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## Report of the Director of Resources

### Corporate Governance and Audit Committee

Date: 17<sup>th</sup> March 2010

### Subject: International Financial Reporting Standards

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#### Electoral Wards Affected:

Ward Members consulted  
(Referred to in report)

#### Specific Implications For:

Equality and Diversity

Community Cohesion

Narrowing the Gap

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## Executive Summary

1. The Council has a statutory obligation to comply with proper accounting practice when compiling and publishing its annual accounts. For the 2010/11 accounts, proper practice for Local Government is defined by International Financial Reporting Standards (IFRSs). The scale and technical difficulties of this fundamental change in accounting practice is seen by the Audit Commission as a significant challenge for Local Authorities and recommends that Audit Committees oversee the arrangements to ensure compliance by the deadline of the 30<sup>th</sup> June 2011.
2. Officers of the Council have established an IFRS Board to monitor progress on the achievement of the project plan. The Board meets on a regular basis to ensure that the work plan is on schedule and that appropriate resources are available. The Board recognises that there are a number of technical issues which are subject to a national debate and are awaiting final guidance before commencing work in these areas. The Board also recognises that the intention of the Government is to ensure that there are statutory overrides which prevents these changes having a significant impact on the financial position of Local Authorities.
3. KPMG have reviewed the Council's progress to date and have assessed the Council as "on track" to achieve full IFRS implementation by the statutory deadline.

## **1.0 Purpose Of This Report**

- 1.1 The purpose of this report is to provide assurance to members that there is an appropriate structure in place to successfully implement International Financial Reporting Standards (IFRSs). In addition, the report updates members as to the latest position in respect of the potential financial implications of these accounting changes.

## **2.0 Background Information**

- 2.1 As part of the 2007 Budget it was announced that all Government bodies will be required to adopt IFRS. Central government, NHS Trusts, Primary Care Trusts and NHS Foundation Trusts are all required to conform to IFRS for 2009/10. For Local Government the requirement is to comply with the standards for 2010/11.
- 2.2 There are two main reason cited for the adoption of IFRS. Firstly to bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice. Secondly to enable Whole of Government Accounts to be compiled by ensuring all public bodies follow a consistent and up to date set of accounting standards.

## **3.0 Main Issues**

- 3.1 Members of this Committee received an initial report on the conversion to IFRS based accounts on the 23<sup>rd</sup> April 2008. This earlier report highlighted the timeframe for implementation along with an initial indication of those areas which could have a potential financial impact on the Council's bottom line.
- 3.2 Since this initial report, the Chartered Institute of Public Finance and Accountancy (CIPFA) have issued the IFRS based Statement of Recommended Practice (SORP) and the Government has, after consulting Local Authorities, issued new regulations designed to mitigate any adverse financial implications of the introduction of IFRS.
- 3.3 With these newly issued documents officers have been able to establish a detailed project plan for implementing the new standards and have reassessed whether there is still potential for the new standards to have a financial impact on the Council.

## **4.0 Progress on IFRS implementation**

- 4.1 An IFRS Board, chaired by the Chief Officer Financial Management, was established in November 2009. The Board is responsible for agreeing and monitoring progress against the IFRS work plan and to ensure appropriate resources are made available to meet the timescales. Currently the work is on schedule for completing the conversion to IFRS accounts by the statutory deadline. The Board also receives regular updates on the adequacy of current legislation to mitigation any significant financial implications of moving to IFRS based accounts.
- 4.2 All key finance officers have attended the appropriate training courses to ensure they are aware of the significant accounting changes required. Key elements of this training will be cascaded down to appropriate officers by way of closedown seminars and circulars in order to ensure that all staff involved with the closedown process are fully aware of the implications and requirements of their areas.
- 4.3 There are a number of very complex technical issues involved in the implementation of the new accounting standards. In order to tackle these problems officers have established two Local Authority working groups. Technical accountants from the Core Cities and the West Yorkshire Districts now meet on a regular basis in order to share ideas, knowledge and best practice. These contacts are particularly important

when responding to the various consultation exercises as a collective response has been shown to carry more weight at a national level.

