LGA Leadership Board
06 June 2018

LGA Group Consolidated Financial Statements for the Year to 31 March 2018

Purpose of report

For decision.

Summary

The LGA Group consolidated financial statements for the year ended 31 March 2018 have been produced and are expected to receive an unqualified (clean) audit opinion by PKF Littlejohn LLP. The final draft of the financial statements is presented for the LGA Leadership Board to agree, prior to these being adopted at the General Assembly on 3 July 2018. The audited financial statements for IDeA, LGA (Properties) Ltd, LGMB Ltd and LGA Commercial Services Ltd are also presented for review, prior to these being presented for adoption to their respective company boards before the end of June 2018. These sets of accounts are all included at **Appendices A – E**. All appendices are included in a supplemental agenda pack.

The attached report substantially reproduces that going to Audit Committee on 4 June 2018 and the company boards. Members of the Audit Committee have been asked to review these accounts, and make any independent comment they consider appropriate to the Leadership Board or the relevant company boards. Due to timings, any such observations will be presented orally at the meeting.

Recommendations
That the LGA Leadership Board are asked to:

1. agree the LGA consolidated financial statements (**Appendix A**) and approve their submission for adoption at General Assembly on 3 July 2018;
2. review the financial statements for IDeA, LGMB, LGA(P) and LGA CS (**Appendices B – E**);
3. review the external auditors' report to the Leadership Board (**Appendix F**); and
4. approve the Representation Letter (**Appendix G**).

Action
As directed by Members

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Local Government Association

LGA Leadership Board
06 June 2018

LGA Consolidated Financial Statements for the Year to 31 March 2018

Background

1. The consolidated financial statements for 2017/18 cover the Local Government Association (“LGA”), the Improvement and Development Agency for Local Government (“IDeA”), Local Government Association (Properties) Ltd (“LGAP”), Local Government Management Board (“LGMB”), and the newly incorporated LGA Commercial Services Ltd (“LGACS”). The consolidated financial statements also disclose the position of the LGA as a stand-alone entity through the presentation of the Association’s Statement of Comprehensive Income and Balance Sheet.

2. All company accounts that feed into the LGA’s consolidated accounts are being reviewed by the Audit Committee on 4 June 2018 and will be adopted by the respective company boards in June 2018, to ensure that a fully verified set of accounts is presented to the General Assembly in July 2018 (after which the accounts will be filed and publicly available). The Leadership Board is therefore being asked to review the LGA consolidated accounts along with the accounts for IDeA, the two property companies and the commercial company included at **Appendices A – E**. All appendices are included in a supplemental agenda pack.

3. Representatives of PKF Littlejohn LLP, the appointed auditors, will be in attendance at the Leadership Board’s meeting. Their report on the audit of the LGA and all its associated companies is included at **Appendix F**.

4. The following paragraphs provide commentary on the information disclosed in the financial statements and highlight the most significant points.

5. Audit Committee will provide Leadership Board with a recommendation of whether to accept the LGA accounts. This will be received orally in the meeting, along with any observations. Members of the individual company boards will also receive a report of the observations of the Audit Committee.

LGA – Group – Appendix A

6. The consolidated accounts show the LGA and its related bodies made an operating surplus of £14.498m (£1.019m in 2016/17). The Balance Sheet net Liability decreased from £71.247m in 2016/17 to £45.378m in 2017/18. The key factors are set out below:

Income

7. Overall income increased by 4.9 per cent from £55.732m to £58.465m despite a modest £0.4m reduction in Government Grants and Subscription Income remaining steady, due to the success in securing increased income from other grants and higher investment/joint venture incomes.

8. The LGA's GeoPlace LLP Joint Venture made another useful contribution to other income during 2017/18, making a dividend payment of £1.625m (2016/17 £1.375m).

Investment Properties / Fixed Assets

9. For Investment Properties, the accounting position is more complex than usual this year. Accounting standard FRS102 requires the LGA consolidated accounts to split the accounting of 18 Smith Square into the element that shows the percentage of the asset which is used by non-group bodies as an Investment Property (calculated at open market values), with the remainder which is 'own-usage' to be shown as Tangible Fixed Assets (calculated at cost). The complication in 2017/18 is that now that 18 Smith Square has been redeveloped to accommodate more tenants, the proportion that is 'own-usage' has dropped from the 89 per cent used in prior years (when there was limited 3rd party use), to 66% as at 31 March 2018 reflecting the current availability of three floors.

10. This reduction in percentage own-occupancy has resulted in the accounting oddity of a 'deemed disposal' (ie we own less than we used to) resulting in an accounting 'loss on disposal' of £4.3m, which is included in our Administrative Expenses in the Statement of Comprehensive Income. This 'loss' is more than offset by the increase in investment values (see below), but has the unfortunate effect of appearing to show a much larger 'Operating Deficit before Interest and Tax' on the face of the Statement of Comprehensive Income. Without this accounting adjustment, the result for 2017/18 would be much more comparable with 2016/17, and demonstrates our ongoing balanced accounting approach overall of showing a slight 'operating deficit' which is then offset by other sources of income such as dividends and interest.

