STATEMENT OF ACCOUNTS 2021-22 – ACCOUNTING POLICIES AND SIGNIFICANT AREAS OF JUDGEMENT

To:
Civic Affairs Committee 02/02/2022

Report by:
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Wards affected:
All

1. Introduction

1.1 The Council is required to produce a Statement of Accounts on an annual basis in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom ('the Code'). This report sets out the significant areas of accounting judgement and sources of estimation uncertainty which are likely to arise in relation to the 2021-22 accounts.

1.2 There are no significant changes to accounting policy proposed this year, although presentational changes are likely as set out in section 6. Furthermore, section 7 briefly sets out accounting policy changes which will come into effect in future years.

2. Recommendations

2.1 To note that there are no significant changes to accounting policy anticipated for the 2021-22 Statement of Accounts.

2.2 To note and approve the proposed critical judgements and major sources of estimation uncertainty in respect of the 2021-22 Statement of Accounts.

2.3 To note and approve proposals to improve the presentation of the Statement of Accounts, in line with latest CIPFA guidance.

2.4 To note the request for informal feedback from Civic Affairs Committee members on the current format of the Statement of Accounts, and suggestions for improvement.

3. Background

3.1 The Code is updated on an annual basis to reflect changes to accounting standards and practice. Having reviewed the 2021-22 Code, there are no changes which will have a significant impact on the Council's accounting policies or Statement of Accounts.

3.2 This year, the government have proposed (subject to ongoing consultation) a deadline for the production of the draft Statement of Accounts of 31 May 2022, with audited accounts to be published by 30 November 2022. The audit deadline represents a 2-month extension in recognition of current sector-wide challenges to audit timetables. However, the accounts preparation deadline of 31 May will require the Council to produce a draft Statement of Accounts earlier than it ever has before. This is a significant challenge for the Finance team, but one which should be achievable through careful planning, early engagement with the auditors, and streamlining of the process and Statement of Accounts document itself (see section 6).

3.3 As part of this planning process, this report aims to give the Civic Affairs Committee early sight of the critical judgements and major sources of estimation uncertainty likely to feature in the 2021-22 Statement of Accounts. It is likely that many of these areas will also be areas of focus for the external auditors when they present their Audit Plan to the Committee.

3.4 A further briefing on the Statement of Accounts will be arranged for members of the Civic Affairs Committee at the time of the draft accounts being published.

4. Critical Judgements in Applying Accounting Policies

4.1 In applying its accounting policies, the Council is required to make certain judgements about complex transactions or those involving uncertainty about future events. Where such judgements are significant, they must be disclosed within the accounts. Only one such judgement has been identified to date in relation to 2021-22 (as consistent with the prior year), and this is set out below.

Funding Uncertainty

4.2 The current local government finance settlement was for one year only (2022-23), and therefore there remains a degree of uncertainty about future funding levels. However, the Council has determined that this uncertainty is not sufficient to provide an indication that the assets of the Council might be impaired as a result of a need to close facilities and significantly reduce levels of service provision.

5. Major Sources of Estimation Uncertainty

5.1 The preparation of the Statement of Accounts requires a range of judgements, estimates and assumptions to be made which affect the figures within the accounts. Where there is a significant risk that such estimates may change materially in the following year, these must be disclosed within the accounts, along with the key methodology and assumptions adopted, and the sensitivity of the estimates to changes in these.

5.2 The following areas of significant estimation uncertainty have been identified for disclosure in the 2021-22 accounts to date:

Pensions Liability

5.3 Estimation of the net liability to pay pensions depends on a number of complex judgements relation to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Council with expert advice about the assumptions to be applied. The net pension liability as at 31 March 2021 was £142.2 million, subject to the following sensitivities to underlying assumptions:

- Decreasing the real discount rate by 0.1% would have increased the liability by £7.9 million.
- An increase in member life expectancy of 1 year would have increased the liability by £16.5 million.
- Increasing the CPI assumption by 0.1% would have increased the liability by £7.2 million.

5.4 The underlying assumptions and therefore the value of the liability will be reassessed by the actuaries as at 31 March 2022. Whilst changes to the assumptions do not immediately impact usable reserves, any longer-term increase in the liability would likely lead to an increase in the level of employer contributions to be charged to the General Fund and HRA in future years.

Property, Plant and Equipment

5.5 Assets are depreciated over useful lives that are dependent upon assumptions about the level of repairs and maintenance that will be incurred in relation to individual assets. If the Council did not sustain its current spending on repairs and maintenance the useful lives currently assigned to assets may be reduced.

