# BRISTOL CITY COUNCIL
# AUDIT COMMITTEE
# 28 JANUARY 2011

**Report of: Service Director, Finance**

**Title: International Financial Reporting Standards (IFRS) - Transitional Balance Sheet 1 April 2009**

**Ward: Citywide**

**Officer presenting report: Peter Robinson**

**Contact Telephone number: 0117 922 2419**

**The Committee is asked to**

i) note the transitional balance sheet at 1 April 2009 and the current position with the project;

ii) confirm acceptance of the draft accounting policies under IFRS.

**Summary**

The first stage towards implementation of IFRS is the preparation of the council's transitional balance sheet as at 1 April 2009. This becomes the starting point for the restatement of the 2009/10 accounts which will be the comparative year for the first year's accounts completed under IFRS, 2010/11.

This report presents the transitional balance sheet with explanation of the key changes to the balance sheet previously prepared under UK GAAP (Generally Accepted Accounting Principles).

**The significant issues in the report are:**

i) The transitional balance sheet at 1.4.09 and its key features
ii) The current position on IFRS adoption and the remaining timetable
iii) The draft accounting policies under IFRS

## Policy

All councils are required to follow the accounting standards set by CIPFA, when preparing their annual accounts. From 2010/11 local government is required to adopt International Financial Reporting Standards (IFRS).

## Consultation

1 Internal - Service Manager, Corporate Property, Head of Human Resources, Corporate Procurement Manager, Finance Manager, Schools, Finance Business Partners.

2 External - Grant Thornton, external auditors

## Context

3 The Committee received a report in November 2009 setting out the requirement to adopt IFRS and details of the main changes that this introduced. Reference has been made to IFRS in subsequent reports and, when approving the 2009/10 accounts in September, the committee requested that the restated balance sheet for 2009 be presented when available.

4 The IFRS Code was finally issued by CIPFA in December 2009. The transitional balance sheet at 1 April 2009 was completed in November 2010 following considerable work, particularly involving the review and reclassification of leases and certain groups of fixed assets.

5 The transitional balance sheet has been reviewed by the external auditor: the council's approaches to managing the more significant elements of IFRS transition have been documented and agreed with the auditors as work has progressed.

6 Considerable progress had already been made towards convergence with IFRS through changes in reporting requirements in previous years, ie those relating to Financial Instruments (in 2008/09) and accounting for PFI and service concessions (in 2009/10).

## Transition balance sheet - 1 April 2009

7 Two schedules are appended that show how the Council's balance sheet at 31 March 2009 has changed to meet the IFRS

requirements:

- representation of the balances prepared and approved under UKGAAP into the new IFRS format (Appendix 1)

- exemplification of the changes to these balances required to meet IFRS standards (Appendix 2)

Each of the columns in Appendix 2 is referenced to the explanation of the adjustments set out below:

1. **Employee benefit accrual**
   The council has included an accrual for employee benefits (principally holiday pay) totalling £13.9m. Of this, £8.5m relates to teachers. This accrual has been charged to a separate employee benefit reserve at the date of transition so that it does not impact on the general fund balance. Ongoing movements to the level of the accrual will also be charged to this reserve.

2. **Assets - Property, Plant and Equipment, etc**
   The adjustments made relate to two areas:

   - the review of £30m of 'Surplus Assets' against the new classification 'Assets held for sale'. The criteria for qualifying for the latter is much stricter, and as a result, £20m of the balance in now transferred to 'Operational property, plant and equipment'.

   - review of assets included under 'Investment property' against new criteria. This has also resulted in the reclassification of some items as 'Operational property, plant and equipment'.

   These reclassifications have also meant that the basis for valuing the assets involved has changed from market value to existing use, the effect of which contributes to the net reduction in the value of total assets.

3. **Cash and cash equivalents**
   Under IFRS, cash and cash equivalents are defined as short-term, highly liquid investments that are readily convertible to cash. In line with CIPFA guidance, amounts convertible within 3 months and previously shown as 'Short-term investments' (total £80m) have been reclassified under this new heading.

4. **Investments and bank overdraft**
The bank overdraft, previously shown as a balance in its own right is now included within 'Cash and cash equivalents'.

5. **Embedded lease**
An embedded lease arises where, under a contract for the provision of services to the Council, the assets used to fulfil the contract are used solely on the Council contract: no other party would receive any benefit from the use of the assets. In this situation, substantially all the risks and rewards of ownership of the assets rests with the Council and the contract is therefore deemed to included an embedded lease.
A detailed review of contracts has identified the Waste Collection contract as including such a lease: the new balance sheet therefore includes an increase to assets in respect of the waste vehicles (£1.3m) and a corresponding increase in long-term liabilities.

6. **Government grants**
Under the IFRS Code, the accounting for all grants and other external contributions is dependant upon the existence of any conditions attached to the funding.

i) **Revenue grants**
In respect of revenue grants, balances of grants held in creditors at 31 March 2009 have been reviewed and a number of items identified which have no conditions attached to them: under IFRS these should be recognised in the general fund (£3.1m adjusted).

ii) **Capital grants**
Unapplied balances at 31March 2009 have also been reviewed to establish the existence of any conditions. IFRS require that where there are no conditions, grants are recognised immediately in the income and expenditure account, and then reversed out in the statement of movement in reserves; where a condition exists but has not been met, the grant is transferred to the Capital Grants Receipts in Advance. Following the review, grants amounting to £2.6m have been reclassified from creditors to Capital Grants Receipts in Advance.

7. **Deferred government grants (capital)**
Under UK GAAP, capital grants once applied to finance

capital spend, were credited to a government grants deferred account and recognised in the income and expenditure account over a period equivalent to the depreciation charge for the asset in question. Under IFRS, capital grants are not deferred and therefore the balance on the government grants deferred account at 31 March 2009 (£128.9m) is transferred to the 'Capital Adjustment Account'.

