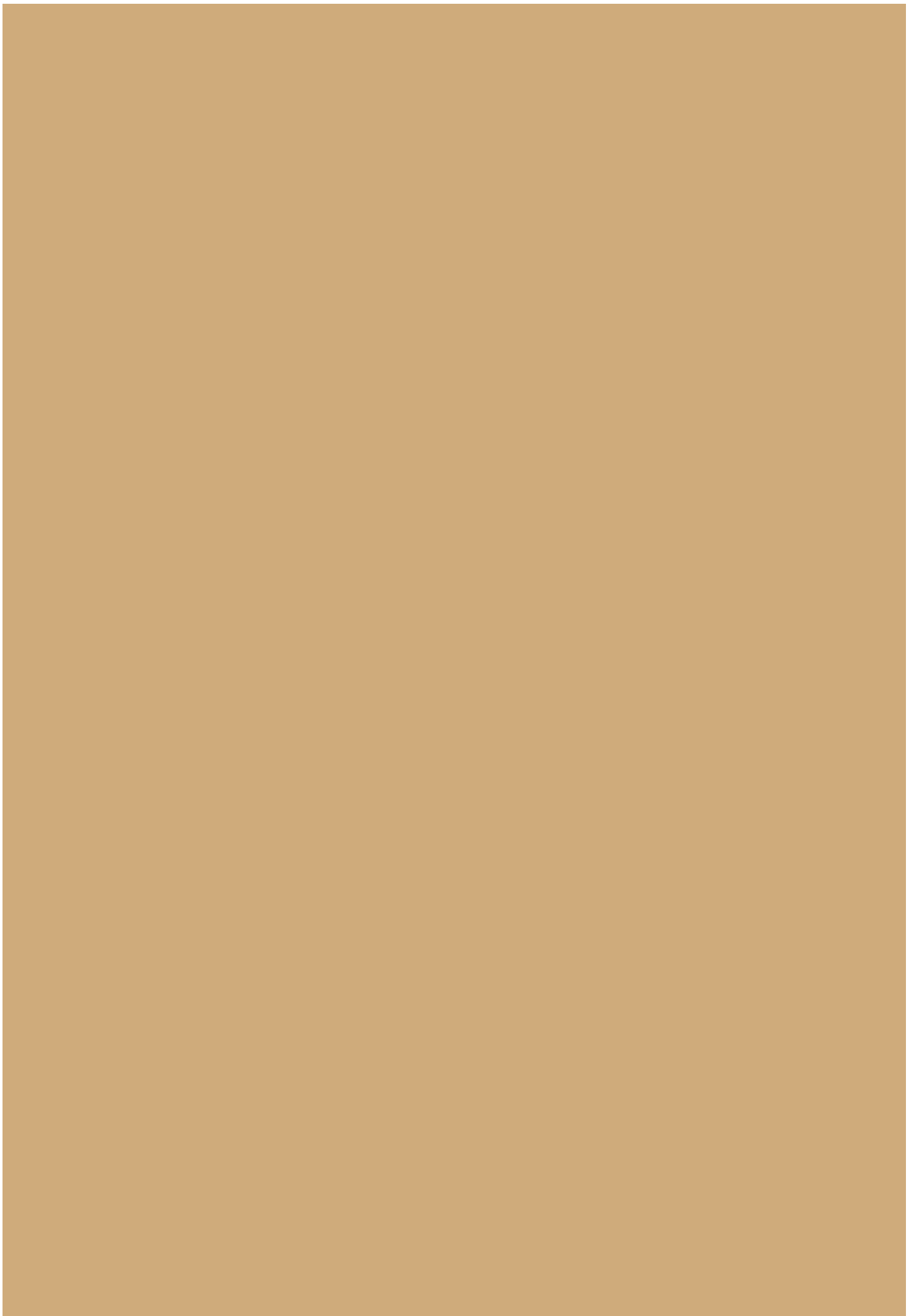


IFRS and local authorities

More than just numbers





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Introduction

IFRS is coming for local authorities

Local authorities will move to accounting on an IFRS basis by 2010/11, a year after central government and the NHS. 2010/11 sounds a long time off, but we recommend that you start thinking about IFRS now.

