AUDIT AND GOVERNANCE COMMITTEE

22nd September 2011

REPORT OF THE CORPORATE DIRECTOR RESOURCES

ANNUAL STATEMENT OF ACCOUNTS AND REPORT 2010/11

EXEMPT INFORMATION

None

PURPOSE

To approve the Statement of Accounts (the Statement) for the financial year ended 31st March 2011 following completion of the external audit.

RECOMMENDATION

That Members approve the Annual Statement of Accounts 2010/11.

EXECUTIVE SUMMARY

As part of the annual audit process for 2010/11, the Audit Commission have prepared a report (to be considered separately on this agenda) summarising their findings for consideration prior to issue of their opinion, conclusion and certificate.

Following identification as part of the audit, a number of amendments have been discussed and agreed with the Audit Commission. These have been actioned within the Final Statement of Accounts for 2010/11 as attached at **Appendix 1 (to follow)**. It is important to note that these adjustments do not have any impact on the net balances of the General Fund, Housing Revenue Account or Collection Fund.

Current legislation, detailed in Accounts and Audit (England) Regulations 2011, requires a Committee of the Council to approve the Statement by 30th September 2011 and for the Council to publish the Statement together with the Auditors opinion by 30th September 2011.

The guidance requires the Chair of the Cabinet meeting to sign and date the Statement of Accounts with the intention that the Chair's signature formally represents the completion of the Council's approval process of the accounts.

Key issues affecting the 2010/11 accounts / accounting process are detailed within the report.

RESOURCE IMPLICATIONS

For 2010/11, Revenue Budget underspends for the General Fund of £0.759m with a reduction in General Fund closing balances of £370k. The Housing Revenue Account identifies an overspend of £157k with an increase in Housing Revenue Account closing balances of £0.374m.

It should be noted that the Medium Term Financial Strategy identified required balances of £3.890m (at 1st April 2011) compared to the draft actual closing balances of £4.511m - additional balances of £0.621m. For the HRA balances of £4.947m were forecast at 1st April 2011 compared to the actual balances of £5.087m - additional balances of £0.140m. Balances above the minimum will be required to provide additional funds for uncertainties regarding future Government funding arrangements.

The actual outturn for capital spending in 2010/11 was £5.624m. This represented an underspend of £1.961m against the approved budget of £7.585m. However, it has been approved that £1.020m of scheme spend be re-profiled into 2011/12. This results in an overall underspend of £0.941m for the 2010/11 capital programme (including £50k unused contingencies).

LEGAL / RISK IMPLICATIONS

Current legislation, detailed in Accounts and Audit (England) Regulations 2011, requires a Committee of the Council to approve the Statement by 30th September 2011 and for the Council to publish the Statement together with the Auditors opinion by 30th September 2011.

SUSTAINABILITY IMPLICATIONS

None

CONCLUSIONS

Following consideration of the External Auditors Annual Governance Report and the approval of the Annual Statement of Accounts for 2010, the Chair's signature formally represents the successful completion of the Council's approval process of the accounts for 2010/11.

BACKGROUND INFORMATION

Prior to 2010/11 Local Authorities were required to prepare their accounts using accounting policies based on UK Generally Accepted Accounting Practice (UK GAAP) and in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice* (the SORP) prepared by the Chartered Institute of Public Finance and Accountancy (CIPFA). It was announced in the 2007 Budget (as amended) that International Financial Reporting Standards (IFRS) would be used for the production of accounts from 2010/11 onwards following a transition period.

The SORP was based on UK Generally Accepted Accounting Principles (GAAP) but modified for local government where legislative requirements demand different treatments to UK GAAP. This was to ensure that there were arrangements in place to mitigate the potential effect upon Council Tax of certain transactions and to recognise the unusual nature of local authority funding.

From 2010/11 there will no longer be a Local Authority SORP produced by CIPFA. Instead, there will be a Code of Practice on Local Authority Accounting prepared by CIPFA under the guidance of the Financial Resources Advisory Board (FRAB), which is the independent body responsible for overseeing the development of financial reporting within the UK public sector.

The introduction of IFRS has significantly changed the way that Local Authority accounts are prepared and a large number of areas are subject to different accounting treatments to that under the SORP. There is also a requirement to restate and present the opening and closing balance sheets for 2009/10 together with comparative figures.

The introduction of IFRS is the latest in a series of changes to the Statement of Accounts over the past few years which are intended to make them more robust and comparable with other local authorities and the wider public sector. Not all IFRS will be relevant to local authorities, however it is expected that there will be very few areas of the SORP that will remain completely unaffected by the requirement to comply with International Accounting Standards (IAS).

