Appendix 1

Briefing Note for Members of Audit Committee

2014/15 Unaudited Statement of Accounts – highlights report

Introduction

This highlights report draws Audit Committee's attention to key disclosures reported in the 2014/15 unaudited Statement of Accounts.

The key financial statements that Members should be aware of are:

- The Explanatory Foreword on pages 2 to 12 which summarises the Council's financial performance against its revenue budget, the level of revenue reserves held by the Council at the of 2014/15, the level of capital investment in the year and how it has been financed, key events that have taken place during the year or are about to take place, and, finally, in the outlook section, the Council's financial prospects in the medium term
- The Balance Sheet on page 17 of the accounts which sets out the assets and liabilities of the Council at the end of 2014/15
- The Movement in Reserves Statement on page 16 of the accounts which sets out the change in the overall level of usable reserves (revenue and capital) available to support revenue spending and the capital programme in future years
- The Collection Fund on page 99 of the accounts which shows separately the surplus or deficit to be distributed or recovered relating to council tax and retained business rates

The Comprehensive Income and Expenditure Statement (CIES) on page 14 of the accounts and HRA on page 91 of the accounts show what the Council's financial performance would have been on an accounting basis under International Financial Reporting Standards, ie a deficit of £120.737m overall on the CIES and £2.437m surplus on the HRA.

This is very different to the revenue outturn reported on the basis on which local government is funded and which is used to determine the amount to be raised from council tax payers and rent payers, ie a net underspend of £0.520m on the General Fund including schools and a net increase in the HRA balance of £4.031m.

The Movement in Reserves Statement on page 16 provides a reconciliation of the deficit reported in the CIES on an accounting basis to the net change in the General Fund balance and HRA balance on a local government funding basis.

Key disclosures

Revenue Reserves

As shown in Note 37 on page 78 of the accounts, the Council had £119.99m of revenue reserves at 31 March 2015 compared to £70.845m the year before.

The increase is mainly due to earmarked reserves (General Fund and HRA) having risen by £44.565m from £36.622m at the end of 2013/14 to £81.187m at the end of 2014/15.

As can be seen in Note 2 on page 24 of the accounts, the increase in earmarked reserves mainly comprises £34.783m in respect of the MRP Adjustment Reserve and £8.457m in respect of the Transformation Reserve.

As explained in section 2.2 of the Explanatory Foreword on page 5 of the accounts, although the level of revenue reserves has increased substantially, most are earmarked for specific purposes or are ring-fenced for use by the HRA or schools.

As a consequence, the level of uncommitted General Fund reserves and balances available to safeguard the Council against potential financial risks is at a similar level to last year. The uncommitted balance of £11.27m represents 5.5% of the 2015/16 net revenue budget of £203.5m. This is a little higher than in previous years but is considered necessary in view of the ongoing financial challenge to the Council from further budget cuts (£41m over the three years 2016/17 to 2018/19), uncertainty about the impact of welfare reform, and, greater risks attached to major sources of income, as risk is transferred from central government to local government through localisation, most notably the impact of appeals on business rates income.

MRP Adjustment Reserve

As explained in the Explanatory Foreword on page 6 of the accounts, the MRP Adjustment Reserve was created as a result of a change to the profile of MRP charges to revenue relating to pre 2007/08 debt. This was prompted by an Inspection Report into Birmingham City Council published late last autumn which led the Council, in common with a number of local authorities, to examine various options for reviewing the calculation of its annual MRP charge.

The effect of using the revised profile is that a correction of £34.783m has been made to the amount of MRP charged on pre 2007/08 debt. However, this is not freely available, as it is needed to cover higher MRP charges that will arise under the revised profile in later years.

As a consequence, the £34.783m has been transferred into an MRP Adjustment Reserve.

The re-profiling of MRP charges has been facilitated by a change to the Council's accounting policy on MRP and methodology to be applied to determining MRP set out in the annual MRP statement, both of which are effective from 2014/15.

Further detail on these changes is contained in the annual report on treasury management which is also being presented to Audit Committee at its meeting today.

Transformation Reserve

In addition to re-profiling MRP relating to pre 2007/08 debt, approval has been given for uncommitted capital resources of £6.263m to replace existing borrowing in order to reduce the amount of MRP chargeable to revenue. This has generated £4.537m of revenue savings in 2014/15 with the balance of savings being achieved in 2015/16 and 2016/17. Further detail on this is contained in the annual report on treasury management.

