Leicestershire County Council

CONSTITUTION COMMITTEE – 27th SEPTEMBER 2016

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

STATEMENT OF ACCOUNTS AND ANNUAL GOVERNANCE STATEMENT 2015/16

PURPOSE

1. The purpose of this report is to:

   a) present the 2015/16 Statement of Accounts, attached as Appendix A to this report, for approval and signing by the Leader of the County Council,
   b) inform the Committee of the main areas of the accounts, and
   c) report the key findings from the external audit of the accounts.

BACKGROUND

2. The Accounts and Audit Regulations 2015 require authorities to approve and publish their accounts, including the auditor's opinion by the end of September following the end of the financial year.

3. A copy of our external auditor's, KPMG LLP, report on the accounts is attached as Appendix B. The letter of representation is attached as Appendix C. The auditor anticipates issuing an unqualified audit opinion.

4. The Corporate Governance Committee will consider the auditor's report at its meeting on 23 September 2016. The auditor is required to communicate the results of the audit to those charged with governance prior to certifying the financial statements. The minutes from that meeting will be reported to the Constitution Committee.

5. The Statement of Accounts is prepared under the International Financial Reporting Standards (IFRS) based Code of Practice on Local Authority Accounts.

STATEMENT OF ACCOUNTS

6. The main areas of the financial statements are set out below:

Narrative Statement

7. This is a new statement from 2015/16 and replaces the Explanatory Foreword. The purpose of the Narrative Statement is to offer interested parties an effective guide to the most significant matters reported in the accounts. It includes a summary of the economy, efficiency and effectiveness, and the financial and non-financial performance of the Authority, and an explanation of the contents of the accounts.

Movement in Reserves Statement (MIRS)

8. This statement shows the movement in year on the different reserves held by the County Council, analysed into 'usable reserves' i.e. those that can be applied to fund expenditure and 'unusable reserves' which cannot be used to fund services. Unusable reserves include reserves that hold unrealised gains and losses as well as adjustments for the differences between amounts charged in accordance with accounting standards and amounts charged for statutory purposes. An example is the short term accumulating compensated absences adjustment account (STACAAA). This account holds the estimated value of untaken annual leave and time-off-in-lieu as at the balance sheet date. This charge is recognised by the accounting standards but statutory mitigation allows it to be reversed out via the STACAAA to avoid it being a charge to the general fund.

9. The main usable reserves held are the General Fund and Earmarked Funds.

10. The General Fund totalled £40.4m as at 31 March 2016 (£27.2m 31 March 2015). The fund contains delegated funding for schools, carry forwards of previous year underspends and the uncommitted fund of the Council, (explained further in the next paragraph). Details of the fund are shown in note 9 to the accounts. The increase as at 31 March 2016 related to an increase in carry forwards, arising from the 2015/16 underspend (£13.8m) reported in the narrative statement, and an increase in delegated school balances to £11.8m (£7.6m 31 March 2015).

11. The uncommitted fund is available for unforeseen risks to the Council. It allows the Council to manage unforeseen financial events without the need to make immediate offsetting savings, with the potential real impact on County Council services. The balance at 31 March 2016 was £14.8m (£14.9m 31 March 2015). The Council's policy is to hold a balance in the range of 4% to 5% of net budgeted expenditure (excluding schools). The balance of £14.8m represents 4.3% of net budgeted expenditure for 2016/17.

12. Earmarked funds, excluding dedicated schools grant, total £85.3m as at 31 March 2016 (£92.5m 31 March 2015).

13. The significant earmarked funds held are:

    - Capital Financing £20.1m. This fund is used to hold revenue contributions to fund capital expenditure in future years including the Street Lighting LED replacement project included in the 2016-20 capital programme. The amount shown in the accounts, in note 10, is £5.1m which is after the £15m investment in Pooled Property Funds. The investment is temporarily shown against the capital financing fund but in effect is funded from the overall balance of earmarked funds and can be realised in the future when required.

- Insurance Funds £19.2m. Held to meet future claims, or parts of claims, that are not covered by insurance policies. This could be due to policy limits and deductibles or claims relating to periods when the insurer has failed, such as Municipal Mutual Insurance or The Independent Insurance Company. The levels are reviewed by independent advisors.

