

IFRS: how to tell the story

IFRS – changes and opportunities

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 briefing note is intended to help CFOs and other senior staff present the IFRS-based financial statements for 2010/11 to members and other key stakeholders. It 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.

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 items accrued for at 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 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	Assets brought onto the balance sheet where the authority controls the asset. Changes made in SORP 2009- no change for 2010/11	
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.	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.

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 hasn't 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. For housing authorities, 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

Balance at 31 March 2010 carried forward	19,698	General Fund share of the Surplus or Deficit . The HRA share is in a separate column
<u>Movement in Reserves during 2010/11</u>		
Surplus or (deficit) on provision of services	(2,783)	Statutory adjustments such as replacing depreciation with MRP, pension liabilities with contributions, etc.
Other Comprehensive Income and Expenditure	-	
Total Comprehensive Income and Expenditure	(2,783)	Deficit for the year
Adjustments between accounting basis & funding basis under regulations (Note 7)	2,635	Offset by transfers from earmarked reserves
Net Increase/Decrease before Transfers to Earmarked Reserves	(148)	Gives the change in the General Fund balance over the year
Transfers to/from Earmarked Reserves (Note 8)	459	
Increase/Decrease in Year	311	How do these last three highlighted figures compare to the budget?
Balance at 31 March 2011 carried forward	20,009	

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 (eg 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. Unusable reserves such as the Capital Adjustment Account and the Pensions Reserve will need to be funded in the future, even if it is over a long period, so increases in these balances show an increasing burden on future taxpayers.

general fund and HRA performance

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.

Comprehensive Income and Expenditure Statement (CIES)

		2010/11		
		Gross Expenditure	Gross Income	Net Expenditure
		£000	£000	£000
Equivalent to the SORP's Income and Expenditure Account	Central services to the public	4,970	(3,765)	1,205
	Cultural, environmental, regulatory and planning services	13,824	(11,370)	2,254
	Education and children's services	63,401	(20,496)	42,905
	Highways and transport services	23,988	(7,930)	16,058
	Local authority housing (HRA)	25,787	(26,901)	(1,114)
	Other housing services	4,250	(3,857)	393
	Adult social care	16,872	(5,518)	11,354
	Exceptional costs of social care legal settlements ⁶	2,024	-	2,024
	Corporate and democratic core	447	(65)	382
	Non distributed costs	604	-	604
	Cost Of Services	155,967	(79,902)	76,065
	Other Operating Expenditure (Note 9)	2,218	-	2,218
	Financing and Investment Income and Expenditure (Note 10)	11,340	(2,359)	8,981
Surplus or Deficit of Discontinued Operations	-	-	-	
Taxation and Non-Specific Grant Income (Note 11)	-	(84,876)	(84,876)	
(Surplus) or Deficit on Provision of Services			2,388	
Equivalent to the SORP's STRGL	Surplus or deficit on revaluation of non current assets			(36,597)
	Surplus or deficit on revaluation of available for sale financial assets			(101)
	Actuarial gains / losses on pension assets / liabilities			(8,444)
	Other Comprehensive Income and Expenditure			(45,142)
	Total Comprehensive Income and Expenditure			(42,754)

Equivalent to the SORP's Net Cost of Services, and reconciles to the Segmental Reporting Note

Equivalent to the surplus or deficit on the I&E Account under the SORP

Whilst the financial statements under IFRS (other than the Movement in Reserves Statement) still don't 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.

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 your authority reports the costs of support services separately, they could appear as a separate segment.

