



**ACCOUNTING**

**FOR INTERNAL TRANSACTIONS**

**AND INSURANCE ARRANGEMENTS**

**ADVISORY NOTICE**

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Further information about LASAAC can be obtained at <http://www.cipfascotland.org.uk/technical/lasaac.cfm>

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### **Date of Application**

1. This guidance applies to the 2018/19 financial year and all future years until amended or withdrawn.

### **Status of Guidance**

2. This advisory notice is intended to assist practitioners and other stakeholders in implementing the requirements of the Local Authority Code of Practice. It does not change or amend those requirements and is not mandatory guidance.
3. This guidance replaces an initial LASAAC Advisory Notice "Internal Transactions and Operating Segments Reporting 2017/18" which was issued in April 2018.

### **Internal Transactions in the Financial Statements**

4. The Code of Practice on Local Authority Accounting (the Code) in the UK 2018/19<sup>1</sup> includes the following:
  - "Income is the inflow of economic benefits or service potential during the reporting period when those inflows or enhancements of assets or decreases of liabilities result in an increase in reserves."<sup>2</sup>
  - "Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or increases of liabilities that result in decreases in reserves."<sup>3</sup>
5. The Code<sup>4</sup> also states explicitly that:
  - "As the service segments in the Comprehensive Income and Expenditure Statement are not intended to cover the reporting requirements for IFRS 8 then transactions between segments are not permitted in the service analysis section of the Statement"
6. As a consequence internal transactions are not to be included in the Comprehensive Income and Expenditure Statement (CIES). A description of different forms of internal transactions, based on text initially provided in the 2017/18 advisory notice, is provided in Appendix A.
7. The Code requirements for 2018/19 now clearly prohibit the inclusion of income and expenditure on a trading basis between segments in the CIES. The apportionment of costs between segments, as the re-allocation of underlying expenditure, in the CIES is however allowed.
8. As a further consequence of the Code requirements, previous LASAAC guidance on accounting for insurance<sup>5</sup> is withdrawn. As a result the presentation of a surplus or deficit

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<sup>1</sup> References cited are to the 2018/19 version unless otherwise stated.

<sup>2</sup> The Code 2018/19 para 2.1.2.28

<sup>3</sup> The Code 2018/19 para 2.1.2.29

<sup>4</sup> The Code 2018/19 para 3.4.2.39

<sup>5</sup> "Accounting For Insurance In Local Authorities In Scotland" (LASAAC, December 2005)

on internal trading arrangements, for example from the use of an Insurance Account, is no longer permitted in the Comprehensive Income and Expenditure Statement line<sup>6</sup>.

9. In relation to Insurance Fund arrangements transfers to and from the Insurance Fund should therefore be presented as a 'transfer to or from other statutory reserves' in the Movement in Reserves Statement. This will be necessary where, for example:
  - a balance on the Insurance Fund is utilised to fund external insurance premiums which have been recognised in the CIES and consequently charged to the General Fund or HRA
  - a decision has been made to increase the balance on the Insurance Fund by a contribution from the General Fund or HRA.

### **Internal Transactions for Management Purposes**

10. The requirements noted above relate to the presentation of an authority's financial performance in the financial statements. This does not preclude authorities from recording, for management and control purposes, internal transactions during the year.
11. Where an authority, for management purposes, records internal transactions during the year adjustments will be required to achieve the required presentation in the financial statements.
12. Adjustments which reconcile an authority's segment management control arrangements, such as those presented in budget monitoring reports during the year, to the required presentation in the Comprehensive Income and Expenditure Statement (CIES) should be made in the Expenditure and Funding Analysis<sup>7</sup>. This may therefore include the elimination of internal insurance charges.

### **Apportionment or Allocation of the Underlying Expenditure Incurred**

13. Where, for statutory purposes a specific fund such as the Housing Revenue Account (HRA) is responsible and accountable for charges, such as insurance costs, in its own right, the segment line for that fund (eg the HRA) may legitimately include the underlying expenditure incurred.
14. Where the authority considers that adopting the same approach for non-HRA General Fund segments would be materially useful to the readers of the financial statements and is in accordance with the Code requirements, the same principle may be applied i.e. the underlying relevant expenditure can be included in non-HRA General Fund segment lines.
15. This may particularly be relevant where a segment has effectively been responsible for the use of resources through a 'controllable budget' arrangement (see Appendix A). Presentation of the underlying related expenditure as part of that segment's gross expenditure may be regarded as helpful for readers to show the consumption of resources.
16. Expenditure related to internal transactions should not be presented in the CIES as giving rise to income for another segment.
17. Such expenditure should be presented as an apportionment or allocation of the original underlying expenditure incurred. This will result in a reduction in the gross expenditure of the segment which initially procured the resources.

