Southend-on-Sea Borough Council

Agenda Item No.

Report of Corporate Director of Support Services
to
Audit Committee
on
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Implementation of International Financial Reporting Standards
A Part 1 Public Agenda Item

1 Purpose of Report

To appraise Audit Committee Members of the preparation plans in place to deliver the implementation of International Financial Reporting Standards in time for the 2010/11 Statement of Accounts.

2 Recommendation

2.1 To note the plan for the implementation of IFRS; and

2.2 To note the likely areas of significant IFRS impact.

3 Background

3.1 In preparing its financial statements for the 2010/11 year (year ending 31 March 2011) the Council will be required to comply with the CIPFA “Code of Practice on Local Authority Accounting in the United Kingdom 2010”. In contrast to previous codes, which were based on UK Generally Accepted Accounting Practice (UK GAAP), the 2010 code is based upon on International Financial Reporting Standards (IFRS).

3.2 This is a step change to the financial reporting requirements and requires more preparation than previous adjustments to accounting practice. This new set of applicable standards is likely to lead to significant changes in the preparation of financial statements of the Council, including a greater level of disclosure on all financial transactions and relationships.

3.3 The Audit Commission believes those charged with governance should be sufficiently aware of the requirements of IFRS to ensure that it is given appropriate corporate priority to make the transition in good time and in a way that ensures its continuing ability to produce reliable financial information. Therefore, this report informs the Audit Committee of the key changes included in the IFRS code and the steps being taken to ensure that the Authority is able to find solutions to meet those challenges.

3.4 The new accounting standards must be implemented in time for the production of the 2010/11 Statement of Accounts. In that published statement, previous financial statements must be shown restated to an IFRS compliant basis. This includes Balance Sheets at 1 April 2009 and 1 April 2010 as well as the Income and Expenditure Account for 2009/10. In essence, now that the 2009/10 Statement of Accounts is now complete, we must begin work to convert these to the new IFRS standards. This requirement for retrospective application of the standards means that early preparation is essential.

3.5 Although the final results of the implementation of IFRS are reflected in changes to the financial statements, to implement the changes the Authority will have introduce new working procedures in a number of areas. It is important that this change process is not regarded as only relating to accountancy. The project plan requires the co-operation and co-ordination of different service departments across the Authority, in particular the assets and legal teams.

3.6 The consequences of failing to implement IFRS successfully could be severe for the Authority. They may include qualification of the accounts, with consequential reputational damage. Future external audit regimes would be more stringent and therefore more costly in terms of fees and officer time.

4 Required Changes

4.1 Progress in the implementation of the CIPFA code will be monitored against the project plan and a series of milestones. The overall Project Plan, in the form of an Issues Matrix, is shown at Appendix 1, setting out the issues to be considered together with the timescale for their resolution. The project will require considerable staff time in order to achieve successful results.

4.2 The areas where IFRS could have a significant impact are as follows;

- **Private Finance Initiative (PFI) and Service Concessions**
  The Council does not currently have any PFI arrangements in place and therefore is largely unaffected by this change. However this change also applies to so called Service Concessions, where a service has been outsourced to a private sector supplier, and as a result that supplier has brought into use “infrastructure” assets such as land and building to deliver its service on behalf of the Council.

  IFRS arrangements for PFI and Service Concessions involve the application of a different set of tests to determine if the scheme is on or off the balance sheet of the authority. If schemes come on balance sheet then the authority recognises the asset created by the scheme as well as a liability for future payments to the PFI contractor.

  In contrast with the rest of the IFRS changes, the new arrangements for PFI and Service Concessions were introduced for the 2009/10 accounting year, making these changes the most urgent in the IFRS agenda. Therefore as part of the 2009/10 closedown an assessment has been undertaken as to whether there were any service concession arrangements that would require new accounting treatment as a result of this change. It was concluded that no changes were required. The results of this work have been shared with our external auditors.

- **Leasing (including all contractual arrangements regarding assets)**
  The new requirements for reporting leases are likely to result in some leases being recognised on the balance sheet. In addition, major contracts involving the use of assets must be examined to determine whether they contain arrangements that are, in substance if not in legal form, a lease to use assets. If so, these contracts must be accounted for in line with the leasing regulations. In order to achieve compliance with the leasing standards a full, centralised, register of leases and lease type arrangements must be maintained. This is standard procedure at Southend for formal lease contracts.

