

## **4 NON CURRENT ASSETS**

### **4.1 Property, Plant and Equipment**

#### **4.1.1 Introduction**

- 4.1.1.1 Authorities shall account for tangible fixed assets in accordance with *IAS 16 Property, Plant and Equipment*, except where interpretations or adaptations to fit the public sector are detailed in the Code.
- 4.1.1.2 *IPSAS 17 Property, Plant and Equipment* is based on *IAS 16*, and introduces no additional accounting requirements, although it provides additional guidance for public sector bodies i.e. the basis for determining fair value and introducing the concept of 'service potential'.
- 4.1.1.3 This section of the Code does not cover property, plant and equipment classified as 'Non-current Assets Held for Sale and Discontinued Operations' in accordance with chapter 4 section 9 (also see *IFRS 5*). *IAS 16* also refers to other areas where the Standard does not apply however, these areas may not be common, if relevant at all within authorities i.e. exploration for and evaluation of mineral resources. Authorities should refer to *IAS 16* for these areas
- 4.1.1.4 Property, plant and equipment classified as finance leases under chapter 4 section 2 of the Code (also see *IAS 17*) shall follow section 2 in terms of recognition, however in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed in this section.
- 4.1.1.5 The section of the Code does not apply to investment property (including investment property under construction) classified under chapter 4 section 4 (also see *IAS 40*).

#### *Adaptation and Interpretation for the Public Sector Context*

- 4.1.1.6 The following adaptations of *IAS 16* for the public sector context apply.

#### Recognition and Measurement;

- Infrastructure, Community Assets and Assets under Construction (excluding investment property – see chapter 4 section 4) shall be measured at historical cost, the option given in *IAS 16* to measure the carrying amount of these classes of assets at fair value has been withdrawn.
- All other classes of asset shall be measured at fair value. If there is no market-based evidence of fair value because of the specialist nature of the asset and the asset is rarely sold, authorities may need to estimate fair value using a DRC approach. The fair value of council dwellings shall be measured using existing use value–social housing (EUV-SH).
- Where an asset is not held for the purpose of generating cash flows, *value in use* is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.

#### Definitions:

- For this section of the Code, fair value (for land and buildings) is to be interpreted as the amount that would be paid for the asset in its existing use. This requirement is met by providing a valuation on the basis of exiting use value (EUV) in accordance with UKPS 1.3 of the RICS Valuation Standards.

4.1.1.7 The following adaptations and interpretations for the public sector context do not directly relate to *IAS 16*, but have been included for clarity and referenced to the relevant section of the Code;

- *[Currently no decision has been made on the accounting treatment of borrowing costs. Once a decision has been made a cross reference will be made to the relevant section of the Code ie chapter 4 section 8]*
- *[Currently no decision has been made on the accounting treatment of Government and Non-government grants/contributions. Once a decision has been made a cross reference will be made to the relevant section of the Code ie chapter 3 section 1x]*
- *[Currently no decision has been made on the accounting treatment of assets transferred to an authority at nil consideration or less than fair value. Once a decision has been made a cross reference will be made to the relevant section of the Code ie chapter 3 section 1x]*

#### **4.1.2 Accounting Requirements**

##### *Definitions*

- 4.1.2.1 *Carrying amount* is the amount at which an asset is recognised after deducting any accumulated depreciation and impairment losses
- 4.1.2.2 *Class of property, plant and equipment* is a grouping of assets of a similar nature and use in an entity's operations.
- 4.1.2.3 *Cost* is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of acquisition or construction.
- 4.1.2.4 *Depreciable amount* is the cost of an asset, or other amount substituted for cost, less residue value.
- 4.1.2.5 *Depreciation* is the systematic allocation of the depreciable amount of an asset over its useful amount.
- 4.1.2.6 *Depreciated Replacement Cost<sup>1</sup> (DRC)* is a method of valuation which provides the current cost of replacing an asset with its modern equivalent asset less deductions for all physical deterioration and all relevant forms of obsolescence and optimisation. Where DRC is used as the valuation methodology, authorities should use the 'instant build' approach at the valuation date and the choice of an

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<sup>1</sup> The Royal Institution of Chartered Surveyors Valuation Information Paper Number 10 *The Depreciated Replacement Cost Method of Valuation for Financial Reporting* provides guidance on this matter

alternative site will normally hinge on the policy in respect of the locational requirements of the service that is being provided.

- 4.1.2.7 *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.
- 4.1.2.8 *Existing Use Value – Social Housing<sup>2</sup> (EUV-SH)* is the estimated amount for which a property should exchange, on the date of valuation, between a willing buyer and a willing seller, in an arm's-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion, subject to the following further assumptions that:
- the property will continue to be let by a body and used for social housing
  - at the valuation date, any regulatory body, in applying its criteria for approval, would not unreasonably fetter the vendor's ability to dispose of the property to organisations intending to manage their housing stock in accordance with that regulatory body's requirements
  - properties temporarily vacant pending re-letting should be valued, if there is a letting demand, on the basis that the prospective purchaser intends to re-let them, rather than with vacant possession
  - any subsequent sale would be subject to all of the above assumptions.
- 4.1.2.9 *Fair value* is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arms length transaction. For this section of the Code, fair value (for land and buildings) is to be interpreted as the amount that would be paid for the asset in its existing use. This requirement is met by providing a valuation on the basis of exiting use value (EUV) in accordance with UKPS 1.3 of the RICS Valuation Standards.
- 4.1.2.10 *Historical cost* is deemed to be the carrying amount of an asset as at 1<sup>st</sup> April 2007 (i.e. b/f from 31<sup>st</sup> March 2007) or at the date of acquisition, which ever date is the later, and adjusted for subsequent depreciation or impairment (if applicable).
- 4.1.2.11 *Property, plant and equipment* are tangible assets (i.e. assets with physical substance) that are; held for use in the production or supply of goods and services, for rental to others, or for administrative purposes, and expected to be used during more than one period.
- 4.1.2.12 *Qualified Valuer* is a person conducting the valuations who holds a recognised and relevant professional qualification and having sufficient current local, national knowledge of the particular market, and the skills and understanding to undertake the valuation competently.
- 4.1.2.13 *Residual value* of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of

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<sup>2</sup> Defined by the RICS Valuation Standards

disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

4.1.2.14 *Useful life* is the period which an asset is expected to be available for use by an entity.

4.1.2.15 Further definitions, including definitions of entity-specific value and recoverable amount are contained in *IAS 16*.

#### *Recognition*

4.1.2.16 The cost of an item of property, plant and equipment falling under this section of the Code shall only be recognised (and hence capitalised) as an asset on a local authority balance sheet if, and only if:

- It is probable that the future economic benefits or service potential associated with the item will flow to the entity; and
- The cost or fair value of the item can be measured reliability

4.1.2.17 Costs that meet the recognition principle in paragraph 4.1.2.16 include initial costs of acquisition and construction, and costs incurred subsequently to enhance, replace part of, or service the asset.

4.1.2.18 Subsequent costs arising from day-to-day servicing of an asset (i.e. labour costs and consumables), commonly referred to as 'repairs and maintenance' should not be capitalised if they do not meet the recognition principle in paragraph 4.1.2.16 because the expenditure does not add to the future economic benefits or service potential of the asset. Rather the expenditure maintains the asset's potential to deliver future economic benefits or service potential that it was expected to provide when the asset was originally acquired.

4.1.2.19 Where a component is replaced or restored (i.e. enhancements), the carrying amount of the old component shall be derecognised to avoid double counting and the new component reflected in the carrying amount, subject to the recognition principles as set out in paragraph 4.1.2.16 being met. This accounting treatment shall be applicable to enhancement expenditure incurred from 1 April 2010.

#### *Initial Measurement*

4.1.2.20 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost and capitalised on an accruals basis.

4.1.2.21 Donated assets transferred to an authority shall be measured at its fair value as at the date of acquisition (see section 2.3 of the Code). In this situation the measurement at recognition of an asset, acquired at no or nominal cost, at its fair value, does not constitute a revaluation.

4.1.2.22 The measurement of cost comprises;

- Purchase price,

- Any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, and
  - The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.
- 4.1.2.23 [*Currently no decision has been made on the accounting treatment of borrowing costs. Once a decision has been made a cross reference will be made to the relevant section of the Code ie chapter 4 section 8*].
- 4.1.2.24 The cost of an item of property, plant and equipment is the cash price equivalent at the date when the asset is recognised. When payment is deferred beyond normal credit terms, the cost of the asset is the cash equivalent, (that is the discounted amount). The difference between this amount and the total payments is recognised as interest over the period of the credit in Surplus or Deficit on provision of services.
- 4.1.2.25 The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with chapter 4 section 2 of the Code (also see *IAS 17*).
- 4.1.2.26 Where property, plant and equipment are acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of the acquired item shall be measured at fair value unless:
- The exchange transaction has no commercial substance, or
  - The fair value of neither the asset received nor the asset given up can be reliably measured
- 4.1.2.27 The acquired item is measured at fair value even if the authority cannot immediately derecognise the asset given up. The acquired item is measured at the carrying amount of the asset given up if it is not measured at fair value.

*Measurement after Recognition*

- 4.1.2.28 Infrastructure, Community Assets and Assets under Construction (excluding investment property – see chapter 4 section 4) shall be measured at historical cost).
- 4.1.2.29 All other classes of asset shall be measured at fair value. If there is no market-based evidence of fair value because of the specialist nature of the asset and the asset is rarely sold, authorities may need to estimate fair value using a DRC approach. The fair value of council dwellings shall be measured using EUV-SH. EUV-SH and DRC are methods of valuation that are based on fair value with additional special assumptions for each of the respective methods.
- 4.1.2.30 Authorities may elect to adopt a depreciated historical cost basis as a proxy for fair value for non-property that have short useful lives or low values (or both). For depreciated historical cost to be considered as a proxy for fair value, the useful life must be a realistic reflection of the life of the asset and the

depreciation method used must provide a realistic reflection of the consumption of that asset class.

- 4.1.2.31 Classes of asset whose fair value can be measured reliably, shall be carried at a re-valued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and accumulated impairment. When an asset is re-valued any accumulated depreciation and impairment at the date of valuation shall be eliminated against the gross carrying amount of the asset and the net amount restated to the re-valued amount of the asset. Where authorities use the alternative method of proportionately restating any accumulated depreciation and impairment at the date of valuation, they should refer to *IAS 16*.
- 4.1.2.32 Where the carrying amount of property, plant and equipment is increased as a result of a revaluation, the increase shall be recognised in the Revaluation Reserve, unless the increase is reversing a previous impairment loss charged to Surplus or Deficit on provision of services on the same asset (see chapter 4 section 7 of the Code) or reversing a previous revaluation decrease charged to Surplus or Deficit on provision of services on the same asset.
- 4.1.2.33 In the same way as the treatment of a reversal of a previous impairment loss (see chapter 4 section 7 of the Code), the reversal of a revaluation decrease previously recognised in Surplus or Deficit on provision of services should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no revaluation decrease been recognised for the asset in prior years. Any excess above the carrying amount that would have been determined (net of amortisation or depreciation) had no revaluation decrease been recognised for the asset in prior years should be treated as a revaluation gain and credited to the Revaluation Reserve.
- 4.1.2.34 Where the carrying amount of an item of property, plant and equipment is decreased as a result of a revaluation (as opposed to an impairment which is covered in chapter 4 section 7), the decrease shall be recognised in the Revaluation Reserve up to the credit balance existing in respect of the asset (i.e. up to its historical cost) and thereafter in Surplus or Deficit on provision of services.
- 4.1.2.35 Where assets are re-valued (i.e. the carrying amount is based on fair value), the entire class of property, plant and equipment to which the asset belongs shall be re-valued. However, a full valuation of a class of assets may be re-valued on a rolling basis within a short period and provided the revaluations are kept up to date. Typically this rolling basis would cover all the class of assets over a 5-year period.
- 4.1.2.36 Where a re-valued asset experiences significant and volatile changes in fair value that result in the fair value differing materially from its carrying amount, more frequent revaluations shall be required (i.e. annual valuations).
- 4.1.2.37 The fair value of land and buildings is normally undertaken by professionally qualified valuers.

#### *Depreciation*

- 4.1.2.38 Land and Buildings are separate assets and shall be accounted for separately, even when they are acquired together. Depreciation applies to all property, plant and equipment, whether held at historical cost or re-valued amount, with two exceptions:
- Investment properties carried at fair value in accordance with chapter 4 section 4 of the Code (also see *IAS 40 Investment Property*)
  - Land where it can be demonstrated that the asset has an unlimited useful life (excluding land subject to depletion i.e. quarries and landfill sites).
- 4.1.2.39 Assets shall not be depreciated until they are available for use, i.e. when they are in the location and condition necessary for them to be capable of operating in the manner intended by management. Depreciation of an asset ceases at earlier of:
- that the asset is classified as held for sale in accordance with chapter 4 section 9 of the Code (also see *IFRS 5*), and
  - the date that the asset is derecognised.
- 4.1.2.40 The only other ground for not charging depreciation is when the residue value of an asset is equal or greater than the asset's carrying amount. Repairs and maintenance do not remove the need to depreciate an asset.
- 4.1.2.41 Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. Where there is more than one significant part of the same asset which have the same useful life and depreciation method, such parts may be grouped in determining the depreciation charge. The requirement for componentisation for depreciation purposes shall be applicable to; enhancement and acquisition expenditure incurred, and revaluations carried out, from 1 April 2010.
- 4.1.2.42 The depreciation charge shall be based on the depreciable amount allocated over the useful life of the asset, using a depreciation method that reflects the pattern in which the asset's future economic benefits or service potential are expected to be consumed.
- 4.1.2.43 The depreciation charge for each period shall be recognised in Surplus or Deficit on provision of services unless it is included in the carrying amount of another asset.
- 4.1.2.44 The residue value, useful life and depreciation method shall be reviewed at least at each financial year end and, if expectations differ from previous estimates in relation to residue value and/or useful life and/or there has been a significant change in the pattern of consumption of the future economic benefits or service potential, the changes shall be accounted for as a change in an accounting estimate (as opposed to a change in accounting policy) in accordance with chapter 2 of the Code (also see *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors*).

- 4.1.2.45 To determine whether an item of property, plant and equipment is impaired, local authorities should refer to chapter 4 section 7 of the Code (also see *IAS 36 Impairment of Assets*).

#### *Derecognition*

- 4.1.2.46 The carrying amount of an item of property, plant and equipment shall be derecognised:
- on disposal; or
  - when no future economic benefits or service potential are expected from its use or disposal
- 4.1.2.47 The gain or loss arising from derecognition of an asset shall be the difference between the net disposal proceeds, if any, and the carrying amount of the asset. The gain or loss arising from derecognition of an asset shall be included in Surplus or Deficit on provision of services when the item is derecognised (unless chapter 4 section 2 of the Code requires otherwise on a sale and leaseback – also see *IAS 17*)
- 4.1.2.48 As set out in paragraph 4.1.2.19 the carrying amount of a replaced or restored part of the asset is derecognised, with the carrying amount of the new component being recognised subject to the recognition principles as set out in paragraph 4.1.2.16 being met. This recognition and derecognition takes place regardless of whether the replaced part had been depreciated separately.
- 4.1.2.49 If not practicable to determine the carrying amount of the replaced part, authorities may use the cost of the new part as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
- 4.1.2.50 The consideration receivable on disposal of an asset is recognised initially at its fair value. If payment is deferred (i.e. beyond normal credit terms), the consideration received 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.
- 4.1.2.51 A deferred credit (i.e. the balance on the Government Grants Deferred Account or [*Currently no decision has been made on the accounting treatment of assets transferred to an authority at nil consideration or less than fair value. Once a decision has been made the name of the account will be inserted here*]) relating to the asset should be recognised in Surplus or Deficit on provision of services.
- 4.1.2.52 *IAS 16* refers to the derecognition issues arising where in the course of its ordinary activities, an entity routinely sells items of property, plant and equipment that it has held for rental to others. This is not anticipated to be common for authorities. In the event that this is relevant, authorities should refer to the *IAS 16*.

