
NORTH AYRSHIRE COUNCIL

28 May 2019

Audit and Scrutiny Committee

Title: Accounting Policies 2018/19

Purpose: To seek the Audit and Scrutiny Committee's approval of the accounting policies which will be adopted in the preparation of the Council's annual accounts for the year to 31 March 2019.

Recommendation: That the Audit and Scrutiny Committee approves the accounting policies as detailed in Appendix 1.

1. Executive Summary

- 1.1 The annual accounts for the 2018/19 financial year summarise the Council transactions during the year and its position at the year end of 31 March 2019. Under the local Authority Accounts (Scotland) Regulations 2014, the Council is required to prepare an annual Statement of Accounts and Section 12 of the Local Government in Scotland Act 2003 requires that these accounts are prepared in accordance with the proper accounting practices.
- 1.2 These practices primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 ("the Code"), supported by International Financial Reporting Standards (IFRS). These are issued jointly by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Local Authority (Scotland) accounts Advisory Committee (LASAAC) and are designed to give a "true and fair view" of the financial performance of the Council.
- 1.3 The accounting policies to be adopted by North Ayrshire Council are reviewed on an annual basis in line with the CIPFA Code and submitted to the Audit and Scrutiny Committee for review in advance of the financial statements being prepared.
- 1.4 Following changes in the Code of Practice on Local Authority Accounting a number of changes have been made to the accounting requirements in relation to Financial Assets. The definition of Financial Assets has been broadened and the basis on which credit losses or impairment costs are calculated has been changed. Any resultant costs will be charged to the Comprehensive Income and Expenditure Statement (CIES), although these are not anticipated to be material.

2. Background

- 2.1 Accounting policies are defined in paragraph 3.3.2.1 of the Code as *'the specific principles, bases, conventions, rules and practices applied by an authority in preparing and presenting financial statements'*.
- 2.2 Councils are required to select accounting policies and apply changes to accounting policies in accordance with International Accounting Standard 8 - Accounting Policies.
- 2.3 The Council is required to adopt the accounting policies most appropriate to its particular circumstances for the purpose of giving a true and fair view. The accounting policies adopted should be reviewed regularly to ensure that they remain appropriate and consider the required treatment of any new policies relevant to the Council's particular circumstances. Sufficient information should be disclosed in the financial statements to enable users to understand the accounting policies adopted and how they have been implemented.
- 2.4 The draft accounting policies proposed for adoption are detailed in Appendix 2.
- 2.5 Appendix 1 highlights the most significant change to the Accounting Policies for 2018/19. These relate to the classification and measurement of financial assets, as detailed in Note I - Financial Instruments, further supported by clarification of the Council's existing policies on its interests in companies and other entities at Note M and the techniques used to determine Fair Value at Note W.
- 2.6 Under the previous Accounting Policies, the financial assets of the Council were identified as loans and receivables, such as loans to other bodies, which were measured at amortised cost. This meant that the amount presented on the Balance Sheet represented the outstanding principal, plus any accrued interest, and the interest charged for the year was credited to the CIES. Impairments were only recognised where a past event resulted in a likelihood that some of the payments due under the contract would not be made.
- 2.7 Following the adoption of IFRS9 – Financial Instruments, the requirements of the Code have been updated. IFRS9 has been designed to give greater transparency of gains and losses arising from the Council's Financial Assets. The definition of Financial Assets now includes cash and deposits, loans, debtors and any equity holdings. These assets must now be classified and measured reflecting the characteristics of their anticipated cashflows.
- 2.8 Assets can be held to collect the contractual cash flows, such as bank interest; for trading purposes, such as shares and other investments; or any other assets held, such as equity in community enterprises. It has been confirmed that all of the Council's financial assets are held to collect contractual cash flows and they have been classified as Financial Assets Measured at Amortised Cost. This is consistent with the current treatment of the Financial Assets of the Council.