8 As indicated above, the balance sheet has now been reviewed by Grant Thornton and their report is attached at Appendix 3. Paragraph of the report 1.9 states:

*Our review identified that the Council is making good progress in its transition to IFRS. The transition balance sheet was supported by comprehensive working papers which clearly set out the approach adopted by the council and justified the conclusions reached. The approach confirmed as in accordance with the requirements of the Code and we did not identify any issues which had not already been considered by the Council.*

**Next steps**

9 Work on the preparation of draft accounting policies under IFRS and the restatement of the 2009/10 primary statements is now being concluded. These will be made available to Grant Thornton for review during February. This work has been delayed from the original plan due to the detailed guidance to the IFRS Code only being published just before Christmas. Also underway is the development of a skeleton of the 2010/11 IFRS accounts, identifying new presentational and disclosure requirements.

10 In order for the Committee to have the opportunity to confirm its acceptance of the accounting policies, a draft statement is attached at Appendix 4. These are based on the pro-forma policies issued by CIPFA and tailored to local circumstances. At this stage, it is only a draft statement as some changes may be necessary following discussions with the auditors and issues arising from the completion and review of the restatement of the primary statements.

**Other Options Considered**

11 Not applicable.

**Risk Assessment**

12 Failure to comply satisfactorily with the requirements of the IFRS

Code could result in a qualified audit opinion. This would have an adverse effect on the Council's financial standing.

**Equalities Impact Assessment**

13 None arising directly from this report.

**Legal and Resource Implications**

**Legal:** None sought.

**Financial:**

**Revenue** - None directly arising from this report.

**Capital** - The completion of the Council's transitional balance sheet at 31 March 2009 is fundamental to the re-statement of the 2009/10 primary financial statements. 2009/10 will be the comparator year for the 2010/11 accounts, to be prepared on an IFRS basis.

**Land/Personnel:** None.

**Appendices:**
1. Format changes from UKGAAP
2. Transitional balance sheet
3. Grant Thornton report
4. Draft accounting policies

**ACCESS TO INFORMATION**

**Background papers:** IFRS Code (CIPFA)
IFRS Code Practitioners Guide (CIPFA)

**Bristol City Council** **APPENDIX NO. (13) 1**

**Restatement of transition balance sheet under IFRS**

| | UK GAAP 31-Mar-09 £'000 | |
|---|---|---|
| **Intangible assets** | 932 | |
| **Operational assets** | | |
| Council Dwellings | 1,063,903 | |
| Land and buildings | 611,155 | |
| Vehicles, plant and equipment | 8,069 | |
| Infrastructure assets | 37,193 | 764,795 |
| Community assets | 108,378 | |
| | | 69,078 |
| **Non operational assets** | | |
| Investment properties | 187,047 | |
| Assets under construction | 69,078 | |
| Surplus assets held for disposal | 30,021 | |
| Total fixed assets | 2,114,844 | |
| **Fixed asset & intangibles** | **2,115,776** | |
| Long term investments | 36,015 | |
| Long term debtors | 75,709 | |
| **Total Long term assets** | **2,227,500** | |
| **Current Assets** | | |
| Stocks and work in progress | 1,095 | |
| Debtors | 70,918 | |
| Investments | 104,718 | |
| Cash and bank balances | 1,134 | |
| **Net current assets** | 177,865 | |
| **Total assets** | 2,405,365 | |
| **Current liabilities** | | |
| Short term borrowings | (17,016) | |
| Creditors | (131,535) | |
| Cash overdrawn | (10,375) | |
| **Net current liabilities** | (158,926) | |
| **Total assets less current liabilities** | 2,246,439 | |
| Long term borrowing >12 months | (357,666) | |
| Government grants | (128,924) | (793,184) |
| Deferred liabilities | (67,816) | |
| Provisions | (7,346) | |
| Deferred capital receipts | (576) | |
| Government grants unapplied | (2,130) | |
| Defined benefit pension scheme liability | (440,142) | |
| PFI contract liabilities | (155,726) | |
| sub- long term liabilities | (1,160,326) | |
| **Total assets less liabilities** | 1,086,113 | |
| Financed by | | |
| Capital adjustment account | 1,262,931 | |
| Revaluation reserve | 110,277 | |
| Pensions reserve | (440,142) | |
| Capital receipts unapplied | 6,729 | |
| Reserves | 92,672 | 99,401 |
| Fin instrument adj account | (955) | |
| ***Balances*** | | |
| - general fund | 14,219 | |
| - housing revenue account | 30,515 | |
| - DSO's | - | |
| - collection fund | 172 | |
| - schools | 9,695 | |
| | 1,086,113 | |

| UK GAAP in IFRS format 31-Mar-09 £'000 | |
|---|---|
| | **Assets** |
| 833,873 | Property, plant and equipment |
| 1,063,903 | Council dwellings |
| 932 | Intangible assets |
| 187,047 | Investment property |
| 36,015 | Long-term investments |
| 75,709 | Long-term debtors |
| **2,197,479** | **Long term assets** |
| 1,095 | Inventories |
| 70,918 | Short-term debtors |
| 104,718 | Short-term investments |
| 1,134 | Cash and cash equivalents |
| 177,865 | |
| 30,021 | Surplus (UK) & new IFRS - Assets "held for sale" |
| 2,405,365 | **Total assets** |
| | **Liabilities** |
| (17,016) | Short-term borrowings |
| (131,535) | Short-term Creditors |
| (10,375) | Bank overdraft |
| (2,130) | Capital grants received in advance |
| (161,056) | **Current Liabilities** |
| (357,666) | Long-term borrowing |
| (7,346) | Provisions |
| (793,184) | Other long term liabilities |
| (1,158,196) | **Long term liabilities** |
| **1,086,113** | **Net assets** |
| | **Unusable reserves** |
| 1,262,931 | Capital adjustment account |
| 110,277 | Revaluation reserve |
| (440,142) | Pensions reserve |
| 172 | - collection fund |
| (955) | Fin instrument adj account |
| | **Usable reserves** |
| 99,401 | Other reserves |
| | **Fund balances** |
| 14,219 | - general fund |
| 30,515 | - housing revenue account |
| 9,695 | - schools |
| **1,086,113** | |

