Agenda Item No:

Report to: Audit Committee

Date of Meeting: 12 January 2010

Report Title: **International Financial Reporting Standards**

Report By: Chief Accountant

Purpose of Report

The Council is required by the Accounts and Audit Regulations, to prepare an annual Statement of Accounts. To date, the format of these accounts has been governed by the Statement of Recommended Practice ("SORP") which is based on UK Generally Accepted Accounting Practice (GAAP). In his 2007 budget report the Chancellor announced that the Government was to adopt International Financial Reporting Standards ("IFRS") and required Central Government and Health to adopt IFRS from 2009/10 and Local Government to adopt IFRS from 2010/11. Listed companies in the European Union have been preparing IFRS compliant accounts since 2005. This report sets out the anticipated impact of moving to International Financial Reporting Standards and the Council's proposed approach.

Recommendation(s)

Members are asked to:

Note the anticipated impact of moving to International Financial Reporting Standards (it is not anticipated that these changes should have any effect on the calculation of annual council tax, a view that is confirmed in recent Government announcements and draft regulations).

Note the Project Initiation Document appended that provides information of the approach the Council is taking to implement these standards.

Reasons for Recommendations

So that Members understand the requirement to implement new accounting standards that will apply to Local Authorities from 1 April 2010, and the steps the Council is taking to conform.

Introduction

Background

1. The move to IRFS is intended to bring consistency and comparability in financial reporting.

2. IFRS 1: First Time Adoption of International Financial Reporting Standards establishes the requirements for the transition from Generally Accepted Accounting Practice (UK GAAP) to IFRS. The standard requires full retrospective application of IFRS from a 'date of transition to IFRS'. Consequently, if authorities are to prepare IFRS-compliant accounts for 2010/11 with full comparative data, the date of transition is 1 April 2009. This will require authorities to restate their opening balance sheet as at 1st April 2009.

3. The various abbreviations used are:-

   IAS : International Accounting Standard

   IFRIC: International Financial Reporting Interpretations Committee

   IFRS : International Financial Reporting Standards

   IPSAB : International Public Sector Accounting Standards

   SIC : Standing Interpretation Committee

   SSAP : Statement of Standard Accounting Practice

Impact of Moving to International Financial Reporting Standards

4. The full impact of the move to IFRS will not be known until the CIPFA/LASAAC boards have issued the 2010/11 Code of Practice for Local Authority Accounting that is due to be published shortly. However, based on known differences between UK GAAP and International Financial Reporting Standards and the experience of implementing IFRS elsewhere it is the following key areas where changes are expected:

   i. Private Finance Initiative (PFI) - (unlikely to affect Hastings at the current time)

   ii. Leases

   iii. Property, Plant and Equipment - (formerly fixed assets)

   iv. Employee Benefits

   v. Disclosures

   vi. Presentation

5. It is not anticipated that these changes should have any effect on the revenue budget and hence the calculation of annual council tax, a view that is implied in recent Government announcements that any changes in costs will be reversed out by statutory adjustments.

Private Finance Initiative ("PFI") Arrangements (IFRIC 12)

6. There is no international standard that directly addresses PFI accounting. IFRIC 12: Service Concession Arrangements looks at such arrangements from the perspective of the private sector service provider. The IFRIC states that, where the service provider does not control the asset, that asset will not appear on the service provider's balance sheet.

7. For government departments and the NHS, the Treasury has adopted a mirror image of the above accounting treatment. Therefore, if the public sector controls the assets within a PFI scheme, those assets should be recognised on the public sector balance sheet. The IFRIC defines two control tests, both of which must be met:

    i. The public sector grantor controls or regulates what services the operator must provide with the asset, to whom and at what price; and

    ii. The public sector grantor controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the infrastructure at the end of the term of the arrangement.

8. PFI schemes, both these control tests seem to be met and it is therefore expected to see most PFI assets appearing on the public sector balance sheet.

9. The Council currently has no PFI schemes but would need to take heed of the requirements of IFRS if sometime in the future it does enter an arrangement with the private sector.

Leases (IAS 17,IFRIC 4, SIC15 and SIC 27)

10. The move to IFRS creates two issues in respect of leases, the breadth of the definition covered by the leasing standard and the way in which finance leases are identified. A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred. An operating lease is a lease other than a finance lease.

11. IAS 17: Leases and IFRIC 4: Determining Whether an Arrangement Contains a Lease introduces some significant changes in lease accounting. IFRIC 4 states that an arrangement is, or contains, a lease when:

    i. The fulfilment of the arrangement depends on a specific asset or assets; and

ii. The arrangement conveys a right to use that asset.

