IFRS and the public sector

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About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application, and finally signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

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Definition and concept

The International Accounting Standards Board (IASB) publishes its financial reporting standards in a series of pronouncements called International Financial Reporting Standards (IFRS). There are still a number of international standards in force that were issued by the IASB’s predecessor body; these pronouncements are termed International Accounting Standards (IAS).

In the UK, public sector financial reporting is undergoing the most fundamental change since the introduction of resource accounts. IFRS will be used to produce the annual financial statements for central government, health bodies and certain other public sector bodies from 2009/10. The 2008/09 accounts will also have to be restated using IFRS principles. For local government the timetable runs one year behind these timescales.

IFRS are the financial reporting rules that have been developed by the London based IASB. Recently, these have become widely mandated, adopted or emulated in about 100 countries globally. Most notably, IFRS have been formally mandated for European Union (EU) listed companies when preparing their group accounts. In the US the securities and exchange commission have issued a roadmap for the adoption of IFRS for filing purposes by 2014.

Context

In the current CIMA syllabus, students will learn about and may be examined on IFRS in the following papers:

Paper C02, Fundamentals of management accounting
Chapter 10, The regulatory framework of accounting
Paper P7, Financial accounting and tax principles
Chapter 7, the IASC and the standard-setting process
Chapter 8, Regulatory framework
Chapter 10, Published financial statements
Chapter 11, Reporting financial performance
Chapter 12, Cash flow statements
Chapter 13, Non-current tangible asset standards
Chapter 15, Inventories and construction contracts
Chapter 16, Non-current intangible assets
Chapter 17, Share capital transactions
Chapter 18, Recognition and disclosure of other significant accounting transactions
Paper P8, Financial analysis
Chapter 1, Financial reporting framework
Chapter 2, The consolidated balance sheet I
Chapter 5, Associates and joint ventures
Chapter 7, Acquisitions in the accounting period
Chapter 10, Foreign currency transactions
Chapter 11, Cash flow statements
Chapter 12, Financial instruments I: disclosure and presentation
Chapter 13, Financial instruments II: recognition and measurement
Chapter 15, The measurement of income and capital: other topics
Chapter 17, Analysis of financial statements: interpretation
Chapter 18, Analysis of financial statements: earnings per share
Chapter 21, International issues in financial reporting

**Overview**

The objective of financial statements is to provide information about the financial position and performance of an organisation that will be useful to a range of people in making economic decisions, and additionally for public sector accounts, demonstrating how taxpayers’ money has been spent to the various stakeholders.

Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need because they largely portray the financial details of past events and do not always provide non-financial data.

Given this objective, the corporate sector has long recognised that there is a demand for a single global set of accounting standards.
In the 2007 budget, the UK government announced that the annual financial statements of government departments and other central government bodies would be prepared using IFRS, adapted as necessary for the public sector. IFRS would replace the UK Generally Accepted Accounting Principles (UK GAAP). The aim was to:

‘… bring benefits in consistency and comparability between financial reports in the global economy and to follow private sector best practice’.

The transition to IFRS was scheduled for 2008-2009, along with the first set of Whole of Government Accounts (WGA), which would be produced on an IFRS basis. However, due to the significance and complexity of the proposed changes, including the large number of PFI projects in the 2008 Budget, the Government subsequently announced that the transition to IFRS and production of the first WGA would be delayed until 2009-2010, in recognition that the original timetable was very challenging for some departments. To put the delayed timetable into context, it is useful to understand that the private sector previously had five years in which to implement IFRS, and that some companies only just managed to meet the deadline.

**Application**

Due to the postponement, the accounts of all central government departments, agencies and non-departmental public bodies will not be prepared under IFRS until the year ending 31 March 2010.

However, in order to ensure the successful achievement of fully compliant IFRS accounts by this date, members of the Financial Reporting Advisory Board (FRAB) recommended that all government departments able to do so should produce 2008-2009 shadow resource accounts on an IFRS basis, alongside their accounts on a modified UK GAAP basis. The Treasury confirmed that those departments will produce IFRS shadow accounts for 2008-2009 if they are in a position to do so.

