AUDIT COMMITTEE
25TH SEPTEMBER 2009

ITEM NO………………

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) – PRIORITIES FOR THE COUNCIL

Purpose of Report

1. This report seeks to inform those charged with governance the areas that it is considered the most significant pieces of work will need to be undertaken to prepare IFRS compliant financial statements for Darlington Borough Council.

Summary

2. IFRS's are International Financial Reporting Standards and are accounting standards issued by the International Accounting Standards Board (IASB). The term IFRS refers to the international equivalent to UK GAAP, the set of Generally Accepted Accounting Principles that includes accounting standards, the IASB's Framework and established accounting practice. The aim is to harmonise financial reporting in a world of cross-border trade and investment and increased globalisation.

3. It is a statutory requirement for all local authority financial statements to be IFRS compliant by 2010/11. In order to prepare IFRS compliant accounts by 2010/11, the Council will need to revise its accounting policies, change the format of its financial statements and include a significant number of additional disclosures. It will need to restate its 2009/10 comparative figures and report these together with its 2010/11 figures on an IFRS basis.

4. An Action Plan (**Annex A**) has been produced to ensure that the Council complies with the relevant timescales and gives a step by step approach which includes a requirement to involve those charged with governance and keep them informed in the whole process.

Recommendation

5. The Audit Committee is requested to note and approve:-

   (a) The Action Plan to enable the Council to proceed with its IFRS transition project;
   (b) The priorities identified to enable the Council to ensure that they produce IFRS compliant financial statements, and
   (c) The Impact Assessment of the effect on the Income & Expenditure Account and Balance Sheet under IFRS.

Reasons

6. The recommendation is supported as it comprises part of the Council's corporate governance arrangements

Paul Wildsmith
Director of Corporate Services

Background Papers

No papers identified

Peter Carrick : Extension 2326

S17 Crime and Disorder	There are no specific issues which relate to crime and disorder.
Health and Well Being	There is no specific health and well being impact.
Sustainability	There is no specific sustainability impact.
Diversity	There is no specific diversity impact.
Wards Affected	All wards are affected equally.
Groups Affected	All groups are affected equally.
Budget and Policy Framework	This report does not affect the budget or policy framework.
Key Decision	This is not a key decision.
Urgent Decision	This is not an urgent decision.
One Darlington: Perfectly Placed	There is no specific relevance to the strategy beyond the report comprising part of the Council's governance arrangements.
Efficiency	There is no specific efficiency impact.

MAIN REPORT

7. In order to prepare IFRS compliant accounts in 2010/11, the Council will need to revise its accounting policies, change the format of its financial statements and include a significant number of additional disclosures. It will need to restate its 2009/10 comparative figures and report these together with its 2010/11 figures on an IFRS basis.

8. In order to restate the 2009/10 closing balances under IFRS the Council will need to recalculate its opening balance sheet as at 1 April 2009 using IFRS and construct an IFRS compliant comparative balance sheet as at 31 March 2010. The initial IFRS changes arising on transition (if applicable) will need to be taken through opening reserves as at 1 April 2009, meaning that there could be a one-off impact on the historical reserves position. The subsequent flow of IFRS based reporting will be through the income and expenditure account and the balance sheet in 2009/10 (restated) and all future figures.

9. As IFRS will have a significant impact on the Council's financial statements, an initial Impact Assessment (**Annex B**) on the Income and Expenditure Account and Balance Sheet has been prepared to show what kind of an effect it is envisaged the new standards will have.

10. There are 5 main areas that the Council will need to concentrate on and these are listed below as the priorities of the Council to enable IFRS compliant accounting statements to be produced.

First Time adoption and Accounting Policies

11. The first time adoption of IFRS (IFRS1) will involve significant investment of management time, and it is wider than just a finance issue, effective implementation of IFRS will involve Council-wide engagement.

12. IAS 1 will have an impact on the format and content of the financial statements, though in some cases the main components of the financial statements are broadly the same, there are however, changes to the categories used in the financial statements and significant additional disclosures.

13. It is recommended that the Council reviews its current processes and procedures for the management accounts and the financial statements production process as well as assessing the resource required to carry out the implementation of IFRS.

14. Further to the review of the chart of accounts and systems in place, the project team should under IAS8 (Accounting policies, changes in estimates and errors) be performing a detailed review of the current accounting policies in place. The accounting policies should be reviewed in line with the IFRS standards and with reference to the principles of relevance, reliability and comparability.

15. Comparatives and opening balances will need to be restated for the changes in accounting policy.

16. Where there have been changes in accounting estimates, disclosure will need to be made of the nature and amount of the change that effects the current period or that is expected to have an effect in future periods, e.g. revision of asset lives.

