Audit Committee – 13 April 2010

Conversion to IFRS-based financial reporting

1. Summary of report

1.1 This report provides an overview of International Financial Reporting Standards (IFRS), how IFRS will change the council's statement of accounts and the approach being taken to ensure successful implementation at Walsall. The report also details what the introduction of IFRS will mean for the Audit Committee.

2. Recommendations

2.1 Audit Committee is requested to note the contents of this report and take note of the measures being taken to ensure the council meets its obligations.

James Walsh Chief Finance Officer 29 March 2010	Rory Borealis Executive Director 29 March 2010

3. Governance

Background to IFRS

3.1 The Chancellor's 2007 Budget announcement introduced IFRS-based financial reporting for government and public sector accounting from 2008/09. This was updated in the 2008 Budget Report and as a result central Government and Health will be required to adopt IFRS for the production of their 2009/10 annual accounts (with comparatives for 2008/09). The adoption by Local Government will be required for annual accounts from 2010/11 (with comparatives for 2009/10).

3.2 IFRS is a set of principal based accounting standards. Their key aim is to enable the production of accounts on a standardised, consistent format, in both the public and private sector, on a worldwide basis, as far as possible. Currently over 113 countries have adopted these standards.

3.3 The purpose of the introduction of IFRS was to achieve greater transparency for stakeholders and help to prevent company collapses and scandals, such as Enron and World Com in the USA. These scandals were due to significant numbers of complex and often risky transactions being excluded from the company's accounts, hiding the true financial position of the organisation.

3.4 The main reason for adopting IFRS within the UK public sector is to bring benefits in consistency and comparability between financial reports as a whole (i.e. between central Government, NHS and local government) and to follow private sector best practice.

Impact on Audit Committee

3.5 The introduction of IFRS-based financial reporting for local authorities will have a direct impact on the Audit Committee. The format of the main financial statements will change; there will be additional disclosures for the Audit Committee to consider and changes in accounting. These changes will mean that the council will need to adopt new accounting policies that comply with IFRS.

3.6 To enable the Audit Committee to carry out its duty of reviewing and questioning the council's statement of accounts following the end of year closedown, there will be further regular briefings (similar to this one) and appropriate training sessions. As various aspects of IFRS are completed that require approval, these will be presented to the Committee. The first of these will be the revised accounting policies based on IFRS which it is timetabled to be presented for approval at the Audit Committee meeting on 14 June 2010.

Change in accounting

3.7 Prior to 2010/11 local authorities, including Walsall, prepared their accounts according to the Statement of Recommended Practice (SORP) prepared by CIPFA. The SORP is based on UK Generally Accepted Accounting Practices (UK GAAP), but modifies these for local government where legislative requirements demand different treatments to UK GAAP. This is to ensure that council tax payers are not subjected to costs incurred for "accounting items" and to recognise the unusual nature of local authority funding.

3.8 The introduction of IFRS will significantly change the way that local authority accounts are prepared. The main change is that there will no longer be a local authority SORP prepared by CIPFA. Instead there will be a code of practice on local authority accounting produced by CIPFA under the guidance of the Financial Resources Advisory Board (FRAB), who are the independent body responsible for overseeing the development of financial reporting within the UK public sector.

3.9 Under IFRS a large number of areas will be subject to different accounting treatments to that under SORP.

Initial impact assessment

3.10 To ensure the council has a successful IFRS implementation, a project team has been set up to coordinate the conversion process. An initial piece of work carried out for this was an initial impact assessment for Walsall.

3.11 This initial impact assessment identified those areas that would potentially have the highest impact on the conversion process, due to things such as fundamental changes in accounting treatment, so representing the highest risk. The results of this assessment can be found in table 1.

Table 1 – Areas of change and their potential impact (high/medium/low)

High Impact	Medium Impact	Low Impact
First time adoption	Presentation of financial statements	Inventories (Stock)
Private Finance Initiatives (PFI) / Public Private Partnerships (PPP)	Cash flow statement	Post balance sheet events
Leases	Related party disclosures	Provisions
Accounting policies	Segmental reporting	Government grants
Tangible fixed assets	Group accounts	
Intangible assets	Financial instruments	
Employee benefits		

3.12 The initial impact assessment also identified a significant increase in the amount of data that needed to be captured as part of the final accounts process under IFRS. From the experience of other organisations including the NHS, overseas public sector organisations and the private sector the number of disclosures in the annual Statement of Accounts will increase by c.50%. Walsall's statutory accounts will look significantly different and require different interpretation from 2010/11.

