LASAAC

Local Authority (Scotland) Accounts Advisory Committee [LASAAC]

holding to account: using local authority financial statements

The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) is constituted of volunteer members representing CIPFA, ACCA, ICAS, Audit Scotland and the Scottish Government. LASAAC is primarily concerned with the development and promotion of proper accounting practices for Scottish local authorities. A key task in achieving this is LASAAC's contribution to the development of the 'Code of Practice on Local Authority Accounting in the United Kingdom' ('the Code').

Further information about LASAAC can be obtained at
http://www.cipfascotland.org.uk/technical/lasaac.cfm

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Holding to Account: Using Local Authority Financial Statements

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Foreword

Never has it been more important to have access to consistent and high quality information about the financial position of local authorities. Audited financial statements contain a wealth of information about the stewardship of public resources and the financial health of local authorities. However, they are also complex and often lengthy documents.

One of the objectives of LASAAC is to improve the quality and relevance of local authority financial statements. We are conscious that audited accounts are complex documents, and that there is a risk they becoming technical statements, not valued by the people they are designed to assist. For that reason, we have produced this reference guide to help elected members to scrutinise and understand their local authority's financial statements.

From 2010/11, Scottish local authorities will be expected to account using international financial standards. This will improve the comparability of local authority accounts with the rest of the public sector and, in due course the private sector. But the financial statements will still be challenging to interpret, particularly for non-accountants.

Nevertheless, the audited accounts are a crucial mechanism for reporting to the public how local authority resources have been applied. They can give assurance about financial health and they can highlight areas of concern. This guide aims to help elected members understand and use the financial statements effectively.

We have designed the guide to be used as a reference document. We envisaged readers dipping into the guide as they scrutinise a set of financial statements. It may also be a useful source document for training or induction purposes.

Example questions for those interested in governance are provided. We are not suggesting that these questions always need to be asked, nor that they are the only questions which should be asked. They are provided as examples of the scrutiny and challenge that can arise from a review of the financial statements. In doing so they illustrate that sometimes the most simple and obvious questions are the ones that should be asked.

We hope that you find the guide useful and would like to express our gratitude to everyone who has contributed to its production.

LASAAC
May 2011

A. Introduction

Local Authority Control of Resources

1. Local authorities are democratically elected bodies responsible for the delivery of local services. It is the responsibility of each local authority to allocate the total financial resources available to it on the basis of local needs and priorities, having first fulfilled its statutory obligations and the jointly agreed set of national and local priorities. Services are largely delivered directly but some may be secured through a contract with another organisation. How an organisation has used its physical and financial resources to deliver local services is reflected in its financial statements.

2. The term 'local authority' means all of those bodies that are obliged to prepare financial statements based on the "Code of Practice on Local Authority Accounting". These comprise councils, joint boards, regional transport partnerships and some other related bodies.

Nature of Local Authority Financial Statements

3. A local authority is required by statute to publish annual financial statements. The financial statements are a formal record and report of the financial activities of the authority. The statements are intended to be used by a potentially wide variety of readers, such as service users, councillors, tax payers, employees, institutions which have lent money to the authority, and suppliers to which the authority owes money.

4. Consequently financial statements are general purpose in nature, rather than being designed for a specific use or reader group. As such, they cannot answer every specific question that a reader may have. Instead, the financial statements can be regarded as an initial primary source of financial information about the authority.

5. Information in the financial statements is expected to show certain characteristics, usually required by accounting standards[1], such as being understandable, relevant, material, reliable and comparable. An item is material to the financial statements if its omission or misstatement would influence the decisions or assessments of users of the statements. Materiality can depend on either, or both of, the size and nature of the item. In practice, judgement is often required to achieve an appropriate balance of the desired characteristics.

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[1] Accounting standards are methodologies and disclosure requirements for the preparation and presentation of financial statements used in disclosing the financial position and transactions of an organisation. They are generally set by recognised accountancy bodies and adherence to them is normally required by professional associations and/or legislation.

6. In general, information that should be disclosed in the financial statements is specified by accounting standards, although legislation can also require some information to be provided, and can affect the application of the accounting standards.

7. It is important to recognise that financial statements are not statements of service performance. Authorities may include the financial statements within an annual report which also provides service performance details, but there is no obligation to do so.

Communication

8. The core purpose of local authority financial statements is communication. Financial statements are an opportunity for the authority to communicate with stakeholders. The statements should provide information which allows readers to assess the stewardship of the authority’s resources on behalf of the public, and for the governing body and other users to make economic decisions.

9. To achieve this, financial statements should identify and highlight the key factors or issues affecting the finances of the authority, and which also affect the physical resources that the authority can control to provide services. Examples include providing details of significant contractual commitments and decisions relating to the control and physical delivery of services.

10. Where appropriate, financial statements can refer the reader to formal council procedures, policy statements and other documents. These include treasury, asset management and risk management policies. The intention is not normally to replicate such material within the financial statements, but to summarise it where necessary and to allow an interested reader to investigate further.

11. Clear communication is best achieved through the use of plain English and clear presentation. While some technical financial terms may be unavoidable, their use should be limited, with an explanation of the terminology provided, either in the main text or as a glossary.

Group Financial Information

12. Group information in local authority financial statements reflects the ability of the ‘parent’ authority to direct or influence the use of resources. This is the case whether these resources are held directly by the council or are under the management of other entities. In some cases, such as the joint board arrangements for fire and police services, the decision to set up a separate entity for service delivery is a central government one. Authorities may also voluntarily establish, and retain some control of, entities such as trusts and partnerships to deliver specific public services.

13. The group can include bodies falling within one of the following categories:

a. Subsidiary: An entity which is effectively fully controlled by the parent authority.

b. Associate: An entity over which the parent authority has significant influence, although not full control.

c. Joint Venture: An entity in which the parent authority cooperates with other parties in determining the operating and financial policies of the joint venture.

14. The use of separate entities to deliver public services can significantly transform the manner in which the authority controls the physical resources used in service delivery. This can affect the risks that those resources are exposed to or shielded from, and the financial sustainability of services. This can therefore influence economic decisions, and the assessment of the stewardship of public resources, made by a user of the financial statements. For this reason group account information is included, where appropriate, in local authority financial statements to provide a wider view of the parent authority’s use of public resources.

B. The Role of Financial Statements in Corporate Governance

Using Financial Statements in Governance

15. The Good Governance Standard for Public Services[2] states that :

> "The function of governance is to ensure that an organisation or partnership fulfils its overall purpose, achieves its intended outcomes for citizens and service users, and operates in an effective, efficient and ethical manner."

16. Used appropriately, the financial statements are a key element in any authority's governance arrangements. Published financial statements constitute an important source of objective, reliable and verified information relating to the corporate resources of the authority. This information forms an important corporate tool for holding decision makers accountable for past decisions and allowing constructive challenge of, and improvement to, the assumptions used for future decisions.

17. Knowledge of the resources available to the authority to support future service delivery, in addition to informed and reasonable assumptions about future resource requirements are two key inputs to the budget setting process. These two inputs must be considered alongside other variables such as strategic service plans, expected service demand, local priorities and other factors in determining the authority's future budget.

18. The preparation of the financial statements helps to support good corporate governance and control. This is evidenced by the internal discipline required to identify assets and liabilities; account for the use of resources; and ensure management accountability for authority assets and liabilities. This internal discipline is supported by the scrutiny of the external audit process. The information and reassurance provided clearly assists the authority in making realistic and informed decisions regarding future service delivery.

19. While financial statements are an important source of information for corporate governance they are not the only source. Reference can also be made to a variety of other sources including Statutory Performance

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[2] "The Good Governance Standard for Public Services", The Independent Commission on Good Governance in Public Services, copyright OPM and CIPFA 2004, ISBN: 1 898531 86 2

Download: http://www.cipfa.org.uk/pt/download/governance_standard.pdf

Indicators[3] (SPIs), audit reports and locally determined financial and performance management information.

Using Financial Statements to Support Accountability

20. The 'Good Governance Standard for Public Services' guidance emphasises the importance of scrutiny and challenge of an authority's actions and decisions. Members of the public, service users and other stakeholders may use financial and other information to hold elected members responsible for policy decisions. Equally, elected members can use the financial statements, when produced and throughout the year, to hold the authority's management accountable at a corporate level for the use of public resources.

21. To support such scrutiny it is best practice to establish an audit committee[4] and include within its remit the active scrutiny and challenge of the financial statements, not simply acceptance of a published document. In this use, financial statements provide a reference point for questions relating to the use or investment of public resources in delivering public services.

22. Securing 'Best Value'[5] through the efficient, effective, economic and equal opportunities based use of resources is one important aspect of good governance and a legislative duty for Scottish local authorities. Question

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[3] Statutory Performance Indicators (SPIs) must be prepared by authorities and are subjected to external audit. They provide service, resource usage and cost information on a comparable basis across all Scottish local authorities. The SPIs are publicly available from Audit Scotland's website.

For details refer to: http://www.audit-scotland.gov.uk/performance/

[4] The establishment of an Audit Committee is generally regarded as an essential part of good corporate governance. Relevant publications which give an indication of the role of Audit Committees include:

The Role Of The Chief Financial Officer In Public Service Organisations (CIPFA)
http://www.cipfa.org.uk/panels/finance_director/download/role_cfo.pdf

Audit Committee Principles In Local Authorities In Scotland (CIPFA Scotland Directors of Finance Section)
http://www.cipfa.org.uk/scotland/download/audit_committee_principles.pdf

[5] Local Government in Scotland Act 2003, Part 1 Section 1. Sub-sections 1-7 provide more detail on Best Value including the statement that "Best value is continuous improvement in the performance of the authority's functions"; a requirement between cost, user charges and quality; and reference to economy, efficiency, effectiveness and equal opportunity requirements.For the act refer to: http://www.legislation.gov.uk/asp/2003/1/contents

and challenge, at a corporate level, to ensure that public resources are appropriately used in the delivery of service outcomes, is therefore a legal obligation inherent in the role of elected members.