- 2.9 The most significant change relates to the calculation of impairment losses which must now be based on an Expected Credit Risk Model. This calculates impairments based on lifetime credit risks and the potential for debtors to default on their repayments, rather than on actual past events. All financial assets will now be recognised at Fair Value in the annual accounts by including the impact of these impairments. Any differences to current values will be charged to the CIES. These costs will be quantified as part of the preparation of the annual accounts and included in the final outturn report for the year. They are not anticipated to be material.
- 2.10 In support of the definitions introduced by IFRS9, additional accounting policies have been detailed at Note M – Interest in Companies and Other Entities, which confirms that treatment of the Council's interest in group entities remains unchanged, and Note W - Fair Value Measurement, which details the existing policies on the measurement of Fair Value and extends them to include financial instruments, where appropriate.
- 2.11 In addition, there have been a number of minor adjustments to the text of the existing policies to ensure that they are fully aligned to the requirements of the Code.

3. Proposals

- 3.1 That the Audit and Scrutiny Committee approves the accounting policies as detailed in Appendix 1.

4. Implications/Socio-economic Duty

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| Financial: | The adoption of the policies in relation to financial instruments may result in additional costs for the impairment of financial assets. These costs will be quantified and reported as part of the final outturn report for the year. |
| Human Resources: | None |
| Legal: | The Local Government (Scotland) Act 2003 requires accounts to be prepared in accordance with proper practices |
| Equality/Socio-economic Duty: | None |
| Children and Young People: | None |
| Environmental & Sustainability: | None |
| Key Priorities: | The annual accounts support the delivery of outcomes outlined in the Council Plan. |
| Community Benefits: | None |

5. Consultation

5.1 No consultation was required in the preparation of this report.

LAURA FRIEL
Executive Director (Finance and Corporate Support)

For further information please contact **David Forbes, Senior Manager (Strategic Business Partner)**, on **01294 324551**.

Background Papers

None

Significant Changes to Accounting Policies 2018-19

Original

I Financial assets

The financial assets of the Council are entirely comprised of loans and receivables i.e. assets that have fixed or determinable payments but are not quoted in an active market.

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument, initially measured at fair value, then at amortised cost. For most of the Council lending, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES 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 that payments due under the contract will not be made, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the CIES. The impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate.

Revised

I Financial Instruments

Financial Assets

Financial assets are classified and measured based on the reasons, or business model, for holding the financial assets and the characteristics of the anticipated cash flows. There are three main classes of financial assets measured at:

- amortised cost;
- fair value through profit or loss (FVPL); and
- fair value through other comprehensive income (FVOCI).

The Council's business model is to hold assets to collect contractual cash flows and our financial assets are therefore classified as amortised cost.

Financial Assets Measured at Amortised Cost

Financial assets measured at amortised costs are recognised on the Balance Sheet when the Council becomes party to the contractual provisions of a financial asset and are initially measured at fair value and then carried at amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the CIES 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 financial assets held by the Council, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

However, the Council has made a loan to a charitable body at less than market rates (soft loan). When a soft loan is made, a loss is recorded in the CIES (charged to the appropriate service) for the present value of the interest that will be foregone over the life of the loan, resulting in a lower amortised cost than the outstanding principal. The value of the interest foregone is then added back to the amortised cost of the loan on the Balance Sheet and credited to the Financing and Investment Income and Expenditure line in the CIES on an annual basis until the loan is repaid.

Any gains or losses which arise on the derecognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

Expected Credit Loss Model

Potential impairment losses on Financial Assets Measured at Amortised Cost are determined using the Expected Credit Loss Model.

Impairment losses are calculated to reflect the expectation that the future cash flows may not take place because the borrower may default on their obligations. Credit risk plays a crucial part in assessing the potential losses. Where risk has increased significantly since an asset was recognised, losses are assessed on a lifetime basis. Where risk has not increased significantly or remains low, losses are assessed on the basis of 12-month expected losses.

