Agenda Item No:

AUDIT COMMITTEE

CARLISLE CITY COUNCIL
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Committee Report

Public

Date of Meeting: **23 January 2007**

Title: **SORP 2006 – ACCOUNTING POLICIES AND REVISIONS TO THE 2006/07 STATEMENT OF ACCOUNTS**

Report of: **The Director of Corporate Services**

Report reference: **CORP77/06**

Summary:
The purpose of this report is to inform members of revisions to the format of the 2006/07 Statement of Accounts, due to the implementation of the 2006 Statement of Recommended Practice (SORP). The report also provides a set of draft Accounting Policies for Members consideration for inclusion within the 2006/07 Statement of Accounts.

Recommendations:
Members are asked to: -

1) Note the changes to the Statement of Accounts required by the SORP.

2) Consider the draft Accounting Policies outlined in **Appendix 1** to this report, for inclusion within the 2006/07 Statement of Accounts.

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Note: in compliance with section 100d of the Local Government (Access to Information) Act 1985 the report has been prepared in part from the following papers: None

CITY OF CARLISLE

To: The Chair and Members of The Audit Committee
23 January 2007

CORP77/06

ACCOUNTING POLICIES AND REVISIONS TO THE 2006/07 STATEMENT OF ACCOUNTS

1. Introduction

1.1 CIPFA reviews the Code of Practice on Local Authority Accounting annually to meet national standards required by the Accounting Standards Board (ASB) and issues a Statement of Recommended Practice (SORP) to incorporate changes required to meet these standards. Practitioner guidance notes are also produced which provides detailed guidance on how to implement the SORP. Although the SORP for 2006 was produced in July 2006, the Practitioner Notes are still not available and are due to be published in February 2007.

1.2 Once produced these guidance notes will need to be reviewed and a further report and training session may be required for the Members of the Audit Committee in April 2007.

1.3 The 2006 SORP proposes some fundamental changes for both the 2006/07 and 2007/08 Statement of Accounts which are substantive in nature and of a higher volume than in previous years.

1.4 This report outlines the changes for both sets of Accounts but concentrates on providing more detailed information on the changes to the 2006/07 Statement of Accounts to enable members to give full and robust consideration of the Accounts when they are submitted for approval later in the year.

2. Summary of the Changes

2.1 The 2006 SORP proposes changes, which affect both the accounting policies of the Council and, more significantly, the way the 2006/07 Statement of Accounts are to be presented.

2.2 The aim of the SORP and associated changes is to ensure that the Statement of Accounts presents fairly the financial position and transactions of the Council and where there are variations from the SORP, or changes to accounting policies arising from implementation of the SORP, then these variations and changes are disclosed in the Statement of Accounts

2.3 The substantive changes proposed for the 2006/07 Statement of Accounts, which affect this Council are as follows: -

(a) Accounting Policies

(i) The requirement to charge services with a notional interest, or capital financing charge, is removed. Therefore services will only be charged with depreciation costs to reflect the reducing value of assets used in service provision. This charge will then be reversed out of the Statement on the General Fund balance thus neutralising the effect of these charges on the Council Tax requirement.

(ii) Gains or Losses on the sale of assets by the Council must now be reflected in the net operating costs of the Council. Such gains or losses arise where the proceeds of the sale are either more (gain) or less (loss) than the value of the asset held within the Balance Sheet at the time of sale.

(iii) The existing Statement of Accounting Policies has been reviewed to reflect these changes and also to provide further explanation of other existing policies and this is attached at **Appendix 1**. Members are asked to consider the accounting polices as outlined to provide the basis for the preparing the 2006/07 Accounts.

(iv) For accounting periods commencing on or after 1 April 2007, i.e. 2007/08 onwards, the Fixed Asset Restatement Account and Capital Financing Account will be replaced by a Revaluation Reserve and a Capital Adjustment Account to meet UK GAAP requirements. This proposal is still subject to consultation so the final details of how these changes will be incorporated into the 2007/08 Statement of Accounts are still awaited. Members will be informed of the final proposals when they have been issued by CIPFA.

(v) Revised requirements for the reporting of Financial Instruments under FRS25 &FRS29 (Disclosure and Presentation) and FRS26 (Measurement) are also proposed for financial years 2007/08 onwards. These proposals will only apply to Councils which have issued listed securities i.e. securities that can be traded on financial markets, or which have undertaken a debt re-structuring exercise, giving rise to a potential premium or discount. Again the proposals are subject to consultation and the final details are still awaited. It may be necessary to bring forward a further report in due course, should the final proposals affect the position of the Council.

(b) Statement of Accounts

(i) The current SORP requires the Council to prepare a Consolidated Revenue Account which summaries the amount the Council spends on its services and how this spending was paid for from Council Tax, Government Grants and Council Reserves. The 2006 SORP has replaced this with: -

- An Income and Expenditure Account, which provides information on the net cost of service provision.

