



# Local Government IFRS Emerging Issues

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Paul Spinks

# Objectives for the seminar

- consider emerging issues relating to IFRS implementation under the 2010 Code
- discuss actions that authorities should be taking now
- consider the role of audit in the restatement process

# IFRS for local authorities

- LG rules set through annual Code with possible mid year updates where necessary
- 2010 Code published December 2009
- seminar based on Code and work performed to date
  - application of IFRS is continuing to evolve
  - further mitigation measures may become necessary

## Early adoption of IFRIC 12 for PFI and similar contracts

# IFRIC 12 for PFI and similar contracts

- 2009 SORP includes requirement to account for PFI schemes and similar contracts under IFRIC 12
- IFRIC 12
  - covers infrastructure assets
  - applies control tests rather than risks and rewards
- asset recognition relatively straightforward
  - virtually all PFI schemes will be "on balance sheet"
  - accounting entries require significant analysis
- SORP covers all service concession arrangements so authorities should be working on these for 2009/10

# Financial impact for local authorities

- assets recognised on balance sheet
- some significant impairments on initial recognition
- impact on net cost of services and finance costs
- bottom line impact would affect Council Tax if not mitigated
- overall impact on amounts required against Council Tax to be mitigated through MRP adjustment

# Determining accounting entries

- its complicated!
  - requires use of modellers
  - many authorities using financial advisers
- access to information is critical
- restating PFI is probably most complex part of IFRS



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## Key IFRS issues affecting local authorities

# Principal IFRS issues

- leasing
- fixed assets (property plant and equipment)
- holiday pay and other employee benefits
- accounting for capital grants and contributions
- accounts disclosure issues

# Lease classification

- finance lease transfers substantially all risks and rewards based on judgement with no “90% test”
- factors that individually or in combination would
  - normally indicate a finance lease
  - could also indicate a finance lease
- separate assessment of land and buildings
- overall substance
- need to consider all leasing arrangements including embedded leases

# Embedded leases

Will need to consider whether an arrangement includes an embedded lease under IFRIC 4

- the arrangement is dependent on the use of a specific asset or assets (evidence may be that it is not economically feasible or practicable for the supplier to perform its obligation through the use of alternative assets)
- the arrangement conveys a right to use the asset

## Factors that individually or in combination would normally indicate a finance lease

- bargain purchase option
- lease is for major part of asset's economic life
- present value minimum lease payments **substantially** all asset's fair value
- specialised asset
- ownership transfers at end of lease

## Factors that individually or in combination that may indicate a finance lease

- the lessee meets any losses incurred by the lessor on cancellation of the lease
- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent

# Property Plant and Equipment (PPE)

fixed assets now known as property, plant and equipment

- PPE valuation issues
- PPE classification
  - investment properties
  - assets held for sale
  - surplus assets
- component accounting inc depreciation
- PPE held at depreciated cost

# PPE valuation issues

- valuation of property
  - property generally valued at market value
  - Code specifically requires use of MEA valuation (using "instant build") for specialist properties and provides option for use of alternative site valuations
  - Code requires council dwellings to be valued at EUV-SH
- valuation of equipment
  - can you apply short life / low value exemption?
  - do you have equipment that will require valuation?
  - how do you value equipment?

# Investment properties

- property (land or a building-or part of ) held solely to earn rentals or for capital appreciation or both
- consider treatment for
  - land held for long-term capital appreciation or for an undetermined future use
  - a building owned by the entity and leased out under one or more operating leases
- properties held in accordance with service objectives are not investment properties
- annual valuations with movement through I&E

# Assets held for sale

- to be classified as 'held for sale'
  - a non-current asset must be available for immediate sale in its present condition
  - its sale must be highly probable, and
  - it must be genuinely sold, not abandoned
- assets held for sale should be measured at the lower of carrying amount (book value) and fair value less costs to sell (net selling price)
- presented separately on the face of the balance sheet

# Surplus assets

- under IFRS properties would be
  - used in business (operational)
  - held for investment or indeterminate purposes (investment properties)
  - held for sale
- Code introduces new category of "surplus" assets which do not fall within any of these definitions
- what examples are there of surplus assets?

