Grant Thornton

Top 5 local authority financial reporting issues for 2013/14

This paper summarises the top 5 financial reporting issues we expect local authorities to face in preparing their statement of accounts for 2013/14 and some discussion questions.

1 Property Plant and Equipment valuations

The 2013/14 Code has clarified the requirements for valuing property, plant and equipment and now states explicitly that revaluations must be 'sufficiently regular to ensure that the carrying amount does not differ materially from that which would be determined using the fair value at the end of the reporting period.' This means that a local authority will need to satisfy itself that the value of assets in its balance sheet is not materially different from the amount that would be given by a full valuation carried out on 31 March 2014. This is likely to be a complex analysis which might include consideration of:

- the condition of the authority's property portfolio at 31 March 2014
- the results of recent revaluations and what this might mean for the valuation of property that has not been recently valued
- general information on market prices and building costs
- the consideration of materiality in its widest sense - whether an issue would influence the view of a reader of the accounts.

The Code also follows the wording in IAS 16 more closely in the requirements for valuing classes of assets:

- items within a class of property, plant and equipment are to be revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates
- a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.

There has been much debate on what is a short period and whether assets that have been defined as classes for valuation purposes should also be disclosed separately in the financial statements. **These considerations are secondary to the requirement that the carrying value does not differ materially from the fair value**. However, we would expect auditors to report to those charged with governance where, for a material asset class:

- all assets within the class are not all valued in the same year
- the class of asset is not disclosed separately in the property, plant and equipment note.

Discussion questions

- How will your authority satisfy itself that the carrying value of assets does not differ materially from the fair value at 31 March 2014?
- Have you consulted your auditor and those charged with governance on:
  - your programme of valuations?
  - your proposals for disclosing information about classes of assets?

2 Business rate appeals

Local authorities are liable for successful appeals against business rates. Local authorities should, therefore, recognise a provision for their best estimate of the amount that businesses have been overcharged up to 31 March 2014.

However, there are some practical difficulties which mean that making a reliable estimate for the total amount that has been overcharged is challenging:

- the appeals process is managed by the Valuation Office Agency (VOA) and so local authorities are reliant on the information provided to them by the VOA
- some businesses may have been overcharged but not yet made an appeal.

The Audit Commission is working with the VOA to ensure that auditors have the information to complete their audit of the financial statements efficiently.

We would expect local authorities:

- to work with the VOA to make sure that they have access to the information they need
- where appeals have been made, to determine a methodology for estimating a provision and to apply this methodology consistently
- where appeals have not been made:
  - to consider the extent to which a reliable estimate can be made (for example, in relation to major businesses)
  - to recognise a provision where a reliable estimate can be made
  - to disclose a contingent liability where a reliable estimate cannot be made
  - to provide a rationale to support their judgement that a reliable estimate cannot be made
- to revisit the estimate with the latest information available immediately before the audit opinion is issued.

Discussion questions

- Is your authority confident of obtaining the information it needs from the VOA?
- Has your authority recognised a provision where it is possible to make a reliable estimate? Has a robust methodology been used?
- Has your authority provided a robust rationale where it has decided it cannot make a reliable estimate. Has it disclosed a contingent liability?
- Is your authority planning to revisit its provision and contingent liability before the audit opinion is issued?

3 Changes to SeRCOP – new public health line

SeRCOP for 2013/14 introduces a new cost of service line for 'Public health'. This has been introduced to reflect new responsibilities placed upon local authorities following restructuring in the NHS. We expect this new service line to be presented on the face of the CIES within cost of services. If there were material amounts relating to this service in 2013/14, we would expect comparative figures to be restated.

Discussion question

- Is your local authority confident that it can provide accurate information and a robust audit trail for the public health line within cost of services?

4 Accounting for and financing the local government pension scheme costs

Accounting issues

The 2013/14 Code follows amendments to IAS 19 and changes the accounting requirements for defined benefit pension liabilities such as those arising from the local government pension scheme (LGPS). This is a change in accounting policy and will apply retrospectively.

