THIS PAPER RELATES TO ITEM 10 OF THE AGENDA

CLACKMANNANSHIRE COUNCIL

Report to: **Scrutiny Committee**

Date: **21st January 2010**

Subject: **International Financial Reporting Standards (IFRS)**

Report By: **Finance Manager**

1.0 PURPOSE

1.1. This paper outlines the background to the introduction of International Financial Reporting Standards (IFRS) within local government, and demonstrates the work required for this Council to achieve full compliance for financial year 2010/11.

1.2. The Council has engaged CIPFA and PricewaterhouseCoopers(PwC) to provide technical advice and support throughout the whole IFRS Transition Process. The overall objective of this engagement is to ensure a smooth IFRS transition process delivered accurately, consistently and with minimum disruption. The timetable for transition is attached in Appendix 1.

1.3. PwC have undertaken a desktop review of our existing accounting records and have prepared a draft impact assessment report which outlines the key issues that need to be addressed to achieve full convergence together with a detailed action plan.

1.4. It is important that those involved with governance are fully briefed on the impact on the financial statements throughout this transition.

2.0 RECOMMENDATIONS

2.1. The Committee is asked to note the report and progress on implementing IFRS to date.

3.0 CONSIDERATIONS

3.1 Background and Timeline

3.1.1 The requirement for government bodies to adopt International Financial Reporting Standards was first announced by the Chancellor in the 2007 Budget, with the intention of bringing benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice.

3.1.2 The implementation of IFRS was subsequently delayed by one year for Central Government and the NHS. As far as the local authority sector is concerned this convergence is to be fully achieved in the 2010/11 financial year.

3.1.3 This new reporting regime will bring significant challenges for Local Government organisations, requiring revisions to accounting policies, changes in the format of financial statements and systems and a significant number of additional disclosures in the Annual Accounts.

3.1.4 This will mean fundamental changes – changes that can impact across the organisation. Planning for conversion, undertaking the necessary research, making the required changes and integrating them fully will take considerable time. The attached IFRS action plan summary outlines the process from now until full adoption of changes by June 2011.

3.1.5 As IFRS-compliant comparative data will be required in respect of the 2009/10 financial figures, all Authorities will need an opening Balance Sheet as at 1 April 2009. This underlines the importance of the early start made to the IFRS project, and subsequently maintaining this momentum. The first key target date is to have this restated opening balance sheet completed by the end of February 2010. It is also important that senior management are on board with the transition project as it should not be seen purely as a 'finance' exercise. The information requirements for IFRS compliant accounts and financial reporting span the whole of the organisation.

3.1.6 The five largest pieces of work that the Council will need to undertake in order to prepare IFRS-compliant financial statements are outlined below. PwC have considered those areas that are likely to have the most significant implications for the Council in terms of the potential impact on the reported financial position and/or the amount of staff time required to generate IFRS-based financial statements and working papers. The detailed impact assessment report prepared by PwC based on our existing accounting records covers 39 action areas which are classified as follows:

Significant numerical impact expected and/or time required	14
Some impact expected	5
Minimal impact expected	12
Not considered applicable	8

3.2 1. First time adoption and Accounting Policies

3.2.1 The first time adoption of IFRS will involve significant investment of management time, and is wider than just a finance issue. Effective implementation of IFRS will involve Council-wide engagement and as such the Accounting and Budgeting Manager is leading a team of cross service representative to progress the issues outlined in the Impact Assessment report.

3.2.2 There will be an impact on the format and content of the financial statements. Though in some cases the main components of the financial statements are broadly the same, there are changes to the categories used in the financial statements and significant additional disclosures.

3.2.3 The Council will be required to review its current processes and procedures for the management accounts and the financial statements production process, as well as the system currently in place to ensure that there is the resource, capability and capacity to bring these in line with the requirements of IFRS.

3.3 2. Leases

3.3.1 Under IFRS the Council will be required to account separately for leases of land and buildings (previously these have been treated as one lease) with land normally treated as an operating lease. With assistance from officers within both Estates and Legal services, the Council has started to review all its property leases in order to identify those that relate to both land and buildings. Where possible, the Council will then need to attribute values to the land and buildings components within each property lease in order to account for each element separately. Consultation with a qualified valuer may be required to facilitate this.

3.3.2 The definitions of finance and operational leases are much stricter under IFRS. Once all the leases are reviewed it is possible that there could be some re-classifications between operational and finance leases. The impact on the Council of any such changes would be the movement of income and expenditure from revenue to capital (or vice versa) depending on whether the lease is a finance one (capital) or operational (revenue). IFRS therefore, requires more judgement in the classification of leases.

3.3.3 IFRS also deals with instances where there are undocumented lease arrangements or legal arrangements which do not explicitly state that they are a lease, but which in substance have the characteristics of a lease. Such arrangements will need to be assessed in accordance with the leasing standards.

3.4 3. PFI /PPP

3.4.1 The CIPFA/LASAAC Local Authority SORP Board has opted to introduce PFI/PPP guidance into the SORP with effect from 1 April 2009, to achieve convergence with the rest of the public sector. Therefore full application of the applicable standards will be required for the 2009/10 financial statements and prior period adjustments may be required for 2008/09. This will bring our PPP transactions 'on balance sheet' from 2009/10.

