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Public Finance & Accountancy

IFRS FORUM, 16 FEBRUARY 2009

Preparing for the Next Stage

SHARED EXPERIENCE FROM TRIGGERS 1 AND 2

Contents

Forum Report	Preparing for the Next Stage - Shared Experience from Triggers 1 and 2	3 - 6
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Case Studies and Other Supporting Material

Annex A	Case Study: The Ministry of Defence	7
Annex B	Case Study: Department for Transport	8
Annex C	Case Study: Audit Scotland	9
Annex D	Case Study: Department of Health	10
Annex E	Programme	11
Annex F	Speaker Details	12-14

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PREPARING FOR THE NEXT STAGE - SHARED EXPERIENCE FROM TRIGGERS 1 AND 2

Introduction

1. CIPFA and the ICAEW Financial Reporting Faculty held a Forum on 16 February 2009 at which finance practitioners in the public sector shared their experiences in producing the opening balance sheets on an IFRS basis, and the initial audit review of these, and looked ahead to preparation of the first set of 'shadow accounts'. The event brought together:

- the HM Treasury view across government as a whole, including technical and budgetary issues which might be resolved centrally
- more specific reports on project implementation and technical issues arising in the Ministry of Defence, the Department for Transport, Scottish Government bodies and the health sector
- an audit overview of the results from opening balance sheet restatement
- issues to address in producing shadow accounts for 2008-09.

Discussion and debate was continued in two workshop sessions which respectively considered:

- accounting for major contracts (PFI/Leases etc)
- other (non-PFI) accounting and auditing issues.

2. The programme for the day is at Annex E, and details of the presenters are at Annex F. Information on future events will be available at: www.cipfa.org.uk/pt/ifrs and www.icaew.com/frf.

IFRS implementation across government

3. The first year of implementation for central government, the NHS and Whole of Government Accounts is 2009-10, while for local government the first year of full implementation remains 2010-11.

4. The postponement allowed the Treasury to implement a 'Trigger Point' process to stage the work required to produce the first sets of IFRS based accounts, starting with the production of opening balances and shadow accounts for the 2008-09 comparatives. The main checkpoints for central government were:

Trigger Point 1	Opening balance sheet (1 April 2008)	30 September 2008
Trigger Point 2	Audit review of TP1	31 December 2008
Trigger Point 3	Shadow Accounts	10 September 2009
Trigger Point 4	Audit conclusion on TP3	31 December 2009

The Ministry of Defence, Department of Health, and the devolved government administrations are following similar approaches on different timetables.

5. The main financial reporting guidance is contained in the IFRS based 2009-10 FReM and equivalent guidance in NHS Manuals of account and the Monitor FReM. The Government Financial Reporting website (www.financial-reporting.gov.uk) also provides accounts proformas, PFI worked examples, and guidance on leases, financial instruments, and accounting for the Trunk Road Network under IAS 16.

6. Government bodies will be subject to in-year budgetary control on an IFRS basis beginning with the Winter Supplementary Estimates, which will be published in September/October 2009, using IFRS based budgeting guidance.

7. IFRS adoption is also being progressed together with broader initiatives including the Whole of Government Accounts, integration of local authority accounting within the FRAB approval process, resolution of data quality issues in the COINS database used to track performance against budgets and parliamentary estimates, and other advancement of the Government Finance Professionalism agenda. In the health sector, IFRS implementation is also being linked to a faster closure project.

The experience of balance sheet preparers

8. Speakers outlined the approach which their department or other bodies had applied to make progress against the first two trigger points. The MOD presentation focused on project plans (Annex A), DfT discussed embedding and succession planning (Annex B) and the Scotland and Health presentations provided comments on sector progress (Annexes C and D). The presentations included many common messages and reinforced observations made at the previous ICAEW/CIPFA IFRS forum 'Planning to Succeed Through Shared Experience' in March 2008. Particular stress was laid upon:

- effective project management
- stakeholder engagement and top level commitment
- building robust systems using the appropriate balance of in-house expertise and knowledge transfer from external providers
- evidence requirements and regular dialogues with auditors.

9. Detail was also provided on technical IFRS implementation issues which had been particularly significant or problematic.

