

AGENDA ITEM

Audit Committee

DATE: 23rd JUNE 2009

DRAFT STATEMENT OF ACCOUNTS 2008/2009

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PURPOSE OF THE REPORT

1. To present to members the draft Statement of Accounts 2008/2009.
2. The Statement of Accounts also includes the accounts for Teesside Pension Fund for which the Council is the Administering Authority.

BACKGROUND

3. The Statement of Accounts is essentially a technical publication containing accounting statements that have been prepared in accordance with the Code of Practice on Local Authority Accounting in Great Britain and the Statutory Accounts and Audit Regulations. The Statement of Recommended Practice (SORP) further supports the accounting framework. The SORP is updated annually and specifies the accounting principles and practices required to prepare a Statement of Accounts, which present fairly the position of a local authority.
4. The key changes introduced by the recent SORPs include:
 - **Revenue Expenditure Funded From Capital under Statute**
Deferred Charges have been replaced with a new category of expenditure – “Revenue Expenditure Funded from Capital under Statute”. This resulted in a

change in the accounting policy because the accounting requirements are now different. There is no impact on the authority's bottom line or Council Tax.

- **Area Based Grant (ABG)**

In 2008/09 the Council received an Area Based Grant from the government that incorporated a range of grants formerly paid on an individual grant by grant basis. This included grants from the Department of Children, Schools and Families (DCSF), the Home Office, Communities in Local Government (CLG) and the Department of Health and amounted to £18.4 million. The major benefits of the Area Based Grant centre around it being a general grant where the Council has full flexibility to determine its use and relaxations in the administration requirements with regard to reporting. The grant must be included in the same section of the Income & Expenditure Account as NNDR and Council Tax income.

- **Pension Fund Valuation**

The 2008 SORP introduced a change in the valuation method for pension fund investments. They are now required to be valued on a fair value basis prior to the 2008 SORP the mid-market price was used as the basis for valuing investments. The effect of this change was dealt with in the Pension Fund accounts for 2007/8. This resulted in some opening balances being restated in line with the new methods of valuation.

5. Following the significant changes in 2006/07 to the layout and accounting treatments, the Statement of Accounts now contains the following:

- An Explanatory Forward
- Annual Governance Statement
- A Statement of Accounting Policies
- Statement of Responsibilities for the Statement of Accounts
- The Main Financial Statements comprising:
 - The Income and Expenditure Account
 - The Statement of Movement on General Fund Balances
 - Statement of Recognised Gains and Losses
 - Balance Sheet
 - Cash Flow Statement
- Notes to the Main Financial Statements
- Collection Fund and notes
- Group Accounts
- Teesside Pension Fund- Fund Account and Net Asset Summary

The purpose of each of the Statements within the Accounts is as follows:

6. **Explanatory Foreword.** Acts as a guide to the most significant matters impacting on the Council's finances. It gives an indication of where the council's funding comes from, what it is spent on and what services it provides. It also sets out the financial position and is intended to assist in the interpretation of the accounting statements.

There is a review of the Financial Year included in this section and the impact on Middlesbrough of the downturn in the economy has been added to the statement:

Business and the Labour Market

- Number of business failures increasing.
- Businesses and stores have been down sizing
- Increased number of requests to reduce or defer rental payments
- Most existing regeneration schemes are continuing but few new schemes have started
- Retail has experienced the greatest difficulties with reduced sales and store closures.
- Unemployment up by 50% and Job Vacancies down by 35% across the Tees Valley
- Business rate arrears increased.

Housing Market

- Fall in the value of property over the year.
- Significant reduction in the number of dwellings completed
- House/Apartment building down by 50+% in the Tees Valley
- Right to Buy sales of former council properties dried up in the fourth Quarter of the financial year.

Individuals

- Money/Debt Enquiries up by over a third
- Council Tax arrears increased
- Rent Arrears increased
- Number of Bankruptcies up

