AGENDA

ITEM 10

Report to: Audit Committee

Date of meeting: 13th January 2010

Report of: Interim Head of Finance

Title: Implementation of International Financial Reporting Standards

1.0 SUMMARY

1.1 This report outlines the changes in financial reporting following the introduction of International Financial Reporting Standards (IFRS) to local government. It highlights for Members :

- What IFRS is
- Why we are doing it
- What has been done to date by officers
- What are the substantive changes
- What effect it will have on the authority

2.0 RECOMMENDATIONS

2.1 That the Committee notes the report and periodically monitors the progress of the implementation of IFRS in the Council by way of future reports to Committee

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3.0 Background

3.1 What Is IFRS ?

IFRSs are International Financial Reporting Standards, these accounting standards are issued by the International Accounting Standards Board (IASB).

They are the international equivalent to UK GAAP, the set of Generally Accepted Accounting Principles.

Accounting standards had been produced in the UK under the control of the Financial Reporting Council, but the globalisation of Financial accounting and the acceptance of the need to harmonise accounting practice internationally led to the development of a working relationship between the international accounting standards setting body and national bodies, which have ultimately led to implementation of international standards across the globe.

The IFRS standards have a slightly different impact on accounting requirements in the UK and the Government in collaboration with the accounting bodies have prepared an implementation programme which all public sector bodies will follow. Private sector organisation are already operating under the IFRS rules.

Accounting standards (IFRS) govern the policies, principles and presentation of Statement of Accounts drawn up at the year end. The object is to ensure that the accounts show a true and fair view of the financial affairs of the organisation and that comparisons can be drawn from a standardised approach to the published information.

3.2 Do We Have to Adopt IFRS ?

The Chancellor’s 2008 Budget announced that the annual financial statements of government departments and other entities in the public sector will be prepared using International Financial Reporting Standards (IFRS).

The stated aims and objectives of implementing IFRS are to :

- To develop a single set of understandable enforceable accounting rules, which will be employed across the whole of government accounting
- To promote the use of and rigorous application of international accounting standards
- To bring convergence of national accounting standards and IFRS

solutions.

Not to adopt IFRS would probably result in an immediate qualification of the Councils annual Statement of Accounts and the resultant adverse publicity which would follow.

3.3 In addition the implementation of IFRS will undoubtedly form a key element of the Financial Reporting criteria within the Councils Comprehensive Area Assessment both for the current and coming years

When do we have to adopt IFRS?

The standards have been adapted, as necessary, for the public sector and are being used from 2009/10 by Central Government and the NHS, and from 2010/11 by Local Government.

For the Council, this means that annual accounts will need to be prepared using IFRS, for the year ending 31 March 2011, but we will be expected to produce them on the new basis for Whole of Government Accounts in 2009/10.

In addition, comparative financial information for 2009/10 will need to be restated along with opening balances at 1 April 2009, and so the transitional countdown to IFRS has already started.

Important Milestones that have already been identified on the project plan in Appendix A include :

- Prepare response to CIPFA consultation paper
- Set up project team
- 3.4 Report Impact Assessment to Audit Committee
- Report Project Plan to Audit Committee
- Ensure the HR information is available by Feb 2010
- Prepare restated 1 April 2009 balance sheet by Feb 2010

What Have Officers Done To Date?

A considerable amount of work has already been undertaken by officers in ensuring that the Council is IFRS compliant by the agreed date. This work includes :

- **Formed a project group** – The group meets monthly, is chaired by the Interim Head of Finance and its members include officers from Property, Accountancy, and Human Resources. The project is being undertaken in a shared service environment using resources from both Three Rivers District Council and Watford Borough Council to twin track the implementation for both Councils. Although each Council has produced their own project plans, a great deal of synergy has been possible and joint working has resulted in efficiency savings in time, effort and cost in the sharing of resources and information.