  The review undertaken for service concessions identified a number of contracts where there is a possibility that lease type arrangements exist, and these are now the subject of further exploration. In addition, all existing standard leases have already been passed to our retained lease advisors for assessment under IFRS.

- **Fixed Assets**
  Fixed assets must now be recorded in greater detail including the use of “component” accounting (breaking an asset value down into its component parts). This requires changes in the Authority’s methods of revaluation as well as recording of the Capital Programme. This is a forward facing change, with no requirement to “componentise” assets until they reach their normal revaluation date.

  Revaluations due in 2010/11 will be in accordance with this component requirement, but as yet there is limited guidance as to what, beyond the normal land and building split, will be the relevant components to consider.

- **Investment Properties**
  Investment properties are those assets which are held by the Council for the purpose of either receiving a rental income or benefitting from capital appreciation. They are not used by the Authority for providing services in any way. The IFRS code sets out new methods for estimating the value of these assets to the Authority, and for recording changes in value. A full evaluation and revaluation of all investment properties will be required in order to be IFRS compliant. Any investment assets will require annual revaluation.

- **Employee Benefits**
  The Authority must now collate, and record as a liability in the accounts, data on unused annual leave and flexi-time entitlements. This is being done on a sample basis, and then extrapolated across the whole establishment.

- **Group Accounts**
  The Authority publishes a set of “Group Accounts” which includes not only the Authority’s financial position and performance but of subsidiaries,

associates and joint ventures. Currently, the only body deemed to be part of the accounting group is South Essex Homes. The IFRS code refines the definitions of what bodies must be included within the group. The relationships of the Council with all external partners must therefore be assessed to determine if the boundary of the group needs to change.

4.3 In addition to the changes in accounting practice being wrought by the introduction of IFRS, the format of the financial statements is different under the IFRS code. In particular, the primary financial statement is now a "Movement in Reserves Statement". Replacing the previous "Statement of Movement on the General Fund Balance", this new statement is intended to give the reader of the accounts a clearer picture of the economic cost of the Council's activities. Also, the disclosure requirements for the Statement of Accounts will be considerably increased which is likely to lead to an increase in the length of the Statement of Accounts. Although not a formal requirement, the IFRS restated 2009/10 accounts will be brought to Audit Committee for information purposes later in the year so that Members will be able to acquaint themselves with the changed format.

4.4 IFRS will require changes in the working practices of officers across the Authority. In particular, staff must be aware of the greater disclosure requirements around financial transactions and relationships.

4.5 Training has and will continue to be provided to all officers who require it, on the impact of IFRS reporting requirements. This training will cover the basics of the IFRS code but also how it will affect working practices at Southend on Sea Borough Council.

4.6 The Council's external auditors will need to be able to obtain assurance that the Authority is planning to meet IFRS requirements in an appropriate fashion. Progress against project milestones will be discussed with PKF and they will be consulted on significant changes to accounting policies. The milestone dates for the project include targets for audits of the restatement of financial statements from years prior to 2010/11. These milestones may vary as a result of discussions with the auditors.

4.7 Work on IFRS implementation is currently being undertaken entirely by in-house staff, with the exception of the formal lease review. It may be necessary during the implementation to consider bringing in external assistance, although not anticipated, if additional technical expertise is required.

5 Conclusion

5.1 The move towards an IFRS Statement of Accounts is a significant change in the external reporting of the Authority's financial position and performance. In order to achieve this change a planned programme of early preparation is required, to be supported by officers and members across the Authority.

6 Corporate Implications

6.1 Contribution to Council's Vision & Critical Priorities

6.2 Financial Implications

6.3 Legal Implications

6.4 People Implications

6.5 Property Implications

6.6 Consultation

6.7 Equalities Impact Assessment

6.8 Risk Assessment

6.9 Value for Money

6.10 Community Safety Implications

6.11 Environmental Impact

7 Background Papers

8 Appendices