1	(1.0)	(0.7)	(0.3)
Police - excluding transfers from reserve	66.0	67.4	1.4	2.6	(1.2)
Police - transfers from reserve	(3.1)	(4.5)	(1.4)	(2.6)	1.2
Policy and Resources	4.0	4.1	0.1	(0.2)	0.3
Port Health and Environmental Services	14.7	13.5	(1.2)	(1.0)	(0.2)
Property Investment Board	(34.7)	(37.6)	(2.9)	(0.5)	(2.4)
City Fund requirement to be met from government grants, local taxation and transfers to/(from) reserves.	117.9	103.9	(14.0)	(3.8)	(10.2)

The Barbican Centre reduced requirement of £2.3m results from box office sales for the theatre and gallery exceeding forecasts and strong commercial income together with a backdated rates refund following a successful valuation appeal.

The £5.7m reduced requirement against central risk/support services on Finance Committee mainly relates to slippage/re-phasing on major revenue repairs, maintenance and improvement projects; increased income from interest earnings; central contingencies and provisions not being required in full; income from grants and contract rebates; and reduced expenditure on support services.

The increase in net income of £2.9m for the Property Investment Board is primarily additional rent income from the City Fund Property Investment Estate including a significant backdated rent review together with reduced operating costs

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 £4.8m 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 2016/17. In addition, £2.1m of projects and works programmes have slipped and/or been rephased to 2015/16.

Government Formula Grant

7. The increased income of £0.9m relates to reimbursement in respect of the impact of the tax changes incurred under the business rates retention scheme (capping of the rates multiplier, doubling of the small business rates relief, and various other reliefs introduced following the autumn statements).

NNDR Premium

8. Growth in business rates has increased the yield from the Premium to £6.9m compared to a budget of £6.5m.

Capital Position

9. The approved capital budget for 2015/16 totalled £44.1m. Actual expenditure during the year was £41.6m, an underspend of £2.5m compared with the budget. This reduction was mainly due to re-phasing of expenditure on highways and streetscene projects.

Balance Sheet

10. The Consolidated Balance Sheet indicates that the City Fund's total net assets increased by £374.9m (or 32%) to £1,555.9m from £1,181m a year earlier. The main reasons for this increase are set out below.

	2015/16	
	£m	£m
Long-Term Assets		
Net unrealised gain on revaluation of investment properties	174.2	
Net unrealised gain on revaluation of other fixed assets	110.5	
Acquisitions	40.2	
Disposals (net book value)	(28.0)	
Depreciation, impairment and amortisation	(24.3)	
Increase in other long-term assets	2.1	
Sub-Total Increase in Long-Term Assets		274.7
Increase in short-term investments		197.1
Decrease in cash and cash equivalents		(10.0)
Increase in current liabilities (mainly business rates related)		(59.6)
Increase in capital grants and contributions received in advance		(20.0)
Decrease in Pension liabilities		47.2
Increase in deferred income - premiums received for operating leases		(51.6)
Decrease in other net assets		(2.9)
Increase in net assets		374.9

11. This increase in net assets of £374.9m is reflected in the following movements in usable and unusable reserves.

	2014/15 £m	2015/16 £m	(Increase)/ Decrease £m
Usable reserves			
Revenue	(136.0)	(123.0)	13.0
Capital	(100.2)	(135.5)	(35.3)
Sub-total usable reserves	(236.2)	(258.5)	(22.3)
Unusable reserves	(944.8)	(1,297.4)	(352.6)
Total reserves	(1,181.0)	(1,555.9)	(374.9)