Format of Statement of Accounts

3.13 The format of the statement of accounts will be different to those being presented under SORP 2009 in June 2010 and previous years. The main difference will be in the presentation of the main financial statements. Table 2 provides details of the changes between the SORP compliant accounts which we currently publish, with those required in the IFRS statements.

Table 2 – SORP 2009 main financial statements vs IFRS main financial statements

SORP 2009 main financial statements	IFRS main financial statements
Income and Expenditure Account and Statement of Total Recognised Gains and Losses	Comprehensive Income and Expenditure Statement
Statement of Movement in General Fund Balances	Movement in Reserves Statement
Balance Sheet	Balance Sheet
Cash Flow Statement	Cash Flow Statement

3.14 The most fundamental difference is that there will no longer be a Statement of Total Recognised Gains and Losses. This will be combined with the Income and Expenditure Account to form the Comprehensive Income and Expenditure Statement.

3.15 The main financial statements will be considerably shorter than those currently contained within the SORP compliant accounts. However this does mean further explanatory disclosures being included in the notes to the accounts to give further details of the summarised information.

3.16 Sample versions of the IFRS main financial statements can be found as Appendix 1.

Progress to date with implementation

3.17 Since the initial impact assessment, the project team has focussed on a few key areas that have emerged as the most important, either due to complexity or timescale. These are PFI's, leases, contracts and employee benefits.

PFI, PPP and similar arrangements (Service Concession Arrangements)

3.18 Private Finance Initiative (PFI) and Public Private Partnership (PPP) are the most urgent area for IFRS implementation. This is due to it being introduced a year earlier than other aspects of IFRS. As such it forms part of SORP 2009 and needs to be completed for the 2009/10 accounts. Due to the short timescale to complete the work required for this and the specialist knowledge required, it was decided to put out a mini tender for this work. The tender was to provide a statement on recommended accounting treatment, and provision of a model to enable calculation of the required accounting entries leading to a successful implementation into Walsall's accounts. Following a successful tender, KPMG were chosen to complete this work. This work is scheduled to be complete by the end of March; ready for inclusion within the 2009/10 statement of accounts.

3.19 In addition to PFI and PPP, the council has been required to look for any other arrangements that might fall into these categories. There were several major contracts that the council had entered into that the project team believed needed reviewing for this. These were the Tarmac Highways Maintenance agreement and the education agreement with SERCO. A review against the criteria given in IFRS for each of these contracts indicated that they did not fall into the service concession arrangement requirements. Instead these contracts needed to be reviewed to determine whether there were any leases.

Leases

3.20 There is a significant difference in accounting for leases, moving to risk and control based principals rather than just risk. This required the identification and assessment of all the council's current leases. For equipment leases the council's leasing advisors, SECTOR, were engaged to review and provide a statement on the recommended accounting treatment. The results from SECTOR were then reviewed by the project team for reasonableness. As a result the accounting treatment for 10 leases were adjusted accordingly.

3.21 The council also has a large number of land and property leases. The IFRS project team have been reviewing these leases to determine the correct accounting treatment. Given the large number of leases this has taken some time. However this review is now nearing completion.

3.22 In addition to the formal leases above, the council is required to review all contracts to determine if there are leases contained within them, either in legal form or suggested (so called embedded leases). This work is ongoing.

Contracts

3.23 As mentioned in the section on leases, a review of all the council's contracts is being undertaken to determine whether there are any embedded leases or formal leases.

This has involved reviewing the council's corporate contracts register, photocopier framework contract, framework and individual contracts for care homes and contacting schools for details of any contracts they have entered into. Work is ongoing with returns being received from schools which are currently being analysed, along with other information received from the sources mentioned. Any leases found will need to be treated in the same manner as all other leases.

Employee Benefits

3.24 A new requirement within IFRS is that the council must make an accrual within its accounts for any outstanding contractual leave not taken by employees at year end. This would cover annual leave, flexible working hours (flexi-time) and time off in lieu (TOIL). As there is a mixture of staff, with some having financial year leave periods and others anniversary year periods (commencing on the anniversary of their initial employment date with Walsall Council), this is significant and time consuming exercise to complete due to having to capture all the relevant information. Discussion with Grant Thornton is ongoing as a suitable sample size for this exercise and any decisions made will be carried forward for future years.

4. Resource and legal considerations

Financial considerations

4.1 At the time of the initial assessment the financial impact of introducing IFRS within local government was unclear. Based on interpretation of the standards and draft code at that time it was identified that requirements for employee benefits, PFI and leases may affect the council's general reserves and council tax payers.