The main changes we expect to see are:

- a reallocation of amounts charged in the comprehensive income and expenditure statement (CIES)
- more detailed disclosures.

We do not expect changes to balance sheet items (the net pension liability and pension reserve balance). This means that whilst we would expect the CIES to be restated, a third balance sheet is not required. Actuaries should be providing local authorities with the information they need to prepare the financial statements, including restated comparatives.

Financing issues

The amount to be charged to the general fund in a financial year is the amount that is payable for that financial year as set out in the actuary's rates and adjustments certificate. Some local authorities are considering paying pension fund contributions early in exchange for a discount but not charging the general fund until later.

Local authorities must be satisfied that the amounts charged to the general fund in a financial year are the amounts payable for that year. Where local authorities are considering making early payments, we would expect them to obtain legal advice (either internally or externally) to determine the amounts that are chargeable to the general fund. We would expect this to include consideration of:

- the actuary's opinion on the amounts that are payable by the local authority into the pension fund
- the agreement between the actuary and the local authority as to when these payments are to be made
- the wording in the rates and adjustments certificate setting out when amounts are payable for each financial year.

For example, if a local authority agrees to make a payment to the pension fund in a single year and proposes to charge this amount to the general fund over a three-year period, we would expect the rates and adjustments certificate to show, unambiguously, that the amount payable is spread over the three years.

Discussion questions

- Is your local authority confident of getting the information from its actuary to meet the changes in the requirements for accounting for the LGPS (including restating the comparatives)?
- If your authority is considering making an early payment to the pension fund, has it set out a reasonable argument for how it proposes to charge this amount to the general fund? Is this supported by legal advice?

5 PFI and other service concessions

Recognising assets during the construction phase

The 2013/14 Code has changed the recognition point for service concession assets. Previously, this was when an asset was made available for use. Now, the recognition point is the same as for assets under construction, when:

- it is probable that future economic benefits associated with the asset will flow to the organisation **and**
- the cost of the asset can be measured reliably.

This suggests that some local authorities may need to recognise service concession assets during the construction phase as assets under construction. This is a matter of judgement for local authorities. We would expect local authorities to consider issues such as:

- construction risk – if construction risk rests with the operator, this would suggest that the local authority does not have an obligation during the construction phase and so should not recognise the asset until it is constructed
- information about costs of construction – if the operator does not provide the local authority with information about the costs of construction at the balance sheet date, this would suggest that the local authority should not recognise the asset because it cannot measure the cost of the asset reliably.

Updating the accounting model during the operational phase

Most local authorities derive their accounting entries from an accounting model which, in turn, is derived from the operator's costing model. The initial accounting model will have included a range of assumptions, such as inflationary increases and performance levels. We would expect local authorities to update the accounting model for actual information, such as inflation and performance variations, during the contract.

Disclosing the impact of inflation on local authority commitments

We expect local authorities to disclose the impact of inflation on their service concession commitments. These commitments are affected by:

- past inflation – previous price rises will be built into future payments
- fluctuations in future inflation – this gives rise to uncertainties about future payments.

Disclosing the fair value of the service concession liability

Service concession liabilities are financial instruments. This means that local authorities are required to disclose the fair value of the liability unless this is not materially different from the carrying value. In most cases we would expect the fair value for operational schemes to be higher than the carrying value. This is because once a scheme is operational local authorities have access to lower interest rates for refinancing. This is because the pre-construction interest rate reflects the risks associated with construction.

Discussion questions

- Has your authority assessed whether it should recognise any service concession assets during the construction phase?
- Does your authority regularly update its accounting model?
- Has your authority disclosed the impact of past inflation?
- Has your authority disclosed uncertainties relating to future inflation?
- Has your authority disclosed the fair value of its PFI liability?