5.6 If the useful life of assets is reduced, depreciation increases and the carrying value of the assets fall. The total charge for depreciation in 2021-22 is currently forecast at £16.5 million, and it is estimated that a reduction in useful lives of 1 year would increase this charge by £1.5 million. Of this, £0.3 million would fall as a charge to the HRA, with the remaining £1.2 million impact on General Fund assets being reversed out to unusable reserves under statutory requirements for capital financing.

5.7 In addition, the Council is required to value its operational properties (land and buildings) at ‘current value’. For non-specialised assets such as office buildings, this is taken to be the value of the property in its existing use (e.g. disregarding any redevelopment potential). For specialised assets such as swimming pools, a depreciated replacement cost approach is used. Council dwellings are valued based upon an existing use value for social housing, which applies a discount factor to reflect the fact that they are let at lower than market rents.

5.8 Any valuation requires certain assumptions and estimates to be made, and therefore there is an inherent risk that valuations may change materially in subsequent years. This risk is mitigated through the use of independent external property valuers, who are engaged to value properties in accordance with the requirements of the Code, and the Royal Institute of Chartered Surveyors (RICS) Valuation Global Standards.

5.9 The frequency of valuations depends upon the type of value of each property, as follows:-

Property type	Total value (land and buildings)	Valuation frequency
Operational – non-specialist	£3 million or greater	Annually
	Less than £3 million	5-yearly
Operational - specialist	£1 million or greater	5-yearly, with indexation in the intervening years
	Less than £1 million	5-yearly
Council dwellings	All	5-yearly, on a beacon basis
Surplus assets	All	Annually
Assets held for sale	All	Annually

5.10 In addition to the above programme of planned valuations, the external valuers also carry out an annual ‘materiality review’ to identify any risks of material movements in the value of properties not scheduled for review in any given year. Where any such risks are identified, an additional valuation is conducted.

5.11 Council dwellings are valued using a beacon approach, whereby properties are grouped into similar ‘archetypes’ based upon type, size, age and location. Within each archetype a representative property is chosen for valuation, and the value derived is then applied to the whole archetype.

5.12 Following a competitive tender process, the Council has appointed new external valuers for its non-dwelling properties for the 2021-22 accounts (Bruton Knowles). This may result in some changes to the methodologies and assumptions used, and the associated disclosures within the Statement of Accounts. However, since all valuers have to apply the same professional standards to their valuations, the impact of this change is not anticipated to be significant. There is no change to the arrangements for the valuation of council dwellings, which is undertaken by Wilks Head and Eve.

5.13 The total value of council dwellings as at 31 March 2021 was £639.8 million, and the total value of other operational properties was £145.9 million.

Business Rate Appeals

5.14 Since the introduction of the Business Rates Retention Scheme from 1 April 2013, local authorities are liable for successful appeals against business rates charged to businesses, both in the current financial year and earlier years, in proportion to their local share of business rates income. The Council's General Fund share of business rates income is 40%.

5.15 A provision is therefore recognised for the best estimate of the amount that will be repayable following successful rating valuation appeals. The provision is calculated using an estimate of the likely remaining average reduction in rateable values over the life of the 2017 Valuation Office Agency (VOA) ratings list, plus an estimate of the amounts which will be required to settle appeals still outstanding on the 2010 ratings list. The estimates are based upon historical experience, and the Council has employed relevant experts to assist with this process. However, it remains possible that appeals may be settled at amounts which differ from these estimates.

5.16 The Council's share of the provision is currently forecast to be £3.4 million as at 31 March 2022, although this will be reassessed at year-end.

Fair Value Measurements

5.17 The Code requires many of the Council's assets to be held on the balance sheet at fair value, which is the price that an independent market participant would pay for the asset as at the balance sheet date.

5.18 Where possible, fair value is measured based upon quoted prices for identical assets in an active market (known as level 1 inputs). However, where such prices are not available, other valuation techniques must be used. These can be based upon observable (level 2) or unobservable (level 3) inputs.

5.19 Wherever level 1 inputs are not available for material assets or liabilities, the Council employs relevant experts to identify the most appropriate valuation techniques and to undertake valuations as required.

5.20 The most significant assets held by the Council and valued using level 2 or level 3 inputs are as follows:-

Asset	Value (31 March 2021)	Valuation Approach
Investment properties (including investment properties held for sale)	£162.1m	Valuation undertaken by external property valuers using a range of observable and unobservable inputs (level 3), such as expected yields, market rents and land values. Approaches adopted include the investment method (capitalising rental values using expected yields) and the comparable method (using recent market transactions of similar properties with appropriate adjustments).
Contingent proceeds from disposal of assets	£2.7m	Present value of likely estimated sales proceeds discounted at an appropriate rate where material.
Council's share of pension fund assets	£271.1m	With the exception of cash and cash equivalents, valuation is based upon quoted prices not in active markets.

