

<b>DECISION-MAKER:</b>	AUDIT COMMITTEE
<b>SUBJECT:</b>	IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS
<b>DATE OF DECISION:</b>	17TH MARCH 2011
<b>REPORT OF:</b>	INTERIM EXECUTIVE DIRECTOR OF RESOURCES
<b>STATEMENT OF CONFIDENTIALITY</b>	
NOT APPLICABLE	

### **BRIEF SUMMARY**

The requirements of International Financial Reporting Standards (IFRS) were introduced to the Audit Committee in March 2010. The purpose of this report is to update the Audit Committee on Southampton's progress in implementing IFRS.

This report sets out the progress to date towards preparing IFRS compliant accounts for 2010/11, the key issues which IFRS presents, and provides Members with assurance that the Council is still "On Track" with its transition to IFRS reporting and will meet the deadlines set to achieve publication of compliant accounts by 30<sup>th</sup> June.

### **RECOMMENDATIONS:**

#### **Audit Committee is recommended to:**

- (i) Note the requirement to implement IFRS and the progress to date.
- (ii) Note the work still required to move to IFRS compliant financial reporting for 2010/11.
- (iii) Note that the Council remains "On Track" to provide IFRS compliant Financial Statements for 2010/11.

### **REASONS FOR REPORT RECOMMENDATIONS**

1. To provide assurance to the Audit Committee that SCC is still "On Track" to provide IFRS Compliant Financial Statements for 2010/11.

### **DETAIL (Including consultation carried out)**

#### **CONSULTATION**

2. Consultation has taken place with the Interim Executive Director of Resources, with officers across both the Council and Capita who have a role to play in implementing IFRS, and with the Audit Commission.

#### **BACKGROUND**

3. The Council is required to prepare its Annual Statement of Accounts using set accounting and disclosure requirements. From 2010/11 these requirements are moving away from UK Generally Accepted Accounting Principles (UKGAAP) to International Financial Reporting Standards (IFRS).

4. Following a consultation process, the Code of Practice for 2010/11 was issued by CIPFA/LASAAC in December 2009 along with some transitional guidance. This required local government accounting to come fully in line with IFRS accounting for the financial year 2010/11. In addition, the presentation of the financial statements for 2009/10 required an early introduction of IFRS for PFI and related contracts. These changes affect a number of the Council's business processes and systems, most notably valuation processes for property assets, lease arrangements and changes to accounting adjustments and the presentation of accounts.
5. As such this change is not simply a finance issue as it has wider implications for the organisation. It encompasses many of the practices of the Council from procurement to staffing. The project is being co-ordinated by Finance but requires buy in and considerable amounts of work from other departments of the Council. Finance staff have been and continue to work closely with colleagues from other areas within the Council and Capita, especially in Property Services, in relation to leases and asset classifications.
6. The detailed practitioners' guidance notes were finally published in December 2010 and set out the requirements for local authority accounts and the disclosures that must be made. They provide clarification of some of the issues not covered by the transitional guidance.

#### **TIMETABLE**

7. The Council is well placed to meet the requirements for IFRS and the project plan has been updated to reflect further developments and this is detailed in Appendix 1.
8. Although the first IFRS compliant accounts do not have to be prepared until 30<sup>th</sup> June 2011, this has required a considerable amount of work to ensure that the Council achieves IFRS accounting and disclosure compliance. The timetable for the IFRS implementation process shows the key milestones achieved to date and those to be achieved up to the point of publication.

#### **SIGNIFICANT AREAS FOR CONSIDERATION**

9. There are a number of significant areas of change that impact on the Council's Annual Statement of Accounts under IFRS. The most significant of these are explained in more detail below together with details of the work undertaken to date.

#### **Re-Statement of Financial Statements**

10. Many of the areas detailed below require a re-statement of the Council's financial position from 1<sup>st</sup> April 2009 in order to provide financial information for the comparative period of 2009/10. These changes are either as a result of having to account for items not previously accounted for (such as untaken annual leave) or to account for items which are treated differently under IFRS (such as Government Grants and Contributions).