# Components

- what are components
  - how do you identify asset components?
  - what does significant in relation to asset mean?
- not usually an issue on restatement but may have longer term implications
  - if do not treat as capital subsequent expenditure would normally be expensed
  - however subsequent expenditure can be capitalised if value of initial asset that is replaced is written off
  - IAS 16 suggests using replacement expenditure as guide to cost of replaced component

## PPE held at depreciated cost

- FReM requires all PPE to be carried at fair value (valuation)
- Code retains use of cost model for certain classes of assets
  - infrastructure
  - community

# Employment benefits

- bodies required to make provision for benefits earned but not yet paid
- short term accumulating absences
  - holiday pay
  - time off in lieu
- long term
  - special rules for disability benefit only expected to be relevant for police and fire authorities
- consultation on mitigation for effects of holiday pay accrual but not other employee benefits

# Short term employee benefits

- what are arrangements for compensated absences
  - accumulating (carry forward permitted)?
  - vesting (cash paid when employee leaves)?
- accrue for all unpaid accumulating absences with adjustment (if appropriate) for employees that leave before they use accumulating non vesting entitlement
- no accrual for non accumulating absences
- accrual is additional amount that authority expects to pay including NI and pension contributions
- bonuses or similar payments depend on whether obligation created at year end

# Holiday pay - practical issues

- large number of employees
  - differing practices across departments
  - lack of centralised records
  - particular issues for teachers given timing of Easter holidays relative to year end covered in CIPFA paper
- requires detailed understanding of leave arrangements
- calculating provision
  - initial calculation based on sampling
  - keeping this up to date
  - systems improvements

# Accounting for grants and contributions

- covers government grants and other contributions
- grants and contributions for capital purposes recognised immediately once all conditions have been met
- no longer any Government Grants Deferred Account with opening balance transferred to Capital Adjustment Account
- amounts received held in payments received in advance until conditions met

# Implications of change to capital grant accounting

- document recognition considerations relating to conditions
- likely to distort I&E
  - credits will flow from entitlement to grant
  - no longer matched with depreciation
- entries subsequently adjusted to CAA through SMGFB
- review accounting for other contributions if amounts not repayable

# Disclosures

- significant disclosures
  - estimates
  - judgements
- format of accounts
- effects of first time adoption of IFRS
- numerous detailed disclosure requirements

# Other IFRS issues

Are there other IFRS impacts that you

- consider to be critical?
- would like to discuss?



# Managing the process

# Key success factors for IFRS implementation

Plan early to ensure that sufficient resources are allocated and required information is available

- project team and scope
- identify key focus areas
- consider systems impact
- consider business impact assessment
- identify training needs
- determine what external consultations needed
- timetable with key milestones - Draft a critical path

# Restatement process

- transition balance sheet at 1 April 2009 so authorities are already playing catch up
- no formal requirement from government for restatement unlike the position for central government
  - central government trigger points
  - health bodies required to follow DH restatement timetable with specified audit assurance requirements
- authorities should set own timetable for both transition balance sheet and 2009-10 accounts

# What role does external audit play in IFRS restatement?

- auditors can
  - review and comment on process
  - discuss key focus areas
  - perform review of restatement workings
    - traffic light review
    - report against specified procedures
- auditors cannot
  - determine accounting treatment
  - provide modelling assistance

# Key questions for authorities

- do you have Project Plan that covers
  - timetable?
  - restatement procedures?
  - involvement of non finance staff?
  - designated Project Lead?
- do you have sufficient resources
  - in-house capability?
  - use of external advisors / interims?



## Key messages

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- authorities slow to tackle IFRS issues
- implementation requires time and planning
- accounting for "discovery" transactions
- some mitigation will be required



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[paul.spinks@gtuk.com](mailto:paul.spinks@gtuk.com)