

2 CONCEPTS AND PRINCIPLES

2.1 Concepts

2.1.1 Introduction

2.1.1.1 Authorities shall prepare financial statements (including group accounts) in accordance with the International Accounting Standards Board (IASB) *Framework for the Preparation and Presentation of Financial Statements* as interpreted by this section of the Code.

2.1.1.2 In presenting information in their financial statements, authorities shall have regard to the:

- a) Objective of financial statements;
- b) Underlying assumptions;
- c) Qualitative characteristics of financial statements;
- d) Elements of financial statements;
- e) Recognition of the elements of financial statements; and
- f) Measurement of the elements of financial statements.

2.1.1.3 In particular regard should be had to the qualitative characteristics in the selection and application of accounting policies and estimation techniques (see chapter 3 section 4 of the Code), and in the exercise of professional judgment. The Code specifies many of the accounting policies and estimation techniques to be adopted for material items. These policies and techniques have been selected to accord with the accounting concepts and principles set out in this section and, with International Financial Reporting Standards (as adapted and interpreted for the public sector context, where necessary).

2.1.1.4 Financial statements shall give a true and fair view of the financial position, financial performance and cash flows of an authority. A true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Code. Although the IASB framework does not deal directly with such a concept, the application of the principal qualitative characteristics and compliance with the Code is presumed to result in the financial statements that convey a true and fair view. Nevertheless it remains the responsibility of the authority to ensure that its financial statements present a true and fair view of the financial position, performance and cash flows of the authority.

2.1.1.5 The hierarchy of standards that authorities shall follow is shown in the Introduction section of the Code (see chapter 1).

2.1.2 Accounting Requirements

Objectives of financial statements

- 2.1.2.1 Authorities need to be familiar with the objective of financial statements. The financial statements of authorities shall provide information about their financial position, performance and cash flows. The presentation of the information shall meet the 'common needs of most users'.
- 2.1.2.2 The financial statements shall also show the results (ie information about an authority's financial position, performance and cash flows) of the stewardship and accountability of elected members and management for the resources entrusted to them, which is of paramount importance in the use of public funds.

Underlying assumptions

- 2.1.2.3 Accrual Basis - an authority shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting, ie the authority recognises items as assets, liabilities, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Code. The accruals basis of accounting requires the non-cash effects of transactions to be reflected in the financial statements for the accounting period in which those effects are experienced and not in the period in which any cash is received or paid.
- 2.1.2.4 Going Concern - an authority's financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future. Transfers of services under machinery of government changes (such as local government reorganisation) do not negate the presumption of going concern.

Qualitative characteristics of financial statements

- 2.1.2.5 Understandability – users of financial statements are assumed to have a reasonable knowledge of accounting and local government, and reasonable diligence in reading the financial statements. However, an authority shall take all reasonable steps to enabling the user of the financial statements to comprehend their meaning. This understanding will be enhanced when information is classified, characterised and presented clearly and concisely.
- 2.1.2.6 Relevance - the objective of financial statements is to provide information about an authority's financial position, performance and cash flows that is useful for assessing the stewardship of public funds and for making economic decisions.
- 2.1.2.7 Materiality – the relevance of information contained in the financial statements is affected by its nature and materiality. Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor. Therefore materiality provides a threshold or cut-off point rather than a primary qualitative characteristic which information must have if it is to be useful. In exceptional circumstances, an authority need not comply with the Code, as to both disclosure and accounting principles, if the information is not material to the true and fair view of the financial statements and to the understanding of the users.

- 2.1.2.8 Reliability – to be useful, information must also be reliable. Financial information is reliable if:
- (a) it can be depended upon to represent faithfully what it either purports to represent or could reasonably be expected to represent, and therefore reflects the substance of the transactions and other events that have taken place;
 - (b) it is free from deliberate or systematic bias (ie it is neutral);
 - (c) it is free from material error;
 - (d) it is complete within the bounds of materiality; and
 - (e) under conditions of uncertainty, it has been prudently prepared (ie a degree of caution has been applied in exercising judgment and making the necessary estimates).
- 2.1.2.9 The financial statements must be prepared in accordance with their substance and economic reality and not merely their legal form. In determining the substance of a transaction, it is necessary to identify all of the transaction's aspects and implications. A group or series of transactions that achieves or is designed to achieve an overall economic effect should be viewed as a whole.
- 2.1.2.10 To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of financial information, they influence the making of a decision or judgment in order to achieve a predetermined result or outcome.
- 2.1.2.11 Often there is uncertainty either about the existence of assets, liabilities, income and expenditure, or about the amount at which they are to be measured. Such uncertainty is a normal part of the accounting process. Prudence is the inclusion of a degree of caution in the exercise of the judgements required in making accounting policies and estimates in recognising and measuring those assets, liabilities, income and expenditure.
- 2.1.2.12 Sound stewardship of public funds calls for a prudent approach to financial management. It is not appropriate to use prudence in financial reporting as a reason to, for example, create hidden reserves or excessive provisions, deliberately understate assets or income, or deliberately overstate liabilities or expenditure, because this would mean that the financial statements are not neutral and therefore not reliable.
- 2.1.2.13 To be reliable, the information contained in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.
- 2.1.2.14 Comparability – The information contained in financial statements gains greatly in usefulness if it can be compared with similar information about the authority for some other period or point in time, and with similar information about other entities. Comparability depends upon consistency and adequate disclosure. Users must be informed of the accounting policies (see chapter 3 section 5) employed

in the preparation of the financial statements, any changes in those policies and the effects of such changes. In considering the accounting policies to be adopted and their disclosure authorities should have regard to the importance of consistency and comparability. Nevertheless consistency is not an end in itself and therefore does not impede the introduction of improved accounting practices. Application of the terms of the Code, and of the Best Value Accounting Code of Practice where relevant, will ensure adequate disclosure and consistency, and thus comparability.

