

Hampshire Fire and Rescue Authority

Governance Committee

24 March 2010

Item 9

**International Financial Reporting Standards Implementation –
Project Update**

Report of the Treasurer

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1. Summary

- 1.1. This report provides an update following the report in November 2009 regarding the required implementation of International Financial Reporting Standards (IFRS) for the financial year 2010/11. It sets out the developments that have taken place in terms of standards and guidance as well as outlining progress made to date with the project.

2. Contextual Information

- 2.1. Following the end of the consultation period on the draft Code of Practice in September 2009, the final Code of Practice was issued jointly by the Chartered Institute for Public Finance and Accountancy (CIPFA) and the Local Authorities (Scotland) Accounts Advisory Committee (LASAAC) towards the end of December 2009. Coming into effect for the financial year 2010/11, this sets out the requirements for presentation of local government financial information in accordance with IFRS. This represents a change from previous local government accounting which has been in line with UK accounting practices as detailed in the Statement of Recommended Practice (SORP) which preceded the Code. The SORP will be the relevant guidance for producing the 2009/10 Statement of Accounts for the final time. The changes between the SORP and Code require a significant project in order to assess accounting information as well as systems, processes and management information.
- 2.2. The change to IFRS is not simply a finance issue as it has wider implications for the organisation. It encompasses many of the practices of the Authority from procurement to staffing. The project is being co-ordinated from within County Treasurer's Department of Hampshire County Council but requires buy in and work from most departments of the Authority and the County Council.

- 2.3. If the Authority were to fail to meet the requirements of the IFRS Code in producing the Statement of Accounts for 2010/11 this could lead to a qualified opinion on the accounts from the Audit Commission. This would impact on the reputation of the Authority and would have a negative effect on the Use of Resources assessment which feeds into the Comprehensive Area Assessment (CAA) score.
- 2.4. The Authority is well placed to meet the requirements. In November 2009 the Audit Commission carried out a survey of local authorities to determine the progress on the implementation of IFRS. This was against a backdrop of deadlines set out in LAAP Bulletin 80 which had presumed that the final Code of Practice and related guidance would be issued well in advance of the actual publication date. The Audit Commission evaluated the progress of authorities based on a traffic light system and the Authority achieved a green light in this evaluation.
- 2.5. As an outcome from the survey the Audit Commission has written a report on their findings. This states that only one in seven authorities was assessed as being on track with the project. Therefore it was a particular achievement that the Authority was given a green light indicator. In addition, weaknesses were found in authorities' project plans as very few of these included the details the Audit Commission expected to find. Feedback received directly from Audit Commission staff in particular praised the Authority's detailed project plan against which the project is being monitored.

3. The Code of Practice

- 3.1. The final Code of Practice for local government accounting in 2010/11 included further information that had not been provided in the draft and had been added following the consultation process with local government.

Government and Non-Government Grants and Contributions

- 3.2. The final Code outlines a change in treatment of Government and Non-Government Grants and Contribution for capital purposes. Currently, once capital grants are received and applied they are held on the balance sheet as a liability called 'Deferred Grants and Contributions'. These are then written down over the life of the relevant assets, the income gradually being released to match the depreciation charge on the assets. The new treatment under IFRS will be to recognise these grants as income in the Income and Expenditure Statement in the year in which they are applied and all conditions attached to them are met. There will no longer be a liability held on the balance sheet, except where grants remain unapplied or conditions have not yet been met. The motivation behind this change is to recognise that these grants and contributions are not in fact liabilities as they are currently presented. Instead they will be presented as income received in order to fund activities.

