CIPFA The Chartered Institute of Public Finance & Accountancy

report

CL 07 11-16

Board	CIPFA/LASAAC Local Authority Accounting Code Board
Venue	CIPFA, Mansell Street London
Date	9 November 2016
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Subject	Analysis of Responses to Consultation on the 2017/18 Code - IFRS 9 *Financial Instruments*

Purpose

To report on the responses to the consultation on the Draft 2017/18 *Code of Practice on Local Authority Accounting in the United Kingdom* on IFRS 9 *Financial Instruments* and seek approval of the 2017/18 Code.

1 Introduction

1.1 CL 06-11-16 summarised the number of responses received to the 2017/18 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) consultation and analysed the first twelve questions. This report deals with questions 13 to 28 on financial instruments.

1.2 The responses received are summarised in the remainder of this report with more detailed analysis in Appendix A, section by section, followed by the Secretariat's comments and suggestions. Issues of principle are considered in the main body of the report. The statistical analysis of all the responses and individual comments are included in Appendix A. Minor corrections or other minor issues are not included in this analysis but may be included in amendments to the Exposure Draft of the Code.

1.3 Note that unless stated otherwise the references in this report to Code paragraphs or sections are those included in the Draft Appendix F for the 2017/18 Code.

2 Inclusion of IFRS 9 Provisions in New Appendix F (Financial Instruments)

2.1 An overwhelming majority of respondents agreed with the approach in the Invitation to Comment (ITC) and Exposure Draft ie to include the provisions on IFRS 9 *Financial Instruments* in the 2017/18 Code but with an effective date for the 2018/19 Code ie 1 April 2018. The respondents commented that this would permit time for local authorities to prepare for the changes and to consider the financial instruments they hold. They also commented that this would allow time for the sector to discuss or debate the financial reporting implications.

2.2 A firm agreed with the proposal but did note the potential concerns over timing and the potential for there to be differences with the Government's Financial Reporting Manual (the FReM) – the relevant edition (the 2018/19 FReM) would be published in December 2017. The Secretariat recognises that this might be a risk but considers that this risk is outweighed by the substantial benefits of issuing the Code requirements in time for local authorities to prepare for the changes. It would also note that the Secretariat is a member of the Technical Working Group on IFRS 9 and will be able to ensure that HM Treasury is aware of the provisions in Appendix F.

2.3 Matters of detail on the approach to adoption and the Secretariat's response are included in Appendix A, rows 13.2 and 13.4.

CIPFA/LASAAC is invited to agree its approach to the adoption of IFRS 9 in the Code ie to include the provisions in an Appendix in the 2017/18 Code with an effective date of 1 April 2018.

3. The Classifications of Financial Assets

General Approach to Classification

3.1 The majority of respondents agreed with the general approach to classification of financial assets in the Code.

3.2 A number of respondents raised the issue of the impact on the General Fund of the new classification requirements ie as a result of the loss of the available-for-sale class of financial assets and the impact of the new classifications (particularly the new 'default' class, fair value through profit or loss) which will mean revaluation gains or losses being charged against the Surplus or Deficit on the Provision of Services and without any statutory mitigation, the General Fund. The issue of the impact on the General Fund is considered in more detail at section 14 of this report.

3.3 A firm recommended that to reduce the burden of complying with the requirements of IFRS 9 the Code be adapted to include a rebuttable presumption that financial assets should be measured at amortised cost. Following the evidence of the consultation responses which have focussed on instruments which were previously classified in the available-for-sale classification and the commentary that local authorities were diversifying their portfolios due to low interest rates (see the responses to question 15 in Appendix A) the Secretariat does not consider that it has the evidence to support this rebuttable presumption. It is also important to note that commentators on the application of the standard indicate that there is not necessarily a crossover from the classes of assets in IAS 39 to those of IFRS 9.

CIPFA/LASAAC's views are sought on this issue.

3.4 A substantial number of respondents agreed with the classification approach, but subject to their concerns raised in relation to question 15 on the designation of equity instruments to fair value through other comprehensive income.

Designation of Equity Instruments to Fair Value through Other Comprehensive Income

3.5 The positive responses to question 15 were marginally greater than those who disagreed with the view set out in the ITC. The ITC set out that the designation of equity instruments to fair value through other comprehensive income should only be used for strategic investments held by authorities (the ITC gave the example of equity shares in bus companies and airports). This issue received a strong negative response from a group of respondents (including a treasury advisor) – see row 15.1 of Appendix A.

3.6 These respondents disagreed with the meaning of the word 'strategic'. They considered that local authorities make long-term strategic investments in corporate bonds via pooled investment funds. The respondents referred to the volatility of such funds and the impact that this would have on the General Fund if the Code prohibited such designations. The respondents raised the concern that if the Code restricted such designations then this might lead to unintended consequences with local authorities having to change their investment/treasury management strategies to riskier investments.