11. Both Investment Properties have increased in value in the year.

    11.1. Layden House (LGMB) value has increased by £8.575m from £28.175m in 2016/17 to £36.750m in 2017/18, despite the building being unoccupied at the year end as we start the redevelopment. This indicates the strength of the location of the building and the surrounding market prices, which are still rising. 100% of this gain in value is included in the LGA consolidated accounts.

    11.2. 18 Smith Square (LGA(P)) value has risen more dramatically, from £22.970 in 2016/17 to £53.550m in 2017/18. As noted above, under the accounting rules, only 34 per cent of this revaluation gain is recognised in the LGA consolidated accounts.

11.3. It should be noted that in 2016/17, the value was for the stripped back shell as the building was being redeveloped. The current valuation is still significantly higher than the pre-development value of c.£36m plus the cost of development of c.£13m, so the investment has resulted in both c.£5m capital appreciation plus the potential for higher rental incomes over the coming years (moving from c.£35psf previously to the current £57.50psf), justifying the investment decision.

Pension Scheme

12. The overall pension fund deficit reported in the accounts has decreased by £9.491m (2016/17 increase of £30.240m) from £124.991m to £115.500m. The overall Statement of Comprehensive Income for the year shows separately the gains and losses that relate to changes in the actuarial assumptions used to calculate pension scheme assets and liabilities (2017/18 £11.639m gain, 2016/17 29.230m loss) with the ongoing payroll contributions and excess contributions made to reduce historic deficits included within Administrative expenses.

13. In line with FRS 17 accounting standards, the valuation in the accounts values assets at market value on 31 March 2017, and liabilities using a discount rate based on the return available on AA corporate bonds, also at the balance sheet date. This valuation is therefore subject to market performance on a specific date and will vary by Scheme. The Pension Scheme Assets have grown in the year by c.£7.6m (2.7%) through investment performance, while the Liabilities have fallen in the year by c.£1.8m, due to increased obligations and interest (£8.8m) being more than offset by actuarial gains (£10.2m – 2016/17 £71m adverse variance) in the year arising from adjusting the assumptions (discount rate, salary growth, demographic changes, etc.) used by the actuaries in their valuations as a result of market conditions and scheme memberships respectively.

Reserves and Notes to the Accounts

14. Finally as agreed in the LGA's three year Financial strategy, the surpluses on the General Reserve created by the LGA and IDEA operations have been combined with the operating deficits for LGAP, LGMB and LGACS with the net deficit of £2.617m being drawn down from the Risk and Contingency Reserve created a few years ago. The Reserve was created in line with the commercial strategy, to provide cash resources to fund developments in future years that provide opportunities to save costs or generate additional commercial income, fund external loan repayments, and also to cover the potential risks to the LGA medium term plan (such as increased pension deficit payments, and reduced rental income as the buildings were developed). This net adjustment is shown on the new Statement of Changes in Equity.

15. Notes – Post Balance Sheet Events. There have been two significant events that occurred in the period after the Balance sheet date of 31 March 2018 that require consideration for disclosure:

15.1. Insurance Mutual – the Insurance Mutual (LGAM Ltd) was incorporated, and a joint venture created in LGACS (see section below) to bid for its administrative services.

15.2. Westminster City Council (WCC) loan – a loan of £20m is currently still in negotiation with WCC to help fund the further developments of our investment properties (the WCC loan is backed by the first Bond being issued by the Municipal Bonds Agency). We now no longer intend to complete the transaction before the statutory accounts are signed off by Leadership Board on 6 June 2018, so there is no separate disclosure included, or required.

IDeA – Appendix B

16. IDeA made an operating surplus after interest of £1.201m in 2016/17 (£2.993m 2016/17). The main causes of the modest trading surplus are:
    16.1. Contributions to overheads from ring-fenced activities - £0.795m;
    16.2. Dividend income arising from GeoPlace LLP - £1.625m;
    16.3. Current year cost adjustment of £1.366m required to account for the pension scheme deficit in accordance with accounting standards. Note this is deducted from the £5.496m debit to the Pension Deficit Reserve arising from an actuarial gain from our pension funds this year (see below);
    16.4. Savings in Workforce, Leadership and Productivity - £0.396m netted off against overspend in Finance and Policy - £0.20m and Corporate Services - £0.397m; and
    16.5. Interest due from inter-group lending in relation to the property developments - £0.348m.

17. IDeA's pension deficit with the Camden Pension Scheme has decreased by net £4.130m (£26.904m net increase 2016/17) as at 31 March 2018. In 2016/17 there was a dramatic adverse change in the actuarial assumptions used (primarily driven by a sharply rising Discount rate which meant more money would be needed to pay future benefits). In 2017/18 there were fewer changes to the actuarial assumptions, but including a small favourable shift in pay-growth assumptions which resulted in a lower expected liability.

