

AUDIT COMMITTEE	AGENDA ITEM No. 6
6 SEPTEMBER 2010	PUBLIC REPORT

Cabinet Member(s) responsible:	Portfolio Holder for Resources, Cllr Seaton		
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INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS): UPDATE / IMPLICATIONS

R E C O M M E N D A T I O N S	
FROM : John Harrison, Executive Director of Strategic Resources	Deadline date : N/A
<p>Audit Committee is asked to</p> <ol style="list-style-type: none"> 1. To note the accounting changes required. 2. To review the progress made so far in this transition. 3. To support the transition to IFRS based accounts. 	

1. ORIGIN OF REPORT

- 1.1. This report follows on from consideration of the report brought to this Committee on 2nd February 2009, the overview training provided on the 2nd November 2009 and provides an update on the progress being made by the Council in its International Financial Reporting Standards (IFRS) transition.
- 1.2. The Chancellor's 2008 Budget announced that the Annual Financial Statement of the Government Departments and other entities within the Public Sector will be prepared using IFRS.
- 1.3. The move to IFRS is extremely complex and will have wide reaching implications that are not limited to the Council's finance function alone but throughout the Council's business activities.
- 1.4. In accordance with the report to the Audit Committee on 2nd February 2009, recommendation 5, it was agreed to report back to the Committee periodically on the progress of IFRS implementation.

2. PURPOSE AND REASON FOR REPORT

- 2.1. The purpose of this report is to brief the Committee on the IFRS transition, significant changes this is likely to bring to the Council's accounts, and the resource demand of this transitional task.
- 2.2. This report is for the Committee to consider under its Terms of Reference 2.8.1.5 (which forms part of the delegations for regulatory committee functions under Part 3, Section 2)

3. TIMESCALE

Is this a Major Policy Item / Statutory Plan?	NO	If Yes, date for relevant Cabinet Meeting	N/A
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4. INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

BACKGROUND

- 4.1. Since the last update on this topic in November 2009 the Council has progressed with the work required for the production of the Statement of Accounts in 2010/11 on an IFRS basis. It should be noted that during this period the 2009/10 Statement of Accounts has also been produced, which has meant resources have been managed between these two tasks.

HIGH LEVEL TIMETABLE

- 4.2. The high level timetable the Council is following is below and was reported to the Audit Committee on 2nd November 2009. It can be confirmed that the critical deadlines for the Restated 2009/10 accounts at the end of Quarter 1 2011 are on track for completion and this progress is outlined in the following paragraphs.

IFRS Action Plan	2009				2010				2011	
	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2
Project Management Team	◆	◆	◆	◆	◆	◆	◆	◆	◆	◆
Involvement of those charged with governance	◆			◆		◆		◆		◆
Liaise with auditors about IFRS transition	◆	◆	◆	◆	◆	◆	◆	◆	◆	◆
Address employee benefit issues	◆	◆	◆	◆	◆	◆				
Review fixed asset accounting	◆			◆	◆	◆				
Address issues with segmental reporting, leases and contracts	◆	◆	◆	◆	◆	◆				
Draft IFRS pro forma accounts								◆		
Restate 2009/10 accounts								◆	◆	
Audit of restated 2009/10									◆	◆
Embed accounting on an IFRS basis (2010/11)								◆	◆	◆

- 4.3. The major milestone approaching is the restatement of the 2009/10 accounts on an IFRS basis as they were required to be produced in 2009/10 under UK GAAP. This is scheduled to be completed by the end of December 2010. PwC will then audit the restated accounts by 31st March 2010.

- 4.4. The major areas of work currently being undertaken by the Council are:

- Transition accounting for the Council's fixed assets
- Implementation of a new asset management system
- Accounting for the infrastructure assets of the Council
- Review and re-working the accounting transactions for all leasing arrangements
- Accounting for capital grants
- Calculating and accounting for holiday and flexi leave
- Segmental reporting
- Continuing development of officers knowledge

These areas are considered in further detail in the remainder of this report.

