

25 February 2011

**REPORT OF DEPUTY CHIEF EXECUTIVE/CORPORATE  
DIRECTOR FOR RESOURCES**

**INTERNATIONAL FINANCIAL REPORTING STANDARDS**

**1 PURPOSE**

Until 31 March 2010, Nottingham City Council has prepared the Statement of Accounts under UK Generally Accepted Accounting Practice (UK GAAP). From 1 April 2010 the adoption of International Financial Reporting Standards (IFRS) is mandatory for Local Government. This report updates the Audit Committee on the transition to IFRS and the impact on the financial statements for 2008/09 and 2009/10.

**2 RECOMMENDATIONS**

It is recommended that this Committee:

- 2.1 Note the presentation for the restated opening balances for 2009/10 and the comparative financial statements (**Appendix A**)

**3 REASONS FOR CONSIDERATION**

3.1 Background to International Financial Accounting Standards (IFRS)

IFRS govern the policies, principles and presentation of the Statement of Accounts. These standards ensure that the accounts show a true and fair view of the financial affairs of the Council and that comparisons can be drawn across the public sector from having a standardised approach to financial information.

Whilst there are many similarities between UK GAAP and IFRS, there are also some notable differences. There have been a number of significant changes, both in the way some of the core financial statements are described, e.g. the Income and Expenditure Account is replaced by the Comprehensive Income and Expenditure Statement and in the format of those statements. Presentational differences include new terminology and changes to form and content of disclosures.

Local authorities are required to report their annual Statement of Accounts for 2010/11 under IFRS and for comparison purposes to restate the published 2009/10 accounts. Whilst some of the new standards will not affect Nottingham City Council, it has been necessary to undertake a thorough review of our activities to assess the impact of IFRS accounting principles. The implementation of IFRS has not been solely an accounting issue and there has been a multi disciplinary approach in order to ensure compliance within the required timescale. The information and experience gathered to date will form the basis to further develop the appropriate systems and procedures to comply with IFRS in the future.

### 3.2 Restated Core Financial Statements 2008/09 and 2009/10

As 2010/11 is the first year that local authorities are required to prepare their accounts under IFRS, standard IFRS 1 – First-time Adoption of IFRS sets out the specific transitional arrangements applicable for the first year. Accounting policy changes have arisen out of the adoption of the IFRS code and as with all changes in accounting policy, these must be accounted for retrospectively as if the policies had always been applied in that way. **Appendix A** provides a reconciliation between the original core statements and the revised figures under IFRS and the restated financial statements for 2008/9 and 2009/10.

## 4 **BACKGROUND INFORMATION**

Statement of Accounts 2009/10

## 5 **FINANCIAL IMPLICATIONS**

None

## 6 **DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION**

None

## 7 **PUBLISHED DOCUMENTS REFERRED TO IN COMPLYING THIS REPORT**

Code of Practice on Local Authority Accounting in the United Kingdom.  
Accounts and Audit Regulations 2003 (amended 2006).

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## APPENDIX A

**ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)**

The accounts have required complete restatement to reflect the transition from UK GAAP to IFRS. The balance sheet for 2008/09 has been restated and the core financial statements for 2009/10 in preparation of full adoption in 2010/11

**Table 1** provides a summary of the key changes to the Council's assets and equity as a result of reporting under IFRS:

<b>TABLE 1: KEY CHANGE TO THE BALANCE SHEET</b>			
<b>TRANSITION ADJUSTMENT</b>	<b>Note Number</b>	<b>31.03.09 £m</b>	<b>31.03.10 £m</b>
<b>IAS 19</b> - Employee Benefits	<b>1</b>	(7.511)	(5.841)
<b>IAS 20</b> – Government Grants	<b>2</b>	248.030	309.807
<b>IAS 17</b> - Leases	<b>3</b>	1.310	0.955
<b>IFRIC 4</b> - PFI/Contract/Embedded Leases	<b>4</b>	tba	tba
<b>IAS 16</b> – Property, Plant & Equipment, <b>IAS 40</b> Investment Property, <b>IFRS5</b> Non Current Assets Held for Sale	<b>5</b>	(5.712)	(3.588)

**Table 2** shows a summary of the Key changes to Councils net expenditure as a result of reporting under IFRS. The financial impact of these changes are mitigated by compensating adjustments to the balance sheet to ensure that there is no overall impact on the General Fund and the taxpayer.

<b>TABLE 2: KEY CHANGE IN NET EXPENDITURE</b>		
<b>TRANSITION ADJUSTMENT</b>	<b>Note Number</b>	<b>AT 31.03.10 £m</b>
<b>IAS 19</b> - Employee Benefits	<b>1</b>	5.841
<b>IAS 20</b> - Grants	<b>2</b>	(88.599)
<b>IAS 17</b> - Leases	<b>3</b>	0.357
<b>IFRIC 4</b> - PFI/Contract/Embedded Leases	<b>4</b>	tba
<b>IAS 16</b> – Property, Plant & Equipment, <b>IAS 40</b> Investment Property, <b>IFRS5</b> Non Current Assets Held for Sale	<b>5</b>	(23.054)
Adjustment under UK GAAP		(0.078)

**Significant IFRS changes and accounting standards****1. IAS 19 – Employee Benefits**

IFRS requires the authority to make provision within the financial accounts for any outstanding contractual leave not taken by employees at the end of the financial year. This covers annual leave, flexi time and time off in lieu.

