Sunderland City Council

Item No. 5

AUDIT AND GOVERNANCE COMMITTEE 29 September 2009

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Report of the Director of Financial Resources

1.0 Purpose of Report

1.1 To provide information on the implications to members of the Committee of the convergence of financial reporting to comply with International Financial Reporting Standards (IFRS).

1.2 To set out and note the proposed project outline

1.3 To identify the necessary actions to enable the requirements to be met.

2.0 Reason for Decision

2.1 The Committee is recommended to note the report and the project outline set out in Appendix 1.

3.0 Background Information

3.1 As part of the Comprehensive Spending Review (CSR) 2007 the government announced that the 2008/2009 accounts were to be prepared using IFRS adapted as necessary for the public sector and its intention to publish the Whole of Government Accounts (WGA) on an IFRS basis for the first time in 2008/2009.

3.2 Following government consultation with its departments and the Financial Reporting Advisory Board (FRAB) on the technical work required in order to implement this change the transition was delayed until 2009/2010.

3.3 The main rationale for implementation of IFRS is outlined as follows:

- To harmonise financial reporting in a world of cross-border trade and investment and increased globalisation, so that they are comparable and follow the same standards.
- To reflect the fact that to date, over 100 countries have adopted or intend to adopt IFRS, and that the International Accounting Standards Board (IASB) expects that to increase to 150 countries by 2011.

3.4 The key dates for the IFRS implementation in local government are:

- 1st April 2009 IFRS transition date.
- July 2009 consultation begins on the IFRS based accounting code for local government. The code will be finalised and published in the autumn of 2009.
- The Department for Communities and Local Government is expected to publish mitigation regulations between September 2009 and December 2009. These will ensure that the new accounting arrangements do not impact on the Council Tax.
- The first IFRS based budgets are to be prepared January to March 2010 for 2010/2011.
- 1st April 2010 IFRS based accounting comes into effect for Local Government.
- 2010/2011 Statement of Accounts will be IFRS compliant and will need to be reported to the Audit and Governance Committee by 30th June 2011.

4.0 Implications

4.1 The implementation of IFRS will be complex and wide reaching, and as such will not just affect the Financial Management section of the Financial Resources Department but will impact on some other key directorates of the Council.

4.2 The resource required for successful implementation should not be underestimated, based on the recent experiences of the Health Service, who have to implement IFRS a year earlier than local government.

4.3 Budget 2010/2011

The budget for 2010/2011 will have to be prepared so that it is IFRS compliant, as this will be the first year of full compliance by the Council. As such the work to identify the impact on the Budget will need to commence immediately (Item 9 of the project outline) to ensure that all issues can be dealt with as part of the budget preparation for 2010/2011. Most IFRS requirements, however, mainly affect the Statement of Accounts and the government has indicated that the implementation of IFRS will not affect the Council Tax. Indeed they are to introduce legislation to ensure that this is the case in the next parliamentary session in the autumn.

Nevertheless the Council has carried out a very high level assessment of areas that could impact on the budget for 2010/2011 and there is one main issue that has been identified in relation to the setting up of a provision for all accrued staff benefits outstanding at the year end (i.e. 31st March 2011). This means that all staff flexi time and untaken or carried forward annual leave and any other outstanding staff benefits at 31st March 2011 must be assessed and quantified in order for the

Council to make an appropriation provision in the budget for 2010/2011.

It is therefore proposed that the provision is based upon the best information currently available (at 31st March 2009) to establish the approximate scale of the issue and then consider options on how this is to be funded. The government may however remove this requirement or negate its impact but as yet has not indicated its intentions in this area.

All other areas such as leasing, asset and PFI changes affected by implementing IFRS will have a neutral impact on the budget because of the way in which they are to be accounted for under IFRS and in accordance with government proposals which are aimed at ensuring that IFRS will have no impact on the council tax.

4.4 With regard to the Statement of Accounts the scale of financial reporting will increase significantly. When IFRS was implemented in the private sector their annual statement of accounts doubled in size and at least the same is expected for public sector bodies. This is due to the increased complexity of the accounts and the significant number of new and more detailed disclosures required under IFRS.

4.5 The first fully compliant IFRS based accounts for the Council will be produced for the financial year 2010/2011; however IFRS requires that the previous year's accounts must also be IFRS compliant in order to show prior year comparisons. In order to achieve this position the Council will need to include an opening transitional balance sheet as at 1st April 2009. This means that the 2008/2009 closing Balance Sheet will need to be restated to take into account the changes required under IFRS in order to be able to produce the comparative information required for the 2009/2010 accounting year.

In effect the accounts for 2009/2010 will need to be reported in the existing format as those for 2008/2009 (under the SORP2009) and then they will also need to be re-stated on an IFRS compliant basis.

4.6 As mentioned above under IFRS requirements, accounting policy changes, are retrospective. They are reflected in the opening balance sheet as if the authority had always accounted under IFRS. This affects the accounting treatment, in a number of key areas, and for the Council the most notable areas affected are the accounting for:

- employee benefits;
- private finance initiatives;
- leases;
- asset accounting.

4.7 Employee Benefits

International Accounting Standard (IAS) 19 looks at employee benefits where they are material. If material, accruals must be created at the end of the financial year for:

- Holiday pay earned but not yet taken.
- Flexi-time balances.
- Injury and early retirement benefits.

Identifying this information will not be straight forward as currently the payroll system does not hold this type of information and not all employees are on the same holiday year. Work in this area between Human Resources (HR) and Financial Management will be started early to establish the most efficient, cost effective way forward that will meet these requirements.

