Taunton Deane Borough Council

Corporate Governance Committee – 24 May 2010

International Financial Reporting Standards

Report of the S151 Officer and the Financial Services Manager
(This matter is the responsibility of the Leader of the Council, Councillor Williams)

1. Executive Summary

1.1. The purpose of this report is to inform the Committee of the statutory requirement of all local authorities to implement International Financial Reporting Standards (IFRS) in 2010/11. This relates to changes to the technical accounting rules that the Council uses for its financial reporting. Unfortunately the nature of the report requires the use of jargon in places.

1.2. The transition to IFRS accounting will require changes in accounting in a number of areas. The Council will need to review and update its Accounting Policies, and the main financial statements in the Statement of Accounts will change in format. The scale of additional information to be provided on the Notes to the Financial Statements will also increase significantly.

1.3. The transition to IFRS accounting will therefore have a significant impact in terms of resources required to adopt and then maintain enhanced financial reporting requirements. This will impact in particular within the Southwest One services of Finance, Property and HR. There is currently no budget for any additional costs arising from this change in requirements.

1.4. Progress has been made in key areas of analysis required for external reporting requirements in July 2010. Significant further work is required to complete the transition, leading to the preparation of the 2010/11 Statement of Accounts in line with IFRS.

1.5. Statutory mitigation has been issued by Central Government to neutralise any impact of accounting changes on the Council Tax payer. The only significant exception to this relates to leased assets, where local authorities have the power to change their Minimum Revenue Provision Policy to mitigate any such impact from retrospective re-statement of leased assets. However, the revenue implications from future acquisition of leased assets could be different than under the current Statement of Recommended Practice (SORP).

2. Background

2.1. International Financial Reporting Standards (IFRS) are the accounting standards issued by the International Accounting Standards Board. These standards are the equivalent of the current UK GAAP, which is the set of 'Generally Accepted Accounting Principles' under which the Council meets its statutory obligations in the preparation of its financial statements.

2.2. IFRS has been introduced with the main aim of creating a consistent and comparable set of financial statements across all continents, driven by the ever-increasing levels of globalisation.

2.3. It is a statutory requirement for all local authorities to report on an IFRS basis from 2010/11. Central government and the NHS moved to IFRS in 2009/10. In order for the Council to achieve compliance it is required to change the format of its financial statements, review and revise where necessary its accounting policies and procedures, and include significant additional disclosures where directed. Financial Statements in the listed (private) sector increased by 60% in size after the introduction of IFRS.

2.4. To comply with IFRS transitional requirements the Council is required to restate its 2009/10 financial statements for comparative purposes and also restate its opening balances as at 1 April 2009 (the date of transition).

2.5. The implementation of IFRS requires particular concentration around 6 key areas in which a considerable amount of resources will be required in order to ensure the achievement of IFRS compliant accounting statements.

3. Outline Implementation Plan

3.1. CIPFA/LASAAC has issued guidance with a possible outline approach that local authorities can apply to the implementation of IFRS. The TDBC outline plan has been based largely on this guidance.

3.2. The summary of the IFRS Transition Plan is set out in Appendix A. The remainder of this report summarises the main areas of impact of IFRS implementation, with brief comments on progress to date.

4. First Time Adoption (IFRS1)

4.1. Adopting IFRS for the first time has and will involve significant management time from the Southwest One Finance service. However it is more than a finance issue and requires significant engagement with other Southwest One services (Property, HR) and service areas across the Council.

4.2. Implementing IFRS under IAS1 will impact on the chart of accounts resulting in amendments to the presentation of the financial statements. A detailed review of accounting policies in comparison with the IFRS standards will highlight the specific areas of concentration.

4.3. The Council's current processes and systems will be reviewed to highlight any adaptations required in order to satisfy the new information needs. Resource requirements will be assessed to ensure sufficient capacity to carry out the successful implementation of IFRS.