### **4.1.3 Statutory Accounting Requirements**

#### *General Fund - Depreciation*

- 4.1.3.1 General Fund service revenue accounts, central support services and trading accounts and the Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice*) shall be charged with depreciation.
- 4.1.3.2 Under regulations and statutory guidance [add footnote to relevant legislation], depreciation charged to Surplus or Deficit on provision of services is not a proper charge to the General Fund. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.
- 4.1.3.3 On a re-valued asset, a transfer between the Revaluation Reserve and Capital Adjustment Account shall be carried out which represents the difference between depreciation based on the re-valued carrying amount of the asset and the depreciation based on the asset's historical cost.

*Housing Revenue Account - Depreciation*

- 4.1.3.4 The Housing Revenue Account shall be charged with depreciation.
- 4.1.3.5 On a re-valued asset, a transfer between the Revaluation Reserve and Capital Adjustment Account shall be carried out which represents the difference between depreciation based on the re-valued carrying amount of the asset and the depreciation based on the asset's historical cost.
- 4.1.3.6 **England:** Under regulations and statutory guidance [add footnote to relevant legislation], depreciation for HRA non-dwellings charged to Surplus or Deficit on provision of services are not proper charges to the Housing Revenue Account. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.
- 4.1.3.7 Under regulations and statutory guidance [add footnote to relevant legislation], depreciation charges for HRA dwellings are real charges to the HRA since the Major Repairs Allowance is likely to constitute a reasonable estimate of depreciation for HRA dwellings. Where the depreciation for HRA dwellings is less than the Major Repairs Allowance (MRA), an amount equal to the difference shall be transferred from the Housing Revenue Account to the Major Repairs Reserve and reported in the Movement in Reserves Statement. Conversely where depreciation charges for HRA dwellings are greater than the MRA, an amount equal to the difference shall be transferred to the Housing Revenue Account from the Major Repairs Reserve and reported in the Movement in Reserves Statement.
- 4.1.3.8 **Scotland:** Under regulations and statutory guidance [add footnote to relevant legislation], depreciation for HRA dwellings and non-dwellings charged to Surplus or Deficit on provision of services are not proper charges to the Housing Revenue Account. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement and replaced with HRA loans fund principal, via an appropriation from the Capital Adjustment Account.
- 4.1.3.9 **Wales:** Under regulations and statutory guidance [add footnote to relevant legislation], depreciation for HRA dwellings and non-dwellings charged to Surplus or Deficit on provision of services are not proper charges to the Housing Revenue Account. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement and replaced with HRA

Minimum revenue Provision, via an appropriation from the Capital Adjustment Account.

*Revaluation Gains or Losses*

- 4.1.3.10 The General Fund and Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice*) shall be charged in certain instances with revaluation gains or losses in accordance with this section of the Code.
- 4.1.3.11 Under regulations and statutory guidance [add footnote to relevant legislation], revaluation gains or losses charged to Surplus or Deficit on provision of services are not proper charges to the General Fund. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

*Gains or Losses on Derecognition*

- 4.1.3.12 The General Fund and Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice*) shall be charged with net gains or losses on derecognition.
- 4.1.3.13 Under regulations and statutory guidance [add footnote to relevant legislation] the gain or loss is not a proper charge to the General Fund or Housing Revenue Account. As a result the General Fund or Housing Revenue Account should be debited (in the case of a gain) or credited (in the case of a loss) with an amount equal to the gain or loss on disposal of the asset, with the double entries being:
- a credit to the Capital Receipts Reserve<sup>3</sup> of an amount equal to the disposal proceeds (subject to paragraph 4.1.2.50)
  - a debit to the Capital Adjustment Account of an amount equal to the carrying amount of the fixed asset disposal (less any balance transferred from the Government Grants Deferred Account or [*Currently no decision has been made on the accounting treatment of assets transferred to an authority at nil consideration or less than fair value. Once a decision has been made the name of the account will be inserted here*])
- 4.1.3.14 If the asset derecognised was carried at a re-valued amount an additional entry is required; the balance on the Revaluation Reserve in respect of asset derecognised is written off to the Capital Adjustment Account and reported in the Movement in Reserves Statement.
- 4.1.3.15 In England and Wales only, the proportion that is required to be paid over to central government as a 'housing pooled capital receipt' should be charged to Surplus or Deficit on provision of services and the same amount appropriated from the Capital Receipts Reserve and credited to the General Fund Balance and reported in the Movement in Reserves Statement.

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<sup>3</sup> It should be noted that in Scotland authorities may pay into a Capital Fund any sums derived from the sale of any property and such other sums as they may from time to time direct. The fund may be used for financing capital expenditure and loans fund repayments.

4.1.3.16 Minimum Revenue Provision (England and Wales) and Loans Fund Charges (Scotland and Northern Ireland) are proper charges to the General Fund, but do not appear in the Comprehensive Income and Expenditure Statement. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or Loans Fund Charges to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance.

#### **4.1.4 Disclosure Requirements**

4.1.4.1 Where authorities conclude that following the requirements of this section of the Code result in accounting entries that are immaterial, authorities need not follow this section of the Code and include the de minimis level within the disclosure of accounting policies (see chapter 3 section 4 of the Code).

4.1.4.2 Disclosure of accounting policies in relation to property, plant and equipment is required (see section 3.4 of the Code).

4.1.4.3 Having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to property, plant and equipment:

- (1) The financial statements shall disclose, for each class of property, plant and equipment:
  - (a) the measurement bases used for determining the gross carrying amount;
  - (b) the depreciation methods used;
  - (c) the useful lives or the depreciation rates used;
  - (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
  - (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
    - (i) additions;
    - (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Chapter 4 section 9 and other disposals;
    - (iii) increases or decreases resulting from revaluations under chapter 4 section 1 and from impairment losses recognised or reversed in Other Comprehensive Income and Expenditure and taken to the Revaluation Reserve in accordance with chapter 4 section 7;
    - (iv) impairment losses recognised in Surplus or Deficit on provision of services in accordance with chapter 4 section 7;
    - (v) impairment losses reversed in Surplus or Deficit on provision of services in accordance with chapter 4 section 7;
    - (vi) depreciation; and
    - (vii) other changes
- (2) The financial statements shall also disclose:
  - (a) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
  - (b) the amount of contractual commitments for the acquisition of property, plant and equipment; and

- (3) In accordance with chapter 3 section 4 an authority discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:
  - (a) residual values;
  - (b) the estimated costs of dismantling, removing or restoring items of property, plant and equipment;
  - (c) useful lives; and
  - (d) depreciation methods.
- (4) If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed:
  - (a) the effective date of the revaluation;
  - (b) whether an in-house or external valuer was involved; and
  - (c) the methods and significant assumptions applied in estimating the items' fair values.

#### **4.1.5 Statutory Disclosure Requirements**

- 4.1.5.1 There are no statutory disclosures required in relation to property, plant and equipment.

#### **4.1.6 Changes since SORP 2009**

- 4.1.6.1 The Code uses the same recognition criteria for subsequent expenditure as initial expenditure with regard to capitalisation (see paragraph 4.1.2.16). The SORP has separate criteria for enhancement expenditure i.e. expenditure can be capitalised where the expenditure '*extends the economic life of the asset*', which is not a requirement of the draft Code. However, it is not expected that this will result in different accounting treatments.
- 4.1.6.2 The SORP required the separate recognition of two or more significant components of an asset for depreciation purposes (i.e. as if each component was a separate asset in its own right) where the useful life is substantially different. However, this section of the Code has a greater emphasis in this area and defines significant in the context of '*the cost that is significant in relation to the total cost of the asset*'.
- 4.1.6.3 The Code requires where a component is replaced or restored, the carrying amount of the old component is derecognised to avoid double counting and the new component reflected in the carrying amount, subject to the recognition principles as set out in paragraph 4.1.2.16 being met. This includes the derecognition of parts of an asset not previously recognised as a separate component.
- 4.1.6.4 The Code requires residual values to be based on current prices at the balance sheet date (see paragraph 4.1.2.44). The SORP defines residual values as being based on prices prevailing at the date of the acquisition (or revaluation) of the asset and which do not take account of expected future price changes.
- 4.1.6.5 Renewals accounting is not permitted under the Code.

- 4.1.6.6 Under the Code there is a clear distinction between an impairment loss and revaluation loss. Under the SORP this was not explicit.
- 4.1.6.7 Other changes since the 2009 SORP that are not directly related to this section of the Code, but have been included for clarity and referenced to the relevant section of the Code, are as follows:
- *[Currently no decision has been made on the accounting treatment of borrowing costs. Once a decision has been made and the accounting treatment differs from the SORP, a cross reference will be made to the relevant section of the Code ie chapter 4 section 8].*
  - *[Currently no decision has been made on the accounting treatment of Government and Non-government grants/contributions. Once a decision has been made and the accounting treatment differs from the SORP, a cross reference will be made to the relevant section of the Code ie chapter 3 section 1x].*
  - The SORP required all assets classified as 'assets under construction' to be carried at historical cost. In contrast chapter 4 section 4 requires investment property under construction to be valued at fair value when the fair value can be reliably determined (also see *IAS 40*).
  - Assets classified as held for sale under chapter 4 section 9 of the Code shall not be depreciated and are valued at the lower of the carrying amount or fair value less costs to sell (also see *IFRS 5*).
  - The SORP stated that 'investment property held on a lease should be depreciated over the period when the unexpired term is 20 years or less'. This provision does not apply under chapter 4 section 4 of the Code where all assets classified as investment property shall not be subject to depreciation (also see *IAS 40*).

## Transition arrangements – Property Plant and Equipment

Transactions in relation to assets classified as held for sale and sold (i.e. derecognised) during 2009/10 will need to be restated in line with the Code. The required entries to restate the 2009/10 transactions are included in step 4 of the transition section of non-current assets held for sale and discontinued operations.

The Code (following *IFRS 1*) requires local authorities to classify and account for property plant and equipment in their opening IFRS balance sheet (1 April 2009) in accordance with chapter 4 section 1 of the Code (see also *IAS 16* and *IPSAS 17*). The Code requires the historical cost to be carried forward from the existing UK GAAP accounting in the SORP (mainly in relation to infrastructure assets, community assets and assets under construction).

The Code introduces the concept of fair value as a basis of valuation for certain classes of assets. However, there is unlikely to be transition issues with regard to the use of fair value because fair value has been interpreted under the property, plant and equipment section of the Code as *'the amount that would be paid for the asset in its existing use. This requirement is met by providing the existing use value (EUV) in accordance with UKPS 1.3 of the RICS Valuation Standards'*, which is the same basis of valuation used under the SORP (ie EUV). In addition the valuation methods under the Code of; existing use value-social housing (EUV-SH) for council dwellings and depreciated replacement cost (DRC) for specialist properties where there is no market-based evidence of fair value, will be same as under the SORP.

The requirement for component accounting as set out in chapter 4 section 1 of the Code, shall be applicable from 1 April 2010 and therefore will have no impact on transition.

The Code requires residual values to be based on current prices at the balance sheet date. This may require the restatement of the residue values and depreciation charges of assets carried at historical cost. However, it is anticipated that for authorities, the residual values of assets carried at historical cost (i.e. community and infrastructure assets) will not be material.

The Code does not permit renewals accounting. The option under the SORP of using renewals accounting as a method of estimating depreciation for infrastructure assets is not widely used by authorities and where it is used previous records detailing the charges may not be readily available. A prospective approach to transition shall therefore be applied with effect from 1 April 2009.

### Step 1 - Restate Comparative Figures for 2009/10

Transactions in relation to renewals accounting shall be reversed and replaced with a depreciation charge based on the depreciation policy of the authority.

Depreciation will need to be restated in the event that an asset's residual value carried at historical cost is different from the residual value based on current prices.

Where an impairment loss in 2009/10 (ie general fall in prices) is reclassified as a revaluation loss, the loss recognised in General Fund or HRA shall be reclassified as a revaluation loss.

## **4.2 Leases and Lease Type Arrangements**

### **4.2.1 Introduction**

4.2.1.1 Authorities shall account for leases in accordance with *IAS 17 Leases*, except where interpretations or adaptations to fit the public sector are detailed in the Code. *IPSAS 13 Leases* is based on *IAS 17*, and introduces no additional accounting requirements, although it provides additional guidance for public sector bodies. *SIC 15 Operating Leases – Incentives*, *SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease* and *IFRIC 4 Determining whether an Arrangement contains a Lease* are also relevant to accounting for leases.

4.2.1.2 This section of the Code shall be applied in accounting for all leases except licensing agreements for items such as patents and copyright. However, this section shall not be applied as the basis for measurement of property held by lessees that is accounted for as investment property or investment property provided by lessors under operating leases; these leases are measured in accordance with section 4.4 of the Code and *IAS 40 Investment Property*. This section shall be applied even where substantial services are provided by the lessor unless the provisions in section 4.3 of the Code (PFI and PPP arrangements) apply, when that section of the Code shall be applied.

#### *Interpretation for the Public Sector Context*

4.2.1.3 No interpretations or adaptations of *IAS 17* and *IPSAS 13* are required for the public sector context; these standards, along with *SIC 15*, *SIC 27* and *IFRIC 4*, are applied in full.

### **4.2.2 Accounting Requirements**

#### *Definitions*

4.2.2.1 A *lease* is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. In considering the accounting arrangements for a particular agreement, authorities shall take into account the requirements of *SIC 27* and *IFRIC 4*.

4.2.2.2 A *finance lease* is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

4.2.2.3 An *operating lease* is a lease other than a finance lease.

4.2.2.4 Further definitions, including definitions of minimum lease payments, gross investment in the lease and net investment in the lease are contained in *IAS 17*.

4.2.2.5 The definition of a lease includes hire purchase contracts.

### *Classification of Leases*

- 4.2.2.6 Leases are classified as either finance leases or operating leases based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee.
- 4.2.2.7 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- 1 the lease transfers ownership of the asset to the lessee by the end of the lease term;
  - 2 the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value so as to make it reasonably certain the option will be exercised;
  - 3 the lease term is for the major part of the economic life of the asset;
  - 4 the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
  - 5 the leased assets are of such a specialised nature that only the lessee can use them without major modifications.
- 4.2.2.8 The examples above are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, if the lease transfers ownership of the asset for a variable payment equal to its fair value, the lessee does not have substantially all risks and rewards incidental to ownership. Lease classification is made at the inception of the lease.
- 4.2.2.9 Leases of land and buildings are classified as finance or operating leases in the same way as leases of other assets. However the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification. When the land has an indefinite economic life, the land element is normally classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term. A payment made on entering into or acquiring a leasehold that is accounted for as an operating lease represents prepaid lease payments that are amortised over the lease term in accordance with the pattern of benefits provided.
- 4.2.2.10 When accounting for a lease of land and buildings, the minimum lease payments are allocated between the land and the buildings elements in proportion to their relative fair values. Where the amount that would initially be recognised for the land element is immaterial, the land and buildings may be treated as a single unit for lease classification.
- 4.2.2.11 Separate measurement of the land and buildings elements is not required where the lessee's interest in both is classified as an investment property (see section 4.4 of the Code and *IAS 40*) and the fair value model is used (as required by section 4.4 of the Code). Where an authority, as lessee, classifies a property

interest held under an operating lease as an investment property, it shall account for the interest as a finance lease and the fair value model shall be used. The authority will continue to account for the interest as a finance lease even where subsequent events mean the property is no longer classified as an investment property. An example would be where the authority occupies the property itself.