The key accounting policy changes impacting on the Council are outlined below:

1. Property, Plant and Equipment

a) Component accounting

IFRS places a greater emphasis on recognising components of assets such as roofs, windows etc. Where components of an asset are significant in value in relation to the total value of the asset as a whole, and they have substantially different economic lives, they should be recognised separately. For example, major assets such as the Marmion House Offices are made up of separate elements that have different useful lives.

There is no requirement to apply these changes retrospectively and instead components should be recognised separately as and when they are replaced. Component accounting will have a very limited effect for the 2010/11 accounts.

b) Investment Property

IFRS introduces a definition of investment property that the old SORP did not have. An investment property is defined as a property which is held exclusively for revenue generation or for the capital gains that the asset is expected to generate. In this respect, the asset is not used directly to deliver the Council's services.

Investment properties are initially measured at cost and thereafter at market value.

c) Impairment of Property, Plant and Equipment

All impairments are charged to the revaluation reserve (where there is a balance relating to the specific asset). If there is an insufficient balance in the revaluation reserve the remainder is charged to the surplus or deficit on the provision of services.

d) Non-Current Assets Held For Sale

IFRS introduces a new classification of non-current assets called assets held for sale. Assets meeting this classification are those where the value of the asset will be recovered mainly by selling the asset rather than through usage.

To be classed as held for sale the asset must meet the following criteria:-

i. Be available for immediate sale in its present condition.
ii. Its sale must be highly probable.
iii. Management expect the sale to take place within twelve months.

Assets held for sale are to be valued at the lower of their existing balance sheet value or their estimated sale price less costs to sell.

2. Cash and Cash Equivalents

This is an expanded definition of cash to include Cash (bank balances and on demand deposits) with Cash Equivalents. These are defined as short-term, highly liquid investments where the date of maturity is three months or less from the date of acquisition that are readily convertible to cash and which are subject to an insignificant risk of change in value. Previously, cash equivalents and on demand deposits were treated as Temporary Investments.

3. Government Grants and Other Capital Contributions

Under the current SORP arrangements, grants received by the Council towards capital expenditure are held in a Government/ Capital Contributions account and written off to Revenue over the life of the asset the grant was used to purchase.

Under IFRS, all such grants are to be treated as revenue income as soon as any conditions relating to the grant have been met. Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as creditors.

4. Leases and Lease Type Arrangements

Leases can be classified as either finance or operating leases. If a lease transfers substantially all the risks and rewards incidental to ownership it will be classified as a finance lease regardless of its legal form.

International Accounting Standard (IAS) 17 specifies key criteria to ascertain whether a lease is to be treated as a finance lease or an operating lease. A comprehensive review of all of the Council’s leases (lessee or lessor) has been required in order to identify the accounting treatment under IFRS.

For assets leased under a finance lease, the asset value should be recognised as either an asset or a liability in the Balance Sheet as appropriate and the annual payments consist of an amount of interest plus an amount to clear the relevant debtor or creditor.

Leases that do not meet the definition of finance leases are accounted for as operating leases and the income or expenditure is either credited, or charged to, service revenue accounts on a straight-line basis over the term of the lease.

Under IFRS, the land and buildings elements of a lease of land and buildings require separate identification for both lease classification and subsequent valuation. In most cases, the land element of a lease will be an operating lease. There were no finance leases included in the Council's 2009/10 accounts. The expectation of the changes under IFRS was that more assets would be classified as finance leases.

It should be noted that regulations have been put in place which mitigate the effect of lease re-classifications on the council taxpayer. However, these do not apply to leases let after 1st April 2010 which could mean treatment of the income of a lease as a capital receipt where considered a finance lease.

5. Employee Benefits - Short-term accumulating compensated absences

The Council implemented this requirement early (in 2008/09) and has therefore calculated and accounted for untaken annual leave and lieu time as at 31st March 2009, 2010 and 2011 in line with the requirements of IAS19 (Employee Benefits).

6. Prior Period Adjustments

Arising from the requirement to implement International Financial Reporting Standards (IFRS) for the 2010/11 year, the 2009/10 financial statements have been restated on an IFRS compliant basis so that comparisons can easily be made.

Previously only the correction of fundamental errors was required to be corrected as a prior period adjustment. Under international standards material errors are corrected as prior period adjustments. Disclosure of the effect of new standards not yet adopted is also required.

