

Countdown to IFRS

Implementation in local government

Local authorities need to make urgent progress now to ensure that their 2010/11 accounts will meet the required standards and will not be late. They also need to ensure that their arrangements for managing the transition achieve good value for money.

Authorities should now act, if they have not already done so, to:

- develop and maintain a detailed project plan, including a budget and resource plan;
- conduct a detailed impact assessment;
- engage the wider organisation, because IFRS is not just a finance issue;
- ensure that their audit committee, or equivalent, is aware of the implications of IFRS; and
- begin a dialogue with their external auditor on the authority's plans and progress, and the issues arising.

Successful implementation of International Financial Reporting Standards (IFRS) is vital to the reputation of individual local government bodies and the sector as a whole. Local authorities are falling behind CIPFA's indicative timetable.ⁱ This brings real risks, but the position is retrievable if authorities take urgent action now.

Local authorities will prepare financial statements based on IFRS under the new *Code of Practice on Local Authority Accounting* for 2010/11. This paper reports local government's progress and highlights the need for authorities to take action now. Several milestones towards implementation have already passed, but the timetable can still be met, if authorities take the right steps now.

In May 2009, the Audit Commission published a briefing paper that considered project management and the issues that will have the most significant impact on authorities' accounts. In May and September 2007, we published papers on the introduction of IFRS into the public sector and what auditors can and cannot do to support local authorities as they prepare for the transition to IFRS.ⁱⁱ

This briefing paper draws on evidence collected in November 2009 by auditors of all local authorities, fire and rescue authorities and police authorities, on local government's readiness for the transition to IFRS. Further briefings will follow, which will focus on the main technical issues.

Local government needs to lead and manage the transition

A failure to achieve successful transition to IFRS would cause significant reputational damage to individual local authorities and the local government sector as a whole. Poor preparation will heighten the risk that accounts will not meet requirements and so attract a qualified auditor's opinion or be published late. At a practical level, there is a risk that extra and unnecessary costs will be incurred.

Only one authority in seven was on track

Our IFRS survey of auditors found that only one authority in seven was on track, and one in five was having serious difficulties. Local authorities therefore need to satisfy themselves that proper arrangements are in place to manage this project and that the project is on track.

i This paper is relevant to local authorities, fire and rescue authorities and police authorities.

ii Further IFRS briefings are available at www.audit-commission.gov.uk/ifrs

In the NHS, which is subject to a transition process similar to central government's, the Department of Health is managing the transition centrally and has set a series of trigger points for producing restated accounts, which bodies have to meet. Auditors have also been asked to review the arrangements that bodies have put in place for the transition and to give an opinion on IFRS-restated comparatives. We have issued a briefing for NHS bodies that highlights that, even within this more structured approach, individual bodies experienced problems and unanticipated technical issues arose.ⁱ Local government does not have an equivalent process as it is constitutionally separate from central government; it is for each local government body to manage the transition individually.

The private sector companies that planned and prepared early did not experience as great a diversion of resources as those which were not so well prepared. Advanced planning and detailed financial work is needed now to successfully meet IFRS by the statutory deadline.

Audit committees need to assure themselves the transition is on track

Every audit committee, or the equivalent, should be sufficiently aware of the requirements of IFRS to ensure that the transition project is given suitable corporate priority. But our survey in November 2009 found that audit committees were not engaged with IFRS implementation. Forty-six per cent of authorities had not informed the audit committee of their transition plans and, in 59 per cent of authorities, the audit committee did not have a role in overseeing IFRS transition.

Forty-six per cent of authorities had not informed the audit committee

Audit committees are an important part of corporate governance. They are a key source of assurance about the organisation's arrangements for managing risk, maintaining an effective control environment and reporting on financial and non-financial performance.

IFRS are principles-based, so professional judgement and interpretation is necessary. A hallmark of successful implementation in health has been early and continuing communication with external auditors. Nearly a third of authorities had not discussed the IFRS transition with their auditor at the time of the survey. Local authorities should be having early discussions with their external auditors to understand and take a view on their interpretation of IFRS requirements. They cannot afford to leave this to the last minute.

Finance departments that have not already done so should report now on IFRS requirements to their audit committee (or equivalent) which should be seeking assurance on progress. Discussions between external auditors, finance teams and the audit committee, should be ongoing.

ⁱ *NHS Briefing Paper 7: Auditors' Review of Restated Comparatives for the 2009/10 Accounts*, February 2010, summarises key findings from auditors' work in relation to restatement of IFRS balances, which will also be helpful to practitioners in local government.

