



**CONSTITUTION COMMITTEE – 29<sup>th</sup> SEPTEMBER 2017**

**REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

**STATEMENT OF ACCOUNTS AND ANNUAL GOVERNANCE**  
**STATEMENT 2016/17**

**PURPOSE**

1. The purpose of this report is to:
  - a) present the 2016/17 Statement of Accounts, attached as Appendix A to this report, for approval,
  - b) inform the Committee of the main areas of the accounts,
  - c) report the key findings from the external audit of the accounts,
  - d) provide an update on the 2017/18 earlier close deadlines, and
  - e) provide an update on the external auditor appointment for 2018/19.

**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 the 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 22 September 2017. 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. 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. The 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. Overall, usable reserves which comprise the General Fund, Earmarked Funds and Capital Funds, has increased as at 31 March 2017 to £156.2m from £147.9m at the same time last year, mainly as a result of the underspend on the 2016/17 revenue budget. Details are shown in the narrative statement.
10. The General Fund totalled £25.8m as at 31 March 2017 (£40.4m 31 March 2016) and contains delegated funding for schools, carry forwards of underspends and the uncommitted balance of the County Council. Details of the Fund are shown in note 11 to the accounts. The decrease at 31 March 2017 related mainly to a reduction in carry forwards of underspends compared with the same time last year.
11. Contained with the General Fund is the uncommitted balance which is held 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 Council's policy is to hold a balance in the range of 4% to 5% of net budgeted expenditure (excluding schools). The balance at 31 March 2017 was unchanged at £14.8m and represents 4.3% of the net budgeted expenditure for 2017/18.
12. Earmarked funds, excluding dedicated schools grant, totalled £106.6m as at 31 March 2017 (£85.3m 31 March 2016). The main reason for the increase was due to underspends on the 2016/17 revenue budget being set aside to fund projects that reduce liabilities and ongoing costs, generates or increases income or offsets areas of high demand and pressure for the County Council. The investments approved include highways maintenance, the asset investment fund, the transformation fund and capital programme future developments. The timing of these projects meant that funding was carried forward in earmarked reserves.

13. The significant earmarked funds held are:
- Capital Financing £45.5m. This fund is used to hold revenue contributions to fund capital expenditure in future years including the Street Lighting LED replacement, to fund slippage in the capital programme and funding for future capital developments to achieve ongoing revenue savings and support necessary service investment. The amount shown in the accounts (note 12), is £25.5m which is after £20m 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.
  - Transformation £21.8m. 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 12 to the accounts is a net balance of £13.4m. This is after the temporary investment of £8.4m in the Local Authority Mortgage scheme (LAMS), £5.4m 2012/13 and £3m in 2013/14. The investment was advanced to Lloyds Bank temporarily funded from the overall balance of earmarked funds and will be repaid to the County Council in 2017/18 and 2018/19, five years after the funding was advanced.
  - Insurance Funds £20.2m. 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.
14. The required level of earmarked funds is kept under review during the year. Formal assessments are undertaken and reported during the Autumn, in February as part of the Medium Term Financial Strategy (MTFS) and also at year end.

### **Comprehensive Income and Expenditure Statement (CIES)**

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 have been updated in 2016/17 (and balances restated for 2015/16) to align to the main reporting areas of the County Council following a change in the Chartered Institute for Public Finance and Accountancy (CIPFA) service reporting code of practice. However the CIES cannot be directly compared to the outturn position reported to the Cabinet 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.
17. The CIES shows a surplus of £4.3m on the Provision of Services for 2016/17 (£14.6m surplus 2015/16). The main reason for the reduction is due to downward revaluations on land and buildings that are charged to the CIES in 2016/17 compared with 2015/16 – see note 17. Asset valuations can change each year, mainly due to

local market conditions. Statutory regulations require the charge to be reversed out of the general fund to avoid a charge on the general fund.

18. The Narrative Statement on page 4 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 £1.3m (after movements to earmarked funds and excluding schools grant) and was used to fund carry forwards to 2017/18.