4.8 Private Finance Initiatives

Property used in a PFI arrangement will be recognised as an asset of the authority if it passes the International Financial Reporting Interpretations Committee (IFRIC) 12 control tests. These tests include:

- The local authority controls or regulates what services the operator must provide within the property, to whom it must provide them, at what price and where.
- The local authority controls through ownership, beneficial entitlement or otherwise a significant residual interest in the property at the end of the term of the arrangement.
- Where the property is used for its entire life, and there is little or no residual interest, the arrangement would still fall within the scope of IFRIC12 where the authority controls or regulates the service provided.

It is anticipated that both of the Council's PFI arrangements would pass these control tests of IFRIC12 and therefore need to be accounted for as assets of the authority. Due to the highly complex nature of PFI accounting, however it is envisaged that external support will be required in some form in order to comply with this aspect of the IFRS reporting changes.

Also, CIPFA has recently announced that the new PFI reporting arrangements will be introduced as part of the SORP2009, a year earlier than anticipated. Detailed guidance has now been recently released and this issue will have to be dealt with outside of the other IFRS areas as the Council will need to report PFI accounting, compliant with IFRS guidelines for the 2009/2010 accounts.

Work has already commenced on this issue to identify and quantify the scale of the changes and the type of external assistance required to help minimise the costs involved.

4.9 Leases

The main change between accounting for leases under IAS17 as compared to SSAP21 is that leases on land and property are accounted for separately as leases on land and leases on buildings. Under the previous regime using SSAP21 there was no such split required. This change may also lead to some leases being reclassified as finance leases under the new guidelines. The implications of this, for the Council, are that all property leases will need to be reviewed and analysed between land and buildings. This will require Property Services, Legal Services and Financial Management sections to work closely together to ensure compliance with the IFRS reporting and accounting requirements.

4.10 Assets

IAS16 requires items of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. This requirement means that assets also need to be split into individual components. CIPFA have announced that there will be no requirement to split existing assets, so only those acquired or re-valued from 1st April 2010 onwards will have to initially follow the new requirements. This change however represents a significant change for the council particularly in the way it will have to value its assets and Property Services will be most affected by these new requirements.

4.11 General Issues

Having examined other sectors who have implemented IFRS, the key elements for a successful transition are, planning, people, systems, timetabling and effective communication.

These wider issues are fully set out in turn below:

a) Planning and Project Outline
Early planning is critical to the success of this project. An initial project outline has been produced and is set out in Appendix 1 for information and sets out the key stages for the successful implementation of IFRS. From this a more detailed project plan will be developed with critical path analysis and key milestones.

b) Project team membership
The project team is to be led by a senior manager from within Technical Accountancy which forms part of the Financial Management Section.

Senior or appropriate managers will need to be identified from within the following areas:
Legal Services (Leasing / Assets)
Property Services Valuation Section (key role in Leasing / Assets)
HR (key role in Staff Benefits)
Financial Resources (SAP system developments)

c) Initial impact assessment/timetable
In line with best practice an initial impact assessment needs to be carried out and is part of the Project outline for completion by August 2009. Most of the impact of converging to IFRS has been outlined in this report as the Council is affected by most of the changes brought about by implementing IFRS.

At this stage it is very difficult to quantify the level of external assistance that will inevitably be required to assist with the project but specialist technical help has already been identified as a requirement at some stage during the process.

The Council is already aware that some Council's have already employed additional staff and/or consultants to assist with the management and implementation work identified and there is no shortage of firms ready to offer help in this area.

This Council's approach is to ensure that we acquire the right expertise at the right time and then build up our knowledge by being actively involved in the process. At this stage it is premature to set out any additional resources required, however, this will have to be reviewed on a regular basis.

d) Awareness and Training (Communication).
A report is to be presented to Cabinet in November in order to make all members aware of this development. Training will also be provided to members as appropriate but especially to this Committee, whose role it is to receive and approve the accounts.

Relevant staff at various levels will also benefit from some general awareness training on this issue and it is further proposed that more detailed specialist training will be required for those areas more affected by the change in the reporting requirements such as Property Services, Finance and HR.

5.0 Conclusions

5.1 PFI accounting changes must be implemented in time for the 2009/2010 accounts and will need an element of external specialist input. It is proposed to test the market to gauge the costs which would apply to the Council's two PFI contracts which is not expected to be significant.

5.2 The Council must be in a position to produce its first IFRS compliant budget for 2010/2011 and the work indicated in paragraph 3.3 is to commence shortly to comply with this requirement.

5.3 The Council must be able to comply with reporting under IFRS in time for its 2010/2011 accounts with comparable accounts produced for 2009/2010.

5.4 It is proposed that a project team is established consisting of the appropriate officers from those key services identified in paragraph 3.11b).above.

5.5 A clear project plan to manage the IFRS transition is essential and the Project Outline set out in Appendix 1 is to be used as a firm basis, to be further developed with input from the project team as appropriate, in order to ensure the Council complies fully with the IFRS requirements.

5.6 Regular progress reports are to be provided to members and the Executive Management Team (EMT)

5.7 External consultants / additional staff resources will need to be reviewed, once a full impact analysis has been carried out in order to assess the optimum arrangements required that allows the best use of the resource and also facilitates knowledge transfer to key staff.

5.8 Awareness and specific training will need to be considered for all relevant staff and members as appropriate.

6.0 Recommendation

6.1 The Committee is recommended to note the report and the project outline set out in Appendix 1.

7.0 Background Papers

Statement of Recommended Practice 2009 (SORP2009)
Draft IFRS Based Code of Practice on Local Authority Accounting in the United Kingdom
Local Authority Accounting Panel (LAAP) Bulletin 81 – Implementation of IFRS