Leases

17. Under IFRS the Council will be required to account separately for leases of land and buildings (previously these may have been treated as one lease). The council will need to review the current lease register to ensure that it is comprehensive and covers all contractual agreements including the split between land and buildings. The Council will need to review its entire property leases in order to identify those that relate to both land and buildings. This valuation exercise will need to be undertaken by a valuer.

18. The Council will need to evaluate its lease and other arrangements to determine whether any changes in accounting treatment are required under IFRS.

19. To facilitate the review of leases and contracts the Council needs to ensure that they have in place a complete contracts and lease register. The Council will need to be able to evidence to the external auditors that this list is complete.

20. IFRIC 12 sets out to determine who controls the asset for its entire useful life, by tests that consider control during the service arrangement, and which separately consider who controls the asset once the concession arrangement has expired. Consequently, the Council will be required to revisit its arrangements to determine who controls the services provided, to whom they are provided and at what price. It will also be necessary to consider who has the benefit of any significant residual interest.

21. The Council will be required to account for its PFI scheme as an on-balance sheet scheme under IFRS.

Fixed Asset Accounting

Measurement

22. Under IAS 16 'Property Plant & Equipment' there has been further clarity provided over the valuation method to be applied:

- Operational Land and Buildings, and Investment Properties – to be held at Fair Value or Depreciated Replacement Cost (DRC) where no fair value exists;

- Council House Dwellings – to be held at Existing Use Value for Social Housing;
- Infrastructure assets and Community assets – to be held at Historical Cost; and
- Vehicles, Plant and equipment – to be held at Fair Value (allowing DRC to be used as a proxy for Fair Value for non property that have short lives or low values);
- Investment Properties – to be held at Fair Value or DRC where no Fair Value exists;
- Assets that are surplus to requirements – Lower of Fair Value less costs to sell, and carrying amount; and

- Community Assets, e.g. parks and cemeteries – to be measured at historical cost.

Component Accounting

23. IAS 16 introduces the concept of accounting for the different components of assets separately, including recognising the depreciation charges of the components separately.

24. Components are different classes of asset that could have a different life e.g. the boilers in a school have a lifespan of between 15 - 20 years whereas the building itself will typically have a lifespan of 40 - 60 years.

25. It should be noted that component accounting will not be applied retrospectively and will only apply to assets newly built, acquired or modified after 1 April 2010.

Assets held for sale

26. The Council will need to undertake a review of the classification of its fixed assets to ensure that assets held for sale are appropriately recognised in the accounts. Any fixed asset disposals in 2009/10 will need to be accounted for under UK GAAP rules in the 2009/10 financial statements and then the transactions will need to be reversed and accounted for using the IFRS criteria in order to restate the 2009/10 comparatives on an IFRS basis.

Infrastructure Assets

27. Under IFRS the Council will have to significantly change the way it accounts for infrastructure assets (these include the Council's roads, footpath and street lighting network). The Department for Transport however, has indicated that these accounting requirements will not be enforced until 2011/12 with a 'dry run' in 2010/11.

28. The current method is based on historical cost net of depreciation. IFRS requires that the Council calculates the Gross Replacement Cost (GRC) and the Depreciated Replacement Cost (DRC). These will provide the Gross Book Value (GBV) and Net Book Value (NBV) respectively in the accounts. GRC is valued by multiplying road length by width by the cost per square metre of road.

29. At the moment the Council's Infrastructure assets are valued at approx £36M whereas under IFRS it is estimated that the Infrastructure Assets could be valued in excess of £700M.

Employee benefits

30. Under UK GAAP local government bodies have not recognized accruals at the year end for staff annual leave entitlement that has not yet been taken and which is being carried forward to the following year. Accounting for this is specifically mentioned in IAS 19 and therefore under IFRS it is expected that all local government bodies will either recognize an annual leave pay accrual or will perform sufficient analysis in this area to satisfy their auditors that it is not a material amount and therefore does not need to be recognized.

31. The Council's annual leave year for the majority of staff runs from 1 April to 31 March, except for teachers' annual leave which runs on an academic year. The Council's current

policy is that no annual leave entitlement can be carried forward into the next financial year without the agreement of the relevant Director.

32. Although it is not perceived to be a problem for the Council, timeliness of data will be a key issue for the Council and it is important that there is liaison with HR to ensure that the necessary information is being collected and made available in good time to demonstrate to external audit that the assumption has a sound basis.

33. One other area of focus is IFRS 8 Operating Segments, where the objective is to require an entity to disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates. IFRS 8 uses a ‘management approach’ under which the segments for which information is disclosed are the same as those reported internally and which management use to monitor and control the resources of the Council. The overall aim is to enable the reader of the accounts to see the ‘business’ through the eyes of management.

Outcome of Consultation

34. The content of this report was not subject to consultation.