Report to the Audit and Governance Committee

Epping Forest District Council

Report reference: AGC-010-2014/15
Date of meeting: 25 September 2014

Portfolio: **Finance.**

Subject: **Statutory Statement of Accounts 2013/14.**

Responsible Officer: **Bob Palmer** **(01992 564279)**

Democratic Services: **Gary Woodhall** **(01992 564470)**

Recommendations/Decisions Required:

(1) That the Statutory Statement of Accounts for 2013/14 be recommended to the Council for adoption.

Executive Summary:

One of the key roles of this Committee is scrutinising the annual Statutory Statement of Accounts. All Members of the Council will have the opportunity to debate the Accounts at Full Council and part of that debate will be to consider the recommendation of this Committee.

It is anticipated that the audit will be completed shortly and that the Statutory Statement of Accounts will be presented to Council on 30 September. There is a separate report elsewhere on the agenda that sets out the key findings of the audit.

The most substantial changes to the annual Statutory Statement of Accounts for 2013/14 arise from the implementation at the start of the year of the local retention of non-domestic rates. This was a significant change to the way local authorities are financed as the Government wanted to provide an incentive for economic development.

To assist Members with their consideration of the Accounts a report follows together with the Accounts themselves.

Reasons for Proposed Decision:

It is important that this Committee scrutinises the annual Statutory Statement of Accounts so that residents and other Members can have confidence in the Accounts.

Officers have exercised their professional judgement and liaised closely with external experts and the External Auditor to produce the Statutory Statement of Accounts. If Members are satisfied with the content of this report and the verbal responses to any questions raised, they are requested to recommend the Statutory Statement of Accounts for adoption by Full Council on 30 September.

Other Options for Action:

The Committee could decide that the accounts should be amended or expanded prior to them being presented to Full Council.

Report:

1. The Accounts and Audit Regulations require Full Council or an Executive Committee

to adopt the Council's Statement of Accounts before the end of September. The Council's constitution reserves the adoption of the Accounts to Full Council only. However, prior to Council considering the accounts it is important that they have been subject to Member scrutiny. This Committee has scrutinised the Statement of Accounts for several years.

2. The consideration of the Statement of Accounts is contained in the Terms of Reference of this Committee, the relevant parts being:

> *"(h) To review financial statements, including the Council's Statement of Accounts, External Auditor's opinion and reports to members, and monitor management action in response to the issues raised by External Audit.*
>
> *(i) Review, and challenge where necessary, the actions and judgements of Management, in relation to the Council's Statement of Accounts, paying particular attention to:*
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> > *(i) critical accounting policies and practices, and any changes to them;*
> >
> > *(ii) decisions requiring a major element of judgement;*
> >
> > *(iii) the extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed;*
> >
> > *(iv) significant adjustments resulting from the audit; and*
> >
> > *(v) any material weakness in internal control reported by the Internal or External Auditor."*

<u>Changes to the Contents of the Statutory Statement for 2013/14</u>

3. Before 2013/14 local authorities acted as the billing and collection agents for non-domestic rates and paid the amount collected in to the National Pool. Part of the funding for local authorities was deemed to come from the National Pool but this amount could not be increased by additional bills being raised or improved collection rates. There was no direct financial incentive to local authorities to engage in economic development to try and grow the rating list. This concerned central government as if a piece of land could be used for either domestic or business purposes it was felt that a local authority would favour a domestic use to benefit from income due under the New Homes Bonus.

4. From 2013/14 local retention of business rates was introduced and this meant local authorities could now increase their financing through keeping a share of any growth in the rating list. The potential downside to this is where the rating list shrinks, for example due to the closure of a major employer, although the new system does have a safety net mechanism to assist authorities suffering large reductions.

5. In theory the non-domestic rates arising in an area are shared with 50% going to central government, 40% the billing authority, 9% the county council and 1% the fire authority. However, the overall funding formulas contain an amount for the billing authority that comes from non-domestic rates and this limits the amount that can initially be retained. If an authority has less non-domestic rate income than is included in the funding formula it receives top-up payments and if an authority has more non-domestic rate income than is included in the formula it has to pay the excess as a tariff to central government. As the non-domestic rates income for the district is far higher than the amount in the funding formula we pay a tariff of nearly £10 million and retain an amount which is much closer to 10% than 40%.