### **Balance Sheet**

19. The Balance Sheet shows the value of the assets and liabilities recognised by the County Council as at the balance sheet date. As at 31 March 2017 net assets of the County Council were £213.4m (£237.4m 31 March 2016). The principal reason for the change is an increase in the pension liability, £91m, offset by an increase in the value of Property, Plant and Equipment £39m, mainly due to capital improvements during the year (capital programme) and an increase in overall current assets, £38m, due to an increase in short term investments from higher balances.
20. As at the balance sheet date, the net deficit on the pension fund has deteriorated to £614.5m compared with £523.7m at the same time last year. The principal reason is that the discount rate used to value future liabilities has reduced to 2.6% (3.5% last year) due to a fall in the AA corporate bond yields which has increased the present value of liabilities substantially, £294m. The accounting standards require the discount rate used to be equivalent to the market yields on high quality corporate bonds as at 31 March 17. Investment returns over the year had the impact of increasing the value of assets by £180m, but this was significantly less than the increases in liabilities. Details are shown in note 16 to the accounts.
21. 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.
22. The Balance Sheet also shows short and long term provisions of £7.8m (£8.1m 31 March 2016). Provisions are held to fund liabilities of uncertain timing or amount and are shown in greater detail in note 27 to the accounts. The main provision held is for Insurance, £4.2m, and represents the estimated value of outstanding unsettled claims at 31 March 2017.
23. Cash and Cash Equivalents have reduced to £23.4m as at 31 March 2017 (£44.1m 31 March 2016). Cash equivalents are highly liquid investments that mature within 3 months or less from the date of acquisition, shown in note 24 to the accounts. The reduction is linked to an increase in short term investments (greater than 3 months maturity) which have increased to £196.5m as at 31 March 2017 (£142.4m 31 March 2016).
24. The balance sheet also shows the valuation of Pooled Property Funds, under long term investments, £19.2m. The valuation is lower than the initial £20m invested

mainly due to transaction fees. However over the mid term the investments are expected to exceed the original investment and continue to pay £0.8m in interest each year.

25. During 2016/17 the County Council continued its policy to reduce debt by making a voluntary additional minimum revenue provision (MRP) contribution of £4.5m. This has the effect of reducing the capital financing requirement (CFR) and the ongoing MRP charge to the revenue budget. The financing costs of capital total £23m each year. The CFR is shown in note 41 to the accounts and stands at £267.7m. The CFR is a measure of capital expenditure incurred historically that has yet to be financed. Actual debt as at the balance sheet was £274.6m. The difference between the CFR and actual debt is a temporary overborrowed position and is pending opportunities for the early repayment of debt where the savings outweigh the redemption penalties. This position is kept under regular review by as part of the Councils Treasury Management Strategy.

### **Annual Governance Statement**

26. 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 22 September 2017.

### **Pension Fund Accounts**

27. The Statement of Accounts includes the Pension Fund accounts for the Local Government Pension Scheme administered by the County Council.
28. The last available triennial actuarial valuation of the pension fund showed that at 31 March 2016 the fund's assets covered approximately 76% of the liabilities accrued up to that date. This funding level was an increase on the 72% position reported in the 2013 valuation. The underperformance puts 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.
29. 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 2016/17 the average employer rate was 21.8% of pay (21.0% 2015/16).

### **Key Findings of the External Auditor**

30. The external auditor has reviewed the financial statements and has concluded that there are no material accounting issues. The external auditor anticipates issuing an unqualified opinion.

31. The auditor has raised two recommendations:

- Earlier committee approval dates. The earlier closedown requirements for 2017/18 will require earlier committee meeting dates to enable approval of the financial statements by the end of July. Committee officers are aware of the new deadlines and are making appropriate arrangements to the timings of committee dates.
- Key staff changes within the Technical Accounting Team. A key member of the team left at the end of August and will be replaced on 1 October. The new team member has transferred from within the County Council wider finance team and is an experienced qualified accountant. A handover of key tasks has taken place and the timing of the move provides a period of time before year end. Additional support will be provided by the Technical Accounting Team Manager, external professional training and the stability and support of the team. The Council will continue to have regular meetings with KPMG to ensure the smooth running of the closedown process.

