

By: The Director of Finance
To: Governance and Audit Committee – 30 June 2008
Subject: DRAFT STATEMENT OF ACCOUNTS 2007-08
Classification: Unrestricted

Summary: This report asks Members to consider and approve the draft Statement of Accounts for 2007-08.

FOR DECISION

1. INTRODUCTION

- 1.1 The draft Statement of Accounts of the County Council for 2007-08 is attached. These need to be approved by Members by 30 June 2008, prior to the issue of the external auditor's report and publication of the Statement of Accounts (Accounts).
- 1.2 Members are encouraged to scrutinise these Accounts and ask questions.
- 1.3 If any Member of this Committee has any questions in relation to these Accounts, then they can be raised prior to the meeting of the Committee with Cath Head, Chief Accountant, who will be happy to meet with any Member or group of Members to give a more detailed explanation of these Accounts. Alternatively, questions can of course be asked at this meeting.

2. STATEMENT OF ACCOUNTS - CONTENTS

- 2.1 The content and format of the Accounts is as prescribed in the Accounting Code of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) which has approval from the Accounting Standards Board as a Statement of Recommended Practice (SORP).
- 2.2 The format of the primary statements within the Accounts has not changed significantly to last year's. However, there have been some changes in the accounting around capital and financial instruments in the move to become Generally Accepted Accounting Practice (UK GAAP) compliant. These changes are outlined in Appendix 1.
- 2.3 The remainder of Section 2 of this report highlights the key facts, figures and issues from the attached draft Accounts.

Foreword Pages 1-4

- 2.4 The details of the revenue outturn are shown on Pages 1 and 2. This shows an underspend of £7.9m, plus a £5m underspend on schools, giving a total underspend in the year of £12.9m. The reasons for these underspends were detailed in the Final Outturn report to Cabinet on 16 June.
- 2.5 The net income figures for the budget and outturn for the Operations, Resources and Skills Portfolio on page 1 of the Accounts are the result of funding for schools, and the corresponding expenditure is shown in the delegated schools budget line.
- 2.6 There has been no reduction in the level of general revenue reserves and these still stand at £25.8m. This is deemed to be an acceptable level based on the current budget and the Council's identified risks by the Director of Finance. Specific reserves and schools' reserves are detailed in paragraphs 2.23 to 2.25 in this report.
- 2.7 The capital expenditure for 2007-08 was £46.7m less than budgeted, which reflects the re-phasing of capital projects across all services. The capital reserves of £60.3m will be used to fund the re-profiling of the 2007-08 and future years' capital programme.
- 2.8 Schools have £17m of capital reserves.
- 2.9 The Insurance Fund continues to be fully funded, in accordance with Financial Reporting Standard (FRS) 12.

Statement of Responsibilities Page 5

- 2.10 This statement sets out the respective responsibilities of the Authority and the Director of Finance in relation to the production of the final accounts.

Annual Governance Statement Pages 6-9

- 2.11 The new Annual Governance Statement builds upon the previous Statement of Internal Control. It identifies areas in which our governance arrangements can be strengthened and meets the requirements of the Accounts and Audit (Amendment) Regulations 2006 (A & A(A)R 2006) in relation to the publication of a statement on internal control.
- 2.12 We are responsible for putting in place proper arrangements for the governance of our affairs and facilitating the effective exercise of our functions including the management of risk. The attached Accounts therefore include such a statement on pages 6 to 9. It confirms that, during the financial year 2007-08, overall Corporate Governance arrangements and internal controls in the Authority were in place and effective in terms of business as well as financial risk. It also confirms that areas where controls

need to be developed or improved are known about and are being actioned. This will be discussed in more detail elsewhere on this agenda.

Auditor's Report Pages 10-11

- 2.13 Within the Accounts and Audit Regulations 2003 we are required to open the accounts for public inspection. This enables a member of the public to inspect the Accounts, ask questions and to request copies of related documents where appropriate. The period of inspection for the 2007-08 Accounts commenced on the 9th June and ends on the 4th July. The appointed auditor day is the 7th July where electors can request a meeting to raise questions about the Accounts.
- 2.14 The external auditors will provide an independent opinion as to whether the Statement of Accounts presents fairly the financial position of Kent County Council at 31 March 2008 and its income and expenditure for the year ended 31 March 2008. The audit started in May and is progressing well. A member of the Audit team will provide a verbal update on progress at this meeting. Following approval of the Accounts by Members, the external auditor will issue a report when the audit is completed. The Accounts are expected to be formally signed on 23 July, assuming no material errors are found that remain uncorrected. Pages 10-11 are blank to accommodate this report.

Accounting Policies Pages 12-15

- 2.15 Our accounting policies remain consistent with the Statement of Recommended Practice (SORP). There have been minor changes to these to accommodate the 2007 SORP changes, predominantly around fixed assets.