4.4. The format and names of the main financial statements will be updated under the new IFRS-based SORP.

Current Statements		**New Statements**
Balance Sheet	→	Balance Sheet
Income & Expenditure Account	→	Comprehensive Income and Expenditure Statement
Statement of Recognised Gains and Losses	→	
Statement of Movement in General Fund Balance	→	Movement in Reserves Statement
Cash Flow Statement	→	Cash Flow Statement

4.5. In order for the Council's financial statements to comply with IAS1 the first IFRS financial statements (2010/11) require the inclusion of the following –

- Three statements of the Balance Sheet: 1 April 2009 (re-stated), 31 March 2010 and 31 March 2011
- Two statements of the Comprehensive Income and Expenditure account: 2009/10 (re-stated) and 2010/11
- Two statements of Cash Flow: 2009/10 (re-stated) and 2010/11
- Two statements of Movements in Reserves: 2009/10 (re-stated) and 2010/11
- All relevant notes to the restated balance sheet at 1 April 2009.

4.6. One of the fundamental issues within IFRS is that when an international standard is implemented for the first time it is done so with retrospective application. The impact of this is that accounts must be restated as though they had always been accounted for using that standard. This requires the rewinding and restatement of transactions right back to their inception in order that the opening balances are restated correctly, which will accordingly present significant challenges (in particular related to leased assets).

4.7. A thorough review of the new International Accounting Standards in comparison to their UK GAAP equivalent has enabled an assessment of the impact on the Council's financial statements and accounting policies.

4.8. Significant work is required to initially restate the opening Balance Sheet under IFRS (as at 31 March 2009) and subsequently produce comparable figures for the 2009/10 financial year under both UK GAAP and IFRS.

5. Leases

5.1. A review of current lease agreements involving the Council as either lessor or lessee is presently underway, giving consideration to the revised parameters of IAS17 (leases). A lease can be classified as a finance or operating lease. If a lease transfers substantially the entire risks and rewards incidental to ownership it will be classified as a finance lease regardless of its legal form. Should this stipulation not be met the lease will be classified as an operating lease.

5.2. All finance leases require recognition as assets or liabilities on the balance sheet at the lower of fair value or present value of minimum lease payments. Each should be determined at the inception of the lease. Operating leases shall be just recognised as income or expense over the lease term.

5.3. IFRS raises the issue of “embedded leases” where under certain circumstances contractual agreements around the use of specific assets and subsequent payments i.e. service contracts, may need to be classified as leases even if they don’t take the legal form of a lease. This presents issues around the identification of such transactions and will require a structured approach with the Council’s key partners.

5.4. Under IFRS the land and buildings element of a lease require separate identification for lease classification and subsequent valuation (historically these were valued as one lease). This subsequent valuation will need to be undertaken by a qualified valuer, and could lead to changes in accounting treatment for part or all of the value of the leased assets.

5.5. Central Government have recently issued statutory mitigation (March 2010) enabling local authorities to neutralise the impact of any changes to the classification of leases held on 31 March 2010, where the Council is the lessor. Local authorities are able to update their Minimum Revenue Provision (MRP) Policy to neutralise the impact of any changes to the classification of leases held on 31 March 2010, where the Council is the lessee. This will enable the Council to mitigate any switch between revenue and capital resources as a result of lease reclassification.

6. Fixed Assets

6.1. Property Plant & Equipment (PPE) (IAS16) is similar to the current SORP and UK GAAP on what constitutes PPE and the valuation methods used however there are potentially significant amendments to consider.

6.2. Fixed asset registers require review and any assets with impairments due to a general fall in prices under the SORP need to be reclassified as revaluation losses. This will ensure the brought forward amounts at transition date are correctly classified, allowing future accounting treatments to be applied correctly.

6.3. Additional criteria have been applied to assets classified as ‘available for sale’. The Council will therefore need to thoroughly review the classification of its fixed assets to ensure correct recognition in its accounts. Any disposals occurring in the 2009/10 financial year require to be accounted for under UK GAAP rules for the 2009/10 Statement of Accounts, however the transactions will need to be reversed out and accounted for under IFRS in order to provide comparative figures for the 2010/11 Statement.

6.4. The criteria relating to the recognition of investment properties (IAS40) is more clearly defined with more stringent rules. Any assets not meeting the criteria must be classified back to PPE.

6.5. Investment properties must be valued at fair value on an annual basis with any changes in value being taken directly to the Comprehensive Income and Expenditure account.

6.6. Significant work will be required in conjunction with Southwest One Property service in order to ascertain correct valuation and treatment of PPE.

6.7. A thorough review of the fixed asset accounting is required in order to align current methodologies with IFRS requirements. The classification of assets will need to be reviewed (e.g. ‘available for sale assets’ and ‘investments properties’) to ensure these are still applicable under the new standards.