On first time application, organisations will have to explain in detail how the transition from UK GAAP to IFRS affected their financial statements. This will result in additional reconciliations, for which significant analysis and documented evidence will be required to maintain an audit trail.
Trigger points

Transition to IFRS in the public sector is being managed by the use of four Treasury directed trigger points. These are intended to provide assurance that implementation is on track.


2. 31 December 2008 - The National Audit Office to complete audit of the 1 April 2008 balance sheet and produce management letters for government departments. The latter to inform Treasury spending teams of the financial impact.

3. 30 September 2009 - Complete the 2008/09 shadow year accounts and feed IFRS-based data to the Treasury.

4. 31 December 2009 - The National Audit Office to complete audit of the 2008/09 shadow accounts.

As stated above the goal is to prepare the first full IFRS based accounts for 2009/10 for the year ending 31 March 2010.

In preparation for IFRS implementation, it will be necessary to undertake a considerable amount of analysis that may only serve to demonstrate the non-materiality of any particular issue. However, this is a vital piece of work in order for bodies and their auditors to gain assurance over the completeness and accuracy of the IFRS conversion process.

General themes

- IFRS is a more rules based system, to ensure consistency across global territories.

- IFRS has a theme of increased disclosure requirements.

The transition to IFRS may be more significant for some public sector bodies than others. The most significant issues for public sector bodies are expected to include the accounting for PFI schemes and similar arrangements, the treatment of derivatives embedded within other contracts and lease accounting. A summary of the key issues is shown in the following table.
<table>
<thead>
<tr>
<th>Topic area</th>
<th>Implications under IFRS</th>
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<tr>
<td>PFI</td>
<td>• Potentially moving schemes on balance sheet using principles of ‘control’ rather than ‘risk’ and ‘reward’.</td>
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| Leases                                             | • Need to separately account for leases of land and buildings.  
• Land leases are normally operating leases.  
• Experience shows that the detailed review of leases between operating and finance leases is time consuming.  
• Other contracts with ‘lease type’ features need to be identified. |
| Segment reporting                                   | • Segments must correspond with internal reporting.  
• Reconciliation to reported financial information.                                                                                                                                                                  |
| Financial instruments/embedded derivatives          | • Very complicated standards.  
• Covers a large part of the balance sheet.  
• New and extensive disclosures.  
• Separate accounting for derivatives (and embedded derivatives).                                                                                                                                               |
| Staff benefits (leave)                              | • Stricter requirements to include accruals for staff benefits such as accrued leave.                                                                                                                                 |
| Increased disclosures                               | • IFRS requires increased disclosures in the financial statements, driving up the length of financial statements and the amount of time required to collect the supporting data.                                        |

Sourced from PricewaterhouseCoopers Access IFRS website at: [www.ifrs.co.uk/index.html](http://www.ifrs.co.uk/index.html)
PFI arrangements

PFI schemes and similar arrangements are, and have been, undertaken by a large number of public sector bodies across a complex range of procurement arrangements. Under IFRS, accounting for PFI schemes will be in accordance with the requirements of IFRIC 12: ‘Service Concession Arrangements’. In order to assess the correct treatment of these schemes organisations will need to go back to the original contract and the related financial model underpinning the commercial arrangements. This in itself may lead to challenges for some early schemes in accessing the relevant information. IFRIC 12 is likely to result in the recognition of more PFI arrangements on the balance sheet. Where schemes are assessed as now being required to be reported as “on balance sheet”, the accounting treatment is retrospective. This means that organisations will have to go back to the date of inception in order to determine the accounting entries that will be required to account for these arrangements under IFRS.

Leases

IAS 17: ‘Leases’ requires the split of land and building elements of property leases. Although they are often the subject of one lease agreement, the land and buildings components within each lease need to be evaluated separately to determine whether they contain the characteristics of operating or finance leases. While it is highly likely that the land element will remain an operating lease, it is possible that the buildings element could become a finance lease, and therefore would need to be recognised on the balance sheet.

IFRIC 4: ‘Determining whether an arrangement contains a lease’ may cause significant problems for some departments which have substantial contracts with major companies for the long-term supply of capital goods.

The treatment of leases is similarly retrospective to that of PFI as discussed above and can present the same practical challenges associated with returning back to the original contract documentation and previous accounting treatments.