The importance of effective governance and management is highlighted by the risks identified by authorities as reported by auditors. Authorities' main concerns surround:

- the capacity to make the changes in the required timescale (expressed by 60 per cent of authorities);
- the preparation of accounts that do not meet requirements in all material respects leading to a qualified audit opinion (expressed by 27 per cent of authorities);
- technical capability (expressed by 20 per cent of authorities); and
- the potential impact on maintaining appropriate support to service delivery (expressed by 12 per cent of authorities).

Authorities need to complete and maintain a risk assessment

If they have not done so, authorities need to complete and maintain a risk assessment for inclusion in their corporate risk register.

Authorities need to catch up

Authorities are behind where they should be. CIPFA has drawn on lessons from other sectors and published LAAP Bulletin 80, *Implementation of IFRS: Outline Project Plan*, in March 2009. This set out a high-level outline project plan for local government bodies.

A project plan is essential. It can help to establish the basis for project governance, approval and monitoring, define roles and accountabilities, policies and standards and associated processes. The survey found that 77 per cent of authorities had a project plan for IFRS transition in November 2009, but just over three-quarters of these did not contain basic details such as a budget and a resource plan.

Table 1 shows that many authorities had not met key milestones in CIPFA's timeline which had already passed at the time of our survey. Although the timeline is only indicative, local government now needs to pick up the pace.

Table 1: **Examples where authorities lag behind the CIPFA timetable**

Step	Latest recommended completion	Proportion of authorities which had not completed by November 2009 (%)
Carry out high-level impact assessment	May 2009	42
Identify key staff	May 2009	20
Assess whether resources are adequate	May 2009	35 ⁱ
Develop skeleton Statement of Accounts under IFRS	September 2009 ⁱⁱ	95
Identify likely impact on budgets (if any)	September 2009	40

Source: Audit Commission

Authorities should not be waiting for CIPFA guidance, as the published Code is authoritative and provides the information needed to prepare IFRS based accounts.

Authorities should not be waiting for CIPFA guidance

Resources for transition activities should have been considered

Authorities should have considered the resources required for the work involved in the transition to IFRS. We recommended in our third briefing paper, *Managing the Transition to IFRS*, that senior management needs to consider whether there are enough resources and skills available within the authority to achieve a timely and smooth implementation of the new standards.

ⁱ Thirty-five per cent had not established a budget for the transition in November 2009.

ⁱⁱ Assumes CIPFA/LASAAC agree formats in March 2009.

Our November 2009 survey found 65 per cent of authorities had not set a budget for transition. Occasionally auditors report this is because authorities have completed an impact assessment and know they can manage transition and ongoing reporting within current staff workloads. However, usually auditors report that this is because authorities do not yet know what the impact will be and therefore do not know what resources will be required.

We know from experience in other sectors that the resources required to manage the transition relate more to the nature and quality of existing systems and arrangements than the size or capacity of the organisation. Transition will incur costs; authorities that have not done so already should develop a detailed resource plan.

There is a significant risk to value for money if there are delays in the transition

Effective leadership and project management is essential to manage the costs of transition effectively. There is a significant risk to value for money if there are delays in the transition. These will lead to extra, avoidable costs to achieve the fixed deadline for the preparation of the accounts.

Knowledge management is essential

Authorities that hire external advisers to help with the IFRS transition need to work collaboratively with them rather than simply outsource. Sixty-three per cent of authorities are using, or plan to use, external advisers to help implementation, mainly for technical input. We do not recommend wholesale externalisation of the IFRS implementation process, unless there is an effective transfer of knowledge between finance and any external consultants. This will lessen the learning curve and help ensure that IFRS reporting is repeatable once the initial change-over is completed.

If authorities decide to use external consultants, they need to make arrangements sooner rather than later to avoid higher costs and to ensure proper arrangements for knowledge transfer can be put in place.