- 2.1.2.15 In practice, a balance between the qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgement.
- 2.1.2.16 Local authorities derive their powers from statute and their financial and accounting framework is closely controlled by primary and secondary legislation. It is a fundamental principle of local authority accounting that, where specific legislative requirements and accounting requirements conflict, legislative requirements shall apply. However, such conflicts are dealt with by the Code by showing the position required by the Code's accounting requirements in the Comprehensive Income and Expenditure Statement and showing the effect of the legislative requirements in the Movement in Reserves Statement.

Elements of financial statements

- 2.1.2.17 The elements directly related to the measurements of financial position in the Balance Sheet are assets, liabilities and reserves. The elements directly related to the measurement of the financial performance in the Comprehensive Income and Expenditure Statement are income and expenses. The presentation of these elements is shown in chapter 3 section 5 of the Code. The cash flow reflects elements in both the Comprehensive Income and Expenditure Statement and Balance Sheet.
- 2.1.2.18 In assessing whether an item meets the definition of an asset, liability or reserve, attention needs to be given to its underlying substance and economic reality and not merely its legal form.
- 2.1.2.19 Assets – a resource controlled by the authority as a result of past events and from which future economic or service potential is expected flow to the authority.
- 2.1.2.20 Liabilities – are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.
- 2.1.2.21 Reserves – the residual interest in the assets of the authority after deducting all its liabilities. The Movement in Reserves Statement shows the true economic cost of providing the authority's services, represented by the line '*Surplus or (deficit) on the provision of services*'. Some income and expenditure is required to be recognised on a different basis or in a different accounting period (ie in accordance with legislation) in the General Fund and Housing Revenue Account. These differences are shown in the line '*Adjustments between accounting basis and funding basis under regulations*'. Voluntary transfers to or from the General Fund Balance and Housing Revenue Account Balance also affect the amount to

be funded from council tax or council dwelling rents; these are shown in the line 'Transfers to or from reserves available to fund services'. The Movement in Reserves Statement also shows Other Comprehensive Income and Expenditure, for example revaluation gains.

2.1.2.22 Income - is the gross inflow of economic benefits or service potential during the reporting period when those inflows or enhancements of assets or decreases of liabilities result in an increase in reserves. Income includes both revenue arising in the course of ordinary activities and gains such as the revaluation of fixed assets.

2.1.2.23 Expenses – are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or increases of liabilities that result in decreases in reserves. Expenses include expenses that arise in the course of the ordinary activities and losses such as revaluation of fixed assets.

Recognition of the elements of financial statements

2.1.2.24 Recognition is the process of incorporating in the Balance Sheet or Comprehensive Income and Expenditure Statement an item that meets the definition of an element and satisfies the criteria for recognition. The relevant sections of the Code set out the criteria for recognition for the elements of financial statements.

Measurement of the elements of financial statements

2.1.2.25 Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the Balance Sheet and Comprehensive Income and Expenditure Statement. The relevant sections of the Code set out the basis of measurement for the elements of financial statements.

2.1.3 Statutory Accounting Requirements

2.1.3.1 There are no statutory accounting requirements regarding the concepts and principles.

2.1.4 Disclosure Requirements

2.1.4.1 Authorities shall apply the objective, underlying assumptions and qualitative characteristics of financial statements, in the selection and application of accounting policies and estimation techniques (see chapter 3 section 3 of the Code).

2.1.5 Statutory Disclosure Requirements

2.1.5.1 There are no statutory disclosure requirements in relation to the concepts and principles.

2.1.6 ***Changes since SORP 2009***

- 2.1.6.1 There are no changes since the SORP in relation to the objective, underlying assumptions and qualitative characteristics of financial statements.
- 2.1.6.2 The Code introduces different criteria for recognition and basis of measurement for some elements of the financial statements.

Transition arrangements – Concepts and Principles

There are no transitional arrangements specific to the application of the concepts and principles relating to the objective, underlying assumptions and qualitative characteristics of financial statements in the preparation of these statements.

The transitional arrangements associated with the recognition and measurement of the elements of the financial statements is dealt with in the other sections of the Code.

2.2 Business Improvement District (BID) Schemes (England, Wales and Scotland)

2.2.1 Introduction

2.2.1.1 Business Improvement District (BID) projects are projects for the benefit of a particular area that are financed (in whole or in part) by a BID levy paid by the non-domestic ratepayers, or a class of such ratepayers, in the BID area. There are two key participants – the billing authority for the area and the BID Body. The appropriate accounting treatment for the billing authority is determined by whether it acts as principal or agent, in accordance with section 2.6 of the Code. England and Wales has had a BID Scheme for some time; the Business Improvement Scheme for Scotland came into force on 1 April 2007 under the Business Improvement Districts (Scotland) Regulations 2007.

