ITEM 6

NORTH YORKSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

5 DECEMBER 2013

ACCOUNTING POLICIES

Report of the Corporate Director – Strategic Resources

1.0 **PURPOSE OF THE REPORT**

1.1 To approve in principle the changes to the County Council's Accounting Policies for the current financial year 2013/14

1.2 To note potential changes in the pipeline that are likely to impact on future year's Accounting Policies and the Statement of Final Accounts.

1.3 To consider whether the current requirement for the Audit Committee to approve changes in the County Council's Accounting policies is appropriate.

2.0 BACKGROUND

2.1 The Audit Committee is responsible for approving any changes in accounting policy.

2.2 The County Council's accounting policies are set out in the annual Statement of Final Accounts (SOFA) and have been developed to comply with the *Code of Practice on Local Authority Accounting in the United Kingdom* issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). These accounting policies have been based on International Financial Reporting Standards (IFRS) since 2010/11.

2.3 An annual updated Code of Practice, applicable for 2013/14, has been issued by CIPFA.

2.4 In addition to considering the required changes to the County Council's accounting policies for 2013/14, there are further changes which CIPFA have recently consulted local authorities upon which are in the pipeline for future years (2014/15 and beyond) to bring to the Committee's attention.

3.0 CHANGES IN ACCOUNTING POLICY FOR 2013/14

3.1 The need for changes in accounting policy can arise from:

(i) mandatory changes under the annual IFRS based *Code of Practice on Local Authority Accounting* which require a new or revised accounting policy to be adopted by all local authorities

(ii) changes within the overall framework of the *Code of Practice* but where the policy to be adopted is discretionary and is dependent upon interpretation of local circumstances

3.2 The changes required to the County Council's accounting policies for 2013/14, therefore arise from an updated IFRS based *Code of Practice on Local Authority Accounting* issued by CIPFA in April 2013.

3.3 Supplementary updates to this 2013/14 *Code of Practice* may be issued to reflect any further developments to statutory accounting or disclosure requirements which have taken place since publication.

3.4 Most of the changes reflected in the 2013/14 updated Code and any subsequent supplementary updates do have to be incorporated into the County Council's accounts but do not necessarily impact on the County Council's accounting policies. This is because the changes are principally around additional or changed disclosure notes, points of clarification and additional guidance etc.

3.5 Changes to the *Code of Practice* that impact on the County Council's Accounting Policies in 2013/14 are as follows:

- Employee Benefits
- Landfill Allowance Trading Scheme
- The presentation of Financial Statement (in particular the Comprehensive Income & Expenditure Account)
- The Localisation of Business Rates since 1 April 2013

3.6 Further details of these proposed changes are set out in **Appendix A**. The Accounting Policies ultimately determined for 2013/14 will be reported to Members on 17 July 2014 as part of the report accompanying the draft SOFA for 2013/14. At this stage, therefore, Members are asked to approve these changes in principle.

3.7 **Appendix A** also lists the key changes to the latest 2013/14 *Code of Practice on Local Authority Accounting* which will need to be considered and, where appropriate, reflected in the 2013/14 SOFA. As mentioned in paragraph 3.3 however, further supplementary updates to this may be issued which may result in further changes to the draft SOFA.

4.0 POTENTIAL CHANGES IN THE PIPELINE FOR FUTURE YEARS

4.1 CIPFA have recently consulted on a draft *Code of Practice on Local Authority Accounting* for 2014/15 and provisional changes for future years beyond 2014/15, with the key potential changes set out in **Appendix B**.

4.2 The extent to which these changes will actually be implemented by CIPFA remains uncertain however and is subject to further confirmation and guidance.

5.0 FUTURE APPROVAL OF CHANGES IN ACCOUNTING POLICIES

5.1 One of the current terms of reference of this Committee is *'to approve changes in accounting policy'.*

5.2 As mentioned in **paragraphs 2.2 and 3.1** however all changes in accounting policies are driven in general by changes to the statutory backed Code of Practice on Local Authority Accounting and are therefore outside the control of the County Council. Local discretion is only required where there are changes within the overall framework of the Code of Practice but where the policy to be adopted is discretionary and is dependent upon interpretation of local circumstances. Such changes requiring local discretion are however relatively infrequent.

