North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 1 DECEMBER 2016

SUBJECT OF REPORT: UPDATE ON THE ANNUAL ACCOUNTS

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: MALCOLM COE, HEAD OF FINANCE AND PROPERTY

KEY DECISION: NO

RECOMMENDATIONS

1. The Audit Committee are requested to note the following:

   a. the requirements of 'faster closing' for the annual accounts process and the impact on the proposed timetable for 2016/17;
   b. the future implications of 'faster closing' for the Audit Committee and Council in 2018 and beyond;
   c. the changes within the CIPFA Code of Practice which will impact on the financial statements for 2016/17;
   d. the update with regards to the introduction of the Highways Network Asset Code of Practice and its impact on the financial statements.

2. That subject to any comments under 1 above, the Audit Committee:

   a. notes the change in legislation which will require the council to certify and publish its draft annual accounts by 31 May each year, this being one month earlier than currently required, and for them to be audited and published by the 31 July each year, which is two months earlier than present arrangements;
   b. notes the proposed timetable with regards to the 2016/17 financial year;
   c. supports further discussion with the Executive that the Council's Constitution should be updated to delegate approval of the annual Statement of Accounts to the Audit Committee with effect from 2016/17, i.e. September 2017.

1. SUMMARY OF REPORT

The purpose of the report is to provide Members with an update of the issues which impact on the annual accounts process, although giving due regard to those items which directly affect the 2016/17 Statement of Accounts. These include faster closing, presentational changes and also Highways Network Assets (now deferred – see para 3.3.8).

2. POLICY

Members will be aware that local authorities in the United Kingdom are required to prepare their accounts in accordance with primary legislation, e.g. the Accounts and Audit Regulations 2015 as well as ‘proper (accounting) practices’, meaning compliance with the terms of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

The Code specifies the principles and practices of accounting required to prepare a Statement of Accounts which gives a true and fair view of the financial position and transactions of a local authority. The Code is updated annually and introduces new, or amended, accounting standards or reporting requirements which will need to be complied with.

3. DETAILS

3.1. Faster Closing

3.1.1 On 17 February 2015 the Accounts and Audit Regulations 2015 were laid before Parliament. One of the changes contained within these Regulations relates to the timing for local authorities to publish and approve their annual accounts.

The current timescales require the Chief Financial Officer to certify and publish the draft accounts by 30 June, and to audit and publish the approved accounts by the 30 September each year. Members will be aware that these are already challenging timescales to achieve and involve contributions from officers all across the council as well as external and partner organisations.

3.1.2 The new Regulations formally apply to the annual accounts for the 2017/18 financial year and will mean that the deadline for the Chief Financial Officer to certify and publish the draft accounts will be brought forward to 31 May 2018, and the audited and approved accounts will need to be published by the earlier deadline of 31 July 2018.

The Government believes that this change will reduce the burden of the closure process, enabling finance staff to give more time to focus upon in-year financial management pressures as well as developing forward-looking financial plans for the future. It will also improve transparency and accountability by increasing public interest in local government accounts, particularly when combined with simplified accounting statements.

Other benefits include;

- raising the profile of the finance function and changing its role from simply a back office function to a key enabler of change and improvement across the organisation,
- more timely financial reporting internally and to stakeholders,
- more rigorous in-year monitoring providing greater certainty of the final financial position,
- improved financial controls and accounting systems as a result of refining processes and also de-cluttered and better quality financial statements

3.1.3 Whilst it is recognised that the Regulations apply to the 2017/18 accounts, the council is proposing to move closer to the new timeframe with its preparation of the accounts for the 2016/17 financial year, a year ahead of the legal requirement.

The financial management team has therefore developed a closure of accounts timetable which brings forward the date at which the draft 2016/17 accounts will be published. It is proposed that these draft accounts will be prepared by the 31 May 2017, with certification and publication by Chief Financial Officer by 6 June 2017; the formal approval and publication will be brought forward to 7 September 2017.

It is anticipated that these accounts will be used as a dry run in readiness for the following year when the timetable will need to be pulled forward by a further 7 days in order to achieve the statutory deadline. The aim of the dry-run is to establish where the pinch points / blockages are so these can be improved upon or eliminated in the following year.

3.1.4 There are many issues to consider as a result of this change, some of the most important include;

- Detailed planning and communication with all relevant stakeholders, both internal and external to ensure they are aware of the impact on them
- Practical delivery to achieve the same outputs within a shorter timescale which could require additional resources, increase reliance on key staff and / or also impact on their ability to deliver other council priorities during this period
- Potential changes to current tasks, operational processes and report writing
- Anticipated increase in the use of estimation and assumptions within the accounts rather than reliance on actual values
- Potential increase in the materiality value applied to accruals and / or stricter controls regarding its application
- Potential changes to the municipal calendar and approver of the accounts
- Potential increase in the amount of items included by the auditors within the ISA260 report

3.1.5 Detailed planning has been undertaken and an initial assessment made regarding the impact on the council's staffing resources. At this time it is anticipated that the timetable could be achieved without seeking additional resources, although this is dependent upon the increased flexibility of staff in some areas, it is proposed that this will be managed through the council's flexible working policy.