FIXED ASSET ACCOUNTING

- 4.5. The current valuation policies of the Council's fixed assets have been reviewed and meetings have taken place between finance and property officers to discuss the requirements of the new IFRS Code.
- 4.6. Instructions have been given to the Council's appointed valuers and a report is expected from them at the end of November 2010, providing updated valuations of the Council's properties using the new basis of assessment. These changes encompass the re-definition of investment assets, the new requirements regarding donated assets and the new requirement of component accounting. Component accounting is where assets are split into their major constituent parts and depreciated according to their individual life, for example where Town Hall would have been classed as one asset, under component accounting the it will now be split between the shell, its roof, and the windows, and each part depreciated according to its relevant life.
- 4.7. Once the report has been received the asset values will be restated in the Council's Balance Sheet in accordance with the IFRS code by the end of December.

NEW ASSET MANAGEMENT SYSTEM

- 4.8. A new asset management system which integrates all of the Council's property information into a single data source has been purchased from Technology Forge.
- 4.9. The asset management system will be the Council's fixed asset register and will replace the spreadsheet system currently in use. This had become necessary due to the complexity of the accounting requirements under the IFRS code and is in line with PwC Audit Recommendations made in the 2008/09 Governance Statement as reported to the Audit Committee previously.
- 4.10. The Property Department are currently entering the base asset information into the new system. In September the Corporate Accounting Capital Team are to undertake comprehensive training from the software provider to establish the financial information held on the database.

INFRASTRUCTURE ASSETS

- 4.11. For the time being the IFRS code will require local authorities to report infrastructure assets (highways, footways, cycle-ways, structures and lighting) on a historical cost basis, which is the cost of purchase or construction less depreciation charged to date. However, HM Treasury has set a timetable for a gradual transition to reporting on a Direct Replacement Cost basis starting with the Whole Government Accounts return in 2011/12.
- 4.12. The intention is for each local authority to develop a single set of financial management information about transport related assets that is robust and supports future infrastructure investment decisions that are taken both nationally and locally.
- 4.13. Council Officers from the Corporate Accounting Teams and the Operations Planning Transport and Engineering Team have set up a working group to ensure the necessary work is being undertaken to comply with the new requirements, starting with the Whole Government Accounts return in 2011/12 and building to the withdrawal of historic cost-based reporting from 2012/13.

LEASING ARRANGEMENTS

- 4.14. All leasing arrangements, both property and plant and equipment, have been or are in the process of being reviewed as to whether they are deemed operating or finance leases under IFRS, as the classification of lease may switch from that used under UKGAAP.
- 4.15. A summary of the impact of this switch between operating and finance lease is shown in the table below. This review is due to be completed by the end of October.

	Operating Lease	Finance Lease
Impact on Income and Expenditure Account		
Income	received in Service	capital receipt
Expenditure	charged to Service	attracts capital charges, interest, MRP*, depreciation and impairment
Impact on Balance Sheet		
Asset	no impact	appears as a Council asset thus affects the Capital Financing Requirement
Liability	no impact	appears as an liability for future payment

* MRP – Minimum Revenue Provision

- 4.16. All property leases, where the Council is lessee and/or lessor have been referred to the Council's appointed valuers for review. The review will determine whether the leases will remain as operating leases or will become finance leases under the new IFRS code. The report is expected back by the end of November. The indications from a preliminary review undertaken earlier this year are that the majority of the property leases will remain as operating leases and so will not require to be accounted for differently.
- 4.17. The existing vehicle and equipment leasing arrangements have been reviewed, including the contract hire vehicles held by City Services. The outcome of this review is that the majority of the leases will change from existing operating lease status to become finance leases. The effect of this reclassification will mean that the vehicles will appear on the Council's Balance Sheet as an asset along with the corresponding liability for the commitment made under the lease agreement.
- 4.18. The new IFRS code requires the consideration of arrangements the Council has with third parties that do not take the legal form of a lease but conveys the right to use an asset. The arrangements that the Council have with Danwood for the Print and Design contract and the Multifunctional Devices are currently under consideration, as is the arrangement with the IT provider Serco. Although the contracts themselves will not change, the way in which the Council accounts for the different parts of the contract may. This review is to be completed by the end of September 2010.