The move to IFRS is a challenge for all organisations, and is not to be underestimated. PwC's experience is that IFRS is not just about financial reporting. Many of the organisations we have worked with have also found that IFRS can impact on available resources and budgets and estimates, as well as other areas such as systems and processes. IFRS is also a good mechanism for facilitating change.

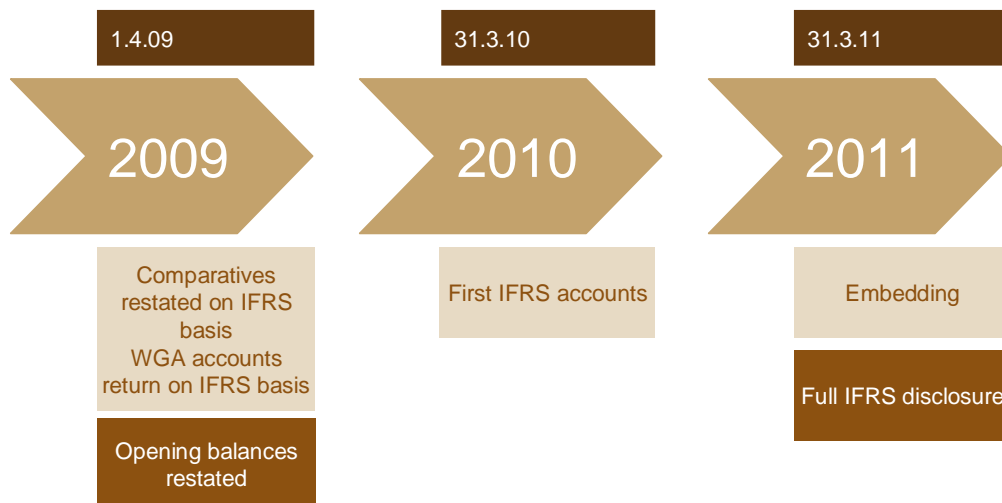
You should already be thinking about what IFRS means for your authority. Considerable extra work is usually needed to make the transition to IFRS, and forewarned is forearmed. We all need to have an understanding of what IFRS is, how it will affect our work and what we need to do about it.

Plan ahead

Planning ahead is essential for the successful implementation of IFRS. We now know that 2010/11 will be the first year for IFRS-based local authority accounts, but this is not just about preparing the 2010/11 accounts on an IFRS basis:

- firstly, the 2009/10 accounts will also need to be restated on an IFRS basis;
- the opening balances at 1 April 2009 (the point of transition) will need to be on an IFRS basis;
- Whole of Government Accounts (WGA) will be on an IFRS basis from 2009/10; and
- what will be the impact on budgets, council tax, systems, training? These are just some of the many areas which need to be considered.

IFRS affects local authorities sooner than might be expected.



IFRS is more than a finance issue

Experience justifies this apparently premature call for action. Early consideration of the IFRS transition issues and the establishment of a proper project framework were key success factors of the private listed sector's transition to IFRS in 2005. If your authority has yet to begin planning for IFRS transition, then it should be doing so now.

IFRS is more than a finance issue

One of the other principle lessons learned from the private sector experience was that IFRS affects all parts of the organisation. It is not just a finance issue. If you think that this is far-fetched then consider the following example. One apparently 'minor' change in IFRS is the need to accrue an amount in the balance sheet for paid holiday leave which had yet to be taken at the year-end. The input of HR specialists is needed before the finance team can interpret the data for input into the accounts. On top of this, consideration should be given to adapting and utilising systems to collect this data automatically rather than relying on inefficient manual systems.

That one example illustrates the need to involve three distinct areas of the authority (finance, HR and IT), as well as raising the policy issue of whether it is appropriate to maintain the current holiday year arrangements.

