

# MIDDLESBROUGH COUNCIL

AGENDA ITEM 4

## COMMITTEE REPORT

### CORPORATE AFFAIRS

22<sup>ND</sup> JUNE 2012

### DRAFT STATEMENT OF ACCOUNTS 2011/12

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#### PURPOSE OF THE REPORT

1. The purpose of this report is for Members of the Corporate Affairs Committee to receive and review the Middlesbrough Council Draft Statement of Accounts 2011/2012.
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 Code). The Code is updated annually and specifies the accounting principles and practices required to prepare a Statement of Accounts, which present a true and fair view of the position of a local authority.
4. The 2011/2012 Statement Of Accounts has been prepared in compliance with International Financial Reporting Standards (IFRS).
5. 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.

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7. The overall economic conditions continue to be difficult, although the impact of these circumstances varies significantly depending upon which sector individual businesses are operating in. Nationally retail continues to struggle, whilst those serving wider markets such as engineering and the oil and gas sectors are taking advantage of increasing global opportunities.

- First Source and Axa have established new contact centres within the town centre, ultimately bringing over 800 jobs into the area;
- Worldwide demand in the oil and gas field is driving growth within companies such as STS, creating 100 new jobs;
- Retail trading conditions continue to impact upon the town centre offer, with companies such as TJ Hughes, Peacocks and Bon Marche closing during the year;
- Digital companies continue to thrive within global markets, with companies such as THAP and Double 11 winning major contracts and attracting significant investment;
- AV Dawsons are investing heavily to increase capacity at their wharfage facilities on Riverside Park to cope with global demand;

8. Key indicators of the state of the local economy are as follows:

| <b>Indicator</b>                         | <b>April 2011</b> | <b>March 2012</b> | <b>Direction</b> |
|--|-------------------|-------------------|------------------|
| Unemployment                             | 7.7%              | 8.1%              | Deteriorating    |
| Youth unemployment                       | 11.6%             | 13.3%             | Deteriorating    |
| Vacancies per '000 of population         | 7.2               | 9.0               | Improving        |
| % of vacancies that are full time        | 75.7%             | 71.6%             | Deteriorating    |
| Unemployed people per vacancy            | 8.4               | 8.5               | Deteriorating    |
| Empty commercial properties              | 776               | 710               | Deteriorating    |
| Occupancy of Council commercial premises | 91%               | 88%               | Deteriorating    |

9. **Impact on the Council:**

|  |   |
|--|---|
| <ul style="list-style-type: none"> <li>• Increase in Council Tax / Benefits overpayments / NNDR bad debts</li> </ul>   | <ul style="list-style-type: none"> <li>• Increased court fees, staff workload and reduced income</li> </ul>                                     |
| <ul style="list-style-type: none"> <li>• Requests for Hardship relief / empty Property relief / small business rate relief for Business Rates up substantially.</li> </ul> | <ul style="list-style-type: none"> <li>• Increase in staff workload</li> <li>• Increase cost to the Council</li> </ul>                          |
| <ul style="list-style-type: none"> <li>• Large increase in Benefit Claimants</li> </ul>  | <ul style="list-style-type: none"> <li>• Increase in staff workload and administration costs. Additional volumes charge from Mouchel</li> </ul> |
| <ul style="list-style-type: none"> <li>• Further reduction in income from Car parks / Commercial Property Rents / planning fees</li> </ul>                                 | <ul style="list-style-type: none"> <li>• Large budget pressures for services.</li> </ul>  |
| <ul style="list-style-type: none"> <li>• Increased demand for Welfare rights / Citizens advice services</li> </ul>   | <ul style="list-style-type: none"> <li>• Increase in staff workload</li> </ul>  |
| <ul style="list-style-type: none"> <li>• Further increase in children taken into care</li> </ul>   | <ul style="list-style-type: none"> <li>• Increase in social worker work load and huge costs</li> </ul>  |
| <ul style="list-style-type: none"> <li>• Capital receipts reduced and delayed</li> </ul>   | <ul style="list-style-type: none"> <li>• Possible difficulties funding the Council's Capital Programme.</li> </ul>                              |

10. **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 approved by the members of the Audit & Governance Committee on the 24th May 2012.

