

<b>COMMITTEE</b> <b>Audit Committee</b>	<b>DATE</b> 22 <sup>nd</sup> March 2011	<b>CLASSIFICATION</b> <b>Unrestricted</b>	<b>REPORT NO.</b>	<b>AGENDA NO.</b> 6.6
<b>REPORT OF:</b> <b>Chris Naylor - Director of Resources</b> <b>ORIGINATING OFFICER(S):</b> <b>Alan Finch – Service Head, Corporate Finance</b>		<b>TITLE:</b> <b>Update on Implementation of International Financial Reporting Standards (IFRS)</b> <i>Ward(s) affected:</i> All		

## 1. SUMMARY

- 1.1 This report provides an update on progress towards implementing International Financial Reporting Standard (IFRS) and a potential change to the timetable of Audit Committee considering the annual Statement of Accounts if draft legislation is agreed.

## 2. RECOMMENDATIONS

Audit Committee is recommended to:-

- 2.1 Note progress towards meeting the International Financial Reporting Standard (IFRS).
- 2.2 Note that if draft legislation is agreed, the audited Statement of Accounts may be submitted to a September Audit Committee for approval meeting rather submitting the unaudited accounts at the June meeting.

---

**LOCAL GOVERNMENT ACT, 1972 (SECTION 100A)**  
**LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT**

---

*Brief description of "background papers"*

*Name and telephone number of holder and address where open to inspection*

*Revision and consolidation of the Accounts and Audit Regulations 2003 (SI 2003 No. 533) as amended*

*Alan Finch (Tel 0207 364 4915)*

### **3. BACKGROUND**

In July 2011, officers reported on the requirement for the Council to adopt International Financial Reporting Standards (IFRS) to Full Council as part of their consideration of the Statement of Accounts. This report provides an update on the requirements and the Council's progress towards implementing the new standards. In addition, a potential change in the reporting of the Statement of Accounts is highlighted

### **4. INTERNATIONAL FINANCIAL REPORTING STANDARD (IFRS)**

- 4.1 With effect from the 2010/11 financial year, local authorities are required to prepare their financial statements in accordance with International Financial Reporting Standard (IFRS). This replaces the existing standards and the Generally Accepted Accounting Code of Practice for the UK (UKGAAP). IFRS, which has applied to Companies for some years, has already been introduced in central government and the NHS and the purpose is to have a single standard upon which all major organisations throughout the world are required to report. Adoption is mandatory for local authorities.
- 4.2. The IFRS introduces many changes to the way results are reported, but the main differences in the presentation of the accounts is as follows:
- New statements in the accounts: the income and expenditure account is now named the **comprehensive income and expenditure account** – as the name suggests, there are lots of similarities.
  - The **balance sheet** is largely unchanged though fixed assets become non-current assets and land, buildings and other equipment is rolled up into a new category of **Property, Plant and Equipment**.
  - A new statement is the **Movement in Reserves Statement** showing the **usable** (i.e. the general fund balance) and **un-usable reserves** (e.g. the revaluation reserve – the difference between the cost of a building and its assessed value). This combines the statement of movement on the general fund balance statement (this strips out certain charges such as depreciation so to not affect council tax levels) and the statement of total recognised gains and losses (this reconciles changes in balance sheet reserves) into one statement.
  - The **cash flow statement** is less detailed (the working papers supporting these are the same), however "**cash equivalents**" (deposits in call accounts easily convertible to cash) are now re-categorised from investment balances.