- A Statement of Movement on the General Fund, showing details of all transactions affecting the movement on the General Fund in the year.

- A Statement of Total Recognised Gains and Losses showing details of

  - The surplus or deficit on the Income and Expenditure Account ,
  - The gains or losses on the revaluation of fixed assets, as opposed to the gains or losses on the sale of fixed assets, which are included in the Income and Expenditure Account.
  - Actuarial gains or losses on pension fund assets and liabilities.
  - Gains or losses arising from movements in reserves held by the Council.

These statements, together with the Balance Sheet and Cash Flow Statement are now recognised as the core financial statements of the Council.

(ii) The core financial statements as defined above are now to be grouped together in one section and be followed by the explanatory notes to the financial statements, the Collection Fund (and associated notes) and other statements such as the Statement of Responsibilities for the Statement of Accounts and the Statement of Internal Control.

It is recognised that it is difficult for members to fully understand the effect of these proposals without seeing the implications at first hand. For this reason, a further training session is proposed for April 2007 when the restated 2005/06 accounts will be available if required.

3. Recommendations

3.1 Members are asked to

- Note the changes to the Statement of Accounts proposed by the SORP and
- Consider the draft Accounting Policies outlined in **Appendix 1** to this report, for inclusion within the 2006/07 Statement of Accounts.

ANGELA BROWN
Director of Corporate Services

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APPENDIX 1

DRAFT

STATEMENT OF ACCOUNTING POLICIES

2.1 General

These accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2006 – A Statement of Recommended Practice (SORP) issued by the Chartered Institute of Public Finance and Accounting (CIPFA). The accounts accord with guidance notes issued by CIPFA on the application of accounting standards and comply with the Best Value Accounting Code of Practice (BVACOP). The Code also constitutes proper practices under Section 21 (2) of the Local Government Act 2003.

This section discloses the specific accounting policies adopted by the Council for the completion of the accounts.

2.2 Fixed Assets

(i) Tangible Fixed Assets

All expenditure on the acquisition, creation or enhancement of fixed assets has been capitalised on an accruals basis. This includes assets held under finance leases, which have been capitalised and included in the balance sheet at a value reflecting the Council's obligation to meet future rental payments.

De-minimis levels have been set at:

- £5,000 for expenditure on individual items of vehicles, plant and
- £20,000 for expenditure on land, buildings and other structures.

Fixed assets are valued and included in the balance sheet on the basis recommended by the CIPFA Code of Practice and in accordance with the Practice Statements in the Royal Institution of Chartered Surveyors (RICS) Appraisal and Valuation Manual:

- Operational assets are included in the balance sheet at the lower of net current replacement cost or net realisable value in existing use.
- Non-operational assets are valued and included in the balance sheet on the basis of open market value.
- Infrastructure works and Community Assets completed or acquired after 1 April 1994 are included in the Balance Sheet at historic cost.

In accordance with the CIPFA recommended practice on capital accounting, assets are re-valued on a cyclical basis over a 5-year period.

(ii) Intangible Assets

Expenditure on assets that do not have physical substance but are identifiable and provide benefit to the Council for periods of more than one year is also capitalised e.g. computer software programmes. These assets are held at cost and written off over their economic lives, subject to a maximum of 20 years dependent on the type of asset.

(iii) Impairment

Every asset category that is depreciated, and material individual assets that are not being depreciated, is reviewed annually for evidence of reductions in value, or impairment. Where impairment is identified as a result of this review or as a result of changes arising from annual valuations, this is accounted for by:

- Charging the relevant service where there is clear evidence of the consumption of economic benefits or,
- Charging the Fixed Assets Restatement Account with the loss in value in all other cases.

(iv) Gains and Losses on the Disposal of Assets

Gains and losses on the disposal of fixed and intangible assets are charged to Net Operating Costs within the Income and Expenditure Account.

Gains and losses are arrived at by calculating the difference between the net book value of the asset sold that is held within the Balance Sheet and the proceeds from the sale.

To comply with proper practices on the use of capital receipts however, all such gains and losses are reversed out of the General Fund balances and an amount equal to the sale proceeds is credited to the Usable Capital Receipts Reserve. The value of the assets held by the Council is reduced by the net book value of the asset(s) sold and a corresponding charge is made to the Fixed Asset Restatement Account.

2.3 Capital Charges

The 2006 SORP required changes to the treatment of capital charges for the use of assets by services. With effect from 1 April 2006, the requirement to charge services with a notional interest charge to reflect the use of council assets as part of the cost of service delivery has been withdrawn. Services are now only charged with the cost of depreciation on the basis outlined in paragraph 2.4 below.

