Leeds CITY COUNCIL

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Report of the Director of Resources

Corporate Governance and Audit Committee

Date: 14th February 2011

Subject: International Financial Reporting Standards

Electoral Wards Affected:	**Specific Implications For:**
	Equality and Diversity ☐
	Community Cohesion ☐
☐ Ward Members consulted (Referred to in report)	Narrowing the Gap ☐

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 (IFRS). 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 30th June 2011.
2. 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.
3. The IFRS Board continues to monitor progress on the critical areas of the IFRS conversion process. To date, all these critical areas are on track for completion in line with the work plan.
4. Draft restated IFRS accounts for 2009/10 have now been completed.

1.0 Purpose Of This Report

1.1 The purpose of this report is to update members on progress towards implementing IFRS based accounts for the 2010/11 financial year.

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 update report on the conversion to IFRS based accounts on the 17th March 2010. Based on this report, members agreed to further updates in line with key milestones within the IFRS conversion process. Members received the latest of these updates when they were informed of the successful implementation of IFRS based accounting for PFI transactions in the 2009/10 accounts. This report is to inform members of progress on IFRS convergence at the next key milestone, namely the restatement of the 2009/10 financial statements.

3.2 In line with the IFRS implementation timetable, the 2009/10 financial statements have now been restated and are attached at Appendix 1. Whilst these statements reflect the new format of the IFRS based accounts, members should note that the figures may change as further work is undertaken on a number of key areas. Section 4 below provides an update on these key areas and identifies whether they will impact on these restated statements.

3.3 Officers on the IFRS Board continue to monitor progress against the IFRS work plan and to ensure appropriate resources are made available to meet the timescales. Currently, it is the Board’s view that the work is on schedule for completing the conversion to IFRS accounts by the statutory deadline.

3.4 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.

3.5 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 involved with the budget setting process. Consequently the IFRS work programme allows for a reduced IFRS work load over the budget period.

4.0 Progress on the key IFRS implementation issues

4.1 There are a number of key work areas which are critical to the implementation of IFRS. Delays in any of these critical areas could have a significant impact on the Council's ability to complete IFRS based accounts by the 30th June. The IFRS Board monitors progress in these critical areas to ensure they are progressing to timetable. The current position on these areas is as follows:

4.1.1 The accrual of employee benefits

Any untaken holiday or flexi time entitlement must be accrued to the year it is earned. The process for collecting this data has now been established and the accrual calculated and included in the restated 2009/10 accounts (see Appendix 1). KPMG are to review the methodology and restated figures at their interim audit in March. Initial feedback from KPMG is that the General Fund accrual is not material and that the Council could use the 2009/10 figures as a reasonable approximation of the 2010/11 accrual in the draft accounts. The ability to use an estimated accrual in June will allow the Council more time to collate the actual data and either, verify the estimate, or amend the figures in the September accounts.

4.1.2 Re assessment of the Council's leasing arrangements under IFRS

Work on the identification of all leases is now complete and the Council now has a comprehensive picture of the Council's leasing arrangements. This was a significant and time consuming piece of work with a number of leases going back to the turn of the century and agreements which went back as far as 1759. The results of this work shows that the Council has some 177 assets it leases in and 4,569 where the Council leases out an asset. Under IFRS all these leases need to be re assessed to determine whether they are operating or finance leases. This work is almost complete with only 228 leases still to be assessed. Of these leases, some 352 have been initially classified as finance leases and work is now ongoing to value the assets involved. As we still await the valuations, the accounting entries required for any new finance leases have not yet been included in the restated financial statements at Appendix 1.

4.1.3 For 2009/10, all current PFI schemes were re-evaluated under IFRS to determine whether the resulting assets were on or off the Council's balance sheet. For 2010/11 a further two PFI schemes (New Leaf and Harehills Joint Services Centre) commenced and work is ongoing to account for these schemes based on the methodology accepted by KPMG in 2009/10. The accounting for these new PFI schemes will not impact on the 2009/10 restated financial statements which already included the 2009/10 PFI schemes.

4.1.4 IFRS apply a different set of criteria for including an entity in the Group accounts. A review of the new Group account boundary has been completed and identified five additional group entities (Belle Isle TMO, Marketing Leeds, Grand Theatre, Craft Centre and Green Leeds). The financial accounts for these entities have been obtained and now require consolidating into the Group account statements.

4.1.5 Under previous accounting practice, any grants received are applied when the expenditure is incurred, with any unapplied grant being carried forward on the balance sheet as a receipt in advance (over £90m in 2009/10). Under IFRS each grant must now be reviewed to see if all the grant conditions have been met; if the conditions have been met then the Council must account for them as income in the year. Unspent grant will then need to be carried forward as an earmarked reserve to fund the expenditure when it is incurred. The review of 2009/10 receipts in advance has identified a number of grants which will need to be recognised as income and carried forward as earmarked reserves.

4.1.6 Under IFRS any significant components within a fixed asset need to be separately recognised in the asset register. A potential example of a component would be say a burner at a crematorium. The burner has both a significant value and a different asset life to that of the main building. As a review of all assets for such components would be disproportionate to any benefit gained through better financial information, it is recommended by CIPFA that Councils consider a materiality level below which assets would not be reviewed for components. For Leeds City Council this threshold has been set at assets with a carrying value of £2m or less. Assets valued over £2m account for 68% of the value of the Council's assets but are only 18% of the total number of assets. Work is now ongoing to analyse all assets over £2m to see if they contain significant components. Unlike other accounting changes under IFRS, this change does not need to be brought in retrospectively and only applies from the current financial year. Consequently this work is not included in the restated 2009/10 accounts and has been programmed later than the other critical areas of work.

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

5.1 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. Consequently, they have required External Auditors to undertake a series of assessments on Local Authority progress towards implementation. KPMG have recently completed the latest assessment of the Council's progress and, as with all previous assessments, have deemed the Council to be on track to implement IFRS. They have not identified any major areas of concern but they have still to undertake a detailed audit of the restated accounts. A more detailed assessment of the Council's progress will therefore be included in the KPMG Interim report due to this Committee in May.

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

6.1 The 2009/10 Local Government Capital Finance Regulations aimed to provide statutory overrides for any areas where the new accounting standards would have a significant financial impact on the Council. As reported to members of this Committee in March 2010, there were a number of omissions in the legislation which could potentially lead to a financial impact on the Council.

6.2 These omissions were reported back to the Government as part of their consultation process and the legislation has now been amended to provide statutory overrides for any potential financial impact on Local Authorities identified to date.

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.

7.3 The last 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 IFRS 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 Statement Of Recommended Practice (SORP). The 2010/11 SORP has been issued and requires the accounts to fully comply with IFRS.

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 IFRS 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 KPMG has completed a number of 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 Statutory overrides are now in place to mitigate any adverse impact of the accounting changes on Local Authorities financial position.

10.0 Recommendations

10.1 Members of the Committee are asked to note the progress to date on implementation of IFRS.

Background Documents Used

Reports to Corporate Governance & Audit Committee – International Financial Reporting Standards (23/04/2008 and 17/03/2010).

2009/10 Statement of Accounts

2010 IFRS based SORP.