2.2.2 Accounting Requirements

2.2.2.1 If the billing authority acts as principal, the income received and expenditure incurred by the billing authority is included in the Net Cost of Services under the appropriate service heads. If the billing authority acts as an agent, only the following amounts are recognised in the billing authority's Comprehensive Income and Expenditure Statement:

- A contribution made by the billing authority to the BID project (i.e. grant-in-aid), which would be shown as service expenditure under the relevant service in the Comprehensive Income and Expenditure Statement.
- BID levy collection costs and associated (reimbursement) income, which would be shown in Net Cost of Services under the relevant service in the Comprehensive Income and Expenditure Statement.
- Income from services supplied by the billing authority to the BID project on a paid basis, which would usually be accounted for as a trading activity as part of Net Operating Costs in the Comprehensive Income and Expenditure Statement. However, where the service supplied for charge is a function of the authority, e.g. a planning application, it is accounted for in the same way as other income of that function.

2.2.3 Statutory Accounting Requirements

2.2.3.1 The billing authority for the area of a proposed BID is required to oversee the balloting arrangements and will incur the costs of this whether a BID is eventually established or not. These costs would be shown in Net Cost of Services under the relevant service in the Comprehensive Income and Expenditure Statement.

2.2.4 Disclosure Requirements

2.2.4.1 There are no specific disclosure requirements for BID schemes. Authorities shall consider separate disclosure of the transactions within a BID scheme if these amounts are material.

2.2.5 Statutory Disclosure Requirements

2.2.5.1 There are no statutory disclosure requirements in relation to BID schemes.

2.2.6 Changes since SORP 2009

2.2.6.1 There are no changes to the requirements in SORP 2009.

Transition Arrangements

There are no transition arrangements in relation to the BID schemes.

2.3 Government and Non-Government Grants

2.3.1 To be determined – see Invitation to Comment

2.4 Landfill Allowance and other 'Cap and Trade' Schemes

2.4.1 Introduction

2.4.1.1 The Waste and Emissions Trading Act 2003 places a duty on waste disposal authorities (WDAs) in England, Scotland, Wales and Northern Ireland to reduce the amount of biodegradable municipal waste (BMW) disposed to landfill. It also provides the legal framework for the:

- Landfill Allowance Trading Scheme, which commenced operation on 1 April 2005 in England
- Landfill Allowances Scheme (Wales) Regulations, which commenced operation on 1 October 2004
- Landfill Allowances Scheme (Scotland) Regulations, which came into force on 1 April 2005 and became a 'cap and trade' scheme from 1 April 2008
- Landfill Allowances Scheme (Northern Ireland) Regulations, which came into force on 1 April 2005.

2.4.1.2 There is no IFRS, IPSAS or UK GAAP covering 'cap and trade' schemes. In the absence of any approved standard or interpretation, the Code adopts the treatment for 'cap and trade' schemes set out in a proposed UITF Abstract on Emission Rights (Information Sheet No. 61) that was issued by the ASB for consultation in 2003 but not proceeded with.

2.4.1.3 The Landfill Allowance Trading Schemes in England and Scotland are the only 'cap and trade' schemes that currently affect local authorities. Should other 'cap and trade' schemes come into operation, they shall be accounted for on the same basis as the Landfill Allowance Trading Schemes in England and Scotland.

2.4.2 Accounting Requirements

England and Scotland

2.4.2.1 The Landfill Allowance Trading Schemes (LATS) that operate in England and Scotland are 'cap and trade' schemes and shall be accounted for in accordance with the treatment set out in Information Sheet No. 61.

2.4.2.2 The Landfill Allowances Trading Scheme gives rise to:

- a) an asset for allowances held;
- b) LATS grant income;
- c) a liability for actual BMW landfill usage.

2.4.2.3 Allowances, whether allocated by DEFRA or the Scottish Government or purchased from another WDA, shall be recognised as assets and classified as current assets. They shall be measured initially at their fair value.

- 2.4.2.4 Landfill allowances are issued free by DEFRA or the Scottish Government. The fair value of the allowances issued to WDAs is a government grant that shall be accounted for as government grant in accordance with section 2.3 of the Code.
- 2.4.2.5 As landfill is used, a liability shall be recognised for actual BMW landfill usage. This liability is a provision that falls within the scope of section 8.2 of the Code and *IAS 37 Provisions, Contingent Liabilities and Contingent Assets*. The liability is discharged by using allowances to meet the liability, paying a cash penalty to DEFRA or the Scottish Government or a combination of both. The liability shall be measured at the best estimate of the expenditure required to meet the obligation at the reporting date. This will normally be the present market price at the reporting date of the number of allowances needed to cover actual BMW landfill usage for the year. However, if, in a WDA's best estimate, some or the entire obligation will be met by paying a cash penalty to DEFRA or the Scottish Government, it shall measure that part of its liability at the cost of the penalty rather than at the market price of the relevant number of allowances.
- 2.4.2.6 After initial measurement, authorities shall remeasure the value of landfill allowances as the lower of cost or net realisable value.
- 2.4.2.7 Where there is no evidence of an active market for landfill allowances, for example where the number of allowances issued is greater than that required by authorities, the fair value of the allowances and the net realisable value of the allowances will be nil.