3.4.5 Following a specific workshop run by PwC, the Council now has a model spreadsheet into which it will populate required information from our own contractors PPP model to arrive at the required accounting entries for 2009/10. This involves separating out the elements of the payments involved throughout the contract between:

- operating costs (PPP Service costs)
- lifecycle maintenance prepayments
- finance costs - lease rental interest
- finance costs - lease rental repayments
- operating costs - contingent rentals

3.5 4. Fixed asset accounting

3.5.1 <u>Assets held for sale / surplus assets</u>

Under IFRS, if a fixed asset is available for immediate sale, is being actively marketed, and if completion of the sale is expected within twelve months, the asset should be classified as a non-current asset held for sale and should be held on the balance sheet at the lower of carrying value and ‘fair value less costs to sell’. Depreciation on such assets should cease.

Under the current SORP there are no specific criteria for classifying an asset as held for sale. Furthermore, such assets would not be exempt from depreciation as is the case under IFRS.

3.5.2 <u>Component accounting</u>

IFRS introduces the concept of accounting for the different components of assets separately, including recognising the depreciation charges of the components separately. Component accounting already exists under UK GAAP and is not precluded by the SORP, however, separate accounting for components has not been widely practiced.

The Draft IFRS Code specifies that the requirement for componentisation for depreciation purposes shall be applicable to enhancement and acquisition expenditure incurred, and revaluations carried out, from 1 April 2010.

3.5.3 The Council has embarked on a revaluation of all Council assets as at April 2009 which will address a number of these new accounting practices. Componentisation had already commenced within the Council in 2008/09.

3.6 **5. Employee benefits**

3.6.1 Traditionally, under UK GAAP, local government bodies have not recognised accruals at year end for staff holiday entitlement that has not yet been taken and which is being carried forward to the following year. Under IFRS it is expected that all local government bodies will either recognise any untaken holiday pay as an accrual or will perform sufficient analysis in this area to satisfy their auditors that it is not a material amount and therefore does not need to be recognised.

3.6.2 With the assistance of Human Resources, the Council are currently evaluating the extent of unpaid leave at the end of March 2009 to quantify the cost of this accrual. Although not yet quantified it should be noted that this will result in a significant cost to the Council at time of implementation. It should be noted however, that the Scottish Government is intending to implement statutory mitigation regulations to avoid any impact of these 'Short Term Compensated Absences' on Councils

3.7 Conclusion

3.7.1 This report has set out the background to these new reporting standards, and outlined the first stage in the process to re-state the balance sheet as at 1st April 2009. The work on convergence will continue up until the closure of the 2010/11 accounts in June 2011. Regular updates on progress on this project will be provided throughout the process.

3.7.2 The Finance Service will also follow closely any developments involving the identification of any possible impacts on the General Fund and the proposals the Government might make to issue regulations allowing some or all of the impact to be neutralised.

4.0 SUSTAINABILITY IMPLICATIONS

4.1. Not applicable to monitoring reports

5.0 RESOURCE IMPLICATIONS

5.1. Financial Details: The full financial implications of the recommendations are not yet fully quantified, and will also be dependant on impending government regulation to mitigate costs.

5.2. Staffing: There are no direct implications to staffing arising from this report .

6.0 EXEMPT REPORTS

Is this report exempt? **Yes** (please detail the reasons for exemption below) **No** ☑

7.0 DECLARATIONS

7.1. The recommendations contained within this report support or implement our Corporate Priorities and Council Policies.

(1) **Our Priorities 2008-2011**

The area has a positive image and attracts people and businesses	☑
Our communities are more cohesive and inclusive	☑
People are better skilled, trained and ready for learning and employment	☑
Our communities are safer	☑
Vulnerable people and families are supported	☑
Substance misuse and its effects are reduced	☑
Health is improving and health inequalities are reducing	☑
The environment is protected and enhanced for all	☑
The Council is effective, efficient and recognised for excellence	☑

(2) **Council Policies** (Please detail)

8.0 EQUALITIES IMPACT

8.1. Have you undertaken the required equalities impact assessment to ensure that no groups are adversely affected by the recommendations? **YES**☐ **NO**☑

Required ☐ **Not Required** ☐

9.0 LEGALITY

9.1 In adopting the recommendations contained in this report, the Council is acting within its legal powers. **YES** ☑ **NO** ☐

10.0 APPENDICES

The following appendix is attached to this report:

Appendix 1: draft IFRS action plan summary

11.0 BACKGROUND PAPERS

11.1 Have you used other documents to compile your report? (All documents must be kept available by the author for public inspection for four years from the date of meeting at which the report is considered)

YES ☑ (Please list the documents below) **NO** ☐

Clackmannanshire Council IFRS Phase 1 Impact Assessment report (draft) prepared by CIPFA/PricewaterhouseCoopers - November 2009.

Author(s)

NAME	DESIGNATION	TEL/EXTENTION
Martin Dunsmore	Accounting & Budgeting Manager	01259 452041

Approved By

NAME	DESIGNATION	SIGNATURE
Susan Mackay	Finance Manager	(Signed: S MacKay)
Angela Leitch	Chief Executive	(Signed: A Leitch)

Appendix 1

A Proposed IFRS Implementation Action Plan – Summary