3.1.6 A review of current tasks and processes has been undertaken to remove any duplication of effort, ensure that the working papers are as efficient as they can be and also prepared in advance where possible.

3.1.7 Currently the annual accounts are considered in detail by the Audit Committee, and are then referred onto Council with a recommendation for their approval. This is unusual in Local Government where almost all Audit Committee's retain delegated authority to approve the accounts. Therefore due to meeting dates this process is often compressed towards the end of September, which is only just before the statutory deadline. In order to achieve compliance with the much shorter revised statutory deadline in the future it is proposed that the annual accounts are approved by the Audit Committee following their detailed review, rather than the additional referral onto Council. If supported by the Audit Committee this change will need further discussion with the Executive before a recommendation is formally agreed for approval by Council.

It is anticipated that the change could be implemented in time for the 2016/17 accounts and would mean that the audited accounts would be considered for approval by Audit Committee at their meeting on 7 September 2017. It will be necessary to amend the Audit Committee dates in 2018 in order to ensure that they are approved before the end of July.

3.1.8 Members should be aware that in future years it may become necessary to include a larger proportion of estimates or assumption within the draft accounts. Whilst these estimates will be prepared as robustly as possible, it is possible that when the actuals appear within the accounts they will be different to the estimates and this may result in an increase in the amount of findings included within the ISA260 (Audit findings) report, and may also potentially require amendments to the accounts before they are formally approved.

It is important that Members recognise that there is an obvious tension in the accuracy of the draft accounts as a result of these reduced timescales and different working practices. It is anticipated that in future the reporting outputs and associated messaging on the draft accounts by the external auditors could be different as a result of this change, and it will be important to identify which of their findings relate to 'errors and omissions;' as opposed to those which are the result of updated or improved information.

3.1.9 Grant Thornton have prepared a paper based on their experiences to date of working with clients who have successfully closed their accounts early and had their audit opinions issued by the end of July. The full document and Executive Summary can be found at http://www.grantthornton.co.uk/en/insights/advancing-closure-the-benefits-to-local-authorities/ and http://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/publication/2016/advancing-closure-report-summary.pdf respectively.

Some of the key messages in this document relate to early communications, getting total organisational buy-in and robust planning. In addition, authorities have met this challenge by reviewing processes, systems and resources to ensure achievement of the new statutory deadline.

3.2. Changes to the 2016/17 Code of Practice

3.2.1 The Code is updated annually to reflect new or updated accounting standards and in 2016/17 there are a number of significant changes, these being;

- new formats and reporting requirements for the Comprehensive Income and Expenditure Statement (CI&ES) and the Movement in Reserves Statement (MiRS)

- the introduction of the new Expenditure and Funding Analysis (EFA) note,
- new and amended disclosure requirements relating to the Pension Fund, and
- the introduction of Highways Network Assets requiring measurement at Depreciated Replacement Cost

3.2.2 From 2016/17 local authorities will be required to report their CI&ES based on the way they operate, structure and manage their services. This will mean that the service section of the CI&ES supports current accountability and responsibility areas and will be more meaningful as it will follow the format of council's own budget and performance monitoring information and other key documents.

3.2.3 The MiRS is being "streamlined" so that ear-marked reserves will not show separately but will be incorporated within relevant overarching balances to which they relate.

3.2.4 The new EFA note is intended to provide a clear link between in-year monitoring and General Fund information and the final out-turn position as set out in the audited financial statements. The EFA brings together local authority performance reported on the basis of expenditure measured under proper accounting practices with statutorily defined charges to the General Fund. The EFA therefore provides an opportunity to explain significant differences closing the accountability loop from budgets through to out-turn.

3.2.5 There are also requirements for additional and amended disclosures relating to the Pension Fund. These include new disclosure requirements for retirement benefit plan investments measured at fair value and recommendations for a new disclosure on investment management transaction costs

3.2.6 The 2016/17 Code includes a separate section on Highways Network Assets and their inclusion in the accounts at Depreciated Replacement Cost and this is explained in further detail below.

3.3. Highways Network Assets

3.3.1 A significant change included within the 2016/17 Code includes the move to measure local authority highways networks at Depreciated Replacement Costs (DRC) instead of historical cost. CIPFA has been keen to ensure that the Highways Network Asset (HNA) is reflected at the true economic value as it is such a valuable asset.

The definition of the Highways Network Asset says that is a *network and grouping of interconnected components, expenditure on which is only recoverable by continued use of the asset created*, i.e. there is no prospect of sale or alternative use.

This interconnected network is made up of carriageways, footways and cycle ways and the structures, street lighting and other assets that are directly associated with them.

The Code proposed that the new accounting policies would be applied from 1 April 2016, with no requirement to restate the information in the preceding year.

