North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 7 DECEMBER 2017

SUBJECT OF REPORT: UPDATE ON THE ANNUAL ACCOUNTS

TOWN OR PARISH: ALL

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

KEY DECISION: NO

RECOMMENDATIONS

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

   a) the requirements of ‘faster closing’ for the annual accounts process and the impact on the proposed timetable for 2017/18, which will require a change to the date of the Audit Committee meeting in the Forward Plan for the next municipal year to late July, to allow approval of the audited statement of accounts;

   b) the changes within the CIPFA Code of Practice which will impact on the financial statements for 2017/18;

   c) the Council’s annual review of accounting policies;

   d) the potential future change of accounting policy for the treatment of library books as inventory from 1 April 2018;

   e) the requirement for the Council’s accounts to provide a ‘true and fair’ view of the Council’s financial position and transactions, and the Council’s concept of materiality;

   f) proposals for the assessment of materiality limits to be applied by officers in drawing up the Council’s statement of accounts, in order to continue the process of ‘de-cluttering’ the accounts, and hence focusing the accounts on key messages;

   g) the proposed changes to the format of the statement of accounts

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

   a) the Council’s library of accounting policies, as set out in Appendix A;

   b) the basis of the assessment of materiality for the preparation of the Council’s statement of accounts, as set out in the report.

1. SUMMARY OF REPORT

The purpose of this report is to provide Members with an update of the issues which impact on the annual accounts process. These include faster closing, changes to the Code, and proposed changes to 'de-clutter' the accounts in line with best practice.

The report also provides Members with a reminder of the concept of materiality, and requests formal approval of the assessment of materiality for the preparation of the Council's future statement of accounts.

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. UPDATE ON THE ANNUAL ACCOUNTS

3.1 Faster closing

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.

Members will recall that previous year's timescales required 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 were already challenging timescales to achieve, and involved contributions from officers all across the Council, as well as external and partner organisations.

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

The financial management team has therefore developed a closure of accounts timetable which brings forward the date at which the draft 2017/18 accounts will be published. It is proposed that the draft accounts will be prepared by the 30 May 2018, to allow certification and publication by Chief Financial Officer by 31 May 2018.

It is important to note that it will be necessary to bring forward the Audit Committee date for the meeting to approve the Council's accounts from September 2018 in to July 2018, in order to allow the external auditors to provide their opinion on the accounts, and for the accounts to be published, before the end of July.

The Committee is therefore requested to incorporate a change to the proposed the Forward Plan for the next municipal year which will set the date of an Audit committee meeting in late July in order to allow approval of the audited statement of accounts.

Members will be aware that in 2016/17 officers aimed to prepare the draft accounts by the 31 May 2017, with certification and publication by Chief Financial Officer by 6 June 2017. Hence the accounts closure timetable will need to be pulled forward by a further 7 days in order to achieve the statutory deadline in the current year. In practice, the 2016/17 draft accounts were subsequently approved for publication by the CFO on 12 June 2017.

A review of tasks and processes has been undertaken to remove any duplication of effort, to ensure that the working papers are as efficient as they can be and are prepared in advance where possible. On-going planning includes early discussion of issues among officers and with auditors, and an early update and communication of closing procedures.

An initial assessment has been made regarding the impact of ‘early close’ on the Council’s staffing resources. At this time of it is anticipated that the timetable could be achieved with the Council’s full complement of existing establishment resources, although this would be dependent upon the increased flexibility of staff in some of the corporate or technical areas. The planning assumes that this additional resource need would be managed through the Council’s flexible working policy, which would be subject to individual approvals from the Head of Finance and Property at that time.

Subsequently the Head of Finance and Property has launched a consultation relating to a review of the Finance Service, the timetable shows that the consultation period will conclude in January 2018, with the proposed implementation and appointments occurring during February and March. It is possible that the Review, together with current staffing vacancies being held within the team, may mean that there will be an impact both establishment resource levels and also the proposed timetable.

3.2 Changes to the Code

The Code is updated annually to reflect new or updated accounting standards. In 2017/18 there are few significant changes to the Code impacting on the Council’s accounts. The only significant impact on the Statement of Accounts is expected to be the revised format and content of the Narrative Report, as follows: “In developing the Narrative Report consideration should be given to the following elements:

a) organisational overview and external environment
b) governance
c) organisational model
d) risks and opportunities
e) strategy and resource allocation
f) performance
g) outlook, and
h) basis of preparation.”

Officers are currently drafting the Narrative Report in order to comply with the revised requirements of the 2017/18 Code. Officers are aiming to include less narrative in the body of the accounts, some of which will be included in the Narrative Report. As discussed at the September 2017 Audit Committee, we also aim to make the narrative report more readable, through extending the use of graphical presentation of numerical data.

3.3 Review of the library of accounting policies

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an individual authority in preparing and presenting financial statements. The financial management team has developed a 'library' of the Council's accounting policies which are applied in the preparation of the financial statements. Of these, only those with significant impact are disclosed within the Council's accounts.

It is good practice for those charged with governance (i.e. the members of the Audit Committee) to approve the Council's accounting policies on an annual basis, including any changes in accounting policy.

The Council's library of accounting policies, including those policies considered sufficiently significant to require inclusion in the 2017/18 Statement of Accounts, are detailed at Appendix A. There are no significant changes to the Council's accounting policies over previous years.

<u>Members are therefore requested to approve the Council's library of accounting policies, as set out in Appendix A.</u>

3.4 Potential future change of accounting policy for the treatment of library books

Officers are considering a change of accounting policy, which would recognise the Council's library books as an inventory balance in the Balance Sheet, and write them down to the Consolidated Income and Expenditure Statement as they are consumed, rather than writing the library books off to expenditure when they are purchased.

This change of accounting policy is not required by the Code, but is considered likely to provide a more meaningful representation of the consumption of the Council's library book stock, as the library books are consumed over a number of years.

Under the Code (para 3.3.2.12), an authority shall change an accounting policy "only if the change is required by the Code or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the authority's financial position, financial performance or cash flows." Hence the change of accounting policy is considered likely to be in line with the requirements of the Code.

The impact of this change in accounting policy is not expected to have a material impact on the Council's financial statements. However, the Code (para 3.3.2.13) requires that where an authority changes an accounting policy, it shall apply the changes retrospectively. Hence the comparators for the prior year in accounts would require restatement, as if the new accounting policy had always been applied.

The restatement would require robust underlying data to support prior year balances. If the policy were actioned in the 2017/18 accounts, the value of the library books as at 1 April 2016 would need to be accurately established. This valuation was derived from a different system to that currently used. It is not clear that this data is consistent with the current system, and hence that the comparator valuation would be robust. Officers are therefore considering implementation of the change of accounting policy from 1 April 2018, in the 2018/19 accounts. This would require restatement of the 2017/18 comparators, using a valuation as at 1 April 2017, based on data from the current library system.

Officers are currently quantifying and determining the accounting entries required to implement the change in policy. If the impact of the change cannot be estimated with sufficient certainty, then the change may not be undertaken. Any proposed change in accounting policy would need to be agreed with the external auditors, and reported to members for approval in future updates on the annual accounts process.

<u>Members are requested to note the potential future change in accounting policy for the treatment of library books as inventory from 1 April 2018.</u>

3.5 Requirement to provide a 'true and fair' view of the Council's financial position and transactions, and the concept of materiality

The Audit Committee is required to consider and, under delegated powers from the full Council, to approve the Council's Statement of Accounts each year. The Chair of the Audit Committee and the Chief Financial Officer are required to sign the Council's Statement of Accounts as representing a 'true and fair' view of the financial position of the Council and its income and expenditure for the year.

The Code specifies the principles and practices of accounting required in order for the Council's statement of accounts to give a 'true and fair' view of the financial position, financial performance and cash flows of a local authority.

Officers aim to produce draft accounts which, taking in to account accounting estimates and critical judgements, to the best of their knowledge represent the Council's finances as accurately as possible.

Examples of material estimates made in preparing the accounts include:

- assessment of the valuation and estimated useful economic lives of Property, Plant and Equipment assets
- assessment of the net pensions liability, and
- assessment of the fair value of long term borrowing.

Examples of critical judgements applied by officers in preparing the accounts include:

- the accounting treatment of Better Care Fund transactions, and
- the recognition of schools non-current assets in the Council's Balance Sheet.

<u>Members should note that 'true and fair' does not mean 100% accurate, but 'materially correct'.</u>

The Code provides a definition of materiality, which is applied to information and disclosures in local authority financial statements: *"Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting authority".*

Materiality is specific to the Council, and based on the nature or magnitude, or both, of the items to which the information in the accounts relates, in the context of the Council's financial statements.

The Code only requires local authority financial statements to disclose information which is material to the presentation of a 'true and fair' view of the financial position, financial performance and cash flows of the authority and to the understanding of users of the financial statements.

Hence setting a materiality limit too high would lead to a risk of omission of information which might influence the user of the accounts, which could lead to the Council's accounts being qualified by their auditors.

In previous years, officers have made an informal assessment of the materiality of disclosures when making judgements as to whether to include disclosures in the draft accounts. As the Council's accounts have previously been given unqualified audit opinions by the auditor, it is reasonable to assert that officers' assessment of materiality has not been too high in previous years.

Setting too low a materiality limit would not lead to a risk of qualification, but could lead to:

a) excessive detail and 'clutter' being included in the accounts, detracting from the clarity of the key messages being communicated,
b) additional officer and auditor time being required to prepare and audit the accounts, at a time when deadlines for closure of the preparation and audit of the accounts are becoming significantly tighter.

As part of the on-going effort to 'de-clutter' the accounts, and to streamline the production of the accounts for the tighter deadlines for closure of the accounts, we are now looking to formalise the basis of officers' assessment of the materiality, and hence to remove non-material disclosures.

The assessment of materiality is a matter of judgement, and is affected by the Council's perception of the financial information needs of users of the financial statements.

Detailed consideration of the assessment of appropriate materiality levels for the Council's preparation of the accounts is detailed in Appendix B.

Officers consider that it is appropriate to set the Council's materiality level in preparing the accounts at one third of the external auditor's materiality (based on 2 % of gross revenue expenditure at 'surplus / deficit on provision of services' level in the previous years' audited accounts).

Based on the 2016/17 audited accounts, this would lead to an indicative materiality for the Council's preparation of the 2017/18 accounts of £3.1m.

Disclosures which are considered material by their nature, and therefore subject to a lower level of materiality, are:
a) disclosures of officers' remuneration, salary bandings and exit packages in notes to the statements
b) disclosure of members' allowances in the notes to the statements
c) disclosure of the audit fee in the notes to the statements, and
d) disclosure of related party transactions.

Members are requested to note:
a) the concept of materiality
b) proposals for the assessment of materiality limits to be applied by officers in drawing up the Council's statement of accounts, in order to continue the process of 'de-cluttering' the accounts, and hence focusing the accounts on key messages.

Members are requested to approve the basis of the assessment of materiality for the preparation of the Council's statement of accounts.

3.6 Proposed changes to the format of the statement of accounts

In previous years, the Council's Statement of Accounts have been presented with the core statements (Movement in Reserves Statement, Consolidated Income and Expenditure Statement, Balance Sheet and Cash Flow Statement) included with the related notes in separate sections within the accounts, rather than presented together at the start of the accounts, followed by the notes to the accounts.

The Code requires that the core statements are presented with 'equal prominence' (Code para 3.4.2.18). Having reviewed the Code, and a range of other councils' financial statements, we are proposing to revert to including the core statements at the start of the accounts, while retaining full referencing and colour coding to the supporting notes.

4. CONSULTATION

Officers will undertake discussions with external audit

5. FINANCIAL IMPLICATIONS

The Council's statement of accounts are a key requirement of its operational responsibilities. Their accuracy and adherence to legislation and relevant guidance are important to ensure the Chief Financial Officer can discharge his 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.

Failure to adequately assess materiality in relation to the Council's accounts could result in the accounts not providing a 'true and fair view' of the Council's financial position, financial performance and cash flows, and leave the Council open to criticism by external audit, and potential qualification of their audit opinion on the accounts.

7. EQUALITY IMPLICATIONS

None

8. CORPORATE IMPLICATIONS

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

9. OPTIONS CONSIDERED

Options considered in setting materiality levels are detailed in the body of the report above.