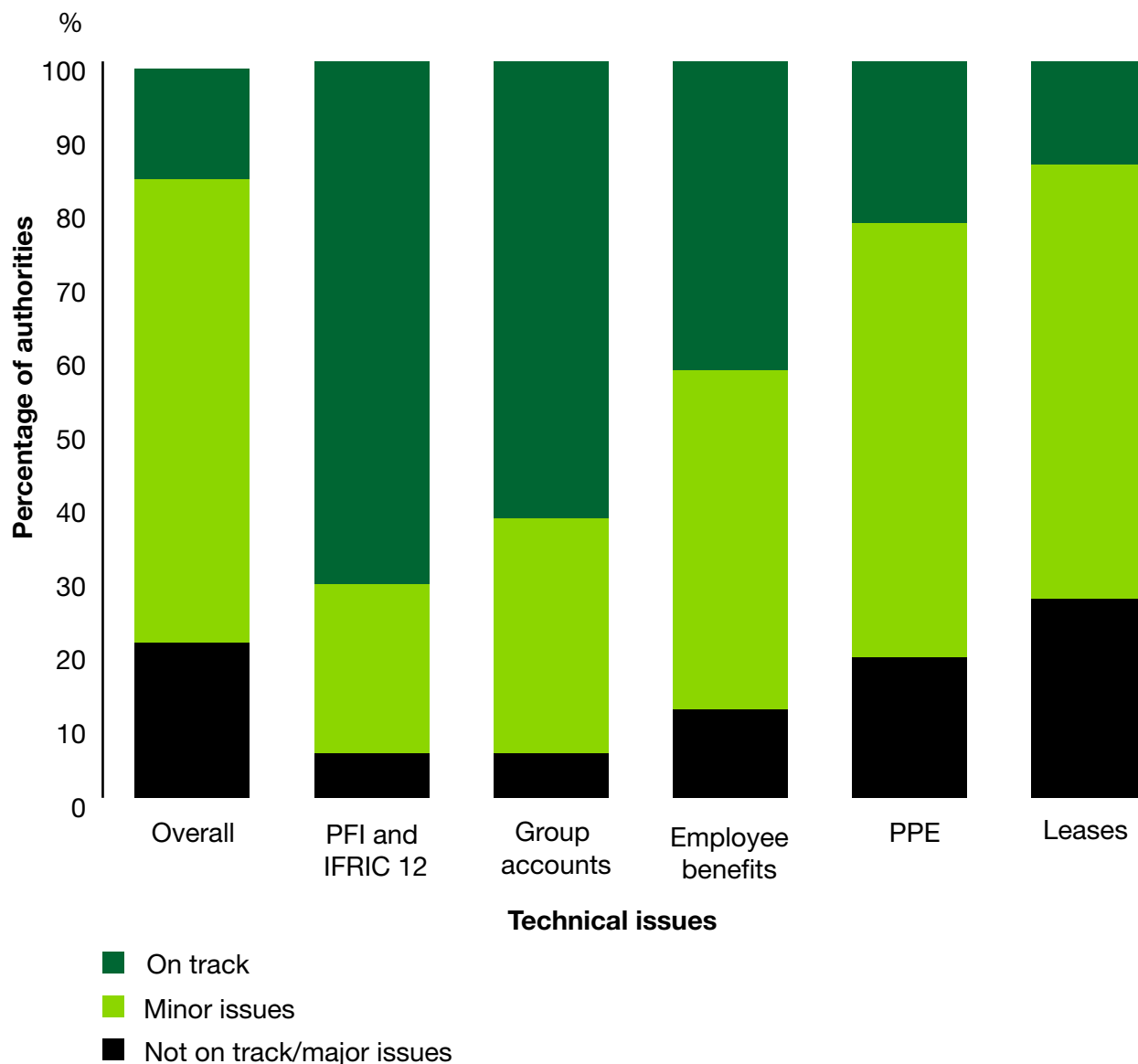
Individuals both inside and outside the financial reporting function, at different levels of seniority, will require some degree of training on IFRS. For some, this knowledge will be necessary to perform their jobs, while for others the understanding will clarify how IFRS may impact on them. Ninety-nine per cent of authorities have already trained staff, or plan to train them, in preparation for IFRS implementation. Training is even more important given auditors' recent continuing concerns about the skill level of staff delivering working papers and financial information for audit.ⁱ

ⁱ Thirteen per cent of local authority auditors have reported concerns to the Audit Commission about the skill level of staff delivering working papers and financial information for audit.

Identification and assessment of the technical impact on accounts is needed urgently

Figure 1: Auditor assessment overall and against key technical areas

Auditor assessments show that property, plant and equipment, and leases are key problem areas for authorities



Source: Audit Commission

Authorities need to address operational and technical issues. In our November 2009 survey, auditors assessed authorities' progress in each of the main technical areas that are likely to have the most significant impact on authorities' accounts and overall. Overall, 15 per cent of authorities were rated as on track, 63 per cent rated as having minor issues, and 21 per cent rated as not on track and having major issues.

Forty-two per cent of authorities had not yet completed an initial impact assessment

Key local drivers for change should be identified through an early analysis of how each IFRS will impact on the authority's systems, structures, people, internal or external financial reporting, and service reporting needs. Forty-two per cent of authorities had not yet completed an initial impact assessment in November 2009 whereas CIPFA had recommended that this work should be completed by June 2009.