Income and Expenditure Account Page 16

- 2.16 The Income and Expenditure Account is accompanied by a set of explanatory notes. The account shows, in the format required by the Accounting Code of Practice, the income and expenditure for the year 2007-08. The revenue budget underspend in 2007-08 is transferred into the rolling budget reserve and is included in the Statement of Movement on the General Fund Balance and can be seen in detail in the Reconciling Items for the Statement of Movement on the General Fund as part of the net transfer to/from earmarked reserves.
- 2.17 The Accounting Code of Practice states that we must reflect the cost of using assets in the provision of services. We do this by including depreciation and impairment within the net expenditure line for each of the service headings shown in the income and expenditure account. The deferred government grant credits are also reflected in the service lines. However, these charges do not impact on the Council Tax payer. The impact is therefore neutralised by entries made in the Statement of

Movement on the General Fund Balance and can be seen in detail in the Reconciling Items for the Statement of Movement on the General Fund. This means that the revenue account is only charged with the true interest costs from borrowing and the statutory provision for the repayment of debt.

- 2.18 Note 13 on page 30 details the turnover and profit/loss of Kent Top Temps Ltd and Kent County Facilities Limited trading as InsideOut. We have agreed with our auditors that this is not material enough to warrant the creation of Group Accounts for KCC. The accounts of KTT Ltd are separately audited and will be available at Companies House in due course.
- 2.19 Note 16 on page 32 summarises the position on Landfill Allowance Trading Scheme (LATS). The accounting entries for this are embedded in the Income and Expenditure Account and Balance Sheet. The estimated residual allowance of £5 per tonne gives a net income of £792k, which is represented in the balance sheet by debtors and creditors with the opposite entry being the balance in an earmarked reserve. This reserve represents the value of cumulative unsold Landfill Allowance permits and is only realised when and if these permits are actually sold.

Balance Sheet and Notes

- 2.20 The Balance Sheet statement sets out the financial position of the Authority as at 31 March 2008 and is accompanied by explanatory notes. The statement shows the balances and reserves at the Authority's disposal, its long term indebtedness, and the fixed and net current assets employed. The principal movements on the balance sheet are described below.
- 2.21 Long-term assets have increased by £83m. This is due to three factors:
- Our significant levels of capital investment
 - The revaluation of our land and buildings. Note 17 details the basis of the valuation
 - An increase in long term investments.
- 2.22 Current Liabilities are up by £87m. This is due to an increase in overdrawn bank balances, which are off-set by investments held within current assets. This is a managed position and is informed by our cash-flow projections. There is also an increase in our level of general creditors as shown in Note 20.
- 2.23 Long-term liabilities have increased by £11m, which is due to:
- An increase in our long-term borrowing of £65m, due to the borrowing required to fund our capital programme, partially off-set by debt repayment through 2007-08
 - An increase of £22m written to the Government grant deferred account
 - A reduction in our 'pension fund deficit' of £74m. Note 25 provides the information on this movement.
- 2.24 Our net worth has increased from £703m to £809m. The gains and losses in our net worth are shown in the Statement of Total Recognised Gains and

Losses (STRGL) on page 18 and reflect the movement in our net worth between 2006-07 and 2007-08. The make up of the various reserves, accounts and balances shown in the balance sheet is on page 20 and in more detail on pages 42 to 47 in Note 24.

Total Movements in Reserves

- 2.25 Earmarked revenue reserves total £86m, including £7.9m in the rolling budget reserve. Cabinet have considered the use of this reserve at their June meeting and will be considering it in the July Cabinet meeting as well. Details of each of the earmarked reserves are shown on Pages 43 and 44 of the Statement of Accounts.
- 2.26 Schools' reserves continue to grow. Schools now hold £67.6m of revenue reserves and £17m of capital reserves. In addition, there is £11.7m of unallocated schools' budgets that will be allocated to schools during 2008-09, based upon decisions by the Schools Forum and its sub-groups.
- 2.27 Capital reserves stand at £60.3m and are needed to fund the re-phasing of the 2007-08 capital programme into future years. In addition to this, we do have funding within the current assets part of the balance sheet, which reflects our treasury management policy of borrowing when it is right to do so, and not specifically when that funding is needed to fund capital expenditure.

Cash Flow Statement Page 19

- 2.28 This statement summarises the inflows and outflows of cash arising from transactions with third parties for both revenue and capital purposes. The statement shows that there has been a net cash outflow of £80.4m.

Pension Fund Accounts Pages 61-72

- 2.29 These are a summarised extract of a more detailed statement produced for the Pension Fund.

Glossary Pages 73-74

- 2.30 A glossary of some of the terms used within the Accounts is provided.

Other Issues

- 2.31 Each year, our external auditors have to produce an Annual Governance Report setting-out how the audit went operationally, highlighting areas of concern, and listing all errors that they have found in the Accounts that we have decided not to adjust in the final Accounts. The list is known as the Statement of Unadjusted Differences (SUD), and the report is formally known as the ISA260.
- 2.32 This year has again proved to be a significant challenge particularly in light of the accounting for and changes to fixed assets and financial instruments.