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BACKGROUND PAPERS

CIPFA Code of Practice on Local Authority Accounting 2017/18
Statement of Accounts 2016/17
Grant Thornton Audit Findings Reports 2016/17, 2015/16, 2014/15

APPENDICES

Appendix A Library of accounting policies 2017/18 for approval
Appendix B Assessment of materiality

APPENDIX A

Library of accounting policies 2017/18 for approval

Significant accounting policies

Accounting Policies

i. General Principles

The Statement of Accounts summarises the council's transactions for the financial year 2017/18, and its position at the year-end of 31 March 2018. The council is required to prepare an annual Statement of Accounts by the Accounts and Audit (England) Regulations 2015, which are required to be prepared in accordance with proper accounting practices.

These practices primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (the Code), supported by International Financial Reporting Standards (IFRS).

The accounting convention adopted in the Statement of Accounts is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments.

The Statement of Accounts has been prepared on a 'going concern' basis.

ii. Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for in the current and any future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made as and when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council's financial position or financial performance. Where a change is made, it is applied retrospectively (unless otherwise stated) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

iii. Accruals of Income and Expenditure

The Council recognises its revenue and capital income and expenditure on an accruals basis. Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from the sale of goods, and the disposal of assets, is recognised when the council transfers the significant risks and rewards of ownership to the purchaser, and it is probable that economic benefits or service potential associated with the transaction will flow to the Council.

- Revenue from the provision of services is recognised when the percentage of completion of the transaction can be measured reliably, and it is probable that economic benefits or service potential associated with the transaction will flow to the Council.

- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption; they are carried as inventories on the Balance Sheet.

- Expenses in relation to services received (including those provided by employees) are recorded as expenditure when the services are received rather than when payments are made.

- Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract.

- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

- Revenue relating to council tax and non-domestic rates is measured at the full amount receivable (net of any impairment losses) as they are non-contractual, non-exchange transactions and there can be no difference between the delivery and payment dates. These transactions are therefore required to be measured at their full amount receivable.

iv. Council Tax and Non-Domestic Rates

The Council acts as agent, collecting Council Tax and Non-Domestic Rates (NDR) on behalf of the major preceptors (including government for NDR) and, as principal, collecting Council Tax and NDR for itself. The Council is required by statute to maintain a separate fund (ie the Collection Fund) for the collection and distribution of amounts due in respect of Council Tax and NDR. Under the legislative framework for the Collection Fund, the Council as billing authority, major preceptors and central government share proportionately the risks and rewards that the amount of Council Tax and NDR collected could be less or more than predicted.

The Council Tax and NDR income included in the Comprehensive Income and Expenditure Statement is the Council's share of accrued income for the year. However, regulations determine the amount of Council Tax and NDR that must be included in the Council's General Fund. Therefore, the difference between the income included in the Comprehensive Income and Expenditure Statement and the amount required by regulation to be credited to the General Fund is taken to the Collection Fund Adjustment Account, and included as a reconciling item in the Movement in Reserves Statement.

The Balance Sheet includes the Council's share of the end of year balances in respect of Council Tax and NDR relating to arrears, impairment allowances for doubtful debts, overpayments and prepayments and appeals.

v. Government Grants and Contributions

Whether paid on account, by instalment or in arrears, government grants and third party contributions and donations are recognised as due to the Council when there is reasonable assurance that:

- the Council will comply with the conditions attached to the payments, and
- the grants or contributions will be received.

Amounts recognised as due to the Council are not credited to the Comprehensive Income and Expenditure Statement until conditions attached to the grant or contribution have been satisfied. Conditions are stipulations that specify that the future economic benefits or service potential embodied in the asset acquired using the grant or contribution are required to be consumed by the recipient as specified, or future economic benefits or service potential must be returned to the transferor.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as receipts in advance. When conditions are satisfied, the grant or contribution is credited to the relevant service line (attributable revenue grants and contributions) or Taxation and Non-Specific Grant Income (non-ring-fenced revenue grants and all capital grants) in the Comprehensive Income and Expenditure Statement.

Where capital grants are credited to the Comprehensive Income and Expenditure Statement, they are reversed out of the General Fund balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied reserve. Where it has been applied, it is posted to the Capital Adjustment Account. Amounts in the Capital Grants Unapplied reserve are transferred to the Capital Adjustment Account once they have been applied to fund capital expenditure.

vi. Accounting for Schools

The Code of Practice on Local Authority Accounting in the United Kingdom confirms that the balance of control for council maintained schools (i.e. those categories of school identified in the School Standards and Framework Act 1998, as amended) lies with the Council.

The Code also stipulates that those schools' assets, liabilities, reserves and cash flows are recognised in the Council's financial statements (and not the Group Accounts). Therefore schools' transactions, cash flows and balances are recognised in each of the financial statements of the Council as if they were the transactions, cash flows and balances of the Council.

vii. Charges to Revenue for Non-Current Assets

To record the cost of holding non-current assets during an accounting period, services, support services and trading accounts are debited with:

- depreciation attributable to the assets used by the relevant service
- revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off
- amortisation of intangible assets attributable to the service.

The Council is not required to raise Council Tax to fund depreciation, revaluation and impairment losses or amortisations. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement equal to an amount calculated on a prudent basis determined by the Council in accordance with statutory guidance.

Depreciation, revaluation and impairment losses and amortisations are therefore replaced by the contribution in the General Fund Balance (Minimum Revenue Provision), by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

viii. Employee Benefits

Benefits Payable during Employment

Short-term employee benefits are those due to be settled wholly within 12 months of the year-end. They include such benefits as wages and salaries, paid annual leave and paid sick leave, bonuses and non-monetary benefits for current employees, and are recognised as an expense in the relevant service line within the Comprehensive Income and Expenditure Statement, in the year in which the employees render service to the Council.

