AGENDA ITEM 5(a)

FALKIRK COUNCIL

Subject: **INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) IN SCOTTISH LOCAL GOVERNMENT**
Meeting: **AUDIT COMMITTEE**
Date: **16 November 2009**
Author: **DIRECTOR OF FINANCE**

1. INTRODUCTION

1.1 This report is intended as a briefing for Members on the adoption of IFRS into the Council's financial systems and accounts.

2. BACKGROUND AND TIMELINE

2.1 The requirement for government bodies to adopt IFRS 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.

2.2 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.

2.3 This new reporting regime will bring significant challenges for Councils, 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.

2.4 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, make the required changes and to integrate them fully.

2.5 The Council will require to restate its Balance Sheet as at 31 March 2009 on an IFRS basis as well as restating its accounts for the year to 31 March 2010. The restated Balance Sheet at 31 March 2009 requires to be prepared by 28 February 2010. 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.

3. TRANSITION PROJECT – PRACTICAL IMPLICATIONS

3.1 The Council has engaged CIPFA and PwC to provide technical advice and support to the Authority throughout the whole IFRS Transition Process. This contract was reported by an Information Bulletin on 29 April 2009 and is attached for information. The overall objective of this engagement is to ensure a smooth IFRS transition process delivered accurately, consistently and with minimum disruption.

3.2 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.

3.2.1 **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.

International Accounting Standard (IAS) number 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.

3.2.2 **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. Consultation with a qualified valuer 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.

3.2.3 **PFI and Service Concessions**

Differences from current practice

The CIPFA/LASAAC Local Authority Statement of Recommended Practice (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.

The International Finance Reporting Interpretations Committee (IFRIC) has issued notice number 12, Service Concessions which is the particular standard interpretation which is applicable to PFI transactions. There is no equivalent standard under the current financial reporting regime, 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 body 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.

3.2.4 Fixed Asset Accounting

<u>Assets held for sale/surplus assets</u>
Differences from current practice
Under IFRS 5, 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 financial reporting regime 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.

<u>Component accounting</u>
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 the current financial reporting regime, however, separate accounting for components has not been widely practised.

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.

3.2.5 **Employee Benefits**

Differences from current practice
Traditionally, under current practice, local government bodies have not recognised accruals at the 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. The same principles also apply for any flexi-leave balances as at 31 March. An initial assessment of the financial effect has been carried out and it is likely that a one off charge of around £12 million will be made to the General Fund. If this was allowed to happen unchecked then the Council (and nearly all other Scottish ones) would have a negative General Fund Balance. Discussions are taking place with the Scottish Government with a view to reversing this entry in the General Fund and creating a new Reserve, however, this requires statutory intervention which it is hoped will be confirmed soon.

4. 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.

5. RECOMMENDATIONS

That Members note the contents of the report and that further reports will be provided to Committee as the project progresses.

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Director of Finance

Date: 29 October 2009

Contact Officer: John Flannigan

<u>LIST OF BACKGROUND PAPERS</u>

1. Information Bulletin dated 29 April 2009

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506371 and ask for John Flannigan.

REPORT FOR INFORMATION BULLETIN

Subject: **ACCEPTANCE OF QUOTATION UNDER £30,000 FOR CONSULTANCY SERVICES TO ASSIST WITH THE INTRODUCTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS [IFRS] WITHIN THE COUNCIL'S FINANCIAL SYSTEMS**
Meeting: **INFORMATION BULLETIN**
Date: **29 APRIL 2009**
Author: **DIRECTOR OF FINANCE**

1. INTRODUCTION

1.1 All UK Local Authorities are required to comply with IFRS with effect from 2010/11. In addition some elements of IFRS are due to take effect from 2009/10 and the balance sheet at 2008/09 will require to be restated under IFRS principles. In order that this deadline is met it will be necessary to start work now to ensure that the Council's financial records and systems are capable of providing the information to ensure full compliance with IFRS.

1.2 The introduction of IFRS has been hailed as the biggest change to financial reporting standards in a generation. As such it is an extremely technical and complex exercise. In order that compliance is achieved within the timescale it will be necessary to commission outside assistance from a reputable firm who have already managed the introduction of IFRS within other sectors.

1.3 In that respect CIPFA Scotland has joined with PricewaterhouseCoopers [PwC] to offer a Scotland wide consultancy service through the previously tendered and agreed Scottish Government Finance Advisory Procurement Framework. This framework has been in place for the last 2 years and is utilised by all of Scotland's public bodies. This permits direct engagement with PwC/CIPFA as the tender process has already been undertaken and the terms and conditions agreed.

2. QUOTATION RECEIVED

2.1 The cost per local authority can be summarised as follows

Per Authority	Estimated Days	Fund Price
2009/10 financial year	15-18	£14,500
2010/11 financial year	9-12	£8,600

2.2 These prices are based on a significant majority of Scotland's Local Authorities contracting for the service.

2.3 The Framework rates represent in excess of a 30% discount on both CIPFA and PwC standard rates.

2.4 It is considered best value for Falkirk Council to accept the quotation from CIPFA/PwC.

3. ACTION TAKEN

3.1 In accordance with Contract Standing Order 6.2(i) I have engaged CIPFA/PwC to provide consultancy services to manage the introduction of IFRS for a sum of £14,500 in 2009/10 and £8,600 in 2010/11.

Director of Finance
31 March 2009
Contact Officer: John Flannigan Ext 6371

LIST OF BACKGROUND PAPERS

1. *Engagement Letter
2. Terms of Business

** items not for publication on the grounds that it involves the disclosure of exempt information as defined in paragraph 8 of Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973.*