*Leases in the financial statements of lessees*

*Finance leases*

- 4.2.2.12 An authority, as lessee, shall recognise finance leases as assets and liabilities at amounts equal to the fair value of the property or, if lower, the present value of the minimum lease payments. The discount rate that shall be used is the rate implicit in the lease or, if it is not practicable to determine, the authority's incremental borrowing rate. Any initial direct costs of the authority are added to the value of the asset.
- 4.2.2.13 Minimum lease payments shall be apportioned between the finance charge (interest) and the reduction of the outstanding liability. The finance charge shall be calculated so as to produce a constant periodic rate of interest on the remaining balance of the liability; approximation may be used to simplify the calculation. Contingent rents shall be charged as expenses in the periods in which they are incurred.
- 4.2.2.14 Assets recognised under a finance lease shall be depreciated in accordance with paragraphs 4.1.2.38 - 4.1.2.45 of the Code. The depreciation policy for leased assets shall be consistent with the policy for owned assets. Where it is not certain that ownership of the asset will transfer at the end of the lease, the asset shall be depreciated over the shorter of the lease term and its useful economic life. After initial recognition, assets recognised under a finance lease are subject to revaluation in the same way as any other asset.

*Operating leases*

- 4.2.2.15 Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the benefits received by an authority. In accordance with *SIC 15*, lease incentives shall be recognised as a reduction in the lease expense over the lease term, on a straight line basis unless another systematic basis is more representative of the benefits received by an authority.

*Leases in the financial statement of lessors*

*Finance leases*

- 4.2.2.16 Lessors shall recognise assets held under a finance lease as a receivable at an amount equal to the net investment in the lease. The lease payment receivable shall be treated as repayment of principal and finance income. The finance income shall be calculated so as to produce a constant periodic rate of return on the net investment; approximation may be used to simplify the calculation.

### *Operating leases*

- 4.2.2.17 An authority shall present assets subject to operating leases according to the nature of the asset. Costs, including depreciation, incurred in earning the lease income are recognised as an expense.
- 4.2.2.18 Income from operating leases shall be recognised on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which the benefit derived from the leased asset is diminished. An authority shall recognise the cost of any lease incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is more representative of the time pattern in which the benefit derived from the leased asset is diminished.
- 4.2.2.19 Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income.
- 4.2.2.20 The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

### *Sale and Leaseback Transactions*

- 4.2.2.21 A sale and leaseback transaction involves an authority selling an asset and leasing back the same asset.
- 4.2.2.22 If a sale and leaseback transaction results in a finance lease, the arrangement is in substance one where the lessor is providing finance to the lessee. Any excess of sales proceeds over the carrying amount shall be amortised over the lease term, as it would not be appropriate to regard an excess of sales proceeds over the carrying amount as income.
- 4.2.2.23 If a sale and leaseback transaction results in an operating lease, and the sale and the lease are at fair value, any gain or loss on disposal shall be recognised immediately. If the sale price is below fair value, any gain or loss on disposal shall be recognised immediately, unless the loss is compensated for by future lease payments below market price in which case it shall be deferred and amortised in proportion to the lease payments. If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used.
- 4.2.2.24 For operating leases, if the fair value of the asset at the time of a sale and leaseback transaction is less than the carrying amount of the asset, the asset shall be revalued to fair value and a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately. No such adjustment is required for finance leases unless the asset has been impaired, in which case section 4.7 of the Code and *IAS 36 Impairment of Assets* shall apply.

### ***Arrangements containing a Lease***

- 4.2.2.25 A local authority may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but

conveys a right to use an asset (eg an item of property, plant or equipment) in return for a payment or series of payments. Authorities shall determine, in accordance with *IFRIC 4*, whether such arrangements are, or contain, leases that should be accounted for in accordance with this section of the Code and *IAS 17*. *IFRIC 4* applies whether the authority is acting as a lessee or as a lessor.

4.2.2.26 An authority shall not account for such arrangements in accordance with this section of the Code where the agreement falls within the scope of section 4.3 of the Code (PPP and PFI arrangements) or where the arrangement is, or contains, a lease excluded from the scope of this section of the Code and *IAS 17*.

4.2.2.27 Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

- a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
- b) the arrangement conveys a right to use the asset.

*Fulfilment of the arrangement is dependent on the use of a specific asset*

4.2.2.28 Although a specific asset may be explicitly identified in an arrangement, it is not the subject of a lease if fulfilment of the arrangement is not dependent on the use of the specified asset.

4.2.2.29 An asset has been implicitly specified if, for example, the supplier owns or leases only one asset with which to fulfil the obligation and it is not economically feasible or practicable for the supplier to perform its obligation through the use of alternative assets.

*Arrangement conveys a right to use the asset*

4.2.2.30 An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

- a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
- b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
- c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

*Assessing or reassessing whether an arrangement is, or contains, a lease*

- 4.2.2.31 The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any one of the following conditions is met:
- a) There is a change in the contractual terms, unless the change only renews or extends the arrangement.
  - b) A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term.
  - c) There is a change in the determination of whether fulfilment is dependent on a specified asset.
  - d) There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.

*Separating payments for the lease from other payments*

- 4.2.2.32 If an arrangement contains a lease, an authority shall apply the requirements of this section of the Code and *IAS 17* to the lease element of the arrangement. Accordingly, if an arrangement contains a lease, that lease shall be classified as a finance lease or an operating lease in accordance with this section of the Code.
- 4.2.2.33 In assessing the lease, payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. The minimum lease payments include only payments for the lease and exclude payments for other elements in the arrangement (e.g. for services and the cost of inputs). In some cases, this may require the use of an estimation technique.
- 4.2.2.34 If a purchaser concludes that it is impracticable to separate the payments reliably, it shall:
- a) in the case of a finance lease, recognise an asset and a liability at an amount equal to the fair value of the underlying asset. Subsequently the liability shall be reduced as payments are made and an imputed finance charge on the liability recognised using the purchaser's incremental borrowing rate of interest. Payments in excess of the repayment of the liability plus the imputed finance charge shall be accounted for as payments for other elements of the arrangement.
  - b) in the case of an operating lease, treat all payments under the arrangement as lease payments, but
    - i) disclose those payments separately from minimum lease payments of other arrangements that do not include payments for non-lease elements, and

- ii) state that the disclosed payments also include payments for non-lease elements in the arrangement.

#### **4.2.3 Statutory Accounting Requirements**

- 4.2.3.1 There are no statutory accounting requirements in respect of operating leases.

##### *Assets held by an authority (as a lessee) under a finance lease*

- 4.2.3.2 Under regulations and statutory guidance, depreciation and impairment charged to the Surplus or Deficit on the provision of services are not proper charges to the General Fund. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

- 4.2.3.3 Minimum Revenue Provision (England and Wales) and the repayment of the liability (Scotland<sup>4</sup> and Northern Ireland) are proper charges to the General Fund, but do not appear in the Comprehensive Income and Expenditure Statement. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or repayment of the liability to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance.

- 4.2.3.4 Gains and losses on the disposal of an investment property held under a lease are subject to the statutory accounting requirements set out in section 4.4.3 of the Code.

##### *Assets disposed of by means of a finance lease*

- 4.2.3.5 Gains and losses on the disposal of property, plant or equipment by way of a finance lease are subject to the statutory accounting requirements set out in section 4.1.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

- 4.2.3.6 Gains and losses on the disposal of an intangible asset by way of a finance lease are subject to the statutory accounting requirements set out in section 4.5.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

- 4.2.3.7 Gains and losses on the disposal of an investment property by way of a finance lease are subject to the statutory accounting requirements set out in section 4.4.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

- 4.2.3.8** A sale and leaseback arrangement that results in a finance lease is not a disposal for the purposes of this section of the Code.

#### **4.2.4 Disclosure Requirements**

- 4.2.4.1 Disclosure of accounting policies in relation to leases is required (see section 3.4).

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<sup>4</sup> The Scottish Government is consulting on accounting for finance leases outside the loans fund.

- 4.2.4.2 Having regard to paragraph 3.5.2.23 of the Presentation of Financial Statements section of the Code, authorities (acting as lessees and/or lessors) shall, in addition to meeting the requirements of Financial Instruments: Disclosures (see chapter 7), disclose the following notes in relation to leases:

Lessee – Finance Leases:

- (1) For each class of asset, the net carrying amount at the balance sheet date.
- (2) A reconciliation between the total of future minimum lease payments at the balance sheet date, and their present value. In addition, an authority shall disclose the total of future minimum lease payments at the balance sheet date, and their present value, for each of the following periods:
  - (a) not later than one year;
  - (b) later than one year and not later than five years;
  - (c) later than five years.
- (3) Contingent rents recognised as an expense in the period.
- (4) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.
- (5) In addition, the requirements for disclosure in accordance with Property Plant and Equipment, Impairment of Assets, Intangible Assets, Investment Property and Agriculture apply to lessees for assets leased under finance leases.

Lessee – Operating Leases:

- (6) The total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
  - (a) not later than one year;
  - (b) later than one year and not later than five years;
  - (c) later than five years.
- (7) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.
- (8) Lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments.

Lessor – Finance Leases:

- (9) A reconciliation between the gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods:
  - (a) not later than one year;
  - (b) later than one year and not later than five years;
  - (c) later than five years.
- (10) Unearned finance income.
- (11) The unguaranteed residual values accruing to the benefit of the lessor.
- (12) The accumulated allowance for uncollectible minimum lease payments receivable.
- (13) Contingent rents recognised as income in the period.
- (14) A general description of the lessor's material leasing arrangements.

Lessor – Operating Leases:

- (15) The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:
  - (a) not later than one year;
  - (b) later than one year and not later than five years;
  - (c) later than five years.
- (16) Total contingent rents recognised as income in the period.
- (17) A general description of the lessor's leasing arrangements.
- (18) In addition, the requirements for disclosure in accordance Property Plant and Equipment, Impairment of Assets, Intangible Assets, Investment Property and Agriculture apply to lessors for assets provided under operating leases.

#### **4.2.5 Statutory Disclosure Requirements**

4.2.5.1 There are no statutory disclosures required in relation to leases.

#### **4.2.6 Changes since SORP 2009**

- 4.2.6.1 The Code requires the land and buildings elements of a lease of land and buildings to be classified and accounted for separately. This requirement did not exist in the SORP, and a lease of land and buildings was classified and accounted for as a single lease.
- 4.2.6.2 One of the factors that indicates a lease is a finance lease is if “the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset”. Under the SORP, “substantially all” was quantified as “normally 90% or more”. This quantitative test does not apply under the Code, and authorities will need to use professional judgement when assessing “substantially all”.
- 4.2.6.3 Under the Code, finance income shall be calculated so as to produce a constant periodic rate of return on the net investment. Under the SORP, the finance income was calculated so as to give a constant periodic rate of return on the net cash investment. This difference in treatment may lead to income being recognised in different periods.
- 4.2.6.4 The Code requires initial direct costs to be added to the carrying amount of the asset in some circumstances. This was not covered by the SORP, but was a permissible (rather than required) treatment under *SSAP 21 Accounting for leases and hire purchase contracts*.
- 4.2.6.5 The Code specifies the accounting treatment for sale and leaseback transactions. The accounting treatment was not covered by the SORP, but was set out in *SSAP 21*. The requirements of the Code are consistent with those of *SSAP 21*.
- 4.2.6.6 The Code specifies the accounting treatment for arrangements containing a lease (*IFRIC 4*). This was not covered by the SORP, but similar results may have arisen from an application of *FRS 5 Reporting the Substance of Transactions*.

## **Transition arrangements (to form part of Section 11)**

### ***A - Reclassification of Leases***

Step 1 - Restate Opening IFRS Balance Sheet as at 1 April 2009

The Code (following *IFRS 1*) requires local authorities to classify and account for leases in their opening IFRS balance sheet (1 April 2009) in accordance with section 4.2 of the Code (see also *IAS 17* and *IPSAS 13*). Authorities will therefore need to separate leases of land and buildings into land and buildings elements, and classify and account for those elements separately. Authorities may also need to recognise a lease that was previously recognised as an operating lease as a finance lease, or recognise a lease that was previously recognised as a finance lease as an operating lease. These requirements are applied retrospectively, and apply when accounting both as a lessee and as a lessor.

#### *Separation of Land and Buildings Leases*

To separate leases of land and buildings into the separate land and buildings elements, authorities will need to review the lease contracts, and separate each lease on the basis of the position at the inception of the lease. Lease payments are allocated to the land and buildings elements in proportion to their relative fair values. The fair values of the land and buildings elements will therefore need to be established as at the inception of the lease.

#### *Lease Reclassification – Accounting as a Lessee*

##### *Operating Lease Reclassified as a Finance Lease*

Where an operating lease is reclassified as a finance lease, an asset and a liability shall be recognised. Authorities will need to establish the fair value of the asset. Where this is not known, the fair value of the asset can be estimated by taking the present value of the minimum lease payments (discounted at the rate implicit in the lease). If the rate implicit in the lease cannot be established, the authority's incremental borrowing rate at the date of reclassification shall be used.

Payments made between the inception of the lease and 31 March 2009 shall be apportioned between the finance charge and the repayment of the liability. These amounts would previously have been charged to the General Fund.

Depreciation on the assets acquired under the lease will need to be charged from the commencement of the lease until 31 March 2009. This should be in accordance with an authority's depreciation policies. Assets will also need to be revalued in accordance with the authority's revaluation policies.

The General Fund shall be charged with the Minimum Revenue Provision (England and Wales) or repayment of the liability (Scotland and Northern Ireland) as required by regulation or statutory guidance.

##### *Finance Lease Reclassified as an Operating Lease*

Where a finance lease is reclassified as an operating lease, the asset and liability will need to be derecognised. Any Minimum Revenue Provision (England and Wales) or repayment of the liability (Scotland and Northern Ireland) shall be adjusted in accordance with regulations or statutory guidance if required.

### *Lease Reclassification – Accounting as a Lessor*

#### *Operating Lease Reclassified as a Finance Lease*

Where an operating lease is reclassified as a finance lease, the asset shall be derecognised and a long-term debtor recognised.

For each lease, authorities will need to separate the lease income into a finance income element and a repayment of principal element. The repayment of principal element of each payment shall be applied to reduce the balance on the long-term debtor, and is classed as a capital receipt; a transfer from the General Fund to the Capital Receipts Reserve (Capital Fund in Scotland) is required unless regulations or statutory guidance permit otherwise.