18. Overall, income increased from £34.610m to £36.836m. This was mainly due to additional ad hoc grant awards more than offsetting the continued reduction in the central government grant.

Local Government Management Board – Appendix C

19. LGMB owns the freehold of Layden House. As part of the overall LGA Strategic Plan, the building was used by LGA Group companies until October 2018, at which point those tenants decanted to the recently refurbished head office at 18 Smith Square.

20. The company's turnover of £0.547 million (2016/17 £0.394 million) comprises rent, rates and service charges received from the LGA, the Improvement and Development Agency for Local Government (IDeA) and a number of third party tenants. As at 31 March 2018, the building was empty and awaiting refurbishment.

21. The company's net operating Income of £6.853 million (2016/17 £1.164 million net Income) arises from the net costs from running the property of £0.954 million (2016/17 £0.860 million), £0.072 million tax (2016/17 £nil) and £7.878 million gain (2016/17 £2.024 million gain) from the latest revaluation of the property at £36.750 million (2016/17 £28.175 million), despite the building being unoccupied at the year end.

22. The refurbishment of Layden House in 2018/19 and 2019/20 should increase both the capital value of the building and its income base.

LGA (Properties) Ltd – Appendix D

23. LGA(P) owns the freehold of 18 Smith Square (formerly known as Local Government House). The building has been the subject of significant investment via a total refurbishment programme started during 2016/17 and completed during 2017/18, such that the building was only available for occupation by tenants from October 2017.

24. The company's turnover of £0.801 million (2016/17 £0.532 million) comprises rent, rates and service charges received from the LGA, the IDeA and a number of third party tenants. As at 31 March 2018, there were two floors of 18 Smith Square unlet.

25. The operating surplus after interest of £18.511 million (2016/17 £16.517 million loss) is mainly driven by the FRS102 recognition at the year end of in-year gains in the value of 18 Smith Square of £18.954 million (2016/17 in-year loss of £14.904 million as the building was in a "stripped back state" during refurbishment).

LGA Commercial Services Ltd – Appendix E

26. LGACS was incorporated on 02 October 2017 as an investment-holding vehicle for the LGA Group. The first investment is the joint venture (JV) with Regis Mutual Management Ltd (RMML) – incorporated on 02 May 2018 and noted as a Post Balance Sheet Event - to bid for the administration services of the Insurance Mutual.

27. The first reporting period for the company is for the six months to 31 March 2018. The company's net operating loss of £424k is entirely start-up costs for the joint venture. It is expected that this initial investment will be recovered from future management fees earned by the JV. A parent company guarantee by the LGA has allowed a "going concern" opinion to be made by the auditors.

Audit opinion – Appendix F

28. A representative of the auditors will be in attendance at the meeting. As part of the audit process, the auditors' report to the Leadership Board with their observations on the audit. A copy of the final draft of this report (the ISA 260 communication) is presented to the Committee at **Appendix F**. This comments on the differences in figures that resulted in adjustments during the audit, on departures from generally accepted accounting practice and on recommendations for improvement of our financial management and reporting.

29. The auditors note (Page 3) that at the time of writing, one item of evidence is outstanding for the LGA Group companies (bank confirmations from Barclays Bank Plc). These are actively being chased and should be in place shortly.

30. The report comments (Page 15) on one matter in which the accounts do not comply with generally accepted accounting practice – there is no separate detailed information on pension scheme assets and liabilities relating to the LGA only. This is consistent with prior years. The view of the Strategic Finance Manager is that further lengthening of the pension disclosure information would add complexity without significantly increasing the reader's understanding. The auditors' view is that this element of non-compliance would not prevent them from giving an unqualified 'true and fair view' audit opinion.

31. The report sets out in detail (Section 4 – Control environment) a number of matters that arose in the course of the audit, with suggestions for improvements in the controls and procedures operated by each entity.

Representations - Appendix G

32. The Chairman on behalf of the LGA Leadership Board is required to make various representations to the auditors that all matters relevant to the accounts have been properly disclosed (draft letter is included at **Appendix G**).

33. As well as seeking general representations on matters such as the completeness of the information supplied for audit and the appropriateness of the accounting policies and accounting estimates used, the auditors will be seeking a number of specific representations.

Recommendation

34. Members are asked to:
    - 34.1. agree the LGA consolidated financial statements (**Appendix A**) and approve their submission for adoption at General Assembly on 3 July 2018;
    - 34.2. review the financial statements for IDeA, LGMB, LGA(P) and LGA CS (**Appendices B – E**);
    - 34.3. review the external auditors' report to the Leadership Board (**Appendix F**); and
    - 34.4. approve the Representation Letter (**Appendix G**).