Note that headings are based on the authority's directorates, not the service classification in BVACOP (or SeRCOP from 2011/12)					
[Directorate] Income and Expenditure ⁵⁹ 2010/11	Education and Learning £000	Health and Social Care £000	Community and Living £000	Environment, Planning and Leisure £000	Total £000
Fees, charges & other service income ⁶⁰	(1,481)	(5,012)	(2,452)	(30,417)	(39,362)
Government grants	(19,015)	(506)	(5,238)	(12,955)	(37,714)
Total Income	(20,496)	(5,518)	(7,690)	(43,372)	(77,076)
Employee expenses	40,252	11,235	8,652	30,565	90,704
Other service expenses	10,369	2,044	9,948	9,894	32,255
Support service recharges	4,326	1,273	2,031	6,232	13,862
Total Expenditure	54,947	14,552	20,631	46,691	136,821
Net Expenditure	34,451	9,034	12,941	3,319	59,745

Outturn figures previously reported to members

The note then needs to be reconciled to the Comprehensive Income and Expenditure Statement (CIES). The example below also doesn't include 100% of the service expenditure – so the missing services 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 the [Directorate] Analysis	59,745
Net expenditure of services and support services not included in the Analysis	2,015
Amounts in the Comprehensive Income and Expenditure Statement not reported to management in the Analysis	37,055
Amounts included in the Analysis not included in the Comprehensive Income and Expenditure Statement	(22,750)
Cost of Services in Comprehensive Income and Expenditure Statement	76,065

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 to match depreciation, whereas capital grants are now credited to taxation and non-specific grant income as they are received (ie 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'.

\ reserves

Reserves – including the General Fund and (where relevant) 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.

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. With a few exceptions (a new line for assets held for sale, and the cash line now including 'cash equivalents'), the top half of the Balance Sheet (assets and liabilities) looks very similar to the SORP Balance Sheet.

The bottom half of the Balance Sheet (reserves) is where the main changes have occurred. The key figures are as follows:

	Notes	31 March 2011
		£000
Usable Reserves	23	27,067
Unusable Reserves	24	382,715
Total Reserves		409,783

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.

Whilst the Balance Sheet aims to show those reserves over which members have control, some of the unusable reserves will become a charge against the revenue account – or usable reserves – over time. In some cases, such as the Unequal Pay Back Pay Account, this might be within a year or two.

Not all reserves can be used to deliver services, and the Code reflects this by reporting reserves in two groups – 'usable' and 'unusable' reserves. Usable reserves such as the General Fund and earmarked reserves are those where members will be involved in deciding on the levels maintained, and their use. Unusable reserves such as the Revaluation Reserve and the Capital Adjustment Account aren't subject to such member influence.

cash flows

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:

	2010/11 £000	
Net (surplus) or deficit on the provision of services	2,388	Surplus or Deficit taken from the Comprehensive Income and Expenditure Statement
Adjustments to net surplus or deficit on the provision of services for non cash movements	(24,067)	
Adjustments for items included in the net surplus or deficit on the provision of services that are investing and financing activities	11,523	3 groups of transactions: <ul style="list-style-type: none"> ■ Operating ■ Investing ■ Financing
Net cash flows from Operating Activities (Note 25)	(10,156)	
Investing Activities (Note 26)	(24,585)	
Financing Activities (Note 27)	35,140	
Net increase or decrease in cash and cash equivalents	399	
Cash and cash equivalents at the beginning of the reporting period	(14,166)	Cash and cash equivalents figure in the Balance Sheet
Cash and cash equivalents at the end of the reporting period (Note 19)	(13,767)	

IFRS questions and answers

IFRS – what is it?

International Financial Reporting Standards (IFRSs) are a suite of accounting standards used across the world. IFRS is the international equivalent of the Financial Reporting Standards (FRSs) used until now in the UK.

Why move to IFRS?

In the 2007 Budget, the then-chancellor announced that the UK Public Sector would adopt IFRS, as this was seen as best practice and allowed for international comparisons to be made.

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

As a result, CIPFA/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.

IFRS is intended for the private sector – why are we using it?

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

IPSAS?

International Public Sector Accounting Standards. These 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 isn’t appropriate. There are also some IPSASs that deal with exclusively public sector issues, and for which there is no IFRS equivalent - such as taxation.

So why use IFRS rather than IPSAS?