5.21 As explained at paragraph 5.12, the Council's portfolio of investment properties will be valued by Bruton Knowles for the first time in 2021-22. Investment properties with a value of £500,000 or greater are valued annually, whilst smaller properties are valued on a rolling 5-yearly basis. As with operational properties, an annual 'materiality review' is conducted by the valuers to identify any risks of material movement in the value of properties not subject to revaluation in any given year.

6. Streamlining the Accounts

6.1 In 2019, CIPFA published 'Streamlining the Accounts', a guide to help local authorities to produce accounts which are more focused and user-friendly, whilst still complying with the requirements of the Code. Due to the delays in accounts production and audit in 2018-19 and 2019-20, the Council has not yet had an opportunity to implement any significant changes in response to this.

6.2 We propose for 2021-22 to take some time to look at the format and content of the Statement of Accounts, and to identify opportunities to make it more concise and easier to read and understand. We will seek early engagement with the auditors on this point to minimise any audit risk arising. It is hoped that any changes can be brought forward in time for the publication of the draft Statement of Accounts by the end of May 2022, and indeed streamlining is likely to be key to our ability to meet this much earlier deadline as set out in section 3 above.

6.3 Any feedback from members of the Civic Affairs Committee on the current Statement of Accounts format, or suggestions for improvement, would be greatly appreciated to feed into this process.

7. Future Developments

7.1 The following developments are likely to affect the Council's Statement of Accounts in future years.

<u>IFRS 16 Leases</u>

7.2 With effect from 1 April 2022, there will be a change to the way in which the Council is required to account for leased assets, under a newly adopted International Financial Reporting Standard (IFRS 16). The main impact will be on leases where the Council is the lessee.

7.3 Currently, all leases where the Council is the lessee are classified as operating leases. The cost of the lease payments is charged to the General Fund or HRA evenly over the life of the lease, with no impact on the Council's Balance Sheet.

7.4 Under IFRS 16, the Council will be required to recognise a long term liability on the Balance Sheet in respect of future years' lease payments. There will also be a corresponding asset in respect of the Council's right to use the leased asset for the term of the lease. Preliminary estimates place the total value of this liability and corresponding asset in the region of £1 million, although work is ongoing to fully quantify this.

7.5 As a result of this new standard, an authorised borrowing limit for long term liabilities of £2 million has been proposed in the 2022-23 Treasury Management Strategy Statement to be presented to Council in February. It is important to note, however, that this is purely a technical accounting change. There is no new liability being taken on by the Council in practice, this is effectively recognition of a liability now for lease payments the Council has already committed to pay in future years.

7.6 The new standard will also result in a slightly different profile of charges to the General Fund and HRA, with higher payments due in the earlier years of the lease due to higher financing costs on the larger liability balance. However, the total amount chargeable over the life of the lease will remain the same.

MRP Consultation

7.7 The government is currently consulting on changes to the Statutory Guidance on Minimum Revenue Provision (MRP). Any changes to this guidance may require a review of the Council's MRP policy, particularly in relation to capital loans on which MRP is not currently charged (on the basis that they are secured on assets).

7.8 Under statutory requirements, loans to third parties for capital purposes must be treated by the Council as capital expenditure, and therefore must be financed in the same way as any other capital expenditure. Currently, secured loans are left unfinanced at the point that they are made, and instead are financed retrospectively from the cash received when the loan is repaid. Adopting this methodology means that there is no revenue impact of making these loans (other than the recognition of any interest received).

7.9 Under the government proposals, certain unfinanced loans would become subject to an MRP charge to revenue on an annual basis. This would not impact the Council's net cost of services, but would be a charge to the General Fund made through the Movement in Reserves Statement (MIRS). Whilst it would still be possible to finance any remaining balance from the cash repayment at the end of the loan, it would not be permitted to 'unwind' MRP charges made in previous years. This would effectively result in a permanent conversion of revenue resources to capital (a charge on the General Fund).

7.10 Should this occur, it is possible that the long-term viability of some of these loan arrangements could be affected. However, it should be noted that these proposals are still subject to consultation, with any changes likely to take affect from 1 April 2023.

8. Implications

a) Financial Implications
As set out throughout this report.

b) Staffing Implications
None.

c) Equality and Poverty Implications
None.

d) Net Zero Carbon, Climate Change and Environmental Implications
None.

e) Procurement Implications
None.

f) Community Safety Implications
None.

9. Consultation and communication considerations

The draft Statement of Accounts will be published on the Council's website by 31 May 2022, and will be subject to a public inspection period in accordance with the Accounts and Audit Regulations 2015 (as amended).

10. Background papers

Statement of Accounts 2020-21

11. Inspection of papers

To inspect the background papers or if you have a query on the report please contact Jody Etherington, Deputy Head of Finance, tel: 01223 - 458130, email: jody.etherington@cambridge.gov.uk.