SOUTH LANARKSHIRE COUNCIL

Agenda Item

Report

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Report to:	**Finance and Information Technology Resources Committee**
Date of Meeting:	**27 October 2009**
Report by:	**Executive Director (Finance and Information Technology Resources)**

Subject:	**International Financial Reporting Standards**

1. Purpose of Report

1.1. The purpose of the report is to:-

- To advise of the implications of the introduction of International Financial Reporting Standards (IFRS's) to Local Authorities.

2. Recommendation(s)

2.1. The Committee is asked to approve the following recommendation(s):-

(1) that the content of the report and the attached Appendix is noted.

3. Background

3.1. From 2010/11, local authorities' Statement of Accounts will be prepared under an IFRS based Code of Practice on Local Authority Accounting, This is part of a wider public sector move to international financial reporting standards. The main benefit to this implementation is considered to be the consistent preparation of Whole of Government Accounts which will assist in future public sector decision making processes, for example, Spending Reviews and comparative exercises

3.2. The move to IFRS will bring a number of accounting changes. Local authorities have already taken a first significant step with the implementation of the IFRS-based financial instrument standards in their 2007/08 statement of accounts. Changing the accounting approach for PFI/PPP schemes for 2009/10 is the second key step towards IFRS implementation.

3.3. One of the important lessons to be learnt from the private sector's experience of implementing IFRS, and the experience of other parts of the public sector that are implementing IFRS in 2009/10, is that early planning and preparation are essential to ensure a smooth transition.

3.2. To aid this smooth transition the Council, alongside the majority of other Scottish Councils, has engaged with CIPFA and PricewaterhouseCoopers (PWC). Through this partnership a service is being offered providing specific advice and assistance to aid the transition to IFRS.

4. IFRS Implications

4.1. As part of this service provided by CIPFA/PWC a summary briefing has been provided detailing the main implications of the introduction IFRS. This summary is attached at appendix 1.

4.2. The summary covers the background to the implementation, the key timelines, likely areas of impact, and next steps.

4.3. The main areas for change highlighted in the briefing are detailed below:-

- First Time adoptions and Accounting policies
- Leasing
- PFI / PPP – main impact is that schools will come back onto the Council's balance sheet.
- Fixed Assets – Requirement to record components of assets and changes to Investment Assets
- Employee Benefits – Primarily holiday pay accruals - requirement to include valuation for leave entitlement not taken by 31 March.

4.4. The implementation of IFRS will require the commitment of all Resources within the Council. Work has already commenced looking at the main areas of change, and action plans are in place to ensure that the transition is managed.

4.5. Further updates will be provided to this Committee as required.

5. Employee Implications

5.1. Resources will be required from Finance and Information Technology, Enterprise, Education and Corporate Resources as a minimum to ensure we are IFRS compliant in the required timescales. Working groups will looking at the specific change areas, and representatives from relevant Resources will be required to participate.

6. Financial Implications

6.1. There is likely to be an impact on the Council's Income and Expenditure Account as a result of the implementation of IFRS Accounting. It is anticipated that this will be reflected within the Resources' expenditure/income figures but regulation to be passed by the Scottish Government will negate this before any impact on the Council's bottom line.

6.2. The cost of the arrangement with CIPFA/PWC will be £14,500 in 2009/10 and £8,600 in 2010/11.

7. Equality Impact Assessment and Consultation Arrangements

7.1. This report does not introduce a new policy, function or strategy or recommend a change of existing policy, function or strategy and therefore no impact assessment is required.

7.2. There is also no requirement to undertake any consultation in terms of the information contained in this report.

Linda Hardie
Executive Director (Finance and Information Technology Resources)

5 October 2009

Link(s) to Council Values and Objectives

- Value: Accountable, Effective and Efficient

Previous References

None

List of Background Papers

None

Contact for Further Information

If you would like to inspect the background papers or want further information, please contact:-

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Appendix 1

IFRS IN SCOTTISH LOCAL GOVERNMENT

Background and Timeline

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.

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.

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.

For many organisations, this will mean fundamental changes – changes that can impact across the organisation. It is likely to take considerable time to plan for conversion, undertake the necessary research, and make the required changes and to integrate them fully.

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 an early start to the IFRS project, and subsequently maintaining this momentum. As such, it is also important that senior management are on board with the transition project from an early stage as the transition to IFRS 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.

Transition Project – Practical Implications

The Council has engaged CIPFA and PwC to provide technical advice and support to the Authority 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 five largest pieces of work that the Council will need to undertake in order to prepare IFRS-compliant financial statements are outlined below. We 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.

1. First time adoption and Accounting Policies

The first time adoption of IFRS (IFRS 1 First Time adoption) 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 senior management involvement is recommended from an early stage.

IAS 1 will have 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.

In response to IAS 1, 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.

2. Leases

Differences from current practice
Under IFRS the Council will be required to account separately for leases of land and buildings (previously these may have been treated as one lease) with land normally treated as an operating lease. The Council will need 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. Valuer consultation may be required to facilitate this.

Although the definition of a finance lease is very similar, IFRS does not apply a quantitative threshold in determining the classification of a lease. Instead, it uses a series of indicative situations which could indicate whether a lease should be classified as a finance lease. IFRS therefore, requires more judgement in the classification of leases.

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. PFI and Service Concessions

Differences from current practice
The CIPFA/LASAAC Local Authority SORP Board has opted to introduce PFI/Service Concessions 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.

IFRIC 12 Service Concessions is the particular standard interpretation which is applicable to PFI transactions. There was no equivalent standard under UK GAAP, but schemes were typically assessed on a transfer of risk and rewards approach in determining whether infrastructure assets should come on an entity’s balance sheet. Under this approach, such assets were usually assessed to be off the public sector’s balance sheet.

IFRIC 12 takes a fundamentally different approach and looks at aspects of control of an asset. Where it is deemed that the public sector has control of the asset, then it should appear on the public sector balance sheet. Examples of control include specifying the services to be provided from a particular asset, and regulating the price paid for the services.

It should be noted that the standards could apply to non PFI transactions where the control criteria are met.

4. Fixed asset accounting

Assets held for sale / surplus assets

Differences from current practice

Under IFRS 5, if a fixed asset is available for immediate sale, is being actively marketing, 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.

Component accounting

Differences from current practice

IAS 16 'Property Plant & Equipment' 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.

5. Employee benefits

Differences from current practice

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. Accounting for this is specifically mentioned in IAS 19 and therefore 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.

Conclusion

The next steps are to engage with stakeholders (the Audit Committee and External Audit) and to mobilise the project team to draw up a detailed project plan, breaking down the transition into separate work streams to which individuals can be assigned. This process will involve the help and support of PwC and CIPFA as part of the agreed contract.

It will be important to set clear milestones and to monitor the achievement against these throughout the project in order for slippage to be identified and corrective action taken. The Council 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.