6.8. Consideration of the values of assets held is required particularly around the classification of assets held at ‘fair value’. Additional valuations are required in order to obtain a split of land and buildings values for leasehold properties.

7. Employee Benefits

7.1. Under IAS19 Employee Benefits provision needs to be made for “short term accumulating compensated absences”. Under UK GAAP local government bodies have not recognised these accruals historically. Under IFRS the Council may need to recognise a liability in respect to the employee benefits to be paid in the future, and recognising an expense when the Council consumes the economic benefit arising from the employee’s services.

7.2. Paid holiday, flexi-time and time off in lieu all meet this definition. Subsequently an accrual is required to recognise the value of the services the Council has received (if the value is ‘material’).

7.3. Sufficient analysis is required in order for the Council to establish the levels of services received but yet to be compensated as at the balance sheet date of 31 March. Southwest One Finance has collected data across the workforce to enable an accurate accrual to be measured and to determine whether the figure is considered to be material as at 31 March 2009 and 31 March 2010. External Audit will be consulted to ensure that they are in agreement with the proposed accounting treatment.

7.4. It should be acknowledged that ordinarily the requirement to accrue for expenditure would result in a draw from the General Fund balance. However, DCLG have issued statutory mitigation so that any accrued expenditure is offset by a provision to neutralise the impact on the General Fund.

8. Component Accounting

8.1. IAS16 Component Accounting requires Local Authorities to account for the individual components of assets separately and apply their individual depreciation rates respectively.

8.2. Components are classified as separate asset types that could have different asset lives e.g. the roof of a building may have a useful economic life of 20 years as opposed to the building itself, which is typically assessed as 50 years.

8.3. Component accounting is not to be applied retrospectively (except for leased assets) therefore it is applicable to any additions from 1 April 2010 and any subsequent revaluations made throughout the normal 5-year rolling cycle. Assessment is required of the Council's assets in order to identify the individual components applicable to the standard. Accounting for significant components of fixed assets will need to be embedded in the financial accounting arrangements for new fixed assets created from 1 April 2010 onwards.

9. Group Accounts

9.1. Under UK GAAP the consolidation of associate companies under the equity method was based on the driving principle of the ability to have 'significant influence' on the decision making process. Under IFRS this has been amended to 'power to participate in the financial and operating decisions'.

9.2. Additional work and clarification around the standard are required in order to ascertain the impact.

10. Other Areas

10.1. There are numerous other issues that will impact on the reporting and production of Council's financial statements that are currently considered to have a lower impact in terms of resource and materiality.

10.2. Segmental reporting is one such example where the notes to the accounts should reflect the organisational structure and internal management reporting methods. The aim is to allow the user of the financial statements to see how various parts of council perform financially and is seen 'through the eyes of management'.

11. Finance Comments

11.1. The financial implications for the transition to IFRS are included throughout this report.

11.2. There is currently no budget to support any additional costs that could arise from this transition, and there is no specific additional external funding from central government. Southwest One will advise the S151 Officer of any resource implications of this transition.

12. Legal Comments

12.1. The Council's financial accounts are produced in line with relevant statute and accounting regulations. As referred within the report, the government has recently issued statutory instruments that directly relate to the impact of IFRS on local authority accounts.

13. Links to Corporate Aims

13.1. Accounting for the Council's financial performance and position, updated through the implementation of IFRS as required, forms a key element of the Council's corporate governance arrangements.

14. Environmental and Community Safety Implications

14.1. Not relevant for the purposes of this report.

15. Equalities Impact

15.1. There are no equalities issues associated with this report.

16. Risk Management

16.1. Successful implementation is important in terms of compliance with statutory accounting requirements. Unsuccessful implementation could lead to the Statement of Accounts to be prepared late or with material errors with the potential for qualification by the External Auditor.

17. Partnership Implications

17.1. There is a significant partnership impact in relation to additional burden placed on Southwest One services, significantly in Finance and Property. Impact upon resources will be monitored, but Members are advised delivering the implementation and ongoing statutory financial reporting requirements under IFRS will have a significant impact on staff time.

17.2. The Council also needs to ensure that information is available from key partners in order to produce the financial statements, including Group Accounts, under IFRS.

18. Recommendations

18.1. Members are recommended to note the impact of IFRS on the Council's financial reporting requirements, and the implementation progress to date.

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