Audit & Governance Committee – 12 January 2011

Vale of White Horse District Council

Report of **Head of Finance**
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To: AUDIT and GOVERNANCE COMMITTEE
DATE: 12 January 2011

Report No. 91/10

Wards Affected
All

International Financial Reporting Standards (IFRS) – Restated 2009/10 accounts

Recommendation

(a) That Audit and Governance note the content of the report and approve the restated 2009/10 accounts for audit.

Purpose of Report

1. This report updates the committee on progress towards complying with International Financial Reporting Standards (IFRS).

Strategic Objectives

2. Sound financial management is central to the strategic objective of managing our business effectively. A full understanding of the transactions involved in the production of the Council's annual financial statement and their transfer into a revised format supports the transparency of process whilst conforming to Government requirements on accounting practice.

Work undertaken since September

3. At the audit and corporate governance committee on 15 September 2010 members were informed that work would begin on restating the 2009/10 accounts in IFRS format once the final accounts work for that year was complete.

4. To enable the council to produce IFRS compliant accounts the following tasks had to be completed:
   - Restatement of the opening balance sheet as at 1 April 2009 to comply with IFRS; and
   - Restatement of the 2009/10 financial statements to provide comparators for the 2010/11 accounts.

5. Since the September meeting both tasks have been completed and this report details the changes that were required to be made.

Restated opening balance sheet

Background

6. A requirement of first time adoption of IFRS is that the opening balance sheet of the comparative period is restated under IFRS, hence the need to restate the 1 April 2009 balance sheet. The 2010/11 accounts will have three balance sheets, dated 1 April 2009, 31 March 2010 and 31 March 2011, all on an IFRS basis. Restatement of the opening balance sheet is therefore the first major task for IFRS compliance.

7. A copy of the council's audited balance sheet for 2009/10 is attached as appendix A. The opening balances for 2009/10 were restated during the 2009/10 closedown on account of the change in accounting policy for council tax. The re-stated balances as at 31st March 2009 are now further restated to provide a balance to use as from 1st April 2009 under IFRS accounting policies. This is the starting position to be used to closedown the accounts for 2009/10 in IFRS format and amend the general ledger so that a full IFRS account can be produced for 2010/11.

8. The process of doing this will also act as an opportunity for members and officers to fully understand the changes required so that by June 2011 the new format of the accounts should not present significant difficulties.

Adjustments required by IFRS

9. A copy of the changes required to be made to the balances as at 31 March 2009 to provide opening balances as at 1 April 2009 is attached as appendix B. Explanation of the changes made is provided below.

   INTANGIBLE ASSETS

10. The definition of intangible assets has been extended. The 2009 Statement of Recommended Practice(SORP), included the following statement:
    "Internally developed intangible assets should only be capitalised where there is a readily ascertainable market value, which is unlikely to occur in a local authority's single entity financial statements."

11. The new IFRS-based code contains no such restriction. Consequently, expenditure in previous years, for example in relation to in-house computer software development, may need to be accounted for as an intangible asset. However, no significant expenditure has been incurred by the council on computer software development or other intangible assets and consequently this balance remains unchanged.

COLUMN 1 – ASSETS HELD FOR SALE

12. Assets held for sale in the council's balance sheet did not previously require a depreciation charge because the notion of "useful life" over which an asset could be depreciated was inapplicable.

13. Under the old code, assets held for sale were shown together with fixed assets. Under IFRS, assets held for sale are shown under current assets. To be classified as an asset held for sale, the asset must conform to the following:

    1. Management is committed to a plan to sell the asset and an active programme has been initiated to locate a buyer and complete the plan; and
    2. The asset is being actively market at a sale price that is reasonable in relation to its current fair value; and
    3. A completed sale is expected within one year from the date of classification (although this period may be extended if any delay is caused by circumstances beyond the entity's control); and
    4. It is unlikely that there will be any significant changes to the plan or that the plan will be withdrawn.

14. The council had one asset classified as "held for sale" which was "highly probable" within one year and this has been re-classified as a current asset. This asset did not fully complete within the year as expected but did complete in early 2010/11.

COLUMN 2 – INVESTMENT ASSET RECLASSIFICATION

15. A check has been done on all investment properties, previously categorised as non-operational assets, to ensure that they meet one or the other or both of the following criteria:

    1. The asset (generally property and/or land) is held to earn rentals, and/or
    2. The asset is held for capital appreciation.

16. The council's Valuer has confirmed that six assets totalling £439,000 did not meet the category of investment asset and were transferred to Land and Buildings.

COLUMN 3 – INVESTMENT PROPERTY - TREATMENT OF REVALUATIONS

17. All investment assets are required to be held at 'fair value'. The definition of fair value is "the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction". The fair value of investment land and property reflects the market conditions at the end of the reporting period. This means that these assets are required to be reviewed and revalued on an annual basis rather than as a part of the five year review programme for other council assets.

18. IFRS require that any gains or losses arising from a change in the fair value of investment assets should be recognised within the profit or loss for the period in which it arises. This means that any revaluation gains which had previously been transferred to a revaluation reserve will need to be reversed and treated as a gain to the comprehensive income and expenditure account. Because this gain must not impact on the charge to council tax payers this amount is then reversed out of the general fund and transferred to a non-useable reserve, the capital adjustment account.

19. During 2008/09 Napier Court was revalued by £195k. This amount was transferred to the Revaluation Reserve. Consequently the opening balance needs adjustment by moving this amount from the revaluation reserve to the capital adjustment account.

COLUMN 4 - REVIEW OF LEASE ARRANGEMENTS

20. The council acts as lessor on a number of investment properties and other land and buildings. To a more limited extent the council is lessee of items of equipment. The requirements of the IFRS code in respect of lease classification are different to those of the 2009 SORP.

21. Under IFRS, where a lease is a lease of property, the land and buildings elements are considered separately for the purpose of lease classification. Under the previous SORP, both elements would have been considered together. Under the IFRS the land has an indefinite economic life. Consequently the land element is normally classified as an operating lease. The property element needs reviewing against set criteria to clarify whether it should be treated as a finance or operating lease.

22. However, investment property leases are treated differently in that separate measurement of the land and buildings elements is not required when the lessee's interest in both land and buildings is classified as an investment property. Likewise investment properties are treated by the council (lessor) as operating leases because in no circumstances would the council let an investment lease whereby the value of the asset was required to be written out of the balance sheet over the period of the lease.

23. For the property elements of leases on assets not classified as investment properties, the criteria used to determine whether the lease is an operating or finance lease are as follows:

    1. The lease transfers ownership of the asset to the lessee by the end of the lease term;
    2. The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value so as to make it reasonably certain the option will be exercised;
    3. The lease term is for the major part of the economic life of the asset;
    4. The present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset, and
    5. The leased assets are of such a specialised nature that only the lessee can use them without major modifications.

24. If one or more of these tests are met then the lease is treated as a finance lease. All other leases are treated as operating leases.

25. These criteria are different from those adopted previously, and how a lease is classified impacts on where income from leases is recognised in the accounts. If, for example, an asset held on the balance sheet as an operating lease was re-classified as being a finance lease, then the asset would be derecognised on the balance sheet and a long-term debtor would be recognised in its place. All the subsequent income would be used to write out the debtor rather than as income to the comprehensive income and expenditure account as is currently the case.

26. A full review of the council's operating leases on land and buildings and equipment has been carried out and no re-designation of lease classification has been required.

27. Members will recall that completion of the council's 2009/10 Statement of Accounts included the early adoption of the IFRS Interpretations Committee Update 12 (IFRIC 12), which concerns "service concession arrangements". Under the requirements of IFRIC 12, it is possible that the assets of contractors providing services on behalf of councils may need to be brought onto the balance sheets of councils, where those assets are used primarily or solely on activities on behalf of those councils as, in accounting terms, those councils are effectively leasing the assets from the contractor. A review of the council's contracts determined that no assets need to be brought on to the balance sheet.

28. Finally, the review of council contracts identified no leases which should be considered "embedded leases". This is defined as being where a contractor is using an asset or a group of assets solely for the use by the council and the council contract would be deemed to consume the full economic life of those assets. This may for example apply to the use of waste collection vehicles. However, the current joint contract with South Oxfordshire District Council (SODC) means that waste vehicles fail the sole usage test.

COLUMNS 5 to 10 – CAPITAL GRANTS

29. IFRS requires the council to recognise all capital grants and contributions through the comprehensive income and expenditure statement once any conditions have been met. This is a change to accounting policy and the opening balances must be re-stated.

30. Grant income of £737,000 previously categorised as receipt in advance was re-stated as revenue grant income with no specific conditions of return but earmarked for specific uses within the budgeting process and transferred to earmarked reserves (Column 5).

31. An amount of £357,000 which had previously been held as a receipt in advance and which was identified as a commuted sum was transferred to the general fund. This amount consisted of a build up of contributions donated by developers to the council to assist with the ongoing maintenance of public spaces in private developments. The council has the ongoing commitment to fulfil it's obligations and there is no clear requirement to return the funding if the obligation is not met. The information available at the time the council receives the money is that they will continue to meet their obligation and therefore these funds should be taken

directly to the income and expenditure account in the year in which they are received (Column 6).

32. Developers' contributions were previously held in the creditors line of the account. They remain as liabilities within the accounts because they usually have a condition attached to them – if they are not spent according to the agreement the developer may seek to recover them. These have been transferred to a Capital grants receipts in advance line. Consequently, they are defined as capital grants receipts in advance - £405,000 (Column 7).

33. An amount of £132,000 of earmarked reserve relating to the collection fund was re-stated as the collection fund adjustment account in unusable reserves (Column 8).

34. There has also been an impact on the practice of maintaining a deferred capital grant account. Deferred grants were those grants which had been received previously and which had been spent but not fully allocated to the cost of the asset – instead the grant was allocated to the funding of the asset annually through funding the depreciation cost over the lifetime of the asset. IFRS requires that all grants categorised as deferred grants are immediately allocated to the comprehensive income and expenditure account and reversed out to the capital adjustment account. The capital grants deferred line in the balance sheet of £3,772m was consequently transferred to the non usable reserve capital adjustment account (Column 9).

35. The council previously had a balance of £180,000 as capital grants unapplied. This was held as a liability in the top part of the balance sheet. This has now been re-classified as a usable reserve – capital grants unapplied - in the equity section of the balance sheet since no conditions are attached to its use and there is no possibility of it being reclaimed by the donor (Column 10).

COLUMN 11 - CASH AND CASH EQUIVALENTS

36. Previously, the only amounts considered to be cash in the balance sheet were balances at the bank and petty cash. IFRS introduces the concept of cash equivalents as a change in accounting policy that requires a restatement of the opening balances.

37. Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

38. Officers have defined an accounting policy for what they consider to be cash equivalents. This is attached as appendix C. As a result of the adoption of this policy, £20.75 million has been reclassified from short term investments to cash and cash equivalents. The policy adopted will be reviewed and discussed with the external auditor when the restated balance sheet is audited. In the event that the policy needs to be amended, then a further, self-balancing transfer will need to be made between short term investments and cash and cash equivalents.

COLUMN 12 – SHORT TERM COMPENSATED ABSENCES ACCOUNT

39. The term "short term compensated absences" includes items such as holiday pay and annualised hours accumulated balances. Under IFRS the council must make provision for benefits which have accumulated but are untaken at the balance

sheet date. As this cost is not chargeable to the council tax payer, the amount is reversed out of the general fund and transferred to a new reserve, the short-term accumulating compensated absences reserve.

40. At Vale of White Horse the implementation of HR Pro has meant that data on untaken annual leave and accrued annualised hours is available from that system. The provision for accumulated absences of £105,000 has been included in the balance sheet.

41. However, harmonisation with SODC changes the leave year start date of 1st April to the employee start date. This will mean that data can no longer be taken straight from HR Pro. Currently the Chief Accountant at SODC is in discussion with the council's external auditors and HR to identify a suitable methodology to be able to identify the provision for the future. It should also be noted that for future years the calculation will become more complex as a result of the increase in shared working with SODC. This is also under discussion with the external auditors.

COLUMN 13 – TERMINATION BENEFITS

42. Previously the council had been able to account for termination benefits (e.g. added years on early retirement) over the period in which the payment was due – i.e. over a five year period. With the implementation of IFRS the liability for future year's payments must be recognised in the year in which they are incurred and a defined benefit obligation set up to represent the liability.

43. A total of £222,000 was incurred during 2008/09 and transferred to the defined benefit obligation.

Restated Balance Sheet 2009/10 and opening balances

44. Once the opening balances and the methodology required to restate the opening balances has been identified, further work was undertaken to restate the transactions undertaken through 2009/10 so that the closing balances also conform to IFRS.

45. This procedure took the same form as previously described in paragraphs 10 – 43. A copy of the revised balance sheet in the new IFRS format is attached as appendix D. Members will note that the impact on the balance sheet has been to increase the Council's worth as at 31 March 2010 by £4.3 million. The majority of this increase (£3.8m) is as a consequence of recognising all grant received for the purchase of assets as at the 1 April 2009 instead of using it to purchase the assets over the lifetime of those assets.