7. Operating Segments

Under IFRS, the Council is required to identify and disclose information in its financial statements in respect of operating segments. These are components of the Council about which separate financial information is available that is evaluated regularly by the Council's 'Chief Operating Decision Maker' (Cabinet / Council) in deciding how to allocate resources and in assessing performance. This will therefore require the Council to include additional financial information on its activities - analysed by Deputy or Assistant Director.

8. Borrowing Costs

The Council may choose to amend its accounting policy as, under IFRS, borrowing costs in respect of capital expenditure may be capitalised as long as the Council has a policy that allows it do so. As the Council currently has no plans to borrow to finance capital expenditure there is no need to amend the existing policy but this will need to be kept under review in the future.

9. The Impact of the Recession

a) Impairment of Investments

The accounting requirements for impairing investments (such as investments placed with Icelandic Banks) have been made in line with CIPFA guidance (with the exception of Glitnir Bank) with the change in impairment included in the surplus or deficit on the Income and Expenditure Account in line with advice and information from the administrators.

Following a capitalisation direction of up to £4m approved by the Government which allowed the Council to capitalise £3.386m in 2009/10 relating to the impact of the impairment of investments on the General Fund – an improvement in the recovery rates for 2 banks is anticipated which has led to a fall in impairment levels. With regard to the investment with Glitnir, CIPFA guidance recommends that 100% repayment in December 2011 is used as the best estimate assuming that the current priority status is maintained (following legal proceedings in Iceland). However, this is subject to appeal and as a prudent approach, a recovery rate of 29% (29% in 2009/10) for 2010/11 has been assumed based on information contained within the banks latest published accounts.

b) Asset Valuation

The Code requires tangible and intangible assets carried in the Balance Sheet at current value to be revalued at intervals of not more than five years. This is to ensure that the amounts carried in the Balance Sheet are materially correct; there is a presumption in the Code that the values of assets will not change materially in a five year period.

However, the present economic climate has resulted in more volatile asset values, and the Council has therefore considered whether circumstances are such that where an impairment is indicated, some or all asset values should be revised.

As such, the valuation approach for 2010/11 has been reviewed and the revised approach is set out below (rather than the usual rolling programme of revaluing 20% of assets each year).

i. Housing Stock

Following the usual rolling programme of revaluing 20% of assets carried out in 2010/11 it has not been necessary to carry out a desktop revaluation exercise (given the relatively small change / potential impact on the whole housing stock valuation).

ii. Other Properties

A revaluation review for all of those properties which are valued to open market value has been carried out i.e. Operational Properties - Direct Services, Indirect Services, Office and Admin (open market value for existing use); Non Operational

Properties – Commercial, Investment (Open market value); Non operational Properties-Surplus (Open market value for existing use); and Open Space.

Those properties which are valued on depreciated replacement cost have not been included as in most cases the land value element will only be a small part of the valuation and, in the opinion of the valuer, building costs will not have significantly altered.

Whenever changes to accounting principles are made it is necessary to produce comparable figures for the previous year on the new basis – therefore changes to the 2010/11 accounts have been mirrored in re-stated accounts for 2009/10 to allow for like for like comparisons.

The changes have had a material impact on individual figures within the Income and Expenditure Account, Balance Sheet, Cashflow Statement and HRA Income and Expenditure and the associated disclosure notes. However, the changes mean that the level of opening balances as at 1st April 2010 increased by £214k (GF £165k / HRA £49k).

The Council's accounts for 2010/11 consist of the following:

- **Core Financial Statements:**

  - **Movement in Reserves Statement**: shows the movement in the year on the different reserves held by the Authority, analysed into ‘usable reserves’ (i.e. those that can be applied to fund expenditure or reduce local taxation) and other reserves. The Surplus or (Deficit) on the Provision of Services line shows the true economic cost of providing the Authority’s services. These are different from the statutory amounts required to be charged to the General Fund Balance and the Housing Revenue Account for council tax setting and dwellings rent setting purposes.

  - **Comprehensive Income and Expenditure Account:** shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation. Authorities raise taxation to cover expenditure in accordance with regulations; this may be different from the accounting cost. The taxation position is shown in the Movement in Reserves Statement.

  - **Balance Sheet:** shows the value as at the Balance Sheet date of the assets and liabilities recognised by the Authority. The net assets of the authority (assets less liabilities) are matched by the reserves held by the authority.

  - **Cash Flow Statement:** shows the changes in cash and cash equivalents of the Authority during the reporting period. The statement shows how the Authority generates and uses cash and cash equivalents by classifying cash flows as operating, investing and financing activities.

- **Supplementary Statements:**

  - **Housing Revenue Account:** reflects the statutory requirement to maintain a separate account for Council Housing.