# APPENDIX NO. (13) 2

**Bristol City Council**
**Restatement of transition balance sheet under IFRS**
**At 31 March 2009**

| | UK GAAP in IFRS format 31-Mar-09 £'000 | IAS 19 - holiday pay accrual *Ref 1* £'000 | Non current assets: Property plant & equipment *Ref 2* £'000 | IAS 1 - reclassify bank deposits as cash and cash equiv *Ref 3* £'000 | IAS 1 - reclassify investments and also bank overdraft *Ref 4* £'000 | IFRIC 4 - Embedded lease adjustment *Ref 5* £'000 | IAS 20 - accounting for government grants (Revenue) *Ref 6 (i)* £'000 | IAS 20 - accounting for government grants (capital) *Ref 6 (ii)* £'000 | IAS 20 - accounting for deferred government grants (Capital) *Ref 7* £'000 | IFRS transition balance sheet 31-Mar-09 £'000 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | | |
| Property, plant and equipment | 833,873 | | 20,402 | | | 1,285 | | | | 855,560 |
| Council dwellings | 1,063,903 | | (1,034) | | | | | | | 1,062,869 |
| Intangible assets | 932 | | | | | | | | | 932 |
| Investment property | 187,047 | | (3,393) | | | | | | | 183,654 |
| Long-term investments | 36,015 | | | | | | | | | 36,015 |
| Long-term debtors | 75,709 | | | | | | | | | 75,709 |
| **Long-term assets** | 2,197,479 | | | | | | | | | 2,214,739 |
| Short-term investments | 104,718 | | | (80,322) | | | | | | 24,396 |
| Inventories | 1,095 | | | | | | | | | 1,095 |
| Short-term debtors | 70,918 | | | | | | | | | 70,918 |
| Cash and cash equivalents | 1,134 | | | 80,322 | (10,375) | | | | | 71,081 |
| Assets held for sale | | | 4,645 | | | | | | | 4,645 |
| **Current assets** | 177,865 | | | | | | | | | 172,135 |
| Surplus assets (Uk) | 30,021 | | (30,021) | | | | | | | |
| **Total assets** | 2,405,365 | | | | | | | | | 2,386,874 |
| **Liabilities** | | | | | | | | | | |
| Bank overdraft | (10,375) | | | | 10,375 | | | | | 0 |
| Short-term borrowing | (17,016) | | | | | (191) | | | | (17,207) |
| Short-term creditors | (131,535) | (13,945) | | | | | 3,069 | 2,643 | | (139,768) |
| Capital grants received in advance | (2,130) | | | | | | | (2,643) | | (4,773) |
| **Current liabilities** | (161,056) | | | | | | | | | (161,748) |
| Long-term borrowing | (357,666) | | | | | (1,143) | | | | (358,809) |
| Provisions | (7,346) | | | | | | | | | (7,346) |
| Other long term liabilities | (793,184) | | | | | | | | 128,924 | (664,260) |
| **Long-term liabilities** | (1,158,196) | | | | | | | | | (1,030,415) |
| **Net assets** | 1,086,113 | (13,945) | (9,401) | 0 | 0 | (49) | 3,069 | 0 | 128,924 | 1,194,711 |
| **Equity** | | | | | | | | | | |
| **Usable reserves** | | | | | | | | | | |
| Fund balances | 54,429 | | | | | | 3,069 | | | 57,498 |
| Other reserves | 99,401 | | | | | | | | | 99,401 |
| | | | | | | | | | | 0 |
| **Unusable reserves** | | | | | | | | | | 0 |
| Capital adjustment account | 1,262,931 | | 16,735 | | | (49) | | | 128,924 | 1,408,541 |
| Revaluation reserve | 110,277 | | (26,136) | | | | | | | 84,141 |
| Pensions reserve | (440,142) | | | | | | | | | (440,142) |
| Fin instruments adj acc | (955) | | | | | | | | | (955) |
| Collection fund adj acc | 172 | | | | | | | | | 172 |
| Accumulated compensated absences reserve | | (13,945) | | | | | | | | (13,945) |
| Capital grant unapplied reserve | | | | | | | | | | 0 |
| **Total reserves** | 1,086,113 | (13,945) | (9,401) | 0 | 0 | (49) | 3,069 | 0 | 128,924 | 1,194,711 |

Grant Thornton

# Bristol City Council

Review of Opening Balance Sheet restatement under International Financial Reporting Standards

January 2011

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# 1 Executive Summary

## Background and purpose of the report

1.1 The IFRS based Code of Practice on Local Authority Accounting in the United Kingdom (the Code) has effect from 1 April 2010. The 'transition date' to IFRS is therefore 1 April 2009.

1.2 In accordance with the requirements of IAS 1 (Presentation of Financial Statements) the Code requires the first IFRS based accounts (2010-2011) to include a Balance Sheet at the:

- opening of the comparative period (1 April 2009);
- closing of the comparative period (31 March 2010); and
- date of the accounts (31 March 2011).

1.3 Bristol City Council ("the Council") is responsible for the preparation of a restated opening balance sheet as at 1 April 2009 following the introduction of International Financial Reporting Standards (IFRS) and in accordance with the Code.

1.4 Auditors will not be issuing a formal 'opinion' on the opening balance sheet but this report is providing feedback to officers.