6. The amounts in the formulas are fixed until 2020 and only meant to be changed annually to match movements in the Retail Prices Index. This fixing creates the opportunity to increase funding through growing the non-domestic rates list.

7. Other issues around local retention of non-domestic rates will be covered later in the report but for this section it is sufficient to note the changes to the Collection Fund and its associated notes.

8. Last year it was noted here that an additional note had been included for Assets Held for Sale. The note related to a Housing Revenue Account property known as Leader Lodge.

9. When compiling the accounts for 2012/13 it had been anticipated that the property would be sold for £515,000. However, the sale then fell through before the accounts were signed off. Subsequently, an unconditional offer has now been received of £652,000.

10. For 2013/14, Assets Held for Sale also includes the former car park site at Church Hill Loughton. This site was sold in May 2014 for £858,000.

Critical Accounting Policies and Practices, and Any Changes to Them

11. There have been no significant changes in accounting policies and practices during the year. The accounting policies are set out on pages 9 to 18 of the Accounts.

Decisions requiring a Major Element of Judgement

12. In preparing a set of accounts at a point in time it is inevitable that some of the information required will not yet be available. If an actual amount is uncertain an estimate is used. The estimate will be based on the assessment of information available at the time the accounts are closed. When the actual figures are determined any difference is usually accounted for in the following year. If the estimate was wrong by a material amount it would be necessary to consider re-stating the figures, this is extremely rare.

13. Two of the additional notes introduced by International Financial Reporting Standards are relevant here, note 3 "Critical judgements in applying accounting policies" and note 4 "Assumptions made about the future and other major sources of estimation uncertainty". The key critical judgement highlighted in note 3 is that the Council does not currently need to close facilities or significantly reduce levels of service provision. If this were not the case it would be necessary to consider any assets that would be affected and any consequent impairment of their values.

14. Three areas are covered by note 4, these are firstly property, plant and equipment, secondly pensions liability and finally arrears. The assumption made on property, plant and equipment is that assets will continue to be maintained so as to maximize their useful lives. If this were not to be the case additional depreciation would need to be charged. In reviewing arrears an estimate has to be made to allow for bad debts and, whilst a prudent view is taken in making this calculation, if the economic climate were to worsen significantly the charge to the Comprehensive Income and Expenditure Statement would increase.

15. The substantial annual fluctuations in the pension's liability make clear the element of judgement exercised by the actuary in establishing the pension figures. The largest creditor on the Balance Sheet is the Council's liability to the pension fund. The Balance Sheet shows that the pension liability for the Council has decreased in the year from £75.4 million to £57.8 million. This reduction in the deficit is due to a £6.7 million increase in the value of the scheme assets and a reduction of £10.9 million in the projected liabilities.

16. Given the size of the reduction in the deficit, the administering authority (Essex County Council) was asked to obtain additional explanations from the scheme actuaries. The actuary has responded that the £18 million improvement can broadly be split between three factors:

(a) £4 million financial – due to a small increase in the real discount rate;

(b) £11 million demographics – the assumptions about rates of withdrawal, death in service and ill health retirement have been aligned with those used by the Government Actuary. Slightly later retirement ages have also been assumed, as many workers are now continuing their employment beyond 65; and

(c) £3 million experience – since the 2010 valuation actual ill health retirements, withdrawals and mortality have been more favourable than had been assumed.

17. The figures shown in the table below have been amended from those that the accounts were initially based on. During the course of the audit it emerged that the investment return had been understated and that the deficit was £0.5 million lower than we were originally advised. The table is included to illustrate how the overall deficit has changed over time. Further fluctuations are likely in subsequent years as it becomes clear how members of the pension scheme are responding to the change from a final salary scheme to a career average based scheme.