Results of the opening balance sheet restatement and audit review

10. The results of the Trigger Point 2 process were published shortly after the IFRS forum in the General Report of the Comptroller and Auditor General on 27 February 2009. Key points included that:

- 23 clear opinions were given on resource accounts
- 24 opinions were qualified or reflected significant outstanding matters
- MOD and Department of Health conclusions were delayed, as planned
- About 200 other opening balance sheets had been audited.

What worked in practice?

11. The overall degree of commitment and the level of achievement compare favourably with central government's previous major change in financial reporting: matters are generally much more advanced than at similar stages in the development of resource accounting and budgeting. Experience of balance sheet preparers and the audit review both confirmed that successful implementation mainly reflected effective planning and strong project management, including:

- planning and starting work at an early stage
- early engagement with Finance Directors and audit teams
- early consideration by the Audit Committee
- clearly documented project plans
- identification of key resources
- focusing on key issues.

12. More specific features of good practice included:

- top down analysis of functions and bodies within the reporting group, so that the impact of new financial reporting requirements could be assessed
- risk analysis including project and technical risks
- stakeholder analysis to inform communication plans
- determining the extent to which the project would be supported by in-house staff or through external providers
- providing IFRS training and other support to accountants, and also to non-accountants
- providing support and guidance to smaller bodies within the group or sector
- 'knowledge transfer' arrangements for any part of the project delivered by external providers
- identifying synergies between different parts of the project (such as review of related IAS/IFRS)
- use of templates and other standardised documentation and guidance, both to help preparation and to provide audit evidence.

Problems in implementation

13. Notwithstanding the achievements in some areas, not all bodies showed the same degree of commitment or progress. The NAO review indicated that this mainly reflected less effective project management, and some issues relating to information and evidence. Key issues included:

- lack of project planning
- little engagement of Accounting Officer, Finance Director or Audit Committee
- Inadequate resourcing
- Failure to review accounting policies as a whole
- Insufficient documentation or evidence to support decisions, including decisions that matters were immaterial
- Insufficient documentation or evidence to support accounting entries
- Missing audit trail or other elements of the restatement exercise
- No early discussion with auditors.

IFRS technical issues

14. Technical issues which arose in many departments and other bodies included:

- accounting policies
- leases (IFRIC 4), PFI (IFRIC 12, with a link to IFRIC 4), and embedded financial instruments
- Reclassification of software as an intangible asset
- Determining methodologies for accrued employee benefits, such as holiday pay and other leave
- Consistency of accounting policies across groups
- Recognition and measurement of intangible assets
- Errors in UK GAAP application 'discovered' during IFRS review
- Discounting.

15. Less frequently encountered IFRS technical issues related to:

- valuation of equity investments
- fair value measurement and reporting on derivative financial instruments
- classification of liquid assets as investments, cash and cash equivalents
- financial guarantees
- complex valuation for leases and PFI arrangements
- access to information
- foreign exchange
- financial instrument impairment reviews
- hedging
- component accounting
- European Funds.

Way forward

16. The next steps for departments and other bodies will be to finalise accounting policies and to finish or revise the Trigger 1 restatements, and make changes to the governance process to support the production of shadow accounts to an agreed timetable.

17. The National Audit Office will also be taking forward the lessons that it has learnt in providing consistent advice to government on the way to Trigger Point 2, including capturing key precedents which will inform Trigger Point 4 and the first full audit, and other considerations such as the impact of the Treasury's 'Clear Line of Sight' alignment project. The other audit agencies will be taking similar steps.

Other topics raised in Q&A and Workshops

18. A variety of technical and other matters raised by forum delegates were discussed by panels of speakers, including:

Selling IFRS within the organisation. The benefits of IFRS adoption may be difficult to 'sell', but it needs to be made clear that public sector financial reporting could not remain based on UK standards, and that early adoption put the UK in a better position to participate in the development of international accounting standards. IFRS adoption is also being progressed partially in the context of other initiatives to improve financial management.

Use of champions/using the experience of similar bodies. There is real benefit to be gained from the experience of those who are farther along the road to IFRS implementation. This may be particularly helpful for smaller bodies, and may reassure them that their circumstances are neither unique nor insoluble.