An accrual is made for the cost of holiday entitlements (or any form of leave, e.g. time off in lieu), earned by employees but not taken before the year-end which employees can carry forward into the next financial year. The accrual is made at the wage or salary rates applicable in the following accounting year, being the period in which the employee takes the benefit. The accrual is charged to Surplus or Deficit on the Provision of Services, but then reversed through the Movement in Reserves Statement so that holiday benefits are charged to revenue in the financial year in which the holiday absence occurs.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date, or an officer's decision to accept voluntary redundancy, and are charged on an accruals basis to the appropriate service or, where applicable, to the Non Service costs line in the Comprehensive Income and Expenditure Statement at the earlier of:

- when the Council can no longer withdraw the offer of those benefits, or
- when the Council recognises costs for a restructuring that involves the payment of termination benefits.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits, and to replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Post-Employment Benefits

The entries in the Statement of Accounts in respect of post-employment benefits are made in accordance with IAS19 Employee Benefits. Although a complex accounting standard, it is based on the simple principle that an organisation should account for post-employment benefits when it is committed to give them, even if the actual giving will be many years into the future. In this way the accounts represent the employer's commitment to increase contributions to make up any shortfall in attributable net assets, or its ability to benefit (via reduced contributions) from a surplus in the scheme.

Employees of the Council are members of three different pension schemes:

- The Local Government Pension Scheme, administered by Bath & North East Somerset Council

- The Teachers' Pensions Scheme, administered by Capita Teachers' Pensions on behalf of the Department for Education (DfE)

- The NHS Superannuation Scheme

a) The Local Government Pension Scheme

The Local Government Pension Scheme (LGPS) is accounted for as a defined benefits scheme:

- Liabilities attributable to the Council are included in the Balance Sheet on an actuarial basis using the projected unit method – i.e. an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions including, for example, mortality rates, employee turnover rates, and projections of future earnings for current employees.

- Liabilities are discounted to their value at current prices, using a discount rate calculated as a weighted average of “spot yields” on AA rated corporate bonds.

- Assets within the scheme attributable to the Council are included in the Balance Sheet at their fair value:
  - quoted securities – bid price
  - unquoted securities - professional estimate
  - unitised securities – bid price
  - property - market value

The change in the net pensions liability is analysed into the following components:

<u>Service cost comprising</u>:

Current service cost – the increase in liabilities as a result of years of service earned this year – allocated in Comprehensive Income and Expenditure Statement to the services for which the employees worked

Past service cost – the increase in liabilities arising from current year decisions whose effect relates to years of service earned in earlier years – debited to the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement as part of Non Distributed Costs

Net Interest on the net defined benefit liability – i.e. net interest expense for the Council – the change during the period in the net defined benefit liability that arises from the passage of time - charged to the Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement. This is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability at the beginning of the period – taking into account any changes in the net defined benefit liability during the period as a result of contribution and benefit payments.

<u>Re-measurement of the net defined benefit liability, comprising</u>:

Return on plan assets – excluding amounts included in net interest expense on the net defined benefit liability – charged to the Pensions Reserve as Other Comprehensive Income and Expenditure

Experience gains and losses - changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation – charged to the Pensions Reserve as Other Comprehensive Income and Expenditure

Actuarial gains and losses – changes in the net pensions liability that arise because the actuaries have updated their financial or demographic assumptions – charged to the Pensions Reserve as Other Comprehensive Income and Expenditure

Statutory provisions require the General Fund balance to be charged only with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are made to and from the Pensions Reserve to remove the notional debits and credits for retirement benefits, and to replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

The debit balance that arises on the Pensions Reserve therefore reflects the beneficial impact to the General Fund of being required to account for retirement benefits on the basis of cash flows, rather than as benefits are earned by employees.

b) Teachers Pension Scheme and NHS Superannuation Scheme

The centralised arrangements for the Teachers' and NHS schemes mean that liabilities for these benefits cannot be identified specifically to the Council. These schemes are therefore accounted for as if they were defined contribution schemes, and no liability for future payments of benefits recognised in the Balance Sheet.

The Children and Young People line in the Comprehensive Income and Expenditure Statement is charged with the employer's contributions payable to the Teachers' Pension Scheme. The Public Health line in the Comprehensive Income and Expenditure Statement is charged with the employer's contributions payable to the NHS Pension Scheme in the year.

c) Discretionary Benefits

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

d) Somerset and Gloucestershire County Council Schemes

The Council also makes payments to Somerset County Council in respect of pension costs which relate to employees prior to Local Government Reorganisation in 1974. These costs are deemed to represent the current cost of service, and are charged to the Non Service Costs line in the Comprehensive Income and Expenditure Statement.

ix. Overheads and Support Services

The costs of overheads and support services are charged to service segments in accordance with the authority's arrangements for accountability and financial performance.

x. Property, Plant and Equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment.

<u>Recognition</u>

Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis as a transaction at the end of each financial year, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred. The Council usually recognises amounts in excess of £10,000 as Property, Plant and Equipment expenditure; in accordance with guidelines issued by the Department for Education, this 'de-minimis' limit is reduced to £5,000 for schools expenditure.

School Assets

The Code confirms that maintained schools are capable of being treated as separate entities for control purposes and that, based on the indicators of control within IFRS10, the balance of control lies with the Local Authority, with control of assets being determined in line with relevant standards.

School assets are consolidated into the single entity financial statements according to the recognition tests set out in the Code and according to IAS16 Property, Plant and Equipment where:

- it is probable that the future economic benefits or service potential associated with the item will flow to the Council
- the cost of the item can be measured reliably.

These recognition tests are applied separately to land and buildings assets, and where legal title does not lie with the Council, the terms of any lease, Trust Deed or 'mere licence' are used to ascertain whether the recognition tests are met and the asset should be consolidated.

<u>Measurement</u>

Assets are initially measured at cost, comprising:

- the purchase price
- any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The Council does not capitalise borrowing costs incurred whilst assets are under construction.

Assets are then carried in the Balance Sheet using the following measurement bases:

- infrastructure, community assets and assets under construction – depreciated historical cost
- council offices – current value, determined as the amount that would be paid for the asset in its existing use (EUV) based on capitalisation of estimated market rent
- school buildings – current value, but because of their specialist nature, are measured at depreciated replacement cost, which is used as an estimate of current value
- car parks – current value, based on capitalisation of actual or notional income as applicable

- surplus assets – the current value measurement base is fair value, estimated at the highest and best use from a market participant's perspective
- all other assets – fair value, determined as the amount that would be paid for the asset in its existing use (EUV).

Where there is no market-based evidence of fair value because of the specialist nature of an asset, depreciated replacement cost (DRC) is used as an estimate of fair value.

