Item 9

Audit & Standards Committee

10 March 2016

Warwickshire County Council – Changes to Accounting Policies

Recommendations

The Audit and Standards Committee is recommended to:

(a) Agree that the accounting policy for the fair valuation of assets outlined in paragraph 2.4 should be used as the basis for the preparation of the 2015/16 Warwickshire County Council Statement of Accounts and;

(b) Agree that the accounting policy for transport infrastructure assets outlined in paragraph 3.2 should be used as the basis of the preparation of the 2016/17 Warwickshire County Council Statement of Accounts and the additional disclosure notes required in 2015/16 and;

(c) Note the amendments to the presentation of the statement of accounts in paragraphs 2.5 and 3.3 that will result from the change in accounting policy.

1.0 Purpose of the Report

1.1 As a local authority we are required to comply with the CIPFA[1] Code of Practice on Local Authority Accounting (the Code) when preparing our annual accounts. The 2015/16 Code includes new accounting requirements for how we account for the fair value of our assets with which we are required to comply. It also includes additional disclosure requirements in relation to transport infrastructure assets that will take full effect for the 2016/17 accounts.

1.2 As part of their remit, in recommending the annual Statement of Accounts to Council for approval, the Audit and Standards Committee are required to approve accounting policies on which the financial statements are based and the approach adopted by the authority in complying with accounting requirements. It is therefore best practice where there has been a potentially material change in accounting policy the Audit and Standards Committee are

[1] CIPFA: Chartered Institute of Public Finance and Accountancy

able to consider and approve this change before it is implemented as part of the year end accounts production process (CIPFA's publication "Audit Committee: Practical Guidance for Local Authorities" (2013)).

1.3 Also under Auditing Standards (ISA 260[2]) the external auditors will report to the Audit and Standards Committee their views on the acceptability of our accounting policies and, as there has been a change, they will comment on it in their formal Audit Findings Report that will come to the Committee in September. This reinforces why it is recommended practice that the Audit and Standards Committee would be aware of and approve any changes to accounting policies prior to the external auditors commenting on them.

1.4 Consequently, this report outlines our proposed approach to meeting the new accounting requirements for measuring the fair value of our assets and accounting for transport infrastructure assets and seeks the agreement of the Audit and Standards Committee to the accounting policies we will use as the basis for the preparation of the Warwickshire County Council Statement of Accounts for 2015/16 and future years.

1.5 The Committee should note that we have fully engaged with the external auditors as the approach outlined in the report was developed and also in how we intended to provide assurance about this impact of the change on our financial statements. The external auditors have indicated they are content with the approach outlined in the report.

2.0 Measuring the 'Fair Value' of our Assets

2.1 Overview of 'Fair Value'

In May 2011 the International Standards Board (IASB) issued IFRS 13 *Fair Value Measurement* (the Standard), setting out the principles for the measurement and disclosure of fair value in financial statements. The Standard defines fair value as being the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The key principle is that a fair value measurement represents the price of an asset or liability from the perspective of the buyer rather than from the perspective of the seller.

The application of a fair value measurement in the public sector is difficult because fair value, as defined by the Standard, requires that the valuation is for the highest and best use. The highest and best use of an asset in the public sector will in a great many cases not be what the actual asset is used

[2] ISA 260: International Standard on Auditing - Communication to those charged with governance

for. CIPFA and HM Treasury have agreed reinterpretations of elements of the relevant accounting standards to state that fair value measurement will only apply to public sector assets that are surplus to requirements and have no restrictions on their use. All assets that are operational and used in the provision of services will continue to be measured at existing use value and not at fair value.

2.2 Valuation Policy

The exclusion of operational assets from the requirement to measure at 'fair value' means the only three classes of assets are impacted by the change:

- <u>Surplus Assets (£2.4 million in 2014/15)</u> - Where there are no plans to bring the asset back into operational use in the future and where no restrictions to the sale exist, surplus assets will be valued at highest and best use. This will require our valuer to consider alternative uses and to document the decision making process.
- <u>Investment Properties (£29.2 million in 2014/15)</u> – Currently, these are carried at their market value. Under the Standard this is redefined as fair value. We therefore will now need to consider every alternative use and value the asset at its best and highest use rather than at its highest value based upon current use.
- <u>Financial Instruments: (£296.8 million in 2014/15)</u> – These are currently held at fair value and therefore the change in policy should not change their carrying value. However, there will be extra disclosures required.