1.5 This report summarises the principal matters arising from our review of the opening balance sheet. The issues raised have been discussed with the Finance team.

## Form of our review

1.6 We were presented with the completed IFRS restatement analysis in October 2010. We commenced our review of the work completed to date by the Council in December 2010 with issues being discussed with officers whilst the fieldwork was undertaken.

1.7 Our review focused on the arrangements the Council has in place for ensuring that its transition to IFRS is progressing well and in accordance with the Code. We did not undertake a detailed analysis of the restated balances. Our work concentrated on restatement areas identified as key on a materiality basis. We reviewed the procedures undertaken by the Council to identify those areas felt to impact the financial statements as a result of the transition to IFRS and on ensuring that the approach adopted by the Council was in line with the requirements of the Code. We also examined whether there were detailed working papers in place to support the transition balance sheet with which we were presented

## What we found and next steps

1.8 The Council has engaged an independent consultant to assist it in its preparations for the introduction of IFRS. We have communicated consistently with the Council throughout its work plan and have discussed some of the major restatement exercises conducted.

1.9 Our review identified that the Council is making good progress in its transition to IFRS. The transition balance sheet was supported by comprehensive working papers which clearly set out the approach adopted by the Council and justified the conclusions reached. The approach was confirmed as in accordance with the requirements of the Code and we did not identify any issues which had not already been considered by the Council.

1.10 At the time of our review, in line with the project plan, and following receipt of the guidance notes in December 2010 (which included a proforma set of IFRS accounts) the Council is now working on accounting policies and supporting notes to the financial statements .

1.11 Overall we are satisfied with the progress made by the Council up to the time of our review. It is important that the Council continues its momentum and ensures that a full set of primary statements, supporting notes and accounting policies are produced as quickly as possible. This will aid the Council in preparing its first full set of IFRS accounts for audit in 2011.

1.12 It is clear from our review that the appointment of an IFRS consultant has been the driving force behind the work conducted thus far. We would therefore recommend that the Council retains that resource to ensure the project continues to progress in a positive manner.

## Use of this report

1.13 This report has been prepared solely for the use of the Council and should not be used for any other purpose or copied to third parties without our consent.

## Acknowledgements

1.14 We would like to record our appreciation for the co-operation and assistance provided to us by Council officers during the course of our review.

# 2 The Review of the Opening Balance Sheet

## Introduction

2.1 We summarise in this section our observations on the Council's opening balance sheet.

## Opinion on the UK GAAP accounts

2.2 On 30 September 2009, we issued our audit report on the full UK GAAP based accounts for the Council for 2008-09. This report concluded that the accounts were presented fairly. We have not, and are not required to, undertake any procedures to review this opinion.

## Scope of our responsibilities in preparing this report

2.3 Our work, for the purpose of preparing this report, has been restricted to reviewing the work undertaken by the Council to convert the 1 April 2009 balance sheet prepared in accordance with UK-GAAP to one prepared in accordance with IFRS.

2.4 Our work also included consideration of the Council's approach to managing its IFRS conversion project. We have not carried out a detailed audit of the conversion project plan, but may comment in this report on an exception basis if we have significant concerns about that project plan.

## Overall financial results

2.5 The Council has reported an increase in total net assets and reserves of £109m on transition to IFRS. This is mainly due to the reclassification of the Government Grants Deferred account to reserves.

2.6 Following the restatement of the amended UK GAAP balance sheet to the IFRS compliant balance sheet, the Council's opening balance sheet shows an increase in net assets from £1,086m to £1,195m. This is due, in the main, to :

a) £128m of deferred government grants being transferred to the capital adjustment account under the new IFRS recognition criteria; and

b) £14m additional accrual in short term creditors due to the need to account for holiday entitlement owing at the balance sheet date.

## Overall project planning arrangements

2.7 Overall, we are satisfied that the Council's approach to project planning was effective and resulted in a well controlled conversion process. The Council has appointed an IFRS consultant to assist in the transition process and has a project plan in place against which it monitors progress.

2.8 The Council plans to take its transition balance sheet to the January 2011 Audit Committee meeting, along with an update on progress against the project plan.

## Basis of preparation and accounting policies

2.9 As part of the review we considered whether the Council has adequate arrangements for identifying and reporting its accounting policies under IFRS, as this sets out the basis on which it has prepared its preliminary opening balance sheet. A review of the Council's accounting policies has not yet been undertaken.

2.10 Furthermore, International Accounting Standard 1 requires that the accounts disclose in the summary of significant accounting policies or other notes, the judgements that the Council has made in the process of applying its accounting policies and that have the most significant effect on the amounts recognised in the financial statements. These judgements can significantly affect the amounts ultimately reported in the financial statements and so should be clearly documented.

2.11 The Council should now review its accounting policies and make a positive statement as to their continued appropriateness. The Audit Committee should then, in due course, be asked to confirm that it is satisfied with the accounting policies adopted by the Council and that they are in accordance with IFRS.

## Accounting for Property, Plant and Equipment

2.12 The Council undertook a detailed review of its property, plant and equipment classifications and valuations in order to satisfy the requirements of the Code in terms of valuations of operational and non-operational assets. A structured approach was adopted across both General Fund and Housing Revenue Account assets, with all properties being considered against the recognition criteria set out in the Code, for example, for investment properties and properties held for sale.

2.13 The net impact of the movements is to reclassify circa £30m of assets held as "surplus assets" (held for disposal), under UK GAAP to other headings. The most significant reclassification are circa £20m being transferred to "Operational property, plant and equipment", and circa £4.6m being transferred to "Non-Current Assets Held for Sale". Where the asset is not classified as "held for sale" under the stricter IFRS criteria it is transferred back to operational surplus. The Council has been careful to review the treatment of associated balances relating to the revaluation reserve and capital adjustment account. We are satisfied that the Council has adopted a stringent approach that is in accordance with the Code.

