North Somerset Council

Report to the Audit Committee

Date of Meeting: 26 January 2023

Subject of Report: Update on Annual Accounts

Town or Parish: All

Officer presenting: Steve Ballard - Principal Accountant (Closure and Systems)

1. Key Decision: N/A

Recommendations

The Audit Committee are requested to **note** the following:

a) the developments in the CIPFA Code of Practice for Local Government Accounts, including that there are limited changes to the Code for the 2022/23.

b) that officers are proposing one additional accounting policy, relating to the Community Infrastructure Levy, for inclusion in the accounts, with no significant changes to existing accounting policies in 2022/23.

c) that officers' initial assessment of the critical judgements made in applying the Council's accounting policies, and the major sources of estimation uncertainty identified in the preparation of the 2022/23 accounts.

d) the requirement for the Council's accounts to provide a 'true and fair' view of the Council's financial position and transactions, the concept of materiality, the initial assessment of materiality limits applied by officers in drawing up the accounts; and disclosures which, although not material due to their value, are considered material due to their nature.

1. Summary of Report

1. The purpose of this report is to provide Members with an update of the issues which impact on the annual accounts process. These include changes to the Code, and the annual review the Council's accounting policies.

2. The report also provides Members with a reminder of the concept of materiality, and outlines officers approach in applying materiality in preparing the draft financial statements.

2. Policy

3. Local authorities in the United Kingdom are required to prepare their accounts in accordance with primary legislation, such as the Accounts and Audit Regulations, 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).

4. 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 may introduce new, or amended, accounting standards or reporting requirements which need to be complied with.

5. The Audit Committee is charged with overseeing the Authority's financial reporting process, and is required to consider and, under delegated powers from the full Council, to approve the Council's Statement of Accounts each year.

6. 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.

7. The Chief Financial Officer is responsible for:
   - the preparation of the Statement of Accounts in accordance with the Code,
   - selecting suitable accounting policies and then applying them consistently,
   - making judgements and estimates that are reasonable and prudent,
   - arrangements for internal control as she determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and
   - for being satisfied that the financial statements give a true and fair view of the financial position and transactions of the Council.

8. Audit Committee members therefore need to consider whether they receive adequate assurance over Council's arrangements for the preparation of the financial statements, including arrangements for making critical judgements in applying accounting policies, and for making accounting estimates, before approving the financial statements.

3. Update on the Council's Annual Accounts

Changes to the Code – 2022/23 and 2023/24

9. The Code of Practice is updated annually to reflect new or updated accounting standards. There are only minor changes to the Code for 2022/23. Following review, none are considered likely to have a significant impact on the Council's accounts.

10. The implementation of 'IFRS16 – Leases' into the Code has again been deferred until 2024/25. This change of accounting policy will require changes to the accounting treatment where the Council is the lessee of long-term assets, and revisions to the related disclosures. Although the implementation of the new standard will be only reflected in the 2024/25 accounts, disclosure of the likely impact of this change will need to be included in the 2023/24 accounts. Work is on-going to quantify the impact of these changes.

11. There is a consensus that the length and complexity of the accounts produced under the current Code can make the accounts impenetrable to many users. CIPFA consulted on changes to the Code for 2021/22, with the aim of delivering accounts that more clearly communicate the authority's financial performance and future financial sustainability. However, no significant changes have yet been proposed in the Code. CIPFA is continuing to develop guidance on revised content for inclusion in the Code in future years.

12. As previously discussed, officers will be holding a workshop with members to update them on proposed changes to simplify and focus the Narrative Report on key messages in the 2022/23 financial statements.

Changes to regulatory requirements

13. Regulatory developments outside of the Code that are likely to impact on the 2022/23 financial statements include:
    - Minimum Revenue Provision (MRP) – The Minimum Revenue Provision is the minimum amount which must be charged to a Council's revenue account each year and set aside as provision for repayment of debt, as required by the Local Government Act 2003. Government have issued further guidance on the calculation of the MRP. Officers believe that the Council already makes prudent provision for the repayment of its debt, and therefore does not expect this guidance to significantly impact on the charges the Council makes in its accounts.
    - IFRS 9 Statutory Override for pooled investments –the IFRS 9 statutory override in local government has been extended for another two years until 31 March 2025. This provides permission for gains and losses on pooled investments, such as those held by the Council, to continue to be held in Balance Sheet reserves, rather than impacting on the Council's surplus or deficit for the year each year.
    - Dedicated Schools Grants deficits – Similarly, the statutory override for Dedicated Schools Grant (DSG) deficits has been extended for the next three years, from 2023-24 to 2025-26.