There are also signs that even those authorities that have made an impact assessment have focused on the most widely reported technical issues, rather than working out what IFRS will mean to their authority. Authorities that have not already done so should complete an impact assessment now. All authorities should now be conducting detailed technical analyses and updating their initial impact assessment regularly.

IFRIC 12 requires urgent attention

Authorities need to be certain that they have identified all arrangements that may fall under IFRIC 12 now. In the NHS many arrangements were not identified early in the transition process. This caused delays and auditors reported concerns to the Department of Health, as we highlighted in our briefing for NHS bodies.

International standards do not directly address Public Finance Initiative (PFI) accounting. IFRIC 12: *Service Concession Arrangements* looks at such arrangements from the perspective of the private sector service provider. While the IFRIC interpretation does not specifically address PFI accounting, the circumstances it addresses are analogous to those found in a PFI scheme. In most PFI schemes we would expect to see the PFI asset appearing on the public sector balance sheet.

It is also important to recognise that it is not only schemes previously identified as PFIs that will be affected. IFRIC 12 applies to other arrangements, with similar characteristics. So even if an authority thinks it may not be affected by this change, it could be. That is why carrying out an impact assessment is essential.

This issue is particularly pressing, because the CIPFA/LASAAC joint committee has opted to adopt IFRIC 12 earlier than the rest of the international standards.ⁱ The 2009/10 Statement of Recommended Practice requires authorities to prepare financial statements using IFRIC 12.

ⁱ With the exception of financial instruments.

Although the survey found that 71 per cent of authorities were reportedly on track for PFI and IFRIC 12, most authorities had not yet completed a detailed impact analysis. Those that had were far less likely to be confident that they were on track. Experience from the NHS and central government suggests that accounting for arrangements falling under IFRIC 12 is complex and time-consuming. Often, the information needed is either held by a service department or by a third party and getting this information can be difficult. Deciding the bases for measuring and valuing the arrangements has also proved challenging. Local authorities need to act with urgency to ensure that the information is available for the 2009/10 financial statements. It should not – and cannot – be left to the year-end to resolve.ⁱ

Finance departments cannot do this alone

One of the principal lessons learned from the NHS and central government experience is that IFRS affects all parts of an organisation. To succeed, the change must be embedded across the wider organisation, involving people at all levels. It is not just a finance issue: corporate direction is essential.

Authorities will need to collect and collate extra or new data that is not readily available. Where this is the case, clear decisions should be taken on how that extra data is to be captured. Departments such as finance, internal audit, estates, IT, human resources and legal have key roles to play, and this needs senior management involvement and leadership. Experience suggests that if the transition is not supported by senior management and an organisation-wide approach is not taken, IFRS implementation will be disjointed, take longer than necessary and be more expensive.

Sometimes, IFRS will require changes to existing systems or even the development of new systems. Not all of those systems will be under the control of the finance department. Therefore, there is a need to ensure that all departments that hold or produce information needed under IFRS are aware of the requirements and have signed up to ensure that information is available in time. Senior managers have a key role in embedding change throughout the organisation and imposing suitable internal controls to help lessen the risk of errors and make sure IFRS reporting is sustainable.

**Senior managers
have a key role
in embedding
change**

Deciding on appropriate departmental representation on an IFRS project team will depend on each authority's impact assessment. Our survey found that, in addition to finance staff, typically IFRS project teams also include representatives from property (in 64 per cent of authorities), human resources (in 37 per cent of authorities), IT (in 23 per cent of authorities), and service departments (in 20 per cent of authorities).

- i The Audit Commission has previously commented on the risks of viewing the year-end accounts as just a one-off annual exercise. Sometimes, the final accounts are the first occasion on which income and expenditure is properly accrued and a balance sheet is prepared. Following their work on the 2009/10 accounts, 24 per cent of local authority auditors expressed concerns about the quality or timeliness of financial information delivered for audit.

Authorities can identify potential benefits

Implementation is a requirement and will come at a cost, but potential benefits have also been identified by authorities and reported to the Commission by auditors in the November 2009 survey. We have found that authorities that are identifying what needs to be done to improve systems, data and in-year management systems see benefits from transition work including:

- better understanding of contractual and lease commitments (acknowledged by 55 per cent of authorities);
- more accurate accounting for fixed asset components (acknowledged by 31 per cent of authorities); and
- better employee benefits data (acknowledged by 19 per cent of authorities).

Further information

Auditors will be discussing the issues summarised in this briefing with their authorities and the Audit Commission will be conducting follow-up work in summer 2010.

The Audit Commission is also planning to publish further briefing papers over the coming months, covering issues arising from key areas such as leases, property, plant and equipment, and employee benefits.

Please visit www.audit-commission.gov.uk/IFRS for more information about IFRS and implementation work.

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