PricewaterhouseCoopers has excellent practical experience of providing assistance to organisations in both the public and the private sectors in their transition to IFRS.

Read on to find out about:

- what makes IFRS different
- how you could approach the transition to IFRS
- further examples of why you should see this as more than a finance issue
- what actions you should be taking now.



How will IFRS be different?

Don't make the mistake of thinking that IFRS is simply a few tweaks here and there to existing UK standards. In many cases it does look quite similar, but don't be fooled. Similar is not the same. You will find that IFRS will bring differences for your organisation.

What will IFRS look like for local authorities?

CIPFA anticipates that the first IFRS-based Code of Practice on Local Authority Accounting will be issued in September 2009 and is currently consulting on changing the governance framework for the issue of the Code. This Code currently has the status of a SORP (Statement of Recommended Practice) and has to undergo a rigorous process with the Accounting Standards Board (as well as CIPFA's own governance processes) before being issued. CIPFA is proposing a change to the current framework to allow for an IFRS-based Code, which would lose its SORP status.

There are a number of unique features to local authority accounting, not least are the differences between the Council Tax setting rules and accounting practice. These features may require the IFRS-based Code to provide certain interpretations of IFRS, but the track record of IFRS application to the government and NHS sectors shows that special interpretations for the public sector are rare.

Some of the differences

Areas where IFRS is expected to present significant differences for local authorities include:

- fixed assets, where IFRS requires fixed assets to be held at 'fair value' as opposed to the current requirement for 'current value';
- leases, where IFRS has a requirement for the leases of land and buildings to be accounted for and disclosed separately;

- defined benefit pension schemes, where there may be a potential change in accounting policy for actuarial gains and losses; and
- joint ventures and associates – under IFRS a local authority only needs the power to influence another entity (rather than to actually exercise it) for it to be treated as part of the group.

We don't have enough room to explore all the areas where IFRS is different, but have instead selected a number of areas to illustrate other differences in a bit more detail.



Don't make the mistake of thinking that IFRS is simply a few tweaks here and there

Retrospective application presents practical challenges

"Retrospective application is, for me, an IFRS issue which most people aren't aware of".

One of the fundamental principles within IFRS is that of retrospective application. What does retrospective application mean? When an international standard is implemented for the first time then you must (unless it says otherwise) restate your accounts as though you had always accounted using that standard. This means that you need to go back as far as practically possible for your balance sheet items to ensure that your opening balances are correctly accounted for. This is what is known as retrospective application under IFRS, and can present significant challenges when first implementing these standards.

Segment reporting shows your authority 'through the eyes of management'

"There aren't many examples of how the segment reporting standard has been applied".

The segment reporting standard has only recently been approved by the European Union and presents a completely new approach to reporting performance of segments. The concept behind this standard is that the notes to the accounts should reflect the organisational structure and how various parts of it perform financially, and will bring changes from current practice under the Best Value ACoP. What does this mean in practical terms? In essence it requires the externalisation of your internal management information. CIPFA/LASAAC are reviewing how this standard would work in a local authority context. For some authorities this may present uncomfortable reading where that type of information had not been previously available publicly.

Changes in the value of investment property will affect available resources

"Property held for income generation would probably fall under the definition of investment property".

Property held for policy purposes is probably not investment property. However, any property held for capital appreciation or income generation would fall under the definition of investment property. If you do hold this type of property then you should currently be holding it at valuation. Under IFRS you will need to continue to hold the assets at valuation ('fair value') and keep this valuation up to date. Any gains or losses arising from changes in the fair value will need to be recognised in Income and Expenditure for that period, thus affecting the availability of resources for other purposes.

PFI – guidance yet to be confirmed

"There are major changes in the way PFI will be accounted for".