12. This definition is wider than that currently used under SSAP 21: Leases and Hire Purchase Contracts. The authority will need to review any arrangements it may have involving the use of an asset, such as a licence, a partnership agreement, or a long-term contract, to consider whether they contain a lease. This may impact on service contracts such as Waste & Street Cleansing where the contractors' own vehicles and equipment are used wholly in the provision of the service. Under IFRS their assets become ours for balance sheet purposes, written down over the life of the agreement.

13. In the Audit Commission's view, these factors taken together will result under IFRS in an increased number of arrangements being classified as leases, with a greater number of those arrangements being recognised as finance leases, as opposed to operating leases, bringing more assets onto the authority's balance sheet. This reclassification may result in some income ceasing to be revenue income and becoming instead a capital receipt. Cash would be the same but the capital receipt could no longer be used to support revenue expenditure. As stated previously the Government intend to introduce regulations to protect authorities from unexpected revenue shortfalls. It is understood that operating leases will disappear altogether after April 2012 after which they will all be classified as finance leases.

Property, Plant and Equipment (IAS 16)

14. IAS 16: Property, Plant and Equipment is broadly similar to FRS 15: Tangible Fixed Assets, and so there should be no major changes. However, it does introduce different requirements for the basis of asset valuations, which may have implications for the arrangements the Council currently has in place. It may also mean that 'heritage' assets not currently held on the balance sheet should be introduced at a current valuation. This could include some Museum exhibits and some civic regalia that were donated or obtained many years ago for which an historic cost does not exist.

15. IAS 16 states that 'each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately'. This is stronger than the equivalent requirement under FRS 15. This introduces the concept of component accounting.

16. As an example, if the authority owns a building with lifts and a boiler system that have a significant cost and significantly different economic lives to the rest of the fabric of the building, those components should be depreciated separately from the rest of the building. This will require asset registers to record separately those significant parts of an asset. For example, buildings can be split between "bricks & mortar", lifts, heating boilers and other plant. This is being dealt with as part of a planned cycle of revaluation of all the authority's properties.

17. Investment properties will need to be examined to determine whether they are truly property acquired/built for the purposes of seeking a return, or whether they are for other reasons such as economic & regeneration purposes. If the former they remain investment properties and if the latter they will have to classified as Property, Plant & Equipment and depreciated over appropriate periods. There are approximately 175 investment properties where leases have been granted. Not

only the treatment of the asset requires examination but the lease itself to determine the land element, the building element and what type it is (finance or operating).

18. To accommodate changes to accounting standards in recent years the Council has introduced new asset management software that will meet the challenge of recording the elements of each asset. The company supplying this has promised that its recently upgraded system will comply with IFRS standards.

Employee Benefits (IAS 19)

19. IAS 19 uses the principle that the cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable.

20. In Hastings, employees currently start their leave year on the 1st April of each year which coincides with the financial year. However an assessment will need to be made of any untaken leave for which an accrual is required in the accounts. This includes annual leave, sabbaticals and flexi-leave. A trial report of the payroll system has shown that information on untaken annual leave can readily be ascertained – the rest may be assessed on the basis of best guess.

21. The required accrual may not be material to the accounts. However, we need to undertake the analysis to be able to demonstrate this.

Disclosures

22. IFRS contains a significant number of additional disclosure requirements over and above those required by UK standards. Until the Code of Practice is finalised, it is difficult to assess the full impact of these additional disclosures. Suffice to say the number of notes to the accounts will increase significantly.

Presentation

23. The presentation of the accounts under IFRS is different in some respects to those under UK GAAP/SORP.

SORP 2009	IFRS
Income & Expenditure Account	Comprehensive Income & Expenditure Account
Statement of Total Recognised Gains & Losses	Movement in Reserves
Balance Sheet	Balance Sheet
Cash Flow	Cash Flow
Notes to Accounts	Notes to Accounts show more detail – includes segmental reporting of major activities in an objective / subjective way (for Hastings BC this

will probably be on a Directorate basis)

24. The implementation of International Reporting Standards requires input from a number of areas across the Council which will need to be recognised. These include:

    i. Estates and Legal input in respect of property issues and leases;

    ii. Spending departments input in respect of equipment leases;

    iii. Human Resources (POD) input in respect of employee benefit accruals;

    iv. Finance and Accountancy staff in restating figures and producing new financial statements.

Wards Affected

None

Area(s) Affected

None

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	No
Environmental Issues	No
Economic/Financial Implications	No
Human Rights Act	No
Organisational Consequences	No

Background Information

Appendix re Project Implementation Document and Timetable

Officer to Contact

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Please note:-

International Financial Reporting Standards - Project Initiation, Appendix A and Work Plan, Appendix B - Could not be published because of the complex tables that it contains. If required, a copy can be obtained by contacting: Emily Horne, Committee Administrator, Tel: 01424 451719 or by emailing: ehorne@hastings.gov.uk