#### *Finance Lease Reclassified as an Operating Lease*

Where a finance lease is reclassified as an operating lease, the long-term debtor shall be derecognised and the asset that would have been derecognised at the commencement of the finance lease shall be reinstated. The balance on the fixed asset account shall be adjusted for the depreciation chargeable between the time the asset was originally derecognised and the time it is reinstated. The asset may also need to be revalued.

Authorities would previously have apportioned the income received under the lease into a finance income element and a repayment of principal element. As an operating lease, all income would be recognised in the General Fund; a transfer to the General Fund from the Capital Receipts Reserve (Capital Fund in Scotland) is required unless regulations or statutory guidance require otherwise.

### Step 2 - Restate Comparative Figures for 2009/10 (Leases taken out prior to 1 April 2009)

Where leases have been reclassified as part of step 1, the comparative figures for 2009/10 will also need to be restated to reflect the accounting arrangements for the new lease classification.

### *Accounting as a Lessee*

#### *Operating Lease Reclassified as a Finance Lease*

Where a lease that was classified as an operating lease under the previous SORP has been reclassified as a finance lease under the Code, the charge for the operating lease in the 2009/10 Comprehensive Income and Expenditure Statement will need to be reversed. Depreciation of the asset now recognised under the finance lease shall be accounted for in accordance with the Code. The General Fund shall be charged with the Minimum Revenue Provision (England and Wales) or repayment of the liability (Scotland and Northern Ireland) as required by regulation or statutory guidance.

#### *Finance Lease Reclassified as an Operating Lease*

Where a lease that was classed as a finance lease under the SORP has been reclassified as an operating lease under the SORP, depreciation will need to be reversed and replaced with the charges required under an operating lease. Any Minimum Revenue Provision (England

and Wales) or repayment of the liability (Scotland and Northern Ireland) shall be adjusted in accordance with regulations or statutory guidance if required.

#### *Accounting as a Lessor*

##### *Operating Lease Reclassified as a Finance Lease*

Where a lease that was classified as an operating lease under the previous SORP has been reclassified as a finance lease under the Code, charges made in 2009/10 in respect of depreciation will need to be reversed out. Part of the income received in 2009/10 will relate to the repayment of the liability and shall be reclassified as a capital receipt. If regulations or statutory guidance permit the amount now recognised as a capital receipt to be retained in the General Fund, the authority shall report a transfer to the General Fund from the Capital Receipts Reserve (Capital Fund in Scotland) in the Movement in Reserves Statement.

##### *Finance Lease Reclassified as an Operating Lease*

Where a lease that was classified as a finance lease under the previous SORP has been reclassified as an operating lease under the Code, the asset (previously treated as disposed of) will still be on the balance sheet, and depreciation charges will be required. Part of the income received in 2009/10 would have been classified as a capital receipt; this will need to be reversed out and credited to the service revenue account. Interest income previously recognised corporately will need to be recognised in the service revenue account (where appropriate). If regulations or statutory guidance require the amount previously recognised as a capital receipt to be retained in the Capital Receipts Reserve (Capital Fund in Scotland), the authority shall report a transfer from the General Fund to the Capital Receipts Reserve (Capital Fund in Scotland) in the Movement in Reserves Statement.

#### Step 3 - Restate Comparative Figures for 2009/10 (Leases taken out during 2009/10)

Where leases that were taken out during 2009/10 are required to be restated, a similar approach to Step 1 will be required. The opening IFRS Balance Sheet (1 April 2009) will not require amendment, but the 2009/10 Comprehensive Income and Expenditure Statement and the Balance Sheet as at 31 March 2010 shall be restated. Separate entries will be required for the service revenue accounts and corporate accounts (e.g. interest payable) when adjusting the 2009/10 Comprehensive Income and Expenditure Statement.

#### ***B – Finance Lease Income***

Following *IAS 17*, the Code requires finance income from a finance lease to be calculated so as to produce a constant periodic rate of return on the net investment. Under the 2009 SORP, the finance income was previously calculated so as to give a constant periodic rate of return on the net cash investment. This difference in treatment may lead to income being recognised in different periods, although this is likely to occur infrequently.

Where a lease previously classified as a finance lease continues to be classified as a finance lease under the Code, the finance income for each period from the commencement of the lease shall be calculated so as to produce a constant periodic rate of return on the net investment. Where these amounts are materially different (for an individual lease or in total) from the finance income previously recognised, the General Fund or HRA will need to be debited or credited with the difference, the contra entry being to the long-term debtor.

These adjustments will also alter the amount recognised as a capital receipt, and an adjustment will be required between Capital Receipts Unapplied and the Capital Adjustment Account. Adjustments will need to be made both within the 1 April 2009 opening balance sheet and in the restated 2009/10 performance statements and balance sheet.

***C – Determining whether an arrangement contains a lease***

For arrangements in place prior to 1 April 2009, an authority shall determine whether the arrangement contains a lease on the basis of the facts and circumstances existing as at that date. For arrangements coming into effect after that date, an authority shall determine whether the arrangement contains a lease on the basis of the facts and circumstances existing as at the inception of the arrangement.

Where an arrangement is found to contain a lease, the authority shall recognise any income, expenditure, assets and liabilities in accordance with section 4.2 of the Code.

## 4.3 PFI and PPP Arrangements

### 4.3.1 Introduction

4.3.1.1 PFI, PPP and similar schemes shall be accounted for in a manner that is consistent with the adaptation of *IFRIC 12 Service Concession Arrangements* contained in the government's Financial Reporting Manual (FRoM). [Note: reference to IPSASB to be added once standard issued.]

4.3.1.2 The following terminology is used throughout this Chapter:

- **Infrastructure** is the term used in *IFRIC 12* to refer to the assets used by the operator to deliver services (which may or may not be recognised on an authority's balance sheet); examples include roads, street lighting, schools, telecommunications networks and fixed assets used for administrative purposes in delivering services to the public
- **Construction payments / element** refers to the finance lease elements of the payment made; only applies where the service element and the construction element (liability and interest) can be separated rather than estimated
- **Asset** is reserved for assets recognised on the local authority balance sheet

4.3.1.3 PPP and PFI arrangements typically involve a private sector entity (the operator) constructing or enhancing infrastructure used in the provision of a public service, and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement.

#### *Scope*

4.3.1.4 PPP and PFI arrangements involve the operator undertaking an obligation to provide infrastructure (and related services) that is used to provide services to the public (irrespective of who provides those services to the public). By extension, this includes providing infrastructure (and related services) for the direct use of a public sector entity where these services contribute to the provision of services to the public (e.g. office and administrative buildings).

4.3.1.5 Other features of PPP and PFI arrangements are:

- the entity granting the service arrangement (the grantor) is a public sector entity;
- the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent of the grantor;
- the contract sets initial prices levied by the operator and regulates price revisions over the period of the service arrangement; and
- the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

## **4.3.2 Accounting Arrangements**

### *Application of PPP and PFI Accounting Arrangements*

- 4.3.2.1 Section 4.3 of the Code applies to PPP and PFI arrangements (as defined in paragraphs 4.3.1.4 and 4.3.1.5) where
- (a) the local authority controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and where
  - (b) the local authority controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the infrastructure at the end of the term of the arrangement.
- 4.3.2.2 Where the property is used for its entire life, and there is little or no residual interest, the arrangement would fall within the scope of this Appendix where the authority controls or regulates the services as described in the first condition.
- 4.3.2.3 Where the control tests described in paragraphs 4.3.2.1 and 4.3.2.2 above are not both met, paragraphs 4.3.2.5 – 4.3.5.1 of the Code do not apply, and reference should be made to other sections of the Code.
- 4.3.2.4 Where the control tests described in paragraphs 4.3.2.1 and 4.3.2.2 above are met, paragraphs 4.3.2.5 – 4.3.5.1 of the Code apply to all infrastructure acquired, constructed or enhanced by the operator for the purpose of the PPP or PFI arrangement, including infrastructure to which the local authority gives the operator access for the purpose of the PPP or PFI arrangement. Paragraphs 4.3.2.5 – 4.3.5.1 of the Code also apply to infrastructure provided by the operator that previously appeared on the operator's balance sheet.

### *Recognition*

- 4.3.2.5 Infrastructure within the scope of section 4.3 of the Code shall be recognised as property, plant and equipment of the local authority because the contractual service arrangement conveys the right to control the use of the infrastructure. A related liability shall be recognised at the same time.
- 4.3.2.6 In line with section 4.1 of the Code and *IAS 16 Property Plant and Equipment*, the infrastructure (and related liability) shall be recognised at the point that (a) it is probable that future economic or service benefits associated with the infrastructure will flow to the local authority; and (b) the cost of the infrastructure can be measured reliably. This will be when the asset is made available for use unless the local authority bears an element of the construction risk, which will not be the case where standard PFI contract terms are used. Where an authority does bear the construction risk, it shall recognise an asset under construction prior to the asset being made available for use where it is probable that the expected future benefits attributable to the asset will flow to the authority. In accordance with *IAS 16*, separate assets shall be recognised in respect of land and buildings where appropriate.
- 4.3.2.7 Where the operator enhances infrastructure already recognised on the balance sheet of the local authority, the local authority shall recognise the fair value of the

enhancement in the carrying value of the infrastructure where the recognition criteria of *IAS 16* are met (see paragraphs 4.1.x - 4.1.x of the Code). *IAS 16* requires the different components of an asset to be accounted for separately if they have a different useful life, and this approach shall be adopted where appropriate. In doing so, an authority shall apply the derecognition requirements of *IAS 16* (see paragraphs 4.1.x - 4.1.x of the Code) where components of the existing infrastructure are replaced. A new liability shall be recognised or the existing liability increased to reflect the authority's requirement to pay for the enhancement.

#### *Measurement*

- 4.3.2.8 Where a PPP or PFI arrangement can be separated into a service element and a construction element, the service element shall be expensed as incurred, and the construction element accounted for as if it were a finance lease.
- 4.3.2.9 Subsequent to initial recognition, the infrastructure shall be measured following the principles set out in section 4.2 of the Code and *IAS 17* (i.e. following the arrangements for assets acquired under a finance lease). The liability shall be measured in a similar manner to the liability resulting from a finance lease, as set out in section 4.2 of the Code and *IAS 17*. The liability shall be reported as a financial liability but shall be measured under section 4.2 of the Code (leases) not section 7 of the Code (financial instruments).
- 4.3.2.10 Where a PPP or PFI arrangement can not be separated into a service element and a construction element, the infrastructure and related liability shall be measured at the fair value of the infrastructure.
- 4.3.2.11 Subsequent to initial recognition, the infrastructure shall be measured following the principles set out in section 4.1 of the Code and *IAS 16* (i.e. following the arrangements for assets purchased or constructed by the authority). Scheduled payments under the arrangement shall be allocated between (a) repayment of the liability, (b) an imputed finance charge (based on the interest rate implicit in the contract), and (c) operating costs to reflect the service element of the arrangement. Where it is not possible to determine the rate implicit in the contract, the authority shall use its cost of capital rate (including inflation). It is expected that this situation would be rare. The liability shall be measured as a financial instrument based on elements (a) and (b) of the scheduled payments above, using the same actuarial method used for finance leases under section 4.2 of the Code and *IAS 17*.

#### *Payments*

- 4.3.2.12 By definition, where a PPP or PFI arrangement can be separated into construction and service elements, the payments for each element will be readily identifiable. The service element shall be charged as expenditure as incurred. The construction element shall be allocated into an element relating to the repayment of the liability and an interest element in accordance with the arrangements for a finance lease (see section 4.2 of the Code and *IAS 17*). The interest element shall be charged to the Surplus or Deficit on provision of services as incurred, with the balance of the payment used to reduce the outstanding liability on the balance sheet.

- 4.3.2.13 Where the PPP or PFI arrangement can not be separated into construction and service elements, payments by the local authority to an operator shall be separated into three elements - repayment of the liability, interest and the service charge.
- 4.3.2.14 The service element of the payments shall be estimated, which could be achieved by obtaining information from the operator or by estimating the fair value of the services. The fair value of the infrastructure (the cost to purchase the infrastructure) determines the amount to be recorded as an asset with an offsetting liability. The total unitary payment is then divided into three: the service charge element, repayment of the liability and the interest element (using the interest rate implicit in the contract). Where it is not possible to determine the rate implicit in the contract, the authority shall use its cost of capital rate (including inflation). It is expected that this situation would be rare.

#### *Local Authority Assets*

- 4.3.2.15 A PPP or PFI arrangement may make use of the existing assets of a local authority. A local authority shall recognise enhancements to those assets and any additional infrastructure provided by the operator in accordance with paragraph 4.3.2.5 - 4.3.2.7 of the Code.
- 4.3.2.16 A local authority may provide the operator with access to existing assets of the authority that are not to be used in the PPP or PFI arrangement in exchange for reduced or eliminated payments. This may involve a permanent transfer of the assets to the operator, or may allow the operator access for a specified period (which may or may not be the same as the period of the PPP or PFI arrangement).
- 4.3.2.17 Where the arrangement involves a permanent transfer of an asset to the operator, the local authority shall derecognise the asset in accordance with section 4.1.x of the Code and *IAS 16*. The authority shall also recognise on the balance sheet the consideration received for the asset transferred to the operator. Depending on the circumstances of the arrangement, this may be the reduction or elimination of an existing liability; a prepayment; or infrastructure provided by the operator. Any difference between the carrying value of the asset given up and the consideration received from the operator shall be recognised in the Surplus or Deficit on provision of services.
- 4.3.2.18 Where the arrangement does not involve a permanent transfer of the assets to the operator, a local authority shall account for the arrangement as a lease under section 4.2 of the Code and *IAS 17*. Where the asset provided by the authority is provided in the form of an operating lease, there is not a disposal of the asset, which remains on the authority's balance sheet. The granting of the operating lease is one element of the consideration provided to the operator for the provision of the infrastructure and services.
- 4.3.2.19 Over the period of the operating lease, the authority shall recognise income from the operating lease in the Surplus or deficit on provision of services. At the point that the income is recognised, the authority shall recognise a corresponding expense in the Surplus or Deficit on provision of services in respect of a reduction in the liability to pay for the infrastructure.
- 4.3.2.20 Where the asset provided by the authority is provided in the form of a finance lease, the local authority shall derecognise the asset in accordance with section 4.2

of the Code and *IAS 17*. The authority shall also recognise on the balance sheet the consideration received from the operator. Depending on the circumstances of the arrangement, this may be the reduction or elimination of an existing liability; a prepayment; or infrastructure provided by the operator. Any difference between the carrying value of the asset given up and the consideration received from the operator shall be recognised in Surplus or Deficit on provision of services.

- 4.3.2.21 Where the arrangement involves either a finance lease or an operating lease, any payments to be made by the operator for use of the asset are to be taken into account when measuring the assets and liabilities to be recognised on the balance sheet.

#### *Depreciation and Impairment*

- 4.3.2.22 Assets recognised under a PPP or PFI arrangement shall be depreciated and revalued in accordance with paragraphs 4.1.x – 4.1.x of the Code. In assessing the economic life of the asset, consideration shall be given to the terms of the arrangement, for example where the arrangement requires assets to be replaced at specific points during the arrangement.

- 4.3.2.23 Where there is evidence that an asset recognised under a PPP or PFI arrangement may have been impaired, an impairment review shall be carried out in accordance with section 4.7 of the Code. Where an asset has been impaired, an authority shall account for the impairment in accordance with section 4.7 of the Code.

