	Audit Committee 3rd March 2010 **Report from the Director of Finance and Corporate Resources**
For Action	Wards Affected: ALL

International Financial Reporting Standards

1. Summary

1.0 Local Authorities are required to convert their accounts to being based upon International Financial Reporting Standards from UK Generally Accepted Accounting Practice. The report sets out the process for the transition, highlights the key changes, and summarises progress to date.

2. Recommendations

2.1 The Audit Committee note the content of the report.

3. Detail

3.1 In the 2007 Budget, the Chancellor announced that the UK would move to using International Financial Reporting Standards (IFRS) in the financial year 2008-9 for the whole of government accounts. The move was delayed a year to 2009-10 by Government with the 2008 Budget. The move to IFRS for the whole of government accounts was motivated by a desire to increase consistency and comparability between Government accounts internationally.

3.2 Once Central Government was committed to moving to IFRS for the whole of government accounts, it was inevitable that local authorities would be required to report under IFRS as well. For most of the changes, the implementation of IFRS in local authorities is a year later than Central Government and the NHS, with the first full IFRS based accounts produced in 2010-11. The exception to this delay is for the changes connected with the Public Finance Initiative: these changes are being implemented in the current financial year, 2009-10.

3.3 There is a legal requirement for the Council to prepare its accounts in line with the new IFRS based standards. The Code of Practice on Local Authority Accounting in the United Kingdom (the code) sets out the proper accounting practices required by section 21(2) of the Local Government Act 2003, which apply to the Statements of Accounts prepared in accordance with the statutory framework established for England by the Accounts and Audit Regulations 2003.

3.4 To meet with the requirements for local authorities to produce IFRS based accounts, the code for the 2010-11 is no longer based on UK Generally Accepted Accounting Practice (UK GAAP), but upon IFRS.

3.5 The financial year 2009-2010 is the transitional year, and accounts for this year have to be stated under both UK GAAP and IFRS. The restatement to the IFRS format will be completed subsequent to the audit of the accounts in GAAP format. This will involve restating the balance sheet as at 1st April 2009, the Income and Expenditure Account for the financial year 2009-2010, and the balance sheet as at 1st April 2010. The restated figures will be used as comparatives for the 2010/11 first set of IFRS accounts.

Key changes and impacts under IFRS

3.6 **Leases** – IFRS sets out a more comprehensive test to determine if leases are finance leases, and hence need to be included on the balance sheet. This change is likely to result in more finance leases being recognised.

3.7 The impact of the increased recognition of finance leases will be to increase the values of the Council's assets and liabilities on its balance sheet, recognising the assets that are being leased. Central government is currently consulting on proposals to ensure that these changes have no impact upon the statement of movement of the general fund, and hence no impact on council tax. The increased recognition of finance leases might require the Council to increase its Prudential Borrowing limit, to recognise its additional liabilities.

3.8 Another possible impact of these changes would affect the treatment of income received by the council in respect of assets leased to another organisation. Under a proposal currently being considered by the government the income from any new finance leases would need to be treated as a capital receipt.

3.9 **Service concessions and embedded leases** – IFRS introduces two definitions of contracts where there might be leases embedded within a contract that is not called a lease. Service Concessions are contracts where an outside body provides a service that is controlled by the council utilising assets nominally belonging to the outside body, but the residual value for which returns to the council at the end of contract, or is negligible. Embedded leases are contracts that contain a lease as well as other elements. These two types of contract will result in the council having to disclose leases upon the assets used. Where these leases are finance leases they will have to be recognised on the balance sheet. In cases where there is a service provided by the outside body then these leases will have to be recognised in the 2009-2010 Statement of Accounts with restatement of 2008-9 position.

3.10 **Private Finance Initiative (PFI)** – under IFRS PFI arrangements entered into by the council are a type of service concession, and therefore will be brought on balance sheet having previously been kept off balance sheet. The authority will recognise both the assets associated with the PFI and a liability representing future payments. Unlike other areas of IFRS changes, this change is being introduced in the 2009-10 code with restatement of 2008-9.

3.11 The impact of the introduction of Service Concessions and Embedded Leases will be similar to the impact of the changes to leases. More finance leases will be recognised, increasing the Council's assets and liabilities. Again, the increased recognition of finance leases might require the Council to increase its Prudential Borrowing limit.

3.12 **Fixed assets** – IFRS introduces a much greater requirement for component accounting. This means that an asset will have to be broken down into its major components. For example, under the current rules property is broken down into just land and buildings; under IFRS buildings will have to be further broken down into their major components where these components will have to be replaced during the life of the building. Such a breakdown for a building could include: various blocks constructed at different times, roof, major items of plant, i.e. boiler system, and lifts etc. As well as properties these rules will apply to transport infrastructure, such as roads, a draft Transport Infrastructure Assets Code has been published, which will govern this area. This change to component accounting is not retrospective, and will only apply as buildings are revalued from 1st April 2010. These changes will require the Council to track more information about fixed assets.

