AUDIT COMMITTEE	AGENDA ITEM No. 5
25 MARCH 2019	PUBLIC REPORT

Report of:	Peter Carpenter - Acting Corporate Director: Resources	
Cabinet Member(s) responsible:	Cllr Seaton - Resources	
Contact Officer(s):	Peter Carpenter - Acting Corporate Director: Resources Kirsty Nutton - Head of Corporate Finance	Tel. 384564 Tel. 384590

NEW ACCOUNTING STANDARDS

R E C O M M E N D A T I O N S	
FROM: Peter Carpenter - Acting Corporate Director Resources	**Deadline date:** N/A

It is recommended that Audit Committee:

1. Note the impact on the Council's 2018/19 Statement of Accounts and accounting policies for the introduction of new accounting standards on income recognition and financial instruments.

2. Note the estimated impact on the Council's 2020/21 Statement of Accounts for the introduction of a new accounting standard on leases and the progress made on implementation to date.

1. ORIGIN OF REPORT

1.1 This report is submitted to Audit Committee following a referral from the S151 Finance Officer.

2. PURPOSE AND REASON FOR REPORT

2.1 The purpose of this report is to enable Audit Committee to understand the new accounting standards, the current, and any potential future, impact on the Council from their adoption of the 2018/19 CIPFA Code of Practice on Local Authority Accounting (the Code).

2.2 This report is for Audit Committee to consider under its Terms of Reference No:

2.2.1.17 To review the annual statement of accounts, specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the council.

3. TIMESCALES

Is this a Major Policy Item/Statutory Plan?	**NO**	If yes, date for Cabinet meeting	n/a

4. BACKGROUND AND KEY ISSUES

International Financial Reporting Standard (IFRS) 9 - Financial Instruments

4.1 IFRS 9 introduces fundamental changes to the classification of financial assets and determines how financial assets and financial liabilities are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.

4.2 IFRS 9 introduces an approach for the classification of financial assets, which is driven by cash flow characteristics and the business model in which an asset is held. Financial assets will be classified and measured into three classes, each of which has its own particular treatment in the Balance Sheet and Comprehensive Income and Expenditure Statement:

- Financial assets measured at amortised cost – where a financial asset meets the criterion that their contractual cash flows are 'solely payments of principal and interest'
- Financial assets measured at 'fair value through other comprehensive income' (FVOCI) – where a financial asset meets the criterion of solely payments of principal and interest for their contractual cash flows Under this option gains or losses will not impact on the Surplus or Deficit on the Provision of Services as they will be reversed out in to a general reserve..
- Financial assets measured at fair value through profit or loss (FVPL) – all other financial assets are measured at fair value through profit and loss. Under this option gains or losses will impact on the Surplus or Deficit on the Provision of Services.

4.3 The impact to the Council's accounts of the new IFRS classifications is considered to be minimal as the Council's financial instruments are mainly normal activity for Local Authorities operations for cash flow activity and are classified at amortised cost. The Council has loans to third parties but these are secured by assets. The final assessment of the Council's financial instruments is under review and will be brought back to the Committee if required.

4.4 Although the Council does not have any equity pooled investments it is worth noting that the Ministry of Housing, Communities and Local Government acknowledged that one of the consequences of making Councils account for equity pooled investments under IFRS 9, at fair value through profit and loss (FVOCI), could mean that there is less money available to fund services due to the fact "fair value losses will need to be recognised as expenditure". The government recognises that many local authorities have built up holdings in pooled investment funds over a number of years, primarily for treasury management purposes rather than with the intention of making a profit. As a result it has introduced a statutory override of five years which will give local authorities time to either divest themselves of financial instruments that they no longer wanted to bear the risks of holding in an orderly way, or to build up revenue reserves to mitigate the impact of fair value movements on instruments they wanted to continue to hold.

IFRS 15 - Revenues from Contracts with Customers

4.5 IFRS15 - Revenue from Contract with Customers was adopted into the 2018/19 Code. It introduces a new five step model for revenue recognition which aims to standardise the approach and provide greater consistency and clarity in response to high profile issues eg Tesco overstating its profits.

4.6 Entities need to assess all their contracts with customers against the new standard which can entail a lot of work for complex long term contracts. Applying IFRS 15 can impact on the timing of income recognition and consequently profits. There are also additional disclosures required to explain to users the key assumptions underpinning the income recognised and highlighting any material uncertainties and balances on long term contracts.

