Report of the Deputy Chief Executive

STATEMENT OF ACCOUNTS 2018/2019 – AMENDMENT TO ACCOUNTING POLICIES

1 <u>Purpose of report</u>

To seek approval to amend the Council's accounting policies to be applied in the production of the 2018/2019 financial statements.

2 <u>Background</u>

The accounting policies to be applied to the treatment of all transactions that make up the Statement of Accounts 2018/19 to ensure the accounts present a true and fair view of the financial position of the Council as at 31 March 2019 were considered and approved by the Governance, Audit and Standards Committee on 11 March 2019.

Subsequent to the meeting, further advice has been received from the Council's treasury advisors, Arlingclose, on the treatment of financial instruments. It is therefore proposed that the accounting policy on Financial Instruments be updated to include the treatment of treatment of financial assets measured at Fair Value though Other Comprehensive Income. This relates to long term investments such as those in property funds.

The updated Financial Instruments policy is set out in the appendix.

3 <u>Financial implications</u>

There are no direct financial costs associated with the accounting policy update.

<u>Recommendation</u>

The Committee is asked to RESOLVE that the updated accounting policy on Financial Instruments to be applied in the production of the Statement of Accounts for 2018/2019 be approved.

<u>Background papers</u>
Nil

APPENDIX

(ix) Financial Instruments

Financial Liabilities

Financial liabilities are recognised on the Balance Sheet when the authority becomes a party to the contractual provisions of a financial instrument, and are initially assessed at fair value and are carried at amortised cost. Annual charges to the Financing and Investment income and expenditure line in the Comprehensive Income and Expenditure Statement for interest payable are based on the carrying amount of the liability multiplied by the effective rate of interest for 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.

All borrowings shown in the Balance Sheet consist of the outstanding principal repayable plus accrued interest. Annual interest is charged to the Comprehensive Income and Expenditure Statement in accordance with the loan agreement.

Gains and losses on the repurchase or early settlement of borrowing are credited and debited to the Financing and Investment income and expenditure line in the Comprehensive Income and Expenditure Statement in the year of repurchase/settlement. However, where repurchase has taken place as part of a restructuring of the loan portfolio that involves the modification or exchange of existing instruments, the premium or discount is respectively deducted from or added to the amortised cost of the new or modified loan and the write down to the Comprehensive Income and Expenditure Statement is spread over the life of the loan by an adjustment to the effective interest rate.

Where premiums and discounts have been charged to the Comprehensive Income and Expenditure Statement or the Housing Revenue Account, regulations allow the impact on the General Fund and Housing Revenue Account Balance respectively to be spread over future years. The Council has a policy of spreading the gain or loss over the term that was remaining on the loan against which the premium was payable or discount receivable when it was repaid. The reconciliation of amounts charged to the Comprehensive Income and Expenditure Statement or the Housing Revenue Account to the net charge required against the General Fund or Housing Revenue Account Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

Financial Assets

Certain reserves are kept to manage the accounting processes for non-current fixed assets and retirement benefits and do not represent usable resources for the Council - these reserves are explained in the relevant policies below.

Financial assets are classified based on a classification and measurement approach that reflects the business model for holding the financial assets and their cashflow characteristics. There are three main classes of financial assets measured at:

- amortised cost
- fair value through profit or loss
- fair value through other comprehensive income

The Council's business model is to hold investments to collect contractual cash flows. Financial assets are therefore classified as amortised cost, except for those whose contractual payments are not solely payment of principal and interest.

Financial Assets measured at Amortised Cost

Financial assets measured at amortised cost are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument.

All such assets held on the Balance Sheet consist of the outstanding principal receivable plus accrued interest. Annual interest is credited to the Comprehensive Income and Expenditure Statement in accordance with the loan agreement.

The Council has provided a number of "soft loans" to employees at less than market rates for the purchase of motor vehicles. These should be correctly shown in the Balance Sheet at fair value. However, the value of these loans is not considered to be material. Accordingly the value as shown in the Balance Sheet represents the value of any loans made less any repayments that have been received.

Any gains or losses that arise on the derecognition of an asset are credited or debited to the Financing and Investment income and expenditure line in the Comprehensive Income and Expenditure Statement.

Expected Credit Loss Model

The Council recognises expected credit losses on all of its financial assets held at amortised cost wither on a 12 month or lifetime basis. The expected credit loss model also applies to lease receivables and contract assets. Only lifetime losses are recognised for trade receivables held by the Council.

Impairment losses are calculated to reflect the expectation that the future cash flows might not take place because the borrower could default on their obligations. Credit risk plays a crucial part in assessing losses. Where risk has increased significantly since an instrument was initially recognised, losse4s 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.

Financial Assets measured at Fair Value through Profit or Loss

Financial assets measured at fair value through profit or loss are recognised on the balance sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value. Fair value gains and losses are recognised as they occur in the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement.

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

- Instruments with quoted market prices – the market price.
- Other instruments with fixed and determinable payments – discounted cash flow analysis.

The inputs to the measurement technique are categorised in accordance with the following:

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

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

Financial Assets measured at Fair Value through Other Comprehensive Income Changes

Financial assets measured at fair value through other comprehensive income are recognised on the balance sheet when the authority becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value. Annual income received from the financial instrument is credited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement when it becomes receivable by the authority.

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

- Instruments with quoted market prices – the market price.
- Other instruments with fixed and determinable payments – discounted cash flow analysis.

The inputs to the measurement technique are categorised in accordance with the following:

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

The Council can elect to classify certain instruments as Fair Value through Other Comprehensive Income, dependent on the contractual arrangements for the instrument.

For an elected financial asset fair value gains and losses are recognised as they occur in Other Comprehensive Income within the Comprehensive Income and Expenditure Statement but are balanced by an entry in the Financial Instrument Revaluation Reserve. In all other circumstances the gain or loss is recognised in the Financing and Investment Income and Expenditure line on the Comprehensive Income and Expenditure Statement before being transferred to the Financial Instrument Revaluation Reserve via the Movement in Reserve Statement

On derecognition of an elected financial asset the balance on the Financial Instrument Revaluation Reserve is transferred to the General Fund via the Movement in Reserves Statement. In all other circumstances the balance on the Financial Instrument Revaluation Reserve is transferred to the Financing and Investment Income and Expenditure line within the Comprehensive Income and Expenditure Statement.