Oldham Council

Report to Audit Committee

2018/19 Proposed Accounting Policies and Critical Judgements

Portfolio Holder: Councillor Abdul Jabbar MBE, Deputy Leader and Cabinet Member for Finance and Corporate Resources

Officer Contact: Anne Ryans, Director of Finance

Report Author: Lee Walsh, Finance Manager (Capital and Treasury)
Ext. 6608

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Reason for Decision

In line with best practice principles, approval is sought for the significant accounting policies and the critical judgements to be adopted in the preparation of the Council's 2018/19 Statement of Accounts.

Executive Summary

The report sets out the Council's proposed accounting policies and critical judgements to be adopted in completing the 2018/19 Statement of Accounts and updates Members on the main differences from 2017/18.

Recommendations

It is recommended that the Audit Committee:

1) approves the Council's proposed accounting policies to be adopted in completing the 2018/19 Statement of Accounts.
2) notes the critical judgements made by management when producing the Statement of Accounts.

1. Introduction

1.1 This report presents the significant accounting policies that will be used in the preparation of the 2018/19 Statement of Accounts and summarises the changes from 2017/18 that have been introduced as a result of amendments to the Code of Practice on Local Authority Accounting 2018/19 (the Code) or as part of the Council's annual review process. The report also explains the requirement to disclose the critical judgements made by management when producing the Statement of Accounts.

2. Accounting Policies

2.1 The Council's accounting policies are the specific principles, conventions, rules and practices that are applied in the production and presentation of the annual Statement of Accounts. These policies have to be disclosed as a note to the annual accounts, and a copy of the policies can be found at Appendix 1. The major change for 2018/19 relates to International Financial Reporting Standard (IFRS) 9 – Financial Instruments, with a smaller change relating to IFRS 15 – Revenue from Contracts with Customers. Both changes are set out below.

IFRS 9 - Financial Instruments

2.2 There have been significant changes to the Code for 2018/19 following the adoption of IFRS 9 - Financial Instruments from 1 April 2018. The Code specifies how the Council should classify and measure financial assets, financial liabilities, and some contracts to buy or sell non-financial items in line with IFRS 9. The full accounting policy can be found at Appendix 1, policy 1.9 with the major requirements of the code detailed below.

2.3 IFRS 9 requires the Council to recognise a financial asset or a financial liability in its balance sheet when it becomes party to the contractual provisions of the instrument. At initial recognition, the Council measures a financial asset or a financial liability at its fair value plus or minus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability. This is explained in more detail at sections 2.4 to 2.8.

Financial Liabilities

2.4 All financial liabilities are measured at amortised cost, except for financial liabilities at fair value through profit or loss. Such liabilities include derivatives (other than derivatives that are financial guarantee contracts or are designated and effective hedging instruments), other liabilities held for trading, and liabilities that the Council designates to be measured at fair value through profit or loss.

Financial Assets

2.5 When the Council first recognises a financial asset, it classifies it based on its business model for managing the asset and the asset's contractual cash flow characteristics, as follows:

- Amortised cost - a financial asset is measured at amortised cost if both of the following conditions are met:
    - the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and

- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

- Fair value through other comprehensive income - financial assets are classified and measured at fair value through other comprehensive income if they are held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

- Fair value through profit or loss - any financial assets that are not held in one of the two business models mentioned are measured at fair value through profit or loss.

Fair value option

2.6 The Code allows the Council to, at initial recognition, irrevocably designate a financial asset or liability that would otherwise have to be measured at fair value through profit or loss to be measured at fair value through other comprehensive income.

Impairment

2.7 The Code also requires impairments of financial assets to be recognised in stages as follows:

Stage 1 - as soon as a financial instrument is purchased, a 12 month Expected Credit Losses (ECL) assessment is conducted. If the assessment identified a 12 month ECL and if material, then the ECL are recognised in the comprehensive income and expenditure statement (CIES) and a loss allowance is established. This serves as a proxy for the initial expectations of credit losses. For financial assets, interest revenue is calculated on the gross carrying amount (i.e. without deduction for expected credit losses).

Stage 2 - if the credit risk increases significantly and is not considered low, full lifetime expected credit losses are recognised in the CIES. The calculation of interest revenue is the same as for Stage 1.

Stage 3 - if the credit risk of a financial asset increases to the point that it is considered credit-impaired, interest revenue is calculated based on the amortised cost (i.e. the gross carrying amount less the loss allowance). Financial assets in this stage will generally be assessed individually and lifetime expected credit losses are recognised on these financial assets.

2.8 The result is impairment losses are recognised much sooner in the financial statements of the Council compared to the previous standard. In addition any changes to the fair value of a financial instrument will have a direct impact on the General Fund balance and therefore the resources of the Council. Previously any movements would have been reversed out to the Available for Sale Financial Instrument Reserve.