Wales and Northern Ireland

- 2.4.2.8 The Landfill Allowances Schemes that operate in Wales and Northern Ireland are not 'cap and trade' schemes and therefore not covered by the requirements of Information Sheet No. 61. Authorities shall not recognise an asset for landfill allowances, grant income in respect of the allowances or liabilities for actual BMW landfill usage.
- 2.4.2.9 WDAs in Wales and district councils in Northern Ireland are required to meet annual target figures for the maximum amount of BMW that can be sent to landfill. For each tonne of BMW sent to landfill in excess of the target an authority may be liable to a penalty of £200 (Wales) or £150 (Northern Ireland). However, current guidance indicates the penalty will be exercised with discretion rather than as an automatic consequence of exceeding the target. An authority shall recognise a provision for penalties payable to the Welsh Assembly Government or Department of the Environment in Northern Ireland. Where a possible landfill allowance liability exists but the authority has concluded that it does not need to make a provision, the authority shall disclose a separate class of contingent liability in relation to the possible penalty.

2.4.3 *Statutory Accounting Requirements*

- 2.4.3.1 There are no statutory accounting requirements in respect of landfill allowances.

2.4.4 *Disclosure Requirements*

- 2.4.4.1 Assets, liabilities and government grant income in relation to landfill allowances shall be disclosed in accordance with the relevant sections of the Code.

2.4.5 Statutory Disclosure Requirements

2.4.5.1 There are no statutory disclosure requirements in relation to landfill allowances.

2.4.6 Changes since SORP 2009

2.4.6.1 There are no changes to the requirements in SORP 2009 [subject to decisions on government grants].

Transition Arrangements

There are no transition arrangements in relation to landfill allowances [subject to decisions on government grants].

2.5 Machinery of Government Changes (e.g. Local Government Reorganisation)

2.5.1 Introduction

2.5.1.1 Chapter 9 of the Code (Group Accounts) includes an interpretation of IFRS 3 that machinery of government changes (e.g. local government reorganisation) are deemed to be a combination of businesses under common control and as such excluded from the scope of IFRS 3. This section of the Code sets out the accounting requirements for machinery of government changes.

2.5.2 Accounting Requirements

2.5.2.1 Public sector bodies such as local authorities are deemed to be under common control. The combination of two or more local authorities into one new authority, or the transfer of functions (in full or in relation to a geographic area) from the responsibility of one authority to another, shall be accounted for using the principles that apply to group reorganisations. Assets and liabilities shall normally be transferred at their carrying amount as at the transfer date, except where:

a) the authorities have agreed revised amounts (in accordance with their statutory duties); and

b) such amounts were agreed after authorities transferring the services had issued their accounts for the year immediately prior to the transfer date;

in which case, assets and liabilities shall be transferred at their agreed amounts, and the difference between these agreed amounts and their previous carrying amounts shall be disclosed in a note to the financial statements.

2.5.2.2 Local government reorganisations normally take place at the start of a financial year. The reorganisation shall be achieved in the accounts by adjusting the opening balance sheet for the current year; transfers shall not be reflected in the Comprehensive Income and Expenditure Statement, but shall be separately disclosed in the Movement in Reserves Statement. The notes to the accounts shall separately identify transfers of assets and liabilities (and any consequential changes to reserves).

2.5.3 Statutory Accounting Requirements

2.5.3.1 There are no statutory accounting requirements in respect of machinery of government transfers.

2.5.4 Disclosure Requirements

2.5.4.1 For new authorities, no corresponding amounts for the previous year will be required in the financial statements. The notes to the accounts of the new authority shall include an opening balance sheet (i.e. transferred assets and liabilities and opening reserve balances). This shall be clearly identified as the opening balance on the creation of the new authority, not the previous year's balance sheet.

- 2.5.4.2 For continuing authorities, newly acquired functions (or functions in relation to a geographic area) shall be disclosed separately in the current year. Functions (or functions in relation to a geographic area) transferred to another authority shall be disclosed separately in the comparative year. Where the transfer requires reporting in the notes to the accounts, a separate line disclosing the transfer shall be included after the balance brought forward from the previous year. A new sub-total shall be inserted to disclose the restated opening balance sheet figures. These lines will be required in the notes showing the movements in assets, liabilities and reserves, including the Movement in Reserves Statement and the Movement on the Housing Revenue Account Statement.

2.5.5 *Statutory Disclosure Requirements*

- 2.5.5.1 There are no statutory disclosures in respect of machinery of government changes.

2.5.6 *Changes since SORP 2009*

- 2.5.6.1 There are no changes to the accounting requirements in respect of machinery of government changes since the SORP 2009.

Transition Arrangements

There are no specific transition arrangements in relation to machinery of government changes except those outlined under disclosures above.