However, this challenge has been met and we presented the attached draft of the Accounts to the Audit Commission on 6 June. Prior to that, the Audit Commission had already audited the Chief Executive's Dept, Commercial Services, Environment and Regeneration and had commenced Communities directorate accounts. The audit of Kent Adult Social Services, Children Families Health and Education began week commencing 9 June. All the paperwork requested by the auditors has been available to them, and the professionalism of their audit approach has been exemplary. Inevitably, there will be a number of issues. These will be reflected in the auditors' Annual Governance Report, which may also include issues where there is a differing approach recommended by the Audit Commission compared to our own. We will then need to decide whether or not to amend the Accounts to reflect those items. In deciding, we will take into account the time involved in correcting the errors compared to the benefit of making the corrections. The final decision on this will be subject to the approval of the Chairman of this Committee. If we decide not to correct any or some of the errors, the contents of the Annual Governance Report will be presented to the next meeting of this Committee for Members information and endorsement of our decision.

3. Annual Minimum revenue Provision (MRP) Statement

- 3.1 There have been changes to the capital regulations in 2007-08. In the new regulations, the detailed rules for making a provision are replaced with a duty for the authority to make an amount of MRP which it considers "prudent". The regulations do not actually define what "prudent" is, but make recommendations as to the interpretation of the term. The changes apply from 2007/08 onwards.
- 3.2 We are required to submit a statement on our policy of making MRP to full council or delegated committee. Any revision to the original statement must also be issued to that committee.
- 3.3 For 2007-08, which is based on 2006-07 spend, we have retained the old method of calculating MRP, which we are allowed to do for this year only. This calculated MRP on the basis of 4% of our adjusted Capital Finance Requirement.
- 3.4 For 2008-09, which is based on 2007-08 spend, we plan to use the asset life method for assets funded from loan unless it is prudent to do otherwise. This method makes provision over the estimated life of the asset for which the borrowing is taken and should not change even after revaluation. This method allows for an "MRP holiday" on new assets i.e. MRP provision does not come into force until the asset is operational. The impact of these changes is still being calculated.

4. RECOMMENDATION

Members are asked to:

- 4.1 Consider and approve the Statement of Accounts for 2007-08 subject to the Chairman, Shadow Chairman and Liberal Democrat Spokesperson being informed of any changes which may be made to the Accounts following completion of the external audit.
- 4.2 Note the recommendations made in the Annual Governance Report.
- 4.3 Note the proposed changes to the calculation of MRP and agree to review this in September.

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Appendix 1

- The Fixed Asset Restatement Account (FARA) has been replaced with the Revaluation Reserve and the Capital Finance Account has been replaced with the Capital Adjustment Account (CAA). The balance on the FARA has been transferred to the CAA and the Revaluation Reserve started 2007-08 with a balance of zero.
- All positive revaluations have been posted to the Revaluation Reserve as a gain but downward valuations have been posted to the Income and Expenditure Account as impairment and then reversed out through the Statement of Movement on the General Fund Balance (SMGFB) to mitigate the impact on council tax. This is because there cannot be a negative balance on the Revaluation Reserve for individual assets.
- In previous years postings to the FARA included spend which was legitimately capital spend but was considered not to add pound for pound value. This included schools delegated expenditure which amounted to £39m in 2006-07. In 2007-08, this spend amounted to £45m and this has had to be broken down into the relevant categories of assets and posted accordingly to the balance sheet. This resulted in an increase of £8.6m to Vehicle Plant and Equipment, £13.6m to deferred charges which are charged through the Income and Expenditure account and then removed through the SMGFB and £22.4m added to buildings or work in progress.
- This change in the treatment largely accounts for the deficit on the Income and Expenditure account - £29m for impairment relating to downward valuations, £23m increase in deferred charges, a loss on the sale of fixed assets, primarily academies, of £63m, offset by an increase in government grants and contributions going through the income and expenditure account of £33m and an increase in the demand on the collection fund of £29m.
- As part of the move to UK GAAP compliant accounts we have had to adopt the requirements of Financial Reporting Standards 25, 26 and 29 in relation to financial instruments. These are very complex reporting standards with resulting disclosures appearing in the accounts on pages 54 to 58. One of the requirements was to create a new account – the Financial Instruments Adjustment Account (FIAA). This can be found on the bottom half of the balance sheet and contains the balance of deferred premiums, previously appearing on the top half of the balance sheet and any impairment relating to soft loans and guarantees.
- A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another. The term ‘financial instrument’ covers both financial assets and financial liabilities and includes both the most straightforward financial assets and

liabilities such as trade receivables and trade payables and the most complex ones such as derivatives and embedded derivatives.

- The reporting standards require these assets and liabilities to be recognised and derecognised accordingly. Financial assets and financial liabilities should be measured initially at fair value less the transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction.