**APPENDIX 1**

**INTERNATIONAL FINANCIAL REPORTING STANDARDS**

# Background

* 1. In common with all local authorities Merseyside Waste Disposal Authority is required by statute to prepare annual accounts in accordance with statutory proper accounting practice. Statutory proper accounting practice has been established as the Statement of Recommended Practice (the SORP) that CIPFA publishes and updates annually.
	2. The Government’s budget statement for 2007 announced that the public sector would move towards preparing accounts on the basis of International Financial Reporting Standards (IFRSs). This will replace CIPFA’s SORP based approach. In local government a timetable for implementing the IFRS based approach has been established and it will be fully implemented for the accounts for 2010-11. The implementation of this initiative represents one of the most fundamental changes in local government accounting practice in recent times.
	3. One of the requirements of an IFRS based statement of accounts is that they should reflect not just the year in question but should also show a comparative figure for the prior period of account. The effect of this is that the current financial year, 2009-10, is the first comparative period, which means that the IFRS transitional period has already started.
	4. The Authority must report its financial performance in SORP terms for 2009-10 and must also be in a position to restate its financial performance in IFRS terms for the same period. While some of the changes are minimal there are also a number of significant changes. It will be important for Members to understand the extent and impact of the changes and to provide support for the Treasurer in preparing accounts on a different basis.
	5. To enable them to comply with the requirements local authorities must restate the opening balances for the comparative balance sheet, as at 1 April 2009. Then the closing balance sheet must also be restated as at 31 March 2010. These restatements will include significant amendments to the accounting policies that underpin the accounts. Then for 2010-11 the accounts will be prepared fully on an IFRS basis, with the 2009-10 comparative figures available as a part of those accounts.
	6. Restating the 2009-10 opening balance will enable the Authority to take a view on whether IFRS compliant accounts have any impact on the budget for 2010-11.

# The impact of the IFRS regime – outline of changes

* 1. The introduction of an IFRS based financial reporting approach into local government is part of the wider programme of convergence with international accounting standards for the UK and the public sector. This convergence has been in train for some time and while there are some big changes there are many aspects of the new regime where there will be little change in the way local government is required to prepare accounts. The formal adoption of the IFRS based regime in local government will finalise the convergence for the public sector.
	2. In preparing for convergence CIPFA has reviewed the areas of local government accounts most likely to be affected by the changes. The key areas they have identified are as follows:
	+ Leases
	+ Tangible assets
	+ Private Finance Initiative (PFI)
	+ Employee benefits
	+ Disclosures in the accounts
	1. The Authority needs to review the way it collects information and presents it in the accounts for each of the first four of these areas. For the additional and extended disclosures in the accounts the Authority will also need to collect different and extra information than in prior years and prepare accounts that comply with the new and additional requirements.
	2. Our overview of the key areas under consideration is as follows:

## Leases

* 1. Leases are used widely across local government as a way of funding assets for either a shorter or a longer term that are used in delivering services. The leases are split between Operating Leases and Finance Leases. In broad terms the operating lease is over a shorter term and not for the whole of the asset life. While finance leases are often for longer periods and the asset they finance is largely used up by the end of the lease period. The practical impact of the distinction is that assets employed under operating leases remain off the balance sheet while assets employed under finance leases go onto the balance sheet and attract capital charges.
	2. Under the IFRS based regime the distinction of operating leases and finance leases remains. However, the rules for interpreting whether a lease is an operating lease or a finance lease have changed. It will be important for the Authority to review all the lease agreements to establish whether under the amended rules the agreement is an operating or a finance lease. This review will involve a number of the Authority’s officers.
	3. However, the IFRS treatment of leases does not simply involve the review of agreements that are already classed as leases. There may be a number of contracts that the Authority has entered that involve a third party delivering services on behalf of the Authority. If the delivery of those services includes the use by the third party of an asset or assets that are largely or wholly employed in delivering a service for the Authority then under the terms of IFRIC4 it is likely that the contract will contain a lease. The impact of these contracts is unclear, but to ensure that the Authority classifies its leases correctly then service contracts that involve the use of an asset will need to be reviewed and an appropriate classification will need to be made.
	4. The use of an asset to deliver a service is complicated because under the IFRS regime it is considered that where the asset includes land then, no matter the length of the contract the asset that is the land can never be used up, so that part of the contract may only be an operating lease. Meanwhile an asset that sits on the land may be substantially used up by the end of the agreement, and that part of the contract may be a finance lease.