#### *Guarantees*

- 4.3.2.24 A local authority may give financial guarantees as part of a PPP or PFI arrangement. Such guarantees should be recognised and measured in accordance with paragraphs 7.x - 7.x of the Code and *IAS 39*.

### **4.3.3 Statutory Accounting Requirements**

- 4.3.3.1 Regulations permit capital receipts to be used to repay borrowing. Capital receipts may therefore be applied to make capital contributions that reduce the liability.

- 4.3.3.2 Under regulations and statutory guidance [add footnote to relevant legislation], depreciation and impairment charged to Surplus or Deficit on provision of services are not proper charges to the General Fund. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Statement of Movement in Reserves Statement.

- 4.3.3.3 Minimum Revenue Provision (England and Wales) and the repayment of the liability (Scotland) are proper charges to the General Fund, but do not appear in the Surplus or Deficit on provision of services. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance.

#### **4.3.4 Disclosure Requirements**

4.3.4.1 Disclosure of accounting policies in relation to PPP and PFI arrangements is required (see section 3.4).

4.3.4.2 Having regard to paragraph 3.5.2.23 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to PPP and PFI arrangements:

- (1) The value of assets held under PFI arrangements at each balance sheet date, and an analysis of the movement in those values.
- (2) The value of liabilities resulting from PFI arrangements at each balance sheet date, and an analysis of the movement in those values
- (3) Details of the payments due to be made under PFI arrangements (separated into repayments of liability, interest and service charges):
  - (a) within one year
  - (b) within 2 - 5 years
  - (c) within 6 - 10 years; and
  - (d) in each additional 5 year period

#### **4.3.5 Statutory Disclosure Requirements**

4.3.5.1 There are no statutory disclosures required in relation to PPP and PFI arrangements.

#### **4.3.6 Changes since SORP 2009**

4.3.6.1 There have been no changes in accounting for PPP and PFI arrangements since SORP 2009.

### **Transition Arrangements**

There are expected to be no transition issues arising from PFI Schemes

## **4.4 Investment Property**

### **4.4.1 Introduction**

4.4.1.1 Authorities shall account for investment property in accordance with *IAS 40 Investment Property*, except where interpretations or adaptations to fit the public sector are detailed in the Code. *IPSAS 16 Investment Property* is based on *IAS 40*, and provides additional guidance for public sector bodies. Recent changes to *IAS 40* have yet to be reflected in *IPSAS 16*, and in these cases the Code requires authorities to follow *IAS 40* rather than *IPSAS 16*.

#### *Interpretation for the Public Sector Context*

4.4.1.2 *IPSAS 16* includes a public sector interpretation of the definition of investment property. Under this definition, an investment property is one that is used solely to earn rentals or for capital appreciation or both. Property that is used to facilitate the delivery of services or production of goods as well as to earn rentals or for capital appreciation does not meet the definition of an investment property under *IPSAS 16*, and is accounted for as Property, Plant and Equipment. The Code adopts this definition of investment property.

4.4.1.3 The Code requires investment property to be accounted for under the fair value model. The option under *IAS 40* and *IPSAS 16* to use the cost model is not permitted.

### **4.4.2 Accounting Requirements**

4.4.2.1 This section of the Code applies to the measurement of investment property interests held under a lease and to investment property provided to a lessee under an operating lease. Other aspects of lease accounting are covered by *IAS 17 Leases* and section 4.2 of the Code. These include:

- classification of leases as finance leases or operating leases;
- recognition of lease income from investment properties;
- measurement in a lessor's financial statements of its net investment in a finance lease.

Property provided to a lessee under a finance lease is outside the scope of this section of the Code and shall be accounted for in accordance with section 4.2 of the Code and *IAS 17*.

#### *Definitions*

4.4.2.2 *Carrying amount* is the amount at which an asset is recognised in the balance sheet.

4.4.2.3 *Fair value* is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. For this section of the Code, fair value is to be interpreted as the amount that would be paid for the asset in its highest and best use, ie market value. The fair value of investment property held under a lease is the lease interest.

- 4.4.2.4 *Investment property* is property (land and / or buildings) held solely to earn rentals or for capital appreciation or both.
- 4.4.2.5 *Owner-occupied property* is property held (by the owner or by the lessee under a finance lease) for use in the delivery of services or production of goods or for administrative purposes.

#### *Classification*

- 4.4.2.6 Property held by a lessee under an operating lease may be accounted for as an investment property if, and only if, the property would otherwise meet the definition of an investment property. This classification is available on a property by property basis. The lease shall be accounted for as if it were a finance lease.
- 4.4.2.7 Owner-occupied property shall be accounted for as Property Plant and Equipment (see Section 4.1 of the Code and *IAS 16 Property Plant and Equipment*).
- 4.4.2.8 Where an authority leases property to a subsidiary, the property is accounted for as an investment property in the authority's accounts if it meets the definition in paragraph 4.4.1.2. The property is not accounted for as an investment property in the group accounts, because from the group perspective the property is owner-occupied.

#### *Recognition and Measurement*

- 4.4.2.9 Investment property shall be recognised as an asset when, and only when:
- (a) It is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and
  - (b) The cost or fair value of the investment property can be measured reliably.
- 4.4.2.10 An authority shall evaluate the costs of an investment property when they are incurred. The costs include acquisition costs and costs incurred subsequently to add to, replace part of or service an investment property, but do not include day to day repairs and maintenance. Where part of an investment property is replaced, an authority shall recognise in the carrying value of the investment property the cost of the replacement; the carrying amount of those parts that are replaced is derecognised.
- 4.4.2.11 Investment property shall be measured initially at cost. The cost of an investment property includes its purchase price, transaction costs and directly attributable expenditure. Where an investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition. The initial cost of a lease interest classified as an investment property shall be as prescribed for a finance lease (see section 4.2 of the Code). Where an investment property is acquired in exchange for a non-monetary asset, the cost of the investment property is its fair value at the time of the exchange, or, where this cannot be reliably determined, the carrying amount of the asset given up.
- 4.4.2.12 After initial recognition, investment property shall be measured at fair value. The use of the cost model allowed under *IAS 40* is not permitted. A gain or loss

arising from a change in the fair value of investment property shall be recognised in Surplus or Deficit on provision of services for the period in which it arises. The fair value of investment property shall reflect market conditions at the balance sheet date. An investment property under construction shall be measured at fair value once an authority is able to measure reliably the fair value of the investment property. Investment properties held at fair value are not depreciated.

- 4.4.2.13 Exceptionally, there may be evidence when an authority first acquires an investment property (or the property first becomes an investment property following a change of use) that the fair value of the investment property is not reliably determinable on a continuing basis. In such cases, an authority shall account for that property using the cost model in *IAS 16* and section 4.1 of the Code (i.e. the investment property is depreciated over its useful life). The residual value of the investment property shall be assumed to be zero.

#### *Transfers*

- 4.4.2.14 *IAS 40* details the accounting arrangements that apply where assets are reclassified as investment property or are reclassified from investment property. Where such reclassifications take place, authorities shall follow the accounting arrangements set out in paragraphs 57 – 65 of *IAS 40*.

#### *Disposals*

- 4.4.2.15 An investment property shall be derecognised on disposal (by sale or by entering into a finance lease) or when the investment property is permanently withdrawn from use and no future economic benefits or service potential are expected from its disposal. Gains or losses arising from the retirement or disposal of investment property shall be recognised in Surplus or Deficit on provision of services (unless *IAS 17* and section 4.2 of the Code requires otherwise on a sale and leaseback) in the period of the retirement or disposal.
- 4.4.2.16 Impairments of investment property are recognised in accordance with *IAS 36* and section 4.7 of the Code. Compensation from third parties for investment property that becomes impaired, lost or is given up is recognised in Surplus or Deficit on provision of services when it becomes receivable.

### **4.4.3 Statutory Accounting Requirements**

- 4.4.3.1 Statute and proper practice restrict the use of capital receipts, and prescribe the charges that can be made to the General Fund. To comply with these restrictions, the gain or loss on derecognition of an investment property shall be reversed out of the General Fund. The General Fund shall be debited (in the case of a gain) or credited (in the case of a loss) with an amount equal to the gain or loss on derecognition of the investment property (excluding any costs of disposal which are a proper charge to the General Fund). The double entries are a credit to the Capital Receipts Reserve of an amount equal to the disposal proceeds and a debit to the Capital Adjustment Account equal to the carrying amount of the investment property (less any balance transferred from the Government Grants Deferred Account).
- 4.4.3.2 These entries will be reflected in the Movement in Reserves Statement.

- 4.4.3.3 Under regulations and statutory guidance [add footnote to relevant legislation], gains or losses on fair value debited or credited to Surplus or Deficit on provision of services are not proper charges to the General Fund. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.
- 4.4.3.4 Minimum Revenue Provision (England and Wales) and Loans Fund Charges (Scotland and Northern Ireland) are proper charges to the General Fund, but do not appear in Surplus or Deficit on provision of services. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or Loans Fund Charges to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance.

#### **4.4.4 Disclosure Requirements**

- 4.4.4.1 Disclosure of accounting policies in relation to investment property is required (see section 3.4).
- 4.4.4.2 Having regard to paragraph 3.5.2.23 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to investment property:
- (1) Whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.
  - (2) The amounts recognised in the Comprehensive Income and Expenditure Statement for:
    - (a) rental income from investment property;
    - (b) direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period; and
    - (c) direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period.
  - (3) The existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
  - (4) Contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.
  - (5) A reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:
    - (a) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised in the carrying amount of an asset;
    - (b) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with chapter 4 section 9 and other disposals;
    - (c) net gains or losses from fair value adjustments;
    - (d) transfers to and from inventories and owner-occupied property; and
    - (e) other changes

The disclosures above apply in addition to those applicable to leases (see section 4.2 of the Code). In accordance with leases the owner of an investment property provides lessors' disclosures about leases into which it has entered. An authority that holds an investment property under a finance or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered

#### **4.4.5 *Statutory Disclosure Requirements***

4.4.5.1 There are no statutory disclosures required in relation to investment property.

#### **4.4.6 *Changes since SORP 2009***

4.4.6.1 SORP 2009 required investment property to be carried at the lower of net current replacement cost or net realisable value (effectively market value). The Code requires investment property to be carried at fair value; as fair value will normally be based on market value, this change is not expected to result in any change to the carrying amount of investment property.

4.4.6.2 SORP 2009 required revaluations of investment property to be adjusted through the revaluation reserve in the first instance. The Code requires changes to fair value to be taken to Surplus or Deficit on provision of services (and then reversed out to the Capital Adjustment Account).

4.4.6.3 SORP 2009 required investment property under construction to be accounted for at cost. The Code requires investment property under construction to be accounted for at fair value once an authority is able to measure reliably the fair value of the investment property.

4.4.6.4 SORP 2009 required investment property held under a lease to be depreciated where the unexpired term was 20 years or less. This requirement has been removed in the Code, although the requirement to fair value the lease interest will have a similar effect.

## **Transition arrangements - Investment Property**

### **Step 1 - Restate Opening IFRS Balance Sheet as at 1 April 2009**

The Code (following *IFRS 1*) requires local authorities to classify and account for investment properties in their opening IFRS balance sheet (1 April 2009) in accordance with section 4.4 of the Code (see also *IAS 40* and *IPSAS 16*). Accounting for investment property at fair value through Surplus or Deficit on provision of services is a change of accounting policy that will require authorities to restate their opening balances in respect of investment property.

Authorities shall transfer any balances on the Revaluation Reserve in respect of investment property as at 1 April 2009 to the Capital Adjustment Account.

Authorities shall adjust the carrying amount of investment property held under a lease to fair value as at 1 April 2009.

### **Step 2 - Restate Comparative Figures for 2009/10 (Investment Property acquired prior to 1 April 2009)**

Transactions in relation to investment property during 2009/10 will need to be restated in line with the Code. Where the revaluation of investment property was effected through the Revaluation Reserve, authorities shall restate the 2009/10 position by reversing these transactions and effecting the change to fair value through Surplus or Deficit on provision of services.

Depreciation charged on investment property held under a lease shall be reversed. The carrying amount of the lease shall be adjusted to fair value if required.

### **Step 3 - Restate Comparative Figures for 2009/10 (Investment Property acquired during 2009/10)**

Where an authority has acquired investment property during 2009/10, any revaluations or depreciation charged on investment property held under a lease shall be reversed in line with Step 2. In addition, an authority shall consider whether any investment property acquired during 2009/10 requires its carrying amount to be adjusted to fair value, and whether any investment property under construction requires its carrying amount to be adjusted to fair value.

IAS 40 states that, where an asset is transferred from operational assets to investment property, the asset is revalued to fair value on transfer and the gain or loss is recognised in the Revaluation Reserve; this balance is retained in the Revaluation Reserve until the investment property is derecognised. This requirement shall apply prospectively (i.e. from 1 April 2010), and shall not be applied on transition to IFRS. This arises due to the difficulties in establishing the balance that would be required on the Revaluation Reserve due to the reserve being constituted with a nil balance at 1 April 2007.

## **4.5 Intangible Assets**

### **4.5.1 Introduction**

- 4.5.1.1 Authorities shall account for intangible assets in accordance with *IAS 38 Intangible assets*, except where interpretations or adaptations to fit the public sector are detailed in the Code.
- 4.5.1.2 Intangible assets may be contained in or on a physical substance (e.g. a compact disc for software). Authorities will need to use judgement to determine whether an asset that incorporates both intangible and tangible elements is accounted for as an intangible asset or as property, plant and equipment.
- 4.5.1.3 This section of the Code does not cover financial assets (see chapter 7), intangible assets held for sale in the ordinary course of business (see chapter 5), leases (see chapter 4, section 2), assets arising from employee benefits (see chapter 6) or non current assets classified as held for sale (see chapter 4, section 9).

### **4.5.2 Accounting Requirements**

#### *Definition*

- 4.5.2.1 An intangible asset is an *identifiable* non-monetary asset without physical substance. It must be *controlled* by the authority as a result of past events, and *future economic or service benefits* must be expected to flow from the intangible asset to the authority. The most common class of intangible asset in local authorities is computer software.
- 4.5.2.2 If an item does not meet the definition of an intangible asset (identifiability, control and future economic benefits), expenditure to acquire it or generate it internally is recognised as an expense when it is incurred.

#### *Recognition and Measurement*

- 4.5.2.3 An intangible fixed asset shall be recognised if it is probable that the expected future benefits attributable to the asset will flow to the authority. An intangible asset shall be measured initially at cost.
- 4.5.2.4 Expenditure incurred on an intangible asset after it has been recognised will normally be charged to Surplus or Deficit on provision of services as incurred. Only rarely will subsequent expenditure meet the recognition criteria in the Code. Where this occurs, an authority shall recognise the expenditure in the carrying amount of the intangible asset. Further details can be found in *IAS 38*.
- 4.5.2.5 Paragraphs 33 – 41 of *IAS 38* deal with the acquisition of intangible fixed assets as part of a business combination. These paragraphs do not apply to the single entity accounts of local authorities, as local authorities are deemed to be under common control and therefore outside the scope of *IFRS 3 Business combinations*. Where authorities are reorganised, intangible assets are accounted for using the merger accounting approach rather than the *IFRS 3* approach. Paragraphs 33 - 41 of *IAS 38* may be relevant to an authority's group accounts where acquisitions take place.