2.4 Depreciation

Depreciation is a charge that reflects the reduction in value of an asset as it gets older and its economic life reduces. It is calculated by apportioning the value of an asset over its finite useful life and therefore is only charged on those assets that have a finite useful life.

The useful life and methods of calculating depreciation for the various classes of assets held by the Council are as follows:-

Asset Category	Rate	Basis
Operational Land & Buildings	10-80 years	Straight-line
Infrastructure Assets	40-80 years	Straight-line
Operational Vehicles & Plant	3-25 years	Straight-line
Intangible Assets	3-20 years	Straight-line

Services and trading operations are charged annually with depreciation to reflect the use of assets owned by the Council in the delivery of their activities and these charges are therefore reflected in the Income and Expenditure Account.

2.5 Minimum Revenue Provision

The Council charges its income and expenditure account with amounts for depreciation, impairment losses and the write-off of government grants associated with capital spending. However the Council is not required to raise Council Tax to cover these costs but is required to make an annual contribution to reduce its outstanding borrowing. This is known as the Minimum Revenue Provision and equals 4% of the Council's underlying capital financing requirement. The Council has also decided to pay additional voluntary contributions to repay its outstanding borrowing. These sums are not reflected in the Income and Expenditure Account but in the Movement on the General Fund Balance and in the Capital Financing Account.

2.6 Leases

(a) Finance Leases

Rental payments under finance leases are apportioned between the finance charge, which is charged annually to the Income and Expenditure Account, and the outstanding liability in respect of the capital value of the asset, which reduces as the lease payments are made.

(b) Operating Leases

Rentals payable under operating leases are charged directly to the Council's Income and Expenditure Account on a straight-line basis over the life of the lease.

2.7 Deferred Charges

Some capital spending does not result in the creation of an asset and this spending is known as a deferred charge. It is Council policy to write off the value of deferred charges to services and reflect them in the income and expenditure account in the year they arise. The Income and Expenditure Account is then adjusted to neutralise the effect of the write off on the amounts to be raised through Council Tax in the year.

2.8 Capital Receipts

Capital receipts are generated from the sale of Council assets and can be used to pay for capital spending or be set aside to repay debt. They are known as usable capital receipts and the value held at 31st March 2007 is shown in note 4.34 to the accounts. Receipts from the sale of assets with a value of less than £10,000 are not treated as capital receipts but are reflected as revenue income to the service who previously held the asset and included in the Income and Expenditure Account.

2.9 Accruals of Income and Expenditure

Income and expenditure is accounted for in the year it relates to, not simply when cash is either received or paid. Particularly: -

- Fees and charges and other receipts from customers are accounted for as income at the date the Council provides the relevant goods and services.
- Supplies and services are accrued and accounted for in the period they are received or used. An exception occurs in respect of payments for energy and other similar quarterly payments that are charged at the meter reading date rather than being apportioned between financial years. This process is

consistently applied each year and therefore does not have a material effect on the accounts.

- Interest paid or received is accrued and accounted for in the period to which it relates on a basis that reflects the overall effects of the borrowing or investment generating the interest.
- Where income and expenditure has been recognised, but cash has not yet been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet.
- Where there is an uncertainty that all the income accrued and accounted for will be collected, a provision for bad debts is created by a charge to the income and expenditure account, reflecting the value of the income that might not be collected

2.10 <u>Stocks and Work in Progress</u>

Stocks are reflected in the Balance Sheet at current prices. This is a departure from the requirements of the Code and SSAP9, which requires stocks to be shown at actual cost or net realisable value, if lower. Stock values reflect a provision for obsolescence.

Work in progress is valued at cost in the Balance Sheet.

2.11 <u>Overheads and Support Services</u>

The costs of overheads and support services are apportioned to services using the principles contained in CIPFA's Best Value Accounting Code of Practice. The main methods of apportionment are as follows:

- Support services have been fully recharged to services based on time allocations completed by members of staff.
- The running costs of the Civic Centre have, with the exception of telephone costs, been apportioned to services on the basis of floor area occupied. Telephone costs have been apportioned on the basis of system usage.

The exceptions to these methods of apportionment relate to the costs for the Corporate and Democratic Core, which recognise the Council's status as a multi-functional democratic organisation, and certain non-distributed costs in relation to pension benefits. These costs are separately identified in the Income and Expenditure Account as part of the net cost of services.

2.12 <u>Provisions</u>

The Council maintains provisions for future liabilities or losses likely or certain to be incurred but whose amounts or timings cannot be determined accurately. The level of provisions is reviewed annually and adjusted where necessary to reflect current needs. Provisions are created by a charge to services and contributions are therefore contained in the net cost of services within the Income and Expenditure Account

2.13 <u>Reserves</u>

The Council maintains certain reserves for the purpose of meeting general, rather than specific, future-spending requirements. Reserves can either be earmarked to specific services or be of a more general nature to meet cash-flow or unexpected increases in spending. Expenditure will not be directly charged to any reserve.

