Agenda Item No:	8
Report To:	**Audit Committee**
Date:	1^{st} February 2011
Report Title:	Presentation of Financial Statements
Report Author:	Ben Lockwood and Maria Seddon

Summary:

The Council is required to adopt international financial reporting standards and this report updates members on the progress being made for the transition to the new standards.

Work is progressing in all areas and our auditors are due to review this in February. The key areas of focus are on embedded leases and lease arrangements for property.

A key area of uncertainty is component accounting in the HRA where further guidance is awaited.

A template for the statement of accounts incorporating the necessary changes has been produced.

Key Decision: NO

Affected Wards: None specifically

Recommendations: **The Audit Committee be asked to:-**

- **Note the report**
- **Consider the how the committee wishes to review the draft statement and closing process (reference para 13).**

Financial Implications: None – the transition will be managed within existing capacity and the changes have been developed to mitigate any potential bottom line impacts from the changes.

Risk Assessment Yes – This report covers it implementation of a new accounting rule book – if the council fails to implement this correctly there is a risk of audit issues and reputational risk.

Equalities Impact Assessment NO

Other Material Implications: None

Background Papers: Template Statement of Accounts 2010/11
Draft Closing Timetable 2010/11

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Agenda Item No. 8

Report Title: Presentation of Financial Statements

Purpose of the Report

1. To update members on the progress of the production of the Statement of Accounts 2010/11 (The Statement) and the adoption of International Financial Reporting Standards (IFRS).

Issue to be Decided

2. Members are asked to note the report and consider how to review the statement and progress against the closing programme.

Background

3. The Council is required to produce an annual statement of accounts for the financial year ended the 31 March which is approved by the Audit Committee by the end of June. These are then audited by the Council's external auditor and an opinion issued by the end of September.

4. For the Financial year ending 31 March 2011 all Local Authorities have to produce an IFRS compliant statement and comply with a new accounting 'rule book.' This transition has been the subject of several reports and presentations to members and work on the transition has been underway for more that a year.

Audit Wrap Up and Closing Timetable

5. Officers met with the audit team to discuss any issues that had arisen in the closing process for 2009/10 and to incorporate any changes into the closing programme for 2010/11

6. Overall Officers and Auditors were happy with the audit process and happy with the working relationship. Changes in location of the audit team, to where the Accountancy team sit, have helped to improve the relationship between the Auditors and the Accounts Department. The only area for improvement identified was communication regarding audit progress to officers on a regular basis. Helping the Accounts department to understand what has been completed and what is due to be looked at in the week to come. Holding regular update meetings through the audit is important and needs to be maintained.

7. Audit were generally happy with working papers and the audit team, who now have several years experience of Ashford Borough Council, have become familiar with the working paper files. However as part of the transition to IFRS it is seen as an opportunity to review working paper structure and referencing. We have discussed some improvements to the process such as referencing and improving the structure which are being implemented for 2010/11. It is important that at the start of the audit there is a hand over briefing of the working papers to ensure the audit team understand the new referencing system.

8. The Audit of the 2010/11 accounts will commence in early July with Audit Commission commencing their planning work on 23rd June. They are due to Audit the Whole of Government Accounts return in August. External audit are due to review the restatement of our accounts for IFRS in early February and have already completed their controls testing programme.

9. Officers have completed a draft closing timetable that is currently being reviewed by the Accountancy team. The key deadlines are:

- service revenue accounts and Collection Fund closed by 21st April
- balance sheet codes closed by the 13th May
- a draft statement by 1st June
- final draft to be put to the audit committee in late June.

This is consistent with previous timetables and is considered achievable.

IFRS Compliant Statement

10. The transition to IFRS has resulted in a fundamental revision of the Statements themselves. It is anticipated that the statement will be longer and have more notes. The statement will also be longer due to the new accounting requirement to include 2 years of comparative date when restating prior years which we are required to do for IFRS.

11. Last year the Accountancy Team reviewed all notes in the statement and removed all notes that were not necessary or were not of a material value. A similar process will be followed for the new statement with non material notes being removed to keep the length of the statement to a manageable level..