23. It is important to recognise that financial statements are concerned with resources at a 'corporate' level. Therefore the main focus is on the total, or aggregate, resources that the authority has within its control. This means they will not usually be able to provide detailed information in relation to all possible questions or areas of interest in relation to service delivery. Rather they allow an objective overview of the authority's resource situation as a whole, and should therefore reflect corporate policies and decisions on service delivery as well as how corporate financial and physical resources are managed.

24. This is recognised within IFRS financial statements by the requirement to provide a reconciliation between the corporate figures presented and the authority's own internal management reporting information. This reconciliation therefore provides an indication of which items service managers are regarded as being responsible for and which items are treated as 'corporately managed'.

25. The scrutiny of the financial statements should therefore complement scrutiny undertaken by service committees and be focused on the overall corporate governance arrangements of the authority. Consequently scrutiny of the financial statements may inform discussion, in an appropriate forum such as full council or service committee, of the authority's future policies.

26. The following three key areas of corporate governance interest are suggested as meriting particular focus when examining the financial statements :

- stewardship of public resources
- risks to which the public resources are exposed
- financial sustainability of public service delivery

27. These key issues can often be inter-related and inter-dependent. Considering each aspect in turn however can help to ensure a comprehensive examination of the financial statements.

Examining the Stewardship of Public Resources

28. The term 'stewardship' refers to the care and concern a person or organisation should have for another person's resources entrusted to their responsibility. Those responsible for governance may therefore reasonably be anticipated to exercise their stewardship responsibilities by using the financial statements to question and challenge decisions and actions relating to the physical and financial resources in the care of the authority.

29. The scrutiny of stewardship will normally involve, for each type of resource, consideration of the way in which that type of resource is managed. In challenging or questioning an item in the financial statements a starting point is often the identification of who is responsible for the item and how the item is controlled across the authority. Financial statements generally present the aggregate, or total, of a type of resource at a corporate level. This total however will often be controlled and affected by a variety of individuals. For example the balance sheet figure for creditors will be the cumulative figure for these liabilities incurred by a wide variety of service managers.

30. Questions and challenge in relation to stewardship will therefore include queries on the policies and processes in place for the control, use and protection of resources. The appropriateness of, or basis for, past decisions may also be reviewed.

31. Example questions on this aspect that might arise from a review of the financial statements are provided in Section C.

Examining the Risk to Public Resources

32. Risk is an inherent aspect of life, and local authorities are subject to events that can affect the demand for, and delivery of, local public services. From a governance and management perspective the challenge lies in understanding the risks and opportunities that can arise and in managing, mitigating and controlling these appropriately. Risk elimination is almost certainly not achievable, and would, in any event not necessarily represent the best use of an authority's resources. Financial statements can provide an initial basis for considering risks, or opportunities, to which the authority's resources are subject.

33. The wide variety of risks and opportunities to which Local Authority resources are exposed includes:

    a. physical risks: such as flood, fire and damage

    b. misappropriation risks: such as theft, fraud and embezzlement

    c. legislative or compliance risks: such as health and safety or data security requirements

    d. market risks: such as changes in interest rates or changes in the number of users of services.

34. Questions in relation to risk will include those relevant to the potential impact of events on the delivery of public services. Aspects that may be specifically queried or challenged could include how risks are identified, the extent of exposure to those risks, the capacity to respond to specific scenarios and any risk-related management decisions.

35. Example questions that might arise from a review of the financial statements are provided in Section C.

36. One common definition of sustainability is "development that meets the needs of the present without compromising the ability of future generations to meet their own."[6] While this is often related to sustainability in environmental terms, it also encompasses the rate at which resources are used to provide public services. This is echoed in a definition of fiscal sustainability as "the ability of public sector entities to meet financial commitments both now and in the future"[7].

37. Not only do financial statements show how current service provision is supported by available financial resources, they also give an indication of the authority's ability to fulfil its future service provision requirements.

38. An important aspect in considering the impact on future generations is the extent to which future resources are already committed. Commitment of future resources can arise in a variety of ways including investment in fixed assets, long term contractual arrangements, borrowing and service design decisions. These kinds of commitments are of course a natural consequence of service provision, but can reduce the flexibility that future generations have in redirecting resources to future service priorities.

39. In understanding the extent of committed resources the time-frame which is being considered is important. Typically some costs, such as the use of a building owned by the authority, may be referred to as 'fixed', because the cost incurred will not change regardless of demand levels or service changes. In the long term however, all costs are variable. For example when a building reaches the end of its useful life the authority will make a decision on whether to replace the building, possibly with more or less capacity, or use a different approach to service delivery. It is therefore important that when a cost is referred to as 'fixed' the time-frame that this relates to is understood. Relevant guidance is available in the form of the Long Term Financial Planning checklist, developed by the Scottish CIPFA Directors of Finance Section[8].

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[6] World Commission on Environment and Development (WCED) (1987) *Our Common Future*. Oxford University Press: Oxford, ISBN 0 19 282080 X

Report available at: http://www.un-documents.net/wced-ocf.htm

[7] International Public Sector Accounting Board, Project: Reporting on the Long-Term Sustainability of Public Finances

Project website: http://www.ifac.org/PublicSector/ProjectHistory.php?ProjID=0076

[8] "Long-term Financial Planning – Good Practice Checklist", CIPFA Directors of Finance Section [Scottish Local Authority Directors of Finance], 2010

Download available from: http://www.cipfa.org.uk/scotland/LTFinancialPlanning.cfm

40. In making borrowing decisions a local authority has a duty to demonstrate appropriate judgement in its capital investment decisions by following the Prudential Code[9]. This requires each authority to produce prudential indicators which act as a basis for informed decision making in committing future resources. Management are required to report these prudential indicators to members. This includes some indicators such as external debt, financing costs and capital expenditure, which are based on information in the financial statements. Notably the Capital Financing Requirement is specifically calculated by combining a variety of figures in the financial statements. This reflects the underlying historic cost of capital expenditure that has not yet been funded by a charge against the authority's usable reserves[10]. The Capital Financing Requirement therefore reflects the extent to which future resources have been committed by investment in capital assets or other items permitted by Scottish Ministers.

41. Questions in relation to financial sustainability are likely to include a focus on the current financial position with reference to potential future scenarios. Typically areas to be queried or scrutinised could include reliance on key funding sources; the impact of critical cost changes and the extent to which future service plans are coordinated with anticipated financial resources. Assumptions, judgements and uncertainties involved in the development of financial plans may also be reviewed.

42. Example questions on financial sustainability that might arise from a review of the financial statements are provided in Section C.

Group Considerations

43. As the 'parent' of related entities, such as subsidiaries, associates and joint ventures, the authority retains responsibility for the stewardship of public resources allocated to such entities and the public services they provide. This view is clearly laid out in the 'Code of Guidance on Funding

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[9] The Prudential Code for Capital Finance in Local Authorities (CIPFA) (second edition 2009). ISBN 978 1 84508 207 9

Available for purchase from: http://secure.cipfa.org.uk/cgi-bin/CIPFA.storefront/EN/product/PUBCF022

[10] "Usable reserves"are explained later in this document – see paragraph 116

External Bodies and Following the Public Pound'[11] This states that the principles of "openness, integrity and accountability" should apply to "funds or other resources which are transferred by councils to arms-length bodies such as companies, trusts and voluntary bodies." This principle is reflected in the financial statements by the inclusion of group information.

44. The 'Following the Public Pound' code also requires that the reasons for transferring funds to an external body should be clearly established and in accordance with council strategy or policy. The basis for such arrangements should not be "the avoidance of controls or legal restrictions which are designed to secure probity and regularity in the use of public funds." Therefore, in voluntarily establishing group entities the parent authority will normally have clear expectations regarding the benefits of the arrangement.

45. The criteria for the inclusion of entities within the group boundary are related to the extent of the authority's control. The role of members or officers as authority representatives in third party governance arrangements however is critical. It should be noted that such appointments can mean the assumption of personal responsibilities, such as those contained within the Companies Act or applying to charity trustees. It is therefore possible that conflicts of interest could arise. Appointees will require appropriate advice and should declare any conflicts of interest when required.

46. The presentation of group information in the financial statements is an opportunity for the members of the authority to scrutinise the actions of the appointees in respect of the use and care of public resources.

47. The level of control that the authority has over the entity will affect its treatment in the financial statements. Where the authority has effective control of the entity, the entity is regarded as a subsidiary. A subsidiary's assets and liabilities are recognised in full in the statements, with separate recognition of any minority interests involved. For associates and joint ventures, where the authority does not have majority control, only the authority's proportionate share of the net assets and liabilities are included.

48. Inclusion of a subsidiary or other entity may not be required where the additional information would not be considered useful to the readers of the financial statements. This will normally be disclosed in the financial

[11] "Code of Guidance on Funding External Bodies and Following the Public Pound", Accounts Commission and COSLA, 1996

Copy available as Appendix 1 within: http://www.audit-scotland.gov.uk/docs/local/2003/nr_040311_following_public_pound.pdf statements, but should not prohibit members of the parent authority from interest in, or constructive challenge of, the use of public resources in the arrangement.

