

International Financial Reporting Standards

Kent County Council

Audit 2009/10

March 2010



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Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/ members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
 - any third party.
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Introduction and background

- 1 Kent County Council is required to produce its financial statements based on the International Financial Reporting Standards (IFRS) in 2010/11. Failure to do so could result in a qualified audit opinion on the statements and reputational damage to the Council.
- 2 The Government's motivation for the move to IFRS reporting in the public sector was stated in the 2007 Budget '...The Government needs to use high value performance data in combination with appropriate financial data...in order to bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice.'
- 3 The Audit Commission has promoted an early start on IFRS in local authorities and has published a series of briefing papers to highlight the key issues for authorities over the last three years. It noted that IFRS implementation in the private sector used fewer resources when planned and managed effectively.
- 4 Progress made by local authorities was assessed by external auditors in late 2009 and this showed that 15 per cent were on track and 20 per cent were having significant difficulties. The main issues that contributed to the difficulties included:
 - a lack of an initial impact assessment to identify how each IFRS impacts on systems, staff and internal and external financial reporting arrangements. A key area is the impact of IFRS on Private Finance Initiative (PFI) schemes and similar arrangements and it is essential that urgent work on these is undertaken as there is a potential impact on the 2009/10 financial statements;
 - robust project planning was not in place or not soundly based (over 50 per cent of project plans that did exist did not contain basic details such as what resources were needed to deliver IFRS compliant financial statements);
 - roles and responsibilities were not clearly defined;
 - resources allocated were not sufficient;
 - technical skills were not available;
 - there was a lack of recognition of the support needed from those service directorates which have a key role in supplying information to core finance teams to support decisions on IFRS accounting treatments; and
 - key tasks were not being delivered to the deadlines set.
- 5 The Commission concluded that effective leadership and project management is essential. Members also have a key role to ensure that IFRS implementation is managed effectively. They should be aware of the core requirements of IFRS and assure themselves that implementation is a corporate priority. Timely progress reports should be made to members. In most of those local authorities that had a good level of member engagement, this was being undertaken by an audit committee, or equivalent, which is in line with the corporate governance responsibilities of such committees.

- 6 IFRS are principles based and requires finance staff to use professional judgement to determine accounting treatments. The experience of implementation in the NHS shows that the best results were linked to good liaison with external audit.

Audit assessment at March 2010

Project planning

- 7 The Council's progress is broadly in line with its implementation project plan. Officers prepared a project plan for IFRS implementation in October 2009 covering the period from October 2009 to November 2011 although initial work on implementation had started earlier than this. The plan is comprehensive and recognises all the key stages and if followed, should ensure a smooth transition. A number of key tasks have been achieved but there has been some slippage. Resources have been identified to undertake the work but not all have been trained yet. Consideration of PFI schemes and leases is behind schedule as is the capture of data required for re-stating the 2008/09 financial statements but officers have recently updated the project plan and are focussed on meeting the key deadlines for all these tasks. We would encourage members and directorate staff to support the IFRS project team in this complex process by ensuring that information is provided quickly and resources are made available when requested in accordance with the plan.
- 8 We have reviewed the Council's progress against its project plan and have set out below the highlights.
 - Impact assessment - the Council has a good understanding of the changes to its financial statements arising from the implementation of IFRS and the work needed to support them.
 - Budgetary implications - the Council has considered the budgetary implications of the changes and concluded that they are mostly neutral in terms of the Council's net worth.
 - System changes - the Council has considered the need for changes to systems to accommodate IFRS reporting in respect of the annual leave accrual and component accounting and concluded that there are no changes required to material systems at this time.
 - Guidance - the Council is up to date with the Chartered Institute of Finance & Accountancy (CIPFA) guidance and Audit Commission briefings.
 - Technical skills - the Council has assessed the resources required to achieve its IFRS plan and while some training has been supplied further training is needed.
 - Directorates hold the detailed information needed by finance to determine accounting treatments for PFI schemes and leases and there have been some delays in gathering the required information. Access to complete information is being addressed by the Council as a priority as it could impact on the audit opinion on the 2009/10 financial statements.

Recommendations

- R1** Directorates should provide support to finance staff to allow the accounting treatments to be determined in accordance with the IFRS project plan.
- R2** A Council-wide central repository for documentation relating to all leases, significant service contracts and PFI schemes should be established.