PFI. Significant determinations remain to be made on PFI projects, although the situation has become clearer following the resolution that 'infrastructure' references in the I-FreM (based on IFRIC 12) may be construed as referring to assets providing almost any public service. When the IFRIC 12 criteria are satisfied then the full Service Concession Arrangement accounting treatment should be used, regardless of any view that the underlying contract may be a simple lease. Some PFI arrangements are being derecognised with the move to IFRS, as they do not satisfy the IFRIC 12 criteria.

Contingent Liabilities and Guarantees. Guidance on these is provided in the relevant standards. While the guidance is not simple to apply, it is not ambiguous.

EU adoption and IFRIC interpretation. Clarification was provided that the FReM guidance will be based on the body of IFRS that has been adopted in the EU at the start of the reporting year. Preparers should have regard to IFRIC interpretations issued and adopted during the year, as these are normally commenting on the application of IFRS which is already effective.

Budgetary implications. The underlying principle is that there will be no budgetary impacts from adjustments to opening balance sheets. Guidance to inform the impact on 2009-10 budgets and estimates would be issued. Some issues have yet to be resolved as to how transitional adjustments will be covered in the context of the statutory break-even duty of health bodies.

Summary of the day

19. The Chair noted that there were some significant technical challenges to be addressed in the areas of PFI, leases and financial instruments, and that guarantees had been identified as an area where more guidance could be helpful. He summarised the key messages from the day's discussions as follows:

- (a) Strong project management is crucial
- (b) Leadership and top level commitment are vital
- (c) The right balance of in-house development and private sector expertise needs to be reached, and some superb resources are available
 - within the public sector
 - within the institutes
 - from private sector providers
- (d) IFRS cannot be implemented in the finance function alone; buy-in from internal and external stakeholder is essential
- (e) Engagement with auditors should be sought at an early stage
- (f) Early Audit Committee involvement should be considered, if not already in place.

Case Study: The Ministry of Defence Executing the Project Plan

1. The MOD is a very large government department with high volumes of contracts and large numbers of expensive and mobile assets, some of which have been procured under very specialised arrangements. MOD managed IFRS adoption as a formal project from an early stage. Project management roles were assigned and analysis carried out on:

Context: a top down analysis of functions and sub-organisations, against which the impact of new financial reporting requirements could be assessed

Approach: the extent to which the project would be run by MOD staff and by external contractors, having regard to technical expertise, resource constraints, the need to ensure both external and internal knowledge was embedded in systems, and the need to engage with stakeholders

Evidence: an approach was developed to document a review of 22,000 contracts against all relevant standards. Overlapping and related standards such as financial instruments, IFRIC 4 and IFRIC 12 were progressed jointly to reduce the review burden.

2. The MOD project team also carried out a stakeholder analysis to identify key stakeholders and communication mechanisms. Care was taken to obtain commitment from senior stakeholders. Contact was made with the NAO audit team at an early stage, and developed into regular and helpful dialogue; they also helped inform judgments on materiality, to help focus efforts on key issues. In general communications worked well, although there are still some issues of understanding and engagement from 'commercial' stakeholders who negotiate contractual arrangements on which accounting treatment and information capture need to be considered at an early stage.

3. Key risks identified at the planning stage included technical issues and information gaps which might arise in relation to:

- financial instruments
- PPP/PFI arrangements
- review of other arrangements under IFRIC 4
- employee benefits.

4. In practice, technical issues arose particularly in connection with:

- embedded derivatives. Considerable work was involved in documenting this, although in practice all candidates for separate reporting proved to be 'closely related'
- IFRIC 4. A particular issue for some MOD arrangements with defence industry suppliers is that IFRIC 4 requires a leasing treatment to be applied, but the arrangements are quite unlike those envisaged in IAS 17
- IFRIC 12, which was applied to more than 60 arrangements.