The Council recognises expected credit losses on all of its financial assets held at amortised cost, either on a 12-month or lifetime basis. Only lifetime losses are recognised for trade receivables (debtors).

For any identified impairment losses, a charge is made to the Financing and Investment Income and Expenditure line in the CIES.

Financial Assets Measured at Fair Value through Profit and Loss

Financial Assets that are measured at FVPL are recognised on the Balance Sheet when the Council becomes party to the contractual provisions of a financial asset and are initially measured and carried at fair value. Fair value gains and losses are recognised in the Surplus or Deficit on the Provision of Services as they emerge.

Fair value measurements of the financial assets are based on the following techniques:

- instrument with quoted market process – the market price; and
- other instruments with fixed and determinable payments – discounted cash flow analysis.

Any gains and losses which arise on the derecognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

The Council does not currently have any Financial Assets measured at Fair value through Profit and Loss.

Additional

M Interest in Companies and Other Entities

The Council has interests in companies and other entities which have the nature of subsidiaries, associates and joint ventures and require it to prepare group accounts. In the Council's single entity accounts, these interests are recorded as financial assets at cost, less any provision for losses.

W Fair Value Measurement

The Council values some of its non-financial assets, such as Surplus Assets and Investment Properties (Common Good Funds only), and some of its financial instruments at Fair Value. Fair Value is the price that would be received either on the sale of an asset or to transfer a liability in an orderly transaction between market participants at the measurement date. The Fair Value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset; or
- in the absence of a principal market, in the most advantageous market for the asset.

The Council measures the Fair Value of an asset or liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

When measuring the Fair Value of a non-financial asset, the Council takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. The Council uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Inputs to the valuation techniques in respect of assets and liabilities for which Fair Value is measured or disclosed in the Council's financial statements are categorised within the fair value hierarchy, as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities that the Council can access at the measurement date;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 – unobservable inputs for the asset or liability.

Accounting Policies 2018-19

General Principles

The Accounts summarise the Council's transactions for the 2018-19 financial year and its position at the year-end of 31 March 2019. The Council is required to prepare an annual Statement of Accounts by the Local Authority Accounts (Scotland) Regulations 2014 and Section 12 of the Local Government in Scotland Act 2003 requires that they are prepared in accordance with proper accounting practices. These practices under Section 21 of the 2003 Act primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19, supported by International Financial Reporting Standards (IFRS) and statutory guidance under Section 12 of the 2003 Act.

The accounting convention adopted in the financial statements is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments.

A Accruals of Income and Expenditure

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from contracts with service recipients, whether for services of the provision of goods, is recognised when (or as) the goods or services are transferred to the service recipient in accordance with the performance obligations of the contract.
- Supplies are recorded as expenditure when they are consumed. Where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the Balance Sheet.
- Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made.
- Interest 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.
- Suppliers' invoices paid in the two weeks following the year-end have been included together with specific accruals in respect of further material items provided the goods and services were received prior to 31 March.
- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. The de minimis level for recognition of such transactions has been agreed at £5,000, therefore all known transactions of £5,000 or above have been included.
- Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

B Allocation of Central Support Costs and Recharges to Capital

A proportion of net central support services is allocated to services outwith the general fund. The balance of the net central support services is reported on the basis of how the services are structured and how the Council operates, monitors and manages financial performance.

C Carbon Reduction Commitment Scheme

The Council is required to participate in the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme. This scheme is due to end on 31 March 2019. The Council is required to purchase allowances, either prospectively or retrospectively, and surrender them on the basis of emissions i.e. carbon dioxide produced as energy is used. As carbon dioxide is emitted, a liability and an expense are recognised. The liability will be discharged by surrendering allowances. The liability is measured at the best estimate of the expenditure required to meet the obligation, normally at the current market price of the number of allowances required to meet the liability at the reporting date. The cost to the authority is recognised and reported in the costs of the Council's services and is apportioned to services on the basis of energy consumption.