## Accounting for Leases under IFRS

2.14 The Council has undertaken an evaluation of its leases held at the opening balance sheet date in order to confirm the accounting treatment as either operating or finance lease and, for finance leases, to calculate the fair value of the lease and the associated accumulated depreciation for inclusion in the balance sheet.

2.15 The Council undertook a detailed review of leases, in terms of plant and equipment and a two phase approach to that of land and property, firstly as lessee and then as lessor. The Council has circa 200 leases as lessee and circa 3000 as lessor. A materiality approach was adopted to considering whether the leases were correctly classified in accordance with the IFRS criteria. The detailed review did not identify any changes in classification and all leases classified as operating leases under UK GAAP will remain classified as such under IFRS.

2.16 The Council also conducted a full review of its contract database, reviewing each contract for evidence of any embedded leases in accordance with the requirements of the Code. This was conducted by the Corporate Procurement team which reviewed each arrangement to determine whether the fulfilment of the arrangement was dependant on the use of specific assets and whether the arrangement conveys the right to use that asset.

2.17 A further review was then conducted on three specific contracts, namely the Waste collection and street cleansing contract, Sports Centre Management and the Care Home Services management contract. A review of the detailed contract clauses identified that an embedded lease exists in relation to the Waste Collection and Street Cleansing contract. The waste vehicles used by the contractor to fulfil the contract are ring-fenced for use specifically on the Bristol City Council contract. There is no possibility of any other party receiving any benefit from the use of the vehicles. Substantially all risks and rewards of ownership for those vehicles rests with the Council and this contract is therefore deemed to include an embedded lease. The value of the adjustment required under IFRS is circa £1.3m. This is reflected via an increase in Property, Plant and Equipment and a corresponding increase in Creditors. As such, there is no effect on net assets as a result of this restatement.

## Accounting for Investment Properties

2.18 A full review of all investment properties held at 1 April 2009 was conducted by the Council in accordance with the stricter criteria under IFRS. Only properties held for rental income, capital appreciation or both are to be classified as investment properties. Any asset used also to facilitate the delivery of services is no longer to be classified as investment.

2.19 The Council identified circa 210 assets which need to be reclassified from investment assets to operational assets. In accordance with IFRS, operational assets are to be valued at fair value existing use and the Council has reclassified the assets in accordance with this valuation model. The value of the reclassification is circa £12m. A further review was also conducted of all surplus assets as at 1 April 2009. A number of investment properties (circa 165) were identified and reclassified as such. The value of these properties is circa £8.2m. Our review confirmed that the approach adopted by the Council is in line with the requirements of the Code.

## Accounting for cash and cash equivalents

2.20 Under IFRS, cash and cash equivalents are short term, highly liquid investments that are readily convertible to cash. The CIPFA guidance suggests this may include (at the discretion of the authority) any amount convertible within 3 months. The Council has adopted this approach as its policy and has reviewed all investments held at 1 April 2009 and analysed them according to maturity. Short term investments at that date, amounting to £80m plus an additional £1m of accrued interest, have been reclassified as cash and cash equivalents.

2.21 The CIPFA Code also states that where overdrafts are an integral part of an authority's cash management practice, these can be included in cash and cash equivalents rather than disclosed separately. The Council uses its overdraft facility to maintain its cash position and not for investment purposes. Therefore it has reclassified its £10m overdraft as at 1 April 2009 into cash and cash equivalents. We are satisfied that this approach is in accordance with the requirements of the Code.

## Accounting for holiday pay accruals

2.22 The CIPFA code states that authorities are required to account for 'short term compensated absences' by providing for annual leave and flexi time which has been accrued by staff at the balance sheet date but has not been taken. The Council has approached this requirement in 3 phases, looking at teachers, schools support staff and 'other' staff (i.e. council officers). This approach was adopted due to the differing holiday terms applicable to each group, with a sampling methodology used where appropriate.

2.23 The Council has calculated its accrual for teachers and schools support staff based on an example calculation provided in the draft CIPFA guidance in the absence of any direct guidance on this issue in the Code. The calculation has resulted in a £10.7m accrual being required.

2.24 For other staff, a sample methodology has been used to project estimated accrued leave entitlement across the entire population of circa 9000 employees. We advised the Council that a minimum sample size of 373 would be preferable (based on a confidence level of 95% and an error margin of 5%) and, therefore, agreed with the Council's approach of using a sample size of 400 employees for the calculation. An accrual of £3.2m has been calculated giving a total holiday pay accrual adjustment of circa £13.9m. Our review of the work conducted by the Council did not highlight any concerns that the approach is not in line with the Code.

### Accounting for capital and revenue grants

2.25 The Code requires grants and contributions relating to capital expenditure to be credited to the Comprehensive Income and Expenditure Statement once any conditions of the grant have been satisfied. Previously, under UK GAAP, such grants were treated as deferred income and recognised in the Income and Expenditure account over the useful life of the relevant asset.

2.26 In accordance with the requirements of the Code, any balance at 1 April 2009 on the Government Grants Deferred Account is to be transferred to the Capital Adjustment Account. The Council has therefore transferred a balance of circa £129m from Government Grants Deferred to the Capital Adjustment Account.

2.27 The Code requires that Grants and contributions unapplied at 1 April 2009 shall be reviewed to ascertain whether there are any conditions attached to the grant or contribution. Where there is no such condition, the grant or contribution shall be transferred to the Capital Grants Unapplied Account. Where a condition has yet to be satisfied, the grant or contribution shall be transferred to Capital Grants Receipts in Advance. Following a review of capital grants received as at 1 April 2009 and the associated accounting treatment applied at that date, the Council has identified the need to reclassify circa £2.6m from creditors to Capital Grants Receipts in Advance.