- 4.4 The work plan, agreed by the IFRS Board, has been devised to allow flexibility in the order individual work streams are undertaken. This is to allow work to be deferred in areas where there is an ongoing technical debate as to the correct basis for implementing a particular standard. This ensures that the Council does not waste resources completing the conversion of one area only to find that a different interpretation has subsequently been agreed. The plan also recognises that key officers involved in the IFRS convergence will also be responsible for closing down the 2009/10 accounts. Consequently the IFRS work programme allows for a reduced IFRS work load over the closedown period.
- 4.5 The work plan recognises a number of key milestones by which the IFRS Board can monitor progress towards IFRS implementation. The main key milestones are:
- 30<sup>th</sup> June 2010 – 2009/10 accounts to include PFI and similar arrangements on an IFRS basis.
  - Jan 2011 – 2009/10 financial statements restated on an IFRS basis
  - 30<sup>th</sup> June 2011 – 2010/11 accounts produced on an IFRS basis
- 4.6 The work plan recognises a number of significant areas of work which are critical to the implementation process. The IFRS Board continues to monitor these areas to make sure they are completed within the required timeframes.
- 4.7 The current position on these work areas is as follows:

#### 4.7.1 The accrual of employee benefits

Any untaken holiday or flexi time entitlement must be accrued to the year it is earned. The Council has currently no central recording system for the amount of leave and flexi time individuals can carry forward, but it is recorded at establishment level. Consequently it will be necessary to request individual employee records for a random sample of all employees (excluding teachers). So far the sample has been extracted from the payroll system and consideration is being given to the best method of collecting the individual holiday and flexi time records of some 2,000 employees. The Council awaits a national view on how to calculate a holiday accrual for teachers. For Leeds City Council the current estimate for this accrual (incl. teachers) would be approximately £16m. Consequently the Council has responded to Government consultation for a statutory override (see para 6.2 below).

#### 4.7.2 Re assessment of the Council's leasing arrangements under IFRS

Asset management are currently in the process of collating all the leasing data onto one system to provide a comprehensive picture of the Council's leasing arrangements. The Council has some 165 assets it leases in and over 4,000 where the Council leases out an asset. A questionnaire has also been drafted to Head Teachers in order to ascertain the leasing arrangements within schools. Officers have also begun the process of assessing each of the 4,000 plus leases in order to determine whether they are operating or finance leases under IFRS.

4.7.3 Early adoption of IFRS based accounting for PFI schemes has meant that the Council must re-evaluate all current schemes to determine whether the resulting assets are on or off the balance sheet for the 2009/10 accounts. An initial evaluation of the current schemes indicates that only one asset will remain off the Council Balance Sheet. This asset is a joint services centre which reverts back to the PCT when the scheme ends. As this is a change to accounting practice, all previous accounting entries for PFI schemes must be

reversed out of the accounts and replaced by new transactions which split the revenue, principal and interest charges based primarily on the original contract details.

Work is ongoing to pull together the contract data and develop the financial model which will derive the appropriate accounting entries. KPMG will then be consulted as to the validity of the model before the accounting entries are included in the 2009/10 accounts.

## **5.0 External assessment of the Council's progress towards successful IFRS implementation**

5.1 In December 2009 the Audit Commission requested that external auditors assess the progress Councils were making to implement IFRSs. The assessment was based on a standard questionnaire in which auditors were asked to give a red, amber or green overall verdict on the Councils' progress. KPMG's assessment for Leeds City Council was green as we are deemed to be on track to implement IFRSs. The Audit Commission report on the national results of this survey states that only one in seven Authorities have been assessed as green and on track.

5.2 The Audit Commission national survey states that nearly a third of authorities had not discussed the IFRS transition with their auditors. Within the Council, Financial Management have regular update meetings with KPMG to discuss accounting issues, including the progress towards IFRS implementation. In addition, in February, KPMG's regional advisor on IFRS implementation attended one of these update meetings to discuss progress on implementation and the technical difficulties Local Authorities are facing. Financial Management will continue to work closely with KPMG in order to agree the main technical issues and monitor our progress towards implementation.

5.3 Based on the findings of the external auditor's assessment, the Audit Commission requested a more detailed study of a small sample of Local Authorities in order to identify key issues and disseminate best practice. Deloitte were commissioned to undertake this assessment and Leeds City Council was one of twenty Local Authorities asked to help Deloitte in their review. Although the overall assessment has still to be published, feedback from Deloitte recognised that the Council is well placed to complete the implementation to the new standards and identified a number of good practices notably:

- The flexibility in the Council's work plan.
- The sharing of knowledge and best practice via the Core Cities and West Yorkshire Technical accounting groups.
- Engagement of external auditors throughout the process.

## **6.0 Update on IFRS areas with a potentially significant impact on the Council's accounts**

6.1 The Government commenced the consultation period for the draft 2009/10 Local Government Capital Finance Regulations in November 2009. The aim of these new regulations was to provide statutory overrides for any areas where the new accounting standards would have a significant financial impact on the Council.