- Notes have to be included within the accounts showing how the 2009/10 accounts have been restated to comply with IFRS. It should be noted that the Council's usable general fund and HRA reserves resources have not changed as a result of the restatement.
- 4.3 The disclosure requirements within the accounts under IFRS are more demanding, so the complete accounts will be a bigger document. The main changes are:
  - 4.3.1 **Lease accounting** – if the council rents an asset (i.e. a building or an item of equipment), then the accounts need to disclose the total amount of future payments that are due. Also, the asset may need to be included on the council's balance sheet under **Property, Plant and Equipment** if the council is using the asset for most of its useful life or the rentals due mean the council has more or less paid for the asset over the term of the lease.
  - 4.3.2 **PFI Contracts** – previously the Council didn't have to include PFI assets on the balance sheet; the change to IFRS rules has brought the council's PFI schools on balance sheet and the heating system on the Barkantine Housing estate. This change has taken place for the 2009/10 accounts.
  - 4.3.3 **Embedded Derivatives** – if a contract is for services over a number of years and the pricing terms mean future increases are different from normal price indexes used in this type of contract, then it may be that costs have been unfairly allocated to the end of the contract. If this is the case, an embedded derivative may be in place – this could require costs to be reallocated across future financial years if payment increases are much above relevant price increases. If the contract contains assets purely for council use, then these may have to come onto the balance sheet.
  - 4.3.4 **Component Accounting** – more emphasis has been placed on whether council assets contain separate components that have a remaining useful life that is different from the main asset it is within as this could mean depreciation charges are incorrectly calculated. Only assets with a value of over £0.5 million and those with possible components over 25% of the value are being considered.
  - 4.3.5 **Employee Benefits** – In cases where annual leave or other leave is rolled over into the next financial year this could mean that an officer may be off for a considerable period of time in the following year – in theory, this absence may mean work has to be covered with other resources, therefore IFRS requires that a monetary value is placed on annual leave carried forward. Arrangements are being put in place to collect details of outstanding leave at the end of March. The roll-over of annual leave will be subject to manager's approval and council regulations. The potential impact on general fund reserves is reversed through a new accumulated absences report. The reserve balance comprises the value of teacher's leave rolled over from one term to another at March end. Non teacher's leave details have been collected but are not considered material for inclusion.
  - 4.3.6 **Infrastructure assets** – infrastructure assets are currently shown as depreciated historical cost values in the accounts. Future guidance may require a different valuation method for infrastructure assets, (i.e. roads) taking account of replacement costs of constituent parts of assets (i.e.

foundations, road surfaces). Any changes would not come into effect until 2012/13 at the earliest. The relevant Highways officers are aware of these potential changes.

- 4.3.7 **Grant Accounting** – When the council receives a grant to fund an activity, the grant may be subject to **conditions** that require the grant is repaid if the funding body is not satisfied that the grant has been used as expected. If there are binding conditions that could require repayment, then the council has to reflect the income received as a **creditor or receipts in advance** on the balance sheet to represent the potential debt. If there are no specific repayment conditions (even if the grant payer has expressed a wish for money to be used for certain purposes) but the money has not been spent, a **reserve** has to be created to show the resource rolled over to the following year.
- 4.3.8 **Segmental Accounting** – the council now has to include details of income and expenditure for each directorate within the accounts in addition to providing details of spend per the headings specified by CIPFA's Best Value Accounting Code of Practice.
- 4.3.9 **Group Accounting** – the rules on including controlled entities in the council's group accounts haven't changed significantly, however if the council has the right to control an organisation without excerpting that power, then it may need to be considered. It is not expected that additional organisations will need to be included in the group accounts, but a review is being conducted for the 2010/11 accounts.
- 4.4. The Council's progress in preparing for IFRS is comparable to most other councils. Detailed discussions have taken place with other Councils on consistent approaches for implementation. The authority remains on schedule to complete the conversion in time for the 2010/11 closedown as the restated IFRS accounts have been drawn up for 2009/10 and passed to the auditors for consideration. **Appendix A** sets out more details of the conversion. A more detailed explanation of the changes under IFRS will be given when the 2010/11 accounts are submitted to Audit Committee.

## **5. PROPOSED CHANGES TO ACCOUNTS AND AUDIT REGULATIONS 2003 – ACCOUNTS APPROVAL TIMETABLE**

- 5.1 Redrafted Accounts and Audit Regulations have been received from CLG (Communities and Local Government) for consultation. Most changes concern other public bodies or the clarification of previous legislation, such as the requirements to publish details of salaries as per the publication in the 2009/10 accounts, however there is a proposal that will change the timetable for tabling the annual Statement of Accounts to Members in September once the statements have been audited to bring arrangements more in line with private companies.
- 5.2 In recent years, it has been necessary to table draft, unaudited accounts to Members by 30<sup>th</sup> June, however the new proposals will mean Members will approve the accounts in September once the auditors have completed their review. Council finance officers will still need to prepare draft accounts by the end of June to allow the auditors to start their audit.

- 5.3 It should be noted that Cabinet will still receive an outturn report for 2010/11 of expenditure in June or July – this will contain the key information on the Council’s financial resources at year end.