PFI accounting is one of headline changes under IFRS, despite the fact that the accounting guidance has yet to be confirmed in this area. One of the reasons why there is some debate around which guidance will apply is that there are no definitive rules under IFRS for accounting for PFI from the public sector perspective. There is, however, guidance for such schemes from the private sector side, and it is this guidance which we expect will be applied to the public sector. The approach to whether an asset is recognised or not on the balance sheet is fundamentally different using this approach. The focus is likely to be on who controls the asset or service, rather than the current focus on transfer of risks and rewards. If you do have assets financed under PFI then it is likely that you will need to have each scheme reviewed to determine the accounting treatment.

Financial statements increased by 60% in size after the introduction of IFRS

Untaken paid holiday accruals

"We need to review our processes for collecting information about untaken paid leave, such as holiday pay".

Strictly speaking, untaken paid holiday leave should currently be accrued for under UK GAAP but few organisations do this. IFRS specifically requires organisations to accrue for any short-term employee benefits earned but which have yet to be taken. The most significant item which this refers to is paid holiday untaken at the year-end. For some local authorities the collection of this data may provide a significant challenge. This will particularly be the case where the holiday year does not coincide with the financial year, or where each individual has a separate holiday year.

More disclosures

"Financial statements in the listed sector increased by 60% in size after the introduction of IFRS".

One of the themes running throughout IFRS is the need for more disclosures in almost all areas. Examples include leases, investment assets, financial instruments, operating segments and many other areas. IFRS also requires the disclosure of the nature and impact of yet-to-be-adopted accounting standards. This could happen where a new accounting standard has been issued but there is no requirement for it to be implemented yet. In this situation you should disclose the fact that the standard has been issued, that your authority has yet to adopt it and that when it is adopted what the financial impact is expected to be.



An approach to IFRS conversion

At PricewaterhouseCoopers we have a strong track record of helping organisations in all sectors successfully convert to IFRS, and our experience shows that a methodical approach to the conversion process is essential to getting it right first time.

We have set out in summary on this page a three step transition methodology which we know to be a robust, tried and tested framework. This methodology has consistently delivered successful results.



The preliminary study (Step 1) involves the delivery of an initial diagnosis of your authority's current accounting policies and presentation against those policies acceptable under IFRS. It will include a determination of the resulting impacts on financial reporting and related systems, and the opportunity provided by conversion to address potential strategic operational issues.

Part of the output of the preliminary study is a recommendation about Step 2, which would include development of a detailed project plan, including project management teams, training, resources and timetable.

Converting any organisation's internal and external reporting to IFRS is a complex business and every organisation is unique.

Why IFRS is more than a finance issue

IFRS is not just a technical accounting issue for the finance team. The impact of the changes brought by conversion to IFRS will encompass many areas of your authority including the setting and measurement of performance targets, budgeting and forecasting - as well as financial reporting.

Accounting is certainly a large part of conversion to IFRS and the scale of any conversion project will depend on the nature of your organisation and its existing accounting policies. PricewaterhouseCoopers' experience of IFRS conversions with the listed sector showed that for many entities the change affected items on the balance sheet, financial indicators and performance measures as well as internal and external relationships and strategy.

To succeed, the change must be embedded across all services, involving people at all levels. Departments such as finance, internal audit, estates, IT and human resources will all have key roles to play. And depending on internal resources, auditors and consultants may also need to play a part.

Some of the areas where the transition to IFRS will need to be seen as more than a finance issue are set out below.

Internal reporting and budgeting

Proper emphasis on accurate and relevant management information is vital for fully informed decision making and the effective running of any authority. Conversion to IFRS provides a fresh opportunity to review the systems and the data produced, particularly in the light of the efficiency agenda.

Aligning internal and external reporting to provide the required information for IFRS can be one of the most challenging parts of the conversion process, according to organisations that have already converted. These changes also need to be incorporated into the planning and budgeting processes. Future available resources may well be affected by the way in which some items are accounted for under IFRS.

The closer alignment of internal and external reporting should improve the reliability and timeliness of information for management and stakeholders alike. It will also improve your performance analysis and help to

avoid surprises that could arise from having separate systems.