	2013/14 £'m	2012/13 £'m	2011/12 £'m	2010/11 £'m	2009/10 £'m
Liabilities	(159.5)	(170.4)	(150.8)	(130.1)	(139.2)
Assets	101.7	95.0	85.2	83.8	82.7
Deficit	(57.8)	(75.4)	(65.6)	(46.3)	(56.5)

18. The inclusion of this amount in the Balance Sheet shows the extent of the authority's liability if the pension fund was to close on 31 March 2014. It does not mean that this full liability will have to be paid over to the pension fund in the near future.

19. There is one other area in the Statement of Accounts to bring to Member's attention as having required a major element of judgement. Historically the values for non-domestic property have been updated every five years. If an occupier is unhappy with the valuation set by the Valuation Office Agency (VOA) they can appeal. Throughout the recession the number of appeals increased and the VOA was unable to keep up with the workload and process the appeals on a timely basis. This meant that when local retention came in there were a very large number of appeals outstanding, most of which related to the 2010 list but some went back to the 2005 list. Even though the appeals arose before the start of the new system, and central government had received the income from the bills being challenged, the liability for settling the outstanding appeals was given to local authorities.

20. The Collection Fund shows the inclusion for the first time of a Provision for Appeals of £1,486,000. This provision was calculated with the help of an external firm of rating experts who analysed each outstanding appeal and gave a projected value for settlement. These values have been closely monitored as cases have been settled and to date they have been proved prudent. Although it is important to include a note of caution here as there are still appeals outstanding on some of the largest non-domestic premises in the District.

21. Where it has been necessary to exercise judgement in the interpretation of the Code of Practice advice has been sought from CIPFA and staff have liaised closely with both the External Audit Manager and other Essex authorities.

<u>The Extent to which the Financial Statements are Affected by any Unusual Transactions in the Year and how they are Disclosed</u>

22. There are no transactions in 2013/14 that require separate disclosure as Exceptional Items. In 2012/13 the Council received a compensation payment of £100,000 and interest on that payment of £237,000. The size of the interest relative to the compensation illustrates the length of time this issue has been running for.

23. The amounts relate to a compulsory purchase order that took some land owned by the Council to construct the M25 in 1992. The case has been quite complex and has required the Council to prove good title to the land.

24. As the compensation relates to the disposal of a piece of land that amount has to be treated as a capital receipt. The interest has been treated as revenue income and as a one-off has been credited to the District Development Fund.

Significant Adjustments Resulting from the Audit

25. The first significant adjustment has been mentioned above, as the information originally provided by the actuary was incorrect. This resulted in the pension deficit initially being overstated by £0.5 million.

26. A significant adjustment has also arisen from an error in the accounting for income due as part of the local retention of business rates. As stated above, there is a “Safety Net” mechanism in the new system that protects authorities suffering a large shortfall in their non-domestic rate income. The draft accounts had assumed that the size of the appeals provision meant the authority would be due £170,000 of funding from the safety net. This was an error as we had only included non-domestic rate income in our calculation and there is a separate grant paid by the Government that also needs to be included. This grant is to compensate for late changes made to the overall system after it had been introduced. The inclusion of the grant means the authority will not receive any funding from the safety net.

27. Both of the adjustments detailed above have been corrected in the Statement of Accounts. The audit is still to be concluded and any further significant adjustments will be reported to this Committee.

Any Material Weakness in Internal Control Reported by the Internal or External Auditor

28. Neither the Internal nor External Auditor have reported any material weakness in internal controls. If any arise before the conclusion of the audit they will be reported to this Committee.

Resource Implications:

The Accounts set out the resource implications of the Authorities activities for 2013/14. The recommendation of the Accounts to Full Council does not in itself have any resource implications.

Legal and Governance Implications:

Full Council must approve the Accounts before the end of September and as part of the overall governance framework the Accounts should be subject to Member scrutiny prior to their approval.

Safer, Cleaner and Greener Implications:

There are no environmental implications.

Consultation Undertaken:

None.

Background Papers:

Reports on the revenue and capital outturns to the Finance & Performance management Cabinet Committee on 26 June 2014.

Impact Assessments:

There are no equalities or risk management impacts.