4.2 The Department for Communities and Local Government (DCLG) are in the process of introducing regulations that will mitigate the financial impact that the changes in accounting standards would introduce. The effect of this mitigation has ensured that no financial burden passed onto council taxpayers.

4.3 There is a small financial cost involved in ensuring the implementation occurs within the defined timescales. This cost is to ensure that the right skills are secured by the council for meeting the new requirements and is covered by an earmarked reserve and existing budgets.

Staffing considerations

4.4 The initial impact assessment identified that if Walsall wanted to ensure that the conversion process was successful there would be a staffing implication. It was not believed that this would involve the creation of any new posts and that the necessary project management and accountancy skills were held in house already.

4.5 However one area, PFI's, was immediately identified as potentially requiring some external advice. This was due to the short timescale to get this work done and the specialist knowledge needed to complete this.

4.6 The work required for this conversion covers more than just finance. It has been identified that input would be required from the following areas to ensure that suitable information is available. Services have been consulted and are assisting the team as required.

- Service finance teams
- Council's property management team
- Corporate procurement
- Financial systems team
- Human Resources

Legal considerations

4.7 Reviewing Walsall's governance arrangements is advised in the context of IFRS. This will be included within the IFRS project approach. Walsall Council is legally bound to comply with IFRS. There is no discretion and IFRS is also referenced in Comprehensive Area Assessment (CAA).

5. Performance and risk management issues

5.1 Staff and councillors will receive briefings and training as appropriate on these new requirements. This is to ensure staff have the correct skill base to ensure the council meets its obligations within the set timescales.

5.2 Failure to implement and manage the requirements of IRFS could have serious consequences for the council, including audit qualification of the annual accounts, with a subsequent impact on use of resource and CAA judgements.

5.3 Risk management is embedded in the final accounts process to enable potential risks to be identified early and addressed. The production of the accounts worked well for 2008/09 putting the authority in a strong position to develop upon. Risks will be identified and managed as part of the project plan and managed. Several finance staff currently have IFRS transition experience from other sectors and have attended relevant training sessions on implementation within local government.

5.4 Changes arising from IFRS will need to be included in the council's financial governance framework.

6. Equality implications

6.1 None directly associated with this report.

7. Consultation

7.1 The report is prepared in consultation with finance and senior officers across the council.

8. Background papers

8.1 CIPFA's Code of practice on local authority accounting, International Financial Reporting Standards, International Accounting Standards, various financial working papers.

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Appendix 1

<u>Sample IFRS compliant core financial statements</u>

Movement in Reserves Statement

This Statement shows the movement in the year on the different reserves held by the authority, analysed into 'usable reserves' (i.e. those that can be applied to fund expenditure or reduce local taxation) and other reserves. The 'surplus or (deficit) on the provision of services' line shows the true economic cost of providing the authority's services, more details of which are shown in Comprehensive Income and Expenditure Statement. These are different from the statutory amounts required to be charges to the General Fund Balance and Housing Revenue Account for council tax setting and dwellings rent setting purposes. The 'net increase / decrease before transfers to earmarked reserves' line shows the statutory General Fund Balance and Housing Revenue Account Balance before any discretionary transfers to or from earmarked reserves undertaken by the council.

	General Fund Balance £m	Earmarked GF Reserves £m	Capital Receipts Reserve £m	Total Usable Reserves £m	Unusable Reserves £m	Total Authority Reserves £m
Balance at 31 March 20XX	**-7.776**	**-41.335**	**-13.239**	**-62.350**	**-244.896**	**-307.246**
Surplus or (deficit) on provision of services (accounting basis)	240.809	0.000	0.000	**240.809**	0.000	**240.809**
Other Comprehensive Expenditure and Income	0.000	0.000	0.000	**0.000**	-151.073	**-151.077**
Total Comprehensive Expenditure and Income	**240.809**	**0.000**	**0.000**	**240.809**	**-151.073**	**89.732**
Adjustments between accounting basis & funding basis under regulations	-245.418	0.000	3.981	**-241.437**	187.287	**-54.146**
Net Increase / Decrease before Transfers to Earmarked Reserves	**-4.609**	**0.000**	**3.981**	**-0.628**	**36.214**	**35.586**
Transfers to / from Earmarked Reserves	7.289	-7.289	0.000	**0.000**	0.000	**0.000**
Increase / Decrease in Year	**2.680**	**-7.289**	**3.981**	**-0.628**	**36.214**	**35.586**
Balance at 31 March 20YY	**-5.096**	**-48.624**	**-9.258**	**-62.978**	**-208.682**	**-271.660**

Comprehensive Income and Expenditure Statement

This Statement shows the economic cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation. Authorities raise taxation to cover expenditure in accordance with regulations; this may be different from the accounting cost. The taxation position is shown in the Movement in Reserves Statement.