49. In considering the care and use of public resources the same principles outlined above in relation to the role of the financial statements apply equally to the group situation. Aspects that may be considered in respect of group accounts include:

a. How the parent authority ensures that value for money in the use of public resources to deliver public services is achieved by the group entities.

b. The risks to which the parent authority is exposed. The creation of a subsidiary to undertake service delivery is unlikely to eliminate all risk to public resources, since the value of the public money invested in the subsidiary, or provided as operating revenue, will be dependent on the performance of the group entity. A key aspect in this respect is that the statutory situation which determines the risk profile of the parent, may not be applicable to the group entity. This can therefore mean that the value of the public investment is open to more volatile market risks than the parent authority. Alternatively however the use of a group entity in some situations may reduce the risks to which public resources are exposed.

c. The extent of control that the parent authority retains over the provision of the public service concerned. The ability of the parent to specify detailed service provision, including pricing policies where relevant, is likely to be of relevance.

d. The amount to which the future resources of the parent authority are committed to group entity service arrangements will also affect the financial flexibility of the parent authority. This may impact on the ability of the parent authority to adjust its use of physical resources in delivering the whole width of public services for which it is responsible. Use of separate entities to provide public services may also however offer opportunities for public benefit, including increasing the services which can be provided and minimising costs, for example from tax concessions. Consideration of the impact on the parent of the cessation of a group entity arrangement will also be important.

Providing Evidence of Governance Control

50. Financial statements not only have a role in supporting good governance but also in demonstrating that good governance is being achieved. In the latter role the financial statements are required to include a statement relating to the internal controls of the authority.

51. As a minimum this must explain the financial control framework for the authority and, where applicable, the group as a whole. The statement

should detail how financial control is managed and reviewed, reference to internal audit arrangements, and indicate how well the controls operate and the level of assurance they provide.

52. Good practice however is for authorities to provide a wider 'Corporate Governance Statement'[12] which also considers the wider control mechanisms by which the authority achieves its overall purpose. Publishing this wider statement allows an authority to provide more assurance that the organisation as a whole is aware of the need for effective governance mechanisms and to identify the key elements of the governance framework. The resultant external audit scrutiny of the Corporate Governance Statement also allows readers to place some reliance on the reported governance framework.

Authorisation of the Financial Statements

53. The processes surrounding the authorisation and publication of the financial statements are affected by legislative requirements, although the authority has freedom to determine how it meets those requirements.

54. Currently in Scotland the 'proper officer' [13] normally the Director of Finance or equivalent, is responsible for the proper administration of the authority's financial arrangements. This is regarded as including the preparation of the financial statements in line with proper accounting practice. The proper officer is legally responsible for ensuring the financial statements are submitted to both the authority and to the Controller of Audit by 30 June each year. Responding objectively and appropriately to question and challenge can also be regarded as part of the proper officer's role. This is indicated by CIPFA's statement that the Chief Financial Officer's role in assurance and scrutiny includes "supporting and advising the Audit Committee and relevant scrutiny groups"[14].

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[12] See section 4 of 'Delivering Good Governance In Local Government Framework' CIPFA/SOLACE, 2007 ISBN 978 1 84508 116 4
Available for purchase from: http://secure.cipfa.org.uk/cgi-bin/CIPFA.storefront/EN/product/BU012a

[13] As required to be appointed by the authority per Section 95 of the Local Government (Scotland) Act 1973The act can be viewed at: http://www.statutelaw.gov.uk/

[14] The Role of the Chief Financial Officer in Local Government, CIPFA, 2010, (see Principle 3)

Available for download:
http://www.cipfa.org.uk/pt/download/role_of_CFO_in_LG_2010_WR.pdf

55. Following formal submission of the financial statements a public inspection process of the statements is required. During this 15 day period public access to the statements, invoices and other supporting documents of the authority is permitted. A member of the public can notify the external auditor of any objections they may have.

56. Within two months of the completion of the audit process (see next section) the certified financial statements and accompanying auditor's report must be presented to a meeting of the authority. The financial statements and the auditor's report should be made available for public inspection.

57. The extent to which members are actively involved in the above processes is a matter for each authority to determine. It is considered a matter of good practice, and a demonstration of good governance, that the initial unaudited financial statements, the final audited statements and the external auditor's report, should be the subject of debate and constructive challenge at a meeting of the authority.

The Role of External Audit

58. A key role of the external auditor is the verification, to an acceptable level of materiality[15], of an authority's financial statements. In order to maintain the independence necessary for this function external auditors are normally appointed by Audit Scotland on behalf of the Accounts Commission, on fixed term contracts typically lasting five years.

59. It should be recognised that the financial statements' audit process is intended to identify errors, frauds or misstatements that would materially affect or distort the information provided. It is not intended to identify all errors, fraud or misstatements. Assurance will often be gained by sampling techniques, system testing and examination of internal audit work. The external auditor will form an opinion on the reliability of the financial statements, using their judgement, based on the evidence obtained.

[15] For an explanation of materiality see paragraph 5 of this publication

60. The external auditor of public sector bodies typically however has a wider role and remit when compared to requirements in the private sector[16]. Consequently the external auditor can also be expected to comment on governance and performance, including the achievement of Best Value.

61. Furthermore the Accounts Commission, which is legally responsible for the audit of Scottish local authorities, has significant powers. They can instruct auditors to carry out further investigations of matters raised in their reports. They can hold public hearings and can make recommendations to Scottish ministers.

62. External audit is a key part of governance and there is an important external dimension to their work: audit opinions are addressed to the members of the authority and the accounts commission; annual audit reports are addressed to members of the authority and the controller of audit. This means that local authorities are held to account publicly.

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[16] See "Code of Audit Practice". Audit Scotland, 2007; also "The Principles of Public Audit", the Public Audit Forum, 1998

For Code of Audit Practice see : http://www.audit-commission.gov.uk/localgov/audit/auditmethodology/Pages/codelocalgov.aspx

For Principles of Public Audit see: http://www.public-audit-forum.gov.uk/popa.htm

C. EXAMPLE QUESTIONS SUPPORTING CORPORATE GOVERNANCE

Example Questions Re Stewardship of Public Resources

Comprehensive Income & Expenditure Statement

63. Query: Why did the net cost of social work services increase by 6.5% when general inflation was 2.5%?

64. Clearly there could be multitude of reasons such as : increased service demand, price inflation specific to social work services (eg in the price of private care home places); the impact of new employment terms and conditions such as single status; increased support service costs; lower income from falling service demand or increases in people exempt from paying charges; and a variety of other reasons. An important aspect of a response is in the ability of the relevant manager(s) to identify and evidence the key causes. Reference may appropriately be made to reports submitted to service committees. It should however be noted that the service descriptions used in the financial statements may not correspond with the internal management structure of the authority. A response may also appropriately reference performance management information as well as other relevant data and statistics.

65. Query: In relation to 'Gross Income' for what services does the authority charge users? Is there a council policy on the level of charges?

66. The authority may have control over the level of user charges for some services. A charging policy can reflect the authority's policies and priorities, and affect the level of taxpayer resources used in the delivery of some public services.

67. Query: How does the authority make sure that it maximises the profit (gain) from the disposal of long term assets?

68. A response to this question could be expected to refer to council policy on long term asset disposals, including an indication of how disposals are authorised, the extent of any delegated powers (eg in what situations an officer can sell an asset without specifically seeking committee approval) and the disposal process (eg how asset sales are advertised). In addition an indication of what evidence is available to show that the policy is being followed may be appropriate.

Balance Sheet

69. Query: The authority has Land and Buildings valued at £650m. How are these managed to ensure that they remain suitable for use in service provision and that the authority gets the most efficient use of them?

70. Larger local authorities may have specific departments (eg 'Estates' or 'Asset Management') responsible for land and buildings. Other authorities may specify that service managers, such as head teachers, are responsible for the general maintenance and condition of such assets. The authority will normally have a policy or 'Asset Management Plan' regarding asset inspection, repairs & maintenance, service design planning (which will affect future asset requirements) and an assessment of whether the full capacity of the asset is being used. This should normally be linked to, and impact on, both revenue and capital budget plans.

71. Query: The authority has a gross figure of £80m for debtors (being organisations and individuals owing money to the authority) with impairment (expected uncollectable debtors) of £25m. What steps are being made to collect the full amount outstanding?

72. Local authorities can generally be expected to have policy and procedures in place to ensure that debts are appropriately collected. In many cases arrangements for repayment may be allowed (eg through phased repayment of a set amount per month etc) and actual write-off of debt will require some level of managerial authorisation. It is important from a corporate viewpoint that the processes are appropriate and suitable in order to properly safeguard public resources. Evidence of compliance with the processes, and of their success in collecting outstanding debts, would appropriately support good governance. Some indication or evidence of trends in debt collection may also be relevant.

Trust Funds

73. Query: There is a separate statement relating to 'Trust Funds', which have reserves of £4m. Can the authority use these reserves, that is trust resources, to deliver its public services?

74. The authority is responsible for administering the trust according to the trust's purposes and/or deeds. Therefore elected members involved with trust governance are responsible for considering the aims, objectives, terms and conditions of the original bequest when making decisions about the use of trust resources. Where these coincide with the authority's own objectives then both the trust and the authority will achieve their aims. Where however the trust has clearly separate objectives these will need to be adhered to. The ability of the authority to use trust fund resources to deliver public services is therefore limited by the trust objectives. It should be noted that, as with the authority 'single entity' statements, some reserves, such as the Revaluation Reserve, are 'unusable' reserves (i.e. not available for use in service provision). Notably where group accounts

are prepared, such trust funds may be included within the ‘group’ to represent the totality of the resources over which the authority has some control or influence.

Example Questions Re Risks To Public Resources

Balance Sheet

75. Query: The authority holds a significant value of resources in the form of Land & Buildings for the provision of its services. To what risks are these assets exposed and how are the risks managed?

76. A response may normally refer to the maintenance of a 'risk register' highlighting the main risks facing public service delivery. A risk register can be regarded as a vital corporate tool to ensure that risks are identified, assessed and assigned to an appropriate manager. Risks related to land and buildings can be expected to include: fire, flood, vandalism, obsolescence, subsidence, and health & safety conditions. How each type of risk is managed may differ including preventative measures (eg capital spend projects), insurance cover, self-insurance and risk acceptance. Some authorities operate self-insurance which requires that resources are set aside in an 'Insurance Fund'. The risk register should normally be reviewed on a regular basis.

