INTERNATIONAL FINANCIAL REPORTING STANDARDS

1. INTRODUCTION

1.1 In the 2007 Budget, the then Chancellor announced that the UK Public Sector would adopt the International Financial Reporting Standards (IFRS), as this was seen as best practice and allowed for international comparisons to be made.

1.2 It was also a question of timing. The UK Accounting Standards Board (ASB) has been reviewing the future of UK Generally Accepted Accounting Principles (GAAP) and in the short to medium term all but the smallest organisations will be producing accounts based on International Financial Reporting Standards.

1.3 As a result, Chartered Institute of Public Finance and Accountancy (CIPFA) / Local Authority (Scotland) Accounts Advisory Committee (LASAAC) now produces the IFRS-based Code of Practice on Local Authority Accounting rather than the Statement of Recommended Practice (the SORP), and this is overseen by the Financial Reporting Advisory Board (FRAB), the independent body that advises the Government on accounting issues, rather than the ASB.

2. IFRS IS INTENDED FOR THE PRIVATE SECTOR – WHY ARE WE USING IT?

2.1 IFRS has been developed for the private sector, but the impact of the vast majority of transactions is the same whatever sector you are in. Where there are specific public sector reasons to diverge from IFRS, there is a hierarchy that CIPFA / LASAAC (and the rest of the UK public sector) follows:

IFRS > IPSAS > UK GAAP

2.2 International Public Sector Accounting Standards (IPSAS) are accounting standards developed specifically for the public sector by the International Public Sector Accounting Standards Board (IPSASB). The 'rules of the road' followed by the IPSASB when developing IFRS-based standards mean that the requirements of IPSAS will be the same as those under IFRS, except where there is a pressing public sector reason to adopt a different treatment. This makes them the natural first port of call for CIPFA / LASAAC when IFRS is not appropriate. There are also some IPSASs that deal with exclusively public sector issues, and for which there is no IFRS equivalent - such as taxation.

2.3 <u>So why use IFRS rather than IPSAS?</u>
When the Treasury took the decision to follow IFRS, IPSASs were not as up to date as IFRS and were still under development in key areas. That has now changed and governments around the world are increasingly adopting IPSAS directly.

2.4 Why does IFRS change everything?
It does not. Recent UK standards have been based on IFRS, so many requirements are unchanged. There are differences, and the work required to reflect these changes should not be underestimated, but for many transactions, there is little or no change as shown in Section 3 below.

3. IFRS CHANGES AND OPPORTUNITIES

3.1 Completing the transition to IFRS involves many challenges. But there are also opportunities to simplify presentation and make the messages in the financial statements clearer. This appendix provides an overview of the main changes involved and explains how the new formats can be used to convey key information in the following areas:

- Comparisons with budgets;
- General Fund and HRA performance;
- Reserves position; and
- Cash flows.

It also provides some answers to commonly raised questions and sources of further information.

3.2 Overview of main changes from UK GAAP to IFRS:

	Significant IFRS Changes	**Substantially the same**
Financial Statements	New statements and amended layouts. More flexibility - detail can be in the statements or the notes; terminology can be amended; and the order of the statements can be changed to suit the authority.	New formats consistent with those used in the SORP where this is possible and helpful.
Purchase of goods and services	None.	Everything.
Salaries and Pensions	Untaken holiday pay and similar employee benefits accrued for at the year end.	Everything else.
Government Grants and Contributions	Capital grants recognised immediately (unless there are conditions) rather than being deferred and matched to expenditure.	Only the same for capital grants if there are conditions.
Property, Plant and Equipment (Fixed Assets)	More emphasis on component accounting (analysing assets into component parts e.g. land, roofs, kitchens, etc.) than under UK GAAP. Impairments taken initially to the Revaluation Reserve rather than Income and Expenditure – like revaluation losses. New class of 'assets held for sale'.	Everything else. Expenditure that can be capitalised under IFRS remains unchanged.
PFI (not applicable to WDC)	PFI Assets brought onto the balance sheet where the authority controls the asset. Changes made in SORP 2009- no change for 2010/11	

	Significant IFRS Changes	**Substantially the same**
Leases	90% 'test' to separate finance and operating leases removed. Property leases classified and accounted for as separate leases of land and buildings. Need to assess whether other arrangements contain the substance of a lease i.e. Refuse and Grounds Maintenance contracts. Assessment made and no such "embedded" lease exists.	Everything else. IFRS retains the concept of the finance lease / operating lease distinction, and the tests carried out to classify leases are substantially the same.
Financial Instruments	None – IFRS is identical to UK GAAP.	Everything.