### *Government Grants*

- 4.5.2.6 An intangible asset may be acquired (either in full or in part) by way of a government grant or other contribution. Where an authority acquires an intangible asset in this way, both the asset and the grant or contribution shall be recognised initially at fair value. The option within *IAS 20 Accounting for Government Grants and Disclosure of Government Assistance* to recognise the asset at nominal value is not allowed by the Code.

### *Internally Generated Assets*

- 4.5.2.7 *IAS 38* requires strict criteria to be met before an internally generated intangible asset may be recognised. These criteria are met where an authority can demonstrate:

- the technical feasibility of completing the asset so it will be available for use or sale;
- its intention to complete the asset;
- its ability to use or sell the asset;
- how the asset will generate future economic benefits or deliver service benefits (either by demonstrating a market for the asset or the usefulness of the asset);
- the availability of adequate resources to complete the asset; and
- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Provided these criteria are met, an authority may recognise an internally generated intangible asset. The generation of the asset is classified into a research phase and a development phase. The cost of an internally generated intangible asset is the sum of expenditure incurred in the development phase of the project, only after it has become probable that the expected future benefits attributable to the asset will flow to the authority. Further details can be found in *IAS 38*.

### *Development of Web Sites*

- 4.5.2.8 *SIC 32 Intangible Assets - Web Site Costs* applies to the development of web sites. The development of a web site for internal or external use creates an intangible asset where the recognition criteria for internally generated intangible assets are met (see 4.5.2.7).
- 4.5.2.9 To qualify as an internally generated internal asset, an economic or service benefit must arise from the operation of the web site. *SIC 32* states that this cannot be demonstrated for a web site that is solely or primarily intended to promote or advertise an entity's goods or services. For local authorities, a web site whose primary purpose is to provide information about services and objectives does not provide an economic or service benefit. Expenditure on such a web site shall not be recognised as an intangible asset, but shall be charged to Surplus or Deficit on provision of services as it arises.
- 4.5.2.10 The planning of a web site is equivalent to the research phase in 4.5.2.7, and expenditure incurred in planning a web site is expensed as incurred. The development of a web site is equivalent to the development phase in 4.5.2.7, and expenditure incurred in the development of a web site shall be included in the cost

of a web site recognised as an intangible asset. Further details can be found in SIC 32.

*Past Expenses not to be recognised as an Asset*

- 4.5.2.11 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

*Measurement after Recognition*

- 4.5.2.12 *IAS 38* allows an intangible asset to be carried at a revalued amount only where its fair value can be determined by reference to an active market. This is unlikely to apply to the single entity accounts of local authorities, and an intangible asset will therefore normally be carried at its cost less any accumulated amortisation and any accumulated impairment loss.
- 4.5.2.13 Where an active market for an intangible asset exists, an authority shall carry that intangible asset at fair value (less any accumulated depreciation and impairment). Where an intangible asset is carried at fair value, all assets in that class shall be carried at fair value unless there is no active market for an asset. Further details can be found in *IAS 38*.

*Useful Life*

- 4.5.2.14 An authority shall assess whether the useful life of an intangible asset is finite or indefinite, and, if finite, the length of that life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of these rights (unless they can be renewed, when the useful life shall include the renewal period only if there is evidence to support renewal by the authority).

*Amortisation*

- 4.5.2.15 An intangible asset with a finite useful life is amortised; an intangible asset with an indefinite useful life is not.
- 4.5.2.16 The depreciable amount of an intangible asset with a finite useful life shall be amortised on a systematic basis over its useful life, beginning when the intangible asset is available for use. The amortisation method used shall reflect the expected pattern of use of the economic benefits. If the pattern cannot be determined reliably, the straight-line method shall be used. The amortisation period and method shall be reviewed at least at each financial year-end, and the amortisation amended where required.
- 4.5.2.17 The depreciable amount of an intangible asset with a finite life is determined after deducting its residual value; in the single entity accounts of a local authority this residual value will normally be zero.
- 4.5.2.18 An intangible asset with an indefinite life shall not be amortised, but shall be tested for impairment annually, and whenever there is an indication the asset may be impaired. The useful life of the asset shall be reviewed annually. A change to a finite useful life may be an indication that the asset has been impaired.

### *Retirements and Disposals*

- 4.5.2.19 An asset shall be derecognised on disposal or when no future economic benefits are expected from the asset. The gain or loss arising from the derecognition of an intangible asset is the difference between the net disposal proceeds (if any) and the carrying amount of the asset; this gain or loss shall be recognised in Surplus or Deficit on provision of services when the asset is derecognised.

### **4.5.3 Statutory Accounting Requirements**

- 4.5.3.1 Statute and proper practice restrict the use of capital receipts, and prescribe the charges that can be made to the General Fund and Housing Revenue Account. To comply with these restrictions, the gain or loss on the derecognition of an intangible fixed asset shall be reversed out of the General Fund or Housing Revenue Account. The General Fund or Housing Revenue Account shall be debited (in the case of a gain) or credited (in the case of a loss) with an amount equal to the gain or loss on derecognition of the intangible asset. The gain or loss that is reversed out of the General Fund or Housing Revenue Account excludes any costs of disposal which either cannot be capitalised under regulation or statutory guidance, or which the authority has chosen not to capitalise. The double entries are a credit to the Capital Receipts Reserve of an amount equal to the disposal proceeds and a debit to the Capital Adjustment Account equal to the carrying amount of the intangible asset (less any balance transferred from the Government Grants Deferred Account).
- 4.5.3.2 In addition, where the intangible asset was carried at fair value, any balance on the Revaluation Reserve in relation to the intangible asset will need to be transferred to the Capital Adjustment Account. The entries required are debit Revaluation Reserve, credit Capital Adjustment Account.
- 4.5.3.3 These entries will be reflected in the Movement in Reserves Statement.
- 4.5.3.4 General Fund service revenue accounts, central support services, trading accounts and the Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice*) shall be charged with a provision for amortisation and, where required, any related impairment loss (in excess of any balance on the Revaluation Reserve in relation to an intangible asset), for all intangible assets used in the provision of the service.
- 4.5.3.5 The reversal of an impairment loss on an intangible asset is only permitted to be recognised in the limited circumstance that the increase in value is attributable to the unexpected reversal of the external event that caused the original impairment to be recognised (see 4.7.17).
- 4.5.3.6 Under regulations and statutory guidance [add footnote to relevant legislation], amortisation and impairment charged to Surplus or Deficit on provision of services are not proper charges to the General Fund or Housing Revenue Account. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.
- 4.5.3.7 Minimum Revenue Provision (England and Wales) and Loans Fund Charges (Scotland and Northern Ireland) are proper charges to the General Fund, but do not appear in Surplus or Deficit on provision of services. Such amounts shall be

transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or Loans Fund Charges to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance.

#### **4.5.4 Disclosure Requirements**

4.5.4.1 Disclosure of accounting policies in relation to intangible assets is required (see section 3.4).

4.5.4.2 Having regard to paragraph 3.5.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to intangible assets:

- (1) An authority shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:
  - (a) whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used;
  - (b) the amortisation methods used for intangible assets with finite useful lives;
  - (c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period;
  - (d) the line item(s) of the income statement in which any amortisation of intangible assets is included;
  - (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
    - (i) additions, indicating separately those from internal development, those acquired separately, and those acquired through business combinations;
    - (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with chapter 4 section 9 and other disposals;
    - (iii) increases or decreases during the period resulting from revaluations in accordance with chapter 4 section 5 and from impairment losses recognised in or reversed in Other Comprehensive Income or Expenditure and taken to the Revaluation Reserve in accordance with chapter 4 section 7 (if any);
    - (iv) impairment losses recognised in Surplus or Deficit on provision of services during the period in accordance with chapter 4 section 7 (if any);
    - (v) impairment losses reversed in Surplus or Deficit on provision of services during the period in accordance with chapter 4 section 7 (if any);
    - (vi) any amortisation recognised during the period; and
    - (viii) other changes.
- (2) In accordance with chapter 3 section 4 an authority discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For intangible assets, such disclosure may arise from changes in estimates with respect to:
  - (a) residual values;

- (b) an assessment of an intangible asset's useful life; and
  - (c) amortisation methods.
- (3) For an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the authority shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.
- (4) A description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the authority's financial statements.
- (5) The amount of contractual commitments for the acquisition of intangible assets.
- (6) If intangible assets are accounted for at revalued amounts, an authority shall disclose the following:
- (a) by class of intangible assets:
    - (i) the effective date of the revaluation;
    - (ii) the carrying amount of revalued intangible assets; and
    - (iii) the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model;
  - (b) the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders; and
  - (c) the methods and significant assumptions applied in estimating the assets' fair values.
- (7) For intangible assets acquired by way of a government grant and initially recognised at fair value (for example Landfill Allowance Trading Scheme allowances):
- (a) the fair value initially recognised for these assets;
  - (b) their carrying amount; and
  - (c) whether they are measured after recognition under the cost model or the revaluation model.

#### **4.5.5 Statutory Disclosure Requirements**

4.5.5.1 There are no statutory disclosures required in relation to intangible assets.

#### **4.5.6 Changes since SORP 2009**

4.5.6.1 Following FRS 10, the SORP 2009 stated that internally developed intangible assets shall only be capitalised where there was a readily ascertainable market value, which was unlikely to occur in local authorities. *IAS 38* recognises a wider range of intangible assets, and internally generated intangible assets may be recognised provided the criteria in *IAS 38* are met.

4.5.6.2 The SORP 2009 stated that there was a rebuttable presumption that the economic lives of intangible assets are limited to periods of 20 years or less. No such presumption is now made.

4.5.6.3 The SORP required impairment arising from the consumption of economic benefits to be charged to the Income and Expenditure Account in all cases. All impairments are now taken to the Revaluation Reserve in the first instance, and will only be

charged to Surplus or Deficit on provision of services once the balance on the reserve in relation to the intangible asset has been reduced to zero.

## **Transition arrangements**

The Code (following IFRS 1) requires local authorities to recognise, in their opening IFRS balance sheet (1 April 2009), all intangible assets whose recognition is required by section 4.5 of the Code (see also IAS 38). Intangible assets shall not be recognised where section 4.5 of the Code does not permit such recognition. Authorities are also required to apply section 4.5 of the Code in measuring all recognised intangible assets.

Any intangible asset that has previously been recognised under the provisions of the SORP will meet the recognition criteria in paragraphs 4.5.2.3 - 4.5.2.4 of the Code. Authorities shall therefore continue to recognise all intangible assets that were previously recognised on their balance sheet. In local authorities, intangible assets will normally have been carried at depreciated historical cost, and the depreciated historical cost of an intangible asset on the opening IFRS balance sheet shall be the depreciated historical cost of that asset as at 31 March 2009.

Because section 4.5 of the Code (following IAS 38) recognises a wider range of intangible assets than the 2009 SORP, it is possible that expenditure in previous years that could have been recognised as an intangible asset had the Code applied at the time was not so recognised under the SORP, but was charged to the Income and Expenditure Account (and therefore to the General Fund). Such expenditure may be recognised as an intangible asset in the opening IFRS balance sheet if, and only if, the recognition criteria in paragraphs 4.5.2.3 - 4.5.2.4 (and 4.5.2.7 for internally generated intangible assets) would have been met at the time the expenditure was incurred. For internally generated intangible assets, this means that an authority, at the time the expenditure was incurred, distinguished between the research and development phases of the generation of an intangible asset, and was able to reliably measure the costs of each phase.

## **4.6 Revenue Expenditure Funded from Capital under Statute**

### **4.6.1 Introduction**

4.6.1.1 Legislation allows some items to be funded from capital resources that under IFRS and normal accounting practice would be charged to Surplus or Deficit on provision of services. This section of the Code defines the accounting arrangements for these items.

### **4.6.2 Accounting Requirements**

4.6.2.1 Revenue expenditure funded from capital under statute shall be accounted for in accordance with proper practice under the rest of the Code, and effect shall be given to the statutory requirements by making the adjustments set out in 4.6.3 below. No IFRS or IAS deals with these items as they are a statutory departure from normal accounting practice.

### **4.6.3 Statutory Accounting Requirements**

4.6.3.1 Legislation in England and Wales allows some expenditure to be classified as capital for funding purposes when it does not result in the expenditure being carried on the balance sheet as a fixed asset. The purpose of this is to enable it to be funded from capital resources rather than be charged to the General Fund and impact on that year's council tax. These items are generally grants and expenditure on property not owned by the authority, and amounts directed under section 16(2) of Part 1 of the Local Government Act 2003.

4.6.3.2 Similarly, there is also legislative provision in Scotland for certain grants to community bodies to be funded from capital resources with the agreement of the Scottish Government.

4.6.3.3 Such expenditure shall be charged to Surplus or Deficit on provision of services in accordance with the general provisions of the Code. Any statutory provision that allows capital resources to meet the expenditure shall be accounted for by debiting the Capital Adjustment Account and crediting the General Fund Balance and showing as a reconciling item in the Movement in Reserves Statement.

### **4.6.4 Disclosure Requirements**

4.6.4.1 Disclosure of items charged to Surplus or Deficit on provision of services shall follow the general provisions of the Code.

### **4.6.5 Statutory Disclosure Requirements**

4.6.5.1 Disclosure of accounting policies in relation to revenue expenditure funded from capital under statute is required (see section 3.4). Further information relating to revenue expenditure funded from capital under statute shall be disclosed in the notes to the accounts (see section 3.10).

### **4.6.6 Changes since SORP 2009**

4.6.6.1 There have been no changes in accounting for revenue expenditure funded from capital under statute since SORP 2009.

### **Transition Arrangements**

There are expected to be no transition issues arising from Revenue Expenditure Funded from Capital Under Statute.

## **4.7 Impairment of Assets**

### **4.7.1 Introduction**

4.7.1.1 Authorities shall account for impairments in accordance with *IAS 36 Impairment of Assets*, except where interpretations or adaptations to fit the public sector are detailed in the Code. The objective of the standard is to ensure that assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the recognition of an impairment loss. Downward revaluations resulting from changes in market value do not necessarily result in impairment.

4.7.1.2 *IPSAS 21 Impairment of Non-cash Generating Assets and IPSAS 26 Impairment of Cash-Generating Assets* are based on *IAS 36*, and introduce no additional accounting requirements, although they provide additional guidance for public sector bodies. Assets falling under the definition of Cash-Generating Assets (i.e. assets held for the primary objectives of generating a commercial return) may not be common within local authorities. Where authorities deem they have assets under this definition they should refer to *IAS 36* and *IPSAS 26* in relation to impairment.

4.7.1.3 This section of the Code does not cover impairment of assets in relation to; employee benefits (see chapter 6), financial instruments (see chapter 7), investment property (see chapter 4 section 4), insurance contracts (see Appendix A paragraph A.1.7, non current assets classified as held for sale (see chapter 4 section 9), inventories (see chapter 5 section 1) and construction contracts (see chapter 5 section 2).

4.7.1.4 *IAS 36 Impairment of Assets* applies to financial assets classified as subsidiaries, associates and joint ventures (see chapter 9).

#### *Interpretation for the Public Sector Context*

4.7.1.5 The following interpretations of *IAS 36* (as defined in *IPSAS 21*) for the public sector context apply.

Recognition and measurement;

- Where an asset is not held for the purpose of generating cash flows, *value in use* is assumed to equal the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential.

### **4.7.2 Accounting Requirements**

#### *Definitions*

4.7.2.1 *Impairment loss* is the amount by which the carrying amount of an asset exceeds its recoverable amount.