14. Officers are due to attend update training in the next few weeks and will continue to keep Members informed of any significant changes in Code requirements for the content and format of the Council's accounts.

Review of accounting policies

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

16. It is good practice for 'those charged with governance' (i.e. the members of the Audit Committee) to review the policies on an annual basis and approve any changes proposed.

17. Officers have reviewed the Council's library of accounting policies. Changes made to the Council's accounting policies in 2021/22, regarding the preparation of group accounts and the disclosure of the value of Infrastructure assets, have been included in the library of policies, and will be included in the Council's accounts on an on-going basis.

18. One existing accounting policy is now proposed for inclusion in the statement of accounts. It relates to the accounting treatment of Community Infrastructure Levy (CIL) funding. Balances and cumulative transactions in relation to CIL are expected to near materiality levels in the near future.

19. The accounting policy proposed for inclusion is shown at Appendix A.

20. No significant changes are proposed to existing accounting policies over those included in the previous year's statement of accounts.

Accounts which provide a 'true and fair' view of the Council's financial position and transactions, and the concept of materiality

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

22. Officers consider that it is appropriate to set an indicative materiality level in preparing the Council's accounts at approximately one third of the external auditor's materiality, i.e. based on 2 % of gross revenue expenditure at 'Cost of services' level in the previous years' audited accounts. This equates to around £7.86m.

23. Disclosures which, although not material due to their value, are considered material by their nature, due to their potential impact on the decisions of likely users of the accounts, are:
    a) disclosures of officers' remuneration, salary bandings and exit packages
    b) disclosure of members' allowances
    c) disclosure of related party transactions

Critical judgements made in applying the Council's accounting policies, and major sources of estimation uncertainty in the preparation of the accounts

24. Officers have completed an initial assessment of the critical judgements made in applying the Council's accounting policies, and the major sources of estimation uncertainty identified in the preparation of the 2022/23 accounts. These issues impact on whether the accounts provide a 'true and fair' view of the Council's financial position. These are listed in Appendix C and D respectively.

25. The judgements proposed remain as detailed in the 2021/22 statement of accounts, except that the judgement in relation to whether group accounts need to be prepared to account for the transactions undertaken by the Council's subsidiary company, North Somerset Environment Company Ltd, is likely to be removed from the disclosure. This is considered to no longer require significant judgement due to the clear materiality of the company's transactions on the group accounts.

26. Each year, members of the Audit Committee participate in a workshop session to review the draft annual financial statements. This provides an opportunity for officers to explain the accounting estimates used in preparing the accounts, and for members to question

officers on the adequacy of the Council's arrangements for making accounting estimates.

27. Papers will be submitted to the Audit Committee later in the year setting out the detail of these issues, and the sources of assurance that members can use in making their assessment of the adequacy of the Council's arrangements to produce 'true and fair' financial statements.

4. Consultation

28. Officers continue to undertake discussions with external audit regarding key issues impacting on the preparation of the accounts, including significant accounting estimates and judgements. Officers will continue to liaise with external audit on emerging issues as the accounts are finalised.

5. Financial Implications

29. Updates to the Code, and the proposed changes to the Council's accounting policies, are expected to have minimal impact on the Council's financial out-turn or balances.

30. As noted in Appendices B and C, critical judgements made in applying the Council's accounting policies, and accounting estimates used in the valuation of the Council's assets and liabilities will have a material impact on the Council's financial statements.

6. Legal Powers and Implications

31. The CIPFA Code of Practice determines 'proper accounting practice' in relation to the Council's statement of accounts. The Council's 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 and Audit Committee can discharge their statutory obligations.

7. Climate Change and Environmental Implications

32. None

8. Risk management

33. Failure to apply appropriate accounting policies, or 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.

9. Equality Implications

34. None

10. Corporate Implications

35. None, other than as highlighted above

11. Options Considered

36. Options considered in the update of accounting policies, and in setting materiality levels, are detailed in the body of the report above.