5.3 Members are therefore asked to consider whether the current requirement for this Committee to approve changes in accounting policies is appropriate. This issue is picked up again elsewhere in the Committee's agenda 'Audit Committee Terms of Reference',

6.0 RECOMMENDATION

6.1 That Members:

(i) approve in principle the changes in accounting policy for 2013/14 required to comply with the 2013 'Code of Practice on Local Authority Accounting' (**paragraph 3.5** and **Appendix A**).

(ii) note the potential changes to the SOFA and accounting policies which are in the pipeline for future years (2014/15 onwards) (**paragraph 4** and **Appendix B**).

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22 November 2013

APPENDIX A

CHANGES TO THE CODE OF PRACTICE ON LOCAL AUTHORITY ACCOUNTING 2013/14

1.0 Introduction

1.1 The have been some changes made to the IFRS-based Code of Practice on Local Authority Accounting for 2013/14. In addition there may be further updates which could impact on the Statement of Final Accounts (SOFA) and also potentially the Accounting Policies of the County Council for this current financial year.

2.0 IFRS Code Change resulting in changes to an Accounting Policy – which are applicable to the County Council

3.0 *Revisions to IAS 19 – Employee Benefits: - Amendments to the terminology, classification, recognition, measurement and disclosure requirements on Post-Employment (retirement) benefits*

3.1 CIPFA have made changes to the definitions and terminology of various Employee Pension Benefits defined under IAS (International Accounting Standard) 19 which will be incorporated into NYCC's Accounting Policy on Pension Benefits.

3.2 The major components of defined benefit costs have been redefined as:

- service cost (previously referred to as "Net Service Cost");
- net interest on the net defined benefit liability (asset) **(**previously referred to as "Pensions interest cost and expected return on pension assets") ; and
- re-measurement of the net defined benefit liability (asset) (previously referred to as "Actuarial losses on pension assets and liabilities.").

3.3 These changes do not impact on the value of assets and liabilities recorded in the Balance Sheet although some of the calculations supporting these figures will change and will need to be reflected in both the Comprehensive Income and Expenditure Statement and the disclosure note for accounting for Pension Fund liabilities (including a restatement for the prior year).

3.4 The Actuary has provided a revised IAS 19 schedule as at 31 March 2013 to illustrate the impact of these changes.

3.5 The lines on the Comprehensive Income & Expenditure Account currently entitled "Pensions interest cost and expected return on pension assets" and "Actuarial losses on pension assets & liabilities" will be renamed to reflect the reclassification of major components of defined benefit costs described above.

3.6 In addition within IAS 19, subtle changes have been made to the point at financial year-end when the accrual of termination benefits must be measured in relation to redundancy and pension strain costs.

4.0 ***Removal of Accounting Policy associated with the Landfill Allowance Trading Scheme because this trading scheme in relation to Waste Disposal Authorities such as the County Council ended in 2012/13.***

5.0 ***Presentation of Financial Statements***

5.1 Changes are required to the presentational grouping and classification of items in the “Other Comprehensive Income” section of the Comprehensive Income and Expenditure Statement. This reclassification is required because certain types of income under this category are potentially open to be reclassified to the Surplus or Deficit on the Provision of Services. Such items are likely to be restricted to “gains or losses” on sales of financial assets (eg short term and long term investments).

5.2 Although CIPFA class this as a change in accounting policy, it is really no more than a presentational change.

6.0 ***Localisation of Business Rates in England and Business Rate Schemes for Local Authority Retention of Business Rates.***

6.1 Under the new NNDR arrangements from 1 April 2013, Non-domestic rating income included in the Comprehensive Income and Expenditure Statement must represent the accrued position at year-end.