### **2017/18 EARLIER CLOSE OF THE ACCOUNTS**

32. The Accounts and Audit regulations 2015 set out requirements for the earlier completion of the financial statements from 2017/18. The new deadlines will require the financial statements to be completed, audited and approved two months earlier than the current timetable, by the end of July instead of September.
33. In preparation for the changes the County Council (and the external auditor) agreed to trial the earlier close dates for 2016/17. The existing member approval dates at the end of September were retained for 2016/17 to provide time if this was needed.
34. Work was undertaken early in the process to review where time could be saved and this was agreed with the external auditor. Improvements included bringing forward the deadlines in the timetable and completing tasks in different ways. An example, was the earlier completion of Property asset valuations which was brought forward to the end of December instead of March and the implementation of a new fixed asset register during 2016/17 that increased automation.
35. No delays were experienced and the draft accounts and external audit were both completed by the earlier deadlines at the end of July. Work will begin shortly on planning for the closedown of the 2017/18 accounts to embed the improvements made and ensure that the new statutory deadlines are met.

### **EXTERNAL AUDITOR APPOINTMENTS FOR 2018/19 – update**

36. An update on the appointment of the external auditor from 2018/19 will be considered by the Corporate Governance Committee at its meeting on the 22<sup>nd</sup> September. A summary of the changes is provided in the following paragraphs for information.
37. The Local Audit and Accountability Act 2014 brought to a close the Audit Commission and transferred the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England to Public Sector Audit Appointments Limited (PSAA), the sector led body set up by the Local Government Association with

delegated authority from the Secretary of State for Communities and Local Government, for contracts until 31 March 2018. After this time Councils will be able to appoint their own external auditor or they can opt in to the PSAA arrangements.

38. Following reports to the Corporate Governance Committee and County Council in 2016, the County Council opted in to the PSAA auditor arrangements from 2018/19. Of 493 eligible local bodies, 484 have opted into the PSAA scheme.
39. The PSAA have now completed their procurement exercise to let audit contracts from 2018/19. The results of the process involve the award of contracts, based on lots, to six auditing firms. The contracts will cover a five year period commencing with the audit of accounts for 2018/19. PSAA has an option to extend the contracts for a further two year period, to a total of seven years, if it chooses to do so.
40. PSAA have now started a consultation process on the appointment of named audit firms to each individual authority and have written to the County Council to propose that Mazars LLP are appointed as the County Council's external auditor, for five years from 2018/19.
41. The County Council is not aware of any conflicts of interest with the proposed appointment of Mazars LLP. However the Council is aware that Leicester City Council (LCC) and Nottingham City Council (NCC) have been advised that Grant Thornton LLP will be their appointed auditor. Given the close working relationship between the County Council and LCC and NCC, through the joint internal audit arrangements with LCC, and East Midlands Shared Service for transactional finance and HR and shared use of the Oracle system with NCC, there will be opportunities to reduce costs and increase efficiency in the audit process for all parties by having the same external auditor.
42. The Corporate Governance Committee has been recommended to approve the County Councils response to the consultation advising that there are no known conflicts of interest with the appointment of Mazars LLP, but asks that consideration is made of the close working arrangements between the County Council and LCC and NCC and that by having the same auditor, Grant Thornton LLP, this will offer efficiencies in the audit to all parties.

## **RECOMMENDATION**

43. The Committee is recommended to approve the Statement of Accounts for 2016/17.

## **BACKGROUND PAPERS**

Provisional revenue and capital outturn, Cabinet 23 June 2017

<http://politics.leics.gov.uk/documents/s129536/FINAL%20201617%20Provisional%20Revenue%20and%20Capital%20Outturn.pdf>

Provisional revenue and capital outturn, Scrutiny Commission 19 July 2017.

<http://politics.leics.gov.uk/documents/s130534/Provisional%20Revenue%20and%20Capital%20Outturn.pdf>

**CIRCULATION UNDER THE LOCAL ISSUES ALERT PROCEDURE**

None.

**EQUALITY AND HUMAN RIGHTS IMPLICATIONS**

None.

**APPENDICES**

Appendix A – Statement Of Accounts 2016/17

Appendix B – External Auditors Report

Appendix C – Letter of Representation

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