Case Study: Department for Transport - Embedding of IFRS knowledge, skills and resources and succession planning

1. Development and embedding of IFRS knowledge in DfT was planned as part of an implementation project initiated in 2007. Project monitoring arrangements on a 4-6 week cycle were established at an early stage. Key elements of the project plan related to knowledge development, including DfT-wide IFRS workshops on risk areas, an 'Overview of IFRS' event and an IFRS Transition seminar reflecting Network Rail's experience. After preliminary risk analyses were completed, DfT determined that implementation would be mainly in-house. Development of IFRS expertise was addressed through a combination of

- professional and DfT specific IFRS training
- IFRS reference resources
- buying in support where necessary.

2. Early in 2008, DfT and the agencies worked to raise awareness and promote engagement through:

- a Project Steering Group of non-executive directors and all agency finance directors, which encouraged high level commitment and also acted as a 'sounding board' providing a wider perspective on project proposals
- questionnaire follow up of preliminary risk analyses
- appointing 'Champions' in core areas to advise on IFRS issues.

These were coupled with early and regular discussions with the NAO audit team. These initiatives were coupled with a consistent approach to evidence gathering and documentation, with standardised formats for objectives and outcome reporting, which were favourably received by the NAO.

3. Particular IFRS challenges arose in the following areas:

- identifying and accounting for financial guarantees. There were three contracts with no useful private sector comparators (Air Travel Insurance Fund, London and Continental Railways, and Network Rail)
- IFRIC 12 consideration of PPPs/PFIs for roads, toll bridges and Network Rail leasing arrangements.

An in-house expert assisted with these and some external support was bought in, but they nevertheless consumed significant amounts of other technical resources.

4. Areas where improvements would be possible include:

- documentation of more strategic decisions to focus work in particular areas
- better documentation of contingent liabilities
- training of non-finance staff.

The DfT presenters also reflected on the substantial scale of the implementation project, and noted that despite considerable resource input, and buy-in from key stakeholders, progress was still not fast enough to allow time for thorough departmental review of figures before they were put forward for audit.

5. Key benefits from DfT's approach are that systems have been developed which will continue to deliver relevant information on an ongoing basis. Staff moves and promotion are also expected to spread IFRS expertise more widely in due course. Clarity in handling the process was also assisted by maintaining IFRS adjustments in a separate ledger.

Case Study: Audit Scotland

IFRS - Planning for the Shadow Accounts

1. Audit Scotland was in the final stages of completing the equivalent of Trigger Point 2. Key observations were that the Scottish Government prepares a single consolidated account, bringing together information from a variety of bodies of with widely varying resources and levels of expertise. They had taken the IFRS implementation exercise seriously and had:

- managed production of the IFRS based opening balances as a co-ordinated project across government
- involved those charged with governance across the piece
- carried out a Gateway Review
- consulted with auditors
- used external consultants where there was insufficient in-house resource or expertise
- developed Application Notes
- used templates.

2. The same project management principles will apply for the shadow accounts. There will be a continuing need to involve those outside the finance function, and to agree timetables within the organisation and with auditors. Good documentation will be needed to support all significant changes, both where changed procedures are developed, and where it is determined that no changes are necessary.

3. Additional considerations for shadow accounts include the need to follow up issues and recommendations from the opening balance sheet audit, to review any changes to guidance including the FReM, whether assumptions made for the opening balance sheet exercise remain valid, and review of accounting policies which were not significant for opening balances. Further consideration will also need to be given to segmental reporting.

4. In pursuing the above, benefits can be obtained by reviewing information prepared by other similar bodies. Benefits can also be obtained by progressing IFRS work in tandem with related work on UK GAAP accounts.

Case Study: Department of Health

NHS Implementation Issues – Review of Transition to IFRS within the NHS

1. Financial reporting capability in the NHS as measured by Auditor's Local Evaluation (ALE) scores continues to improve, with increasing numbers of health bodies performing strongly or consistently above minimum requirements. The 2008 assessments showed that only 3% of health bodies were unable to achieve adequate financial reporting, although a further 33% were unable to exceed minimum requirements.

2. Against this background the Department of Health is implementing IFRS. This project is being managed together with another improvement workstream designed to achieve faster closure of financial statements. Implementation is being viewed as a 'whole system' issue, tracking the implications for technical accounting, budgeting and estimates, statutory duties, training, resourcing, PFI and capital regimes, and relationships with key stakeholders such as auditors and the Public Accounts Committee.