D Cash and Cash Equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are investments that mature in three months or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

In the Cash Flow Statement, cash and cash equivalents are shown net of bank overdrafts that are repayable on demand and form an integral part of the Council's cash management.

E Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e. in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council's financial position or performance. When a change is made, it is applied retrospectively (unless otherwise stated) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior years are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

F Charges to Revenue for Non-Current Assets

Services are charged with the following amounts to record the cost of holding non-current assets during the year:

- depreciation attributable to the assets used by the relevant service;
- revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off; and
- amortisation of intangible fixed assets attributable to the service.

The Council is not required to raise council tax to cover depreciation, revaluation and impairments losses or amortisation. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement, equal to an amount calculated on a prudent basis determined by the Council in accordance with the Statutory Repayment of Loans Fund Advances. This is known as the Loans Fund principal repayments. Depreciation, revaluation and impairment losses and amortisation are replaced by Loans Fund principal repayments in the General Fund Balance by way of an adjusting transaction within the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

G Employee Benefits

Benefits Payable during Employment

Short-term employee benefits are those due to be settled wholly within 12 months of the year end. They include such benefits as salaries, wages, overtime and paid annual leave for current employees and are recognised as an expense in the year in which employees render service to the Council. All salaries and wages earned up to 31 March are included in the financial statements irrespective of when the payment was made. An accrual is made for the cost of holiday entitlements earned by employees but not taken before the year-end and which employees can carry forward into the next financial year. The accrual is made at the wage and salary rates applicable in the following year, being the period in which the benefits will be taken. Such accruals are required, under statute, to be reversed out of the General Fund Balance by a credit to the Accumulating Compensated Absences Adjustment Account in the Movement in Reserves Statement.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date or an officer's decision to accept voluntary redundancy. They are charged on an accruals basis to the relevant services line in the CIES at the point when the offer of termination can no longer be withdrawn by the Council. Where termination benefits include the enhancement of pensions, the General Fund balance is charged with the amount payable by the Council to the pension fund or pensioner in the year.

Post-Employment Benefits

The Council participates in two separate pension schemes:

- The Scottish Teachers' Pension Scheme administered by the Scottish Government
- The Local Government (Scotland) Pension Scheme administered by the Strathclyde Pension Fund.

Both schemes provide defined benefits to members (retirement lump sums and pensions), earned while employees work for the Council. However, the arrangements for the teachers' scheme mean that liabilities for these benefits cannot be identified specifically to the Council. The scheme is therefore accounted for as if it were a defined contributions scheme. No liability for future payments of benefits is recognised in the Balance Sheet and the Education and Youth Employment services line in the CIES is charged with the employer's contributions payable to the Teachers' Pension Scheme in the year.

The Local Government Pension Scheme

The Local Government Pension Scheme (LGPS) is accounted for as a defined benefits scheme.

The liabilities of Strathclyde Pension Fund attributable to the Council are included in the Balance Sheet on an actuarial basis using the 'projected credit 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 projected earnings for current employees.

Liabilities are discounted to their value at current prices, using a discount rate as advised by the actuaries, Hymans Robertson.

The assets of Strathclyde Pension Fund attributable to North Ayrshire Council are included in the Balance Sheet at their fair value:

- Quoted securities – current bid price;
- Unquoted securities – professional estimate;
- Unitised securities – current bid price; and
- Property – market value.

The change in the net pension liability is analysed into the following components:

Service Costs:

- current service cost – the increase in liabilities as a result of service earned by employees this year. This is allocated in the CIES to the services for which the employees worked.
- past service cost (including curtailments) – the increase in liabilities as a result changes to the scheme, including amendments or curtailments, where the changes impact on the service earned by employees in previous years. These costs are charged to the Surplus or Deficit on the Provision of Services in the CIES.
- net interest on the net defined benefit liability (asset), i.e. net interest expense for the Council – the change during the period in the net defined benefit liability or asset that arises from the passage of time. This is charged to the Financing and Investment Income and Expenditure line in the CIES, calculated by applying the discount rate used to measurement the defined benefit obligation at the beginning of the period – taking into account any changes in the net defined benefit liability or asset during the period as a result of contribution and benefit payments.