6.2 The current draft regulations will provide a statutory override for the employee benefits accrual. It does not however provide an adequate override for the potential impact of all possible reclassification of leases. As the officers have not yet finished analysing the thousands of leases the Council has entered into, we cannot determine what financial impact this may have. Leeds City Council has responded to the Government consultation by requesting amendments to the regulations which

would ensure there is no financial impact of the new accounting standards on the finances of Local Authorities. As the new accounting standards only come into force for 2010/11 it is still possible that even if these draft regulations are not amended then next years regulations could provide the necessary mitigations. The Council will continue to lobby the Government and CIPFA to provide comprehensive statutory overrides in time for full IFRS implementation.

- 6.3 In addition, in conjunction with other Core Cities, the Council has requested that the Government mitigate against the unintentional financial impact on the General Fund of the early adoption of IFRS accounting for PFI schemes. The impact of any liabilities recognised on the Balance sheet for PFI schemes will impact on the methodology by which the HRA is charged for it's share of the Council's debt (the item 8 determination). The Government has recognised this for 2010/11 and is consulting on changes to the item 8 determination for that year. In response to lobbying from Local Authorities the Government has now indicated that it is proposing to also amend the legislation for 2009/10. Failure to do so would cost the Council an estimated £4m reduction in the income generated for the General Fund through the item 8 charge.

## **7.0 Implications For Council Policy And Governance**

- 7.1 Training on the interpretation of IFRS based accounts will be made available to members of this committee prior to the approval of the 2010/11 accounts.
- 7.2 Officers continue to work closely with KPMG to ensure full compliance with proper practice. KPMG are informed of any changes to our accounts prior to implementation and are asked to confirm compliance with approved accounting standards. This process will continue as we move towards implementation of IFRS.
- 7.3 The Audit Commission national IFRS implementation survey highlighted that 46% of Authorities had not informed their audit committee of the change in accounting standards and 59% of audit committees did not have a role in overseeing IFRS transition. This report seeks to give members assurance that the Council has the resources, the skills and the procedures in place to successfully implement IFRSs and that work is on schedule to meet the statutory deadline for implementation.

## **8.0 Legal And Resource Implications**

- 8.1 Under the Accounts and Audit (Amendment) (England) Regulations 2006 the Council's accounts must comply with proper practice. The regulations define this proper practice as the Local Authority SORP. The 2009/10 SORP complies with UK Generally Accepted Accounting Practice apart from PFI transactions which fall under IFRS. The 2010/11 SORP has already been issued and this requires the accounts to fully comply with IFRSs.
- 8.2 The Audit Commission's national IFRS implementation survey stated that 63% of Authorities did not have the necessary in house skills to implement IFRSs and had hired external advisors to deal with specific technical issues such as PFI. The IFRS Board continues to monitor both the resources and technical skills required for conversion to IFRS based accounts. To date all resource requirements can be contained within existing Asset Management and Financial Management resources.

## **9.0 Conclusions**

- 9.1 The IFRS Board has agreed a flexible work plan for the convergence to IFRS and monitors progress on a regular basis. The work plan is on schedule and although challenging there is no indication that the work will not be completed on time and to the appropriate standard.

- 9.2 The Board has assessed the in-house expertise and resources available and does not consider additional external resources are currently required.
- 9.3 Both KPMG and Deloitte have completed high level assessments of the plans and work to date and have confirmed that they believe the Council is on schedule to complete convergence to the statutory timescales.
- 9.4 The draft legislation shows the Government's intent to neutralise any adverse impact of the accounting changes on Local Authorities financial position. However in a number of areas the legislation does not achieve this objective and the Council continues to press the Government for further overrides.

## **10.0 Recommendations**

- 10.1 Members of the Committee are asked to:
- 10.1.1 Note the framework established for planning and monitoring progress on the implementation of IFRSs
- 10.1.2 Note the progress to date
- 10.1.3 Note that the current draft legislation does not fully mitigate any adverse financial impact of IFRS implementation on Local Authorities but the Council continues to lobby the Government for amendments to the draft legislation
- 10.1.4 Agree that further IFRS up date reports are brought to this Committee in line with key milestones outlined in para 4.5 above.

### Background Documents Used

Report to Corporate Governance & Audit Committee – International Financial Reporting Standards (23/04/2008).

Draft Government legislation & LCC response.

2010 IFRS based SORP.

Audit Commission national survey– Countdown to International Reporting Standards.

KPMG's IFRS assessment of LCC.

Deloitte's IFRS assessment of LCC.