2.6 Principal and Agent Transactions

2.6.1 Introduction

2.6.1.1 The accounting treatment of transactions within an authority's financial statements shall have regard to the general principle of whether the authority is acting as the principal or agent.

2.6.2 Accounting Requirements

Definitions

2.6.2.1 *Agent* is where the authority is acting as an intermediary.

2.6.2.2 *Principal* is where the authority is acting on its own behalf.

Recognition and measurement

2.6.2.3 Where an authority is acting as a principal as opposed to acting as an agent, transactions shall be included in an authority's financial statements, following the relevant section of the Code.

2.6.2.4 Where an authority is acting as an agent, transactions shall not be reflected in an authority's financial statements, with the exception in respect of cash collected or expenditure incurred by the agent on behalf of the principal, in which case there is a debtor or creditor position and the net cash position being included in financing activities in the cash flow statement. Another exception is where the authority receives payment for acting as an agent, in which case any amount of commission received or receivable shall be recognised as revenue in the authority's financial statements.

2.6.2.5 Examples of where an authority is acting as an agent include; , billing authorities for the collection of NNDR and Council Tax in England (see chapter 9 section 3).

2.6.3 Statutory Accounting Requirements

2.6.3.1 There are no statutory accounting requirements in relation to principal and agency transactions.

2.6.4 Disclosure Requirements

2.6.4.1 There are no specific disclosure requirements for principal and agent transactions. The transactions will be included in the disclosure requirements of other sections of the Code.

2.6.5 Statutory Disclosure Requirements

2.6.5.1 There are no statutory disclosures required in relation to principal and agent transactions.

2.6.6 ***Changes since SORP 2009***

2.6.6.1 There have been no changes in accounting for principal and agent transactions since SORP 2009.

Transition arrangements – Principal and Agent

There are expected to be no transition issues arising from principal and agent transactions.

2.7 Revenue Recognition

2.7.1 Introduction

2.7.1.1 Authorities shall account for revenue recognition in accordance with *IAS 18 Revenue*, *IPSAS 23 Revenue from Non-Exchange transactions (Taxes and Transfers)* and *SIC 31 Barter Transactions involving Advertising Services*.

2.7.1.2 *IPSAS 9 Revenue from Exchange Transactions* is based on *IAS 18*, and provides additional guidance for public sector bodies.

2.7.1.3 This section of the Code does not cover revenue arising from; construction contracts (see chapter 5 section 2), lease agreements (see chapter 4 section 2), dividends arising from investments in associates (see chapter 9), insurance contracts (see Appendix A paragraph a.1.7), changes in fair value of financial assets and liabilities or their disposal (see chapter 7 and chapter 4 section 1, section 4, section 5), changes in the fair value of other assets and changes in fair value of investment property (see chapter 4 section 4), and revenue from agriculture produce (see Appendix a paragraph A.1.5) and extraction of minerals (this is unlike to apply to authorities – see *IFRS 6*).

2.7.1.4 This section of the Code shall be applied to the accounting for revenue arising from:

- The sale of goods (produced by an authority for the purpose of sale or purchased for resale)
- The rendering of services (excluding services directly related to construction contracts i.e. project managers and architects, which are covered in chapter 5 section 2)
- Interest, royalties and dividends
- Non-exchange transactions (i.e. council tax)
- Where previously a liability had been recognised (i.e. creditor) on satisfying the revenue recognition criteria

Interpretation and adaptation for the Public Sector Context

2.7.1.5 No interpretations or adaptations of *IAS 18* and *IPSAS 23* are required for the public sector context; these standards are applied in full in relation to the recognition and measurement of revenue.

2.7.1.6 *IPSAS 9* includes a public sector adaptation which the Code has adopted. The adaptation is as follows:

Definitions

- The definition of revenue excludes the reference to 'ordinary activities'.

2.7.1.7 The Code includes an interpretation of *IAS 39* which has a direct impact on the measurement of revenue, as follows:

Recognition and measurement

- Revenue relating to such things as council tax, general rates, etc shall be measured at the full amount receivable as they are non-contractual, non-exchange transactions and there can be no difference between the delivery and payment dates.

2.7.1.8 The consensus in *SIC 31* is that revenue from an exchange involving advertising services cannot be reliably measured by reference to the fair value of the services received. This is because reliable information is not available to the seller to support such measurement. However, a seller can reliably measure revenue at fair value of the advertising service it provides in a barter transaction by reference to its non-barter transactions that meet certain criteria specified in *SIC 31*. It is not expected that these transactions will be common for authorities. Where an authority considers it has relevant transactions, it shall refer to *SIC 31*.

2.7.2 Accounting Requirements

Definitions

2.7.2.1 *Exchange transactions* are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

2.7.2.2 *Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

2.7.2.3 *Non-exchange transactions* are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

2.7.2.4 *Revenue* is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net worth.

Recognition and measurement

2.7.2.5 Revenue shall be measured at the fair value of the consideration received or receivable except for a financial asset that is measured under chapter 7 of the Code.