12. CIPFA has now released its guidance notes on the new IFRS code and has released an example statement of accounts to illustrate how the statement will change. Officers have now developed a template for the statement which will be completed for the statement of accounts. Originally it was proposed that this be appended to this report, however due to the length of the statement (120 pages) and the fact that it does not contain any figures, it was decided not to attach the template.

13. The Template is available to members if they choose to request it. At a recent discussion on the future of the committee it was suggested that for technical issues a lead member be assigned to work with officers on issues relating to their specialty. The Financial Statement may be an appropriate area for this approach to be tested and the Committee is asked to consider whether this approach be adopted for reviewing the statement or whether it wishes to review the template in another way.

Accounting Policies

14. The transition to IFRS has required a fundamental review of the Councils accounting policies. The proposed draft policies are attached in appendix A, these have been used as the basis of restatement and will be followed for the closure of the 2010/11 accounts.

Leases

15. Officers have completed their review of leases in accordance with the new code. The review has highlighted 2 material property leases that need to be treated as finance leases. All other property leases are either at peppercorn rents or for suitably short periods that they need to be treated as operating leases.

16. The two finance leases are:

    - Victoria Park Bowls Centre – the rent charged by the Council was set to recover the construction costs and is for the whole life of the building. The calculations for this lease are completed.

    - Edinburgh Rd car park – the council leases the top floor of the multi-storey car park on a 75 year lease. Officers have has some difficulty identifying the original cost for this building upon which to base the lease calculation. Work is continuing on this however due to the age of the building a reasonable estimate has been calculated, this will need to be discussed which the external audit team.

Embedded Leases

17. Embedded leases are assets within a service contract that are purely used for the delivery of that contract. Therefore there is an implicit lease for the equipment used in the contract. An example of this is the refuse contract where the contractor has purchased refuse tenders to work on the refuse contract. The Council needs to breakdown the lease payments for these contracts into service and asset costs.

18. Good progress has been made on this with the Refuse and Street Cleansing contracts. Information on the number and type of vehicles used on the contract has been used and whilst we have not been successful in getting information on the cost of vehicles from the contractor we have been able to get this information on similar vehicles from authorities that run these services. This has enabled an estimation of the embedded lease in the contracts to be made.

19. It does not appear that there is an embedded lease for Landscape services contact due to the life of the equipment used, and the way the equipment can be transferred between contracts. These findings will be discussed with the Audit team to ensure they are happy with the Council's findings.

Fixed Assets

20. The Council undertook a full IFRS compliant revaluation of its fixed assets as at 1st April 2009 and therefore much of the work on this area has been completed.

21. A small number of assets have been reclassified as there have been a few changes in definitions for Assets for Sale and Investment Assets. These changes will be discussed with the Audit team.

22. One area where there is work outstanding is over the issue of HRA component accounting. We are still awaiting guidance from CIPFA and the CLG on how component accounting will be introduced for the housing stock.

Other Issues

23. The Calculation for Annual Leave accrual has been completed for the previous 2 years and the calculation will be completed as at 31 March 2011. The initial calculations have estimated that the value of Annual Leave accrued is £137,000.

24. Deferred grants have been assessed and all grants that have been applied have been written out of the balance sheet. There will be no amortisation of grants through the Income and Expenditure account for 2010/11 as there has been in previous years.

25. In previous years call account balances (instant access saving accounts) and fixed term investments have been included as short term deposits. Due to the transition to IFRS all call account balances will be classified as 'cash and cash equivalents' and as per our accounting policies, any investments due to expire within 3 months of the balance sheet date will also be classed as 'cash and cash equivalents'.

Risk Assessment

26. The required technical changes to the format of the 2010/11 Statement of Accounts increase the potential for errors, but this has been mitigated through training of relevant staff and discussions with the external auditors.

Consultation

27. External audit are due to commence a review of the restated accounts for 2008/09 and 2009/10 in early February. This review will include assessment of the Council's assumptions. Due to a the number of reviews the Audit Commission will be doing we are not expecting feedback until the end of March.

Handling

28. Members are asked to note the changes to the final accounts process.

29. The relevant staff need to familiarise themselves with the new code and associated guidance notes and the changes from previous years.

Conclusion

30. The transition to IFRS represents a significant workload for the Council and it is important that the Council complies with the new rules. Good progress has been made in this project however a continued focus is needed to ensure successful completion of this project.