The accounting adjustment in the financial statements as a result of this requirement is an accrual in 2008/09 of **£7.511m** and in 2009/10 of **£5.841m**. The main difference between the two financial years is due to the timing of the school Easter

holidays. The financial impact of this change in accounting under IAS 19 is mitigated by an adjustment account called the "Accumulated Absences Account" within the balance sheet; this ensures there is no impact on the taxpayer.

## 2. IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance

Under UK GAAP, Capital grants were deferred and recognised in the Income and Expenditure Account over the useful life of the relevant asset or for revenue grants as the relevant expenditure was incurred. The new guidance essentially provides that grants are recognised in their entirety once received and any conditions are met.

- Capital Grants

Capital grants were previously shown in Government Grants Deferred Account which formed part of liabilities in the balance sheet. Under IFRS this account no longer exists and the **£291.266m** balance at 31 March 2010 is transferred to the Capital Adjustment Account which is included in Unusable Reserves in the bottom section of the Balance Sheet. Grants in 2009/10 totalling **£88.599m** have been recognised in Net Expenditure as the grant conditions were satisfied during the year.

- Revenue Grants

In accordance with IAS 20, all revenue grants for which conditions have been satisfied have been reviewed and accounted for through the Comprehensive Income and Expenditure Statement. As at 31 March 2010 a balance of **£2.693m** which is to be matched to expenditure in 2010/11 was held in Creditors. This has been transferred to Earmarked Reserves which again forms part of Unusable Reserves.

## 3. IAS 17 – Leases

The objective of IAS 17 is to ensure that both lessees and lessors account for leases within their financial statements in accordance with their commercial substance. IAS 17 requires all leases to be classified as either a 'finance lease' or an 'operating lease' depending on its substance. A finance lease is now a lease that transfers 'substantially' all the risk and rewards incidental to ownership of an asset. In addition authorities are now required to ensure that leases for land and building are identified separately (as all land leases are usually operating leases)

In total **5,900** lease agreements were reviewed in order to determine the correct accounting treatment under IFRS, which has resulted 103 assets being reclassified and a net increase in assets of **£0.955m**. These include:

- 42 vehicles – previously accounted for as operating leases are now deemed to be finance leases and have been included on the balance sheet
- Offices at Eastcroft (lease in) – reclassified as a finance lease with a book value of £2.126m at March 2010

The overall change in net expenditure **£0.357m** relates to depreciation charges in respect of these assets.

#### 4. IFRIC 4 - Embedded Leases

Under this standard all significant contracts or transactions required review to identify whether any 'embedded leases' existed (i.e. if the contract conveyed the right to use an asset in return for a payment or series of payments). If embedded leases are found to exist they need to be treated in the same way as a formal lease.

There were 12 significant agreements identified. These included the Eastcroft Incinerator and arrangements with Nottingham City Homes. The NET1 PFI scheme is the only embedded lease which requires to be brought on balance sheet in 2009/10 under IFRIC 4.

PFI contracts are complex and have required highly detailed review; the NET 1 agreement failed the IFRIC 12 test and remained off balance sheet during 2009/10. However, under IFRIC 4 NET1 PFI has been recognised as a finance lease and will form part of the 2009/10 restatement. The financial modelling is still being carried out and is due for completion during March 2010. The impact has not been included in any of the figures presented within the restated accounts.

#### 5. IAS 16 – Property, plant and equipment, IAS 40 – Investment property and FRS 5 – Non current assets held for sale

The transition to IFRS requires Nottingham City Council to review all of its assets in order to determine the correct classification, measurement and accounting treatment. In total 448 property revaluations were required to be undertaken in relation to the following accounting standards:

- IAS 16 – Property, plant and equipment (PPE)  
PPE includes the former 'land and building' 'vehicles, plant and equipment' and 'assets held for disposal'

395 assets have been transferred to PPE during the process, these relate to the reclassification of investment properties, surplus assets and the recognition of finance leases. These additions bring the total number of assets in this category to 1017 with a net movement in value of **c.£78m**

- IAS 40 - Investment property  
IAS 40 sets out the accounting treatment for investment property and related disclosure requirements. Investment property is subject to new recognition criteria:
  - Investment property is land or a building held to earn rentals or for capital appreciation or both. (i.e. is not used in the delivery of Council services)
  - is valued at fair value (the amount that would be paid for investment property in its existing use).

The application has resulted in 379 properties being transferred to PPE, the most significant transfers related to the reclassification of Industrial Units and Housing Estate shops.

- IFRS 5 - Non-current assets held for sale and discontinued operations  
IFRS 5 incorporates the prescribed accounting treatment for all non-current assets held for sale, including properties.

A property is regarded as 'held for sale' if its carrying amount will be recovered principally through a sale transaction. Properties held for sale are subject to new recognition criteria:

- The property is available for immediate sale
- Authority is in place to proceed with disposal
- The sale is expected within 12 months
- Actively marketed

The assets are valued at fair value (the amount that would be paid for investment property in its existing use) less costs to sell.

Under UK GAAP 20 assets were "held for sale" however 17 did not meet the test of IFRS 5 and have subsequently been transferred to PPE and investment properties.

As a result of the application of these standards, there has been an overall movement in equity of **£5.712m** in 2008/09 and **£3.588m** in 2009/10 and a reduction in the CIE of **£23.054m**