The review of the treatment of PFI lifecycle costs identified that the Council has prepaid lifecycle expenditure of £2.180m in advance of the expenditure being incurred by the PFI provider and that a further £1.741m of expenditure that has been incurred is of a capital nature and has therefore been capitalised in accordance with proper practice. These two elements together have generated revenue savings of £3.921m in 2014/15.

Overall, the MRP saving of £4.537m and PFI lifecycle saving of £3.921m, has enabled £8.458m to be added to the transformation reserve to bring the overall balance on the reserve at the end of 2014/15 to £16.851m. This has been set aside to support the specific purpose of meeting the likely additional significant costs and potential liabilities of addressing the failings identified in OFSTED's inspection of Children's Services and wider Corporate Governance inspection at the earliest opportunity.

Child Sexual Exploitation claims

As disclosed in Note 36 on page 77 of the accounts, the Council is liaising with its insurers and taking expert legal advice to determine the extent to which the Council's insurance policies can be used to meet any liabilities arising from legal claims brought against the Council.

Accounting for Schools

The clarification provided in the Code on accounting for schools has not led to any change to the way in which local authority maintained schools are accounted for in the Council's accounts.

However, there continues to be a major impact from the effect of schools converting to academy status. The impact on the Council's 2014/15 Statement of Accounts from schools converting is summarised in section 6(a) of the Explanatory Foreword on page 10 of the accounts.

Pensions liability

As disclosed in Note 50 on page 89 of the accounts, the Pensions Liability, representing the Council's share of the estimated deficit on the South Yorkshire Local Government Pension scheme, has increased from £264.2m at the end of 2013/14 to £369.8m at the end of 2014/15.

This has largely arisen due to a change in the financial assumptions made by the actuary which have had the following estimated effect:

- Reduction in discount factor from 4.5% to 3.3% - Increase deficit by £300m
- Reduction in rate of inflation (CPI) from 2.4% to 2% - Reduce deficit by £100m
- Reduction in pay growth from 4.15% to 3.75% - reduce deficit by £20m
- Actuarial gain due to the actual return on the Scheme's assets exceeding the actuary's forecast – reduce deficit by £75m

As can be seen from the above, relatively small changes to these assumptions can have a major effect on the deficit.

Under normal accounting practice, the pensions deficit would form part of the Council's reserves. However, because the charges to revenue under local government funding rules are the employer contributions due to be paid over to South Yorkshire Pensions Authority in the year, the pensions deficit does not form part of Council's revenue reserves but is instead shown as unusable (see Note 38 on page 79 of the accounts). This means that that the deficit does not need to be taken into account in determining the amount to be met by council tax payers and rent payers. It does, however, give an indication of the size of the deficit which might ultimately need to be recovered in between the triennial valuations of the Pension scheme undertaken by the actuary.

Collection Fund – Business rates

The introduction of the business rates retention scheme in 2013/14, means that the Council now shares the risks and rewards of growth or reductions in business rates income with central government. The Council's share as billing authority is 49%, central government's is 50% with South Yorkshire Fire and Civil Defence Authority bearing the other 1%.

A major factor on the level of business rates income is the number and value of appeals made by business ratepayers against the rateable value of their business property. These appeals can, in some cases, be back-dated for several years and give rise to significant refunds.

At the time that the business rates retention scheme was introduced at the beginning of 2013/14 there was no reliable information on appeals on which to make a reliable estimate of the potential liability from refunds.

Since then, the Valuation Office, who are the government agency responsible for maintain the Rating List, have started to provide appeals data on a regular basis. This has enabled better estimates to be made of the potential liability.

At the end of 2014/15, the overall provision for appeals was £7.905m, the Council's 49% share of which was £3.874m as shown in Note 36 on page 76 of the accounts.

Whilst better appeals data now exists, the potential liability for refunds remains volatile, due to the unpredictable nature of what appeals might be lodged in the future, and uncertainty over the value at which outstanding appeals are ultimately settled. This should reduce over time as the Valuation Office clears the backlog of outstanding appeals and as a result of new regulations being introduced which prevent appeals lodged on or after 1 April 2015 being back-dated to 2014/15 or earlier.

The Collection Fund has been segmented to show separately, the surplus or deficit attributable to business rates from that attributable to council tax. Note 5 to the Collection Fund on page 101 of the accounts, shows that there is a deficit on business rates at the end of 2014/15 of £4.904m which has still to be recovered of which the Council's 49% share is £2.403m. This deficit arose in 2013/14 due the impact of appeals being underestimated in the absence of reliable appeals data.