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Appendix A – Proposed Accounting Policies
Statement of Accounting Policies
General Principles

The Statement of Accounts is prepared on an income and expenditure basis in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11: Based on International Financial Reporting Standards. The Code is based on approved accounting standards, comprising International Accounting Standards (IAS), International Financial Reporting Standards (IFRS's) approved by the International Accounting Standards Board, International Public Sector Accounting Standards (IPSAS) and the Urgent Issues Task Force's (UITF) Abstracts.

1. **Accounting Concepts and Conventions**

   The Statement of Accounts summarises the Council's transactions for the 2010/11 financial year and its position at the year end of 31 March 2011. The accounting convention adopted is historical cost, modified by the revaluation of certain categories of assets.

2. **Accruals of Income and Expenditure**

   With the exception of the Cash Flow Statement, the Statement of Accounts is presented on an accruals basis. The accruals basis of accounting requires the non-cash effect of transactions to be reflected in the Statement of Accounts for the year in which those effects are experienced, and not in the year in which the cash is actually received or paid. In particular: fees, charges and rents due from customers are accounted for as income at the date the Council provides the relevant goods or services; interest payable on borrowings and receivable on investments is accounted for 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 income 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 it is doubtful that debts will be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

3. **Estimation Techniques**

   Estimation techniques are the methods adopted by the Council to arrive at estimated monetary amounts, corresponding to the measurement bases selected for assets, liabilities, gains, losses and changes in reserves. Details of where these are used are contained in the relevant Note to the Accounts. Where a change in an estimation technique is material, an explanation is also provided of the change and its effect on the results for the current period.

Costs of Internal Support Services

All costs of management and administration are fully allocated to services. The basis of allocation used for the main costs of management and administration is outlined below.

	of Allocation
Accounting, Legal and other services	Actual time spent by staff, as recorded on

	time recording systems
Administrative Buildings	Area occupied
IT support of corporate financial systems	Actual direct costs (hardware costs etc.) plus cost of estimated staff resources
Network / PC support	Per capita
Executive Support, Call Centre, Customer Contact Centre and Printing	Actual use, as recorded by monitoring systems
Internal Audit	Per audit plan
Payroll and Personnel Costs	Per capita
Debtors and Creditors	Per transaction

Any non-material balances on management or administrative holding accounts at the year-end remain on those accounts, and as such are incorporated into the General Fund balances.

4. **Council Tax and National Non-Domestic Rates**

The Council is a billing authority and as much is required to bill local residents and businesses for Council Tax and National Non-Domestic (Business) Rates. The Council acts as an agent on behalf of the major precepting authorities, Kent County Council, Kent Police Authority and Kent Fire Authority, for Council Tax and the Government for National Non-Domestic (Business) Rates.

As such the accounts only show the amount owed by and to taxpayers in respect of our Council Tax. Major precepting authorities will be shown as net debtors or creditors on the balance sheet. Similarly the accounts only show the net debtor of creditor in respect of National Non-Domestic (Business) Rates received and paid over to the Government

The amount shown in the Comprehensive Income and Expenditure Account as the demand on the collection fund includes the accrued amount of council tax collected as well as amounts from previous year's estimates. This adjustment is subsequently reversed within the Movement in Reserves Statement to the Collection Fund Adjustment Account.

5. **Capital Charges to Revenue**

General Fund Service Revenue Accounts, Support Services and Trading Accounts are charged with a capital charge for all fixed assets used in the provision of services. The total charge covers the annual provision for depreciation.

The charges made to the Housing Revenue Account are the amounts as determined by statutory provision.

The premature repayment of the long term loans that result in either a premium or a discount are to be amortised to the Revenue Account either in accordance with the Housing Subsidy determinations or by reference to the Treasury Management Code of Practice.

External interest payable and amounts set aside from revenue for the repayment of external loans are charged to the Income and Expenditure Account. The reversal of capital charges is credited to the Statement of

Movement of General Fund balance. Capital charges therefore have a neutral impact on the amounts required to be raised from local taxation.