Remeasurements:

- return on plan assets – excludes amounts included in net interest on the net defined liability (asset). This is charged to the Pensions Reserve as Other Comprehensive Income and Expenditure.
- actuarial gains and losses – changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions. This is charged to the Pensions Reserve as Other Comprehensive Income and Expenditure.
- contributions paid to the Strathclyde Pension Fund – cash paid as employer's contributions to the pension fund in settlement of liabilities. This is not accounted for as an expense.

Statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, this means that there are transfers to and from the Pensions Reserve to remove the notional debits and credits for retirement or pension enhancement termination benefits and replace them with charges for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the Pensions Reserve thereby measures the beneficial impact on the General Fund of being required to account for retirement benefits on the basis of cash flows rather than as benefits earned by employees.

Discretionary Benefits

The Council also has restricted powers to make discretionary awards to retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff, including teachers, are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

H Events After the Reporting Period

These are events, both favourable and unfavourable, that occur between the end of the reporting period (31 March) and the date when the financial statements are authorised for issue.

The Statement of Accounts are adjusted to reflect events where they provide evidence of conditions that existed at the end of the reporting period.

Where events indicate conditions, which arose after the reporting period, would have had a material effect, the Statement of Accounts are not adjusted but a disclosure is made in the notes of the nature of the event and the estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the Statement of Accounts.

I Financial Instruments

Financial Liabilities

Financial liabilities are recognised on the balance sheet when the Council becomes party to the contractual provisions of a financial liability. Liabilities are initially measured at fair value and then carried at amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the CIES for interest payable are based on the carrying amount of the liability, multiplied by the effective interest rate of the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

For most of the borrowings that the Council has, this means that the amount presented in the balance sheet is the outstanding principal repayable (plus accrued interest) and interest charged to the CIES is the amount payable for the year according to the loan agreement.

Costs associated with debt restructuring (premiums and discounts) are charged to the Financing and Investment Income and Expenditure line in the CIES in the year of repayment of the original debt in accordance with accounting regulations.

Where premiums and discounts have been charged to the CIES, regulations permit the costs of restructuring to be released to revenue over the period of the replacement loan. The reconciliation of amounts charged to the CIES to the net charge required against the General Fund balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

Financial Assets

Financial assets are classified and measured based on the reasons, or business model, for holding the financial assets and the characteristics of the anticipated cash flows. There are three main classes of financial assets measured at:

- amortised cost;
- fair value through profit or loss (FVPL); and
- fair value through other comprehensive income (FVOCI).

The Council's business model is to hold assets to collect contractual cash flows and our financial assets are therefore classified as amortised cost.

Financial Assets Measured at Amortised Cost

Financial assets measured at amortised costs are recognised on the Balance Sheet when the Council becomes party to the contractual provisions of a financial asset and are initially measured at fair value and then carried at amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the CIES 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 financial assets held by the Council, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

However, the Council has made a loan to a charitable body at less than market rates (soft loan). When a soft loan is made, a loss is recorded in the CIES (charged to the appropriate service) for the present value of the interest that will be foregone over the life of the loan, resulting in a lower amortised cost than the outstanding principal. The value of the interest foregone is then added back to the amortised cost of the loan on the Balance Sheet and credited to the Financing and Investment Income and Expenditure line in the CIES on an annual basis until the loan is repaid.

Any gains or losses which arise on the derecognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

Expected Credit Loss Model

Potential impairment losses on Financial Assets Measured at Amortised Cost are determined using the Expected Credit Loss Model.

Impairment losses are calculated to reflect the expectation that the future cash flows may not take place because the borrower may default on their obligations. Credit risk plays a crucial part in assessing the potential losses. Where risk has increased significantly since an asset was recognised, losses are assessed on a lifetime basis. Where risk has not increased significantly or remains low, losses are assessed on the basis of 12-month expected losses.