Restated Primary Statements for 2009/10

46. In order to provide comparators for the 2010/11 Statement of Accounts in IFRS format the remaining following primary statements also need to be restated and represented in the following IFRS format and order.

MOVEMENT IN RESERVES STATEMENT – Appendix E

47. The Movement in Reserves Statement (MiRS) is a summary of the changes that have taken place in the bottom half of the Balance Sheet over the financial year. It does this by analysing:
    - The increase or decrease in the net worth of the authority as a result of incurring expenses and generating income.
    - The increase or decrease in the net worth of the authority as a result of movements in the fair value of its assets.
    - Movements between reserves to increase or reduce the resources available to the authority according to statutory provisions.

48. In the SORP Statement of Accounts for 2009/10 the MiRS appears on page 57.

49. In the IFRS primary statement the total of the Authority's reserves is split between:
    - Usable reserves – General fund, earmarked reserves, capital receipts reserve and capital grants unapplied reserves, and
    - Unusable reserves – these are the adjustment accounts and any reserve accounts that cannot be used to fund the council's ongoing commitments.

    Whilst the summary level report doesn't identify all the different funds and reserves, notes to the Statement will be required to show the detail to readers. (NB Appendix E can be expanded to show the detail.)

COMPREHENSIVE INCOME AND EXPENDITURE STATEMENT – Appendix F

50. The comprehensive income and expenditure statement (CIES) consolidates all the gains and losses experienced by the council during the financial year. As a public body, the council does not have any equity in it's balance sheet, the gains and losses reconcile to the overall movement in net worth. The total recognised gains and losses for the year is calculated to be £15.794 million deficit. This is reflected by the downward movement on the balance sheet of net value £52.934 million as at 1 April 2009 to £37.140 million as at 31 March 2010.

51. The CIES has two sections:
    - Surplus or deficit on the provision of services – the increase or decrease in the net worth of the authority as a result of incurring expenses and generating income.
    - Other comprehensive income and expenditure – shows any changes in net worth which have not been reflected in the surplus or deficit on the provision of services. Examples include the increase or decrease in the net worth of the authority as a result of movements in the fair value of its assets and actuarial gains or losses on pension assets and liabilities.

52. Appendix F summarises the key figures and shows the difference between the SORP income and expenditure account and the IFRS comprehensive income and expenditure statement. (NB Appendix F can be expanded to show the detail of the movements and comparison between SORP and IFRS).

BALANCE SHEET – Appendix D

53. The balance sheet summarises an authority's financial position at 31 March each year. In its top half it contains the assets and liabilities that it holds or has accrued

with other parties. As local authorities do not have equity, the bottom half is comprised of reserves that show the council's net worth falling into two categories:

- Usable reserves, which include the revenue and capital resources available to meet future expenditure, and
- Unusable reserves, which include unrealised gains and losses, particularly in relation to the revaluation of property, plant and equipment in the revaluation reserve; and, adjustment accounts that absorb the difference between the outcome of applying proper accounting practices and the requirements of statutory arrangements for funding expenditure (e.g. the capital adjustment account and the pensions reserve).

As the revaluation reserve was only constituted on 1 April 2007, any revaluation gains accrued before that date were consolidated into the capital adjustment account. So the revaluation reserve doesn't truly represent the accumulated total of revaluation gains for a number of years and the two types of accounts are therefore presented as a single category of balances – unusable reserves.

54. Paragraphs 9 – 43 itemised the adjustments to the council's opening balances. Further adjustments made to the balance sheet with regard to the closing balances are detailed on Appendix D (ii).

CASH FLOW STATEMENT – Appendix G

55. The cash flow statement summarises the flows of cash that have taken place into and out of the authority's bank accounts over the financial year. It separates the flows into:
    - Those that have occurred as a result of the authority's operations;
    - Those arising from the authority's investing activities;
    - Those attributable to financing decision.

56. There are two methods of preparing the Cash Flow Statement:
    - The direct method – the statement is prepared using cash records as source documents. The Council has previously used this method.
    - The indirect method – the statement is prepared using the surplus or deficit on the provision of services and cash flows are derived by adjusting for non-cash items, removing the effects of accruals and extracting transactions relating to investing or financing activities.

57. The council is required to use the indirect method for another government return – the Whole of Government Accounts, and will therefore use the indirect method in its statement of accounts.

58. Paragraphs 36 – 38 and appendix C refer to the changed definition of cash and cash equivalents. Cash and cash equivalents on the balance sheet move from £20.931 million at 1 April 2009 to £15.908 million at 31 March 2010. This represents a decrease of £5.023 million.