3.3 Comparisons with Budgets

For members, probably the most important issue will be whether the authority has a surplus or deficit compared to its budget (and Council Tax) for the year. Because the financial statements follow accounting standards rather than local government legislation, this has not been easy to identify in the past. However, the new Movement in Reserves Statement gives this information. The extract below shows how this can be done for the General Fund. There is a separate column in the Movement in Reserves Statement showing the equivalent HRA figures; other columns show earmarked reserves etc.

Movement in Reserves Statement	**£000**	
Balance at 31 March 2010 c/fwd	3,948	
Movement in Reserves 2010/11		
Surplus or (Deficit) on provision of services	1,358	General Fund share of the Surplus or Deficit. The HRA share is in a separate column
Other Comprehensive I & E	0	
Total Comprehensive I & E	**1,358**	
Adjustments between accounting basis and funding basis under regulations	156	Statutory adjustments such as replacing depreciation with MRP, pension liabilities with contributions, etc.
Net Increase / (Decrease) before Transfers to Earmarked Reserves	**1,541**	Surplus / (Deficit) for year *
Transfers to / (from) Earmarked Reserves	(3,843)	Offset by transfers to earmarked reserves
Increase / (Decrease) in Year	**(2,302)**	Gives the change in the General Fund balance over the year
Balance at 31March 2011 c/fwd	**1,646**	**

* Surplus declared in January / February Executive reports

** Core Balance £1.5m, £0.1m for 2011/12 Contingency budget, £44,000 final accounts surplus report plus small residual £2,000

Other Comprehensive Income and Expenditure are taken from the Comprehensive Income and Expenditure Statement (CIES) (see example below), which replaces both the Income and Expenditure Account and the Statement of Total Recognised Gains and Losses (STRGL). The Surplus or Deficit on Provision of Services is the equivalent to the Income and Expenditure Account under the SORP. Other Comprehensive Income and Expenditure includes unrealised gains and losses (e.g. revaluation of land and buildings), and is the equivalent of the STRGL under the SORP.

Members will have previously approved the transfers to or from earmarked reserves shown in the Movement in Reserves Statement. The increase or decrease on the General Fund balance which is shown in this Statement would also normally be reported to members as part of the outturn report, although it might have been described as the surplus or deficit for the year.

A loss shown in the CIES is an indication that the costs of providing this year's services have not been covered by income, which will need to be funded by taxpayers in future years. An overall increase in usable reserves despite a loss being shown in the CIES normally means that there is a corresponding change in unusable reserves as for example MRP charges are replaced with depreciation and impairment. The difference will be reflected in the Capital Adjustment Account. Increases in Unusable Reserves such as the Pensions Reserve will need to be funded in the future, even if it is over a long period, placing an increasing burden on future taxpayers.

4. GENERAL FUND AND HRA PERFORMANCE

4.1 The format of the first section of the new Comprehensive Income and Expenditure Statement, the (Surplus) or Deficit on Provision of Services, is very similar to the Income and Expenditure Account under the SORP, although less detail is required below the Cost of Services. The format of the second section of the Comprehensive Income and Expenditure Statement is very similar to the STRGL under the SORP as shown below.

4.2 Comprehensive Income and Expenditure Statement (CEIS)

		Gross Expenditure £000	Gross Income £000	Net Expenditure £000	
Equivalent to the SORP's Income and Expenditure Account	Cost of Services	184,727	(75,252)	109,475	Equivalent to SORP's Net Cost of Services, and reconciles to the Segmental Reporting Note
	Other Operating Expenditure	1,692	(659)	1,033	
	Financing and Investment I & E	5,966	(6,282)	(316)	Now includes income & expenditure relating to Investment Properties and also change in market value of Investment Properties (+£1,056,000 in 2010/11)
	Taxation and Non-Specific Grant Income	0	(19,919)	(19,919)	Now includes capital grants & contributions received in year (£623,000 in 2010/11)
	(Surplus) / Deficit on Provision of Services			90,273	Equivalent to the surplus or deficit on the I & E Account under the SORP
Equivalent to the SORP's STRGL	(Surplus) or Deficit on revaluation of non-current assets			9,708	
	Actuarial (gains) / losses on pension assets / liabilities			(8,844)	
	Other Comprehensive Income & Expenditure			864	
	Total Comprehensive Income & Expenditure			91,137	

Whilst the financial statements under IFRS (other than the Movement in Reserves Statement) still do not provide a direct comparison with the budget, one of the new notes to the financial statements – on segmental reporting – can also provide a bridge between budgets and the financial statements. Whether it does this in practice depends on the decisions authorities take about what goes in this note.