The Council recognises expected credit losses on all of its financial assets held at amortised cost, either on a 12-month or lifetime basis. Only lifetime losses are recognised for trade receivables (debtors).

For any identified impairment losses, a charge is made to the Financing and Investment Income and Expenditure line in the CIES.

Financial Assets Measured at Fair Value through Profit and Loss

Financial Assets that are measured at FVPL are recognised on the Balance Sheet when the Council becomes party to the contractual provisions of a financial asset and are initially measured and carried at fair value. Fair value gains and losses are recognised in the Surplus or Deficit on the Provision of Services as they emerge.

Fair value measurements of the financial assets are based on the following techniques:

- instrument with quoted market process – the market price; and
- other instruments with fixed and determinable payments – discounted cash flow analysis.

Any gains and losses which arise on the derecognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

The Council does not currently have any Financial Assets measured at Fair value through Profit and Loss.

J Government Grants and Contributions

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

- the Council will comply with the conditions attached to the payments, and
- the grants or contributions will be received.

Amounts recognised as due to the Council are not credited to the CIES until conditions attached to the grant have been satisfied.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as creditors. When conditions are satisfied, the grant or contribution is credited to the relevant service line (for revenue grants) or Taxation and Non-Specific Grant Income (for non-ring-fenced revenue grants and all capital grants).

Capital grants are then reversed out of the General Fund Balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied Account.

Capital grants which are used and amounts previously posted to the Capital Grants Unapplied Account which have now been applied, are transferred to the Capital Adjustment Account.

K Heritage Assets

A heritage asset is defined as a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.

The Council holds heritage assets consisting of civic regalia and silverware, historical artefacts, fine art and public artworks. The assets are held at valuation and no depreciation is charged on the assets. Expenditure to maintain the assets is written off to the Comprehensive Income and Expenditure Statement (CIES) in the year of expenditure. Donated heritage assets are reflected in the balance sheet at valuation with a gain equivalent to the value of the asset reported in the CIES in the year of donation.

Measurement

The Council's heritage assets are recognised on the Balance Sheet at values determined by specialist external valuers and by experienced officers within the Connected Communities service. Valuations have been largely undertaken on an insurance basis at retail level. Only items deemed to have a value of £10,000 and above have been disclosed in the Balance Sheet.

Disclosure

Not all of the Council's identified heritage assets will be disclosed in the Balance Sheet. It is not deemed practicable to obtain external valuations for all items defined as heritage assets. These include: Museum and Gallery items with a value of less than £10,000; Castles; Monuments and War Memorials.

L Intangible Assets

Expenditure on non-monetary assets that do not have physical substance but are controlled by the Council as a result of past events (e.g. loan licences) is capitalised when it is expected that it will bring benefits to the Council for more than twelve months. Intangible assets are measured initially at cost. Amounts are not revalued, as the fair value of the assets held by the Council cannot be determined by reference to an active market. The depreciable amount of an intangible asset is amortised over its useful life (generally between 1 and 6 years) to the relevant service line(s) in the CIES.

M Interest in Companies and Other Entities

The Council has interests in companies and other entities which have the nature of subsidiaries, associates and joint ventures and require it to prepare group accounts. In the Council's single entity accounts, these interests are recorded as financial assets at cost, less any provision for losses.

N Inventories

Inventories include consumable stock and work-in-progress and are recognised in the Balance Sheet at the lower of cost and net realisable value. The valuation of work-in-progress has been made at cost plus an appropriate proportion of overheads, together with attributable profits and allowances for foreseeable losses.

O Investment Properties

Investment properties are those that are used solely to earn rentals and/or for capital appreciation. Investment properties are measured initially at cost and subsequently at fair value, being the price that would be received to sell such an asset in an orderly transaction between market participants at the measurement date. As a non-financial asset, investment properties are measured at highest and best use. Properties are not depreciated but reviewed annually and revalued regularly to ensure their carrying value reflects market conditions at the year-end.