59. Appendix G can be expanded to show the detail of the non cash movements that have been removed from the deficit on the net revenue activities.

Restated Notes to the Statement of Accounts

60. A number of the notes relating to the statement of accounts will need revision as a result of the changes to provide comparators for the IFRS 2010/11 Statement.

    FIXED ASSET NOTE – Appendix H

61. The Movement of Fixed Assets note 16 to the accounts has been amended in line with the reclassification of asset types.

62. Any further notes will be reviewed and updated as required following further discussions with the council's auditors.

Financial Implications

63. The financial implications are as set out in the body of the report.

Legal Implications

64. None.

Other Implications

65. There are no human resources, sustainability, equality or diversity implications of this report.

Conclusion

66. This report provides details of the changes required to be made to the Primary Statements within the Statement of Accounts 2009/10 to comply with the requirements of IFRS.

Background Papers:

1. CIPFA – draft guidance extracts
2. International Accounting Standards 16, 17, 19, 20, 36, 38, 40
3. International Financial Reporting Interpretations Committee 4, 12
4. Audited Statement of Accounts for 2009/10 completed under the Statement of Recommended Practice.

APPENDIX A

BALANCE SHEET
(as at 31 March 2010)

2008/09 £'000	2008/09 Restated* £'000		2009/10 £'000	2009/10 £'000
		FIXED ASSETS		
167	167	Intangible Fixed Assets		127
		Tangible Fixed Assets		
		Operational Assets		
34,462	34,462	Land and Buildings:	33,510	
907	907	Vehicles, Plant, Furniture & Equipment	1,115	
95	95	Infrastructure Assets	79	
1,488	1,488	Community Assets	1,504	
36,952	36,952			36,208
		Non-Operational Assets:		
27,626	27,626	Investment properties	29,501	
3,200	3,200	Surplus assets held for disposal	3,200	
30,826	30,826			32,701
		Other		
		Long Term Investments	740	
116	116	Long Term Debtors	118	
				858
68,061	**68,061**	**Total Fixed Assets**		**69,894**
		NET CURRENT ASSETS		
		Current Assets:		
116	116	Stocks and Work in Progress	20	
6,998	4,690	Debtors	4,851	
20,567	20,567	Temporary Investments	15,897	
363	363	Cash and Bank	11	
28,044	25,736			20,779
		Current Liabilities:		
(10,947)	(8,640)	Creditors due within 1 year	(6,520)	
(3,000)	(3,000)	Short Term Borrowing	(2,700)	
(13,947)	(11,640)			(9,220)
82,158	**82,158**	**Total Assets less Current Liabilities**		**81,453**
		LONG TERM LIABILITIES		
(3,772)	(3,772)	Capital Grants Deferred – Applied	(3,753)	
(180)	(180)	Capital Grants Unapplied	(134)	
(3,952)	(3,952)			(3,887)
(29,990)	(29,990)	Liabilities Relating to Defined Pension Scheme		(44,766)
48,216	**48,216**	**TOTAL ASSETS LESS LIABILITIES**		**32,800**

APPENDIX A

		FINANCED BY:		
(63,887)	(63,887)	Capital Adjustment Account	(64,812)	
249	249	Financial Instruments Adj. Account	0	
(308)	(308)	Revaluation Reserve	(494)	
29,990	29,990	Pension Reserve	44,766	
(11,139)	(11,139)	Capital Receipts Reserve	(9,776)	
(32)	(32)	Deferred Capital Receipts	(25)	
(45,127)	(45,127)			(30,341)
		Ring-Fenced & General Reserves		
(707)	(839)	Earmarked Reserves	(697)	
(2,250)	(2,250)	General Fund Balance	(1,762)	
(132)	0	Collection Fund A/c	0	
(3,089)	(3,089)			(2,459)
(48,216)	**(48,216)**	**TOTAL NET WORTH**		**(32,800)**

APPENDIX C

Definition of cash and cash equivalents

South Oxfordshire District Council & Vale of White Horse District Council

1. Cash and cash equivalents shall include bank overdrafts that are an integral part of the authority's cash management.

2. Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment purposes.

3. There are no strict criteria to follow relating to the nature and maturity of items treated as cash equivalents and therefore the council has determined that the composition of cash equivalents will be as follows:

- Investments that can be liquidated or accessed within 30 days i.e. money market funds, call accounts, and deposit accounts with a notice period of 30 days or less; and
- Fixed term deposits with a maturity period of thirty days or less.

4. Equity investments are excluded from the definition.