Impact on the Council

<ul style="list-style-type: none">• Increase in bad debts	<ul style="list-style-type: none">• Increased court fees, staff workload and reduced income
<ul style="list-style-type: none">• Requests for Hardship relief / empty Property relief / small business rate relief for Business Rates up substantially.	<ul style="list-style-type: none">• Increase in staff workload
<ul style="list-style-type: none">• Large increase in Benefit Claimants	<ul style="list-style-type: none">• Increase in staff workload and administration costs.
<ul style="list-style-type: none">• Reduced income from Car parks / Commercial Property Rents / planning fees	<ul style="list-style-type: none">• Budget pressures for services.
<ul style="list-style-type: none">• Council share of Right to Buy receipts down	<ul style="list-style-type: none">• Massive budget pressure.
<ul style="list-style-type: none">• Increased demand for Welfare rights / Citizens advice services	<ul style="list-style-type: none">• Increase in staff workload
<ul style="list-style-type: none">• Increase in children taken into care	<ul style="list-style-type: none">• Increase in the work load of social workers and huge costs
<ul style="list-style-type: none">• Significant increase in numbers of free school meals.	<ul style="list-style-type: none">• Additional funding provided by schools to maintain the quality
<ul style="list-style-type: none">• Capital receipts reduced and delayed	<ul style="list-style-type: none">• Possible difficulties Funding the Council's 5 year £328 million Capital Programme.

7. **Annual Governance Statement.** The Annual Governance Statement reports on the key financial controls and wider governance arrangements in operation within the Council. The Statement was presented to the Corporate Affairs Committee on the 3rd June 2009.
8. **Statement of Accounting Policies.** The purpose of the statement is to explain the basis for the recognition, measurement and disclosure of transactions and other events in the accounts. In certain circumstances, where more than one accounting basis or estimation technique is acceptable, the accounting policy and/or estimation techniques followed can significantly affect an authority's reported results and financial position.

The accounting policies have been reviewed and where appropriate changes made in preparation for the introduction of the International Financial Reporting Standards (IFRS). The following policies were updated:

- a) Provisions
- b) Self Insured Risks
- c) Contingent Liabilities / Assets
- d) Intangible Assets

9. **Income and Expenditure Account - Appendix A.** This is equivalent to a profit and loss account in a private sector companies accounts. It shows the income and expenditure of all the Council's functions, the net cost of Council services for the financial year and demonstrates how this has been funded (e.g. Government Grants, Non Domestic Rates and Council Tax). The format of the income and expenditure of the Council's services is presented using the Best Value Accounting Code of Practice (BVACOP) classification, again a statutory requirement.

The day to day budget monitoring arrangements of the Council are based around its own organisational structure and are different to both the statutory and BVACOP requirements. The outturn accounts reported to the Executive on the 26th May 2009 have had to be reworked to fit these formal requirements. The resulting changes however do not affect the overall net expenditure to be funded from central government grant and Council Tax, although the presentation of the figures in the Statement - Income and Expenditure account is very different.

The main difference between the Council's accounts and the published statutory accounts are as follows:

a) Service Headings

The following service headings are used in preparation of the accounts in accordance with BVACOP:

- Central Services to the Public
- Court Services
- Cultural, environmental and planning services
- Children's and Education Services
- Highways, roads and transport services
- Housing services
- Adult social care
- Corporate and democratic Core
- Non –distributed costs

b. Capital Deprecation Charges

In the Statement of Accounts the Council is required to ensure that each service has to reflect a depreciation charge for the assets they use (land, buildings, plant and machinery etc).

c. Transfers To and From Reserves

Transfers into and expenditure funded from reserves are not considered part of the net cost of services and are therefore not reflected at all within the income and expenditure account.

d. Central Support Services

Under BVACOP, the costs of corporate services that are provided to front line services and an allocation of certain central expenses have to be included as service costs rather than central 'corporate' costs. Such services and costs include Finance, Legal, HR, IT, Payroll, Creditors etc.

e. Employer's Pension fund Contributions

Accounting for retirement benefits (FRS17) requires that employer's contributions to pension schemes, reflected in service accounts should only consist of 'current service' costs. As the actual contributions made to the Pension fund by the Council include an element of back funding to recover any previous pension scheme deficit, the service expenditure figures reported in the Statement have to be adjusted to reflect the current service costs as calculated by the fund actuary.

In addition the income and expenditure account includes as part of operating expenditure the net impact of the notional return on the pension fund assets and the increase in accrued future pension liabilities (Middlesbrough Council elements)

f. Other Differences

Other transactions such as interest earned and paid, precept payments to Cleveland Police / Cleveland Fire Brigade / Parish Councils and trading units are not considered as part of the net cost of services and are required to be shown as separate items in the section below the service expenditure totals in the income and expenditure account.