3.13 **Employee benefits** – the authority must now calculate the liability for any annual leave taken forward into the next financial year. For technical reasons, around the academic year, this is particular large for teachers. The Government has proposed changes to ensure that this does not impact upon the statement of movement of the general fund, so that this change will not impact upon council tax.

3.14 **Group accounts** – under IFRS the authority only needs to be able to influence an outside body for it to be considered part of the group, and require consolidation into the group accounts. Work is being undertaken to ascertain whether any further outside bodies will need to be consolidated into Brent's accounts.

3.15 **Segment reporting** – the accounts will have to present information on the council broken down into segments. The segments will be the service areas and central items to represent the information that the Executive sees within the Performance and Finance Review in order to allocate financial resources.

3.16 Overall, the experience in the private sector has been that many more disclosures are required in almost all areas. The size of the statement of accounts has typically risen by 60%. Furthermore, there is considerable change in terminology.

Actions taken so far

3.17 A number of actions have been taken to date to ensure that the transition to IFRS progresses smoothly:

(i) The Head of Financial Management has been appointed as the lead officer for the project.

(ii) A project team has been established within Finance and Corporate Resources. This team has involved Property and the service areas, to ensure that preparation is taking place across the council for the changes.

(iii) Members of the project team have attended training events, seminars and undertaken research to enable a full understanding of the requirements of IFRS, and how to successfully implement IFRS

(iv) An outline conversion plan and a detailed work plan have been produced which sets out what is required, and when for the full implementation of IFRS. The detailed work plan identifies the staff responsible for implementing each area of IFRS.

(v) PricewaterhouseCoopers have been employed as external advisors to analyse the PFI schemes as the accounting treatment for these is very complex, and to provide advice upon IFRS.

(vi) The PFI schemes have been referred to PricewaterhouseCoopers for analysis, and the first reports have been received.

(vii) High value contracts held by the council are being analysed for service concessions and embedded leases.

(ix) Work is being carried out within Housing, Property and Financial Management to assess which leases need to be reclassified.

(x) A draft calculation has been submitted to the auditors for the employee benefits accrual. In addition to this there has been an ongoing dialogue with the Audit Commission to ensure the appropriateness of the views on accounting treatment being taken by the Council. Several documents around the technical aspects associated with accounting for leases are currently being considered.

IFRS Outline Conversion Plan

3.18 The outline conversion plan is attached to this report at Appendix 1. The key milestones are set out below:

(i) End of March 2010 – Restate 1st April 2009 balance sheet. This work will be concurrently audited by the external auditors.

(ii) End of June 2010 – Prepare 2009/10 UK GAAP accounts (including PFI, Service concessions and relevant embedded leases under IFRS)

(iii) End of September 2010 - Audit of UK GAAP Accounts

(iv) End of December 2010 – Restate 2009/10 Accounts under IFRS

(v) January – March 2011 – Audit of restated Accounts

(vi) End of June 2011 – First Statement of Accounts under IFRS rules

4. Financial Implications

4.1 Central government is currently consulting on proposals to ensure that the changes arising from the implementation of IFRS will have no impact upon the statement of movement of the general fund, and hence no impact on council tax. The two areas where there is a perceived risk to this are: first, the recognition of more finance leases means that the council may have to increase its prudential borrowing limit to allow for this reclassification of leases; and second, the lease payments made under any new finance leases upon assets owned by the council and leased out to another party will have to be treated as a capital receipt, they cannot be used as a revenue stream. There has not been any clarification yet on the matters being consulted on.

4.2 As stated above, the changes around lease accounting, including the creation of Service Concessions and Embedded Leases, might impact upon the budgeting process as recognition of more finance leases means that the council may have to increase its prudential borrowing limit to allow for this reclassification of leases.

4.3 Component accounting should not require major additional resources for valuation of buildings. Component accounting is being built into the capital coding structure of the new Oracle Financials system to minimise the amount of work needed by the finance teams to comply with these rules.

4.4 The staff and resources used for implementation of IFRS have been found from existing budgets, including the cost of PricewaterhouseCoopers to act as external consultants to carry out the work on the PFI schemes and advise Brent upon IFRS.

4.5 The impact upon staff and resource of meeting statutory financial reporting requirements will be kept under review.

5. Legal Implications

5.1 As stated in the body of the report, there is a legal requirement for the Council to prepare its accounts in line with the new IFRS based standards. The Code of Practice on Local Authority Accounting in the United Kingdom (the code) sets out the proper accounting practices required by section 21(2) of the Local Government Act 2003, which apply to the Statements of Accounts prepared in accordance with the statutory framework established for England by the Accounts and Audit Regulations 2003.

6. Diversity Implications

6.1 None

7. Background papers

7.1 Appendix 1 - Outline Conversion Plan

8. Contact Officers

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