Author

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

Steve Ballard, Principal Accountant (Closure and Systems)   Tel: 01275 884037
steve.ballard@n-somerset.gov.uk

Appendices

Appendix A   Accounting policy – Community Infrastructure Levy
Appendix B   Assessment of materiality
Appendix B   Critical judgements in applying the Council's accounting policies
Appendix C   Significant accounting estimates and sources of estimation uncertainty

Background Papers

CIPFA Code of Practice on Local Authority Accounting 2022/23
CIPFA Guidance Notes for Practitioners 2022/23
Statement of Accounts 2021/22
Grant Thornton Audit Findings Report 2021/22

Appendix A

Accounting Policy - Community Infrastructure Levy

The authority has elected to charge a Community Infrastructure Levy (CIL). The levy will be charged on new builds (chargeable developments for the authority) with appropriate planning consent. The council charges for and collects the levy, which is a planning charge. The income from the levy will be used to fund a number of infrastructure projects (these include transport, flood defences and schools) to support the development of the area.

CIL is received without outstanding conditions; it is therefore recognised at the commencement date of the chargeable development in the Comprehensive Income and Expenditure Statement in accordance with the accounting policy for government grants and contributions set out above. CIL charges will be largely used to fund capital expenditure. However, a proportion of the charges may be used to fund revenue expenditure.

Income received by the Council in relation to CIL is classified as follows;

- CIL Administration – The collecting authority may apply up to 5% towards administration expenses incurred. The Council recognises 5% of CIL income towards these costs. This element has been recognised as revenue in the year in which receipts are due.
- CIL Infrastructure - CIL income applied to infrastructure is treated as a capital financing contribution.
- CIL Local Council element – CIL income to be passed to local councils (parishes) is treated as a Balance Sheet liability.
- CIL Surcharges – Any surcharges received have been treated as revenue in the year in which they are due.

Appendix B

Assessment of materiality

1. Introduction

The CIPFA Code of Practice for Local Government accounting specifies the accounting practices required for the Council's Statement of Accounts to give a 'true and fair' view. However, 'true and fair' does not mean 100% accurate, but 'materially correct'.

The Code provides a definition of materiality, which is applied to information and disclosures in the Council's financial statements: "information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific local authority."

The assessment of materiality helps officers to ensure that the accounts focus on key messages, notably in relation to the Council's performance, financial resilience and accountability for use of public funds.

2. Users of the accounts

The assessment of materiality is affected by the financial information needs of users of the financial statements.

The Code defines the primary users of local authority financial statements as 'service recipients and their representatives, and resource providers and their representatives'.

'Service recipients and their representatives' are likely to consist of local residents and their locally elected representatives. 'Resource providers and their representatives' are likely to mean central government, and local Council Tax and Non-domestic rates payers.

Other users are likely to include existing and potential lenders, credit ratings agencies, financial advisors, the media, trade unions, statisticians, analysts and academics, and businesses considering entering contracts with the Council.

In the public sector, providing information that allows for an assessment of the stewardship and accountability of elected members and management for the resources entrusted to them is of paramount importance.

Ensuring that the Council's audited financial statements focus on the needs of key users of the accounts is challenging, as different stakeholder groups will be interested in different information, have differing expectations of whether a particular transaction is material, and will have differing levels of financial literacy.

Hence, engagement with members, through the Audit Committee, provides a useful opportunity of officers to gain an understanding of the content of the financial statements which are likely to influence the decisions of members as users of the accounts.

3. Benchmarks for determining overall materiality

Determining a value for materiality involves the exercise of judgement. A percentage of a chosen benchmark in the accounts is often applied as a starting point. Appropriate benchmarks might include the total assets, liabilities, income, or expenditure in the accounts. As a public sector entity, other benchmarks used in the private sector such as profit before tax, gross profit, revenue and equity, are of limited relevance.

As the Council has custody of public assets to deliver services, 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 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 (ie gross expenditure less gross income). However, use of net expenditure does not fully reflect the income and expenditure transactions, and hence is considered to lead to too low a materiality level to be meaningful.

The overall benchmark considered to be most relevant to users of the accounts is gross revenue expenditure, as it reflects both the revenue expenditure and income for the year, and can meaningfully be applied when considering entries in the Council's Balance Sheet.