3.7 The ITC raised this issue as it was an issue raised during the development of IFRS 9 and by respondents to CIPFA/LASAAC's early consultation on IFRS 9 last year. During the Secretariat's research on this issue it discovered that an accounting firm did not consider that a type of these pooled funds (Money Market Funds) met the definition of an equity instrument. This would therefore cast doubt on whether such funds would be able to be designated to fair value through other comprehensive income under IFRS 9.

3.8 The ITC covered this issue so it could be considered in more detail by interested parties but it did not suggest adapting the Code in any way. It is possible that some of these pooled funds might meet the criteria in IFRS 9 for designation (in summary that they are equity instruments that are not held for trading). However, a local authority will need to be very careful that they meet these criteria both in substance and in form.

3.9 There were a number of other detailed responses provided at rows 15.2 to 15.4 of Appendix A. This included a number of respondents querying whether other types of equity instrument would meet the definition of a strategic investment. In line with the approach in IFRS 9 itself the Secretariat has not added any further prescription to the Code.

3.10 The Secretariat in accordance with the approach in the ITC and the Exposure Draft has included the ability to designate equity instruments to fair value through other comprehensive income in accordance with IFRS 9.

CIPFA/LASAAC is requested to consider the issues raised in relation to the designation of equity instruments and whether it considers that further provisions are required in the Code.

CIPFA/LASAAC is invited to agree the approach to classification included in section 7.1 of the Code Draft.

4. Designation of Financial Instruments to Fair Value through Profit or Loss

4.1 The majority of respondents to the Code consultation supported the approach in the ITC to remove the current Code prohibitions against designation and to permit designations of financial instruments to fair value through profit or loss.

4.2 A small number of respondents disagreed indicating that the Code needs to emphasise that such designations should be applied consistently and that some authorities might 'cherry pick' in order to take unrealised gains to the Comprehensive Income and Expenditure Statement. The Secretariat does not consider that the Code should include any additional provisions outside of those in IFRS 9. The substantial disclosure framework should discourage inconsistent use of the provisions.

CIPFA/LASAAC is requested to confirm it wishes to remove the adaptation which prohibits designation to fair value through profit or loss and agree the provisions in the Code at paragraph 7.1.5.6 and 7.1.5.8.

5. Reclassification of Financial Assets

5.1 The majority of respondents to the Code consultation agreed with the approach in the ITC and Exposure Draft ie that minimal provisions should be included in the Code on this issue (as local authorities are unlikely to reclassify their financial assets) but that where they do they should follow the requirements of IFRS 9 and IFRS 7 *Financial Instruments: Disclosures*.

CIPFA/LASAAC is requested to confirm the approach in the Code Draft (see section 7.2.8 and paragraph 7.3.2.7).

6 Impairment of Financial Assets

Approach to Adoption in the Code

6.1 The majority of respondents agreed the approach in the ITC and Exposure Draft of the Code in relation to impairment of financial assets. The Code Exposure Draft adopted the requirements of IFRS 9 and the expected credit loss model without direct adaptation or interpretation.

6.2 The Secretariat would note with some concern that this question received a smaller number of comments than many of the other questions. This is particularly the case as is noted by some respondents (who disagreed with this approach) that it is likely that there is more work in preparing for the new reporting requirements under the standard (see Appendix A row 18.2). In addition where impairment losses do not transpire they will be written back to the financial statements. Although it is possible that the total impairment losses recognised will not be greater than under IAS 39, the impairment allowances will be recognised as a 'day one' loss therefore this will affect the timing of the budgetary consequences of the change.

CIPFA/LASAAC is invited to note the impact of the introduction of the new expected credit loss model under IFRS 9 and whether it wishes the Secretariat to take any further action.

6.3 A respondent also noted that housing rent debtors may be considered to be credit impaired on acquisition. The Secretariat does not consider that this is definitely the case (it is not aware that authorities purchase or acquire housing tenants in rent arrears) and would seek the Board's views but it has included the relevant provisions on purchased or originated credit impaired financial assets in the Code Draft (see paragraph 7.2.9.15).

CIPFA/LASAAC is invited to consider whether housing rent debtors may be credit impaired on acquisition and whether it wishes to include the new paragraph on originated or purchased credit impaired financial assets at paragraph 7.2.9.15.

6.4 The same respondent also noted that specific consideration needs to be given to loans made for capital purposes. The Secretariat concurs and notes that for transactions meeting the definition of capital expenditure under statutory provisions movements in current/fair value are, like items of property, plant and equipment, not chargeable to the General Fund. It has added appropriate explicit provision at paragraph 7.2.10.1. Note that this is not a change in statutory accounting provisions but was already implicit in the Code.