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<sup>6</sup> Expenditure and income (as defined in the Code) is expected to be included in the relevant CIES lines specified by the Code of Practice 2018/19 paragraph 3.4.2.38.

<sup>7</sup> See The Code 2018/19 paras 3.4.2.98-3.4.2.102

18. The following provides an example of the management reporting presentation that may be used internally, and the presentation in the CIES that would be required for the financial statements.
19. The example is based on a situation where a 'Corporate Services' segment line includes income of £1.0m, which exactly recovers £1.0m of externally incurred insurance premium charges, from service departments. This includes £0.2m charged to the HRA with the balance of £0.8m charged to non-HRA General Fund services. The Council has determined that expenditure on non-HRA general fund services is most appropriately reported in the 'Corporate Services' segment.

<b>Example Management Reporting Information</b>			
<b>Segment</b>	<b>'Income'</b>	<b>'Expenditure'</b>	<b>'Net'</b>
Corporate Services	£1.0m	£1.0m	£0.0m
HRA		£0.2m	£0.2m
Non-HRA General Fund Services		£0.8m	£0.8m
<b>Total (incl. internal transactions)</b>	<b>£1.0m</b>	<b>£2.0m</b>	<b>£1.0m</b>

<b>Example Presentation in the CIES</b>			
<b>Segment</b>	<b>Income</b>	<b>Expenditure</b>	<b>Net</b>
Corporate Services		£0.8m	£0.8m
HRA		£0.2m	£0.2m
<b>Total (excl. internal transactions)</b>		<b>£1.0m</b>	<b>£1.0m</b>

20. A further example for an internal trading arrangement, such as a Building Services Trading Service, is provided below. The example illustrates the elimination of a (deemed material) surplus on the internal trading arrangement.

<b>Example Management Reporting Information</b>			
<b>Segment</b>	<b>'Income'</b>	<b>'Expenditure'</b>	<b>'Net'</b>
HRA		£0.80m	£0.80m
Non HRA General Fund Services		£0.20m	£0.20m
Building Services Trading Service	£1.00m	£0.90m	(£0.10m)
<b>Total (incl. internal transactions)</b>	<b>£1.00m</b>	<b>£1.90m</b>	<b>£0.90m</b>

<b>Example Presentation in the CIES</b>			
<b>Segment</b>	<b>Income</b>	<b>Expenditure</b>	<b>Net</b>
HRA		£0.72m	£0.72m
Non HRA General Fund Services		£0.18m	£0.18m
Building Services Trading Service			
<b>Total (excl. internal transactions)</b>		<b>£0.90m</b>	<b>£0.90m</b>

### **Accounting Policy Choice and Disclosures**

21. In determining the presentation in their financial statements, authorities are advised to:
- Determine an accounting policy in accordance with the Code requirements for such a decision (see Code 2018/19 paragraphs 3.3.2.9 -13)
  - Provide relevant disclosure, where material, of the accounting policy used

## **Restatement of 2017/18 Presentation**

22. For comparative purposes, where the effect is material, prior year comparatives for example relating to the CIES and Expenditure & Funding Analysis will be expected to be restated. The change in presentation should be briefly explained.

<b>Appendix A – Description of Internal Transactions</b>
<b>Based on previously issued LASAAC Advisory Notice “Internal Transactions and Operating Segments Reporting 2017/18”</b>

### Description of Internal Transactions

A	Internal Recharges which are part of a service manager’s ‘controllable budget’.	<p>In this situation the service recipient is held accountable during the year for the use of these services (eg financial monitoring reports show the charge as expenditure within the control of the manager i.e. as part of a manager’s ‘controllable budget’).</p> <p>Examples may include the Education service charging the Social Work service for the use of accommodation and facilities in the provision of Social Work services. In such a situation typically the (internal to the council) income for the Education service is regarded as ‘controllable budget’ income; and the (internal to the council) spend for Social Work is regarded as part of their ‘controllable budget’ expenditure.</p>
B	Internal Recharges which are not part of a service manager’s ‘controllable budget’.	<p>In this situation the service recipient is not held accountable during the year for the use of these services (eg financial monitoring reports do not regard these as part of a manager’s ‘controllable budget’; budget matching or re-alignment may be undertaken at the year-end without consultation with the service manager).</p> <p>Typically some central support costs may be treated in this manner (eg where the charges are calculated on a pre-set ‘price per item’ basis rather than a year end allocation or apportionment)</p>
C	Cost apportionments or allocations which are not part of a service manager’s ‘controllable budget’ and which are presented as income for one segment and expenditure for another	<p>In this situation the service recipient is not held accountable during the year for the use of these services (eg financial monitoring reports do not regard these as part of a manager’s ‘controllable budget’; budget matching or re-alignment may be undertaken at the year-end without consultation with the service manager).</p> <p>Typically some central support costs may be treated in this manner eg those apportioned at the year end.</p>