6.2 The change in accounting policy has arisen due to recent (2013/14) changes to how NNDR is collected, allocated and retain locally. The collection of NNDR is an agency arrangement, with the cash collected by the billing authority belonging proportionately to the billing authority, central government and major preceptors with NYCC now receiving 9% of NNDR collected by each District Council.

6.3 Billing authorities will be expected at the year-end to provide information on the accrued income associated with each major preceptor’s share of the accrued non-domestic rating income.

6.4 Further guidance is expected from CIPFA to clarify this change in accounting policy.

6.5 However it is expected that this change in accounting policy will be broadly similar to the existing Accounting Policy in relation to the Council Tax Collection Fund accounts held by the 7 District/Borough Councils.

6.6 There will be a debtor/creditor position at the year-end between the billing authority, central government and each major preceptor to be recognised, as the cash paid to central government and each major preceptor in the year will be different to each recipient’s share of actual NNDR collected. This difference between accrued and actual NNDR received will not impact on the General Working Balance or Revenue Budget of the County Council in 2013/14 however, and it is expected that this will be adjusted for through the Movement in Reserves Statement. Such variations will however impact on the following year’s budget.

6.7 It is expected that the County Council will also need to make provision for the following values in its Balance Sheet at the year-end for the following:-

- Debtor provision for the County Council's share of NNDR arrears
- Provision for bad debts of Debtors in relation to the County Council's 9% share of NNDR arrears
- Creditor provision for NNDR over-payments and pre-payments

6.8 CIPFA have also provided initial guidance, with more detail expected in due course on the accounting arrangements where a group of local authorities have formed a Business Rates Pool. This may affect the County Council in future years if a recent proposal for a North Yorkshire Business Rates Pool from 1 April 2014 is successful.

7.0 Code of Practice Changes Resulting in Changes to the SOFA which could apply to the County Council:

8.0 *Service Concession Arrangements (PFI/PPE)*

8.1 CIPFA have enhanced their guidance on accounting for Service Concession Arrangements (which includes PFI Schemes). This guidance provides new definitions and clarifications regarding at what point an organisation should bring on-balance sheet assets under construction under these types of arrangements. The new guidance also confirms that intangible fixed assets can be brought on balance sheet under the guise of a Service Concession Arrangement.

8.2 This does not have an immediate impact on NYCC's accounts or its' current Accounting Policies, but will need consideration for any future PFI Schemes.

9.0 *Financial Instrument Disclosures*

9.1 CIPFA have amended their requirements on disclosures in relation to Financial Instruments. In particular this change relates to circumstances where an authority may choose to off-set Financial Assets and Liabilities. More disclosure requirements would be required in such a rare circumstance to explain what the grossed up value of these financial assets and liabilities actually represent, the financial instruments which fall under the scope of these off-setting arrangement and a reconciliation of these amounts to the balance sheet.

9.2 This is not expected to have any impact on the County Council as its Accounting Policy is to gross up values of Assets and Liabilities in the Balance Sheet.

10.0 *Accounting for Leases and Non-current Assets*

10.1 CIPFA have issued a number of re-clarifications and amendments of guidance in relation to leases and non-current assets. None of these changes appear to change the County Council's Accounting Policies or Disclosure requirements.

10.2 New definitions have been included for the inception and commencement of a lease term for clarification purposes.

10.3 Extra guidance has been provided to local authorities for determining the lease-status of lease arrangements where a peppercorn rental is charged.

APPENDIX B

POTENTIAL FUTURE CHANGES TO THE CODE OF PRACTICE ON LOCAL AUTHORITY ACCOUNTING & ACCOUNTING POLICIES FOLLOWING RECENT CIPFA CONSULTATION

1.0 Introduction

1.1 CIPFA have recently consulted on some proposed changes to the 2014/15 Code of Practice (to be issued in early 2014), and have also provided indications of further potential changes that are likely to be reflected in updates to the 2015/16 Code and beyond. Some of the changes outlined below were however reported to the Audit Committee in December 2012 as being in the pipeline.