P Leases

Leases are classified as finance leases where the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the property from the lessor to the lessee. All other leases are classified as operating leases. Where a lease covers both land and buildings, the land and buildings elements are considered separately for classification.

The Council as Lessee

North Ayrshire Council currently has no finance leases where the Council is the lessee.

Rentals paid under operating leases, for vehicles and plant, are charged to the appropriate service account in the CIES as an expense of the services benefiting for use of the leased equipment.

The Council as Lessor

North Ayrshire Council has no finance leases where the Council is the lessor.

The Council rents out property on cancellable operating leases only. Where the Council grants an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet.

Q Property, Plant and Equipment

Assets that have physical substance and are held for use in the supply of services, for rental to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment.

All valuations of land and buildings are carried out by RICS qualified valuers, with the exception of valuations of council dwellings which are based on beacon values calculated by the District Valuer. Both valuations are in accordance with the methodologies and bases of estimation as set out in the professional standards of the Royal Institution of Chartered Surveyors (RICS).

Recognition

Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis. Expenditure that merely maintains the condition of an asset (i.e. repairs and maintenance) is charged as an expense when it is incurred.

The Council has a de minimis level of £10,000 for expenditure to be classed as capital. Land and Buildings with a valuation below £10,000 are not recognised on the Council Balance Sheet.

Measurement

Assets are initially measured at cost, comprising:

- the purchase price; and
- any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended.

The Council does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of assets acquired other than by purchase is deemed to be its fair value.

Assets are carried on the Balance Sheet using the following measurement bases:

- Council Dwellings - Fair value, determined using the basis of existing use value for social housing (EUV-SH);
- Other Land and Buildings - Fair value, determined by the amount that would be paid for the asset in its existing use (existing use value - EUV).
- Vehicles, Plant and Equipment - depreciated historical cost
- Infrastructure Assets - depreciated historical cost
- Community Assets - depreciated historical cost
- Surplus Assets - fair value based on market value in highest and best use

- Assets Under Construction - historical cost
- Investment Properties (Common Good only) - fair value based on market value in highest and best use

Where there is no market-based evidence of fair value because of the specialist nature of an asset, depreciated replacement cost is used as an estimate of fair value.

Assets included in the Balance Sheet at fair value are revalued on a rolling 5-year programme. Increases in valuations are matched by credits to the Revaluation Reserve to recognise unrealised gains.

Where decreases in value are identified, the revaluation loss is accounted for as follows:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- where there is no balance in the Revaluation Reserve or insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the CIES.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

Impairment

Assets are assessed at each year-end to establish whether there is any indication that an asset may be impaired. Where indications exist, and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for as follows:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- where there is no balance in the Revaluation Reserve or insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the CIES.

Where an impairment loss is subsequently reversed, the reversal is credited to the relevant service line(s) in the CIES, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for on all Property, Plant and Equipment assets. An exception is made for assets without a determinable finite useful life (i.e. freehold land and certain Community Assets) and assets that are not yet available for use (i.e. assets under construction). Investment Properties and Assets Held for Sale are not subject to depreciation.

Depreciation is charged on a straight-line basis over the useful life of the assets (as advised by a suitably qualified officer). Depreciation is charged in the year of acquisition but not in the year of sale.

Where a Property, Plant and Equipment asset has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately. For the purposes of component accounting the Council considers significant components being those with a cost that is at least 20% of the overall cost of the asset. Individual assets shall be disregarded for component accounting where their carrying value is below £2m.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an Asset Held for Sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the CIES. Gains in fair value are recognised only up to the amount of any previously recognised losses. Depreciation is not charged on Assets Held for Sale.