12. The £13m reduction in usable revenue reserves primarily relates to a £15.8m transfer from the earmarked reserve for Business Rates Equalisation to the Comprehensive Income and Expenditure Account to mitigate the impact of differences between the accounting and statutory requirements for business rates. This £15.8m reduction has been partly offset by the increase of £0.8m in the unallocated reserve (paragraph 3) and a £2m increase in the HRA reserve. The £35.3m increase in usable capital reserves is the proceeds from planned disposal of certain property assets partly offset by the financing of capital expenditure.
13. Although usable reserves are a relatively healthy £258.5m 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. Whilst City Fund budget policy recognises that in some years of the financial planning period it may be necessary to make contributions from revenue reserves to balance the revenue budget, the strategy is to achieve the 'golden rule' of matching ongoing revenue expenditures and incomes over the medium term.
14. The main movements included within the overall net increase of £352.6m in unusable reserves are as follows:
- revaluation gains on investment and operational properties - £284m;
 - financing of capital expenditure - £41m;
 - deferred capital receipts - £2m;
 - collection fund adjustment account - £31m;
 - a decrease in pension liabilities - £47m (City £9m, Police £38m)
- partly offset by:
- disposals, depreciation and impairments - £52m

Crossrail

15. 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 2017. 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 was based on the accumulation of annual rental income from

specific investment properties and receipts from the sale of assets. The funding is now in place for this contribution to be made.

Pension Liabilities

16. The City Fund's total net assets of £1,555.9m are after having deducted net pension liabilities totalling £1,017.1 (City £240.5m, Police £774.6m, Judges £2m). The comparator for 31 March 2014 is £1064.3m (City £249.1m, Police £813.2m, Judges £2m). 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

17. 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.

18. 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.

19. The total net deficit in the City of London Pension Fund was £481m at 31 March 2016 (31 March 2015: £498.2m). The City Fund's estimated proportion of this deficit is £240.5m or 50% (31 March 2015: £249.1m or 50%).

20. Pension fund deficits (or surpluses) are relatively sensitive to movements in the underlying assumptions. The main reason for the net reduction of £17.2m (City Fund share £8.6m) in the City of London Pension Fund deficit is an increase in the discount rate used for calculating the present day value of future payments from the fund - with an increase in the rate resulting in reduced liabilities and vice-versa - partly offset by a reduction in the fund's assets. The discount rate is required by regulations to be based on market yields on high quality corporate bonds. For the 31 March 2016, a discount rate of 3.6% has been used, compared to 3.3% a year earlier.

21. 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% for the years 2014/15 to 2016/17 in order to recover the pension fund deficit over a period of 20 years.

22. A triennial valuation as at 31 March 2016 is currently being undertaken by Barnett Waddingham. The results will be considered by the Finance Committee in the autumn with decisions being required on the deficit recovery period and the rate of employer's contribution to be applied during the years 2017/18 to 2019/20.

City Police Pension Schemes

23. 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 2016 was £774.6m, a reduction of £38.6m since last year. Again, the main reasons for the decrease in the deficit is the increase in the discount rate used to value liabilities.
24. The City of London Corporation in its capacity as Police Authority pays an employer's contribution of 21.3% 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 £774.6m 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

25. BDO commenced its audit on 8 June. BDO's progress report on its audit of the City Fund is set out in Annex 2 and indicates that there are a number of items still being reviewed including investment property valuations and the business rates retention scheme. A progress report on the audit of the City of London Pension Fund is set out in Annex 3 and again there are a number of items still being reviewed including the agreement of asset valuations to readily available observable data and the reasonableness of the assumptions used for calculating pension liabilities. It is anticipated that these reviews will be concluded satisfactorily to enable BDO to issue unqualified opinions. Representatives from BDO will be in attendance at the Audit and Risk Management Committee to present their progress reports and to clarify any points or issues.

Subsequent Adjustments to the Accounts

26. BDO 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

27. As soon as reasonably possible after the conclusion of the audit, and in any event by 30 September 2016, the City is required to publish the 2015/16 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 BDO on its audit will be presented to the Court of Common Council for information.

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Chamberlain

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

Annex 2: BDO's City Fund Progress Report

Annex 3: BDO's Pension Fund Progress Report