Two further reserve accounts have been established in the Balance Sheet:

- The Fixed Asset Restatement Account represents principally the balance of the surpluses or deficits arising from the periodic revaluation of fixed assets

- The Capital Financing Account represents amounts set aside from revenue resources or capital receipts for the repayment of external loans and certain other capital financing transactions.

Neither the Fixed Asset Restatement Account nor the Capital Financing Account represent usable resources for the Council.

Total movements in the level of reserves are shown in the Statement of Total Gains and Losses and details of the individual reserves held by the Council are shown in note 4.34 to the Accounts.

2.14 <u>Pension Costs</u>

Employees of the Council are members of the Local Government Pension Scheme (LGPS), administered by Cumbria County Council.

The scheme is a funded defined benefit scheme meaning:

- Retirement benefits are determined independently of the investments of the scheme and employers have obligations to make contributions where assets are insufficient to meet employee benefits.
- It is accounted for by recognising liabilities as benefits are earned (i.e. employees work qualifying years of service), matching them with the Council's share of the assets of the scheme.
- The net position can either be an asset or liability matched by a pension reserve.
- The liabilities of the Cumbria County Council Pension Scheme attributable to the Council are included in the balance sheet on an actuarial basis. This basis uses an assessment of the future payments that will be made in relation to the retirement benefits earned to date by employees, after considering assumptions about mortality rates, employee turnover and earnings projections for employees.
- Liabilities are discounted to their value at current prices using a real discount rate of 4.9%

The assets of the LGPS attributable to the Council are included in the Balance Sheet at their fair value. Around 90% of LGPS assets are held in equity investments and bond issues with the remainder held in property and other assets.

Measurement bases applied in respect of the LGPS assets and liabilities are set out in note 4.38 to the Accounts.

The change in the defined benefit asset or liability (other than that arising from contributions to the Scheme) is analysed into the following components and recognised in the Statements as follows:

(a) Periodic costs

- Current service cost - included within Net Cost of Services.
- Interest cost and expected return on assets- included within Net Operating Expenditure
- Actuarial gains and losses - recognised in the Statement of Total Movements in Reserves. These charges or credits are taken directly to the Pensions Reserve and do not impact on the Income and Expenditure Account.

(b) Non-periodic costs

- Past service costs and gains and/or losses on settlements and curtailments - recognised in Net Cost of Services within Non-Distributed Costs.

As a result of the full implementation of FRS17 the pension costs charged to the Council's service revenue accounts are equal to the current service costs, rather than the contributions paid to the pension fund. The contributions paid into the fund on behalf of current employees together with costs arising in respect of pensions paid to retired employees are offset against the current service cost, and any compensating adjustment is shown as an appropriation to or from the Pensions Reserve. Any unpaid contributions to the scheme are presented in the balance sheet as a creditor due within one year.

Pension Reserve

The cost of providing pensions for employees is funded in accordance with the statutory requirements governing the particular pension schemes or funds in which the Authority participates.

Where the contributions paid to the pension scheme do not match the change in authority's recognised asset or liability for the year, the recognised cost of pensions will not match the amount to be raised in taxation. This is represented by an appropriation to or from the Pension Reserve, which equals the net change in the pension liability recognised in the Income and Expenditure Account.

2.15 Investments

Investments are shown in the Balance Sheet at lower of cost or market value. Interest receivable is credited to the Income and Expenditure Account. Further details can be found in Note 4.25 to the Financial Statements.

2.16 Government Grants

Revenue grants are accrued and credited to the Income and Expenditure Account in the same period in which the related revenue expenditure has been charged. Capital grants are credited to the Deferred Government Grant Account and written off to the Income and Expenditure Account over the life of the asset, thereby off-setting the depreciation charge for the asset. Grants in respect of deferred charges are written down over the same period as the deferred charge.

2.17 Gains and Losses on Debt Re-structuring

Gains and losses associated with discounts and premiums on the repurchase or early settlement of borrowing are normally recognised in Net Operating Costs within the Income and Expenditure Account in the period in which the repurchase or settlement is made. The exception to this is where the repurchase is coupled with a restructuring or financing of borrowing, and as a result does not substantially impact on the size of the overall loan portfolio or finance costs. Where one or more of these conditions is met the effect of the resulting premium or discount is deferred and charged to Net Operating Costs over the term of the replacement loan.

2.18 Value Added Tax

Value Added Tax is only included as income and expenditure received or paid by the Council, if it is classed as irrecoverable by HM Revenue and Customs.

2.19 Group Accounts

The authority has reviewed its interests with external bodies in 2006/07 as required by the SORP. The Council's analysis has concluded that it does not have any interests in subsidiaries, associated companies and joint ventures that are material in aggregate and therefore there is no requirement to produce a set of Group Accounts.