6. **Revenue Expenditure Funded from Capital Under Statute**

Legislation allows some expenditure to be classified as capital for funding purposes when it does not result in the expenditure being carried on the Balance Sheet as a Fixed Asset. The purpose of this is to enable it to be funded from Capital Resources rather than being charged to the General Fund and impact upon the Council Tax. These items are generally grants and expenditure on property not owned by the Authority.

Such expenditure is charged to the Comprehensive Income and Expenditure Account in year. A Statutory Provision allows that capital resources that meet the expenditure be debited to the Capital Adjustment account, credited to the General Fund Balance and shown as in Movement in Reserves Statement.

7. **Government Grants and Contributions**

Revenue grants received are accrued and credited to the Comprehensive Income and Expenditure Account in the same period as the related expenditure is incurred.

Grants specific to a particular service will be shown against the service expenditure line. General grant in the form of Revenue Support Grant and the contribution from the National Non-Domestic Rate Pool are credited and disclosed separately in the Comprehensive Income and Expenditure Account under General Government Grants.

Capital grants and capital contributions (such as Section 106 Developer Contributions) received will be credited to the Comprehensive Income and Expenditure Account in the year that the capital expenditure is incurred. This income will subsequently be transferred to the Capital Adjustment Account through the Movement in Reserves Statement.

8. **VAT**

VAT is accounted for separately and is not included in the Income and Expenditure Account, whether of a capital or revenue nature. Input VAT which is not recoverable from HM Revenue and Customs will be charged to Service Revenue Accounts or added to capital expenditure as appropriate. The Council’s partial exemption status is reviewed on an annual basis.

9. Assets Held for Sale (Non-Current Assets)

These are assets that have been declared surplus to the Council’s operational requirements and are being actively marketed and have an estimated sale date within twelve months of the balance sheet date. They will be reported on the balance sheet date at the lower of the carrying amount or the fair value (market value) of the asset less the costs to sell the asset. Assets available for sale are not subject to depreciation.

10. **Intangible Fixed Assets**

Expenditure on assets that do not have physical substance but are identifiable and controlled by the Council (e.g. software licences) is capitalised when it will bring benefits to the Council for more than one financial year.

An intangible asset shall initially be measured at cost and is not subject to revaluation. It is, however, subject to amortisation over their useful economic life. The accounting policies practiced will be the same for all fixed assets as stated below.

11. Investment Properties

Investment property is property (land and / or buildings) held solely to earn rental income or for capital appreciation or both.

Investment property is initially recognised at cost, but is subject to valuation at fair value at the end of each accounting period, losses or gains shall be recognised in the Comprehensive Income and Expenditure statement.

Depreciation will not be charged against investment property.

12. **Fixed Assets**

12.1. **Recognition**

All expenditure on the acquisition, creation or enhancement of a fixed asset is capitalised on an accruals basis.

12.2. **Property Plant and Equipment**

Property, plant and equipment are tangible assets (i.e. assets with physical substance) that are; held for use in the production or supply of goods and services, for rental to others, or for administrative purposes, and expected to be used during more than one period.

The category is split into five sub categories.
Land and Buildings.
Vehicles, Plant and Equipment.
Community Assets.
Infrastructure Assets.
Assets under Construction.

The Accounting policy for each type of asset is detailed below.

Council dwellings

These are held on the balance sheet on a market value basis but discounted to allow for the Existing Use Value – Social Housing (EUV-SH) valuations.

An annual valuation is carried out by a qualified surveyor in accordance with the latest guidance issued by the Royal Institute as at 1st April. Material changes will be reflected in the Accounts if they arise after the valuation.

Land and Buildings

These are held on the balance sheet at cost allowing for revaluation every five years. The last revaluation was as at 1st April 2009.

The valuations are carried out by a qualified surveyor in accordance with the latest guidance issued by the Royal Institute of Chartered Surveyors (RICS) on a market value for existing use, unless it is felt the property is of a specialist nature where depreciated replacement cost may be used. The method used on the current year's valuation will be explained in the notes to the accounts. Items of plant that are functional to the operation of a building are included in the valuation for that building.

All buildings are subject to straight line depreciation over there estimated useful lives which depends on the asset type. In accordance with recognised accounting practice land is not depreciated.