Where non-property assets have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for fair value.

Revaluation

Assets included in the Balance Sheet at fair value are revalued sufficiently regularly to ensure that their carrying amount is not materially different from their current value at the year-end, but as a minimum every five years. Increases in valuations are matched by credits to the Revaluation Reserve to recognise unrealised gains. Exceptionally, gains might be credited to the Comprehensive Income and Expenditure Statement where they arise from the reversal of a loss previously charged to a service.

Where decreases in value are identified they are accounted for by:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains)
- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

The Section 151 Officer obtains an annual appraisal of trends in property values from the Council's Property Estates and Regeneration Manager in respect of the Council's assets. Based on this appraisal a judgement will be made as to whether any amendment to the Council's accounts is required or whether an adjustment is needed to its revaluation programme.

Impairment

Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for by:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains)
- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

Where an impairment loss is reversed subsequently, the reversal is credited to the relevant service line(s) in the Comprehensive Income and Expenditure Statement, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

The Section 151 Officer is provided with an annual statement from the Property Estates & Regeneration Manager of any of the Council's assets that suffered an impairment loss during the year.

Depreciation

Depreciation is provided for on all Property, Plant and Equipment assets by the systematic allocation of their depreciable amounts over the useful lives. An exception is made for assets without a determinable finite useful life (i.e. freehold land, certain Community and Heritage Assets) and assets that are not yet available for use (i.e. assets under construction).

Where an asset has a finite useful life in its existing use, it will be depreciated based on the valuation of the asset at 1 April each year calculated on the following bases:

- other land and buildings – straight-line allocation over the useful life of the property as estimated by the valuer (between 1 and 60 years)
- vehicles, plant, furniture and equipment – a percentage of the value of each class of assets in the Balance Sheet, as advised by a suitably qualified officer (between 1 and 50 years)
- infrastructure – straight-line allocation over the estimated useful life of the asset (between 20 and 60 years)
- surplus assets not held for sale – straight-line allocation over the useful life of the property as estimated by the valuer (between 1 and 60 years)

The remaining life of the Council's assets is determined by the Council's Property Estates & Regeneration Manager or other professional staff under his/her control when the asset is acquired or at the time of revaluation. If the existing use of an asset changes at any time or an asset becomes surplus to requirements then its finite useful life will be re-assessed.
Where an item of Property, Plant and Equipment asset which has a value in excess of £3m, and has major components whose cost is greater than 20% of the total cost of the asset, the components are depreciated separately.

Depreciation is provided on an appropriate basis according to the asset class of the component which may be different to the class of the overall asset. Components could be:

- separate blocks / buildings within an overall asset site
- specific elements which form part of the overall asset e.g. roof, engineering, sub-structures, etc.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals and Non-Current Assets Held for Sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an Asset

Held for Sale. The condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement. Gains in fair value are recognised only up to the amount of any previously recognised losses in the Surplus or Deficit on Provision of Services. Depreciation is not charged on Assets Held for Sale.

If assets no longer meet the criteria to be classified as Assets Held for Sale, they are reclassified back to non-current assets and valued at the lower of their carrying amount before they were classified as Held for Sale, adjusted for depreciation, amortisation or revaluations that would have been recognised had they not been classified as Held for Sale, and their recoverable amount at the date of the decision not to sell.

Assets that are to be abandoned or scrapped are not reclassified as Assets Held for Sale.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet (whether Property, Plant and Equipment or Assets Held for Sale) is written off to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the Comprehensive Income and Expenditure Statement also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

Amounts received for a disposal in excess of £10,000 are categorised as capital receipts.

The written-off value of disposals is not a charge against Council Tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement. Disposals are reflected as a transaction at the end of the financial year.

xi. Revenue Expenditure Funded from Capital Under Statute

Expenditure incurred during the year that may be capitalised under statutory provisions but that does not result in the creation of a non-current asset has been charged as expenditure to the relevant service in the Comprehensive Income and Expenditure Statement in the year. Where the Council has determined to meet the cost of this expenditure from existing capital resources or by borrowing, a transfer in the Movement in Reserves Statement from the General Fund balance to the Capital Adjustment Account, then reverses out the amounts charged so that there is no impact on the level of Council Tax.

xii. Investment Property

Investment properties are those that are used solely to earn rentals and/or for capital appreciation. The definition is not met if the property is used in any way to facilitate the delivery of services or production of goods or is held for sale.

Investment properties are measured initially at cost and subsequently at fair value, being the price that would be received to sell such an asset in an orderly transaction between market participants.

As a non-financial asset, investment properties fair value is measured at 'highest and best' use. Properties are not depreciated but are revalued annually according to market conditions at the year-end. The inputs to the measurement techniques are categorised in accordance with the following three levels:

- Level 1 inputs – quoted prices (unadjusted) in active markets for identical assets that the council can access at the measurement date.
- Level 2 inputs – inputs other than quoted prices included within Level 1 that are observable for the assets, either directly or indirectly.
- Level 3 inputs – unobservable inputs for the asset.

Gains and losses on revaluation are posted to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement. The same treatment is applied to gains and losses on disposal.

Rentals received in relation to investment properties are credited to the Financing and Investment Income and Expenditure line, and result in a gain for the General Fund balance. However, revaluation and disposal gains and losses are not permitted by statutory arrangements to have an impact on the General Fund balance. The gains and losses are therefore reversed out of the General Fund balance in the Movement in Reserves Statement, and posted to the Capital Adjustment Account and (for any sale proceeds greater than £10,000) the Capital Receipts Reserve.

xiii. Financial Instruments

Financial Assets

The Council holds two types of Financial Assets:

- loans and receivables – assets that have fixed or determinable payments but are not quoted in an active market
- available-for-sale assets – assets that have a quoted market price and/or do not have fixed or determinable payments.

a) Loans and Receivables

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument. For most of the loans that the Council has made, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the Comprehensive Income and Expenditure Statement is the amount receivable for the year in the loan agreement.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made, the asset is written down and a charge made to the relevant service or the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement. The impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate.