2.28 The Council conducted a full review of all its revenue grants received at 1 April 2009 which had been held as creditor balances (for example those grants not recognised immediately due to conditions attached which could result in repayment of the grant if not complied with). The Council identified two directorates which held as creditor balances grants which did not have any conditions attached to them. These are therefore being recognised immediately in accordance with IFRS. The required adjustment is circa £3m removed from creditors and recognised in the general fund.

# 3 Next Steps

3.1 From our review of the work undertaken so far by the Council, we are pleased to report that the Council is making good progress in its transition to IFRS. We have discussed the work being carried out on an ongoing basis with the Service Manager Corporate Finance and IFRS consultant.

3.2 It is clear from our review that the appointment of an IFRS consultant has been the driving force behind the work conducted thus far. We would therefore recommend that the Council retains that resource to ensure the project continues to progress in a positive manner.

3.3 The Council should ensure that it compiles a full set of supporting notes and accounting policies now that it has completed its initial transitional balance sheet, thereby consolidating the positive start already made.

**Bristol City Council**
**Draft IFRS accounting polices**

## 1. Accounting Policies

### i General Principles

The Statement of Accounts summarises the Authority's transactions for the 2010/11 financial year and its position at the year end of 31 March 2011. The Authority is required to prepare an annual Statement of Accounts by the Accounts and Audit Regulations, which those Regulations require 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 2010/11 and the Best Value Accounting Code of Practice 2010/11, 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.

### ii Accruals of Income and Expenditure

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

### iii 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 three months 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 Authority’s cash management.

### iv Exceptional Items

When items of income and expense are material, their nature and amount is disclosed separately, either on the face of the Comprehensive Income and Expenditure Statement or in the notes to the accounts, depending on how significant the items are to an understanding of the Authority’s financial performance.

### v 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 prospectively, i.e., in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made 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 Authority’s financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) 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.

### vii Charges to Revenue for Non-Current Assets

Services, support services and trading accounts are debited with the following amounts to record the cost of holding fixed assets during the year:

- 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 fixed assets attributable to the service.

The Authority is not required to raise council tax to fund depreciation, revaluation and impairment losses or amortisation. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement calculated on a prudent basis determined by the authority in accordance with statutory guidance. Depreciation, revaluation and impairment losses and amortisation are therefore replaced by the contribution in the General Fund Balance, described as the minimum revenue provision “MRP”, 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

<u>Benefits Payable During Employment</u>
Short-term employee benefits are those due to be settled 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

for services in the year in which employees render service to the Authority.  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 based on a sample of employees using current salaries. The accrual is charged to Surplus or Deficit on the Provision of Services, but then reversed out 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 Authority 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 Non Distributed Costs line in the Comprehensive Income and Expenditure Statement when the Authority is demonstrably committed to the termination of the employment of an officer or group of officers or making an offer to encourage voluntary redundancy.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Authority 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 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

Employees of the Authority are members of two separate pension schemes:

- The Teachers' Pension Scheme, administered by Capita Teachers' Pensions on behalf of the Department for Education (DfE).
- The Local Government Pensions Scheme (called the Avon Pension Fund), administered by Bath and North East Somerset Council.

Both schemes provide defined benefits to members (retirement lump sums and pensions), earned as employees work for the Authority.

However, the arrangements for the teachers' scheme mean that liabilities for these benefits cannot ordinarily be identified specifically to the Authority.  The scheme is therefore accounted for as if it were a defined contribution scheme and no liability for future payments of benefits is recognised in the Balance Sheet. The Children's and Education Services line in the Comprehensive Income and Expenditure Statement is charged with the employer's contributions payable to Teachers' Pensions in the year.

*The Local Government Pension Scheme*

The Avon Pension Fund is accounted for as a defined benefits scheme:

- The liabilities of the Avon Pension Fund attributable to the Authority 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 about mortality rates, employee turnover rates, etc, and projections of projected earnings for current employees.
- Liabilities are discounted to their value at current prices, using an appropriate discount rate based on the return for high quality corporate bonds.

- The assets of Avon Pension Fund attributable to the Authority are included in the Balance Sheet at their fair value:
    - quoted securities – current bid price
    - unquoted securities – professional estimate
    - unitised securities – current bid price
    - property – market value.
- The change in the net pensions liability is analysed into seven components:
    - current service cost – the increase in liabilities as a result of years of service earned this year – allocated in the 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.
    - interest cost – the expected increase in the present value of liabilities during the year as they move one year closer to being paid – debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.
    - expected return on assets – the annual investment return on the fund assets attributable to the Authority, based on an average of the expected long-term return – credited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.
    - gains or losses on settlements and curtailments – the result of actions to relieve the Authority of liabilities or events that reduce the expected future service or accrual of benefits of employees – debited or credited to the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement as part of Non Distributed Costs.
    - actuarial gains and losses – changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions – debited to the Pensions Reserve.
    - contributions paid to the Avon Pension Fund – cash paid as employer's contributions to the pension fund in settlement of liabilities; not accounted for as an expense.

In relation to retirement benefits, statutory provisions require the General Fund balance to be charged with the amount payable by the Authority 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, this means that there are appropriations to and from the Pensions Reserve to remove the notional debits and credits for retirement benefits and 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 negative balance that arises on the Pensions Reserve thereby measures 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.

*Discretionary Benefits*

The Authority 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.

### ix Events After the Balance Sheet Date

Events after 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.

### x Financial Instruments

*Financial Liabilities*

Financial liabilities are recognised on the Balance Sheet when the Authority becomes a party to the contractual provisions of a financial instrument and 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 Authority 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.