4.7 IFRS15 has been designed with private sector companies pursuing profits in mind. IFRS15 only applies to income received under contracts with customers (which includes implied contracts). Much of the Council's income is out of scope of the new standard eg Grants, Property Taxes, Fines and Fees and Charges under Statute where the customer does not receive economic benefit of equivalent value in exchange for the charge. The Council's income from customers with contracts which is in scope is generally of straight forward nature so the impact of applying IFRS15 is minimal.

4.8 The Council undertook an assessment of its income against IFRS15 as part of the work to support the Accounting Standards Issued but not Adopted disclosure in the 2017/18 accounts and EY reviewed this as part of the 2017/18 Statement of Accounts audit with no issues in the Council's assessment being raised.

IFRS 16 - Leases

4.9 IFRS 16 replaces IAS 17 Leases and will apply to the 2019/20 financial statements. These changes will primarily affect the leases that the Council have where it is the Lessee -leasing the asset in to the Council. The new leasing standard will lead to a substantial change in the accounting practice for lessees where the current distinction between operating and finance leases will be removed. It requires that a lessee recognises assets and liabilities for all leases with a term of more than 12 months unless the underlying value if of a low value. A lessee will recognise a right- of-use asset representing its right to use the underlying leased property, and a lease liability representing the lessee's obligation to make lease payments for the assets.

4.10 Although the implementation of this new IFRS has been delayed from 2018/19 accounts to the 2019/20 accounts the Council has been proactive by attending workshops by both CIPFA and EY (the Council's external auditors). These workshops have provided the Council the relevant knowledge and skills to be able to implement this new standard by 1 January 2020 and ensure that it is incorporated into the 2019/20 accounts and the Medium Term Financial Strategy for 2020/21.

4.11 The summary of the IFRS impact to the Council is:

- a review of the Council's leases will be undertaken and classified according to the new IFRS
- the initial recognition of the right-of-use asset will meet the definition of capital expenditure and will therefore be included in the Capital Programme
- the capital expenditure will impact the Capital Financing Requirement and the Minimum Revenue Provision
- the Council's MRP policy will need to include the treatment of finance leases to lease where the right-to-use asset is recognised on the Council's Balance Sheet

4.12 The Council will prepare working papers to support the assessment of the Councils leases and the required accounting of IFRS 16 which will then be discussed with the EY later this year.

5. CONSULTATION

5.1 The impact of the new accounting standards has been discussed with the Council's External Auditors, Ersnt & Young (EY) as part of their work on the audit of the 2017/18 Statement of Accounts and 2018/19 Statement of Accounts and is included within their audit plan which has been considered at 19 November 2018 and 11 February 2019 Audit Committees.

6. ANTICIPATED OUTCOMES OR IMPACT

6.1 To note the impact of the new standards and progress made towards implementation and comment on any issues the Committee considers relevant.

7. REASON FOR THE RECOMMENDATION

7.1 To give Audit Committee information on the changes to 2018/19 and 2020/21 Statement of Accounts in advance of being asked to sign off the accounts for those years enabling greater time for consideration.

8. ALTERNATIVE OPTIONS CONSIDERED

8.1 The Council is required to prepare the Statement of Accounts in accordance with the relevant CIPFA Code of Practice on Local Authority Accounting (The Code) for that financial year. The Code has been updated to incorporate these IFRS's. Therefore the Council has limited alternatives available for the accounts to be prepared tothe regulatory deadline and specification.

9. IMPLICATIONS

Financial Implications

9.1 The financial implications of the adoption of the new accounting standards are set out in the main body of the report. The work required to implement the changes are planned to be carried out by the existing finance team, therefore no additional costs are forecast. EY have not asked for any additional audit fee specifically related to this work to date.

Legal Implications

9.2 The legal framework for the production of the Council's Statement of Accounts is governed by regulation 21(2) of the Local Government Act 2003, which requires all Local Authorities in the United Kingdom to keep their accounts in accordance with 'proper (accounting) practices'. This is defined, for the purposes of local government legislation, as meaning compliance with the terms of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

Equalities Implications

9.3 None.

10. BACKGROUND DOCUMENTS

Used to prepare this report, in accordance with the Local Government (Access to Information) Act 1985

10.1 2018/19 CIPFA Code of Practice on Local Authority Accounting
IFRS 9 - Financial Instruments
IFRS 15 - Revenue from Contracts with Customers
IFRS 16 - Leases
CIPFA Consultations / Statements on adoption of IFRS16 into Code.