- Transformation £16.5m. Funding set aside to invest in transformation projects to achieve efficiency savings and service improvements across the County Council and to fund potential restructuring costs of reconfiguring those services. The amount shown in note 10 to the accounts is a net balance of £8.1m. This is after the temporary investment of £8.4m in the Local Authority Mortgage scheme (LAMS). A total of £8.4m (£3m in 2013/14 and £5.4m 2012/13) has been advanced to Lloyds Bank temporarily funded from the overall balance of earmarked funds. The funding will be returned to the County Council in 2017/18 and 2018/19, five years respectively after the date it was advanced.

- Adults and Communities Developments £6.9m. This earmarked fund is held to meet a number of investments in maintaining social care levels and assisting the department in achieving its transformation programme. The fund also includes £2.5m from an underspend on Care Act grant funding in 2015/16, following the Government's announcement in July 2015 to delay the introduction of the cap on care costs until April 2020. This funding will be used to temporarily fund staffing resources and contracts, that were engaged for the Care Act, to allow time for a smooth transition.

- Broadband £6.1m. Funding held to develop super-fast broadband to areas with poor service within Leicestershire. A contract has been entered into with British Telecom and they have completed a significant amount of work. There is a time lag in spending County Council funds due to grant conditions that require Central Government and European funding to be spent within a set period. The majority of funding is expected to be spent by the end of 2017/18 as phase 2 of the programme is completed.

14. The required level of earmarked funds is kept under review during the year. Formal assessments are undertaken and reported during the Autumn, in January and February as part of the Medium Term Financial Strategy (MTFS) and also at year end.

<u>Comprehensive Income and Expenditure Statement (CIES)</u>

15. The CIES shows the accounting cost of providing services in accordance with accounting standards rather than the amount funded from taxation and income. The County Council raises taxation to cover expenditure in accordance with statutory regulations which can be different from the accounting cost.

16. The headings used in the CIES are presented in line with the Chartered Institute for Public Finance and Accountancy (CIPFA) service reporting code of practice. This ensures consistency and comparability across local authorities and is not comparable to the format of the County Council budget.

17. The CIES cannot be directly compared to the outturn underspend reported to members. This is because the financial accounts comply with various reporting standards whereas the management accounts are compiled on a slightly different basis. The key differences relate to the way depreciation, impairment and earmarked funds are reported.

18. The CIES shows a surplus of £14.6m on the Provision of Services for 2015/16 (£74.8m deficit 2014/15). The deficit in 2014/15 was primarily due to the conversion of 21 schools to Academy status during that year. During 2015/16 five schools transferred. The buildings have been transferred as 125 year finance leases that require the assets to be written out of the County Council's accounts through the Other Operating Expenditure section of the CIES, and Balance Sheet.

19. The Narrative Statement on page 3 of the Statement of Accounts explains the net outturn position in the context of the County Council's budget. In summary, this shows a gross underspend of £13.8m (after movements to earmarked funds and excluding schools grant) and was used to fund carry forwards to 2016/17.

Balance Sheet

20. The Balance Sheet shows the value of the assets and liabilities recognised by the County Council as at 31 March 2016. This shows that the County Council has net assets of £237.4m, compared with net liabilities of £36.7m as at 31 March 2015. The principal reasons are an increase in the Property, Plant and Equipment, due to capital improvements during the year (capital programme) and a reduction in the net pension fund liability (£207.3m), which is explained below.

21. The net position on the pension fund is a deficit of £523.7m and is shown in more detail in note 14 to the accounts. The position has improved since the previous year (£731.0m deficit). The principal reason is that the discount rate used to value future liabilities has increased, which has the impact of reducing the current value of liabilities. The accounting standards require the discount rate used to be equivalent to the market yields on high quality corporate bonds as at 31 March 16. The discount rate used was 3.5%. (3.2% 31 March 2015). Investment returns over the year were negligible and there was little change to the value of assets.

22. The pension fund balance represents all pension entitlements that have been earned to date but which are not yet in payment and has a substantial impact on the net position of the balance sheet. However, statutory arrangements will result in the deficit being made good through increased contributions by the employer, over the remaining working life of employees, as assessed by the pension fund scheme's Actuary. The County Council has agreed a strategy with the Actuary to achieve a funding level of 100% over the next 20 years.

23. The Balance Sheet also shows short and long term provisions totalling £8.1m (£9.0m 2014/15). Provisions are held to fund liabilities of uncertain timing or amount and are shown in greater detail in note 25 to the accounts. The main provision held is for Insurance, £4.7m. This provision represents the estimated value of outstanding unsettled claims at 31 March 2016.