77. Query: 'Infrastructure assets' includes much of the local road network which is vital to the community and the local economy. What risks to these assets could disrupt service provision and how are they controlled?

78. The road network is subject to specific risks, such as deterioration in the road service, flooding, accident damage, winter weather damage, landslides and erosion. The risk register should reflect these risks and they should normally be managed appropriately. Identification of priorities, for instance in the event of wide-scale flooding, may be required.

79. Query: The authority has over £1 billion invested in operational fixed assets. What is the risk of obsolescence and how often is the asset base reviewed to ensure that obsolete or under-used assets are either sold or used more efficiently?

80. An authority will typically have a policy or an Asset Management Plan in relation to this. Where a policy exists, evidence of compliance and progress, such as what value of fixed assets has already been reviewed, could be appropriately provided.

81. Query: The authority has combined short term investments, bank balances and cash of £30m. What has been done to control the risk of loss to the council?

82. Authorities will normally have a Treasury Management Policy, often required by legislation. The policy is likely to have been approved by Council, or an appropriate committee, and management should report back on the operation of the policy. Key actions will normally include credit assessment of the other parties involved, diversification of investments and consideration of the risks and rewards of any investment. Security of cash held in authority establishments will normally be subject to the financial regulations of the authority, with internal or external audit inspections to verify compliance.

83. Query: The council has short-term liabilities for creditors and short-term borrowing of £98m. What is the risk that the council will be unable to pay these liabilities? What exposure does the council have to changes in interest rates?

84. The management of cash flow is a vital part of the financial management of the authority. Failure to pay staff, suppliers, contractors or lenders can stop public service delivery. In the short term the authority will normally seek to predict significant known cash inflows and outflows (eg monthly payroll runs, direct debit income for Council Tax) with a margin allowed for variability. A response could be expected to refer to the policy and processes adopted. In the longer term (more than 12 months) borrowing maturity dates and any new borrowing will normally be managed to ensure that any loan repayments due can be met in cash terms. The Treasury Management Policy will normally refer to these issues and to the management of interest rate risk. It would be appropriate for management to provide evidence demonstrating compliance with the approved policies.

85. Query: The balance sheet shows ‘Fund Balances and Reserves’ of £10m. What level of resources does the council have available to deal with unexpected events, such as severe flooding affecting local communities, and when were these last reviewed?

86. Typically ‘Fund Balances and Reserves’ includes various reserves. Some of the balances reported are already earmarked or set aside for known, or anticipated, expenditure commitments. This includes the planned use of resources in the next financial year, any Insurance Reserve and any Repairs & Renewals Fund. Normally an authority will have a set policy on the level of ‘contingency reserves’ it aims to retain in order to deal with unexpected events. This policy objective will be taken into account during the budget setting process. The chief financial officer may refer to external

guidance in this respect, such as that issued by CIPFA[17]. Recurring use of a contingency balance to deal with a specific situation, such as service overspends or the consequences of flooding, could be regarded as indicative of a need to include such items within the normal budgetary process, leading to questions regarding the financial sustainability of current service delivery choices.

87. Query: The authority has an Insurance Fund of £1.6m which is regarded as a 'Usable Reserve'. Does this mean that these funds can be used to support service provision?

88. The Insurance Fund is regarded as a 'usable reserve' because the authority can make decisions on its use. It is important to recognise that the primary purpose of the Insurance Fund is normally to achieve savings by not paying insurance premiums for risks which the authority considers that it can 'self-insure'. This normally means that a specific contingency reserve, the Insurance Fund, is held in case any losses arising from these risks occur. The level of such contingency required is a matter for professional judgement by a suitably skilled person. As such Insurance Fund reserves will not normally be regarded as being available to fund service provision. It could be noted however that, over time, the difference between the external premiums which would have been payable and the contingency set aside represents savings which have been applied to support service provision or General Fund balances.

Group Accounts

89. Query: Some years ago the authority created a trust to manage its leisure centre services and many staff transferred to become employees of the trust rather than of the council. What responsibilities does the council have for the pension liabilities for these staff, if the trust ceases to function?

90. The arrangements for staff transfer and the creation of the trust will normally have specified responsibilities at that time for any existing pension obligations for transferring staff and for future pension obligations following the creation of the trust. In most cases the new trust will have been treated as an 'admitted body' to the pension scheme and staff will still be members of the scheme, although contribution rates may now differ. The exact details of any admission agreement for entry into the pension scheme may vary for each specific trust established and the authority's management should normally be able to explain these. In some

[17] CIPFA Local Authority Accounting Panel (LAAP) BULLETIN 77, November 2008, Local Authority Reserves And Balances

Available as a download from:
http://www.cipfa.org.uk/pt/pt_details_l.cfm?news_id=59273

cases some form of 'pensions guarantee' may have been agreed by the authority and the exposure of the authority in this respect should be established. Pension accounting arrangements are likely to be different for the trust.

91. Query: In the authority's 'single entity' information there are disclosures regarding contingent liabilities related to legal actions affecting the authority, as well details of financial guarantees given by the authority. Are there similar items affecting any entities in the group financial statements?

92. Where such items affect group entities they should normally, where material, be disclosed in any accompanying notes within the financial statements, in accordance with presenting a 'true and fair view' of the financial position and performance of the group. The materiality of the item will normally depend on both its size and nature and, for these items, the possibility of the obligation occurring.

93. Query: The financial statements clearly present the 'usable reserves' of the authority itself as being £17.8m. What is the level of usable reserves, those that the authority has some control over, in the group entities?

94. The manner, or mechanism, by which an authority directs the resources of a subsidiary, associate or joint venture in order to provide public services is normally a matter for the authority itself to determine. To fulfil this function the authority should be aware of the level of usable reserves that it can influence within each entity. Although this information may not be explicitly provided on the face of the primary financial statements, disclosure in an accompanying note is appropriate.

Example Questions Re Financial Sustainability

95. Query: The financial statements indicate that the Education service received £6m of income towards current service provision. How much of this is ‘one-off’ non-recurring funding and what action will be taken when such grants/contributions cease?

96. Grants and contributions to service provision may often be linked to specific services or initiatives. Typically when the initiative finishes or funding ceases an authority will be faced with a choice as to whether to reduce service delivery, achieve savings elsewhere in the authority or use local taxation to support continued service provision. A prudent authority may have assessed the likelihood of funding withdrawal, and possible options as a result of this, prior to undertaking an expansion of service delivery.

97. Query: There was significant capital expenditure on assets to provide future social work services last year. How have the revenue consequences of this, both savings from increased efficiency and the impact of operating costs, been addressed?

98. Prior to authorisation for approval in the authority’s capital spending programme each project will normally be subject to a ‘business case’ review. This would normally be expected to consider the long-term revenue implications of the project, with inclusion of any increase or decrease in revenue costs in the forward budget plan. A ‘Whole Life Costing’ approach may be adopted in assessing the project, which for some authorities may be embedded in a corporate Asset Management Plan.

99. Query: There is a reference in the financial statements to joint working with the NHS to provide care services for the elderly. What is the anticipated impact on future resources of this service redesign?

100. Service redesign will impact in many ways on the authority, with a clear focus being placed on how service users are affected. Financially key aspects will include the impact on future resources and the additional or reduced risks to which the authority is exposed. An authority might generally be anticipated to know the extent to which, in both amount and time, costs are ‘fixed’ for future years.

101. Query: In the financial statements there is a contingent liability of £15m for the cost of agreeing and implementing new contract terms and conditions with employees. Has this been reflected in the current year's budget and how sustainable is any proposed new pay agreement going forwards?

102. A contingent liability is not recognised as a liability on the balance sheet because it is uncertain whether settlement will be required or the amount of the obligation cannot be reliably estimated. As such the nature of the contingent liability will largely determine how an authority elects to deal with the element of uncertainty involved, including whether to specifically budget for the item, increase the level of 'contingency' reserves held or take some other action. In agreeing any new pay award the financial impact, and therefore funding requirements, will normally be modelled.

103. Query: The authority is having difficulty achieving its savings targets this year. Can the surplus reserve balance on the Housing Revenue Account from last year, as shown in the financial statements, be used to support the authority's general services, rather than just for Housing Revenue Account services?

104. The operation of the Housing Revenue Account (HRA) is determined by legislation, with the original act being the Housing (Scotland) Act 1987. Effectively the legislation provides the Scottish Ministers with control over what can be charged against or credited to the HRA balance. Schedule 15[18] of the act allows any surplus on the HRA to be used to support the general services of the authority. This however is accompanied by a requirement for the authority to make good any deficit on the HRA from its general reserves. This ensures that the HRA is never allowed to be in deficit. The legislation also allows the Scottish Ministers to limit the budgeted General Fund contribution of revenue resources to the Housing Revenue Account. Prudence would therefore be required to ensure that the HRA was not placed in a deficit situation. Consideration would also need to

[18] Relevant sections of the Housing (Scotland) Act 1987 include paragraph 204 and Schedule 15 paragraphs 6-9

The can be viewed at : http://www.statutelaw.gov.uk/

be given as to whether the use of HRA balances to support the continuance of non-HRA services would be financially sustainable.

105. Query: The authority's balance sheet shows that its liabilities exceed its assets by £100 million, with pension liabilities shown as £160 million. Does this mean that the authority is no longer a going concern due to the extent of the pension liabilities?

- The management of pension liabilities is an important task for authorities. At present legislation specifies that the General Fund is charged only with the amounts that are currently payable to the pension fund or to pensioners. Since the actual payments are normally expected to fall due over an extended period of years in the future, potentially 80 years or more, a relatively large pension liability does not automatically mean that there is a short-term 'going concern' problem. Naturally an important question is whether the current arrangements are financially sustainable in the longer term. In considering the situation with respect to pension liabilities the following points may be relevant:

- The inclusion of pension liabilities on the authority's balance sheet is correct and appropriate in that the authority has specific responsibilities to fund the pensions of current employees and current pensioners.