## **Format of the Accounting Statements**

11. The table below summarises how the existing main statements are shown under IFRS.

<b>SORP(*) Accounting Statement</b>	<b>IFRS Code of Practice</b>
Income & Expenditure Account	Comprehensive Income & Expenditure Account
Statement of Movement on the General Fund Balance	Movement in Reserves Statement (MIRS)
Statement of Total Recognised Gains and Losses	Split between Comprehensive Income & Expenditure Account and the MIRS
Balance Sheet	Balance Sheet

(\*SORP – Statement of Recommended Practice)

12. The format of the Financial Statements Format and Notes are in the process of being reviewed and updated to incorporate the format changes and additional note requirements, following receipt of the CIPFA Practitioners Guidance in December.
13. Changes to the presentation of the accounts have been assessed and are being incorporated within systems in preparation for the process of producing the 2010/11 financial statements. The 2008/09 balance sheet and the main 2009/10 accounts have been restated as far as possible at this stage and include all the adjustments which have been calculated to date. Examples of the above statements are shown in Appendix 2 and the figures reflect the restatement work completed to date.
14. The work to date on the re-statement has focused on the figures. Further work on the narrative will be undertaken as the accounts are prepared in the spring of 2011.
15. The experience of other government bodies is that the disclosure requirements that back up the primary financial statements will become significantly more onerous, particularly in the year of transition. Significant additional disclosure requirements include;
- Providing a detailed breakdown of the financial information presented to Councillors as part of day to day financial management (known as segmental reporting) together with a reconciliation of how those reports relate to the primary financial statements.
  - The Balance Sheet at the start of the year of transition must be shown in addition to the normal comparative figures, (i.e. as at 1<sup>st</sup> April 2009). This means that the 2010/11 accounts will include Balance Sheet information as at three different dates.
  - Significant extra reporting on lease commitments, both as lessee and lessor.

### **Accounting Policies**

16. Although most of the Statement of Accounts is prepared in accordance with statutory guidelines, it is necessary for the Council to make decisions on the treatment of certain transactions, for example a de minimus level for capital expenditure. The Council's Accounting Policies convey the principles and concepts within which the Council prepares its Financial Statements. These Accounting Policies are in the process of being reviewed and amended where appropriate to incorporate the changes required by transition to IFRS.

### **Leases**

17. IFRS requires all leases in which the Council has an interest, either as lessee or lessor to be reviewed to ensure that the substance of transactions is properly reflected in the accounts regardless of the legal arrangements of the contract.
18. The Council has approximately 3,700 Investment Property operating leases which have been reviewed. Of the 82 Leases identified that met the agreed criteria, (where the value exceeds £250,000 and lease period is more than 15 years), only five relate to Land and Buildings, none of which are required to be reclassified as Finance Leases, (that is be treated as disposals).
19. A review of our 69 Plant & Equipment Operating Leases, in existence as at 1<sup>st</sup> April 2009 identified that essentially all are Finance Leases. This has resulted in approximately £4.6M of Plant and Equipment Assets being brought onto the Balance Sheet. A review of 2009/10 Leases identified a further 22 leases that require to be treated as Finance Leases giving rise to another £1.6M of Plant and Equipment Assets.
20. An initial review of contracts valued at more than £100,000, (a de-minimus level agreed with the Audit Commission), did not identify any embedded lease arrangements apart from potentially the Strategic Services Partnership (SSP) with Capita. The provision of IT Equipment may be required to be accounted for as a lease arrangement if material, however, a recently received interpretation of the relevant standard suggests that no embedded lease arrangement exists. In addition, consideration has been given to the recent outsourcing of Leisure Venues (including the Golf Course) and Highways Maintenance for potential embedded leases. Although it is considered unlikely that this will give rise to any material adjustments a final review in relation to the contract for the Golf Course is required.

### **Fixed Assets – Property Plant and Equipment**

21. Method of Valuation - Members of both the Finance and Property Services have recently attended a workshop hosted by Drivers Jonas Deloitte to review the most significant impact of the new requirements. Under IFRS certain assets have to be valued differently and in some cases, more regularly.
22. Component Accounting - IFRS places greater emphasis on component accounting. Where the value of a component of an asset is significant in terms of the overall value of that asset (generally assumed at 20% of the value) and it has a substantially different useful economic life, it should be recognised separately for depreciation purposes (e.g. lifts within a building).