24. The capital receipts fund totals £11.0m (£14.0m 31 March 2015). This fund holds the proceeds from the sale of non-current assets that have not yet been applied to fund new capital expenditure. The funding will be carried forward to 2016/17 (and later years) to fund slippage from the 2015/16 capital programme and to fund the approved 2016-20 capital programme.

25. Cash and cash equivalents have reduced to £43.0m as at 31 March 2016 (£92.3m 31 March 2015). Cash equivalents are highly liquid investments that mature within 3 months or less from the date of acquisition, shown in note 22 to the accounts. Conversely, short term investments (greater than 3 months maturity) have increased to £142.4m as at 31 March 2016 (£80.7m 31 March 2015).

26. During 2015/16 the County Council continued its policy to reduce debt by making a voluntary additional minimum revenue provision (MRP) contribution of £2.9m. This has the effect of reducing the capital financing requirement (CFR) as shown in note 40 to the accounts, which stands at £283.6m. The CFR is a measure of capital expenditure incurred historically that has yet to be financed. Actual debt at the balance sheet was £275.1m. The difference between this and the CFR is the temporary use of working cash balances held by the Council and is sometimes referred to as internal indebtedness.

Annual Governance Statement

27. The Statement of Accounts is accompanied by the Annual Governance Statement (AGS) signed by the Chief Executive and Leader of the County Council. The statement sets out the purpose of the system of internal control, how it operates in the County Council and how its effectiveness has been reviewed. The AGS will be considered by the Corporate Governance Committee on 23 September 2016.

Pension Fund Accounts

28. The Statement of Accounts includes the County Council's pension fund accounts.

29. The last available triennial actuarial valuation of the pension fund showed that at 31 March 2013 the fund's assets covered approximately 72% of the liabilities accrued up to that date. This funding level was a decrease on the 80% position of the 2010 valuation and this was primarily due to the lower-than-expected investment returns achieved in the three year period. This underperformance put significant upward pressure onto the contribution rates of employing bodies but these were contained somewhat for tax raising bodies by using a smoothing mechanism and by the use of a 20 year deficit-spreading period. The results of the 31 March 2016 valuation will be known later in 2016.

30. To ensure that the fund remains financially sound to meet benefit payments, the Actuary will recommend the rate of employer contributions on an individual employer basis for each employing body in the fund for a three year period. In 2015/16 the average employer rate was 21.3% of pay (20.3% 2014/15).

Key Findings of the External Auditor

31. The external auditor has reviewed the Statement of Accounts and Pension Fund Accounts and has concluded that there are no material accounting issues. The external auditor anticipates issuing an unqualified opinion.

32. There was one accounting adjustment to the Statement of Accounts as a result of the external audit. During 2015/16 a school academy lease was surrendered and therefore the building should have been brought back on to the balance sheet. The finance team were not aware of the lease surrender resulting in the incorrect accounting treatment of subsequent capital expenditure. The adjustment made added £2.8m to the Property, Plant and Equipment heading in the balance sheet. The Council will implement a formal process to ensure that the finance team are made aware of all lease surrenders.

33. The auditor has also raised a recommendation to consider implementing a formal review process for journal approvals, either through automated authorisation processes built into the accounting system, Oracle, or a management review based on materiality. Currently while there is segregation between journal creation and journal posting, except for certain members of the technical accounting team who can create and post journal entries, there is no formal review process of journals in place. The Head of Finance has started a review of journal authorisation and the potential to use Oracle to automate this process. The assessment will be completed by 31 December 2016 with the implementation plan to follow the assessment.

RECOMMENDATION

34. The Committee is recommended to approve the Statement of Accounts for 2015/16.

BACKGROUND PAPERS

Provisional revenue and capital outturn, Cabinet 17 June 2016
http://politics.leics.gov.uk/documents/s119853/Final%202015-16%20provisional%20outturn%20Cabinet%20report.pdf

Provisional revenue and capital outturn, Scrutiny Commission 13 July 2016.
http://politics.leics.gov.uk/documents/s120635/2015-16%20provisional%20outturn%20SC%20report.pdf

CIRCULATION UNDER THE LOCAL ISSUES ALERT PROCEDURE

None.

EQUALITY AND HUMAN RIGHTS IMPLICATIONS

None.

APPENDICES

Appendix A – Statement Of Accounts 2015/16
Appendix B – External Auditors Report
Appendix C – Letter of Representation

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