- The figure of £160 million represents the current best estimate of the future pension benefits that employees and pensioners have earned to date that will be paid in the future, normally over a significant number of years. Where the pension operated is a 'defined benefit' scheme the estimate can be subject to a significant degree of uncertainty. This arises from necessary assumptions relating to a variety of factors such as: mortality rates of pensioners and employees, future stock market and other asset returns (Local Government Pension Scheme only), future pay awards, inflation and the discount factor that is used to express the liability in current value terms.

- As a result of the uncertainties noted above the total value of the pension liability for a 'defined benefit' scheme can, when circumstances require that the assumptions are altered, vary quite significantly from one financial year to another. Consequently many organisations with defined benefit schemes witness a certain amount of volatility in relation to their pension liabilities.

- For defined benefit schemes there is normally a requirement for the employer, and in some cases for the employee, contribution rates to be reviewed and if necessary updated on a regular basis, for example every three years. Such reviews will normally consider the long-term prospects of the pension scheme in detail and, where a shortfall is envisaged in the longer term, increases in contribution rates are likely to occur. If the employer's contribution rate rises the increased cost of employing staff will naturally need to be included in the financial planning process.

106. More information on Scottish public sector pensions is available in the Audit Scotland report “The Cost of Public Sector Pensions in Scotland”[19].

[19] February 2011- see http://www.audit-scotland.gov.uk/docs/central/2010/nr_110210_public_sector_pensions.pdf

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D. COMMON KEY ELEMENTS IN THE FINANCIAL STATEMENTS

107. The Code of Practice on Local Authority Accounting ('the Code') is primarily based on International Financial Reporting Standards[20], in line with central government accounting practices. The Code is the UK wide publication which sets the principal accounting requirements for local Authorities. Every local authority can normally be expected to publish the following key elements in its financial statements:

Explanatory statements

These help readers to interpret the financial statements and to understand how the authority meets its financial responsibilities. They comprise:

- Explanatory Foreword
- Statement of Responsibilities
- Accounting Policies
- Statement on Internal Financial Controls
- Remuneration Report

Numerical statements

The numerical statements present the resources used and generated in providing services, as well as the financial position of the authority. They comprise:

- Movement in Reserves Statement
- Comprehensive Income and Expenditure Statement
- Balance Sheet
- Cash Flow Statement
- Notes to the Financial Statements

The Explanatory Statements

Explanatory Foreword

108. The explanatory foreword applies to both the single entity and the group, where relevant. It is intended to provide a commentary and overview explanation of the authority's financial position and to assist in the

[20] International Financial Reporting Standards (IFRS) are developed and issued by the International Accounting Standards Board (IASB). In addition specific international standards for the public sector are issued as 'International Public Sector Accounting Standards' (IPSAS) by the International Public Sector Accounting Standards Board (IPSASB) which is overseen by the International Federation of Accountants (IFAC).

IASB / IFRS website: http://www.ifrs.org/Home.htm

IPSASB / IPSAS website: http://www.ifac.org/PublicSector/

interpretation of the statements. An informative and helpful explanatory foreword is therefore a significant factor in ensuring that the financial statements support and demonstrate corporate governance. The foreword can be expected to highlight key facts, note major changes in the year and provide contextual information. The foreword is normally prepared by the responsible financial officer and is not intended to provide commentary on the authority's policy choices.

Statement of Responsibilities

109. The statement of responsibilities seeks to provide readers of the statements with clarity on the respective roles of the authority as a corporate body (e.g. full council, governing board) and the statutory responsibilities of the relevant finance officer.

Accounting Policies

110. The accounting requirements of the Code of Practice must be coupled with the application of judgement in order to present a 'true and fair' view in the financial statements. The application of these judgements, being the adoption of accounting policies appropriate for the authority, should be explained in the financial statements.

111. Where an authority chooses to change its accounting policies, and the change is material in nature, the previous year's figures shown in the financial statements will normally be restated to ensure comparability. Restatement of previous year figures will normally also be required where a material error was made in previous financial statements.

Statement on Internal Financial Controls

112. The statement on internal financial controls is required to provide readers with an understanding of how the authority controls its resources. The statement will explain the authority's responsibility for controlling its finances, the main features of how the authority has done this during the year, the role of internal audit, any reviews undertaken and any significant weaknesses identified in the control processes. The statement applies to the group as a whole, where relevant. As an example of good practice many authorities provide a wider 'Annual Governance Statement' including the key elements required above.

Remuneration Report

113. The publication of a Remuneration Report is a legislative requirement introduced by the Scottish Government reflecting similar practices in other public sector organisations. The report includes an explanation of the authority's remuneration policy for senior councillors and senior employees. Information provided includes the remuneration and pension benefits of named senior employees or councillors and an indication of the number of employees within each pay band (above a minimum limit). Where the authority controls a subsidiary organisation similar information

on senior employees and councillors is required in respect of the subsidiary.

The Numerical Statements

Movement in Reserves Statement

114. The Movement in Reserves statement presents the financial resources available to the authority. This will normally be a key focus for readers since the extent of these resources will affect the ability of the authority to support future service delivery and cope with unexpected events. It will impact on decisions regarding levels of future local taxes, rents and charges.

Usable and Unusable Reserves

115. The statement differentiates between ‘usable’ and ‘unusable’ reserves.

116. A usable reserve represents resources which the authority can control in making service delivery decisions. Each usable reserve may have different restrictions upon its potential use, dependent upon both legislation and decisions by the authority. For example resources held in the Capital Receipts Reserve may normally only be used to fund expenditure on assets providing long-term benefits or the repayment of borrowing.

117. Usable reserves include the following:

- General Fund (excluding Housing Revenue Account balance)
- Housing Revenue Account balance
- Insurance Fund
- Renewal & Repair Fund
- Capital Fund
- Capital Receipts Reserve
- Capital Grants Unapplied Account

118. Unusable reserves do not represent funding that is available to support service delivery. These reserves generally arise from statutory adjustments and the treatment of ‘unrealised’ changes in the value of assets or liabilities. Unusable reserves include the following:

- Capital Adjustment Account
- Pensions Reserve
- Financial Instruments Adjustment Account
- Available for Sale Financial Instruments Reserve
- Revaluation Reserve
- Employee Statutory Adjustment Account

119. A brief explanation of common usable and unusable reserves is provided in Appendix A.

Movement in the Year

120. For each reserve, or group of reserves, the statement shows the following movements in the year separately:

- Resource Changes per the Comprehensive Income & Expenditure Statement
- Statutory Adjustments
- Transfers to/from Earmarked or Statutory Reserves

Resource Changes per the Comprehensive Income & Expenditure Statement

121. The net figure in the comprehensive income and expenditure statement shows the change in the total resources of the authority based on accounting standards, which are intended to reflect the economic substance of transactions.

122. A distinction is drawn between the change in resources arising from the provision of services and other income and expenditure, generally representing 'unrealised' gains or losses. These are normally disclosed as 'Other Comprehensive Income and Expenditure' and are not regarded as affecting the resources available to fund services. As such these movements are reflected in the unusable reserves. Examples of items included in this category are detailed in the explanation of the Comprehensive Income and Expenditure Statement.

Statutory Adjustments

123. The majority of local authority income is from taxpayers in the form of Scottish Government grant, redistributed non-domestic rates and council tax. Statutory adjustments arise where the Scottish Government determines, for policy reasons, that certain costs which require to be recognised when applying an accounting standard should not be taken into consideration when setting budgets and council tax. The statutory adjustment will identify what costs should be taken into consideration.

124. Statutory intervention may take different forms, such as changing the timing of the impact of an accounting standard or permanently offsetting the impact on an ongoing basis.

125. Statutory adjustments are represented in the statement as a transfer between the usable reserves and the unusable reserves. Important examples of the statutory adjustments currently required are:

  - o The replacement of depreciation (an accounting charge to reflect the consumption of the benefits of long-term assets) with a 'statutory provision for the repayment of debt' (e.g. the repayment of borrowing incurred to create the asset).

- The replacement of the accounting-based estimated cost to the authority of retirement benefits earned by employees during the year with the employer's contributions payable to the Pension Fund for the year.

- An adjustment to eliminate costs relating to leave entitlement which has been earned by employees but which remains untaken as at the balance sheet date

Transfers to/from Earmarked or Statutory Reserves

126. Where the authority transfers resources from one usable reserve to another following a decision on the funding of planned future expenditure, this is reflected in the statement. For example an authority may decide to set aside resources to support future capital expenditure by transferring funds from the General Fund to a Capital Fund.

Comprehensive Income and Expenditure Statement

127. The Comprehensive Income and Expenditure Statement provides information on the resources used, and gained, by the authority during the year as a result of corporate and service delivery decisions. In doing so accounting standards and practice are applied in order to represent the economic reality or substance of transactions.

128. The Comprehensive Income & Expenditure Statement will typically consist of the following sections:

Surplus or Deficit on Provision of Services

- Cost of Services
- Other Operating income and Expenditure
- Financing and Investment Income and Expenditure
- Taxation and Non-Specific Grant Income

Other Comprehensive Income and Expenditure

- Revaluation of fixed assets
- Actuarial Gains or Losses on Pension Assets and Liabilities

Surplus or Deficit on Provision of Services

Cost of Services

129. This section provides users with service cost information. For consistency and comparability between authorities the services shown must be based on the Service Expenditure Analysis definitions provided in the 'Service Reporting Code of Practice'. Due to this the 'Education' heading, for example, in the financial statements may not exactly correspond to an authority's definition of 'Education' within its management structure.