Project set up and governance

IFRS adoption will require a full project management process to enable good management of the transition period and ensure that your authority is operationally ready. The whole authority will need to be aware of the project and what it involves so it is crucial that the project is launched well in advance of the planned publication of IFRS financial statements in 2011.

The features of an up and running dedicated conversion project should include, as a minimum:

- completed impact analysis and comprehensive conversion plan;
- operational steering and technical committees;
- regular progress reporting against the plan;
- audit committee oversight;
- the commitment of key stakeholders in the organisation; and
- the necessary project management resources.

Properly constituted projects also align responsibilities for managing the interdependencies between IFRS conversion and other projects within the authority, whether they are related to financial reporting, systems, service efficiency, estates or other topics.

To succeed, the change must be embedded across all services

System requirements

The impact of IFRS on information systems varies from one organisation to the next, depending on the existing systems in place. But generally conversion to IFRS will at least require a rethink of the parts of the system that deliver financial information and thus require the involvement of the IT and systems department. Organisations should consider their overall financial reporting systems and not simply the main accounting package.

For some authorities, IFRS conversion may also be the appropriate moment to move internal and external reporting onto the same basis, which could require some fundamental systems changes.

At the very least adoption of IFRS is likely to require:

- changes to the chart of accounts;
- modifications to the accounting systems of each consolidated entity to meet IFRS information needs;
- an analysis of all systems and possible adaptations to the new information needs; and
- reorganisation of information flows to the centre to ensure timely receipt of data for consolidation and presentation of the new information.



When to take action

Planning for the introduction of IFRS should start before the transition date of 1 April 2009. Conversion is likely to be a complex process, affecting much more than the financial statements, and this is borne out through conversion experience in other sectors.

The message is that you need to be thinking about this now, if you have not done so already.

Preparing early will allow for implementation of a proper change management methodology and a suitable project structure. It will also help the transition to go smoothly with time to raise awareness of the differences between IFRS and current accounting practice, time to run simulations of the financial impact of IFRS before going live and time to prepare stakeholders for any potential changes in performance trends. Early preparers will also be able to make the best use of their available resources (both internal and external) by spreading the work.

What you need to consider

Actions to take	Confirmed?
Managing the IFRS conversion project	
<p>Project set-up and management</p> <p>How will you manage and govern your IFRS project to ensure its success?</p> <ul style="list-style-type: none"> Steering group – oversight and operation Project manager – IFRS expertise plus broader operational understanding Involvement from all affected services to ensure you meet deadlines 	
<p>Project governance</p> <p>Is your Cabinet and Audit Committee fully committed, involved and knowledgeable about the implications of IFRS conversion?</p> <ul style="list-style-type: none"> Senior management – awareness of options, strategic decision-making Audit Committee – reporting structures and timings Internal Audit – role in risk-management, involvement from the outset 	
<p>Resource levels and training</p> <p>Do you have the right people with the right skills to complete the transition and embed the changes across your authority?</p> <ul style="list-style-type: none"> Your people – number required, skill levels, other commitments Training – strategy, functional areas, delivery, support tools 	
Internal and external reporting	
<p>Impacts on performance measurement</p> <p>What are the high-level effects on performance measures and financial drivers?</p> <ul style="list-style-type: none"> Cabinet’s awareness of strategic implications – impact on Budgets and Estimates Impact on specific financial and performance measures that are important to your authority 	