11. **Comprehensive Income and Expenditure Statement - 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.

12. 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 19th June 2012 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.

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13. 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;
- Cultural, Environmental, Regulatory and Planning services;
- Children's and Education Services;
- Highways and Transport services;
- Other Housing services;
- Adult Social Care;
- Corporate and Democratic Core;
- Non-distributed costs.

b. Capital Depreciation 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, Human Resources, IT, Payroll, Creditors, Debtors, Performance & Policy, Audit etc.

e. Employer's Pension Fund Contributions:

Accounting for retirement benefits (IAS26) 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, the 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 comprehensive income and expenditure statement.

14. **Revenue Spending**

The outturn of the Council showed a strong, positive financial position with all services showing improvements on the figures reported at quarter 3. There was a clear focus on managing vacancies in preparation for budget cuts in later years, restricting supplies and service spending to essentials and making the best use of grant funding. There was also significant one off savings and income across all service areas.

The main components of the revenue budget for 2011/2012, and how these compare with the actual income and expenditure are set out below:

| <b>Budgeted Expenditure</b>                | <b>Budget<br/>£Million</b> | <b>Outturn<br/>£Million</b> | <b>Variance<br/>£ Million</b> |
|--|----------------------------|-----------------------------|-------------------------------|
| <b>Service Budgets</b>                     |                            |                             |                               |
| Children, Families & Learning              | 27.7                       | 27.5                        | -0.2                          |
| Social Care                                | 45.3                       | 44.1                        | -1.2                          |
| Environment                                | 22.5                       | 21.9                        | -0.6                          |
| Regeneration & Culture                     | 7.5                        | 7.2                         | -0.3                          |
| Central Services                           | 24.0                       | 23.5                        | -0.5                          |
| Corporate Costs                            | 9.8                        | 12.1                        | 2.3                           |
| <b>Net Service Expenditure</b>             | <b>136.8</b>               | <b>135.1</b>                | <b>-0.5</b>                   |
| <b>Budgeted Contribution from Reserves</b> | <b>-0.3</b>                | <b>-0.3</b>                 | <b>0.0</b>                    |
| <b>Net Impact on the General Fund</b>      | <b>136.5</b>               | <b>134.8</b>                | <b>*-0.5</b>                  |

\* **NB. actual outturn variance for 2011/12 was -£506,000**

The net budget of £136.5 million was funded by

| <b>Item</b>                               | <b>£million</b> |
|---|-----------------|
| Revenue Support Grant from the Government | 20.4            |
| Share of National Business Rates Proceeds | 66.0            |
| Council Tax payers for 2010/10*           | 50.1            |
| <b>= total net budget in 2011/12</b>      | <b>136.5</b>    |

Income from Council taxpayers totalling £50.1 million was based on a charge of £1,513.5 for an average Band D property.

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15. The Council had identified savings from service efficiencies, staffing structure reviews, a review of accommodation, joint working with other bodies, and service reductions to fund the reductions of £13.8 million in 2011/2012. The cuts process is continuing with reductions of £12.8 million for 2012/2013 and the Council will need to make some difficult and fundamental changes in the services it provides and the way it operates to make the level of savings due in 2013/2014 and 2014/2015.
16. There will be a significant risk on the delivery of planned savings/cuts and the Council will need to continue to invest in service reconfiguration both to improve services and generate greater savings. The Council has transferred savings made during 2011/2012 (£1.2 million) in to the Change Programme Reserve to fund this essential investment. It has also transferred £0.5 million into the Social Care / Vulnerable Children reserve to cover financial risks related to increased demand.
17. **Balance Sheet - Appendix B.** This statement is important to the understanding of the local authority's financial position as at the 31<sup>st</sup> March 2011. 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:
18. Long Term 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 2012 is £563.2 million (March 2011 - £634.1 million). Fixed assets are revalued at least every five years and there was a decrease in the value of assets revalued during 2011/2012 of £71.0 million. The main reason for the significant change in asset value was due to a change in valuation methodology from the depreciated replacement cost method to the investment method to obtain existing use value. This new method resulted in a significant reduction in value for the Councils asset portfolio. Intangible assets are expenditure, which does not result in a tangible asset. Such as software and other licences.
19. A new category of asset has now been added to the Balance Sheet - Heritage Assets. Heritage assets are assets that are held by the Council principally for their contribution to knowledge or culture. The heritage assets held by Middlesbrough Council are the art, books & artefacts collections either exhibited or stored in the local museums or MIMA art gallery.
20. 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.