CIPFA/LASAAC is invited to agree the amendments to paragraph 7.2.10.1.

6.5 A firm was concerned that the FReM included a proposal to mandate the simplified approach to impairment (for trade receivables, contract assets and lease receivables). The Secretariat would note that this was a late change made as a result of a comment by a member of the Government's Financial Reporting Advisory Board (FRAB) during the June FRAB meeting. The Secretariat would also note that this is only being considered at this stage. During the development of the Exposure Draft it could see no reason for restricting the choice of local authorities. The Secretariat will liaise with HM Treasury and the Technical Working Group to understand the direction the FReM will take. This would reduce the reporting burden for local authorities as this would reduce the need for constant assessment. However, it would result in a more significant 'day one' loss for local authorities.

The Secretariat would seek CIPFA/LASAAC's views on this issue and whether it wishes to pursue this potential adaptation to the Code for the simplified approach to expected credit losses.

CIPFA/LASAAC is invited to agree the amendments to the Code under the new expected credit loss model– see sections 7.2.9 to 7.2.10. This is with exception of the Board's decision on the simplified approach to expected credit losses.

Financial Guarantee Contracts

6.6 The ITC raised the issue of whether a local authority might have a financial guarantee contract which should be accounted for under IFRS 4 *Insurance Contracts*. This was to discover whether there might be any implementation issues arising from the adoption of IFRS 9 before implementing the replacement standard for IFRS 4. There is no evidence that this is the case (see Appendix A rows 19.1 and 19.2).

6.7 A responding firm considered that there might be more examples in the future of authorities needing to account for financial guarantees under that standard. The Secretariat considers that this should be included on the development programme for the Code.

CIPFA/LASAAC is invited to note the above points in relation to Financial Guarantee Contracts.

7 Impairment Allowance for Council Tax, Non-Domestic Rates and District Rates

7.1 The majority of respondents agreed with the proposals and concurred that council-tax, non-domestic rates and district rates are outside of the financial instruments standards, with the majority of respondents agreeing with the approach in the ITC and Exposure Draft that impairment losses on these debtor balances should continue to be measured under the incurred loss model.

7.2 A number of respondents raised the issue of other non-exchange contracts and particularly housing benefits overpayments (reference was also made to fines). The respondents noted that any debtor balances do not arise from contracts should be treated the same way. The Secretariat concurs that on a principles basis such balances should be treated the same way and has therefore included the relevant provisions in paragraphs 5.2.2.11 to 5.2.2.13.

7.3 This 'principles based' approach would mean that local authorities would need to ascertain that these balances are not the subject of a contract and that a contract has not been agreed with the other party (note that this contract need not be in written form). The Secretariat would also highlight that the FReM Exposure Draft on IFRS 15 is applied to fines and penalties which implies that there is a contract in place. The Secretariat considers that this should not be an issue for consistency if the local authority has assessed that there is no contract.

7.4 The Secretariat considers that a principles based approach normally provides a better accounting solution where the local authority can ensure that their individual circumstances are reflected in order to present 'a true and fair view'. However, the Secretariat would point out that perhaps a simpler alternative approach might be to only allow this treatment for council tax, non-domestic rates and district rates, which are clearly not financial instruments. This would move towards 'a rules based' approach.

CIPFA/LASAAC's views are sought on whether it wishes the treatment for impairment losses to apply to all debtor balances which are not the subject of a contract (ie 'a principles based' approach) or whether it wishes to apply this treatment only to council tax, non-domestic rates and district rates using 'a rules based' approach (the Code Draft has been based on the principles based approach).

7.5 Two firms were critical of this approach and were of the view that the impairment loss model to be used for the non-financial instruments debtor balances was the expected loss model as it is deemed to provide better information. Other supporting comments included:

- the standard contained both practical expedients which permitted the use of provision matrices, and
- the simplified model could be used (see row 20.3 of Appendix A for further details).

7.6 The Secretariat considers that there are difficulties measuring under the expected credit loss model where the definition of expected credit loss is based on contractual cash flows (which will not exist). The measurement of credit losses is based on credit losses for financial instruments, again which do not exist. The incurred loss model is based on objective evidence of default. The Secretariat would also refer CIPFA/LASAAC to the responses to question 18 where a number of respondents raised the potential reporting burden of the expected credit loss model.

CIPFA/LASAAC is requested to consider the responses of the two firms and to confirm they wish to maintain the incurred loss model for debtor balances that are not financial instruments.