CAPITAL GRANTS

- 4.19. The way in which grants and contributions for capital purposes are recognised in the accounts of the Council is to change. Under IFRS the grants are recognised in the Income and Expenditure Account once any condition of the grant has been satisfied. The SORP treated the grant as deferred income and then recognised this income in the Income and Expenditure Account over the life of the asset for which the grant or contribution was received.
- 4.20. All capital grants are being reviewed and this work is due to be completed by the end of September 2010.

HOLIDAY AND FLEXI LEAVE PAY

- 4.21. The new IFRS code requires local government bodies to accrue for the costs of staff holiday entitlements and flexi leave that has not been taken in the year and is carried forward to the next financial year.
- 4.22. As part of the 2009/10 accounts closure, this data was captured and the following table shows this calculation.

Directorate	Flexi-time / TOIL* £000	Holidays Carry Forward £000	Total £000
Chief Executive/ACE	17	27	44
Children's Services**	33	84	117
City Services	4	65	69
Operations	38	36	74
Strategic Resources	11	48	59
Schools		6,443	6,443
Total	103	6,703	6,806

* TOIL - Time Off In Lieu

** Children's Services figure excludes schools related data which is show separately

The schools figure is based on a calculation provided by CIPFA which accounts for the way that teachers earn holiday on a term by term basis (school year) rather than on an annual basis (financial year).

Number of Employees FTE	3,257
Working Year Days	261
Average Annual Salary	£24,587
Number of Days to Accrue	21
Value of Accrual	£6,443,207

SEGMENTAL REPORTING

- 4.23. IFRS 8 requires the reporting of income and expenditure and assets to be reported in the segments that are reported to the 'Chief Operating Decision Maker'.
- 4.24. The overall aim is to enable the reader of the accounts to see the 'business' through the eyes of management. Appendix 1 provides an illustration as to what this may look like.
- 4.25. The 2009/10 accounts are currently being reviewed for the change in the way this is to be reported and the work is scheduled to be completed by October 2010.

SKILLS AND KNOWLEDGE OF OFFICERS

- 4.26. Members of the Corporate Accounting teams have been, and have arranged to go on a number of IFRS focused training sessions. These have primarily been provided by PwC, the Audit Commission or CIPFA through their associated training arm or through their Financial Advisory Network (CIPFA FAN) to which the Council subscribes.
- 4.27. These sessions have provided useful hints and tips and the CIPFA FAN sessions facilitate the sharing of ideas and knowledge between similar authorities.
- 4.28. Members of the team who have attended such sessions then disseminate this knowledge to the wider finance community and inform suggested approaches with pieces of work eg the holiday pay accrual trial run.

5. CONSULTATION

- 5.1. No consultations are being considered for this item as this is a statutory change.

6. ANTICIPATED OUTCOMES

- 6.1. As set out in the report.

7. REASONS FOR RECOMMENDATIONS

- 7.1. This report and update is given to the Committee to advise of the progress of the transition to IFRS highlighting the work completed to date, and ensure involvement of the Committee in this process.

8. ALTERNATIVE OPTIONS CONSIDERED

- 8.1. The Statement of Accounts will be required to be prepared in accordance with the IFRS by 2010/11, and this report sets out the progress made to date to ensure the satisfactory production of these Accounts. The options are therefore limited in order for the accounts to be prepared to the regulatory deadline and specification.

9. IMPLICATIONS

- 9.1. The implications arising from this report are to consider the changes required in the transition to IFRS based accounts.
- 9.2. To provide the Committee the opportunity to consider the role and requirements of the Council to meet the transition to IFRS based accounts.

10. BACKGROUND DOCUMENTS

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

The IFRS-Based Code of Practice on Local Authority Accounting in the United Kingdom 2010/11

Peterborough City Council, IFRS Conversion – Phase 1 Preliminary Study, August 2009.

FAN Briefing on the Code of Practice – Transport Infrastructure Assets.