IFRS requires the consideration of componentisation for material items of property, plant and equipment, where they are of a material financial nature or have significantly differing life expectancies. The Council has set a minimum asset value of £1,000,000 and a component size of at least 10% of the value.

Vehicles, Plant and Equipment

Major items of plant are included within the valuation of buildings above. Other items of plant are recognised in the balance sheet at cost and are subject to straight line depreciation over the expected life of the asset.

Community Assets

These are defined as Assets that the local authority intends to hold in perpetuity, that have no determinable useful life, and that may have restrictions on their disposal. Examples of community assets are parks and allotments. These assets are held on the balance sheet at historic cost and are not subject to revaluation or depreciation.

Assets under Construction

This covers assets currently not yet ready for operational purposes. The Council does not depreciate or revalue assets under construction.

12.3. **Depreciation**

on assets with a finite useful life in line with Financial Reporting Standard (FRS 15) on a straight line basis according to the following policy:

- All assets with a finite useful life are depreciated on a straight line basis over the asset life. The life of buildings is reviewed as part of the asset revaluation. The life of vehicles, plant and equipment is generally taken to be five years, unless evidence exists to support a longer or shorter life.

- Newly acquired assets are depreciated in year one; assets in the course of construction are not depreciated until they are brought into use.

For Council Dwellings the Major Repairs Allowance is used as a proxy for depreciation. Council Dwellings are revalued annually. Other HRA land and property are valued as above.

12.4. **Impairment of Fixed Assets**

A review for impairment of a fixed asset whether carried at historical cost or valuation should be carried out if events or changes in circumstances indicate that the carrying amount of the fixed asset may not be recoverable. Examples of events and changes in circumstances that indicate impairment may have been incurred include:

- a significant decline in a fixed asset’s market value during the period;
- evidence of obsolescence or physical damage to the fixed asset;
- a significant adverse change in the statutory or other regulatory environment in which the authority operates;
- a commitment by the authority to undertake a significant reorganisation.

In the event that impairment is identified the value will either be written off to the revaluation reserve, where sufficient reserve levels for that asset exist or written off to revenue through the Comprehensive Income and Expenditure Account. Any impairment at the balance sheet date is shown in the notes to the core financial statements, along with the name, designation and qualifications of the officer making the impairment.

13. **Gains or Losses on Disposal of Fixed Assets**

When an asset is disposed of or de-commissioned, the value of the asset and the income from the sale are both charged to the Comprehensive Income and Expenditure Account which, therefore, bears a net gain or loss on disposal. Any revaluation gains in the Revaluation Reserve are transferred to the Capital Adjustment Account.

The receipt is required to be credited to the Usable Capital Receipts Reserve, and can then only be used for new capital investment. Receipts are appropriated to the Reserve via the Movement in Reserves Statement.

The loss on disposal 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 Movement on Reserves Statement.

14. **Leases**

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

An operating lease is a lease other than a finance lease.

A definition of a lease includes hire purchase arrangements.

Finance Leases

As lessee, the Council shall recognise finance leases as assets and liabilities at amounts equal to the fair value of the property or, if lower, the present value of the minimum lease payments.

Minimum lease payments shall be apportioned between the finance charge (interest) and the reduction of the outstanding liability. The finance charge shall be calculated so as to produce a constant periodic rate of interest on the remaining balance of the liability.

The authority will recognise asset under finance lease in the balance sheet at an amount equal to the net investment of the lease.

Assets recognised under a finance lease shall be depreciated. The depreciation policy for leased assets shall be consistent with the policy for owned assets. Where it is not certain that ownership of the asset will transfer at the end of the lease, the asset shall be depreciated over the shorter of the lease term and its useful economic life. After initial recognition, assets recognised under a finance lease are subject to revaluation in the same way as any other asset.

As lessor, the Council shall derecognise the asset

Operating Leases

Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the benefits received by an authority.

Embedded Leases

These are assets that although not owned by the Council are used primarily by the authority for service provision. An example of this would be vehicles used by the Council's Street Cleansing and Refuse and Recycling Collection contractor. In this case an estimated value for the vehicles has been used along with a leased term in line with the contract period. Assets will be recognised in the balance sheet at the Net Book Value and offset by a Deferred Liability. The lease charge will then form part of the contract payment on behalf of these vehicles on a straight line basis over the life of the asset.