4.7.2.2 *Carrying amount* is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

- 4.7.2.3 *Recoverable amount* of an asset is the higher of fair value less costs to sell (i.e. net selling price) and its value in use.
- 4.7.2.4 *Fair value less costs to sell* is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal.
- 4.7.2.5 *Historical cost* is deemed to be the carrying amount of an asset as at 1<sup>st</sup> April 2007 (i.e. b/f from 31<sup>st</sup> March 2007) or at the date of acquisition, whichever date is the later, and adjusted for subsequent depreciation or impairment (if applicable).
- 4.7.2.6 *Value in use* of a non-cash-generating asset is the present value of the asset's remaining service potential. *Value in use* of a cash-generating asset is the present value of the future cash flows expected to be derived from an asset.
- 4.7.2.7 Further definitions, including definitions of active market, cost of disposal and useful life are contained in *IAS 36, IPSAS 21 and IPSAS 26*.
- 4.7.2.8 *IAS 36* refers to cash-generating units; this definition may not be relevant to local authorities in the majority of cases. Where authorities deem they have assets under this definition they should refer to *IAS 36 and IPSAS 26*.

#### *When to Assess for Impairment*

- 4.7.2.9 At the end of each reporting period an assessment shall take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount shall be estimated having regard to the application of the concept of materiality in identifying whether the recoverable amount of an asset needs to be estimated. If no indication of an impairment loss is present the Code does not require a formal estimate of recoverable amount, with the exception of intangible assets.
- 4.7.2.10 An intangible asset with an indefinite useful life or not yet available for use shall be assessed annually at any time during the year, irrespective of whether there is any indication that it may be impaired.

#### *Examples of Impairments*

- 4.7.2.11 Examples of events and changes in circumstances that indicate an impairment may have incurred include (this list is not intended to be exhaustive):
- a significant decline (i.e. more than expected as a result of the passage of time or normal use) in an asset's market value during the period;
  - evidence of obsolescence or physical damage of an asset;
  - a commitment by the authority to undertake a significant reorganisation; and
  - a significant adverse change in the statutory or other regulatory environment in which the authority operates.

- 4.7.2.12 If there is an indication that an asset may be impaired, this could indicate that the useful life, the depreciation method or the residual value need to be reviewed, even if no impairment loss is recognised.

*Recognition of Impairment*

- 4.7.2.13 Impairment shall be recognised on assets carried at a re-valued amount and historical cost.
- 4.7.2.14 An impairment loss on a re-valued asset shall be recognised in the Revaluation Reserve (these entries will be reflected in the Movement in Reserves Statement) to the extent that the impairment does not exceed the amount in the Revaluation Reserve for the same asset (i.e. up to the historical cost of the asset) and thereafter in Surplus or Deficit on provision of services.
- 4.7.2.15 An impairment loss on a non-revalued asset (i.e. an asset with a carrying value based on historical cost) shall be recognised in Surplus or Deficit on provision of services.

*Reversing an Impairment*

- 4.7.2.16 At the end of each reporting period an assessment shall take place as to whether there is any indication that an impairment loss recognised in earlier periods for an asset may no longer exist or have decreased. If any such indication exists, authorities shall estimate the recoverable amount of that asset.
- 4.7.2.17 The reversal of an impairment loss of an asset (previously recognised in Surplus or Deficit on provision of services) is only permitted to be recognised in the limited circumstance that the increase in value is attributable to the unexpected reversal of the external event that caused the original impairment to be recognised. Indications of the potential decrease of an impairment loss mainly mirror (but are not limited to) the indications of a potential impairment loss set out in paragraph 4.7.2.11.
- 4.7.2.18 If there is an indication that the impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the useful life, the depreciation method or the residue value need to be reviewed, even if no impairment loss is reversed for the asset.
- 4.7.2.19 The reversal of an impairment loss previously recognised in Surplus or Deficit on provision of services shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. Any excess above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years shall be treated as a revaluation gain and charged to the Revaluation Reserve.
- 4.7.2.20 The Code does not allow the reversal of an impairment loss for goodwill. Goodwill may not be relevant to local authorities in the majority of cases. Where authorities conclude they have assets under this definition they shall refer to *IAS 36*.

### **4.7.3 Statutory Accounting Requirements**

- 4.7.3.1 General Fund service revenue accounts, central support services, trading accounts and the Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice*) shall be charged with an impairment loss (in excess of any balance on the Revaluation Reserve) and reversal of an impairment loss (net of amortisation or depreciation).
- 4.7.3.2 Under regulations and statutory guidance [add footnote to relevant legislation], impairment loss and reversal of impairment loss charged to Surplus or Deficit on provision of services are not proper charges to the General Fund or Housing Revenue Account. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

### **4.7.4 Disclosure Requirements**

- 4.7.4.1 Disclosure of accounting policies in relation to impairments of assets is required (see section 3.4).
- 4.7.4.2 Having regard to paragraph 3.5.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to impairment of assets:
- (1) An authority shall disclose the following for each class of assets:
    - (a) the amount of impairment losses recognised in Surplus or Deficit on provision of services, during the period in which those impairment losses are included.
    - (b) the amount of reversals of impairment losses recognised in Surplus or Deficit on provision of services, during the period in which those impairment losses are reversed.
    - (c) the amount of impairment losses on revalued assets recognised in Other Comprehensive Income and Expenditure and taken to the Revaluation Reserve during the period.
    - (d) the amount of reversals of impairment losses on revalued assets recognised in Other Comprehensive Income and Expenditure and taken to the Revaluation Reserve during the period.
  - (2) An authority shall disclose the following for each material impairment loss recognised or reversed during the period for an individual asset:
    - (a) the events and circumstances that led to the recognition or reversal of the impairment loss.
    - (b) the amount of the impairment loss recognised or reversed.
    - (c) for an individual asset:
      - (i) the nature of the asset; and
      - (ii) the reportable segment to which the asset belongs, in line with the format of segmental reporting in chapter 3 section 4.
      - (iii) Whether the recoverable amount of the asset is its fair value less costs to sell or its value in use.
      - (iv) If the recoverable service amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market).
      - (v) If the recoverable service amount is value in use, the approach used to determine value in use.

- (3) Cash-generating units containing goodwill or intangible assets with indefinite useful lives, may not be relevant to authorities in the majority of cases. Where authorities deem they have assets under this definition they should refer to *IAS 36* for disclosures).

#### **4.7.5 Statutory Disclosure Requirements**

- 4.7.5.1 There are no statutory disclosures required in relation to impairments.

#### **4.7.6 Changes since SORP 2009**

- 4.7.6.1 The Code requires that an annual assessment shall take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount shall be estimated. There is no longer a specific requirement to undertake an impairment assessment of assets when either; (a) no depreciation charge is made on the grounds that it would be immaterial (either because of the length of the estimated remaining useful life or because the estimated residual value of the fixed asset is not materially different from the carrying amount of the asset), or (b) the estimated remaining useful life of the fixed asset exceeds 50 years. In addition *IAS 36* does not exempt non-depreciable land from impairment reviews.
- 4.7.6.2 *IAS 36* makes no distinction between impairments due to the clear consumption of economic benefit and other impairments (i.e. general fall in prices). In line with *IAS 36*, the Code requires all impairment losses on re-valued assets to be recognised in the Revaluation Reserve up to the amount in the Revaluation Reserve for each respective asset. The SORP 2009 required an impairment loss due to the clear consumption of economic benefits on a re-valued asset to be recognised in Surplus or Deficit on provision of services, (previously called the Income and Expenditure Account). As a result of this change the accounting entry between the Revaluation Reserve and the Capital Adjustment Account to reflect the difference between impairment based on historical cost and the re-valued amount, is no longer required.
- 4.7.6.3 The events or circumstances that indicate that a previous impairment can be reversed are the same for both intangible and tangible assets under *IAS 36*. In contrast *FRS 11* set out the events or circumstances separately for intangible and tangible fixed assets.

## **Transition arrangements – Impairment of Assets**

### **Step 1 - Restate Opening IFRS Balance Sheet as at 1 April 2009**

The Code (following *IFRS 1*) requires local authorities to classify and account for impairments in their opening IFRS balance sheet (1 April 2009) in accordance with section 4.7 of the Code (see also *IAS 36* and *IPSAS 21 and 26*). Accounting for Impairment of Assets following *IAS 36* is a change of accounting policy that will require authorities to restate their opening balances in respect of Impairment. *IAS 36* requires all impairments, including the term referred to in the SORP as 'clear consumption of economic benefits', on re-valued assets to be recognised in the Revaluation Reserve up to the amount in the Revaluation Reserve for each respective asset and thereafter recognised in Surplus or Deficit on provision of services, (previously called the Income and Expenditure Account).

No adjustments are required to authorities' opening balance sheet in relation to impairments as the 2009 SORP required an adjustment between the Revaluation Reserve and the Capital Adjustment Account that matches the adjustment that would otherwise be required on transition to the IFRS-based Code.

### **Step 2 - Restate Comparative Figures for 2009/10**

Although in step 1 it was not necessary to restate the opening sheet position as at 1 April 2009, it may be necessary to restate comparative figures for 2009/10 in relation to impairments classed 'consumption of economic benefit' under the SORP and any associated reversals, that were recognised in the Income and Expenditure Account on a previously re-valued asset.

#### *Impairment due to Clear Consumption of Economic Benefit*

Where an impairment loss due to the clear consumption of economic benefits on a re-valued asset has been charged to the Income & Expenditure Account in 2009/10, the charge to the service revenue account, trading account, support service or non-distributed cost shall be reduced to the amount of the impairment loss that takes the carrying amount below historical cost<sup>5</sup>, with the corresponding entry reducing the Revaluation Reserve.

Further entries will be required to reverse the entry within General Fund/HRA that was required by statute to negate the impact on General Fund / HRA Balances and the corresponding entry in the Capital Adjustment Account, together with the reversal of the original entries associated with writing down the balance on the Revaluation Reserve to the Capital Adjustment Account with regard to the impairment based on re-valued amounts.

#### *Reversal of Impairment Loss due to Clear Consumption of Economic Benefit*

Where a reversal of a previous impairment loss due to the clear consumption of economic benefit on a re-valued asset has been credited to the Income & Expenditure Account in 2009/10, it may be necessary to restate comparative figures for 2009/10 in relation to this reversal. This restatement will only be required when the original impairment loss was based on a previous re-valued asset and the subsequent gain is in excess of the historical

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<sup>5</sup> Historical cost is referred to throughout this section and is deemed to be the carrying amount of an asset as at 1<sup>st</sup> April 2007 (i.e. b/f from 31<sup>st</sup> March 2007) or at the date of acquisition, whichever date is the later, and adjusted for subsequent depreciation or impairment (if applicable)

cost as it would have been without the original impairment (adjusted for depreciation that would have been applied).

Further entries will be required to reverse the entry within General Fund/HRA that was required by statute to negate the impact on General Fund Balances of the impairment reversal and corresponding entry in the Capital Adjustment Account, together with the original entries associated with the reinstatement of the balance on the Revaluation Reserve from the Capital Adjustment Account with regard to the impairment based on re-valued amounts.

**4.8 Borrowing Costs**

**4.8.1 To be determined – see Invitation to Comment**

## 4.9 Non-current Assets Held for Sale and Discontinued Operations

### 4.9.1 Introduction

4.9.1.1 Authorities shall account for assets held for sale and present and disclose discontinued operations in accordance with *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*, except where interpretations or adaptations to fit the public sector are detailed in the Code. The Standard specifies that:

- assets held for sale should be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on those assets should cease; and
- assets held for sale should be presented separately, on the face of the balance sheet, and the results of discontinued operations should be presented separately in Surplus or Deficit on provision of services and Balance Sheet.

4.9.1.2 The classification and presentation requirements of this section of the Code (also see *IFRS 5*) apply to all recognised non-current assets and to all disposal groups of an authority that are to be sold and such assets are excluded from the scope of chapter 4 section 1 of the Code (also see *IAS 16*) and chapter 4 section 5 (also see *IAS 38*).

4.9.1.3 This section of the Code does not cover the measurement of assets in relation to; employee benefits (see chapter 6), financial instruments (see chapter 7), investment property (see chapter 4 section 4) and insurance contracts (see chapter 7 section 5). *IFRS 5* also refers to other areas where the Standard does not apply in terms of measurement however, these areas may not be common, if relevant at all within authorities i.e. deferred tax assets and agriculture. Authorities should refer to *IFRS 5* for these areas.

4.9.1.4 Assets held for sale shall not be reclassified as current assets from non-current assets or classified immediately as current assets in line with chapter 3 of the Code (also see *IAS 1 Presentation of Financial Statements*), unless they meet the criteria to be classified as held for sale in accordance with this section of the Code.

#### *Adaptation and Interpretation for the Public Sector Context*

4.9.1.5 The following interpretations of *IFRS 5* for the public sector context apply.

Recognition and measurement;

- Where an asset is not held for the purpose of generating cash flows, *value in use* is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.
- In order to qualify as 'discontinued operations', the activities must cease completely: that is, responsibilities transferred from one part of the public sector to another (such as machinery of government changes) are not discontinued operations

Definition;

- For this section of the Code, fair value is to be interpreted as the amount that would be paid for the asset in its highest and best use, ie market.

#### **4.9.2 Accounting Requirements**

##### *Definitions*

- 4.9.2.1 *Costs to sell* is the incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs.
- 4.9.2.2 *Current asset* is an asset that is intended to be sold within the normal operating cycle, the asset is held primarily for the purpose of trading or the authority expects to realise the asset within twelve months after the reporting date.
- 4.9.2.3 *Discontinued operation* is an activity of an authority that must cease completely: that is, responsibilities transferred from one part of the public sector to another are not discontinued operations.
- 4.9.2.4 *Disposal group* is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.
- 4.9.2.5 *Fair value* is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arms length transaction. For this section of the Code, fair value is to be interpreted as the amount that would be paid for the asset in its highest and best use, ie market.
- 4.9.2.6 *Historical Cost* is deemed to be the carrying amount of an asset as at 1st April 2007 (i.e. b/f from 31st March 2007) or at the date of acquisition, which ever date is the later, and adjusted for subsequent depreciation or impairment (if applicable).
- 4.9.2.7 *Non-current asset* is an asset that does not meet the definition of a current asset.
- 4.9.2.8 *Recoverable amount* of an asset is the higher of fair value less costs to sell (i.e. net selling price) and its value in use.
- 4.9.2.9 *Value in use* of a non-cash-generating asset is the present value of the asset's remaining service potential. *Value in use* of a cash-generating asset is the present value of the future cash flows expected to be derived from an asset.
- 4.9.2.10 Further definitions, including the definition of firm purchase commitment are contained in *IFRS 5*.

##### *Classification of Non-current Assets (or disposal groups) as Held for Sale*

- 4.9.2.11 An authority shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continued use.