Actions to take	Confirmed?
Internal and external reporting	
<p>IFRS financial statements</p> <p>Do you understand what your financial statements will look like under IFRS?</p> <ul style="list-style-type: none"> • Impact on the presentation of the income and expenditure statement and balance sheet • Addressing disclosure requirements 	
<p>Management information and internal communications</p> <p>How will you update your internal communications and management information?</p> <ul style="list-style-type: none"> • Need for management information to follow IFRS – impact on your authority • Implications for management – additional segment disclosures and information requirements 	
<p>Reporting to external stakeholders</p> <p>Will you enhance the information you publish to ensure it is useful and clear?</p> <ul style="list-style-type: none"> • Annual reports – including additional information to aid clarity • IFRS implementation – opportunities for improved financial reporting 	
Data, systems, processes and controls	
<p>Data modelling and requirements</p> <p>How will you collect the required data and ensure that there are adequate controls in place?</p> <ul style="list-style-type: none"> • Data and information – knowledge of additional requirements under IFRS • Your first IFRS financial accounts – tactical or embedded methods of data collection • Continuing data capture – methods and processes • New data – controls over data accuracy 	
<p>System enhancements and developments</p> <p>Will you need to enhance your current systems or develop new ones to meet your IFRS obligations?</p> <ul style="list-style-type: none"> • Identification of financial information systems and processes – at all levels of the authority • Your chart of accounts – need for change/overhaul • Your systems and processes – adequacy for new reporting regime 	
<p>Internal control environment, process development and other initiatives</p> <p>How is your IFRS conversion project integrated with other initiatives, and have you identified all interdependencies?</p> <ul style="list-style-type: none"> • Integration with other changes across the authority • Process changes and controls – documentation compliant with corporate governance requirements 	

How PricewaterhouseCoopers can help you

PricewaterhouseCoopers has significant expertise in advising on conversion to IFRS. We are supporting major public sector organisations in implementing IFRS in the UK and around the world and supported the European Commission in its implementation of IPSAS. We have also advised over a thousand private sector organisations to support their implementation of IFRS.

PricewaterhouseCoopers offers a comprehensive suite of services to assist government organisations in understanding and implementing IFRS.

Impact analysis

PwC can provide assistance in understanding the impact of IFRS on your organisation. We can undertake a full impact assessment, providing you with additional resource, or review the completeness and robustness of any assessment which has already been undertaken.

We have an established impact assessment methodology, the outputs of which can be tailored to your needs. We will usually provide you with a written report which analyses the potential impact of IFRS on each area of your accounts as well as suggestions on how you should next proceed with your conversion project.

Training on IFRS

IFRS is often billed as being the most significant accounting change for a generation. Finance staff, management and non executives need to learn and understand a new language of accounting. PwC can offer you a full range of training solutions. These include training tailored to your authority's individual needs as well as our unique 'P2P' computer-based IFRS training package.

Modelling the impact of IFRS accounting changes, such as PFI

Some IFRS changes will mean significant differences in the way that some items are accounted for, including potentially PFI transactions. PwC has long-standing experience of modelling the impact of complex transactions and could use this to illustrate the impact of different accounting treatments

Technical advice on IFRS

As you might expect with a firm like PwC, we have deep technical specialists in all aspects of government and public sector accounting. We can advise you on an individual basis or through our subscription service which provides you with access to a question and answer service. We also offer an on-line accounting reference service, PwC Inform, which is available at www.pwcinform.co.uk.