15. **Current Assets and Liabilities**

15.1. **Debtors and Creditors**

The Revenue and Capital accounts of the Council are maintained on an accruals basis in accordance with the Code and other relevant IAS's.. That is, sums due to or from the Council during the year are included, whether or not the cash has actually been received or paid in the year.

15.2. **Stocks**

Stocks are valued at the latest price paid. This is a departure from the requirements of the Code and ISA 2, which requires stocks to be shown at actual cost or net realisable value if lower. The effect of the different treatment is immaterial given the low stock levels held.

15.3. **Investments**

See the accounting Policy on Financial Instruments

15.4. **Bad Debts**

The figure shown in the Statement of Accounts for debtors is adjusted for bad debts. This provision is recalculated annually by applying a percentage factor to the debt in each age category that is unlikely to be collectable. Known un-collectable debts are written off.

16. **Contingent Assets and Contingent Liabilities**

Contingent assets are not recognised in the Statement of Accounts. They are disclosed by way of notes if the inflow of a receipt or economic benefit is probable. Such disclosures should indicate the nature of the contingent asset and an estimate of its financial effect.

Contingent liabilities are not recognised in the accounting statements; they are disclosed by way of notes if there is a possible obligation which may require a payment or a transfer of economic benefits. For each class of contingent liability the Authority should disclose the nature of the contingency, a brief description, an estimate of its financial effect, an indication of the uncertainties relating to the amount or timing of any outflow and the possibility of any reimbursement.

17. **Provisions**

The Council sets aside provisions for specific liabilities or losses which are likely or certain to be incurred, but the amounts or the dates on which they will arise are uncertain. The value of the provision must be the best estimate of the likely liability or loss.

18. **RESERVES**

The Council maintains both general and earmarked reserves. General reserves are to meet general, rather than specific, future expenditure and earmarked reserves, such as the building repairs reserve, are for specific purposes. No expenditure is charged directly to a reserve but is charged to the service revenue account within the Comprehensive Income and Expenditure Account, this is then offset by a reserve appropriation within the Movement in Reserves Statement.

Capital Reserves are not available for revenue purposes and certain Capital Reserves (e.g. Usable Capital Receipts) can only be used for certain statutory purposes.

The Major Repairs Reserve is required by statutory provision to be set up in relation to the Housing Revenue Account.

19. **Pension Costs**

The amount charged to the Income and Expenditure Account and the Statement of Total Recognised Gains and Losses for employees pensions should be in accordance with FRS17 Retirement Benefits, subject to the interpretations set out in the SORP.

Employees are members of the Local Government Pension Scheme administered by Kent County Council. The Scheme provides defined benefits to members (retirement lump sums and pensions), earned as employees of the Council. This is accounted for in the following ways:

- Liabilities of the pension scheme attributable to the Council 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 a discount rate of 5.5% based on the indicative rate of return.

- The assets of the pension fund attributable to the Council are included on 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 net pensions liability is analysed into seven components:

  - Current service cost – the increase in liabilities as result of years of service earned this year – allocated in the Income and Expenditure Account to the revenue accounts of 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 net cost of services in the Income and Expenditure Account as part of the Non Distributable 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 Income and Expenditure Account under net operating expenditure.

  - Expected return on assets – the annual investment return on the fund assets attributable to the Council, based on the average expected long term return – credited to the Income and Expenditure Account under net operating expenditure.

  - Gains/losses on settlements and curtailments – the result of actions to relieve the Council of liabilities or actions that reduce the expected future service or actuarial benefits of employees - debited to the net cost of services in the Income and Expenditure Account as part of the Non Distributable 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 assumptions have been updated. Debited to the Statement of Total Recognised Gains and Losses.

A prerequisite of the introduction of FRS17 was that it did not impact on taxation requirements. Where the contributions paid to the pension scheme do not match the change in the Authority's recognised liability for the year, the recognised cost of pensions will not match the amount required to be raised in taxation. Any such mismatch is to be dealt with by an equivalent appropriation to or from a pension reserve. Actuarial gains/losses are shown as movements on the pensions asset/liability account and pensions reserve. There is no impact on the Income and Expenditure Account. The Balance Sheet is to show the net pension asset or liability and an equivalent pension reserve balance.