Gains and losses on the repurchase or early settlement of borrowing are credited and debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement in the year of repurchase/settlement. However, where repurchase has taken place as part of a restructuring of the loan portfolio that involves the modification or exchange of existing instruments, the premium or discount is respectively deducted from or added to the amortised cost of the new or modified loan and the write-down to the Comprehensive Income and Expenditure Statement is spread over the life of the loan by an adjustment to the effective interest rate.

Where premiums and discounts have been charged to the Comprehensive Income and Expenditure Statement, regulations allow the impact on the General Fund Balance to be spread over future years. The Authority has a policy of spreading the gain or loss over the term that was remaining on the loan against which the premium was payable or discount receivable when it was repaid. The reconciliation of amounts charged to the Comprehensive Income and Expenditure Statement to the net charge required against the General Fund Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the

Movement in Reserves Statement.

*Financial Assets*

Financial assets are classified into two types:

- 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.

Loans and Receivables

Loans and receivables are recognised on the Balance Sheet when the Authority becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their 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 Authority 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.

However, the Authority has made a number of loans to voluntary organisations at less than market rates (soft loans). When soft loans are made, a loss is recorded in the Comprehensive Income and Expenditure Statement (debited to the appropriate service) for the present value of the interest that will be foregone over the life of the instrument, resulting in a lower amortised cost than the outstanding principal. Interest is credited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement at a marginally higher effective rate of interest than the rate receivable from the voluntary organisations, with the difference serving to increase the amortised cost of the loan in the Balance Sheet. Statutory provisions require that the impact of soft loans on the General Fund Balance is the interest receivable for the financial year – the reconciliation of amounts debited and credited to the Comprehensive Income and Expenditure Statement to the net gain required against the General Fund Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

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 (for receivables specific to that 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 derecognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.

Available-for-Sale Assets

Available-for-sale assets are recognised on the Balance Sheet when the Authority 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 Authority.

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

- 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 prices – independent appraisal of company valuations.

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. 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 derecognition 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).

Instruments Entered Into Before 1 April 2006

The Authority entered into a number of financial guarantees that are not required to be accounted for as financial instruments. These guarantees are reflected in the Statement of Accounts to the extent that provisions might be required or a contingent liability note is needed under the policies set out in the section on Provisions, Contingent Liabilities and Contingent Assets.

### xi Foreign Currency Translation

Where the Authority has entered into a transaction denominated in a foreign currency, the transaction is converted into sterling at the exchange rate applicable on the date the transaction was effective. Where amounts in foreign currency are outstanding at the year end, they are reconverted at the spot exchange rate at 31 March. Resulting gains or losses are recognised in the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.

### xii Government Grants and Contributions

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

- the Authority 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 creditors. 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.

### xiii Intangible Assets

Expenditure on non-monetary assets that do not have physical substance but are controlled by the Authority 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 Authority.

Internally generated assets are capitalised where it is demonstrable that the project is technically feasible and is intended to be completed (with adequate resources being available) and the Authority will be able to generate future economic benefits or deliver service potential by being able to sell or use the asset. Expenditure is capitalised where it can be measured reliably as attributable to the asset and is restricted to that incurred during the development phase (research expenditure cannot be capitalised).

Expenditure on the development of websites is not capitalised if the website is solely or primarily intended to promote or advertise the Authority’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 Authority can be determined by reference to an active market. In practice, no intangible asset held by the Authority meets this criterion, and they are therefore carried at amortised cost. The depreciable amount of an intangible asset is amortised over its useful life to the relevant service line 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 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 sale proceeds) the Capital Receipts Reserve.

### xiv Interests in Companies and Other Entities

If the Authority has a material interest in either a subsidiary, associate or joint venture (e.g. jointly controlled entities) it prepares Group Accounts in addition to single entity financial statements.

### xv Inventories and Long Term Contracts

Inventories are included in the Balance Sheet at the lower of cost and net realisable value on a FIFO basis.

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.

### xvi 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, based on the amount at which the asset could be exchanged between knowledgeable parties at arm's-length. Properties are not depreciated. Valuations are completed as follows:

- the top 250 commercial properties are valued annually.
- 50% of the remaining properties are valued in the current year and 50% in the following year (on a rolling basis).
- current "in year" valuations are also used to adjust any non valued properties (where appropriate) in order to ensure that properties are held at fair value.

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 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 sale proceeds) the Capital Receipts Reserve.

### xvii Jointly Controlled Operations and Jointly Controlled Assets

Jointly controlled operations are activities undertaken by the Authority in conjunction with other venturers that involve the use of the assets and resources of the venturers rather than the establishment of a separate entity. The Authority recognises on its Balance Sheet the assets that it controls and the liabilities that it incurs and debits and credits the Comprehensive Income and Expenditure Statement with the expenditure its incurs and the share of income it earns from the activity of the operation.

Jointly controlled assets are items of property, plant or equipment that are jointly controlled by the Authority and other venturers, with the assets being used to obtain benefits for the venturers. The joint venture does not involve the establishment of a separate entity. The Authority accounts for only its share of the jointly controlled assets, the liabilities and expenses that it incurs on its own behalf or jointly with others in respect of its interest in the joint venture and income that it earns from the venture.

### xviii 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>

*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 Authority 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 Authority is not required to raise council tax to cover depreciation or 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 and 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.

*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

*Finance Leases*

Where the Authority grants a finance lease over a property or an item of plant or equipment, the relevant asset is written out of the Balance Sheet as a disposal. At the commencement of the lease, 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. A gain, representing the Authority's net investment in the lease, is 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), matched by a lease (long-term debtor) asset in the Balance Sheet.

Lease rentals receivable are apportioned between:

- a charge for the acquisition of the interest in the property – applied to write down the lease debtor (together with any premiums received), and
- finance income (credited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement).