  - **The Collection Fund:** shows the non-domestic rates and council tax income collected on behalf of Staffordshire County Council, the Police Authority, the Fire and Rescue Authority and this Council's General Fund.

These accounting statements are supported by appropriate notes to the accounts including the Statement of Accounting Policies - this provides details of the framework within which the Council's accounts are prepared and published and was approved by the Committee on 30th June 2011.

GENERAL FUND, HOUSING REVENUE ACCOUNT AND CAPITAL OUTTURN

Below are details of the outturn fund balances for the General Fund and the Housing Revenue Account together with a summary of the outturn position on Capital Expenditure for the year.

GENERAL FUND

When compared to the final approved budget (which reflects decisions made by members during the financial year) an under-spend of £0.759m is reported, £138k less than reported in the provisional outturn report.

Closing General Fund balances as at 31st March 2011 were £4.881m:

General Fund Balances Movement 2010/11	**Final Outturn £'000**	**Projected Outturn £'000**
Balances B/fwd.	4,881	4,715
Approved Budget transfer To / (From) balances	(1,129)	(1,129)
Approved Budget Changes during year	0	0
Outturn variance – Surplus	759	592
Balance C/fwd.	**4,511**	**4,178**

The change since the provisional outturn was prepared is due to:

- An increase in balances brought forward due to the reversal of the accrual of outstanding Annual Leave / lieu time – arising from the requirement to implement IFRS, £166k;
- Write back of reserves as approved by Cabinet on 6th April, £29k;
- Lower than anticipated costs from the waste management arrangements, £160k;

The favourable outturn variance of £0759m is mainly attributable to savings made in the following areas:

- Non Domestic Rates Refund – Peaks (net of fees), £548k;
- VAT refund of £96k following submission of claims;
- Targeted Earmarked Savings from contingency budgets of £220k;
- Lower Treasury Management Debt Charges to Housing, £204k.
- Lower Outside Car Parks – Parking Fees, £160k.

It should be noted that the Medium Term Financial Strategy identified required balances of £3.890m (at 1st April 2011) compared to the draft actual closing balances of £4.511m, the additional balances of £0.621m above this minimum will be required to provide additional funds for uncertainties regarding future Government funding arrangements.

Members should be aware that any unplanned call on the above balance could adversely affect the Authority's ability to resource activity within the Medium Term Financial Strategy period.

HOUSING REVENUE ACCOUNT

The Housing Revenue Account (HRA) is overspent against the approved budget for the year by £0.157m, £9k more than reported in the provisional outturn report. The Housing Revenue Account balances as at 31st March 2011 were £5.087m.

HRA Balances Movement 2009/10	**Final Outturn £'000**	**Projected Outturn £'000**
Balances B/fwd.	4,713	4,664
Approved Budget	531	531
Approved Budget Changes during year	0	0
Outturn variance – Surplus	(157)	(148)
Balance C/fwd.	**5,087**	**5,047**

The change since the provisional outturn was prepared is mainly due to an increase in balances brought forward due to the reversal of the accrual of outstanding Annual Leave / lieu time – arising from the requirement to implement IFRS, £49k.

The outturn variance surplus of £0.157m shown above is mainly attributable to the following areas:

- Higher payments Under Subsidy System, £404k; offset by
- Lower Debt / Capital Charges from the General Fund, £204k

It should be noted that the Medium Term Financial Strategy identified required balances of £4.947m (at 1st April 2011) compared to the draft actual closing balances of £5.087m, the additional balances of £0.140m above this minimum will be required to provide additional funds for uncertainties regarding future funding arrangements.

CAPITAL OUTTURN

The actual outturn for capital spending in 2010/11 was £5.624m.

This represented an underspend of £1.961m against the approved budget of £7.585m. However, it has been approved that £1.020m of scheme spend be re-profiled into 2011/12. This results in an overall underspend of £0.941m for the 2010/11 capital programme (including £50k unused contingencies).

Full details are contained within the Capital Outturn Report reported to Cabinet on 29th June 2011.

REPORT AUTHOR

Stefan Garner, Deputy Director Corporate Finance, Exchequer and Revenues

LIST OF BACKGROUND PAPERS

Capital Outturn Report 2010/11 - Cabinet, 29h June 2011
Provisional Outturn Report 2010/11 - Cabinet, 29th June 2011
Annual Governance Statement 2010/11 - Audit and Governance Committee, 30th June 2011
Draft Accounting Policies 2010/11 - Audit and Governance Committee, 30th June 2011
Draft Annual Statement of Accounts 2010/11 – distributed to Audit and Governance Committee Members, 30th June 2011