10. Revenue Spending

The main components of the revenue budget for 2008/2009, and how these compare with the actual income and expenditure are set out below:

Budgeted Expenditure	Budget £Million	Outturn £Million	Variance £Million
Service Budgets			
Children, Families & Learning	22.8	23.6	0.8
Social Care	35.3	34.7	-0.6
Environment	24.5	24.5	0.0
Regeneration & Culture	8.1	7.6	-0.5
Corporate Services & Provisions	36.3	36.5	0.2
Net Service Expenditure	127.0	126.9	-0.1
Budgeted Contribution from Reserves	-0.7	-0.7	0.0
Net Impact on the General Fund	126.3	126.2	-0.1*

***Actual outturn was a £61k saving**

The net spend of £126.2 million was funded by

Item	£million
Revenue Support Grant from the Government	9.7
Share of National Business Rates Proceeds	69.7
Council Tax payers for 2008/09*	46.8
= total net spending in 2008/09	126.2

Income from Council taxpayers totalling £46.8 million was based on a charge of £1,410 for an average Band D property.

11. **Statement of Movement on the General Fund Balance - Appendix B.** This statement reconciles the differences between the surplus/deficit for the year on the Income and Expenditure Account and the General Fund Balance.

The following table summarises the general fund position shown in the Statement of accounts and reconciles it with the information included in the 2008/2009 Outturn report to Executive on the 26th May 2009.

Movement in balances reported in the Outturn Report	£000
Transfers from Earmarked Reserves	415
Transfers to Earmarked Reserves	-750
Increase in balances at 31 March 2009, resulting from service savings as per the May 2009 Outturn Report to Executive	396
Increase in General Fund balances during 2008/09	61

Movement on the General Fund balance as per the Statement of Accounts	£000
Opening Balance	5,477
Changes to the General Fund in year	61
Closing Balance General Fund as at 31 st March 2009	5,538

12. **Statement of Total Recognised Gains and Losses - Appendix C.** The principle reason for this statement is to bring together all the gains and losses that affect the Council's net worth, including the gains and losses from the revaluation of assets and the actuarial valuation of the pension fund which do not pass through the income and expenditure account.
13. **Balance Sheet - Appendix D.** This statement is important to the understanding of the local authority's financial position as at the 31st March 2009. It reports details of, the value of assets owned by the council, the level of creditors (amounts owed by the Council), the level of debtors (amounts owed to the Council) and the level of provisions and balances maintained by the Council. The main items of note are as follows:

Fixed Assets – these are assets owned by the authority which are used either in direct service provision or held for investment purposes. The value as at 31 March 2009 is £566 million (March 2008 - £544 million). Fixed assets are revalued at least every five years. Other long-term investments and long term debtors relate to investments with a maturity date in excess of 12 months from the balance sheet date and debt outstanding on mortgages provided to third parties for the purchase of Council and private dwellings.

Current Assets – the main items included within this heading are debtors i.e. money owed to the Council as at 31 March 2009 and short-term investments. Investments reduced only slightly by 0.8 percent over the year and the Council currently has £49.3 million invested in other local authorities, a variety of banks

and building societies. The Council's debtors increased by £8.2 million to £45.1 million, which is due to:

- An increase in outstanding government grants of £9.5 million;
- Council Tax and NNDR debt increasing by £1.2 million;
- A reduction of £2.5 million in sundry debtors mainly due to an improvement in debt collection procedures.

Current liabilities – this is the amount of money owed by the Council to its suppliers and contractors, which totalled £46.305 million as at 31 March 2009 (£41.724 million as at 31 March 2008). The increase in the amount of £4.6 million is due mainly to outstanding payments for equal pay claims.

Long term liabilities – this section is made up of several different items. Long term borrowing and the value of the pension liability makes up approximately 56.3% of the total. Long term borrowing of £100.5 million remained static over the year as the Council has mainly used grants and contributions to fund capital expenditure. The Pension Liability amounts to £97.16m as at March 2009 (£95.93 million March 2008). This is the value placed on the Council liability by the Pension Fund Actuary and is offset in the balance sheet by a corresponding credit on the Pension Reserve. The section on the Pension fund Accounts – paragraphs 17 to 21 below explains why the Council's liability has increased.

The Council has set £5.2 million aside in Provisions to deal with long term liabilities. Including equal pay and Building Schools for the Future. A full list is included in Appendix F.