3. An overall timetable and project plan was developed, and this has been cascaded to Strategic Health Authorities who will need to develop local programme arrangements to support implementation.

4. Effective implementation will depend upon:

- project management and planning
- focusing on areas of business change
- early data cleansing
- understanding skills and resource requirements
- communications and stakeholder engagement
- building confidence in the process
- identifying and managing consequential outcomes.

These will have to be achieved across different types of health organisation, with varying levels of accounting resource and capability.

5. A key part of the monitoring process was the development of a 'readiness review' questionnaire, to be used by individual bodies to self-assess IFRS knowledge, local project planning, high level commitment, audit liaison, resourcing issues, procedures, financial impact and the use of IFRS based information to develop 09/10 financial plans. Strategic Health Authorities will identify organisations with 'No' answers to any questions, and issues arising from these will need to be addressed before submission of final information.

6. Particular issues have arisen in connection with:

- PFI and Local Improvement Finance Trust (LIFT) schemes
- leases
- financial instruments
- 'discovery' of areas such as holiday pay, where UK GAAP accounting should have been better
- charitable fund accounting issues
- uncertainty over how transitional adjustments will affect the break-even duty.

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PREPARING FOR THE NEXT STAGE - SHARED EXPERIENCE FROM TRIGGERS 1 AND 2

	PRESENTATION	SPEAKER
9.30	Registration and coffee	
10.00	Introduction and objective of the Forum	Martin Sinclair, National Audit Office
10.10	Views from the Treasury	Chris Wobschall, H M Treasury
10.30	Executing the Project Plan	Francine Coles, Ministry of Defence Major Nick Shanahan, Ministry of Defence
11.00	Embedding of IFRS knowledge, skills and resources and succession planning	Hiru Bhudia, Department for Transport Eleanor Gill, Department for Transport
11.30	COFFEE	
11.45	Planning for the Shadow Accounts	Russell Frith, Audit Scotland
12.15	NHS Implementation Issues	Colin Forsyth, Department of Health
12.45	Panel session with morning speakers	
13.15	LUNCH	
14.15	Restating the Opening Balance Sheet - The results of the Trigger Points 1 and 2 Exercise	Andrew Baigent, National Audit Office
15.00	Workshop 1: Technical Q&A (excluding PFI)	Andrew Baigent, National Audit Office Chris Wobschall, HM Treasury Andy Simmonds, Deloitte LLP
	Workshop 2: Major Contracts	Francine Coles, Ministry of Defence Peter Morgan, National Audit Office
15.50	Summary and Next Steps	Martin Sinclair, National Audit Office
16.00	CLOSE AND COFFEE	

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PREPARING FOR THE NEXT STAGE - SHARED EXPERIENCE FROM TRIGGERS 1 AND 2

SPEAKERS

**Forum Chair: Martin Sinclair, National Audit Office**

Martin leads the NAO's financial audit practice. He is responsible for the Home Office, Ministry of Justice, Northern Ireland and Parliament families of clients embracing both value for money and financial audit assignments. He also oversees the NAO's international activities including the audit of international public sector organisations and a programme of technical cooperation assistance to other supreme audit institutions worldwide.

Martin was elected to the CIPFA Council in 2007. He is Chair of CIPFA's Accounting and Auditing Standards Panel and a member of a range of professional committees.

**Chris Wobschall, HM Treasury**

Chris is the Head of Assurance and Financial Reporting Policy at HM Treasury. Until December 2008 he was an Assistant Director in CIPFA's Policy and Technical directorate, on secondment from the National Audit Office. His responsibilities at CIPFA encompassed standards and policy in the areas of Accounting, Auditing, Pensions, Governance and Central Government, European and International matters.

At the NAO he worked on Trade and Industry, Education and Defence audits, as well as on technical guidance and training and overseas assignments in Australia and Hong Kong. Chris also took secondments as the Secretary to the Accountancy Foundation, at the European Court of Auditors and at the Office of Telecommunications.

Francine Coles, Ministry of Defence

Francine is responsible for the implementation of IFRS for MOD departmental resource accounts.