There is no requirement to apply these changes retrospectively and instead components should be recognised separately as and when they are replaced or when assets are revalued. Property Services are incorporating the IFRS requirements into their cyclical revaluation programme and are regularly liaising with Finance.

23. Restatement of historical revaluations - Under previous accounting regulations upwards revaluations to all assets were credited to the Revaluation Reserve. Under IFRS upwards revaluations in respect of Investment properties (those held solely for rental income or capital appreciation) are now credited directly to the Comprehensive Income and Expenditure Account. All restatement work has been completed and these entries are subsequently reversed out in the movement in reserves statement so that there is no impact on the charge to the Council Tax Payer.

#### **Employee Benefits**

24. IFRS requires that the amount of annual leave and flexi-time accrued by staff but not taken at the year end is quantified and provided for in the Comprehensive Income and Expenditure Account. The calculations for this have been prepared in respect of Teachers Pay as at both 31<sup>st</sup> March 2009 and 2010 using the CIPFA Methodology. For other staff this is unlikely to be material and therefore it is proposed that a simplistic calculation will be performed subject to agreement with the Audit Commission for both annual leave and flexi-time. The impact of this potential additional charge is offset by a transfer to a balance sheet adjustment account and does not, therefore, create an additional charge to the Council Tax Payer.

#### **Capital Grants and Contributions**

25. Under the SORP capital grants and contributions received for capital purposes were amortised over the life of the asset that they were used to finance to offset the effects of depreciation. However, under IFRS all such grants will be treated as revenue income as soon as any conditions relating to the grant have been met. In order to meet this requirement work has been completed to determine if any material grants and contributions held on the balance sheet have conditions attached. The Unapplied Capital Grants & Contributions balance of £21M (long term liabilities) remains to be reviewed to determine whether some should be reclassified as useable reserves. This is unlikely to give rise to a significant movement to useable reserves given that conditions are likely to exist at the Balance Sheet date, and the accounts have been restated on this basis.

#### **NEXT STEPS**

26. During the coming months work will continue in accordance with the timetable shown in the Appendix 1 in respect of IFRS Restatement of 2009/10 and between April and June Finance will be working to prepare the Council's accounts for 2010/11 in accordance with IFRS.

## **APPROVAL OF THE ACCOUNTS FOR AUDIT**

27. The draft Accounts and Audit Regulations for 2010/11 have removed the requirement to have the accounts approved by Committee prior to being audited. It is not expected that this will be changed in the final regulations. This means that the Chief Financial Officer will approve the accounts for audit by 30<sup>th</sup> June, after which the annual audit will take place. The Standards & Governance Committee will still be required to approve the audited accounts by 30<sup>th</sup> September and this will be scheduled appropriately.

## **RESOURCE IMPLICATIONS**

### **Capital/Revenue**

28. None

### **Property/Other**

29. None

## **LEGAL IMPLICATIONS**

### **Statutory Power to undertake the proposals in the report:**

30. Accounts and Audit Regulations 2003.

### **Other Legal Implications:**

31. None

## **POLICY FRAMEWORK IMPLICATIONS**

32. None

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**SUPPORTING DOCUMENTATION**

**Non-confidential appendices are in the Members' Rooms and can be accessed on-line**

**Appendices**

1.	International Financial Reporting Standards Transition Timetable
2a	2009/10 Comprehensive Income & Expenditure Account – Restated (2010 Code – IFRS)
2b	2009/10 & 2008/09 Balance Sheets – Restated (2010 Code – IFRS)
2c	2009/10 Movement in Reserves Statement – New 2010 (Code – IFRS)

**Documents In Members' Rooms**

1.	
2.	

**Integrated Impact Assessment**

Do the implications/subject/recommendations in the report require an Integrated Impact Assessment to be carried out.	Yes/No
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**Other Background Documents**

Title of Background Paper(s)

Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)

1.		
2.		

**Integrated Impact Assessment and Other Background documents available for inspection at:**

<b>WARDS/COMMUNITIES AFFECTED:</b>	
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