- **Undertaken an initial impact assessment** – considered impact on systems, staff and finances, and considered and scoped the work required to implement the IFRS requirements.
- **Formulated a project plan**, which sets out a time scale allocates responsibility for tasks set ,milestones and schedules activity up to and beyond the implementation of the new IFRS accounting statements. This plan is attached as Appendix A. At the time of the report all project milestones have been achieved
- **Discussed progress** on the implementation of IFRS with the Councils Internal and External Auditors
- **Identified the substantive changes** and the work related to those changes

3.5

What are the Major Substantive Changes ?

The implementation of IFRS will vary in different authorities. In some authorities with large property portfolios and numerous and various leases, with schemes undertaken under the Private Finance Initiative (PFI) the work would be considerable, with £100k set aside to provide resources to undertake the work. The work in Watford Borough Council and Three Rivers District Council is not small but it is considered manageable using existing staff. Whilst work is still ongoing the initial impact assessment carried out for both Councils has revealed the following substantive areas of work to be done.

- Reconsidering the classification of investment assets – IFRS requires Investment property to be held solely for capital appreciation or income generation. If there is any partial service reason for retaining the asset it must be considered operational and would require to be depreciated. The added difficulty is that the restated IFRS balance sheet would have to be amended retrospectively for different accounting treatment required.

- Identifying the property leases of the Council and establishing the category of the lease, into either finance or operational lease. The current work has identified approximately 150 asset which are held on lease for 15 years or less, and these due to the length are all operational leases. 35 leases of 16 years to 50 years have been evaluated against a criteria to assess and establish the party which has the risks and rewards of ownership. With regard to the longer leases in excess of 50 years 90 leases have been considered most of which are for ground leases

- Identifying leases on Vehicles Plant and equipment and establishing the category of the lease, into either finance or operational lease –

approximately 50 leases have been assessed

- Collecting data related to employee benefits that have been earned but not taken, and therefore need to be accounted for as accruals. IFRS requires costs to be recorded in the contractual year, and this means that if leave is carried forward the cost of leave needs to be taken out of the year it will be taken and passed back as a cost into the year it relates to. Data needs to be collected of untaken leave in respect of carry forward leave, sick leave, and maternity leave, also banked leave at TRDC

- Considering the requirements for component accounting which is required where an asset has different elements and those elements have different lives a more accurate assessment of depreciation is needed. For example the Central baths may have a number of elements land which is not depreciated, the main building which may have a life of say 60 years, and the filtration and other equipment which might have a significantly shorter life.
- New Final Accounting statements including the restatement of
3.6 previous statements into an IFRS format – The current Financial accounting statements will need to have format amendments, the
3.6.1 balance sheet presentation will be slightly different, a comprehensive Income and Expenditure account will include the Statement of Total Gains and Losses,
and changes also apply the movement on reserves and the cash flow

What Effect Will it Have On the Authority ?

Freehold Property and Leased property

The impact on the Council of the changes required under IFRS will not all be visible. They will include a need to consider in greater detail the lease
3.6.2 arrangements of assets held by the council, and will force a reconsideration of the council's approach to aspects of assets management including the elements or components of assets held. – For example the asset might still
3.6.3 appear in the accounting statement at the same value, but a great deal of work might have been undertaken to break the components of an asset down to enable better assessment of both depreciation and the repairing needs of the asset.

Property Services have a great deal of additional work to do and have required some extra help from temporary staffing support

Staff

3.6.4 Staff need to be aware of the requirements of IFRS generally and how it may affect their work. For example the accounting for employee benefits rules will require much better reporting of different types of leave to be completed, and this may lead to deeper consideration of policy towards leave carry over etc.

3.6.5 Accounting staff will need to advise and keep service managers informed of how IFRS will affect the services. Training has been provided to key staff and this has enabled a better understanding of the issues by some members of staff. More training will be required as the project progresses and publicity to the issues need to be generated to better inform staff and members

Systems

3.6.6 The New Financial Management system is being implemented with effect from 1st April 2010. Officers are working with the suppliers to ensure that the new system is IFRS compliant. In addition the new payroll system has a module which will assist in compiling information on staff leave arrangements.