## **6. COMMENTS OF THE CHIEF FINANCIAL OFFICER**

- 6.1 The comments of the chief financial officer are incorporated within this report of which he is the author.
- 6.2 There are additional costs incurred in adopting IFRS, both in relation to the project and to maintain processes and systems and continue to report on the new basis. These will need to be contained within existing resources.

## **7. RISK MANAGEMENT**

- 7.1 There are no specific risk management implications.

## **8. CONCURRENT REPORT OF THE CHIEF LEGAL OFFICER**

- 8.1 The Council is required by section 151 of the Local Government Act 1972 to make arrangements for the proper administration of its financial affairs. This includes the relevant reporting standards. In the body of this report the Council’s chief finance officer has demonstrated the measures he is taking in regard to the financial procedures to ensure the Council’s proper financial administration

## **9. ONE TOWER HAMLETS CONSIDERATIONS**

- 9.1 The Statement of Accounts is a single statement of the financial position of the whole Council which is potentially of interest to all individuals and organisations which have dealings with the Council.

## **10. ANTI-POVERTY CONSIDERATIONS**

- 10.1 There are no specific anti-poverty implications arising out of this report.

## **11. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT (SAGE)**

- 11.1 There are no SAGE implications arising out of this report.

**APPENDIX A**

<b>INTERNATIONAL FINANCIAL REPORT STANDARDS PROJECT - PROGRESS REPORT</b>			
<b>Issue</b>	<b>RAG Status</b>	<b>Explanation</b>	<b>Progress to Date</b>
Contracts	<b>GREEN</b>	All major contracts must be reviewed to ensure that clauses which involve transfer of assets or risk are properly accounted for.	Material contracts have been reviewed – no embedded assets required for inclusion under the IFRS regulations have been identified. This has included a review of potential embedded derivatives.
Leases	<b>GREEN</b>	IFRS changes the rules which differentiate between a finance lease and an operational lease. All major leases must be reviewed to ensure they are properly classified	Leases identified have been reviewed and reclassified where necessary. An exercise is being conducted to identify any new agreements.
PFI	<b>GREEN</b>	IFRS will change the accounting arrangements for PFI, bringing assets obtained through this route onto the authority's balance sheet.	The authority has three extant PFI schemes; two relating to schools and one relating to the Barkantine estate. Asset valuations have been obtained and the necessary accounting transactions have been calculated for the restated accounts.
Employee Benefits	<b>GREEN</b>	The new accounting rules require authorities to value and account for liabilities in relation to non-financial staff benefits. The most obvious example is where staff carry forward leave at the end of financial year to be taken in a later year, this represents value owed to the member of staff to the authority.	Data was collected on staff leave carried forward at the end of 2008/09 and 2009/10. The accounts have been rested to accrue for teacher's leave (£3.9m). Non teachers accruals amount to around £260,000 a repeat exercise is being undertaken at the end of the current financial year to confirm the value is not material – this approach is in line with other similar councils.

Infrastructure	<b>AMBER</b>	The rules on valuing infrastructure assets may change. For example in future the road network must be assessed according to the width of roads and their underlying fabric as well as road length.	Highways & Transportation are looking to ensure the relevant information can be obtained in setting infrastructure asset management plans. This will not impact upon the accounts until 2012/13 at the earliest, but data would though some general disclosures may be necessary for the WGA return.
Component Accounting	<b>GREEN</b>	IFRS requires future works to components of assets to be separately valued and accounted for if they are material in value and have a significantly different remaining useful life.	This will apply from April 2010. The Council has conducted a review of potential components in existing assets – potential components will be identified as new capital schemes are approved. The reviews conducted have not identified any significant assets with a materially different remaining lifespan to the underlying asset.
Segmental reporting	<b>GREEN</b>	Expenditure and income will need to be reported by Directorate by Directorate in future as well as by standard headings.	This information is already available in management reports.
Training	<b>GREEN</b>	Training of accountancy staff in all Directorates and selected others, notably Property Management staff, is necessary to embed IFRS	IFRS Training has been undertaken for officers. Any further training requests will be considered.
Restatement of Balance Sheet	<b>GREEN</b>	The balance sheet as at 1 <sup>st</sup> April 2009 is required to be restated on IFRS principles.	The restated balance sheets for 2008/09 and 2009/10 have been prepared. These have been sent to the auditors for review.