Financed by – the total of all the items within this section is the value of the net worth of the Council. It shows the reserves and balances held as at 31 March 2009, and can be split between technical and earmarked reserves as follows:

- Technical Reserves - The two technical reserves are the Restatement Reserve (£72.0 million) and the Capital Adjustment Account (£262.6 million), which are not cash backed. The Capital Adjustment Account records the consumption of the value of asset and what used to be called deferred charges and is now Revenue Expenditure Funded from Capital under Statute over the period that the authority benefits from the expenditure.
- Earmarked Reserves – The Council's budget monitoring gives greater prominence to the level of cash-backed reserves in the form of the general fund balance and earmarked reserves which are potentially useable to finance revenue and capital spending. The earmarked reserves (£11.1 million) are linked directly to specific Council risks and plans such as, Invest to Save/Change Programme and the Insurance Fund. A full list is included in Appendix G.

14. **Cash Flow Statement - Appendix E.** This Statement explains the movement in the Council's cash balances over the year and summarises the inflows and outflows of cash. The other main Statements are produced on an accruals basis, whereby income and expenditure are matched to the period to which they relate whether or not it has been paid or received. This Statement has any non-cash

accounting adjustments and accruals removed and displays the situation relating to actual cash received from third parties and actual cash paid to third parties

15. **Collection Fund.** This statement has no equivalent in the private sector. It is required by statute and shows the transactions the Council has undertaken in relation to Non-Domestic Rates and Council Tax income. The information within the collection fund statement is consolidated into the Income and Expenditure Account under sources of finance.
16. **Group Accounts.** The authority conducts some of its activities through partnerships and separate undertakings. The SORP requires the production of Group Accounts to take account of these relationships in order to provide a full picture of the Council's overall financial position.
17. **Teesside Pension Fund Accounts.** The Pension Fund Accounts show the contributions to the Council's Pension Fund for employees employed by the 60+ contributing bodies during 2008/2009, together with the pensions and other benefits paid from it, movements in investments during the year and the financial position of the fund as at 31 March 2009.
18. 2008 was the worst year for pension fund investment returns since 1974. Markets performed poorly in the first quarter of the year, but in the second half of the year both the credit and money markets virtually ceased functioning as banks and others were unable to gauge counterparty risk. As the world plunged into recession precipitated by the global credit crises, equity markets plummeted and volatility surged to unprecedented levels. The financial sector was particularly badly hit. The very existence of some of the best known high street banks was in jeopardy as they were forced to write off massive sums and, in some cases, seek emergency funding from the Government.
19. As the parlous state of the UK economy became apparent the Government slashed interest rates in an attempt to stave off recession. This coupled with the growing perception that Government borrowing would have to reach levels unprecedented in peace time, caused Sterling to fall sharply against other major currencies. Perversely the weakness of Sterling gave some protection to UK Funds which did not hedge their currency exposure with the Euro gaining 32%, the US Dollar 40% and the Yen 70% against Sterling.
20. The 2008/2009 financial year was a difficult one for Teesside Pension Fund, continuing the downward trend, which started in the final quarter of 2007/2008. The fund's total value has reduced by £347 million from £2,048 million to £1,701 million, a reduction of 17% in the year. This reduction was entirely due to the fall in the market value of the Fund's investments.
21. Naturally the fall in the value of the Fund has had a direct impact on its Funding Level – the extent to which its assets are able to meet its liabilities. The most recent Actuarial valuation was carried out as at 2007 and found that the Fund had a Funding Level of 98.5%, considerably up on the 81% in the previous valuation in March 2004. As a result of the impact of the falling equity markets the Actuary now estimates that as at 31st March 2009 the Funding Level now stands at 93%, whilst

this is a disappointing reduction it is still well above the average LGPS Fund and still significantly above the value of the fund five years ago. The Fund, however, did not have any cash deposits with the Icelandic banks or Lehman Brothers.

22. Attached to this report are extracts from the draft Statement of Accounts providing details of the main accounting financial statements. A copy of the full draft statement has been made available to all members of the Corporate Affairs Committee. A copy of the full statement has been deposited within the Members Library. In addition a copy of the accounts will be made available on the Council's Web site.
23. A combined Annual Report / Summary of Accounts will be produced for 2008/09. The report includes performance information and summary financial data and which will be published in the summer edition of Middlesbrough News.