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21. Current Assets – the main items included within this heading are debtors i.e. money owed to the Council as at 31 March 2012 and short-term investments (money invested in other local authorities, a variety of banks and building societies). Short-term investments have reduced by £11.4m to £14.1 million mainly as a result of less available money to invest. The Council's cash and cash equivalents reduced by £3.3 million to £17.6 million as a result of the Council stopping using some of the counter parties used previously.
22. Current Liabilities – this is the amount of money owed by the Council to its suppliers and contractors, which totalled £44.1 million as at 31 March 2012 (£45.3 million as at 31 March 2011).
23. Long term Liabilities – this section is made up of several different items. Long-term borrowing and the value of the pension liability make up approximately 98.0% of the total. Long-term borrowing was increased by £10.3 million to £85.6 million during 2011/2012 as the Council arranged loans to fund road repairs and invest in housing renewal.
24. The Pension Liability increased to £199.5 million from £79.1 million at March 2011. This is due to 2 main reasons. Firstly, investment returns over the year were lower than assumed 0.5% per annum (compared to 6.8% per annum). Thus the value of assets were lower than expected. Secondly the value placed on the liabilities increased by more than assumed due to reduction in corporate bond yields, which is the discount rate that the accounting standard requires the actuaries to use. The lower the discount rate the higher the value placed on the liabilities. The discount rate reduced from 5.5% to 4.6%. A bit of a double whammy year with assets and liabilities going in opposite directions widening the gap. 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.
25. The Council used £1.1 million of Provisions, which it had set aside to deal with longer term liabilities including single status, Early Retirements/Voluntary Redundancies, dilapidation claims and Mouchel contract Residual Value of the ICT equipment & software. A full list of provisions is included in Appendix E.
26. 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 2012, and can be split between unusable and usable reserves as follows:
  - Useable 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. A full list is included in Appendix F.
  - Unusable Reserves - The unusable reserves are the Revaluation Reserve (£79.8 million) and the Capital Adjustment Account (£361.7 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.

27. **Movement in Reserves Statement - Appendix C.** This statement shows the movement in the year on the different reserves held by the Council, split into 'usable reserves' (i.e. those that can be applied to fund expenditure or reduce local taxation) and other reserves.
28. **Cash Flow Statement – Appendix D.** 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.
29. **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 Comprehensive Income and Expenditure Account under sources of finance.
30. **Teesside Pension Fund Accounts.** The year under review was a volatile one for markets globally as macro-economic factors dominated and hit business confidence levels. At the forefront of investor concerns were events in the Eurozone, with Greek economy collapsing and significant stress being felt in the much larger Spanish and Italian markets. Action by the European authorities initially failed to deal with the fundamental issue of the solvency of a number of European states. Forecasts for economic growth globally were under pressure as economists estimated the implications of the Eurozone crisis on global trade resulting in sharp falls in the Asian markets.
31. The financial performance of the Fund in the year to 31st March 2012 was again positive, the Fund's value increasing by 0.4% to £2,597 million. Although the market value of investments fell, this was more than offset by invest income
32. The membership of the Fund continues to increase, with total membership at the year end now standing at 62,962, an increase of 1,574 over last year. However the impact of the current depressed economic situation is shown by the fact that, for the fourth consecutive year. Over the last 5 years, the number of active members has fallen by almost 7.5%, the numbers of pensioners has increased by 25.4% and the number of deferred members has increased by almost 54.0%..
33. Where a member retires early there is a cost to the Fund arising from the fact that Contributions are no longer being received for the member, and a Pension is drawn earlier than the Actuary had assumed. It is the policy of the Fund to recharge the actuarial cost of these retirements to the employers. This policy has the advantage that the Fund recovers the cost of an early retirement at the outset. For the employer the advantages are;