130. Expenditure will typically include employee costs, premises costs, transport costs, supplies & services, payments to third parties and administration costs. It should be noted that the intention is to reflect the total resources used in service delivery and therefore these costs will include an appropriate proportion of central administration costs (e.g. the Finance and Human Resources services). Also included will be depreciation, which represents the consumption of long term assets (e.g. buildings, vehicles, plant) used in the delivery of services.

131. Income will typically include grants or contributions towards service expenditure (e.g. grants which can be claimed only by providing the specified public service); sales income (e.g. café sales, vending machines); fees & charges income (e.g. for the use of facilities, services provided); rental income and other miscellaneous income sources.

Other Operating Income and Expenditure

132. This relates to various items that are appropriately reported at a corporate level. These will normally include any gain or loss on the disposal of long term assets. It should be noted that this gain or loss does not impact on the General Fund balance, being reversed out in the Movement in Reserves Statement[21].

Financing and Investment Income and Expenditure

133. Financing costs and interest income are reported as corporate items. This section includes interest payable on any borrowing, interest charges relating to PFI schemes and finance leases, the attributable interest cost associated with pension liabilities, the attributable expected return on pension scheme assets, interest and investment income and the gain or loss in the year from changes in the value of investment properties.

Taxation and Non-Specific Grant Income

134. Taxation and non-specific funding is a key element in the financing of local authority services, supporting the procurement of resources to deliver services. Where such funding is not dependent upon the provision of a specified service by the authority, the authority will have autonomy over the use of such funding. As such it is appropriate to show these funding sources as supporting the totality of corporate net expenditure. Typically these funding sources will include local taxation, income assigned by central government (eg non-domestic rate income), and central government grants not linked to specific services (e.g. Revenue Support Grant, capital grants).

Other Comprehensive Income and Expenditure

135. Generally ‘Other Comprehensive Income and Expenditure’ includes unrealised gains or losses. These occur when there is a change in the balance sheet value of an asset or liability to reflect the current market or economic situation but the gain or loss is not regarded as having been ‘realised’.

136. Two principal examples included within this section are :

- Revaluations of non-current assets, such as buildings and land. Where an authority is holding such assets for service provision, without the expectation of disposing of the asset, any change in value is regarded as notional.

- Actuarial gains or losses on pension assets and liabilities. Generally these will arise where the actuarial assumptions previously used in the valuation process change. Assumptions which might change could relate to the expected return on

[21] The Movement in Reserves Statement is explained in paragraph 114 onwards.

stock-market investments (eg due to changing economic conditions) and the estimated average life-span of pension scheme members.

Balance Sheet

137. The balance sheet represents the authority's financial situation as at the balance sheet date. The balance sheet is composed of two main parts:

   a. Net Assets

   b. Total Reserves

Net Assets

138. The Net Assets section is the net total of the 'top part' of the balance sheet. This shows the assets that the authority would have control of after settling its liabilities i.e. the recorded liabilities are regarded as having 'first claim' against the assets under the authority's control.

139. The assets and liabilities that the authority has are presented in defined categories to provide an indication of the nature of the resources and obligations of the authority, and to allow comparison with other authorities.

140. Assets represent resources within the control of the authority. Assets are generally split between long term assets, which are expected to provide benefits to the authority beyond the next 12 months, and current assets, which are expected to be consumed within the next 12 months. Typically long-term assets will include buildings, vehicles, plant, equipment, Information Technology and council dwellings. Current assets will normally include stocks, debtors owing the authority money and cash (or cash equivalents).

141. Where it is determined that an asset's value or its potential to provide services is reduced an allowance for this impairment will normally be made. The value of a debtor, for instance, may decrease if it is deemed that there is a possibility that the debt may not be collected. Similarly loss of the service potential that an asset is expected to provide may occur if an asset is damaged, for instance if a school suffers fire damage.

142. Liabilities represent commitments which the authority will have to settle using the resources within its control. Liabilities are normally split between current liabilities and long-term liabilities. Current liabilities would typically include creditors (e.g. staff wages due but not paid, supplier invoices not yet paid) and borrowing repayable within 12 months. Long term liabilities will normally include borrowing repayable in more than 12 months, a portion of PFI or leasing commitments and pension liabilities.

143. Where the liabilities exceed the total assets, a 'net liability' position will be presented. Where the pensions liability is a major factor in presenting a net liability position the statutory funding arrangements for the pensions liability, which typically allows the liability to be met from future revenue sources, will normally ensure that the authority is able to continue public service provision and to meet its liabilities as they become payable.

144. In order to understand and interpret the balance sheet the way in which assets and liabilities are measured, and the accuracy of the measurement, is of significant importance. Appendix B provides a brief overview of the normal valuation or measurement bases used. International financial reporting standards often specify that a ‘fair value’ basis is used to value assets. This normally means the amount for which an asset could be exchanged between knowledgeable willing parties in an arm’s length transaction. For local authority accounting the Code of Practice provides a specific individual definition of ‘fair value’ for different asset types, and this is reflected in Appendix B.

Total Reserves

145. Having established the authority’s ‘Net Assets’ which are not committed to meeting liabilities the balance is then shown as being attributable to various reserves. For local authorities there is a clear distinction between ‘Usable Reserves’ and ‘Unusable Reserves’. Usable reserves are those which the authority can use for future service provision. Unusable reserves cannot be used to provide funding. More detail on this is provided in the section on the ‘Movement in Reserves Statement’.

Cash Flow Statement

146. The Cash Flow Statement represents the cash flows which have occurred during the year. 'Cash flows' relates to cash and cash equivalents, which include short-term investments that are readily convertible to cash and which are subject to only insignificant risk of changes in value.

147. Cash flow is of vital importance to authorities since it determines the ability of an authority to settle its liabilities in the short-term and to cope with unexpected future payment requirements. Authorities will normally actively manage their cash position with reference to an agreed Treasury Management policy. This allows the authority to specify an appropriate balance between the security of invested cash and the achievement of satisfactory returns.

148. The cash flow statement shows the net cash flows relating to :

- Operating activities
- Investing activities
- Financing activities
- Cash and cash equivalents

Operating Activities

149. Cash outflows will include payments for employees, supplies, services, interest on borrowings, housing benefits and grants to third parties. Cash inflows will include local taxation, government grants (specific and non-specific), fees and charges for services, sales of inventories or services and interest received on cash equivalents.

Investing Activities

150. In this context 'investing' does not only refer to treasury investment decisions and interests in external authorities, but also includes investment in assets for future service delivery. As such cash outflows will include the purchase of property, plant, equipment, investment property, intangible assets, investments not classified as 'cash equivalents' and interests in external authorities (e.g. subsidiaries and associates etc). Cash inflows will include sale proceeds, dividends and interest relating to any of the above.

Financing Activities

151. Financing activities relate to the cash received from, or paid to, the external providers of finance. It should be noted that this relates to actual cash flows with external authorities, not the statutory provision for the repayment of debt that is charged against the General Fund. Cash outflows will therefore include cash repayment of borrowing and payments to reduce PFI and finance lease liabilities. Cash inflows will normally primarily represent cash received through borrowing.

Cash and Cash Equivalents

152. The combination of the activities above represents the total net cash flow that the authority has experienced in the year. This should reconcile to the change in the figure for ‘cash and cash equivalents’ from the previous year to the current year balance sheet.

Notes to the Financial Statements

153. The principal statements provide readers with an overview of the financial situation and performance of the authority. For readers seeking a more comprehensive understanding of the authority's finances more detailed information is required. This is achieved through the use of disclosure notes.

154. The objective of the disclosure notes is the same as for the overall financial statements, to allow users to assess the stewardship of the authority's resources and to make economic decisions. As such the notes may be expected to assist users in understanding the resources an authority has, how it has managed them during the year and how it has used public funds in providing services. For some items the qualitative aspects of the information can be as important as, or more important than, the quantitative data provided.

155. Where appropriate this could include information relating to any significant risks facing those resources and how those risks are managed. An explanation of the authority's plans on how it intends to settle significant liabilities may also be relevant for readers.

156. The majority of the disclosure notes are required by accounting standards or legislation. Generally while the content of the disclosure notes is mandatory the presentation, layout and nature of any explanatory text are at the discretion of the authority. Disclosure notes are not normally required where the information would not affect a reader's understanding of the financial position and performance of the authority.

157. A comprehensive list of the notes required is not appropriate in this document, however an overview of some of the disclosure notes required is provided in Appendix C.

E. AUTHORITY SPECIFIC ELEMENTS IN THE FINANCIAL STATEMENTS

158. The Code of Practice on Local Authority Accounting ('the Code') requires additional elements to be included where these are appropriate for the authority concerned. These include the following:

- Housing Revenue Account
- Council Tax Income Account
- Non-Domestic Rate Account
- Common Good and Trust Funds
- Pension Scheme Statements

Housing Revenue Account

159. The Housing Revenue Account (HRA) statements reflect a statutory obligation, introduced under the Housing (Scotland) Act 1987, to maintain a separate account for specified local authority housing provision. Legislation specifies and gives guidance as to what items should be charged or credited to the Housing Revenue Account. Not all authorities will have a Housing Revenue Account since some have transferred their housing stock to other bodies and no longer have control over the provision of social housing in their area.

160. The HRA statements constitute:

- HRA Income & Expenditure Statement – reflecting, based on accounting standards, resources used and gained in the provision of Housing Revenue Account services

- Movement on the Housing Revenue Account Statement – reflecting the impact of legislative requirements on the HRA balance and therefore on rent levels. This acts as a reconciliation between the accounting statement and the legislative position (i.e. the Housing Revenue Account balance).

- Specific Disclosure Notes

HRA Income and Expenditure Statement

161. Expenditure charged to the account will normally include the revenue costs associated with repairs and maintenance of the relevant housing properties. Significant items will normally include:

- Repairs and maintenance costs. These will be costs incurred in maintaining, rather than improving, the properties. Examples might include the cost of planned repairs (e.g repainting), responsive repairs (e.g. plumbing repairs, fixing a broken window), void repairs (repairs to empty dwellings prior to re-letting) and special services (eg running costs of communal heating, lighting, lifts etc.).