## Tangible Assets

* 1. Tangible Assets are what are currently referred to as Fixed Assets. The key issues in relation to Tangible Assets concern Valuation and the Component Parts of the assets.
	2. In terms of valuation of assets local authorities have used a system of quinquennial valuations for some time. The practical effect of this is that either all assets are valued every five years or about one fifth of the assets are valued every year under a rolling programme.
	3. Under the IFRS regime there is a requirement to ensure that assets are valued at Fair Values. There is a recognition that it may be sufficient for the valuation to remain on a five year basis in general terms. However, for certain assets in a volatile market it may be necessary to gain a more up to date valuation from time to time. We are currently working with the valuer from St Helens Council (who provides a valuation service for the Authority) to establish whether there are any assets that need to be valued more regularly than the quinquennial valuation programme.
	4. The IFRS regime brings some clarification to the way that asset values are depreciated to reflect the use of the asset. Under the SORP regime a building may have been assigned a life of 30 years and depreciation charges would have been made that reflected the use of the asset over 30 years.
	5. Under the IFRS regime there is more clarity that where components of an asset have different lives then those components should be assessed and valued separately. The components should then have depreciation applied to them at different rates dependent upon the life of the individual asset.
	6. For example a building may have a 30 year life, but within the building the lift may have a life of 15 years and the roof of 20 years. The lift should be depreciated over 15 years, the roof over 20 and the remainder of the building over 30.
	7. The requirement to identify the components of assets and their lives separately is more rigorous than current requirement and will require additional work. We are working with the valuer to identify the impact of component accounting on the Authority assets. From there we will be able to consider the implications for the accounts and whether there are any budgetary implications.
	8. The need to account for the Authority’s assets in a more detailed way has meant that the way records of the Authority’s assets are maintained has been reviewed. Under the IFRS regime the records of components of assets, valuations, depreciation, impairment and all the required accounting entries means that the current, fairly high level, spreadsheet based approach is not fit for purpose as an asset register. In order to maintain appropriate records that enable the Authority to comply with the IFRS regime a different system will need to be either developed or bought in. Members approval will be required for the Treasurer to specify the requirements and ensure the Authority has a system in place that complies with the requirements. The estimated costs of developing these arrangements have not yet been identified.

## Private Finance Initiative (PFI)

* 1. The Private Finance Initiative (PFI) is a device which brings funding for significant public sector projects to deliver services through private sector partners. One of the key issues in the public sector was that any assets associated with delivering the service were deemed not to be on the balance sheet of the public sector organisation. This helped significantly with the affordability of these schemes as they did not attract capital charges.
	2. Under the IFRS regime IFRIC12 suggests that PFI scheme assets will normally not be on the balance sheet of the private sector provider. The impact of this is that the public sector must therefore mirror this treatment and the asset will normally sit on the balance sheet of the public sector partner. The effect of this will be to lessen the affordability of any PFI scheme to the extent that asset charges will need to be made.
	3. For the current year and for 2010-11 it is unlikely that this will impact on the Authority accounts as the Authority has not entered any PFI scheme at this stage. However, for the future the proposed RRC contract is predicated upon the use of a PFI contract. While the effect is not immediate, medium to longer term plans will have to consider the effect of bringing the PFI scheme onto the balance sheet and as well as the impact of the associated capital charges.

## Employee benefits

* 1. Employee benefits under the IFRS based regime bring some new accounting issues. Where an employee has earned a benefit from the Authority through their employment, but has not received that benefit by the year end, the Authority has to consider the impact and to make an accrual in that year’s accounts to reflect the earned benefit owed to the employee at the year end.
	2. The benefit and accrual that is the easiest to consider is for holidays. An employee earns a full year’s holiday entitlement by working for the year. If they do not take the holiday during the year and are entitled to carry the benefit forward then under the IFRS regime the Authority is required to make an accrual for the holiday owing to the employee.
	3. For the Authority the information systems are already in place to manage the holiday accrual. Good records are maintained of staff holidays, the standard year end for holidays is the same as the financial year end and the maximum number of days that employees are able to carry forward is five. In this situation and given the relative number of staff compared with the size of the organisation it is unlikely that any holiday accrual would be material to the accounts, as such the Authority would not have to make the accrual. However, in this transitional period we will be required to demonstrate that we have sufficient information to make an assessment that the accrual is not required.
	4. Similar calculations will have to be made to reflect the impact of carried forward flexi-time at the year end and also to reflect the impact of any shift work for example. However, it is unlikely that these calculations will lead to a material accrual in the accounts.