Property, land and buildings are classified as 'held for sale' when the following criteria are met:

- the property is available for sale in its present condition;
- the sale is highly probable;
- the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value;
- the sale is expected to qualify for recognition as a completed sale within one year.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. Receipts from disposals are credited to the same line in the CIES as part of the gain or loss on disposal. Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

To comply with statutory guidance, this gain or loss is excluded when determining the General Fund balance within the Movement in Reserves Statement.

R Public Private Partnership (PPP) / NPD and similar contracts

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

The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) was balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment. For North Ayrshire Council Schools PPP contract, the liability was written down by an initial capital contribution of £1.743 million.

The amounts payable to the PPP/ NPD operators each year are analysed into four elements:

- service charges and lifecycle replacement costs – value of services including cleaning and janitorial services, repairs and maintenance, energy, non domestic rates and insurances debited to the relevant service in the CIES;
- interest payments – the interest charge on the outstanding Balance Sheet liability, debited to the Financing and Investment Income and Expenditure line in the CIES;

- contingent rent – increases in the amount to be paid for the property arising during the contract, debited to the Financing and Investment Income and Expenditure line in the CIES;
- liability repayment– repayment of the principal owed to the PPP operator, applied to write down the Balance Sheet liability.

S Provisions, Contingent Liabilities and Contingent Assets

Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. For instance, the Council may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the CIES in the year that the Council becomes aware of the obligation, and measured at the best estimate, at the balance sheet date, of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the balance sheet. Estimated settlements are reviewed at the end of each financial year; where it becomes less than probable that a transfer of economic benefits will be required (or a lower settlement than anticipated is made); the provision is reversed and credited back to the relevant service.

Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the Council settles the obligation.

Contingent Liabilities

A contingent liability arises where an event has taken place that gives the Council a possible obligation, whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council. Contingent liabilities also arise in circumstances where a provision would otherwise be made but either it is not definite that an outflow of resources will be required, or the amount of the obligation cannot be measured reliably.

Contingent liabilities are not recognised in the balance sheet but disclosed in a note to the accounts.

Contingent Assets

A contingent asset arises where an event has taken place that gives the Council a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council.

Contingent assets are not recognised in the balance sheet but disclosed in a note to the accounts where it is probable that there will be an inflow of economic benefits or service potential.

T Reserves

Reserves are created by appropriating amounts out of the General Fund Balance in the Movement in Reserves Statement. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the Surplus/Deficit on the Provision of Services in the CIES. The reserve is then appropriated back into the General Fund Balance in the Movement in Reserves Statement so that there is no net charge against council tax for the expenditure.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments and retirement benefits and do not represent usable resources for the Council; these reserves are explained in the relevant notes.

U Revenue Expenditure Funded from Capital Under Statute

Expenditure incurred during the year that may be capitalised under statutory provisions but does not result in the creation of a non-current asset is charged as expenditure to the relevant service in the CIES in the year. Where the Council has determined to meet the cost of this expenditure from existing capital resources or by borrowing, a transfer in the Movement in Reserves Statement from the General Fund Balance to the Capital Adjustment Account then reverses out the amounts charged so that there is no impact on the level of council tax.

V VAT

All income and expenditure excludes amounts relating to VAT, as all VAT collected is payable to HM Revenue and Customs and net VAT paid is fully recoverable by the Council.

W Fair Value Measurement

The Council values some of its non-financial assets, such as Surplus Assets and Investment Properties (Common Good Funds only), and some of its financial instruments at Fair Value. Fair Value is the price that would be received either on the sale of an asset or to transfer a liability in an orderly transaction between market participants at the measurement date. The Fair Value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset; or
- in the absence of a principal market, in the most advantageous market for the asset.

The Council measures the Fair Value of an asset or liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

When measuring the Fair Value of a non-financial asset, the Council takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. The Council uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Inputs to the valuation techniques in respect of assets and liabilities for which Fair Value is measured or disclosed in the Council's financial statements are categorised within the fair value hierarchy, as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities that the Council can access at the measurement date;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 – unobservable inputs for the asset or liability.