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- the impact of retirement decisions is transparent
  - the cost is invoiced separately rather than being recovered in the employers Contribution Rate, which was once the case
34. In this financial year the Fund received over £5.5 million from these early retirement recharges, down on last years figure of £9.2 million, but still a significant amount.
35. Every three years the Fund actuary, Barnett Waddingham, carries out a full actuarial valuation of the Fund. The purpose of this is to calculate how much the employers in the scheme need to contribute going forward to ensure that the Fund's liabilities and the pensions due to current and future pensioners, will be covered. Unlike most other Public Sector schemes the Local Government Scheme is a funded scheme. This means there is a pool of investments, that produces income, which meets a significant part of the liabilities. The actuary calculates to what extent the Fund's assets meet its liabilities, this is presented as a Funding Level. The aim of the Fund is to be 100% funded. At the latest valuation the actuary was able to declare a funding level of 99%. This allowed many of the employers in the Fund to decrease the amount of their contribution for the next three years, releasing money for front-line services. The next valuation is due to be carried out in March 2013.
36. **Appendices:** 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 statement will be deposited within the Members Library. In addition a copy of the statements will be made available on the Council's Web site.

### External Review

37. The Statements will be subject to external audit - Deloitte, which will commence on 3rd July and is expected to be complete on the 31st August. A statement (ISA260) will be produced which details any unadjusted misstatements found during the course of the audit.
38. 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 CODE and IFRS.

### ROLE OF THE CORPORATE AFFAIRS COMMITTEE

39. The role of the Corporate Affairs Committee is to examine the accounts and in particular to consider the following:
- What were the key judgments made in preparation of this years accounts?
  - 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.

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40. The members of the committee also have a responsibility to challenge and be confident in the robustness of the overall financial position of the Council.
41. 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 can be improved in the future are therefore welcome.

### OPTION APPRAISAL/RISK ASSESSMENT

42. Risk:

| <b>Risk</b>   | <b>Category</b>      | <b>Implications</b>  |
|---|----------------------|--|
| The Council's accounts are significantly incorrect, incomplete or misstated and are "qualified" by the External auditor | Financial Reputation | Member's confidence in the finance service reduced.<br>External criticism.                                     |
| The Council's overall financial position is not robust.   | Financial Service    | The Council could not meet future financial challenges/<br>increases in service demands without imposing cuts. |

### FINANCIAL, LEGAL AND WARD IMPLICATIONS

43. 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.
44. 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 £506,000 (0.37%).
45. Actual capital spend in the year was £63.7 million, compared with a budget of £70.0 million. Expenditure during the year was mainly funded from grants (70.3%), from borrowing (22.8%), and from capital contributions (6.96%). The percentage of spend achieved compared to the budget represented 91.0%.

### RECOMMENDATIONS

46. It is recommended that Members of the Corporate Affairs Committee comment on the contents of the draft Statement of Accounts 2011/2012.

### REASONS

47. The purpose of the Statement of Accounts is to present the overall financial position of the Council at 31 March 2012 in accordance with guidance produced by CIPFA.

**BACKGROUND PAPERS**

48. The following papers were used in the preparation of the report: -
- Code of Practice on Local Authority Accounting in Great Britain and the Statutory Accounts and Audit Regulations (The Code)
  - Annual Governance Statement Report to Audit & Governance Committee 24th May 2011
  - 2011/2012 Outturn report to Executive on the 19<sup>th</sup> June 2012

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