2.7.2.6 In most cases, the consideration receivable is in the form of cash and cash equivalents and the amount of revenue is the amount of cash and cash equivalents receivable. However, if payment is on deferred terms (i.e. beyond normal credit terms), the consideration receivable is recognised initially at the cash price equivalent, (that is the discounted amount). The difference between this amount and the total payments received is recognised as interest revenue in Surplus or Deficit on provision of services (see chapter 7 of the Code).

- 2.7.2.7 There is no difference between the delivery and payment dates for non-contractual, non-exchange transactions i.e. revenue relating to council tax and general rates, and therefore these transactions shall be measured at their full amount receivable.
- 2.7.2.8 When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. This type of transaction is not expected to be common in authorities.
- 2.7.2.9 When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred. This type of transaction is not expected to be common in authorities.
- 2.7.2.10 The following cover the revenue recognition of the transactions and events referred to in paragraph 2.7.1.4:
- *The sale of goods*; revenue shall be recognised when all of the following conditions have been satisfied:
 - (a) The authority has transferred to the purchaser the significant risks and rewards of ownership of the goods
 - (b) The authority retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
 - (c) The amount of revenue can be measured reliably
 - (d) It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and
 - (e) The costs incurred or to be incurred in respect of the transaction can be measured reliably
 - *The rendering of services*; when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the percentage of completion method at the reporting date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:
 - (a) The amount of revenue can be measured reliably
 - (b) It is probable that the economic benefits or service potential associated with the transaction will flow to the entity
 - (c) The stage of completion of the transaction (using the percentage of completion method) at the reporting date can be measured reliably; and
 - (d) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

The requirements of chapter 5 section 2 of the Code (construction contracts) are generally applicable to the recognition of revenue and the associated

expenses for a transaction involving the rendering of services over a period of time.

When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognised only to the extent of the expenses recognised that are recoverable.

- *Interest, royalties and dividends*; revenue shall be recognised when:

- (a) It is probable that the economic benefits or service potential associated with the transaction will flow to the authority; and
- (b) The amount of the revenue can be measured reliably

The accounting treatments (subject to the recognition criteria above being met) are as follows:

- (a) Interest should be recognised using the effective interest method as set out chapter 7 of the Code (also see *IAS 39*)
- (b) Royalties should be recognised as they are earned in accordance with the substance of the relevant agreement; and
- (c) Dividends or their equivalents should be recognised when the authority's right to receive payment is established

- *Non-exchange transactions*; revenue shall be recognised when:

- (a) It is probable that the economic benefits or service potential associated with the transaction will flow to the authority; and
- (b) The amount of the revenue can be measured reliably

- *Where previously a liability had been recognised (i.e. creditor) on satisfying the revenue recognition criteria*; in the event that a liability had been recognised, revenue shall be recognised equal to the reduction of the carrying amount of a liability when the relevant revenue recognition criteria has been met.

2.7.2.11 In the event that the consideration is received but the revenue does not meet the recognition criteria set out in paragraph 2.7.2.10 above, an authority shall recognise a creditor (i.e. receipt in advance) in respect of that inflow of resources (see chapter 8 section 1).

2.7.2.12 In the event that revenue meets the recognition criteria set out in paragraph 2.7.2.10, but the consideration has not been received, an authority shall recognise a debtor in respect of that inflow of resources (see chapter 5 section 3).

2.7.2.13 Revenue is recognised only when it is probable that the economic benefits or service potential associated with the transaction will flow to the authority. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense (i.e. impairment of financial assets – see chapter 7), rather than as an adjustment of

the amount of revenue originally recognised in the Comprehensive Income and Expenditure Statement.

2.7.3 *Statutory Accounting Requirements*

2.7.3.1 There are no statutory accounting requirements in relation to revenue recognition.

2.7.4 *Disclosure Requirements*

2.7.4.1 Disclosure of accounting policies in relation to revenue recognition is required (see section 3.3 of the Code).

2.7.4.2 There are no specific disclosure requirements covering revenue recognition, however transactions may be disclosed as part of the disclosure requirements of trade and other receivables (see section 5.3) and trade and other payables (see section 8.1).

2.7.5 *Statutory Disclosure Requirements*

2.7.5.1 There are no statutory disclosures required in relation to revenue recognition.

2.7.6 *Changes since SORP 2009*

2.7.6.1 There have been no changes in accounting for revenue recognition since SORP 2009.

Transition arrangements – Revenue Recognition

There are expected to be no transition issues arising from revenue recognition.

2.8 Tax Income (Council Tax, Residual Community Charges, National Non-Domestic Rates (NNDR) and Rates)

2.8.1 Introduction

2.8.1.1 This section of the Code applies the accounting principles contained within the Code to the accounting requirements in respect of tax income collected by local authorities.