- 4.9.2.12 The following criteria have to be met before an asset can be classified as held for sale under this section of the Code:
- The asset (or disposal group) must be available for immediate sale in its present condition subject to terms that are usual and customary for sales of such assets (or disposal groups)
  - The sale must be highly probable; the appropriate level of management must be committed to a plan to sell the asset (or disposal group) and an active programme to locate a buyer and complete the plan must have been initiated
  - The asset (or disposal group) must be actively marketed for a sale at a price that is reasonable in relation to its current fair value
  - The sale should be expected to qualify for recognition as a completed sale within one year<sup>6</sup> from the date of classification and action required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn
- 4.9.2.13 If all the above criteria are not met the asset shall continue to be accounted for in accordance with the relevant section of the Code i.e. chapter 4 section 1 and chapter 4 section 5.
- 4.9.2.14 Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance in accordance with chapter 4 section 1 of the Code (also see *IAS 16 property, plant and equipment*).
- 4.9.2.15 If after the reporting period but before authorising of the financial statements (see chapter 3 section 8, events after the balance sheet), the criteria for recognition are met, as set out in paragraph 4.9.2.12, authorities shall disclose the information within the notes to the accounts, as set out in sub-section 4.9.4.
- 4.9.2.16 Assets that are to be abandoned or scrapped shall not be classified under this section of the Code. This is because the carrying amount of such assets will not be recovered from 'sale' but from continued use up to the point of being scrapped or abandoned.

*Measurement of Non-current Assets (excluding disposal groups) Classified as Held for Sale*

- 4.9.2.17 Authorities shall measure a non-current asset classified as held for sale at the lower of its carrying value and fair value less costs to sell.
- 4.9.2.18 When the sale is expected to occur beyond one year, authorities shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time represents the unwinding of the discounting and shall be presented in Surplus or Deficit on provision of services as a financing cost.

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<sup>6</sup> Events or circumstances may extend the period to complete the sale beyond one year, for example the delay in the completion of the sale is beyond the authority's control and there is sufficient evidence that the authority remains committed to the plan to sell the asset (or disposal group). Further information regarding the 'extension of the period required to complete the sale' is given in Appendix B of *IFRS 5*

- 4.9.2.19 Immediately before the initial classification of an asset as held for sale, the carrying amount of the asset shall be measured in accordance with the relevant section of the Code. On the initial reclassification of the asset to held for sale or subsequently, an authority shall recognise an impairment loss on a write-down to fair value less costs to sell (if required).
- 4.9.2.20 Authorities shall recognise a revaluation gain for any subsequent increase in fair value less costs to sell an asset following reclassification, but not in excess of the cumulative impairment loss or revaluation loss that has been recognised under this section of the Code or previously in accordance with chapter 4 section 7 or chapter 4 section 1 of the Code.
- 4.9.2.21 An authority that is committed to a sale plan involving loss of control of a subsidiary (see chapter 9) shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraph 4.9.2.12 are met, regardless of whether the authority will retain a minority interest in its former subsidiary after the sale.
- 4.9.2.22 An authority that is committed to a sale plan involving loss of control of a subsidiary (see section 10) shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraph 4.9.2.12 are met, regardless of whether the authority will retain a minority interest in its former subsidiary after the sale.

*Measurement of Disposal Groups Classified as Held for Sale*

- 4.9.2.23 Where authorities deem they have a disposal group they should refer to *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*.

*Depreciation*

- 4.9.2.24 A non-current asset (or disposal group) classified as held for sale shall not be depreciated (or amortised in relation to intangible assets).

*Derecognition*

- 4.9.2.25 A gain or loss not previously recognised by the date of sale of a non-current assets (or disposal group) shall be recognised in Surplus or Deficit on provision of services as part of the gain or loss on disposal at the date of derecognition. The requirements relating to derecognition including accounting for gains or losses on disposal are set out in chapter 4 section 1 of the Code in relation to property, plant and equipment and chapter 4 section 5 of the Code in relation to intangible assets.

*Changes to a Plan of Sale*

- 4.9.2.26 If the criteria in paragraph 4.9.2.12 are no longer met, the authority shall cease to classify the asset (or disposal group) as held for sale and shall value the asset at the lower of:
- Its carrying amount before the asset (or disposal group) was classified as held for sale; adjusted for depreciation, amortisation or revaluations that

would have been recognised had the asset (or disposal group) not been classified as held for sale, and

- Its recoverable amount at the date of the decision not to sell

4.9.2.27 For an asset previously carried at historical cost (in accordance with chapter 4 section 1; property, plant and equipment and section 5; intangible assets) before classification as held for sale, any adjustment to the carrying amount arising from paragraph 4.9.2.26 above shall be recognised in Surplus or Deficit on provision of services, in the period that the criteria are no longer met.

4.9.2.28 For an asset previously carried at a re-valued amount (in accordance with chapter 4 section 1 and section 5) before classification as held for sale, any adjustment to the carrying amount arising from paragraph 4.9.2.26 shall be treated as a revaluation increase or decrease and recognised in the Revaluation Reserve in the period that the criteria are no longer met.

4.9.2.29 The measurement of a disposal group where an individual asset or liability is removed is not expected to be common for authorities. Where authorities deem they have this occurrence they should refer to *IFRS 5*.

#### *Presentation of Discontinued Operations*

4.9.2.30 Where an authority deems it has a transaction(s) that meets the definition of a discontinued operation, it shall present this transaction(s) separately on the face of the Comprehensive Income and Expenditure Statement and Balance Sheet.

4.9.2.31 Prior periods presented in the financial statements shall be restated for discontinued operations, so that the current and prior periods relate to all operations that have been discontinued by the end of the reporting period being presented. Where an authority ceases to classify a transaction as a discontinued operation the transaction, including prior periods, shall be reclassified as continued operations.

### **4.9.3 Statutory Accounting Requirements**

#### *Derecognition*

4.9.3.1 The statutory accounting requirements in relation to the treatment of gains or losses on disposal are set out in chapter 4 section 1 of the Code in relation to property, plant and equipment and chapter 4 section 5 of the Code in relation to intangible assets.

#### *Re-measurement of Carrying Amounts*

4.9.3.2 In some instances General Fund accounts, central support services, trading accounts and the Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice*) shall be charged with the re-measurement of an asset's carrying amount (i.e. before/ subsequent classification as held for sale and changes to a plan of sale).

4.9.3.3 Under regulations and statutory guidance [add footnote to relevant legislation], adjustments to the carrying amount of an asset that have been charged to

Surplus or Deficit on provision of services are not proper charges to the General Fund or Housing Revenue Account. Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

#### **4.9.4 Disclosure Requirements**

4.9.4.1 Disclosure of accounting policies in relation to non-current assets held for sale and discontinued operations is required (see section 3.4 of the Code).

4.9.4.2 Having regard to paragraph 3.5.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to non-current assets held for sale and discontinued operations:

(1) An authority shall disclose the following information in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

(a) the breakdown of the gain or loss recognised in accordance with this section of the Code and, separately presented on the face of the Comprehensive Income and Expenditure Statement.

#### **4.9.5 Statutory Disclosure Requirements**

4.9.5.1 There are no statutory disclosures required in relation to non-current assets held for sale and discontinued operations.

#### **4.9.6 Changes since SORP 2009**

4.9.6.1 The Code requires an authority to measure an asset classified as held for sale at the lower of its carrying value and fair value less costs to sell. Where the carrying amount is lower, this will lead to a different valuation when compared to the valuation under the SORP which required the asset to be measured at market value less expected selling costs. This change will potentially result in more profits being recognised in an authority's Comprehensive Income and Expenditure Statement .

4.9.6.2 The SORP does not include any criteria that an authority has to meet in order to classify an asset as held for sale. In contrast this section of the Code sets out strict criteria (see paragraph 4.9.2.12), all of which have to be met before an authority can classify an asset as held for sale.

4.9.6.3 The classification of asset held for sale are categorised within the fixed asset heading under the SORP. Under this section of the Code, assets held for sale that satisfy the definition of current assets, shall be classified under this heading within the balance sheet.

4.9.6.4 When the sale is expected to occur beyond one year, authorities shall measure the cost to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in the Comprehensive Income and Expenditure Statement as a financing cost. The SORP does not require the costs to sell to be measure at their present value where sale is expected to occur beyond one year.

- 4.9.6.5 A non-current asset (or disposal group) classified as held for sale shall not be depreciated (or amortised in relation to intangible assets). The SORP states that assets held for sale are not exempt from depreciation.
- 4.9.6.6 The asset classification; 'surplus assets held for disposal' within the SORP has been replaced by 'assets held for sale' (see section 4.9 of the Code).
- 4.9.6.7 The Code introduces the concept of a 'disposal group' in relation to assets that are to be grouped and sold in a single transaction.
- 4.9.6.8 Following reclassification, the subsequent amount of revaluation gains arising from an increase in fair value less costs to sell an asset, were not limited under the SORP. In contrast under the Code any subsequent gains are recognised but not in excess of the cumulative impairment loss or revaluation loss that has been recognised under this section of the Code or previously in accordance with chapter 4 section 7 or chapter 4 section 1 of the Code.
- 4.9.6.9 The definition of discontinued operations within the SORP and associated guidance notes encompasses local government reorganisation. In contrast the definition within the Code does not include local government reorganisation since any 'machinery of government changes' are not discontinued operations. However, authorities are encouraged to separately identify the amounts associated with local government reorganisation, on the face of the financial statements to enable users of the financial statements to evaluate the financial effects of the reorganisation. The Code requires prior periods to be restated for discontinued operations, so that the current and prior periods relate to all operations that have been discontinued by the end of the reporting period being presented. The restatement of prior periods is not required by the SORP.

## **Transition arrangements – Non-current Assets Held for Sale and Discontinued Operations**

There is not expected to be any transition issues arising from discontinued operations.

The impact on transition of re-measuring costs to sell at their present value where sale is expected beyond one year is not expected to be common and will only be required where material. Where authorities deem that the re-measurement of costs to sell is required, and the present value of costs to sell increase from a passage of time (representing the unwinding of the discount) it will be necessary to reduce the carrying amount of the asset and show the corresponding entry as a financing cost in Surplus or Deficit on provision of services.

Where assets meet the criteria to be classified as held for sale they shall be treated as either non-current assets or current assets dependent on meeting the respective definitions.

### **Step 1 - Restate Opening IFRS Balance Sheet as at 1 April 2009 (assets classified as held for sale prior to 1 April 2009)**

The Code (following *IFRS 1*) requires authorities to classify and account for Non-current Assets Held for Sale in their opening IFRS balance sheet (1 April 2009) in accordance with chapter 4 section 9 of the Code (see also *IFRS 5*). In accordance with *IFRS 1 First Time Adoption of IFRS* the exemption of applying *IFRS 5* prospectively (as opposed to retrospectively) is not permitted because the date of transition for authorities is after 1 January 2005. Accounting for Non-current Assets Held for Sale following chapter 4 section 9 of the Code is a change of accounting policy that will require authorities to restate their opening balances in respect of Non-current Assets Held for Sale.

The opening balance sheet (1 April 2009) will need to be restated for assets classified as held for sale prior to 1 April 2009.

In the event that the criteria under chapter 4 section 9 of the Code have not been met as at 31 March 2009, authorities shall reclassify the assets held for sale to non-current assets (under the previous asset classification) and adjust the carrying amount of the asset to the level it would have been as at 1 April 2009 before the asset was classified as held for sale.

In the event that the criteria under chapter 4 section 9 of the Code have been met as at 31 March 2009, authorities shall reclassify surplus assets held for disposal to the classification of non-current assets held for sale, reinstate the carrying amount where this amount is lower than fair value, and reverse the depreciation that would have been charged after the asset has been classified to surplus assets held for disposal. Further entries will be required where any subsequent revaluation gains have been recognised following reclassification that are in excess of cumulative impairment losses recognised under chapter 4 section 9 of the Code or previously under chapter 4 section 7 of the Code.

### **Step 2 - Restate Comparative Figures for 2009/10 (assets classified as held for sale prior to 1 April 2009)**

Transactions during 2009/10 in relation to assets classified as held for sale that have not been sold as at 31 March 2010, will need to be restated in line with the Code. The required transactions will lead on from the adjustments carried out in step 1.

In the event that the criteria under chapter 4 section 9 of the Code have not been met as at 31 March 2010, authorities shall reverse the depreciation charge following reclassification to held for sale and if applicable reinstate the depreciation charge and any depreciation adjustment that would have been charged if the original reclassification to Surplus Assets held for Disposal had not taken place.

In the event that the criteria under chapter 4 section 9 of the Code have been met as at 31 March 2010, authorities shall reverse the depreciation and depreciation adjustment that would have been charged after the asset has been classified to surplus assets held for disposal.

Transactions during 2009/10 in relation to assets classified as held for sale that have been sold as at 31 March 2010, will need to be restated in line with the Code in the event of the restatement of the opening balance, where the carrying amount is lower than fair value, as carried out in step 1.

In the event that the carrying amount of an asset that has been sold is lower than the fair value less costs to sell, authorities shall reverse the derecognition of the asset and derecognise the carrying amount of the asset reflecting the revised gain or loss in Surplus or Deficit on provision of services.

### **Step 3 - Restate Comparative Figures for 2009/10 (assets classified as held for sale during 2009/10)**

Transactions in relation to assets classified as held for sale during 2009/10, that have not been sold as at 31 March 2010 will need to be restated in line with the Code.

In the event that the criteria under chapter 4 section 9 of the Code have not been met as at 31 March 2010, authorities shall reclassify the assets held for sale to Non-current Assets (under the previous asset classification) and adjust the carrying amount of the asset to the level it would have been before the asset was classified as held for sale.

In the event that the criteria under chapter 4 section 9 of the Code have been met as at 31 March 2010, authorities shall reclassify surplus assets held for disposal to the classification of non-current assets held for sale, reinstate the carrying amount where this amount is lower than fair value, and reverse the depreciation that would have been charged after the asset has been classified to surplus assets held for disposal. Further entries will be required where revaluation gains for any subsequent increase in fair value less costs to sell an asset following reclassification are in excess of cumulative impairment losses recognised under chapter 4 section 9 of the Code or previously under chapter 4 section 7 of the Code.

### **Step 4 - Restate Comparative Figures for 2009/10 (assets classified as held for sale and sold during 2009/10)**

Transactions in relation to assets classified as held for sale and sold during 2009/10 will need to be restated in line with the Code. Transition issues will arise when the carrying amount of an asset that has been sold is lower than the fair value less costs to sell or when any revaluation gains for any subsequent increase in fair value less costs to sell an asset following reclassification are in excess of cumulative impairment losses recognised under chapter 4 section 9 of the Code or chapter 4 section 7 of the Code.

The accounting entries for gains and losses on the sale of an asset is included in chapter 4 section 1 in relation to property, plant and equipment and chapter 4 section 5 in relation to intangible assets.

In the event that the carrying amount of an asset that has been sold is lower than the fair value less costs to sell, authorities shall reverse the derecognition of the asset, reinstate the value of the asset to its carrying amount and reclassify (following the applicable entries in steps 1, 2 or 3 above) and derecognise the carrying amount of the asset reflecting the revised gain or loss in Surplus or Deficit on provision of services.

Where revaluation gains for any subsequent increase in fair value less costs to sell an asset following reclassification are in excess of cumulative impairment losses or revaluation losses recognised under chapter 4 section 9 section 7 or section 1 of the Code, authorities will reverse the entries that derecognised the asset, reverse any subsequent revaluation gains have been recognised following reclassification that are in excess of cumulative impairment losses or revaluation losses recognised under chapter 4 section 9 of the Code or previously under chapter 4 section 7 or section 1 of the Code, reclassify the asset including reverse any depreciation (following the applicable entries in steps 1, 2 or 3 above) and derecognise the carrying amount of the asset reflecting the revised gain or loss in Surplus or Deficit on provision of services.