3.3.2 Within the councils 2015/16 accounts infrastructure assets (i.e. highways, footways, bridges etc) are included within Property, Plant and Equipment on the balance sheet using a depreciated historical cost basis.

Under the new system the council will need to recognise a new asset category on the balance sheet, the Highways Network Asset, and these values will be disclosed separately in the notes to the accounts. This will consist of seven components: carriageways, footways and cycle tracks, structures, street lighting, street furniture, traffic management systems and land.

3.3.3 The change in valuation from depreciated historical cost to depreciated replacement cost will have a significant impact on the council's balance sheet. The current method of valuation does not take into account the condition of the asset or how far it matches spending need.

Depreciated replacement cost (or DRC) is defined as the current cost of replacing an asset with its modern equivalent asset, less deductions for all physical deterioration and all relevant forms of obsolescence and optimisation. Therefore the new method does take into account the condition of the asset and how far it matches the spending need.

3.3.4 The highways network represents by far the biggest value asset that the authority holds. Based on the Whole of Government Account figures published for 2014/15, the gross replacement cost (or GRC) of the highways network for North Somerset Council would increase from £149m to £3,370m if these changes had been applied. This will result in a significant revaluation gain. Similarly the increase across all of the UK public sector is estimated to be approximately £1 trillion.

3.3.5 Since the start of 2016 work has been undertaken to verify carriageway lengths including the addition of new adoptions in 2015/16. Similarly structures, street lighting and traffic management have been updating their inventories and condition factors which are used to produce GRC and DRC figures.

3.3.6 As well as the identification and verification of assets, a key component part in determining the associated values of these HNA assets are the centrally provided GRC rates, which will be used to apply to the council's own metrics of road length etc. Clearly these rates are of significant importance as they will be used to underpin the values used within all local authority accounts, and as such are being subjected to a range of central assurance processes to confirm their accuracy at the start of the process, rather than these assurance tests be carried out at a local level by all individual authorities.

3.3.7 Effective implementation will require highway engineers and finance staff to work closely together to ensure that financial information is timely, consistent and of high quality to meet the needs of both. Regular meetings are in place between financial management and highways to monitor progress, discuss issues and provide support.

3.3.8 For the last eighteen months CIPFA has been working with the relevant stakeholders, including the Department for Transport, to ensure that the review of the central rates for the measurement of the HNA would be ready for the 2016/17 implementation date. New rates are critical to implementation given the time frame since the last rates were produced, they were originally developed at the start of the CIPFA project and are now over five years old.

Unfortunately, despite best efforts, CIPFA has recently advised that it has become clear that these rates will not be ready in good time for the 2016/17 financial statements and as a result **they have taken the decision to defer implementation and will review the position with a view to implementation in 2017/18.**

The impact of this recent decision means that the council will now have more time to complete its asset validation processes as this work will still be required.

4. CONSULTATION

None.

5. FINANCIAL IMPLICATIONS

The council's statement of accounts are a key requirement of its operational responsibilities and are their accuracy and adherence to legislation are important to ensure the Chief Financial Officer can discharge the statutory obligations.

6. RISK MANAGEMENT

Failure to comply with the faster close statutory requirement in 2017/18 would result in non-compliance of Statutory Legislation and leave the council open to criticism by external audit. The changes required to achieve faster close take time to develop, implement and embed to ensure that the right systems and processes are in place and that officers have the capacity and skills to make the change a reality. To facilitate this change takes leadership and oversight from senior finance officers and elected members and buy-in from officers across the organisation.

7. EQUALITY IMPLICATIONS

None

8. CORPORATE IMPLICATIONS

None. The CIPFA Code of Practice determines accounting requirements and treatments.

9. OPTIONS CONSIDERED

None.

AUTHOR

Malcolm Coe, Head of Finance and Property Tel: 01934 634619
malcolm.coe@n-somerset.gov.uk

Melanie Watts, Head of Corporate Accountancy Tel: 01934 634618
melanie.watts@n-somerset.gov.uk

Kathryn Morris, Closure & Control Accountant Tel: 01275 884037 kathryn.morris@n-somerset.gov.uk

BACKGROUND PAPERS

Grant Thornton "Advancing Closure : transforming the financial reporting of local authority accounts" (Advancing closure: the benefits to local authorities)

APPENDICES

App **A** Proposed Timetable

Task	Target Completion Date
Revenue Position Closed	03-May-17
Capital Position Closed	10-May-17
Provisional Outturn Reporting to Members	12-May-17
Core Statements Complete	23-May-17
Notes to the Accounts Prepared	25-May-17
First Draft of Statement of Accounts	31-May-17
Working Paper Review Completed	05-Jun-17
S151 Sign Off of Draft Statement of Accounts	06-Jun-17
Accounts and Working Papers Handed Over to Audit	07-Jun-17
Approval of Final audited Accounts by Audit Committee	07-Sep-17
Publication of Final Approved Accounts	08-Sep-17