Any gains and losses that arise on the de-recognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.

b) Available-for-Sale Assets

Available-for-sale assets are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, and are initially measured and carried at fair value. Where the asset has fixed or determinable payments, annual credits to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest receivable are based on the amortised cost of the asset multiplied by the effective rate of interest for the instrument. Where there are no fixed or determinable payments, income (e.g. dividends) is credited to the Comprehensive Income and Expenditure Statement when it becomes receivable by the council.

Assets are maintained in the Balance Sheet at fair value. Values are based on the following techniques:

- instruments with quoted market prices – the market price
- other instruments with fixed and determinable payments – discounted cash flow analysis
- equity shares with no quoted market price – independent appraisal of company valuations.

The inputs to the measurement techniques are categorised in accordance with the following three levels:

- Level 1 inputs – quoted prices (unadjusted) in active markets for identical assets that the council can access at the measurement date.
- Level 2 inputs – inputs other than quoted prices included within Level 1 that are observable for the assets, either directly or indirectly.
- Level 3 inputs – unobservable inputs for the asset.

Changes in fair value are balanced by an entry in the Available-for Sale Reserve, and the gain/loss is recognised in the Surplus or Deficit on Revaluation of Available-for-Sale Financial Assets line in the Comprehensive Income and Expenditure Statement. The exception is where impairment losses have been incurred – these are debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement, along with any net gain or loss for the asset accumulated in the Available-for-Sale Reserve.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made (fixed or determinable payments) or fair value falls below cost, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.

If the asset has fixed or determinable payments, the impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate. Otherwise, the impairment loss is measured as any shortfall of fair value against the acquisition cost of the instrument (net of any principal repayment and amortisation).

Any gains and losses that arise on the de-recognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and

Expenditure Statement, along with any accumulated gains or losses previously recognised in the Available-for Sale Reserve.

Where fair value cannot be measured reliably, the instrument is carried at cost (less any impairment losses).

Financial Liabilities

Financial liabilities are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument. They are initially measured at fair value and are carried at their amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

For most of the borrowings that the Council has, this means that the amount presented in the Balance Sheet is the outstanding principal repayable (plus accrued interest); and interest charged to the Comprehensive Income and Expenditure Statement is the amount payable for the year according to the loan agreement.

xiv. Fair Value Measurement

The Council measures some of its non-financial assets, such as surplus assets and investment properties, and some of its financial instruments, such as equity shareholdings and available for sale financial instruments, at fair value at each reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

a) in the principal market for the asset or liability, or
b) in the absence of a principal market, in the most advantageous market for the asset or liability.

The Council measures the fair value of an asset or liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

When measuring the fair value of a non-financial asset, the Council takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Council uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Inputs to the valuation techniques in respect of assets and liabilities for which fair value is measured or disclosed in the Council's financial statements are categorised within the fair value hierarchy, as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities that the council can access at the measurement date
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 – unobservable inputs for the asset or liability.

xv. Cash and Cash Equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are investments that mature in 30 days or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

In the Cash Flow Statement, cash and cash equivalents are shown net of bank overdrafts that are repayable on demand and form an integral part of the Council's cash management.

xvi. Provisions, Contingent Liabilities and Contingent Assets

Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation.

Provisions are charged as an expense to the appropriate service line in the Comprehensive Income and Expenditure Statement in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the Balance Sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties. When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.

Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the Council settles the obligation.

Contingent Liabilities

A contingent liability arises where an event has taken place that gives the Council a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council. Contingent liabilities also arise in circumstances where a provision would otherwise be made but either it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured reliably.

Contingent liabilities are not recognised in the Balance Sheet, but disclosed in a note to the accounts.

Contingent Assets

A contingent asset arises where an event has taken place that gives the authority a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the authority.

Contingent assets are not recognised in the Balance Sheet, but disclosed in a note to the accounts where it is probable that there will be an inflow of economic benefits or service potential.

xvii. Leases

Leases are classified as finance leases where the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the property, plant or equipment from the lessor to the lessee. All other leases are classified as operating leases.

Where a lease covers both land and buildings, the land and buildings elements are considered separately for classification.

Arrangements that do not have the legal status of a lease, but convey a right to use an asset in return for payment, are accounted for under this policy where fulfilment of the arrangement is dependent on the use of specific assets.

<u>The Authority as Lessee</u>

a) Finance Leases

Property, plant and equipment held under finance leases is recognised on the Balance Sheet at the commencement of the lease at its fair value measured at the lease's inception (or the present value of the minimum lease payments, if lower). The asset recognised is matched by a liability for the obligation to pay the lessor. Initial direct costs of the Council are added to the carrying amount of the asset. Premiums paid on entry into a lease are applied to writing down the lease liability. Contingent rents are charged as expenses in the periods in which they are incurred.

Lease payments are apportioned between:

- a charge for the acquisition of the interest in the property, plant or equipment – applied to write down the lease liability, and
- a finance charge (debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement).

Property, Plant and Equipment recognised under finance leases is accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life (where ownership of the asset does not transfer to the authority at the end of the lease period).

The Council is not required to raise Council Tax to cover depreciation, revaluation and impairment losses arising on leased assets. Instead, a prudent annual contribution is made from revenue funds towards the deemed capital investment, in accordance with statutory requirements. Depreciation, revaluation and impairment losses are therefore substituted by a revenue contribution in the General Fund balance, by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

b) Operating Leases

Rentals paid under operating leases are charged to the Comprehensive Income and Expenditure Statement as an expense of the services benefiting from use of the leased property, plant or equipment. Charges are made on a straight-line basis over the life of the lease; even if this does not match the pattern of payments (e.g. there is a rent free period at the commencement of the lease).

The Authority as Lessor

a) Finance Leases

The Council does not own any property that it leases out under finance leases.

b) Operating Leases

Where the Council grants an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet. Rental income is credited to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement. Credits are made on a straight-line basis over the life of the lease, even if this does not match the pattern of payments (e.g. there is a premium paid at the commencement of the lease). Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the relevant asset and charged as an expense over the lease term on the same basis as rental income.

xviii. Reserves

The Council sets aside specific amounts as usable reserves for future policy purposes or to cover contingencies. For each reserve established, the purpose, usage and the basis of transactions is clearly identified.

Reserves are created by appropriating amounts out of the General Fund Balance in the Movement in Reserves Statement. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement. The reserve is then appropriated back into the General Fund Balance in the Movement in Reserves Statement so that there is no net charge against Council Tax for the expenditure.