Project management

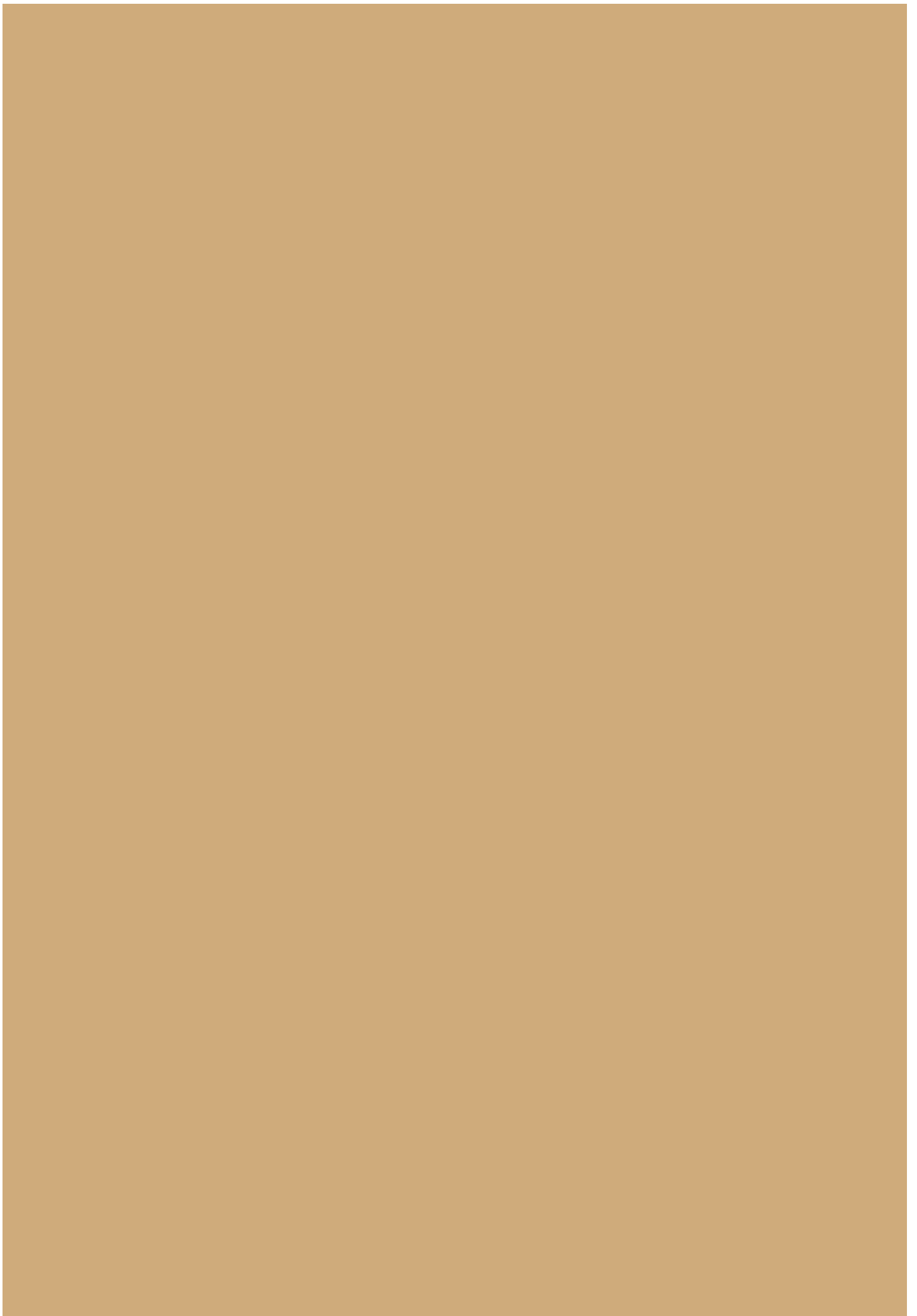
The transition to IFRS can be a major project for many organisations. PwC can provide strong project management skills and advice to help you ensure that such projects are as efficient and effective as possible.

Advising on data and system changes

The transition to IFRS may mean that you need different financial data and that you need to adapt your systems to provide this data. This may also impact on other areas such as your chart of accounts. PwC can provide constructive and informed advice on all these areas.

Providing assurance on spreadsheets

Experience has shown that spreadsheets are often used as a temporary measure when restating figures on an IFRS basis. These one-off solutions are usually developed outside your authority's control environment, and can increase the risks of error and miscalculation. PwC's data assurance specialists can provide you with assurance over these spreadsheets through using tried and tested methodologies.



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This isn't just a finance
issue – involve the whole
organisation

PricewaterhouseCoopers

Other PwC IFRS publications for the public sector

- IFRS – Rising to the challenge
- I-FReM and FReM: A comparison
- Are you ready for take-off? A survey of readiness for IFRS in government
- What is IFRS? Your questions answered
- IFRS – Have you taken the plunge

Insights based on PwC's IFRS experience

You can share PwC's IFRS experience through registering at our free website Access IFRS at www.ifrs.co.uk. This will also entitle you to receive 'Inside IFRS', PwC's regular e-newsletter on IFRS for government and the public sector.

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