Contributions to the pension scheme are determined by the Fund's actuary on a triennial basis. The latest formal valuation of the Kent County Council Pension Fund for funding purposes was at 31 March 2007 and changes to contribution rates as a result of that valuation will take effect from 1 April 2008.

For further details see Note XX

20. **Employee Benefits**

Three categories of employee benefits exist, under IAS 19 and IPSAS 25 Employee Benefits as detailed below.

Benefits payable during employment

This covers:

a) Short-term employee benefits, such as wages and salaries, paid annual leave and paid sick leave, bonuses and non-monetary benefits (e.g. cars) for current employees.
b) Benefits earned by current employees but payable twelve months or more after the end of the reporting period such as, long-service leave or jubilee payments and long-term disability benefits.
   Where considered of a material nature these are accrued in accordance with Accounting Policy 2 above.

Termination benefits

This covers costs that are payable as a result of either an employer's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary redundancy in exchange for those benefits. These are often lump-sum payments, but also include enhancement of retirement benefits; and salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

In the event of notice of termination being served on an employee the costs of redundancy are accrued to the year that the notice is served, but other costs will be charged to the year they are incurred.

Post-employment benefits

This not only covers pensions but also other benefits payable post-employment such as life insurance and medical care which are not offered to staff at this Council.

As part of the terms and conditions of employment of its employees, the authority offers retirement benefits. Although these benefits will not actually be payable until employees retire, the authority has a commitment to make the payments that needs to be disclosed at the time that employees earn their future entitlement. The Local Government Pension Scheme is administered locally by Kent County Council – this is a funded defined benefit final salary scheme, meaning that the authority and employees pay contributions into a fund, calculated at a level intended to balance the pension's liabilities with investment assets.

Under IAS 19 requires that the employer recognises as an asset or liability the surplus/deficit in a pension scheme. The surplus / deficit in a pension scheme is the excess/shortfall of the value of assets when compared to the present value of the scheme liabilities. A prerequisite of the introduction of IAS 19 was that it did not impact on taxation requirements. Where the contributions paid to the pension scheme do not match the change in the authority's recognised liability for the year, the recognised cost of pensions will not match the amount required to be raised in taxation. Any such mismatch is to be dealt with by an equivalent appropriation to or from a pension reserve. Actuarial gains/losses are shown as movements on the pensions asset/liability account and pensions reserve. There is no impact on the Comprehensive Income and Expenditure Account. The balance sheet is to show the net pension asset or liability and an equivalent pension reserve balance.

Contributions to the pension scheme are determined by the Fund's actuary on a triennial basis. The latest formal valuation of the Kent County Council Pension Fund for funding purposes was at 31 March 2010 and changes to contribution rates as a result of that valuation will take effect from 1 April 2011.

21. **Financial Instruments**

The SORP has significant disclosure requirements relating to Financial Instruments (e.g. loans and investments). They relate to the identification of the various types of Financial Instruments, gains and losses arising from transactions during the year, comparative valuation statements, and the assessment of risks associated with holding Financial Instruments.

Detailed disclosure of the Council's holding of Financial Instruments is included in Note XX on page XX and relevant gains and losses in Notes XX on page XX.

Financial Liabilities

Financial liabilities are initially measured at fair value and carried at their amortised cost. Annual charges to the Income and Expenditure Account for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument.

The reconciliation of amounts charged to the Income and Expenditure Account 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 Statement of Movement on the General Fund Balance.

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; and,
- 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 initially measured at fair value and carried at their amortised cost. Annual credits to the Income and Expenditure Account 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 Council has made, this means that the amount presented in the Balance Sheet is the outstanding principal receivable, and interest credited to the Income and Expenditure Account is the amount receivable for the year in the loan agreement.

Where assets are identified as impaired because of a likelihood arising from a past event and payments due under the contract will not be made, the asset is written down and a charge made to the Income and Expenditure Account.

Any gains and losses that arise on the derecognition of the asset are credited/debited to the Income and Expenditure Account.