4.3 Segmental Reporting Note
As discussed above, a comparison with budgets is one of the key items members will look for. Since the financial statements contain figures members won't be used to seeing, it may be helpful to start explaining the accounts by starting with the Segmental Reporting note.

The note is based on internal management structures and has to include at least 75% of service expenditure. The example below starts off by showing outturn information previously reported to members, and includes a line for support service recharges. However, if an authority reports the costs of support services separately, they could appear as a separate segment.

Note that the headings are based on the authority's portfolios, not the service classification in BVACOP (or SeRCOP from 2011/12)

Portfolio Income and Expenditure 2010/11	Community Protection £000	Culture £000	etc	HRA £000	TOTAL £000
Government Grants	(108)	0	….	(10)	(41,119)
Fees and Charges	(310)	(2,700)	….	(665)	(11,829)
Etc	….	….	….	….	….
Total Income	**(4,438)**	**(4,553)**	**….**	**(31,482)**	**(106,575)**
Employees	818	2,763	….	2,106	11,779
Premises	708	1,824	….	6,665	10,493
Etc	….	….	….	….	….
Total Expenditure	**5,071**	**9,638**	**….**	**124,018**	**215,849**
NET EXPENDITURE	**633**	**5,085**	**….**	**92,536**	**109,274**

Outturn figures previously reported to members

The note then needs to be reconciled to the Comprehensive Income and Expenditure Statement (CIES). The example above does not have to include 100% of the service expenditure – so the missing services would appear in the reconciliation. Including all the service expenditure in the note is likely to be more beneficial for members, and simplifies the reconciliation. Other reconciling items are likely to be common year-end adjustments such as for depreciation, pension adjustments etc. provided that these aren't already included in monitoring reports.

	2010/11 £000
Net Expenditure in Portfolio Analysis	109,274
Remove Net income on investment properties included in above analysis but shown elsewhere in the Comprehensive Income and Expenditure Statement	201
Cost of Services in Comprehensive Income and Expenditure Statement	**109,475**

The cost of services that used to form part of the Income and Expenditure Account now appears in the CIES, and forms part of the Surplus or Deficit.

Under IFRS, this figure might be different to under the SORP, because of changes to the accounting for capital grants. Previously, these were credited to services from the Government Grants Deferred Account, an "Unusable" Reserve to match depreciation, whereas capital grants are now credited to taxation and non-specific grant income as they are received (i.e. not matched with depreciation). This means that service lines won't include capital grant income; and also that the Surplus or Deficit might be more 'lumpy'.

4.4 <u>Reserves</u>

Reserves – including the General Fund and the Housing Revenue Account – are an indication of the resources available to an authority to deliver services in the future. The key messages that members will be looking for in terms of reserves – especially the General Fund and the HRA – are how the balances have changed over the year, whether the balances are still adequate, and what the balances mean in terms of future budgets and services.

Information on the level of reserves can be found in the Balance Sheet and related notes, and in the Movement in Reserves Statement and related notes. This latter statement will be more useful in explaining the changes that have taken place during the year, including contributions to and from earmarked reserves.

4.5 <u>The Balance Sheet</u>

The Balance Sheet remains under IFRS, and the layout is also very similar to the SORP's Balance Sheet. One difference is that the minimum requirements under IFRS are less detailed than under the SORP. For example, only one line is required for Property, Plant and Equipment – although more details than this can be shown if required.

The Council's Fixed assets are now described as Non-Current Assets and the major change affecting them concerns revaluation and impairment losses. Under SORP, all impairment losses had to be debited to the revenue accounts even if there was a balance in the Revaluation Reserve for that particular asset. Under IFRS, all losses whether revaluation or impairment are charged against any balance for that asset in the Revaluation Reserve first and then after that is exhausted the residue is charged to the revenue accounts.

There is now a stricter definition of Investment Property. Property can only be defined as Investment Property if it is held solely for the purpose of deriving commercial rental income or for capital appreciation. The Council has a number of properties, for instance the Althorpe Innovation and Enterprise Centre (AIEC) from which it earns rentals but because they deliver an objective of the Councils, in the case of the AIEC economic regeneration they have to be counted as Operational Assets. This stricter definition has resulted in assets such as the various cafés in the parks moving from Investment Properties to Operational Assets. Any changes in the "fair" value of Investment Properties are now debited directly to the Comprehensive Income and Expenditure Statement and then reversed out to the Capital Adjustments Account rather than as previously under SORP managed initially through the Revaluation Reserve.