2.8.2 Accounting Requirements

National Non-Domestic Rates (NNDR) (England, Wales, Scotland)

2.8.2.1 Billing authorities in England, Scotland and Wales collect NNDR under what is in substance an agency arrangement with each jurisdiction's Government. It therefore follows that:

- a) NNDR income is not the income of the billing authority and shall not be included in its Comprehensive Income and Expenditure Statement. The cost of collection allowance received by billing authorities in England and Wales is the billing authority's income and shall be included in the Comprehensive Income and Expenditure Statement (in Scotland an amount for 'collection of non-domestic rates' is included in Revenue Support Grant).
- b) NNDR debtor and creditor balances with taxpayers and the impairment allowance for doubtful debts are not assets and liabilities of the billing authority and shall not be recognised in the billing authority's balance sheet.
- c) Cash collected from NNDR taxpayers by billing authorities (net of the cost of collection allowance in England and Wales) belongs to the Government and the amount not yet paid to the Government at the balance sheet date shall be included in the balance sheet as a creditor; similarly, if cash paid to the Government exceeds the cash collected from NNDR taxpayers (net of the billing authority's cost of collection allowance in England and Wales), the excess shall be included in the balance sheet as a debtor.
- d) Cash collected from NNDR taxpayers by a billing authority is collected for the Government and is therefore not an operating activity of the billing authority and shall not be included in the billing authority's Cash Flow Statement as a cash inflow except for the cash retained in respect of the cost of collection allowance. Similarly, the billing authority's payment into the NNDR national pool is not an operating activity and shall not be included in the billing authority's Cash Flow Statement as a cash outflow. The difference between the cash collected from NNDR taxpayers and the amount paid into the NNDR national pool shall be included within financing activities in the Cash Flow Statement.
- e) Amounts are sometimes billed to NNDR taxpayers over and above the NNDR due, usually to recover the billing authority's costs of pursuing unpaid NNDR debts. Any amounts charged to NNDR taxpayers in respect of amounts that the authority is not required to account for to the Government are income of the billing authority.

Council Tax (England)

- 2.8.2.2 Council tax income included in the Comprehensive Income and Expenditure Statement for the year shall be the accrued income for the year. Each major preceptor's share of the accrued council tax income would be available from the information that is required to be produced in order to prepare the Collection Fund Statement (see section 3.6 of the Code).
- 2.8.2.3 Since the collection of council tax is in substance an agency arrangement, the cash collected by the billing authority from council tax debtors belongs proportionately to the billing authority and the major preceptors. There will therefore be a debtor/creditor position between the billing authority and each major preceptor to be recognised since the net cash paid to each major preceptor in the year will not be its share of cash collected from council taxpayers.
- 2.8.2.4 If the net cash paid to a major preceptor in the year is more than its proportionate share of net cash collected from council tax debtors/creditors in the year the billing authority shall recognise a debit adjustment for the amount overpaid to the major preceptor in the year and the major preceptor shall recognise a credit adjustment for the same amount to the debtor/creditor position between them brought forward from the previous year. If the cash paid to a major preceptor is less than its proportionate share of net cash collected in the year from council tax debtors/creditors the billing authority shall recognise a credit adjustment for the amount underpaid to the major preceptor in the year and the major preceptor shall recognise a debit adjustment for the same amount to the debtor/creditor position between them brought forward from the previous year.
- 2.8.2.5 The Cash Flow Statement of the billing authority shall include within operating activities only its own share of council tax net cash collected from council tax debtors in the year; and the amount included for precepts paid shall exclude amounts paid to major preceptors. The difference between the major preceptors' share of the net cash collected from council tax debtors and net cash paid to major preceptors as precepts and settlement of the previous year's surplus or deficit on the Collection Fund shall be included within financing activities in the Cash flow Statement.
- 2.8.2.6 The Cash Flow Statement of a major preceptor shall include within operating activities the net council tax cash received from the Collection Fund in the year (ie precept for the year plus share of Collection Fund surplus for the previous year, or less the amount paid to the Collection Fund in respect of share of the previous year's Collection Fund deficit). The difference between the net cash received from the Collection Fund and the major preceptor's share of cash collected from council tax debtors by the billing authority in the year shall be included within financing activities in the Cash Flow Statement.

Residual Community Charge (England)

- 2.8.2.7 Any residual community charge income 'adjustments' (losses or gains) are also required to be included in the Collection Fund. Such adjustments, which will now often be nil or negligible, are borne wholly by the billing authority and are excluded from the Collection Fund surplus or deficit in calculating the amount

that is shared between the billing authority and major preceptors. The community charge adjustment for the year shall be taken to Surplus or Deficit on provision of services.

Council Tax (Scotland)

- 2.8.2.8 Scotland does not have precepting authorities. The whole council tax income accruing in the year shall be included as council tax income of the authority collecting the tax. Council tax debtors and creditors and the impairment allowance for doubtful debts shall be wholly included in the authority's balance sheet. In the Cash Flow Statement the cash inflow for council tax received shall be included within operating activities and shall be the net cash collected from council tax debtors or creditors.

Council Tax (Wales)

- 2.8.2.9 Billing authorities in Wales do not maintain a Collection Fund. Under regulation major preceptors in Wales (in effect Police Authorities), like community councils receive the exact amount of their precept. Major preceptors do not therefore share with the billing authority the risk that actual council tax outturn will be greater or lesser than assumed when setting council tax requirements.
- 2.8.2.10 Since the billing authority bears the whole risk of council tax income being higher or lower than estimated, it is acting as a principal rather than an agent in relation to major preceptors. All council tax income is therefore the income of the billing authority and shall be included as council tax income in the billing authority's Comprehensive Income and Expenditure Statement. Council tax debtors or creditors and impairment allowance for doubtful debts shall be included wholly in its balance sheet. The major preceptors' precepts shall be included as expenditure in the billing authority's Comprehensive Expenditure Statement. The council tax income for the year included in a major preceptor's Comprehensive Income and Expenditure Statement shall be its council tax precept for the year.
- 2.8.2.11 In a billing authority's Cash Flow Statement the amount included within operating activities in respect of council tax receipts shall be the net cash collected from council tax debtors or creditors including amounts arising in respect of the major preceptors' precepts. The amount included in respect of operating activities for precepts paid shall include the amounts paid to major preceptors.