2.0 Code of Practice on Transport Infrastructure Assets:

2.1 CIPFA consulted in summer 2013 on the future adoption in the 2015/16 code of the measurement requirements of the CIPFA Code of Transport Infrastructure Assets.

2.2 The Accounting Code currently measures infrastructure assets at depreciated historical cost, which is compliant with the requirements of IFRS, but it is not, in CIPFA's view, the most appropriate measurement base for the valuation of transport infrastructure Assets of local authorities. CIPFA has long held the view that current (depreciated replacement cost) value accounting is the more appropriate measurement base of local authority assets. This would have the impact of significantly increasing the value of non-current assets held on the balance sheet with an associated significant increase in value of depreciation charges on the Comprehensive Income and Expenditure Statement.

2.3 NYCC have complied with the additional reporting requirements of valuing highways infrastructure assets at depreciated related cost for providing additional information for Whole of Government Accounts, and have maintained a state of readiness to address future developments in this area. Indeed, until the Accounting Code adopts the measurement requirements of the Transport Infrastructure Code, councils are likely to need to operate dual reporting arrangements.

2.4 CIPFA still believe however that there are significant practical difficulties with the implementation of depreciated replacement cost as a measurement requirement. Therefore a phased implementation is being proposed which includes a "dry run" of the approach in the 2014/15 code.

2.5 For 2014/15 local authorities will be required to provide DRC information in the financial statements (which CIPFA say would not need retrospective restatement in 2013/14). This would then be followed by the formal adoption of the DRC measurement base for transport infrastructure in 2015/16 (with the requirement for comparative information to be provided for 2014/15).

2.6 CIPFA is also considering an additional form of a phased implementation whereby the formal adoption of the DRC measurement based for 2015/16 would be for carriageways only and that remaining classes of infrastructure assets move to a DRC basis from 2016/17. Carriageways are the more material type of asset.

2.7 Other key changes to Transport Infrastructure are as follows:

- The Transport Code has been revised to take into account issues raised during its initial implementation, to update references and strengthen links between the Code of Practice on Local Authority Accounting

- Use of R199b road lengths (previously agreed with the DoT): The original Transport Code required R199b road lengths, adjusted for dual carriageways, to be used in order to calculate Gross Replacement Cost and required an authority's own inventory data to be used for Depreciated Replacement Cost. The updated Code proposed that for valuation purposes, own inventory data should be used for both types and that GRC rates are updated to reflect this.

- For valuation purposed, in order to reflect the usage of the asset, it is to be assumed that components or elements will only be replaced or reinstated when they reach the end of their useful economic life.

3.0 **Fair Value Measurement (IFRS13)**

3.1 The 2014/15 Code will include proposals for adoption of IFRS 13 *Fair Value Measurement.* The Standard provides a single definition of fair value, which is based mainly on market values. Currently the County Council value Land and Buildings at their fair value in existing use for assets where there is an active market (eg. Offices) and Depreciated Replacement Cost (for assets where there is not an active market). Market prices for an asset and for Property Plant and Equipment (PPE) will require a valuation to be at its highest and best use. This standard was deferred for a year due to concerns over applicability to public sector organisations.

3.2 The proposals for the approach to the adoption of IFRS 13 by local authorities will offer 3 routes for the measurement of local authority PPE:

- Route 1: where local authorities hold their assets in the same way as commercial entities, (eg. office accommodation): the measurement of these assets would apply to the requirements of IFRS 13 – and these assets would be measured at their highest and best use, which might be different to the current measurement basis outlined above. For this Route, some assets will need to be re-valued using a desk-top exercise to be done using appropriate indices and relevant market information for a period of 3 years until local authorities can undertake a formal revaluation under the new requirements.

- Route 2: assets which have unique characteristics, or where it is difficult to estimate the asset value at highest and best use. Assets that have unique characteristics such as crematoria buildings would be measured by means of a theoretical estimation of fair value. In this case, the best measurement basis would continue to be Depreciated Replacement Cost (DRC).