Certain 'unusable' reserves are maintained to manage specific accounting processes for non-current assets, financial instruments, retirement and employee and post-employment benefits and do not represent usable resources for the Council – these reserves are explained in the relevant policies.

xix. Events After the Reporting Period

Events after the reporting period, i.e. the balance sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Statement of Accounts is authorised for issue. Two types of events can be identified:

- those that provide evidence of conditions that existed at the end of the reporting period – the Statement of Accounts is adjusted to reflect such events

- those that are indicative of conditions that arose after the reporting period – the Statement of Accounts is not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the Statement of Accounts.

xx. VAT

VAT payable is included as an expense only to the extent that it is not recoverable from Her Majesty's Revenue and Customs. VAT receivable is excluded from income.

xxi. Allocation between Current and Non-Current

With the exception of employee entitlements, the determination of whether an asset or liability is current or non-current, consideration is given to the time when each asset or liability is expected to be realised or paid. The asset or liability is classified as current if it is expected to be turned over within the next 12 months, being the Council's operational cycle. For employee entitlements, all annual leave entitlement is classified as current.

xxii. City Region Deal

The Council has applied the principles of IPSAS23 'Revenue from non-Exchange transactions' (taxes and transfers) in accounting for the transactions and balances relating to the City Region Deal.

City Region Deal business rates growth paid to the accountable body (South Gloucestershire Council) for the Business Rates Pool (BRP) is recognised by the Council as a debtor until such point that the funds are paid out by the BRP or committed and allocated by the Economic Development Fund (EDF) to fund EDF payments in respect of approved programmes.

- Income - Income receivable by the Council from the BRP is recognised as revenue in the year in which it is due. The Council recognises revenue and a debtor balance to the extent that EDF disbursements are to be received, have been committed to by the EDF, and sufficient cash remains in the BRP to fund the payments.

- Expenditure – Expenditure is recognised by the Council on payments being made by the BRP. Expenditure is recognised in proportion to the degree that the Council has contributed to the BRP through its growth figure, and is capped at the limit of the Council's payment of growth to the BRP in this period, and any previous growth figures paid over which have not been previously paid or committed by the BRP.

xxiii. Joint Operations

Joint operations are arrangements where the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement. The activities undertaken by the Council in conjunction with the other joint operators involve the use of the assets and resources of those joint operators. In relation to its interest in a joint operation, the Council, as a joint operator recognises:

- its assets, including its share of any assets held jointly;
- its liabilities, including its share of any liabilities incurred jointly;
- its revenue from the sale of its share of the output arising from the joint operation;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

Non – material accounting policies

i. **Acquired & Discontinued Operations [Not applicable]**

Acquired operations
Additional policy detail required where an authority has acquired operations (or transferred operations under combinations of public sector bodies) during the financial year.

Discontinued operations
Additional policy detail required where an authority has discontinued operations (or transferred operations under combinations of public sector bodies) during the financial year.]

ii. Foreign Currency [Not applicable]

iii. Heritage Assets [Not Material]

Heritage assets are non-current assets (either tangible or intangible) with historical, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained by the council principally for their contribution to knowledge or culture.

Heritage Assets are recognised and measured (including the treatment of revaluation gains and losses) in accordance with the council's policies on property, plant and equipment. However, some of the measurement rules are relaxed in relation to heritage assets as detailed below.

The carrying amounts of heritage assets are reviewed where there is evidence of impairment, e.g. where an item has suffered physical deterioration or breakage or where doubts arise as to its authenticity. Any impairment is recognised and measured in accordance with the council's general policies on impairment (see policy xx).

Any disposals of heritage assets are accounted for in accordance to the general provisions for property, plant and equipment and in accordance with statutory accounting requirements relating to capital receipts.

Museum Collection (Artworks)
The museum collection (principally works of art) is reported in the Balance Sheet at insurance valuation based on market values. The insurance valuations are reviewed regularly by an external valuer. The assets are deemed to have indeterminate lives and a high residual value and therefore the council does not consider it appropriate to charge depreciation.

Fountains and Monuments
The council owns a number of fountains and monuments which are deemed to have historical importance to the locality. The council does not consider that reliable cost or valuation information can be obtained for these assets due to a lack of comparable market values and therefore these assets are not recognised on the Balance Sheet.

iv. Intangible Assets [Not material]

Expenditure on non-monetary assets that do not have physical substance but are controlled by the council as a result of past events (e.g. software licences) is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the council.

Expenditure on the development of websites is not capitalised if the website is solely or primarily intended to promote or advertise the council's goods or services.

Intangible assets are measured initially at cost. Amounts are only revalued where the fair value of the assets held by the council can be determined by reference to an active market. In practice, no intangible asset held by the council meets this criterion, and they are therefore carried at amortised cost.

The depreciable amount of an intangible asset is amortised over its useful (finite) life to the relevant service line(s) in the Comprehensive Income and Expenditure Statement. An asset is tested for impairment whenever there is an indication that the asset might be impaired – any losses recognised are posted to the relevant service line(s) in the Comprehensive Income and Expenditure Statement. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement.

Where expenditure on intangible assets qualifies as capital expenditure for statutory purposes, amortisation, impairment losses and disposal gains and losses are not permitted to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reserves Statement and posted to the Capital Adjustment Account and (for any sale proceeds greater than £10,000) the Capital Receipts Reserve.

v. Service Concession arrangements, PFI/PPP Schemes [Not Applicable]

vi. Interest on Internal Balances

In the main, subject to the principles of materiality, interest on internal balances is only paid where required by statute or where sums have been deposited with the council for specific purposes, e.g. developers' contributions to developments. The exceptions to this rule are where the council is acting as the accountable body for a partnership of which it is a member.

vii. Interests in Companies and Other Entities [Not material]

Subsidiaries are entities over which the Council has control. The Council controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through its power over the entity.

The Council has a non-material interest in one company that has been classified as a subsidiary, Wyvern SW Limited, and has therefore chosen not to prepare group accounts. The investment in this subsidiary is not material to the Council's single entity accounts.

In its single entity accounts, the Council has opted to account for its investment in the subsidiary in accordance with Chapter 9 of the Code, 'Group accounts'. The investment, relating to shares in an unlisted company, is carried in the Balance Sheet at cost.