4. External auditor's assessment of materiality

In conducting their audit of financial statements, the Council's external auditor seeks to obtain reasonable assurance about whether the financial statements 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 the applicable financial reporting framework.

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

In their Audit Findings Report for 2021-22, the Council's external auditors quantified their **overall materiality at £7.75 million** (being 2% of gross revenue expenditure at 'Cost of services' level in the audited 2020-21 accounts).

Note that this provides a lower measure of materiality than that based on a similar percentage of gross revenue expenditure at 'Surplus / deficit on provision of services' level, which includes the impact of financing expenditure and one-off expenditure on losses on disposal of non-current assets. It can be argued that the inclusion of such expenditure might mask the reflection of the cost of the provision of the Council's services in the accounts.

The external auditor's assessment of materiality is a key benchmark in determining the Council's overall materiality level when preparing the draft accounts.

There is a risk that more than one non-material error or omission could be material to the accounts when considered in aggregate. Hence external auditors also set a 'performance materiality', at a level less than the overall materiality, 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 ‘performance materiality’ in the range of 50-75% of overall materiality 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

In their Audit Findings Report for 2021-22, the Council’s external auditors quantified their **‘performance’ materiality at £5.8 million**, being 75% of their overall materiality level.

5. Council’s assessment of materiality

The Council needs to provide sufficient assurance to the external auditors that the financial statements are materially correct. 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.

Setting a materiality limit too high could 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. 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:

- excessive detail and ‘clutter’ being included in the accounts, detracting from the clarity of the key messages being communicated, and
- additional officer and auditor time being required to prepare and audit the accounts when deadlines are already tight.

The Council has a history of producing high quality, accurate draft financial statements. 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, in recent years.

It is therefore considered appropriate to set the Council’s performance materiality level in preparing the accounts at one third of the external auditor’s materiality (based on 2 % of gross revenue expenditure at ‘Cost 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.

This gives a value of overall materiality to be used as a guideline by officers in drafting the Council’s 2022/23 accounts of **£7.75m**, and a performance materiality estimated at **£2.58m.**

6. Items which are material by nature

Officers drawing up the accounts, and auditors undertaking the audit of the accounts, may identify 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.

Officers have reviewed the statement of accounts, including the associated disclosures, for other items which would be most likely to impact on the decisions of likely users of the accounts, notably local residents. Disclosures identified as 'material by nature' are:

- Officers' remuneration, salary bandings and exit packages
- Members' allowances - as of interest to local residents, and
- Related party transactions –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 numerical 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 to 'de-clutter' the accounts, and allow better focus on the key messages in the accounts.

Appendix C

Critical judgements in applying the Council's accounting policies

In applying its accounting policies, the Council has had to make judgements about complex accounting transactions.

The critical judgements currently identified by officers are:

- the accounting treatment of Covid-19 response funding,
- the accounting treatment of Better Care Funding,
- the accounting treatment of schools' non-current assets, and
- the classification of the Council's commercial investment property.

The judgement disclosed in the 2021/22 accounts in relation to whether group accounts need to be prepared to account for the transactions undertaken by the Council's subsidiary company, North Somerset Environment Company Ltd, is likely to be removed from the disclosure of critical judgements. This is considered to no longer require significant judgement due to the clear materiality of the company's transactions on the group accounts.

Appendix D

Significant accounting estimates and sources of estimation uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future or that are otherwise uncertain. Estimates are made considering historical experience, current trends and other relevant factors.

There have been no significant changes to the basis of these estimates compared to the previous year.

The areas of the accounts which are subject to material accounting estimates, or significant estimation uncertainty are currently assessed as follows:

- investment property valuations, including impairments,
- property, plant and equipment valuations, including impairments, and
- the pension fund (LGPS) net liability valuation, and actuarial gains and losses. Note that a triennial revaluation of the pension fund assets and liabilities is due to be undertaken by the actuary in 2022/23.

Other areas where accounting estimates are used, but considered less likely to have a material impact include:

- estimated remaining useful lives of PPE / depreciation and amortisation,
- measurement of financial instruments,
- bad debt provisions / credit loss allowances,
- provisions for liabilities, and
- accruals.