2.3 Overall, we do not expect measurement of the fair value of assets to make a material difference to the value at which assets are held in the Financial Statements as most of the relevant assets are already valued a 'fair value'. The main changes will be:

- When our valuers are assessing assets they will need to consider every alternative use and value the asset at its best and highest use and document their decision-making processes throughout.
- The statement of accounts will need to include additional disclosures depending on the basis of estimating value. The stronger the factual basis of evidence supporting the valuation the less that has to be disclosed as less judgement is involved.

2.4 Impact on the Financial Statements – Accounting Policies

Adoption of the Standard represents a change of accounting policy from 1 April 2015. Within our accounting policies in our 2015/16 Financial Statements we propose to include a new accounting policy that defines fair value that can be cross-referenced when considering the basis of measurement for each type of asset. The wording we propose is as follows:

*"**Fair Value***

We will consider every alternative use and value the asset at its best and highest use when assessing the fair value of our assets. Each asset will be categorised as follows:

- *Level 1 – valuation based on quoted prices (unadjusted) of identical assets or liabilities that we 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.*

When valuing our assets we will give the highest priority to quoted prices and the lowest priority to unobservable inputs."

2.5 Impact on the Financial Statements – Notes to the Accounts

We will include two new disclosure notes in the accounts that analyse the assets valued a fair value across each of the levels; one for physical assets and a second for financial instruments. The information will be presented in a table, as shown below.

Asset Types	Level 1 £m	Level 2 £m	Level 3 £m
Investment properties			
Surplus assets			

We will be provide information detailing any movements between the different levels of valuations year-on-year and where assets are categorised as Level 3 we will, for each asset, disclose additional information as to the basis of valuation.

3.0 Transport Infrastructure Assets

3.1 Overview

Local authorities and central government currently account for transport infrastructure assets differently. The result of the different treatments has resulted in the Whole of Government Accounts (WGA) being consistently qualified since they were first published in 2009/10 due to ‘material inconsistencies’.

To resolve the issue CIPFA have produced a Code of Practice on Transport Infrastructure Assets (the Code) and this will be implemented in the 2016/17 Code of Practice on Local Government Accounting. Adoption of the Code in the 2016/17 accounts will bring local authorities in line with central government and remove inconsistencies in WGA reporting.

The intention of the Code is for each local authority to produce a single set of financial statements for transport infrastructure assets that deliver robust, consistent financial information to support transport asset management, financial management and reporting.

It is estimated that the carrying value of our non-current assets will increase from £1.3 billion in 2015/16 to £8.4 billion in 2016/17 as a result of implementing the Code.

The reason for seeking agreement of the revised accounting policy now is that as part of the 2015/16 Statement of Accounts we will need to include a note that outlines the likely implications of future accounting standards changes and ideally this should be consistent with the accounting policy that will be in place next year.

3.2 Impact on the Financial Statements - Accounting Policies

The fundamental principle of the new policy is that the same information will be used for asset management, financial management and financial reporting. The wording we propose is as follows:

“Measurement of Transport Infrastructure Assets
We will value our transport infrastructure assets using depreciated replacement cost (DRC). That is gross replacement cost (GRC) less a depreciation element which will be calculated using nationally set parameters (by CIPFA), our own annual conditions surveys and other asset management indicators as required. We will use the valuation toolkits produced by CIPFA and the Highways Asset Management Financial Group (HAMFIG), information from the United Kingdom Pavement Management System (UKPMS) and our own asset management systems to support the work of the Highways engineers or other relevant professionals in informing the valuations.

We will value each of the seven categories of transport infrastructure assets separately. These categories are carriageways, footways and cycle tracks, *structures consisting primarily of road and foot bridges but also contain assets such as signs and signal gantries, street lighting, street furniture, traffic management systems and land.*

We will not define public rights of way, private permissive paths, trams, light railways or any other asset for which we do not control the economic benefits and service potential of the asset as a transport infrastructure asset."

3.3 Impact on the Financial Statements and Notes to the Accounts

The change in the methodology for valuing transport infrastructure assets under the new accounting policy will significantly increase the value of non-current assets held on the Balance Sheet with an associated significant increase in value of depreciation charges on the Comprehensive Income and Expenditure Statement. These changes will not impact on the cash flow of the authority and will not impact on the resources available to Elected Members to allocate. The value of the Transport Infrastructure Assets will appear as a separate, single line within the balance sheet.

Currently transport infrastructure assets are included as part of the consolidated note to the accounts on property, plant and equipment. Following the implementation of the accounting policy for the 2016/17 accounts this note will be split into two – transport infrastructure assets and all other assets. The same level of detail will be provided in each note.

Background Papers

None

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<u>Local Members consulted</u>
Not applicable

<u>Other Members consulted</u>
None