- Supervision and management costs. These will include policy and management costs (e.g. registers of houses and tenants, management of maintenance and improvement works, tenant consultation), managing tenancies (e.g. providing advice, eligibility assessment, waiting list management) and rent collection activities.

- Depreciation and impairment of non-current assets. This represents the consumption, or use, of long-term assets (eg dwelling houses) in the provision of Housing Revenue Account services. It should be noted that this accounting requirement, to fairly allocate the cost of long-term assets over their useful life, does not affect the rent levels set. This is because legislation specifies that it is the repayment of debt that should be recognised when rent levels are set, not depreciation and impairment. More information is provided in the Movement on the Housing Revenue Account Statement section below.

162. In general terms the majority of income will normally be from rents for relevant housing properties. Other income sources should also be disclosed.

163. The full authority Comprehensive Income & Expenditure statement provides an analysis based on set service categories. Some of these categories, such as Corporate & Democratic Core and Non-Distributed Costs can be regarded as being corporate in nature and relevant to all individual services. In order to recognise that such items also relate to the provision of HRA services an appropriate share is normally included in the HRA statements. Note that this does not refer to central support costs, which are more appropriately included in expenditure (see above).

164. The full authority Comprehensive Income & Expenditure statement also includes costs and income which are regarded as 'corporate' and are not normally identified to individual services. As above, in order to fairly represent all the resources involved in the provision of HRA services a share or allocation of such corporate items is presented.

Movement on the HRA Statement

165. This statement reflects the movement in the year in the HRA Balance, anlaysed between:

- The surplus or deficit as shown in the HRA Income & Expenditure Account
- Adjustments to reflect the statutory position. These will normally include, as for the authority Movement in Reserves statement:
    - replacement of depreciation and impairment with debt repayment and revenue funding used to support capital expenditure
    - replacement of estimated pension benefits earned with actual pension payments made
    - Elimination of any gains or losses on the disposal of long term (non-current) assets

- Any other movements between reserves affecting the HRA Balance

Council Tax Income Account

166. The Council Tax Income Account shows the gross income raised from council taxes levied and deductions made under statute. The resultant net income is transferred to the Comprehensive Income and Expenditure Statement of the authority.

167. The statement should reflect the amount of council tax levied; the cost of Council Tax Benefits (net of any related government grant received); the cost of discounts given for prompt payment; the cost of any other discounts and reductions or exemptions; bad debts written off and any impairment allowed for; and any adjustment to previous years' council tax income.

168. The account should be accompanied by details of how the council tax for the year was calculated, normally showing the assumptions used in estimating the number of chargeable dwellings per Council Tax band.

Non-Domestic Rate Account

169. Scottish councils collect Non-Domestic Rates on behalf of the Scottish Government. The Scottish Government has discretion over the use of this income and re-allocates the funds back to local authorities, as a form of grant assistance.

170. In collecting Non-Domestic Rates a council is therefore acting as an agent for the Scottish Government. The Non-Domestic Rate Account statement reflects this arrangement. The statement shows the gross income from the rates and deductions made under statute. The net income is paid to the Scottish Government as a contribution to the national non-domestic rate pool.

171. The statement should reflect the gross rates levied, any reliefs and deductions given, payment of interest, bad debts written off and any impairment allowed for; any adjustment to previous years' non-domestic rate income; and the amount receivable from the national pool of Non-Domestic Rate income.

172. The statement should be accompanied by an analysis of the rateable values of properties as at the start of the year being reported.

Common Good and Trust Funds

173. Scottish local authorities are often responsible for managing funds for a specific purpose. This can arise where funds or property have historically been left for the 'common good'[22] of an area, or where a trust fund was

[22] The concept of the Common Good originated in legislation in the Common Good Act 1491. Various legislative amendments have occurred since that date. Currently Common Good funds may be applied for any lawful purpose for the benefit of the inhabitants of the specified area. The use of the funds should be within the scope of municipal

established to be administered by an authority to achieve a specific purpose.

174. In such a situation a committee of the authority's elected members normally constitutes the 'board' of the common good or trust fund. If the fund has been registered as a charity with the Office of the Scottish Charity Regulator (OSCR) then OSCR's financial reporting requirements apply to the charity. Where the fund is not a registered charity the Code applies and the authority's financial statements should include statements, where material, on these funds.

175. It should be noted however that the legislative framework that surrounds Scottish local authorities does not always affect these funds. As a result a change in the requirements of accounting standards can directly impact on the level of usable funds. In particular the statutory treatment of capital expenditure and income does not apply to common good or trust funds. One impact of this is that the depreciation and impairment of buildings are direct charges against the usable reserves of such funds.

176. The information included in the authority's financial statements will normally include an Income & Expenditure Account and a balance sheet. Due to the number of individual funds it is common for the funds to be consolidated into one set of statements. Separate consolidated statements are normally prepared for Common Good funds and Other Trust Funds.

177. The statements should reflect the resources used and gained during the year, and the financial position at the end of the year as managed by the authority in the interests of the funds. An analysis of the statements or year end fund balances relating to the larger funds is normally provided.

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administration. More information is available in LASAAC's document "Accounting For The Common Good Fund" available at:
http://www.cipfa.org/scotland/download/Accounting_For_The_Common_Good_Final_Version.pdf

Local Authority Pension Scheme Statements

178. Each Scottish local authority with pension liabilities is required to include those liabilities in its financial statements as the pension benefits are earned by employees.

179. Scottish local authority employees can opt to participate in different pension schemes dependent on the nature of their employment or post. The main schemes involved are outlined below:

Scheme	Administered By	Scheme Assets
Teachers Pension Scheme	Scottish Government	None. All pension liabilities in year met from current revenue.
Police Pension Schemes	Employing Joint Board or Authority	None. All pension liabilities in year met from current revenue.
Firefighters' Pensions Schemes	Employing Joint Board or Authority	None. All pension liabilities in year met from current revenue.
Local Government Pension Scheme (LGPS)	Specified local authority	Scheme assets held. Level of scheme assets and expected future returns on assets (assessed every 3 years) affect the level of employer's contribution payable and may affect employee contribution rates

180. Since the Teachers Pension Scheme is administered by the Scottish Government there is no requirement for Scottish local authority to provide a financial statement for the scheme.

181. For police and fire pension schemes each employing body administers a scheme for its own employees, with funding supplied by the Scottish Government. Each employing body is required to provide a pension fund account statement showing the pensions payable for the year, the contributions received from current employees and the contribution from, or to, the Scottish Government.

182. Local government pension schemes however are generally more complex and will often consist of the employees of a variety of different authorities and other bodies. One council is normally the legally responsible administering authority. In such a situation the administering authority is

required by legislation[23] to produce separate pension fund financial statements which provide clear information on the pension scheme as a whole. The statements will include:

- Fund Account – showing the resources used or gained during the year
- Net Assets Statement – showing the assets of the scheme less liabilities (excluding pensions)
- Actuarial valuation of pension liabilities

183. The Fund Account will normally show the following:

- Income: including employers' contributions; employees' contributions; transfers from other pension funds (when an employee transfers money in on joining the scheme); other income
- Expenditure: benefits paid (e.g. pensions, commuted payments where a pensioner elects to receive a lump sum rather than receive higher annual payments, annuities, lump sum death benefits); payments to those leaving the scheme (e.g. transferring out); administrative expenses; investment income (normally analysed by type); gains or losses on investments; non-recoverable taxation

184. The Net Assets Statement will normally show investment assets (normally analysed by type); investment liabilities; borrowings; current assets; current liabilities. Note that the liabilities exclude future pension benefits liabilities.

185. The actuarial valuation of pension liabilities will normally be shown separately from the above statements due to the fact that a full formal valuation is only undertaken every three years and may therefore not be directly comparable to the 'net assets' figure.

186. Detailed disclosures are also required including information on the scheme; the funding policy adopted (which can affect the employers' annual contributions); the actuarial assumptions made; and the bases of asset and liability valuations.

187. The Local Government Pension Scheme financial statements are audited are included within a Pension Fund Annual Report[24] and receive a separate audit certificate. Administering authorities are not required to include the statements within their own financial statements but must refer to their availability.

[23] Scottish Government: Local Government Finance Circular 1/2011

[24] As required by the Local Government Pension Scheme Amendment (Scotland) Regulations 2010 (SSI 2010/234)

APPENDIX A

SCOTTISH LOCAL AUTHORITY RESERVES

The following is a description of the reserves that may commonly be shown for a Scottish local authority.

USABLE RESERVES

Usable reserves are those that are available to fund local service provision.

Reserve	Explanation
General Fund	The main fund of a local authority. An authority may 'earmark' a portion of the General Fund as being set aside for specific future expenditure. Authorities will also normally regard part of the General Fund balance as being held for 'contingencies', generally having a specific financial strategy regarding the level of contingency funding that should be held. Authorities which raise local taxes will normally consider the General Fund (excluding the HRA balance) when setting tax levels.
Housing Revenue Account Balance	The Housing Revenue Account (HRA) balance is legally part of the General Fund balance. Due to the legislation surrounding the HRA however the HRA balance is normally shown separately. The HRA balance is normally considered when setting housing rent levels.
Insurance Fund	Authorities may decide to 'self-insure' against some risks rather than pay premiums to an external insurer. Where this is undertaken it is necessary to set funds aside from the General Fund to meet the potential costs arising.
Renewal & Repair Fund	Authorities may specifically set funds aside from the General Fund to renew or repair a particular asset or group of assets.
Capital Fund	Authorities may set aside funds, including capital receipts, in a Capital Fund. The Capital Fund may only be used to repay borrowing (advances made by the Loans Fund) or support capital expenditure.
Capital Receipts Reserve	This is the default reserve for holding capital receipts. Receipts may be used to support capital expenditure or may be transferred to the Capital Fund.
Capital Grants Unapplied Account	The authority may have received capital grants where the terms and conditions of the grant have been met sufficiently for the authority to have entitlement to the funds. Where this occurs such grants are held in this reserve until they are applied to support relevant capital expenditure.