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’s now changed and governments around the world are increasingly adopting IPSAS directly.

Why does IFRS change everything?

It doesn’t. Recent UK standards have been based on IFRS, so many requirements are unchanged. There are differences, and the work required to reflect these changes shouldn’t be underestimated, but for many transactions, there is little or no change as shown in the table on page 2.

The accounts are already too long – and IFRS will make them worse.

Yes, the accounts can be long, but local authorities have a complex story to tell. IFRS does introduce more disclosures. But notes only need to be produced if they are material - leaving out notes that aren’t material or required by legislation is a good start.

The Pension deficit is meaningless – why do we have to show it?

The deficit doesn't have to be funded from this year's budget, but it's still a true cost – it represents the amount that will need to be found from future budgets to pay for pension entitlements already incurred in delivering services. So it's a real call on future funding. Not showing this would hide the liability that the authority has incurred.

This also applies to other reserves. Like the Pension Reserve, the Capital Adjustment Account, the Unequal Pay Back Pay Account and similar reserves all do one thing: they hold expenditure that the authority has incurred but not yet financed. Think of them as being a bit like a credit card balance - these amounts will have to be funded in future, either from taxation or from usable reserves.

Concerns have been expressed that all these reserves make the Balance Sheet incomprehensible. But all that needs to be shown on the Balance Sheet itself are 'Usable Reserves' and 'Unusable Reserves' – the details can all go in a note. This will help to de-clutter the Balance Sheet.

The HRA accounts just replicate what is shown elsewhere. Can't we get rid of them?

Not just yet. CIPFA/LASAAC agreed not to review the HRA straight away, partly because many of the requirements are set out in legislation, and partly because of the major review in England – we didn't want to change the accounts for 2010/11, then have to change them again shortly afterwards. But watch this space...

A lot of detail is required in relation to employees' pay. Is it really needed?

Yes - it's a legal requirement. It's also in line with the rest of the public sector, and in the current climate of transparency, local authorities can't be seen to be less open than everyone else.

sources of further information

Code of Practice on Local Authority Accounting in the United Kingdom: Guidance Notes for Practitioners - 2010/2011 Accounts

This publication provides guidance on the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 – the first Code to be based on International Financial Reporting Standards.

The Guidance Notes can be purchased from:

<http://secure.cipfa.org.uk/cgi-bin/cipfa.storefront/4d93349800b7691427403efdf4070676/Product/View/PUBAC102H>

Code of Practice on Local Authority Accounting in the United Kingdom: Disclosure Checklist for 2010/2011 Accounts

The 2010/11 version of the Disclosure Checklist is the first to be based on International Financial Reporting Standards (IFRS) rather than UK GAAP, and reflects the reporting requirements introduced by the 2010/11 IFRS-based Code of Practice on Local Authority Accounting.

The Disclosure Checklist can be purchased from:

<http://secure.cipfa.org.uk/cgi-bin/cipfa.storefront/4d93349800b7691427403efdf4070676/Product/View/PUBAC106C>

Transition Guidance Notes

The Transition Guidance Notes set out the detailed accounting requirements to be followed as part of the first-time adoption process in respect of the differences between IFRS and UK GAAP. They can be downloaded free of charge from:

http://www.cipfa.org.uk/pt/cipfalsaac/transition_guidance.cfm

Local Authority Accounting Panel Bulletins

LAAP Bulletins provide guidance on topical issues and accounting developments and when appropriate provide clarification on the detailed accounting requirements. A Bulletin covering issues relating to the closure of the 2010/11 accounts will be issued in April.

LAAP Bulletins can be downloaded free of charge from:

<http://www.cipfa.org.uk/pt/laap.cfm>

IFRS Implementation Support

CIPFA has developed a range of additional IFRS products and services to help public sector organisations understand the requirements of IFRS, overcome the key challenges and smooth the way for a successful transition. Details can be found at:

<http://www.cipfa.org.uk/ifrs/support.cfm>



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