Francine joined the MOD in 1989 as a trainee accountant and qualified with CIMA. She subsequently worked in a range of financial management posts in the United Kingdom, Cyprus, and Bosnia. In September 2005, Francine returned to the UK to head the team producing the Departmental Resource Accounts.

Major Nick Shanahan, Ministry of Defence

Major Nick Shanahan leads a team of military management accountants providing support to investment decisions in Defence projects.

He was commissioned into 1st Battalion, The Royal Gloucestershire, Berkshire and Wiltshire Regiment in 1995, and transferred to the Adjutant General's Corps in 2000 to pursue a specialisation in finance and management. He has served in Cyprus, Jordan, Kuwait, Botswana, Nepal, USA, Greenland, Northern Ireland and most of the glamorous garrison towns in the UK. Nick is an alumnus of the University of Bristol and Henley Management College, and a CIMA global prize-winner.

**Hiru Bhudia, Department for Transport**

Hiru heads the Group Financial Skills and Specialist Advice Team in the DfT Group Financial Accounting Division. She is also Deputy Head of Finance Profession. She joined the Department for Transport in March 2004 from the Ministry of Justice, where she managed the Courts Services Accounts Production Team for four years. Prior to that she worked for nine years in MOD, having previously worked in the private sector for 14 years.



Eleanor Gill, Department for Transport

Eleanor is the project manager for the IFRS transition project for the Department for Transport. She also provides accountancy advice to the line and managed the finance training team for a number of months earlier this year.

Eleanor joined the department in May 2007. Previously she worked at the Ministry of Justice and the NAO where she qualified as a Chartered Accountant. At the NAO Eleanor led financial audits of the Defence Procurement and Logistics organisations and contributed to good governance and VFM studies in the Ministry of Defence.



Russell Frith, Audit Scotland

Russell is the Director of Audit Strategy at Audit Scotland responsible for oversight of the procurement and quality of audits and also leads the provision of technical support for auditors. He is a member of the Financial Reporting Advisory Board, the CIPFA/ LASAAC Local Authority SORP Board and the Auditing Practices Board's Public Sector Sub committee and has been involved in the move to IFRS from the beginning. He is also a member of the audit committee of the Office of the Comptroller & Auditor General in Ireland.



Colin Forsyth, Department of Health

Colin is now working at the Department of Health as a Performance Manager. It is an NHS facing role with a specific focus on areas such as effective financial closure, financial accounting and IFRS implementation.

Colin's career in the NHS has spanned 22 years and at one time or another he has operated across almost all of the NHS sectors. He is a Fellow of the Chartered Association of Certified Accounts and is Vice Chair of the ACCA UK Health Service Network Panel. He recently worked as a Performance Manager at a Strategic Health Authority and subsequently as Head of Corporate Finance at a PCT. Responsibilities in these roles included the areas of financial performance reporting and financial governance.



Andrew Baigent, National Audit Office

Andrew is Director of Financial Audit Policy and Support at the National Audit Office, having previously been responsible for the audit of several government departments, most recently the Ministry of Defence. In his current role he is responsible for developing NAO policy on technical audit and accounting issues within the NAO. He is also the leader of the NAO's Financial Management and Governance Practice.

Andrew is a member of the ICAEW governing council, and is Vice-Chair of the ICAEW Financial Reporting Committee and a member of the Public Sector Advisory Board. He is a member of the Accounting Standards Board's Committee on Accounting for Public Entities (CAPE) and the oversight board reviewing the UK Government Internal Audit Standards.



Andy Simmonds, Deloitte LLP

Andy is chair of the Board of the ICAEW Financial Reporting Faculty and a member of its Financial Reporting Committee.

He is a partner at Deloitte and served as a member of the UITF before being appointed to the Accounting Standards Board in 2007.

Andy is a member of ICAEW Council and is a former chairman of the London Society of Chartered Accountants (LSCA) Technical Committee.



Peter Morgan, National Audit Office

Peter Morgan is a manager with the NAO's central financial audit support team, and specialises in providing accounting advice. Peter has advised on the appropriate accounting treatment for some 150 or so PPP projects under both UK GAAP and IFRS.