STATEMENT OF ACCOUNTS 2022-23 – ACCOUNTING POLICIES AND SIGNIFICANT AREAS OF JUDGEMENT

To:
Civic Affairs Committee 08/02/2022

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 2022-23 accounts.

1.2 There are no significant changes to accounting policy proposed this year. Furthermore, section 6 briefly sets out accounting policy changes relating to future years.

2. Recommendations

2.1 To note that there are no significant changes to accounting policies anticipated for the 2022-23 Statement of Accounts.

2.2 To note and approve the proposed critical judgements and major sources of estimation uncertainty in respect of the 2022-23 Statement of Accounts.

2.3 To note the progress made in streamlining the 2021-22 accounts and to request further 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 2022-23 Code, there are no changes which will have a significant impact on the Council's accounting policies or its Statement of Accounts.

3.2 The previous year's draft accounts were published on 31 July 2022 and the final audited accounts were published on 30 November 2022. This meant that both the key statutory deadlines were met. For the 2022/23 accounts the deadline for publishing the draft accounts is 31 May 2023. Local authorities are required to publish their audited accounts by 30 September 2023.

3.3 This authority made excellent progress in 2021/22 as part of an ongoing project to streamline the financial statements to make them more accessible for stakeholders and easier to compile. Meeting the revised deadline for publication of the draft accounts this year will be challenging but plans are in place to ensure the revised deadline can be achieved. Members of this Committee are encouraged to provide further feedback on the format and content of the previous year's accounts so this can be considered when preparing this year's statements.

3.4 It is uncertain to what extent external audit firms will be able to achieve the revised deadline for completing their audits of local authority financial statements. The increasing complexity of local authority accounting combined with continuing resourcing difficulties impacting the audit sector meant that only 12% of authorities were able to publish their audited 2021/22 accounts by 30 November 2022, a 3% improvement on the previous year. The current situation is being closely monitored by Public Sector Audit Appointments, the appointing body, and the Department of Levelling Up, Housing and Communities (DLUHC). The committee will be informed if any changes are made to the statutory timetable for the current and future financial years.

3.5 As part of the closedown-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 2022-23 Statement of Accounts. It is expected 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. One such judgement has been identified to date in relation to 2022-23 (as consistent with the prior year), and this is set out below.

Funding Uncertainty

4.2 The government published the provisional local government finance settlement in December 2022. The announcement combined details of funding levels for 2023-24 with an indication of the approach that would be taken for 2024-25. This represented an improvement on recent years when settlements have only covered a single financial year. There remain long-term uncertainties about the funding of local government. These uncertainties are complicated further by challenges arising from the current economic environment, particularly inflation (especially wage inflation) and a sustained period of higher interest rates.

4.3 Officers could instruct the Council's valuers to make specific assumptions regarding future service levels to inform the valuation of land and buildings owned by the Council which are used to provide Council services. Anticipated reductions in service levels may contribute to a reduction in the valuation of assets for accounting purposes. This is because local authorities value their assets with reference to their existing use value which is determined with reference to the service potential associated with those assets. At the current time officers have not provided any specific directions regarding future service levels. This reflects both uncertainty about future funding and ongoing work within the Council as part of its 'Our Cambridge' transformation programme to review how services operate and the assets the Council will need to retain to support future service provision.

4.4 The decision not to make specific assumptions about future service provision to inform the valuation of assets is consistent with previous years and remains reasonable and consistent with the Council's Medium Term Financial Strategy and its Corporate Plan. Nevertheless, officers believe that it is instructive to users of the accounts to identify and disclose the approach taken as a critical accounting judgment. This disclosure complements the disclosures relating to estimation uncertainty referred to below.

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 assumptions.

5.2 The following areas of significant estimation uncertainty have been identified for disclosure in the 2022-23 accounts:

Pensions Liability

5.3 Estimation of the net liability to pay pensions depends on several complex judgements relating 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 2022 was £103.961 million, subject to the following sensitivities to underlying assumptions:

- Decreasing the real discount rate by 0.1% would have increased the liability by £7.7 million.
- An increase in member life expectancy of 1 year would have increased the liability by £15.9 million.
- Increasing the CPI assumption by 0.1% would have increased the liability by £7 million.

5.4 The underlying assumptions and therefore the value of the liability will be reassessed by the actuaries as at 31 March 2023. 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 2022-23 is currently forecast at £16.835 million, and it is estimated that a reduction in useful lives of one year would increase this charge by £0.564 million. Of this, £0.186 million would fall as a charge to the HRA, with the remaining £0.378 million impact on General Fund assets being reversed out to unusable reserves under statutory requirements for capital financing. The arrangements relating to depreciation in the HRA operate differently as depreciation is reversed out to the Major Repairs Reserve which is then available to fund the cost of HRA capital works.