Segmental Reporting

IFRS 8: ‘Operating segments’ has caused considerable debate; as this is a relatively new standard there are not yet many examples available of how it is being applied. The concept behind the standard is that the notes to the accounts should reflect the organisational structure and how the various parts of it perform financially. In essence, this represents an externalisation of internal management information.
Financial Instruments/Embedded derivatives

IFRS introduces the concept of embedded derivatives which may be found in contracts such as leases, PFI arrangements and insurance contracts. An embedded derivative is an instrument within a contract which has the capacity to cause the cash flows within that contract to vary. Where they have dissimilar economic characteristics to their host contract, embedded derivatives may require separate recognition from the host contract. The relevant disclosure standard, IAS39 is over 400 pages long and is primarily aimed at the financial sector and applies to all financial instruments.

Organisations will need to search for embedded derivatives in contracts and then determine whether or not they must be separately accounted for, for which fair values must be determined. Additionally, new disclosures are required for all financial instruments.

Staff benefits (leave)

Under IFRS, there are stricter requirements to include accruals for staff benefits such as accrued leave. For some government departments this will be a significant challenge, not only because of the size of the payrolls, but also due to the nature of leave arrangements. For example, the MoD has various arrangements, most notably for serving personnel. Here the movement in accrued leave due to operational requirements may vary significantly year-on-year, whereas for other departments the year-on-year movement may be insignificant.
FURTHER INFORMATION

Articles

CIMA members can obtain articles on this topic from the Business Source Corporate database, which can be found in the CIMA Professional Development section of the CIMA website. [www.cimaglobal.com/mycima](http://www.cimaglobal.com/mycima) [Accessed 21 May 2009]

Banzacar, K. *IFRS brings a radical change to financial statement presentation.* CMA Management, February 2009, Volume 82, Issue 9, pp 28-33


Epstein, B.J. and Jermakowicz, E. K. *IFRS converges to US GAAP on segment reporting.* Journal of Accountancy, April 2009, Volume 207, Issue 4, p. 50


Jetuah, D. *Bank bailouts intensify IFRS headache.* Accountancy Age, 12/03/2009, p. 1


Other articles

Sallu, M. *Watch out for embedded derivatives* on the publications section of the PricewaterhouseCoopers website.

Books


Websites

International Accounting Standards Board (IASB)
News and downloadable documents.
Available from: www.iasb.org/Home.htm
[Accessed 21 May 2009]

IFRS Taxonomy 2009
Available from: http://digbig.com/4ysqs
[Accessed 21 May 2009]

Access IFRS
Monitors developments in IFRS and its impact on business. Access IFRS is regularly updated with articles and publications by PricewaterhouseCoopers subject specialists. Available from: www.ifrs.co.uk/index.html
[Accessed 22 May 2009]

AICPA IFRS Resources

The American Institute of Chartered Public Accountants (AICPA) in partnership with its marketing and technology subsidiary, CPA2Biz, has developed the IFRS.com web site.
Available from: www.ifrs.com
[Accessed 21 May 2009]

Deloitte IAS Plus
Summaries of International Financial Reporting Standards.
[Accessed 21 May 2009]

Ernst & Young iGAAP 2009
Contains newsletters, regulatory updates and web-based learning resources.
Available from: www.ey.com/IFRS
[Accessed 21 May 2009]

Department of Health Finance Manual
Contains guidance on treatment of PFI.
Available from: www.info.doh.gov.uk/doh/finman.nsf
[Accessed 22 May 2009]
KPMG International Financial Reporting Standards Group
News and downloadable documents Available from: www.kpmgifrg.com/index.cfm
[Accessed 21 May 2009]

RSM Richter IFRS page
[Accessed 21 May 2009]

Securities and Exchange Commission
Proposal for First-Time Application of International Financial Reporting Standards by Foreign private issuers registered with the SEC.
Available from: http://digbig.com/4ysqw
[Accessed 21 May 2009]

SAP Community Network
User community with blogs, forums, articles & other resources designed for businesses implementing IFRS, especially using SAP solutions.
Available from: www.sdn.sap.com/irj/bpx/ifrs
[Accessed 21 May 2009]