Rates (Northern Ireland)

- 2.8.2.12 In Northern Ireland rates are levied on both domestic and non-domestic properties at a rate in the pound set by the authority as the proceeds of a penny rate product but are collected by the Land and Property Services Agency (LPSA), an Executive Agency of the Department of Finance and Personnel. The rate income for the year shall be the amount receivable for the year from the LPSA ie the income shall be based on the 'actual penny rate product' for the year. Instalments of rates income are received from the LPSA during the year based on the 'estimated penny rate product' made when the authority's budget was set. A debtor or creditor for the 'actual penny rate product' adjustment for the year that will be made by the LPSA in the following year shall be included as a

debtor or creditor. If the formal notification from the LPSA of the amount of the 'actual penny rate product' adjustment for the year is not available from the LPSA at the time the accounts are finalised an estimated amount shall be accrued.

2.8.3 Statutory Accounting Requirements

Council Tax (England)

- 2.8.3.1 For both the billing authority and major preceptors, the difference between the income included in the Comprehensive Income and Expenditure Statement and the amount required by regulation to be credited to the General Fund shall be taken to the Collection Fund Adjustment Account and reported in the Movement in Reserves Statement.

Residual Community Charge (England)

- 2.8.3.2 The difference between the community charge adjustment included in the Comprehensive Income and Expenditure Statement and the amount required by regulation to be taken to the General Fund (ie the previous year's community charge adjustment) shall be taken to the Collection Fund Adjustment Account.

2.8.4 Disclosure Requirements

- 2.8.4.1 Tax income reported in the Comprehensive Income and Expenditure Statement shall be disclosed in line with the requirements of the Code set out in section 3.4 (Format of the Financial Statements), which include disclosures for council tax (Wales) and rates (Northern Ireland)

2.8.5 Statutory Disclosure Requirements

- 2.8.5.1 Statutory disclosures in respect of the Collection Fund (England), Council Tax Income Account (Scotland) and Non-Domestic Rates Account (Scotland) are set out in section 3.6 of the Code.

2.8.6 Changes since SORP 2009

- 2.8.6.1 There are no changes to the accounting requirements in relation to tax income since the SORP 2009.

Transition Arrangements

There are no transition arrangements in relation to tax income.

2.9 Value Added Tax

2.9.1 Introduction

2.9.1.1 The preparation of the Code follows an agreed hierarchy of Standards, because there are no IFRS¹ or IPSAS specifically relating to value added tax (VAT), authorities shall account for VAT in accordance with SSAP 5 Accounting for Value Added Tax, and apply specific rules for the recovery of VAT.

Interpretation and adaptation for the Public Sector Context

2.9.1.2 No interpretations or adaptations of SSAP 5 are required for the public sector context; this standard is applied in full.

2.9.2 Accounting Requirements

Definitions

2.9.2.1 Input tax is VAT charged on purchases.

2.9.2.2 Output tax is VAT charged in sales.

2.9.2.3 Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net worth.

2.9.2.4 Value Added Tax is an indirect tax levied on most business transactions and on many goods and some services.

Recognition and measurement

2.9.2.5 Revenue to be included in an authority's Comprehensive Income and Expenditure Statement shall be only the gross inflows of economic benefits or service potential received or receivable by an authority on its own behalf (see section 2.7, revenue recognition) and therefore excludes VAT that must be passed onto (where output tax exceeds input tax) or repaid (where input tax exceeds output tax), to HM Revenue and Customs.

2.9.2.6 The net amount due to or from HM Revenue and Customs in respect of VAT shall be included as part of creditors or debtors.

2.9.2.7 VAT should be included in the Comprehensive Income and Expenditure Statement, whether of a capital or revenue nature, only to the extent that it is irrecoverable.

2.9.3 Statutory Accounting Requirements

2.9.3.1 There are no statutory accounting requirements in relation to VAT.

2.9.4 Disclosure Requirements

¹ IAS 18 Revenue makes a reference to value added tax

2.9.4.1 Disclosure of accounting policies in relation to VAT is required (see section 3.4 of the Code).

2.9.4.2 There are no specific disclosure requirements covering VAT, however transactions may be disclosed as part of the disclosure requirements of trade and other receivables (see section 5.3) and trade and other payables (see section 8.1).

2.9.5 Statutory Disclosure Requirements

2.9.5.1 There are no statutory disclosures required in relation to VAT.

2.9.6 Changes since SORP 2009

2.9.6.1 There have been no changes in accounting for VAT since SORP 2009.

Transition arrangements – Value Added Tax

There are expected to be no transition issues arising from value added tax.