	31 March 20YY		
	Expenditure £m	**Income £m**	**Net £m**
Adult social care	125.690	-42.481	83.209
Central services to the public	9.737	-4.064	5.673
Education & children's services	441.988	-255.710	186.278
Corporate & democratic core	8.614	-0.221	8.393
Court services	0.353	-0.040	0.313
Cultural, environmental, regulatory & planning services	162.271	-19.883	142.388
Highways & transport services	38.948	-17.978	20.970
Housing services	115.000	-110.335	4.665
Non-distributed costs	0.451	0.000	0.451
Cost Of Services	**903.052**	**-450.712**	**452.340**
Other Operating Expenditure	40.456	0.000	40.456
Financing and Investment Income and Expenditure	59.390	-37.603	21.787
Surplus or Deficit of Discontinued Operations	0.000	0.000	0.000
Taxation and Non-Specific Grant Income	0.000	-273.774	-273.774
Surplus or Deficit on Provision of Services			**240.809**
Surplus or deficit on revaluation of fixed assets			-115.098
Surplus or deficit on revaluation of available for sale financial assets			0.000
Actuarial gains / losses on pension assets / liabilities			-35.979
Other Comprehensive Income and Expenditure			0.004
Other Comprehensive Income and Expenditure			**-151.077**
Total Comprehensive Income and Expenditure			**89.732**

Balance Sheet

The Balance Sheet shows the value as at the balance sheet date of the assets and liabilities recognised by the authority. The net assets of the authority (assets less liabilities) are matched by the reserves held by the authority. Reserves are reported in two categories. The first category of reserves are usable reserves, i.e. those reserves that the authority may use to provide services, subject to the need to maintain a prudent level of reserves and any statutory limitations on their use (for example the capital receipts reserve that may only be used to fund capital expenditure or repay debt). The second category of reserves are those that the authority is not able to use to provide services. This category of reserves includes reserves that hold unrealised gains and losses (for example the revaluation reserve), where amounts would only become available to provide services if the assets are sold; and reserves that hold timing differences shown in the Movement in Reserves Statement line “Adjustments between accounting basis and funding basis under regulations”.

	£m
Property, plant and equipment	694.329
Investment property	8.102
Intangible assets	0.401
Assets held for sale	0.000
Long term investments	31.705
Investments in associates and joint ventures	0.000
Long term debtors	10.592
Long term assets	**745.129**
Short term investments	43.025
Inventories (Stock)	0.580
Short term debtors	42.584
Landfill allowance trading scheme	0.000
Cash and cash equivalents	11.498
Assets held for sale	18.785
Current assets	**116.472**
Bank overdraft	0.000
Short term borrowing	-0.181
Short term creditors	-49.080
Liabilities in disposal groups	0.000
Current liabilities	**-49.261**
Long term creditors	0.000
Provisions	-2.936
Long term borrowing	-262.730
Other long term liabilities	-275.014
Long term liabilities	**-540.680**
Net assets	**271.660**
Useable reserves	-62.978
Unusable reserves	-208.682
Total reserves	**-271.660**

Cash flow Statement

The Cash Flow statement shows the changes in cash and cash equivalents of the authority during the reporting period. The statement shows how the authority generates and uses cash and cash equivalents by classifying cash flows as; operating, investing and financing activities. The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the authority are funded by way of taxation and grant income or from the recipients of services provided by the authority. Investing activities represent the extent to which cash outflows have been made for resources which are intended to contribute to the authority's future service delivery. Cash flows arising from financing activities are useful in predicting claims on future cash flows by providers of capital (i.e. borrowing) to the authority.

	31 March 20YY £m
Net surplus or deficit on the provision of services	240.809
Adjust net surplus or deficit on the provision of services for non cash movements	-276.979
Adjust for items included in the net surplus or deficit on the provision of services that are investing and financing activities	19.726
Net cash flows from Operating Activities	-16.444
Investing Activities	-2.313
Financing Activities	14.255
Net increase or decrease in cash and cash equivalents	-4.502
Cash and cash equivalents at the beginning of the reporting period	-6.996
Cash and cash equivalents at the end of the reporting period	-11.498