The gain credited to the Comprehensive Income and Expenditure Statement on disposal is not permitted by statute to increase the General Fund Balance and is required to be treated as a capital receipt. Where a premium has been received, this is posted out of the General Fund Balance to the Capital Receipts Reserve in the Movement in Reserves Statement. Where the amount due in relation to the lease asset is to be settled by the payment of rentals in future financial years, this is posted out of the General Fund Balance to the Deferred Capital Receipts Reserve in the Movement in Reserves Statement. When the future rentals are received, the element for the capital receipt for the disposal of the asset is used to write down the lease debtor. At this point, the deferred capital receipts are transferred to the Capital Receipts Reserve.

The written-off value of disposals is not a charge against council tax, as the cost of fixed assets is fully provided for under separate arrangements for capital financing. Amounts are therefore appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

*Operating Leases*

Where the Authority 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.

### xix Overheads and Support Services

The costs of overheads and support services are charged to those that benefit from the supply or service in accordance with the costing principles of the CIPFA *Best Value Accounting Code of Practice 2010/11* (BVACOP). The total absorption costing principle is used – the full cost of overheads and support services are shared between users in proportion to the benefits received, with the exception of:

- Corporate and Democratic Core – costs relating to the Authority's status as a multi-functional, democratic organisation.
- Non Distributed Costs – the cost of discretionary benefits awarded to employees retiring early and impairment losses chargeable on Assets Held for Sale.

These two cost categories are defined in BVACOP and accounted for as separate headings in the Comprehensive Income and Expenditure Statement, as part of Net Expenditure on Continuing Services.

### xx 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>

Assets costing individually or collectively less than £20,000 are classed as de-minimus and are not capitalised. The expenditure is charged direct to the appropriate service line.

Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Authority 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.

<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 Authority does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of assets acquired other than by purchase is deemed to be its fair value, unless the acquisition does not have commercial substance (i.e., it will not lead to a variation in the cash flows of the Authority). In the latter case, where an asset is acquired via an exchange, the cost of the acquisition is the carrying amount of the asset given up by the Authority.

Donated assets are measured initially at fair value. The difference between fair value and any consideration paid is credited to the Taxation and Non-Specific Grant Income line of the Comprehensive Income and Expenditure Statement, unless the donation has been made conditionally. Until conditions are satisfied, the gain is held in the Donated Assets Account. Where gains are credited to the Comprehensive Income and Expenditure Statement, they are reversed out of the General Fund Balance to the Capital Adjustment Account in the Movement in Reserves Statement.

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

- infrastructure, community assets and assets under construction – depreciated historical cost.
- dwellings – fair value, determined using the basis of existing use value for social housing (EUV-SH).
- all other assets – fair value, determined as the amount that would be paid for the asset in its existing use (existing use value – 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 that have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for fair value.

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 fair 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 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.

<u>Impairment</u>

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 of the asset, 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 lines 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.

Depreciation

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

Deprecation is calculated on the following bases:

- dwellings and other buildings – straight-line allocation over the useful life of the property as estimated by the valuer.
- vehicles, plant and equipment – a percentage of the value of each class of assets in the Balance Sheet, as advised by a suitably qualified officer.
- infrastructure – straight-line allocation over 25 years.

The Authority applies component accounting (i.e. major components of the asset are depreciated separately over their respective estimated economic lives) to all assets with a book value in excess of £5 million (where components are evident and the impact of component accounting is considered material to the Financial Statements).

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 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 losses recognised 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 are categorised as capital receipts. A proportion of receipts relating to housing disposals (75% for dwellings, 50% for land and other assets, net of statutory deductions and allowances) is payable to the Government. The balance of receipts is required to be credited to the Capital Receipts Reserve, and can then only be used for new capital investment or set aside to reduce the Authority's underlying need to borrow (the capital financing requirement). Receipts are appropriated to the Reserve from the General Fund Balance in the Movement in Reserves Statement.

The written-off value of disposals is not a charge against council tax, as the cost of fixed 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.

### xxi Private Finance Initiative (PFI) and Similar Contracts

PFI and similar contracts are agreements to receive services, where the responsibility for making available the property, plant and equipment needed to provide the services passes to the PFI contractor. As the Authority is deemed to control the services that are provided under its PFI schemes, and as ownership of the property, plant and equipment will pass to the Authority at the end of the contracts for no additional charge, the Authority carries the assets used under the contracts on its Balance Sheet as part of Property, Plant and Equipment.

The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) was balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment.

Non current assets recognised on the Balance Sheet are revalued and depreciated in the same way as property, plant and equipment owned by the Authority.

The amounts payable to the PFI operators each year are analysed into five elements:

- fair value of the services received during the year – debited to the relevant service in the Comprehensive Income and Expenditure Statement.
- finance cost – an interest charge on the outstanding Balance Sheet liability, debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.
- contingent rent – increases in the amount to be paid for the property arising during the contract, debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.
- payment towards liability – applied to write down the Balance Sheet liability towards the PFI operator (the profile of write-downs is calculated using the same principles as for a finance lease).
- lifecycle replacement costs – proportion of the amounts payable is posted to the Balance Sheet as a prepayment and then recognised as additions to Property, Plant and Equipment when the relevant works are eventually carried out.

### xxii Provisions, Contingent Liabilities and Contingent Assets

Provisions

Provisions are made where an event has taken place that gives the Authority 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. For instance, the Authority may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the Comprehensive Income and Expenditure Statement in the year that the authority 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 authority settles the obligation.

Contingent Liabilities

A contingent liability arises where an event has taken place that gives the authority 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 authority. 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.

### xxiii Reserves

The Authority sets aside specific amounts as reserves for future policy purposes or to cover contingencies. 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 reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement and employee benefits and do not represent usable resources for the Authority – these reserves are explained in the relevant policies.

### xxiv 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 Authority 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.

### xxv 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.