## Other matters

* 1. There are a number of other matters that we will need to take account of in preparing the accounts on an IFRS basis going forward. These include: long term employee benefits; treatment of intangible assets; investment property; ‘non-current assets’ held for sale. These are not considered to be as significant for local authorities as the matters already raised.

## Disclosure

* 1. The IFRS regime will bring about changes in the disclosures included in the accounts. These changes will range from minor changes of terminology to more significant and extensive disclosures in the published accounts.

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| Accounting policies | Will need to be fully reviewed and revised |
| Introducing the four Primary statements | Which replace the existing statements |
| 1 - Balance sheet  | Terminology changes, e.g. moving to non-current assets and current assets, similarly with liabilities. Introducing Property plant and equipment category |
| 2 - Comprehensive Income and Expenditure Statement | Replacing the I&E |
| 3 - Movement in Reserves statement | Replacing the Statement of movements in General Fund Balance  |
| 4 - Cash flow | Some clarifications – to ensure this is about cash and cash equivalents |
| Other disclosures |  |
| Leases | Significant additional disclosures |
| Related parties | Additional disclosure requirements |
| Impairment of assets  | Additional disclosure requirements |
| Other issues | Inventories (stock) changes in rules;Prior period adjustments – where there are material (rather than fundamental) errors;Changes proposed re. accounting for government grants;Changes in group accounting requirements; |

# The transitional arrangements

* 1. In order to meet the requirements of the transition from SORP based accounts through to IFRS based accounts the Authority needs to ensure that it has arrangements in place to understand the nature and scale of the changes and is well placed to apply them to its processes.
	2. The Business Support Manager(BSM) and the Treasurer are taking a lead in ensuring the Authority is ready for the transition. This report to Members is a part of that process. Elsewhere as part of the process for preparing the 2010-11 budget the BSM is raising awareness of the requirements on other Authority officers and has also prepared an IFRS plan to enable the Authority to comply with the requirements.
	3. While the finance team are taking a lead there is concern that the transition from SORP to IFRS based accounting will present a very significant challenge. The Finance team are very likely to be stretched through the transition, additional resources may need to be called for even on a temporary basis as the scale of the challenge materialises. One of the effects of this challenge is that it will impact on the extent to which members of the finance team are available to support other Authority initiatives that will continue to need support during this period. Members need to be aware of these pressures, the risks they present and the possibility that additional resources may be required in the medium term.
	4. Arrangements are in place to ensure we are well placed to collect the relevant information that will enable the Authority to restate its accounts in line with the IFRS requirements. However, we will need to review the systems that provide the Authority’s financial information to establish whether they can support the information requirements. This may be a particular issue where additional information needs to be collected, for example in the fixed assets system. Where systems are not adequate the Authority will need to establish how to obtain the information, either through an enhancement to a system or even by replacing an information system.
	5. The next step once the information has been collated is for the opening balance sheet for 2009-10 to be re-stated. The opening balance sheet will be restated during December 2009 which is in line with the proposed timetable set out by CIPFA. There is no hard deadline for this restatement (other than the normal deadlines for the 2010-11 accounts), but in order to learn from the process for the next stage, to understand any budgetary implications and be in a better position to share the outcome with the auditor, the plan is to meet the proposed timescale set out by CIPFA.
	6. The accounts for 2009-10 will be prepared in the usual way on a SORP compliant basis for Member approval in June 2010. Alongside the preparation of the SORP accounts we will also prepare an IFRS compliant closing balance sheet for 2009-10. Again there is no statutory timescale for preparing the IFRS compliant restated balance sheet but we will seek to prepare the restatement in a timely way to learn lessons and share the outcome with the auditor.
	7. Finally as part of the transitional arrangements we will prepare skeleton accounts for 2010-11, including additional disclosure notes and accounting policies to discuss with the auditor well in advance of preparing the first set of accounts that are fully compliant with the IFRS regime.