PFI schemes

- 9** The Council has several PFI schemes and the accounting treatment of these schemes could change as a result of IFRS. To comply with the new reporting requirements, the Council needs to undertake a detailed review of the original PFI contract documentation, calculate the fair values of assets that may revert to their ownership at the end of the contract and consider whether a finance lease may exist in respect of those assets.
- 10** There are several key stages in this process and we have reviewed progress.
- Acquire original financial model for each PFI scheme - the Council holds most of these although some are less detailed than others and further information might be needed.
 - Consider in respect of each scheme whether scheme assets should be disclosed on the Council's balance sheet under IFRS - the Council has concluded that for each of the schemes, the relevant assets will need to be reported on its balance sheet.
 - Identify fair values of assets and calculate interest rates - this has been completed for all but one PFI scheme. The Council is taking action to get the outstanding information.
 - Draft the resulting accounting treatment for each scheme - this is planned for later in the year when it is clearer whether or not any late guidance may be forthcoming from CIPFA. We will review all proposed accounting treatments as they are submitted to us which should, if possible, be ahead of the preparation of the Council's financial statements.

Recommendation

- R3** Outstanding information to support the development of accounting treatments for PFI schemes should be obtained.

Leases

- 11 A potentially significant change resulting from IFRS implementation in 2010/11 is the revised definitions of finance and operating leases. This means that some leases, previously classified as operational, might be reclassified as finance leases with the asset and associated liability coming onto the Council's balance sheet. This applies to situations where the Council is the lessor or the lessee. The Council has demonstrated a good understanding of the disclosure requirements.
- 12 There is also a requirement to review significant service contracts and concessions and consider whether any assets involved may need to be accounted for as if subject to a finance lease for inclusion in the 2009/10 financial statements.
- 13 In summary a service concession contractually obliges a private sector operator to provide services related to infrastructure (property) to the public on behalf of a local authority. This typically includes roads, street lighting, schools and telecommunications networks. It also includes fixed assets used for administrative purposes in delivering services to the public.
- 14 There are several key stages in this process which we have reviewed with officers.
 - Identify and obtain details of all leases - this process is taking longer than anticipated and a questionnaire has recently gone to all schools to assist in the acquisition of relevant information.
 - Identify service concessions that may contain a lease - a questionnaire has recently been sent out to directorates asking them to consider whether such arrangements exist and responses are awaited.
 - Reclassify leases where appropriate and calculate asset and liability values - this process will take place when all information is available.

Recommendation
R4 Outstanding information to support the development of accounting treatments for leases should be obtained as a priority.

Employee leave accrual

- 15 There is a requirement under IFRS for the Council to recognise the year end value of its employees' accrued holiday entitlement. The Council is gathering this information at 31 March 2010 which is in line with its project plan.

Re-statement of 2009/10 financial statements

- 16 The 2009/10 financial statements will need to be restated under IFRS in order to provide comparative figures for the 2010/11 financial statements.

- 17 The Council has progressed well with this although as noted in paragraph 14, obtaining the details of leases is taking longer than anticipated. This is covered by recommendation 4.

Intangible assets

- 18 The definition of intangible assets is broadened under IFRS and the Council has developed a process for identifying expenditure that meets the new definition.

Appendix 1 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
6	R1 Directorates should provide support to finance staff to allow the accounting treatments to be determined in accordance with the IFRS project plan.	3	All	Yes	There is a project launch on the 1 April to which reps from all directorate/CED relevant units are attending and this will be reiterated. There is currently support from the Finance Operations Group and this will be enhanced as the project moves ahead.	1 April 2010
6	R2 A Council-wide central repository for documentation relating to all leases, significant service contracts and PFI schemes should be established.	2	All	In principle	Property leases are currently held within Property but other leases are held in Legal and within directorates and schools. The full extent of the situation will not be known until we have moved forward on this part of the project and the practicalities understood as to whether this is feasible or not.	1 April 2010
6	R3 Outstanding information to support the development of accounting treatments for PFI schemes should be obtained.	3	PFI teams in CFE and KASS	Yes	Since this report has been written most of the PFI information has been received.	6 April 2010
7	R4 Outstanding information to support the development of accounting treatments for leases should be obtained as a priority.	3	All	Yes	This will be addressed at the project launch.	1 April 2010

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