- 3.3. This change will reduce the balance of liabilities over assets and to conversely increase income within the year. On the 2008/09 balance sheet the total outstanding balance of the Deferred Grants and Contributions liability, after the amortisation in the year, was £443,000. The effect of this change in restating the 2008/09 balance sheet will be to transfer the balance from liabilities in the balance sheet to the Capital Adjustment Account. The overall effect will be to increase the total net worth shown in the balance sheet. In future years the effect of this change will be to show grants and contributions as income in the Comprehensive Income and Expenditure Statement, which will then be reversed out through the Statement on Movement in Reserves to the Capital Adjustment Account. There will be a further impact when restating the 2009/10 balance sheet totalling the amount of capital grants and contributions received and applied in the year.

Borrowing Costs

- 3.4. In line with the move to IFRS the Code will allow capitalisation of borrowing costs in some circumstances, a mechanism which has not previously been permitted. Authorities will be able to capitalise interest and other borrowing costs which are directly attributable to the acquisition, construction or production of qualifying assets. Qualifying assets would be those which necessarily take a substantial period of time to get ready for their intended use or sale.
- 3.5. It will not be mandatory to capitalise borrowing costs and each authority must determine its own accounting policy in that respect. Where an authority chooses to adopt an accounting policy of capitalising borrowing costs for a certain type of project it must then apply this accounting policy consistently to all projects meeting the same criteria.
- 3.6. This mechanism is designed to allow organisations to capitalise the total cost of major projects, particularly where projects have a long gestation period and are associated with a future income stream, such as regeneration projects. It is not expected that this Authority would want to capitalise borrowing costs and the intention is to develop an accounting policy to this effect.

Introduction of Regulations

- 3.7. The Department for Communities and Local Government (DCLG) began consulting in November 2009 on changes to regulations for local government capital finance. This included proposals for mechanisms to negate some of the impacts of transition to IFRS accounting. The Treasurer has responded to this consultation which ended in January 2010. The summary of responses to the consultation including any expected amendments to proposals was published in February 2010.
- 3.8. As a result of the transition to IFRS accounting it is quite likely that leases which were previously classified as operating leases will now be classified as finance leases.

3.9. As reported in November the change to IFRS accounting requires an accrual in the accounts for accumulating employee benefits. This covers annual leave and flexi-leave which is carried forward at year end. This could impact upon the General Fund balance in the initial year of transition, for the restatement of the 2008/09 balance sheet. It is unlikely that the impact of this accrual would change materially year on year, and so there would be no further material impact. However the consultation on capital finance has proposed the creation of an Employee Benefits Adjustment Account to avoid it having any revenue impact at all. The entry of an accrued liability in the Balance Sheet would therefore be offset by an entry in the Employee Benefits Adjustment Account.

4. Early transition elements

4.1. Some elements of IFRS accounting have been introduced earlier than the overall 2010/11 target in order to smooth the transition and tackle some of the bigger issues early on.

4.2. In the 2007/08 SORP the requirements regarding the presentation of Financial Instruments in the accounts were changed to be in line with possibly the most complex IFRS. Financial Instruments are any contracts which give rise to a financial asset of one organisation and a financial liability or equity instrument of another. This covers debtors, prepayments and investments. For the 2007/08 Statement of Accounts the Authority successfully implemented the new requirements with regard to the presentation of these items. Recent feedback from the Audit Commission has suggested that many authorities experienced difficulties with this transition. It can therefore be seen as a success story for the Authority that our external auditors were satisfied with our approach and outcome.

5. Progress for 2010/11 Statement of Accounts

Statement Format

5.1. IFRS require some changes to the presentation of the main statements including the introduction of a new statement on the movement of reserves to replace the current statement of movement on the general fund balance and the statement of total recognised gains and losses (STRGL). A set of skeleton accounts in the new format has been prepared and is ready to use for the restatement of the 2008/09 balance sheet and the preparation for restating the Statement of Accounts for 2009/10. In addition, under IFRS, authorities will be required to produce segmental reporting information in the accounts which shows the income and expenditure across different segments of the organisation. It is planned to use the same format as the Budget Monitoring Statement regularly presented to the Finance and General Purposes Committee.