There is a new category of current assets "Assets Held for Sale" and this relates to property which previously would have been accounted for under Property, Plant and Equipment as part of "Surplus Assets". In order to qualify as "Assets Held for Sale", there must be a high probability of the assets in question being sold within the next 12 months and the assets must have an active disposal policy e.g. be marketed on the open market. In this Council's case, 18A & 18B Southbank Road have been classified as "Assets held for Sale" as they will shortly be disposed of as part of the Wilton House sale to McCarthy & Stone.

The cash line now includes 'cash equivalents', these previously formed part of the Short Term Investments line and are highly liquid investments which are readily convertible to cash. Typically these include Instant Access bank accounts, Money Market Call Investments and Money Market Funds. In the case of this Council at 31 March 2011 the "cash equivalents " equated to £3.7m invested in the Prime Rate Money Market Fund.

Under SORP, grants and contributions received from external bodies and developers for capital projects were held as short term creditors until used. IFRS now requires that these contributions are held within two separate accounts: the Capital Grants and Contributions Unapplied Account where there are no legal conditions requiring the repayment of the contribution if not used for the purpose intended and the Capital Grants and Contributions Received in Advance Account where such conditions exist and which is termed a long term liability (£1,598,000 at 31 March 2011).

Under IFRS the Council is required to account for accrued employee benefits such as untaken leave at the year end. The liability for this is now contained within short term creditors and amounts to £315,000 at 31 March 2011.

There is now a requirement to split the General Fund and Housing Revenue Account Insurance Provisions into two separate accounts, the one showing those liabilities at the balance sheet date which are likely to be payable in the following year and the other containing all liabilities payable beyond one year. The former is accounted for as a short term liability (£117,000 at 31 March 2011) and the latter appears in the long term liabilities (£214,000 at 31 March 20).

Changes have also occurred to the bottom half of the Balance Sheet (reserves). The key figures are outlined in the table below:

	Notes	31 March 2011 £000
Usable Reserves		31,244
Unusable Reserves		273,104
Total Reserves		**304,348**

The minimum requirement is to include only two lines – usable reserves (such as General Fund and earmarked reserves) and unusable reserves (such as the Revaluation Reserve and the Capital Adjustment Account).

Other reserves can be shown on the balance sheet as long as these totals are shown.

The Usable reserves are as per SORP (Capital Receipts, Housing and General Fund balances, various earmarked reserves and the Major Repairs Reserve) with the addition of the Capital Grants and Contributions Unapplied Account as referred to above and which amounts to £766,000 at 31 March 2011.

The Unusable reserves consist of reserves such as the Revaluation Reserve and Capital Adjustments Account which reflect the movements in the value of the Council's property, plant and equipment and previous capital financing decisions. They also contain reserves designed to provide statutory mitigation such as the Pensions Reserve, Available for Sale Financial Instruments Reserve, Financial Instruments Adjustment Account and Accumulated Absences Account, the latter being the reversal of the accrued employee benefits referred to above, so that various movements required under IFRS accounting principles within the Comprehensive Income and Expenditure Statement do not impact on either the Council Tax or Housing rents.

4.5 <u>Cash Flows</u>

The final statement required by the Code is the Cash Flow Statement. Although similar to the SORP Cash Flow Statement, the cash flows of an authority are presented over fewer headings under IFRS than under SORP. Consequently, the statement will be quite short if the minimum presentation is used. A key difference is that the statement balances to the movement in 'cash and cash equivalents', not just to the movement in cash. The indirect method could look like this:

	Notes	2010/11 £000		
Net (Surplus) or deficit on the provision of services		90,273	---	Surplus or deficit taken from the Comprehensive Income and Expenditure Statement
Adjust net (surplus) or deficit on the provision of services for noncash movements		(100,147)		
Adjust for items included in the net (surplus) or deficit on the provision of services that are investing and financing activities		659		3 groups of transactions:
Nest cash flows from Operating Activities	27	**(9,215)**	)	• Operating
Investing Activities	28	10,867	)	• Investinging
Financing Activities	29	-	)	• Financing
Net (increase) or decrease in cash and cash equivalents		**1,652**		
Cash and cash equivalents at the beginning of the reporting period		(5,631)		
Cash and cash equivalents at the end of the reporting period		**(3,979)**	---	Cash and cash equivalents figure in the Balance Sheet