In the group accounts, the subsidiary is consolidated on a line by line basis with adjustments to eliminate intra-group transactions, balances and unrealised gains on transactions between the group entities. Where necessary, amounts reported by subsidiaries have been adjusted to conform to the Council's accounting policies.

viii. Inventories and Long Term Contracts

Inventories are included in the Balance Sheet at the lower of cost and net realisable value. The cost of inventories is assigned using the 'First In, First Out' costing formula.

Long term contracts are accounted for on the basis of charging the Surplus or Deficit on the Provision of Services with the value of works and services received under the contract during the financial year.

APPENDIX B

Assessment of materiality

1 Auditor's assessment of materiality

In conducting their audit of financial statements, the overall objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

Auditors are required to determine their assessment of materiality for the financial statements as a whole.

2 Benchmarks for determining overall materiality

The assessment of materiality is a matter of judgement, and is affected by the Council's perception of the financial information needs of users of the financial statements.

The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) in an audit of the financial statements of a public sector entity is therefore influenced by law, regulation or other authority, and by the financial information needs of legislators and the public in relation to public sector programs.

In local government, the user of the accounts are likely to consist of local residents and central government. It is not considered likely that the accounts would be used by potential investors, lenders, or businesses considering entering into contracts with the Council, largely as the Council is a statutory body, and has a strong credit rating.

It is reasonable to assume that users:

a) have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
b) understand that financial statements are prepared, presented and audited to levels of materiality;
c) recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
d) make reasonable economic decisions on the basis of the information in the financial statements.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include, for example the elements of the financial statements (assets, liabilities, income, and expenditure). As a public sector entity, other benchmarks relating to profit before tax, gross profit, revenue and equity are of limited relevance.

As the Council has custody of public assets, the value of long term assets might be considered an appropriate benchmark. Similarly, the Council holds long term borrowing to finance its long term assets. However, a materiality based on these measures alone would not be considered to be relevant to the wider financial performance of the Council reflected in the financial statements.

Council budgets are set and monitored based on net revenue expenditure. The benchmark considered to be most relevant to user of the accounts is considered to be gross revenue expenditure. Use of this benchmark is considered most relevant to both the revenue expenditure and income for the year, and can meaningfully be applied when considering entries in the Council's Balance Sheet. Use of net expenditure is considered to lead to too low a materiality level to be meaningful.

In their audit plan for 2016-17, the Council's external auditors determined their overall materiality to be £9.142 million (being 2% of gross revenue expenditure at 'Surplus / deficit on provision of services' level in the audited 2015-16 accounts).

A similar measure based on the audited 2016-17 accounts would be £9.393m. This is considered to provide a useful benchmark in determining the Council's overall materiality level when preparing the draft accounts.

3 'Performance' materiality

Any omissions or misstatements need to be considered individually and in aggregate to assess whether they could reasonably be expected to influence decisions made by the users taken on the basis of the financial statements.

There is a risk that more than one non-material error or omission could be material to the accounts as a whole when considered in aggregate. Hence it is appropriate to set a 'Performance materiality', at a level less than the overall materiality, in order to reduce to an appropriately low level the probability that the aggregate of uncorrected errors and omissions exceeds materiality for the financial statements as a whole.

External auditors typically quantify a 'performance materiality' in the range of 50-75% of overall materiality in order to direct their audit testing.

The assessment of performance materiality is typically based on a risk assessment, including:

- an assessment of the past experience of errors identified in the Council's accounts
- the knowledge, experience and continuity of the Council's financial reporting team
- the strength of the Council's overall control environment, including anti-fraud arrangements, and wider IT environment
- the strength of the Council's key financial reporting systems

4 Council's assessment of materiality

The Council needs to provide sufficient assurance to the external auditors that the financial statements are materially correct, within their assessment materiality. Hence it is appropriate for the Council to take in to account the auditor's assessment of materiality when setting its own materiality in preparing the draft accounts.

The Council has a history of producing high quality, accurate draft financial statements. Although subject to some staff turnover in the current year, the Council's financial reporting team have strong knowledge and experience of local government accounting, and accounts closure issues. The Council's overall control environment is considered strong, with no significant internal control weaknesses, including in relation to the Council's key financial systems, reported by the external auditors in their Audit Findings Reports, or by Internal Audit in the Annual Governance Statements for the last 3 years.

It is therefore considered appropriate to set the Council's materiality level in preparing the accounts at one third of the external auditor's materiality (based on 2 % of gross revenue expenditure at 'Surplus / deficit on provision of services' level in the previous years' audited accounts), such that three such errors, impacting in the same direction, would be needed to lead to a misstatement material to the external auditor's opinion.

Members are therefore request to approve this basis of the assessment of materiality for the preparation of the Council's statement of accounts.

5 Items which are material by nature

Officers drawing up the accounts, and auditors undertaking the audit of the accounts, may identify particular classes of transactions, account balance or disclosures which are considered more likely to influence the user of the accounts, and hence where it may be appropriate to set a lower materiality level than for the financial statements as a whole.

For example, in their Audit Plan for the audit of the 2016-17 accounts, Grant Thornton disclosed that they would apply lower materiality thresholds to the following disclosures:

- Disclosures of officers' remuneration, salary bandings and exit packages in notes to the statements.
- Disclosure of members' allowances in the notes to the statements.
- Disclosure of the audit fee in the notes to the statements.

Their materiality for these disclosures was set at £5,000, due to 'public interest in these disclosures and the statutory requirement for them to be made'.

Officers have reviewed the statement of accounts, including the associated disclosures, for other items which were it may be appropriate to apply lower materiality thresholds than that set for the accounts as a whole. The disclosures identified by the auditors are agreed as likely to be potentially sensitive to the user of the accounts, notably local residents. Other disclosures proposed to be identified as material by nature are:

- Related party transactions – as required to ensure transparency of the Council's transactions with bodies or individuals who have control or influence over the Council.

Hence these disclosures will be retained in future statement of accounts, despite being below the value of the materiality for the accounts as a whole.

Other disclosures below the Council's materiality threshold, and which are not considered material by nature, will be considered for removal from the accounts, in order to 'de-clutter' the accounts, and allow better focus on the key messages in the accounts.