Report to	Audit committee	**Item**
	12 March 2019	
Report of	Chief finance officer (Section 151 Officer)	7
Subject	Impact of New Accounting Standards, and Valuation of Council Housing for the HRA	

Purpose

This report provides information on the impact of the new accounting standards applied under the Code of Practice on Local Authority Accounting in the United Kingdom, standards IFRS 9, IFRS 15 and IFRS 16; and the valuation of council housing for the HRA.

Recommendation

To receive the report.

Corporate and service priorities

The report helps to meet the corporate priority value for money services.

Financial implications

There are no direct financial implications arising from this report.

Ward/s: All Wards

Cabinet member: Councillor Kendrick - Resources

Contact officers

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Background documents

None

Report

Background

1. The following actions were agreed at the audit committee on 16 October 2018:

   (a) To ask the chief finance officer to report back to the committee on the impact of the new accounting standards applied under the Code of Practice on Local Authority Accounting in the United Kingdom, standards IFRS 9, IFRS 15 and IFRS 16; and

   (b) To ask the chief finance officer to report to the committee on the valuation of council housing for the HRA.

(A) Impact of New Accounting Standards

IFRS 9: Financial Instruments

2. This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The changes being implemented to IFRS 9 are largely a reaction to the global financial crisis and aim to provide greater transparency on gains and losses arising on financial assets and greater pessimism about potential credit losses.

3. Financial assets held by the council include cash, investments, equity shareholdings and any contractual right to receive cash (e.g. loans and receivables balances).

4. The key impacts on the council's accounts will be:

   - A change in classification of Financial Instruments
   - The introduction of a forward looking 'expected loss' model for impairment of financial assets; and,
   - Increased disclosure requirements.

5. Our initial impact assessment has identified a number of key impacts. A full impact assessment will be available for the auditors during their interim visit.

Classification of Equity Shares (excluding wholly owned subsidiaries)

6. The council's shareholding in Norwich Airport Ltd and the two Legislator companies has historically been held in the accounts at cost; under the new standard this must be held at fair value (market value). A valuation of the shareholding is being undertaken.

7. The default classification for equity shares is fair value through the profit and loss. This would mean that any change in value directly impacts on the income and expenditure statement as a gain or loss on revaluation.

8. As these are equity instruments which are not held for trading purposes, a choice is available to the council under the Code as to whether these are held at fair value with movements going through the profit and loss account, or irrevocably designated as ‘fair value through other comprehensive income’ thereby deferring any gains/losses until the investment matures or is sold. We plan to utilise this designation option for our equity shares, with any movement fair value taken to a new unusable Financial Instrument Revaluation Reserve.

Classification of Equity Shares in Wholly Owned Subsidiaries

9. The Code permits equity investments in subsidiaries to be excluded from the IFRS 9 requirements where they are fully consolidated into the group financial statements, as they are covered by more specific provisions about their recognition, measurement and disclosure. The equity shareholding in NRL will therefore continue to be held at cost and the company’s results fully consolidated into the Group Accounts.

Expected Loss Model

10. There will also be a requirement to adopt an expected credit losses model, requiring the council to assess the value of possible default events over the expected life of a financial asset. The high credit quality adopted by the Council for its investment counterparties is likely to see an immaterial expected credit loss position.

11. Loans to the council’s wholly-owned subsidiary Norwich Regeneration are within the scope of IFRS 9 and will also be subject to the expected credit loss model. The lending to the council is on the basis of an approved company Business Plan and financial model. In addition the council has security on the loan in the form of the company’s assets (housing). A full review expected loss review will be undertaken on the loan, although given the factors above no impairment of the loan is expected.

12. Other soft loans balances (e.g. Decent Homes Loans) will also be reviewed and any expected losses taken through the income & expenditure statement.

IFRS 15: Revenue from contracts with Service Recipients

13. This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The standard introduces a five step approach to identify contracts and the performance obligations and has been revised to help to clarify and harmonise the treatment relating to revenue recognition. The standard requires enhanced disclosures around revenue, including different categories of revenue, judgements around performance obligations and contract balances.

14. The following types of council income are within the scope of IFRS 15.

- *Fees and charges for services under statutory requirements* e.g. charges for planning application fees, application fees for taxi licensing or alcohol and entertainment licensing, various inspection fees

- *Sale of goods* e.g. sales may include retail sales in the tourist information centre or aids and adaptations for social care activities

- *Charges for services provided by local authorities* e.g. leisure services, car parking income, cemetery, cremation services and maintenance service charges for housing dwellings

15. A review has been undertaken of all the council's material income streams. The review has not identified any income streams where the accounting treatment needs to be amended in light of the implementation of IFRS 15.

16. A review of income recognition in Norwich Regeneration Ltd has also been undertaken. The review has not identified any income streams where the accounting treatment needs to be amended in light of the implementation of IFRS 15.

IFRS 16: Leases

17. In December 2018 CIPFA/LASAAC agreed to delay implementation of IFRS 16 until 1 April 2020 to avoid additional work load from Whole of Government Accounts data collection processes.

18. Under the new standard the accounting treatment of leases by **lessees** will change fundamentally. The definition of a lease under IFRS 16 is 'a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration'.

19. The standard eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. This will result in the Council recognising new assets and liabilities, with the aim of bringing added transparency to the balance sheet.

20. Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases.

21. The first task in assessing the impact of the standard is to identify all arrangements that the Council has which falls under the definition of a lease. We have carried out a circularisation of all budget holders and procurement to identify lease arrangements (where Norwich are the lessee) and built up a dataset of all the relevant contract information.

22. We are awaiting further guidance from CIPFA with particular focus on the application to local authorities. In particular around assets leased at peppercorn rent and whether our private sector leasing properties are within the scope of the standard.

(B) Valuation of Housing Stock

23. Within the accounts, the valuation basis for social housing is called Existing Use Value – Social Housing (EUV-SH). This valuation represents the assumption that the properties have sitting tenants with potentially below market value rents and statutory rights such as right to buy.

24. The valuation therefore reflects the constraints of a regulated sector, including the levels of rent at which properties may be let, which must remain affordable. It typically, therefore, produces opinions of value which are considerably lower than Market Value with vacant possession.

25. A full valuation is carried out every 5 years, with a desktop valuation carried out every interim year. These valuations are carried out by Norfolk Property Services Ltd (NPS) in accordance with the RICS Valuation – Professional Standards 2012 as published by the Royal Institute of Chartered Surveyors.

26. In carrying out the valuation the beacon principle is adopted which allocates the stock into groups of properties of similar design, age, type, or construction. A sample property, "the beacon" is selected, which is representative of the group, and a detailed inspection and valuation carried out. The Beacon method avoids the necessity of valuing and inspecting each individual property. Only selected properties are inspected and any verification of property information will only be required for the beacon.

27. An Adjustment Factor (a percentage) is then applied to the Beacon Value to calculate the EUV-SH. The Adjustment Factor measures the difference between private open market rented and socially rented property at a regional level. It is the discount which, when applied to the cumulative total of all beacon values, gives rise to the EUV-SH. The adjustment factor is prescribed by MHCLG and determined at a regional level. The adjustment factor is 38% for the Eastern Region.

28. The Council Dwelling valuation shown in the 17/18 accounts was £757m. This valuation will fluctuate between years on the basis of movements in the underlying property market. The accounts fully disclose this as a significant estimate within the accounts and detail the impact of a 1% change in the valuation assumption (movement of £7.57m).