

Local Government IFRS Emerging Issues
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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

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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

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Early adoption of IFRIC 12 for PFI and similar contracts

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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 but limited work performed at some authorities in 2009/10

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Experience on accounting for PFI

- its complicated and time consuming!
 - required use of modellers
 - many authorities used financial advisers
- access to information was critical
- significant financial impact on balance sheets mitigated on General Fund through
- detailed disclosure requirements caused some difficulties
- 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

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Lease classification

Principles apply whether council is lessee or lessor

- 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
- consider overall substance
- need to consider all leasing arrangements including embedded leases

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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

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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

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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

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Property, Plant and Equipment

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
- schools
- PPE held at depreciated cost

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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?

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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

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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)
 - council dwellings being disposed under RTB valued at discounted RTB price
- presented separately on the face of the balance sheet

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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?

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Components

- Code requires this for "enhancement and acquisition expenditure" incurred and revaluations from 1 April 2010
 - how do you identify asset components?
 - what does **significant** in relation to asset mean?
- 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
- how do you relate to valuation movements?

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Schools

- IFRS reviews are requiring authorities to reconsider approach to recognition of following types of schools
 - Community
 - Voluntary aided or controlled
 - Foundation
 - Academies
- not within IFRIC 12 scope so deal with on restatement
- complex accounting issues covering
 - control
 - link with funding
 - risks / rewards of ownership

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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

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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
- CLG plan mitigation for effects of holiday pay accrual but not other employee benefits

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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

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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

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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

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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

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Disclosures in IFRS accounts

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

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Other IFRS issues

Are there other IFRS impacts that you

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

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Managing the process

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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

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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

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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

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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?

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Key messages

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