- Route 3: There are circumstances where application of the principle of highest and best use does not fully capture the service and geographical constraints faced by the public sector. This would mean that local authorities cannot realistically access the economic benefits available to market participants under the Standard. Examples of this would be buildings which are used by the public sector which have to be provided in a specific location for a specific purpose. CIPFA consider that IFRS 13 needs adapting to reflect local government circumstances and therefore the measurement methodology will not change.

3.3 The impact of this proposed change will require consideration by NYCC's valuers (currently Bruton Knowles) and is likely to result in some changes to valuations for non-school properties (although not expected to be significant) and consequential depreciation charges.

4.0 **Group Account Standards**

4.1 CIPFA are consulting on 5 new or amended group accounting standards introduced by the IASB in 2011. These include a new single control model under IFRS 10 Consolidated Financial Statements which focuses on the power of a parent to control variable returns (including non-financial returns) from its involvement or interest in another entity. CIPFA do not expect these amendments to affect the determination-process of the Group Boundary, but the proxy indicator of simply having voting rights may no longer be the main indicator of a parent/subsidiary relationship.

4.2 IFRS 11 Joint Arrangements: There are new provisions under IFRS 11 Joint Arrangements in relation to the classification of joint arrangements. IFRS 11 now only includes 2 types of joint arrangement; - joint operations and joint ventures. This standard now focuses on how the rights in the arrangement are shared as opposed to previous requirements which focused on structure. This may cause local authorities to review the classification of joint arrangements.

4.3 The group accounting standards also include IFRS 12 Disclosure of Interests in Other Entities. The proposals for both this and IFRS 13 introduce numerous new and amended disclosure requirements for local authorities which focus on the parent-subsidiary arrangement, how this arrangement has been determined, the practical nature of this arrangement and risks associated with these group arrangements for both the parent and the subsidiary organisations.

4.4 Although further clarification is expected the impact of these changes on the County Council's Group Accounts will potentially be an increase in the disclosure requirements regarding the nature of our relationship with group organisations.

5.0 **Simplifying and Streamlining the presentation of Local Authority Financial Statements:**

5.1 Local Authorities are required to keep their accounts in accordance with proper practices and in line with the *Code of Practice on Local Authority Accounting in the UK (the Code)* which has been based on International Financial Report Standards since 201/11. CIPFA acknowledge that the statutory requirements for determining an authority's financial position for council tax remain different to the complicated accounting adjustments needed to produce year-end financial accounts.

5.2 Following the implementation of IFRS, CIPFA acknowledge that local authority financial statements have become too lengthy and complex a similar issue which blights the accounts of other sectors in the UK. The Audit Commission have highlighted this is a report "Lets be Clear" which noted that the average length of the 2010/11 accounts were 113 pages long and ranged between 39 and 250 pages. The County Council's 2012/13 accounts were 173 pages long.

5.3 IFRS were developed from a private sector perspective, and were originally designed to meet the needs of investors who were seen as a primary user of a financial statement of an organisation. CIPFA have stated that they are concerned some of the IFRS disclosures are not best suited to a public sector context.

5.4 In June 2013 HM Treasury issued a consultation paper on the process of simplifying and streamlining central government accounts. CIPFA concur with HM Treasury and whilst wishing to ensure transparency remains, during times of resource constraint, accounts need to be seen to meeting the needs of users and are not overly burdensome to prepare.

5.5 Users and preparers of local authority accounts have been asked for their views on:

- Identification of sections of the financial accounts which are either particularly informative or particularly difficult to use.
- Do local authority accounts add value or are there any further areas which need to be included within these accounts to improve usability?
- Does the formatting of local authority accounts need changing?
- Are the accounts too lengthy and unwieldy?
- Are the accounts burdensome to prepare?
- Is the prescribed format for preparation of the accounts tailored to the local authority or are there many sections which appear less relevant?
- Do the financial statements accurately and cohesively convey the performance of the authority over the year?

5.6 The potential outcome of the consultation is still unclear but the Audit Committee will be informed of any future developments in this area.