Available-for-sale Assets

Available-for-sale assets are initially measured and carried at fair value. Where the asset has fixed or determinable payments, annual credits to the Income and Expenditure Account 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 Income and Expenditure Account when it becomes receivable by the Council. 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; and,
- 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 Statement of Total Recognised Gains and Losses (STRGL). The exception is where impairment losses have been incurred – these are debited to the Income and Expenditure Account, along with any net gain/loss for the asset accumulated in the Reserve.

Where assets are identified as impaired because of a likelihood arising from a past event and payments due under the contract will not be made, the asset is written down and a charge made to the Income and Expenditure Account.

Any gains and losses that arise on the derecognition of the asset are credited/debited to the Income and Expenditure Account, along with any accumulated gains/losses previously recognised in the STRGL. Where fair value cannot be measured reliably, the instrument is carried at cost (less any impairment losses).

Credit Risk

The SORP requires Authorities to estimate the “Fair Value” of their Financial Instruments and compare them with the carrying amounts which appear on the Balance Sheet. The Fair Value estimate will include the future discounted cash flows associated with the Council’s Financial Instruments as at 31 March 2010. The discount rate should reflect prevailing interest rates as at 31 March 2010. Full details of this disclosure are included in Note XX to the Core Financial Statements on page XX.

The SORP identifies the following three types of risk associated with Financial Instruments:

(a) Credit risk relates to the possibility of counterparties defaulting on their financial obligations.

(b) Liquidity risk relates to the possibility of funds being unavailable to meet financial commitments.

(c) Market risk relates to possible exposure to adverse interest rate movements, or changes in other market conditions e.g. foreign exchange rates.

The SORP requires Authorities to produce a sensitivity analysis, detailing the impact of a 1% interest rate change. A full assessment of these risks, including the sensitivity analysis, is included in Note XX to the Core Financial Statements.

The SORP’s disclosure requirements in relation to credit risk are equally applicable to outstanding debtors. Note XX includes an age analysis of overdue debtors at the balance sheet date. In addition to this a provision for bad debts is also included in the Statement of Accounts (Statement of Accounting Policies 12.4).

22. Cash and Cash Equivalents

Cash and Cash Equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value and are shown on the balance sheet at their nominal value, these include investments with a maturity of three months or less from the balance sheet date.

23. **Private Finance Initiative (PFI)**

PFI contracts are agreements to receive services, where the responsibility for making available fixed assets, needed to provide the services, passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes and as the ownership of the fixed assets will pass to the Council at the end of the contact at no charge, the Council carries the fixed assets used under the contract on the balance sheet.

The original recognition of these fixed assets was balanced by the recognition of a liability for the amounts due to the scheme operator to pay for the assets.

The stock is recognised at market value less the EUV-SH factor and additions are measured at cost as per the contractor model. Lifecycle costs are accounted for when they occur.

Fixed assets recognised on the balance sheet are revalued and depreciated in the same way as property, plant and equipment owned by the council.

The amounts payable to the PFI operators will be analysed into the following elements:

- Fair value of the services received during the year.
- Finance charge – an interest charge on the balance sheet liability.
- Payment towards the liability.

24. **Group Accounts**

Local Authorities are required to consider all their interests in subsidiaries, associated companies and joint ventures and to prepare a full set of group financial statements where they have material interests, thereby providing a complete picture of the Authority's control over other entities.

This Council has undertaken an exercise examining all its partnership arrangements and workings with other undertakings, and has determined that it has no interests in subsidiaries, associated companies or joint ventures.

25. **Exceptional Items and Prior Year Adjustments**

Exceptional items are included in the cost of the service to which they relate, or on the face of the Comprehensive Income and Expenditure Account if that degree of prominence is necessary in order to give a fair presentation of the accounts. An adequate description of each exceptional item should be given within the notes to the accounts.

Events after the Balance Sheet Date

Where an event occurs after the Balance Sheet date, favourable or unfavourable, which provides evidence of conditions that existed at the Balance Sheet date, the amounts in the Statement of Accounts and any affected disclosures should be adjusted.

Where an event occurs after the Balance Sheet date and is indicative of conditions that arose after the Balance Sheet date the amounts recognised in the Statement of Accounts should not be adjusted but a disclosure made including:

- The nature of the event

- An estimate of the financial effect