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 on protected tenancies 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 appointment 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	Annually, on a beacon basis, with full valuation, including physical inspection, of beacon properties on a rolling 5-yearly cycle
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 appointed new external valuers for its non-dwelling properties for the 2021-22 accounts (Bruton Knowles). The 2021-22 audit was completed with only minimal queries being raised about the methodologies used by Bruton Knowles. Bruton Knowles will complete the valuation of non-dwelling properties for the 2022-23 accounts and initial discussions about this year's work programme have already taken place. No significant issues have been identified. Wilks, Head and Eve will continue to be responsible for the valuation of council dwellings and early engagement with their team is scheduled to commence shortly.

5.13 The total value of council dwellings as at 31 March 2022 was £726.43 million, and the total value of other operational properties was £144.35 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 Valuation Office Agency has recently completed a revaluation of properties registered for business rates and this will determine business rates payable with effect from 1 April 2023. The need for any provision relating to appeals in respect of the 2023 rating list will be considered as part of work to produce the 2023/24 accounts.

5.17 The Council's share of the provision is currently forecast to be £4.67 million as at 31 March 2023, although this will be reassessed at year-end.

Fair Value Measurements

5.18 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.

5.19 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.

5.20 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.

5.21 The most significant assets held by the Council and valued using level 2 or level 3 inputs are its investment properties. The table below provides more information regarding the approach taken to value these assets:-

Asset	**Value (31 March 2022)**	**Valuation Approach**
Investment properties (including investment properties held for sale)	£161.3m	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).

5.22 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. Future Developments

6.1 This section provides an update on upcoming developments impacting the Council's accounts including the latest position in relation to matters brought to the committee's attention in previous years.

<u>IFRS 16 Leases</u>

6.2 It had originally been anticipated that a change in the approach to accounting for leased assets would be implemented from 1 April 2022. Following consultation with local authorities, HM Treasury, local authority auditors and other stakeholders CIPFA determined in April 2022 that the implementation date would be put back to 1 April 2024. Authorities are permitted to voluntarily adopt from 2022/23 if they wish to do so.

6.3 Early work has been undertaken to assess the likely impact of implementing the new standard. However, since no material benefits associated with early implementation have been identified, officers do not propose to implement the standard until 2024/25 when it becomes mandatory.

MRP Consultation

6.4 It was reported to this Committee in February 2022 that the government was undertaking a consultation on changes to the Statutory Guidance on Minimum Revenue Provision (MRP). During the consultation the government made changes to its original proposals to address concern expressed by local authorities about the impact the proposed changes would have on authorities which had made loans to Council-owned subsidiaries, joint ventures and third parties.

6.5 The Council has made loans to a range of organisations. The original MRP proposals could have significantly impacted on the viability of future loans and meant the Council needed to charge MRP on existing loans. The revised proposals reduce the likelihood that MRP will be required in relation to Council loans providing there is no expectation that the Council will experience a loss in respect of the loans it has made. Existing budgeting and accounting arrangements already require the Council to be vigilant about the risk of loans not being recoverable. Therefore, the expected changes to MRP guidance, as referred to in the most recent consultation documentation, are not expected to impact the Council's financial statements or its Medium Term Financial Strategy.

6.6 Originally, it was expected that changes to the statutory guidance would be effective from 2023/24. It is now anticipated that the changes will be effective from 2024/25.

Pooled Funds

6.7 The government also consulted recently on the future of an existing statutory override relating to the accounting treatment applied to local authorities' investments in pooled funds. Currently, the Council is required to transfer the difference between the fair value of its investments in pooled funds, as determined by financial markets at the balance sheet date, and their book value, i.e. the original cost of the investment, to an unusable reserve. This means that local authorites' usable reserve balances are not impacted by changes in market sentiment which can lead to volatility in the value of pooled funds.

6.8 The current override was scheduled to end on 31 March 2023. After considering responses to the consultation the government announced in December 2022 that the override would remain in place for a further two years until 31 March 2025.

7. 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.

8. Consultation and communication considerations

The draft Statement of Accounts are due to be published on the Council's website by 31 May 2023, and will be subject to a public inspection period in accordance with the Accounts and Audit Regulations 2015 (as amended).

9. Background papers

Statement of Accounts 2021-22

10. Inspection of papers

To inspect the background papers or if you have a query on the report please contact Neil Krajewski, Deputy Head of Finance, tel: 01223 - 458130, email neil.krajewski@cambridge.gov.uk