Notes to the Accounts

- 5.2. Under IFRS the notes to the accounts have changed and become slightly more complex. An initial piece of work has been done to compare the IFRS notes with the SORP 2009 notes in order to establish differences. Further work on this area is ongoing in order to determine how some of the new information will be gathered. It is expected that the comparative information for 2009/10 will be largely gathered during or around the forthcoming final accounts process.

Employee Benefits

- 5.3. A survey of staff across the Authority has been carried out to determine the average level of annual leave, flexi-leave and time off in lieu (TOIL) carried forward at the end of March 2009 in order to restate the 2008/09 balance sheet.
- 5.4. The total value for accrued employee benefits may have been considered to be material as at 31st March 2009. However, with the reduction in the number of TOIL hours being permitted to be carried forward, it is not now believed to be significant enough to warrant an entry into the accounts. However, it is likely that the Authority will be required to continue to conduct an annual review at least for a couple of years of this figure to ensure that it does not reach a material level.
- 5.5. As noted earlier in this report, any accrual in the Balance Sheet for employee benefits would not impact upon the General Fund and will instead be offset by an Employee Benefits Adjustment Account and so there would be no impact on the council tax.

Leases

- 5.6. Significant work has been carried out to identify all the material existing lease arrangements of the Authority. A large proportion of these have been assessed against the indicative criteria included in the Code to determine whether they are operating or finance leases. The overarching principle against which to assess the leases is where the risks and rewards of the assets lie, regardless of the legal arrangements of a contract. This work requires in depth investigation into the lease agreements, the use of the assets and the values of those assets.
- 5.7. This is an area where most change will be seen. All front line appliances are likely to have to be reclassified as finance leases, calculations will then be done to determine the entries in the accounts for those leases which are reclassified. This work will be incorporated within the restated balance sheet for 2008/09 and will feed into the restatement of the 2009/10 accounts.
- 5.8. Consideration has also been given to whether the Authority has other contract arrangements which contain embedded leases. This is where a contract confers the power to control specific assets. Having investigated the major contracts of the Authority it has been concluded that there are currently no embedded leases. However, this work will be ongoing to continue to assess any new contracts.

Investment Property and Assets Held for Sale

- 5.9. Work is currently being completed by the Estates Practice of Hampshire County Council to assess whether any of the property held at the end of 2008/09 met the criteria in the new IFRS Code for classification of Investment Property or Assets Held for Sale. Once completed there will be work required to determine to relevant entries to restate the 2008/09 balance sheet for any assets meeting these criteria.

Systems

- 5.10. Some small system changes have been identified for SAP and discussions have taken place with the Corporate Solutions team at Hampshire County Council and SAP representatives on how to implement these. Testing and developments in this area will be taking place shortly. It does not appear that SAP will be able to carry out or automate the necessary calculations for the transactions to deal with finance leases. It is expected that this work will be completed manually.

6. Future work

- 6.1. Work is now ongoing to resolve outstanding issues and restate the 2008/09 balance sheet in advance of the final accounts process for 2009/10. The 2009/10 Statement of Accounts will be prepared in accordance with the final SORP 2009. During this process the relevant information will be collected in order to restate these accounts in line with IFRS requirements to present comparative figures in the 2010/11 Statement of Accounts.
- 6.2. Overall this ongoing work will be completed in accordance with the project plan, drawing on external advice where necessary and keeping the external auditor informed.

7. Recommendation

- 7.1. That the Governance Committee note the progress made and supports the work still required for the successful implementation of the IFRS Code of Practice.
- 7.2. That a further report on IFRS implementation be considered by the Governance Committee in September 2010.

8. People impact assessment

- 8.1 The proposals in this report are considered compatible with the provisions of the European Convention on Human Rights and the Human Rights Act 1998 and the Race Relations (Amendment) Act 2000.

Section 100 D – Local Government Act 1972 – background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report.

NB the list excludes:

Published works.

Documents which disclose exempt or confidential information as defined in the Act:

None