Financial Reporting

Many of the accounting changes will **materialise** in different Final Accounting statements. The extra effort required to achieve this is currently being achieved from within existing resources.

Financial Impact on Councils General Fund

The Impact on the General fund is not completely resolved, but new capital finance regulations have been produced by the government which are intended to prevent the new rules affecting the costs to be borne by the Council taxpayer, This means the following:

- Any accrual for employment benefits not taken and needing to be charged to services, will be mitigated after the cost of service to remove the impact for the taxpayer

- Any loss of income to revenue as a result of property lease income being apportioned to capital receipts will be mitigated after the cost of service to remove the impact for the taxpayer. This will apply to existing leases as at November 2009. Any new leases will have an impact on the income generated if the leases are drafted in a way
3.7 that categorises it as a finance lease.
- Any reduction in revenue cost due to the operating lease costs being
3.7.1 re categorised as finance leases will require a statutory Minimum Revenuen Provision.

The impact on the Council for past transactions that did not comply with the IFRS rules will therefore be mitigated and only new lease transactions might affect the councils financial position. Property officers will need to
3.7.2 ensure that future leases are drawn up to ensure classification as operational leases and hence avoid any financial impact on the councils revenue account

How important is it the Authority is prepared for IFRS?

The Council performance on IFRS implementation will be viewed as part of the use of resources score under the Comprehensive Assessment framework. It could therefore assist the Council in achieving a good score if the Council can show that it is prepared and on track for a smooth implementation. Conversely being ill-prepared for IFRS may have an adverse effect on the councils overall score.

This report is the first report of a regular quarterly reporting process that has been programmed in the IFRS Project Plan. The work is underway and good progress has been made. This was confirmed in a meeting in November with the External Auditor who commented that it appeared that Watford was making good progress.

3.7.3 **Will the Council need to budget for implementation costs?**

The current work has been funded from within existing budgets, and this does include where extra external staff have been used in Property services. It is difficult to identify the amount of resources that may be required because the full impact of the implementation of IFRS is not absolutely clear, however, the Head of Strategic Finance has made a provision of £20,000 in 2009-10. This is to cover any possible unforeseen costs that may prevent the smooth implementation of IFRS.

4.0 Conclusions

International Financial Reporting Standards (IFRS) will become a statutory accounting requirement from 2009-10, and will require the restatement of the balance sheet as at 1 April 2009, and the restatement of 2009-10 Final accounts into the IFRS format. The implementation is part of an international objective to standardise financial statements and improve comparability

The implementation of IFRS has involved Officers in significant additional work, and a project team has been established producing a detailed project plan which has been presented to the External Auditor and progress on the substantive changes has been viewed to be good which will assist in contributing towards the Comprehensive Area Assessment score.

The effect on the authority will be significant and much of it will not be visible. However, the impact on the Council's general fund will be mitigated for past transactions and will only impact on ongoing leases.

Existing resources has been able to support the work to date .

The Council therefore is in a good position at this point in time and progress has been good, plans have been made and implementation is on track with the current Project Plan.

5.0 **IMPLICATIONS**

5.1 **Financial Issues**

The implementation is currently achieved by the use of existing resources.

5.2 **Legal Issues** (Monitoring Officer)

The legal implications are contained within the body of the report

5.3 **Potential Risks**

Potential Risk	Likelihood	Impact	Overall score
Failure to accurately identify changes to be made to accounts	2	3	6
Failure to meet timetable	2	3	6
Insufficient resources to implement	1	3	3
Financial Impact on Council	1	3	3
Those risks scoring 9 or above are considered significant and will need specific attention in project management. They will also be added to the service's Risk Register.			

8.4 **Staffing**

8.4.1 None Directly

8.5 **Accommodation**

8.5.1 None Directly

8.6 **Community Safety**

8.6.1 None Directly

8.7 **Sustainability**

8.7.1 None Directly

<u>Background Papers</u>

IFRS Working paper files

<u>File Reference</u>

None