IFRS 15 - Revenue from Contracts with Customers

2.9 A further amendment to an accounting policy relates to the Revenue Recognition policy following the adoption of IFRS 15 Revenue from Contracts with Customers, presented in Appendix 1, policy 1.16. IFRS 15 establishes the principles that the Council applies when reporting information about the nature, amount, timing and uncertainty of revenue and cash flows from a contract with a service recipient. When applying IFRS 15, the Council recognises revenue to reflect the transfer of promised goods or services to a service recipient in an amount that reflects the consideration to which the Council expects to be entitled in exchange for those goods or services. As reported in the 2017/18 Statement of Accounts this change has had no material impact on the Council.

Other Accounting Policies

2.10 The remainder of the Council's accounting policies are consistent with those previously presented at Audit Committee. There have been small amendments to streamline narratives and improve presentation but this has not affected the content or essence of the policies.

2.11 Best practice principles dictate that the proposed accounting policies which will be used to prepare the Council's 2018/19 Statement of Account are approved by Audit Committee.

3. Critical Judgements

3.1 In line with International Financial Reporting Standards (IFRS) and the Code, the Council is required to disclose those judgements that management have made in the process of applying the Council's accounting policies that have the most significant effect on the amounts recognised in the financial statements. These are shown at Appendix 2.

3.2 Critical Judgements include, which schools property, plant and equipment and PFI should be included on the Council's balance sheet, which entities fall within the Council's group boundary and which properties should be classified as investment property.

3.3 One additional judgement the Council has included in 2018/19 is regarding the Council's shareholding in Manchester Airport Holdings Limited (MAHL). As detailed in section 2 IFRS 9 Financial Instruments was adopted by the Code on 1 April 2018, and the standard introduced three new categories of classification in which financial assets should be allocated, amortised cost, fair value through profit and loss and fair value through comprehensive income. The majority of the Council's financial assets are simple instruments for collecting contractual cash flows i.e. solely for the payment of principal and interest.

3.4 Up to 31 March 2018 the shareholding in MAHL was held as an 'Available for Sale Financial Asset' and measured at fair value each year. Any change in fair value was posted to Other Comprehensive Income and Expenditure and accumulated gains and losses have been held in an Available-for-Sale Financial Instruments Reserve. As at 1 April 2018 the 'Available for Sale Financial Asset' category is no longer available. The new standard sets out that investments in equity should be classified as fair value through profit and loss. The shareholding in MAHL is an investment in an equity instrument and as such, gains and losses on changes in fair value are recognised through profit and loss which could have a significant impact on the Council's General Fund balance, unless there is an election to designate the asset as fair value through other comprehensive income.

3.5 The shareholding is a strategic investment and not held for trading and therefore the Council has the option to designate it as fair value through other comprehensive income. This would mean that there is no impact on the revenue budget but the decision is to designate the investment into Fair Value through other Comprehensive Income is irrevocable. After consultation with officers, external treasury advisors and other Greater Manchester Authorities the Council has determined that the more prudent approach is to designate the shareholding as a strategic investment with changes in fair value treated as Other Comprehensive Income. This means that any gains or losses on the valuation of the shareholding will be transferred to a Financial Instruments Revaluation Reserve.

4 **Options/Alternatives**

4.1 The options that Audit Committee Members might consider in relation to the contents of this report are:

a) not to approve any of the accounting policies or note the critical judgements.
b) not to approve some of the accounting policies or note the critical judgements.
c) to approve all the accounting policies and note the critical judgements.

5 **Preferred Option**

5.1 The preferred option is option C at paragraph 4.1.

6 **Consultation**

6.1 Consultation has taken place with the Councils External Auditors, Mazars LLP.

7 **Financial Implications**

7.1 Dealt with in the body of the report.

8 **Legal Services Comments**

8.1 There are no Legal implications.

9 **Co-operative Agenda**

9.1 Improving the quality and timeliness of the financial information available to citizens of Oldham supports the cooperative ethos of the Council.

10 **Human Resources Comments**

10.1 There are no Human Resource implications.

11 **Risk Assessments**

11.1 There are no risk implications as a result of this report.

12 **IT Implications**

12.1 There are no IT implications as a result of this report

13 **Property Implications**

13.1 There are no Property implications.

14 **Procurement Implications**

14.1 There are no Procurement implications.

15 **Environmental and Health & Safety Implications**

15.1 There are no Environmental and Health & Safety implications as a result of this report.

16 **Equality, community cohesion and crime implications**

16.1 There are no Equality, community cohesion and crime implications.

17 **Equality Impact Assessment Completed?**

17.1 Not Applicable

18 **Key Decision**

18.1 No

19 **Key Decision Reference**

19.1 Not Applicable.

20 **Background Papers**

20.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref: Background Papers are provided at Appendices 1 and 2.
Officer Name: Lee Walsh
Contact No: 0161 770 6608

21 **Appendices**

21.1 Appendix 1 – 2018/19 Proposed Accounting Policies
Appendix 2 – 2018/19 Proposed Critical Judgements