External Consultation

24. Notice will be given in the local press for any interested person to inspect, and make copies of, The Statement of Accounts and other documents between 6th July and 31st July 2009. Interested persons are able to question the Auditor about the accounts and make objections to the same with effect from 3rd August 2009 until the completion of the audit.
25. The Statements will be subject to external audit - Deloitte, which will commence on 3rd August and is expected to be complete on the 24th August. A statement (ISA+260) will be produced which details any unadjusted misstatements found during the course of the audit.
26. The draft Statements have been produced well within the timetable and the quality of the working papers has again improved.
27. The preparation of the Statement of Accounts has been undertaken in accordance with an internal quality assurance framework to ensure the accounts are prepared in accordance with the SORP and other relevant legislation.

FUTURE ACCOUNTING DEVELOPMENTS

28. Internationally a number of accountancy regulatory bodies have agreed to a convergence of accounting standards and practices globally to enable easier comparison of accounts across countries. Local Government accounts are moving to a standard known as International Financial Reporting Standards (IFRS). This has, and will, lead to significant changes to the format and accounting practices for local government. The Council has commenced the implementation project.

ROLE OF THE AUDIT COMMITTEE

29. The Corporate Affairs Committee received the Corporate Governance Statement on the 3rd June 2009. The statement covers the review of the effectiveness of the Council's systems of internal control and governance arrangements.

At the meeting the members of the committee asked for:

- An evaluation of whether there were any barriers to the effectiveness of partnerships and outside bodies to be included in future reviews.
- An overall summary/assessment of the six core principles underpinning the governance arrangements of the Council would be included in future Corporate Governance Statements.

An overall assessment of the six core principles has now been carried out and a summary of the outcome has been included in the Corporate Governance Statement incorporated into the 2008/2009 draft Statement of Accounts.

30. The role of the Audit Committee is to examine the accounts and in particular to consider the following:

- What were the key judgments made in preparation of this year's accounts?
- Are there any significant changes from the previous year?
- What impact has the economic climate had on the accounts?
- Assurances about the financial systems that have provided the figures for the accounts;
- What quality control arrangements over the preparation of the accounts were put in place by the Director of Resources and his staff;
- Any issues raised by the External Auditors - Deloitte.

The members of the committee also have a responsibility to challenge and ensure themselves of the robustness of the overall financial position of the Council

31. As noted earlier in this report, the format of the Statement of Accounts is heavily prescribed by a range of regulations and reporting arrangements. However, it is important that they are understandable and meaningful to all stakeholders. Although constrained by regulations and reporting standards, the Council is always looking to improve the content and format of the Statement of Accounts. Members' comments on how the Accounts and explanatory information could be improved in the future are therefore welcome.

OPTION APPRAISAL/RISK ASSESSMENT

32. Risk:

Risk	Category	Implications
The Council's accounts are significantly incorrect, incomplete or misstated and are "qualified" by the External auditor	Legal, CPA	The Council's Use of Resources CPA score could not be above a 1 (Poor).
The Draft Statement of Accounts is not approved by 30 June 2009	Legal, Reputation, CPA	There is a statutory requirement for the Draft Statement of Accounts to be approved by 30 June. Failure to do so would result in external criticism and would limit progress on CPA.
The Council's overall financial position is not solid.	Financial Service	The Council could not meet future financial challenges/ increases in service demands without imposing cuts.

FINANCIAL, LEGAL AND WARD IMPLICATIONS

33. Overall the accounts show a sound financial position for the Council with the level of balances being in line with the Council's Medium Term Financial Plan.
34. The application of sound financial management across all services was reflected in the final outturn for the year with a net saving compared to budget of £61,000 (0.1%).
35. Actual capital spend in the year was £52.6 million, compared with a budget of £59.2 million. Expenditure during the year was mainly funded from grants (68%), from usable capital receipts (9%), from borrowing (15%), from revenue contributions (3%) and from capital contributions (5%). The percentage of spend achieved compared to the budget represented 89%.

RECOMMENDATIONS

36. It is recommended that Members note the contents of the draft Statement of Accounts 2008/2009.

REASONS

37. The purpose of the Statement of Accounts is to present the overall financial position of the Council at 31 March 2009 in accordance with guidance produced by CIPFA.

38. The recommendation is supported by the requirement to comply with the 2004 Accounts and Audit Regulations, which require the draft Statement of Accounts to be approved by the 30th June 2009.

BACKGROUND PAPERS

The following papers were used in the preparation of the report: -

- Code of Practice on Local Authority Accounting in the UK – SORP 2008.
- Annual Governance Statement Report to Corporate Affairs Committee 3rd June 2009
- 2008/2009 Outturn report to Executive on the 16th May 2009.

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