UNUSABLE RESERVES

Unusable reserves are not available to fund service provision. They generally represent either the impact of statutory adjustments made in determining the General Fund balance or unrealised gains and losses on assets and liabilities.

Reserve	Explanation
Capital Adjustment Account	A statutory adjustment account reflecting the replacement of depreciation (an accounting requirement to reflect the consumption of long term assets) with the repayment of borrowing (advances from the Loans Fund). This account therefore affects the timing of charges to the General Fund for the use of long term assets in service provision.
Pensions Reserve	A combined statutory adjustment account and accounting reserve which reflects the replacement of the estimated cost of pension benefits earned by employees, and any actuarial gains or losses on the estimated liability, with the actual contributions made by the employer. This affects the timing of charges to the General Fund for pension benefit obligations.
Financial Instruments Adjustment Account	A statutory adjustment account affecting the timing of charges to the General Fund for some financial instruments. In particular statute allows the cost of some premiums related to the early redemption of borrowing to be spread over a number of years, whereas accounting requirements can require the full cost to be recognised in the Comprehensive Income & Expenditure Statement immediately.
Available for Sale Financial Instruments Reserve	An accounting reserve which represents unrealised gains and losses arising from the revaluation (change in value) of financial instruments (financial contracts) which are classified as being ‘available for sale’.
Revaluation Reserve	An accounting reserve which represents unrealised gains and losses arising from the revaluation of long term assets.
Employee Statutory Adjustment Account	A statutory adjustment account affecting the timing of charges against the General Fund in relation to employee benefits, such as annual leave entitlement and injury benefit schemes.

VALUATION OF ASSETS AND LIABILITIES

Item	Valuation Basis
Property, Plant & Equipment	Infrastructure (e.g. roads, bridges, harbours) and community assets (e.g. parks): depreciated historical cost. This represents the remaining economic benefits of the original cost of the asset that are still to be used up. This basis is used since there is normally not expected to be any alternative use for such assets. All other categories are normally shown at the amount that would be paid for the asset in its existing condition and use. This reflects the economic benefits, expressed at current prices, which will be consumed in service provision. A professional valuer will normally provide the valuation based on market knowledge, although in some cases a 'Depreciated Replacement Cost' will be used to estimate the value. Impairment[25] may apply.
Investment Property	Market value: since the asset is not held for service provision the current market value indicates the resources that would be available if the asset was sold.
Intangible Assets	Historical Cost: if there is no active market for the asset. Impairment may apply. Market Value: if the asset could be sold (this will be uncommon for local authorities)
Long-term Investments	Valuation will depend on the nature and purpose of the investment, generally: • Loans made to other organisations will normally be valued by a calculation based on the predicted cash flows. An impairment allowance for non-recovery may be made. • Investments that are regarded as 'available for sale' or as 'held for trading' are shown at market value. Generally this will be rare in local authorities.
Investments in Associates and Joint Ventures	Investments in subsidiaries, associates or joint ventures will be shown at historical cost or at market value. Impairment may apply.
Long-term debtors	Valuation will depend on the nature and purpose of the debtor, generally however:

[25] For an explanation of impairment see paragraph 141

- long-term debtors owing money will normally be valued by a calculation based on the predicted cash flows. An impairment allowance for non-recovery may be made.
- prepayments made for future services or assets will normally be shown at historical cost

Short-term Investments

Valuation will depend on the nature and purpose of the holding, generally however

- Loans made to other organisations will normally be valued by a calculation based on the predicted cash flows. An impairment allowance for non-recovery may be made.
- Investments that are regarded as 'available for sale' or as 'held for trading' are shown at market value. Generally this will be rare in local authorities.

Inventories

Generally valued at the lower of cost or net realisable value. An impairment allowance for damaged or obsolete inventories may be made.

Short-term debtors

Valuation will depend on the nature and purpose of the debtor, generally however

- short-term debtors owing money will normally be valued at the amount due. An impairment allowance for non-recovery may be made.
- prepayments made for future services or assets will normally be shown at historical cost

Cash and cash equivalents

Normally cash value.

Assets held for sale

Normally shown at the lower of the existing carrying value (when the asset was removed from service) or net realisable value. Generally possible gains on sale are not recognised until the asset is actually sold.

Bank Overdraft

Cash value.

Short-term borrowing

Normally valued at the amount due

Short-term Creditors

Normally valued at the amount due

Provisions

Normally valued at the amount due

Long-term Creditors

Valuation will depend on the nature and purpose of the creditor, generally however long-term creditors will normally be valued by a calculation based on the predicted cash flows.

Provisions	Normally valued by a calculation based on the predicted cash flows.
Long Term Borrowing	Normally valued by a calculation based on the predicted (i.e. committed) cash flows.
Other Long Term Liabilities	Valuation will depend on the nature and purpose of the liability, however generally: • Pension liabilities are valued based on the predicted future cash flows arising from the employer's obligations for the pensions of those employees, deferred pensioners and current pensioners existing as at the balance sheet date. The pension liability is reduced (netted down) by the predicted future cash flows arising from any pension scheme assets existing at the balance sheet date. • PFI and finance lease liabilities are normally based on the initially recognised value of the asset provided, reduced annually by the element of the annual payment that is calculated as being a payment for the asset

OVERVIEW OF SELECTED DISCLOSURE NOTES

This overview is not intended as a detailed guide to all the disclosure notes required or their detailed information requirements. It is intended to highlight some common notes and explain what they represent.

Note	Explanation
Statement of assumptions	The authority should outline the assumptions it has made in preparing the financial statements, including assumptions about the future and any significant areas of uncertainty in estimating assets and liabilities at the balance sheet date.
Events after the balance sheet date	Where a significant event affecting the authority's financial position occurs after the balance sheet date but before the statements are authorised for issue, the event and its impact should be explained.
Related Parties	Where the authority has a relationship with another party that is not a normal 'arm's length' relationship this should be explained and the transactions with that party disclosed.
Property, Plant & Equipment	These assets normally represent a significant value on the balance sheet and are critical for future service delivery. Consequently detailed disclosures are required by sub-categories, including details on valuation, the depreciation policy (i.e. how the consumption of the economic benefits of the asset are represented in the accounts), an analysis of value changes in the year and any relevant contractual commitments.
Leases	Leases generally represent agreements to pay another party for the right to use an asset, without necessarily transferring ownership. Leases are classified as either finance or operational. A finance lease is effectively regarded as being a means of financing the long term use of an asset, generally as an alternative to borrowing cash in order to purchase the asset outright. An operational lease is regarded as simply a 'service provision' contract. Authorities may either be the lessee (the party paying for use of the asset) or the lessor (the party receiving payment for providing the asset). An explanation of the leases the authority has, the assets concerned and the contractual commitments undertaken is required.
PFI & Similar Contracts	Private Finance Initiative (PFI) and similar contracts can, when certain criteria are met, be generally regarded as complex contracts which include a 'finance lease' element. Due to their complex nature and normally large scale, detailed disclosures and explanations are generally provided.

Debtors The amount of money that an authority is owed by third parties is normally a significant factor in assessing its liquidity. An analysis detailing the debtors is normally provided.

Creditors The amount of money that an authority owes to third parties is normally a significant factor in assessing its liquidity. An analysis detailing the creditors is normally provided.

Pensions The provision of pension entitlement to employees can be a significant commitment on the part of an authority.

Defined Benefit Schemes
Where the pension entitlement is a 'defined benefit scheme' (i.e. where the scheme specifies the benefits payable to members on retirement) the employer may be committed to a liability of uncertain amount and timing. The estimation of this liability is a complex process including an estimation of the expected length of life of scheme members and of expected returns on any pension fund assets (e.g. stock market investments).

Defined Contribution Schemes
Where the employer's contribution to the pension entitlements is fixed the scheme is a 'defined contribution' scheme and the employer's liability is more certain.

Detailed disclosures are required concerning each pension scheme the authority offers, including the assumptions underlying the calculation or estimation of the liabilities.

Financial Instruments The term 'financial instrument' is defined in accounting standards and generally includes the following :

- Liabilities: creditors, money borrowed, financial guarantees
- Assets: bank deposits, debtors, loans receivable, investments

Financial instruments can be subject to fluctuation in value and some uncertainty. For most authorities, due to the scale of these items, disclosures are required relating to their:

- Significance to the financial position and performance (e.g. analysis by category, any security held/given, allowance made for impairment, market value, value changes in year)
- Nature and the extent of risks arising from financial instruments (e.g. textual description of risks, management approach, risk of default by a third party (credit risk), impairment, liquidity risk, market risk)

Provisions A provision is a liability of uncertain timing or amount which meets certain criteria meaning that it must be recognised as a liability on the balance sheet. Typically a provision may be required in anticipation of the settlement of a court case, an employment tribunal, planned redundancies and other similar situations.

Due to the uncertainty involved in making a provision the disclosure of the nature of each provision, the uncertainties involved and any movement in the year compared to the previous year is required.

Note: Where a provision would normally be recognised but the amount cannot be reliably estimated it may be disclosed as a contingent liability (see below).

Contingent Liability

A contingent liability is generally a possible obligation that arises from past events but where the existence of the obligation is dependent (i.e. contingent) on future events not within the control of the authority.

A contingent liability is not recognised on the balance sheet, but due to the potential obligation, a disclosure is required. This includes an explanation of the nature of the contingent liability, an estimate (if possible) of the amount and details of the uncertainties arising.