8 The Approach to Adaptations in the Code

8.1 The Exposure Draft of the Code has largely maintained the current adaptations and interpretations included for IAS 39 *Financial Instruments: Recognition and Measurement*. This is with the exclusion of:

- the approach to designations of financial instruments
- the removal of the adaptation in relation to regular way trades of financial instruments, and
- the addition for hedge accounting (see section 9 below).

8.2 Two firms raised the issue of the 'adaptation' in relation to Lender Option Borrower Option loans. One stated that it was '*confused by the adaptation relating to LOBOs which states that the authority shall not separately account for the derivatives embedded in a LOBO, whilst allowing authorities the option to do just that if they feel that the terms of the loan justify it'*.

8.3 The Secretariat is of the view that this was an interpretation and not an adaption and that the first reference to 'options' was related to the call options in the contract because the Code is clear that if there is an embedded derivative in the contract, it should be accounted for under IFRS 9/IAS 39. The Secretariat has added this clarification to paragraph 7.1.1.3. It has also clarified which of the items listed in this paragraph are adaptations and interpretations. The Secretariat will also include this clarification, where relevant, in the 2017/18 Code.

CIPFA/LASAAC is invited to agree the list of adaptations and interpretations listed in paragraph 7.1.1.3 of the Code Draft.

9 Hedge Accounting

Approach to Drafting in the Code

9.1 The majority of respondents agreed with the view set out in the ITC and Exposure Draft that the Code only needs to cross-refer to the accounting provisions in IFRS 9 agreeing that hedge accounting in local authorities was rare.

Adaptation on the Choice of Hedge Accounting Policy (ie allowing the use of IAS 39 or IFRS 9)

9.2 The ITC set out CIPFA/LASAAC's view that the accounting policies for hedge accounting in IFRS 9 are superior to those in IAS 39. IFRS 9 allows the accounting policy choice for entities to apply either IAS 39 hedge accounting or IFRS 9 hedge accounting. As CIPFA/LASAAC was of the view that local authorities have rarely used hedge accounting then it would be simpler and clearer to adapt the Code and allow local authorities only to use the IFRS 9 hedge accounting policies.

9.3 However, a group of respondents asked for clarity on whether these provisions apply to pension funds. The respondents made it clear that most pension funds undertake hedging activities. The provisions of chapter seven apply to pension funds. If local authority pension funds undertake hedge accounting under IAS 39 then the adaption may not be able to apply as it was agreed by CIPFA/LASAAC on the basis that local authorities very rarely use hedge accounting and this was unlikely to have a substantial impact on individual authorities. The Secretariat has made initial investigations and is of the view that local authority pension funds will hedge their financial instruments but that they do not undertake hedge accounting and therefore has retained the adaptation but would seek the Board's views on this issue.

CIPFA/LASAAC is invited to consider the issue above and agree to retain the adaptation in the Exposure Draft and to permit local authorities to only use the IFRS 9 hedge accounting policies.

10. Approach to Financial Instruments Disclosures

General Approach to Financial Instruments' Disclosures

10.1 The majority of respondents agreed with the approach set out in the ITC and the Exposure Drafts of the Code ie the Code should not include those disclosures that rarely apply to local authorities.

10.2 A group of respondents considered that the disclosures relating to master netting agreements and the disclosures relating to default on loans payable rarely apply and so could be omitted. The Secretariat concurs that these events will rarely apply but considers that it would not be useful to partially edit a disclosure. The Secretariat considers that although the expectation of default is low, it could occur and if it did would be such an important issue that such disclosures would be essential and has therefore not removed these disclosures from the Code Draft.

10.3 A firm did not agree with the approach as it considered that the Code summarised the disclosure requirements in the Standard. The Secretariat does not concur - each new disclosure introduced to IFRS 7 by IFRS 9 has been included in the Code unless it is unlikely to apply in which case the Code Draft has included appropriate cross reference to the relevant disclosure in IFRS 9.

10.4 The same firm suggested that CIPFA/LASAAC might wish to consider FRS 101 *Reduced Disclosure Framework, Disclosure exemptions from EU-adopted IFRS for qualifying entities*. The Secretariat does not concur as this reduced disclosure framework only applies to the individual financial statements of qualifying entities and the accountability framework is provided by the consolidated financial statements of the parent. CIPFA/LASAAC will be aware that the majority of local authority bodies are the parent entity and therefore would not be excluded. This would mean that if smaller local authorities applied the exemption approach in FRS 101 the financial accountability offered by IFRS 7 disclosures would no longer exist.

CIPFA/LASAAC is invited to agree that the approach to disclosures should remain as presented in the Exposure Draft see section 7.3 Part 1.

10.5 A group of respondents were clear that local authorities may hold collateral if they invested in reverse repurchase agreements. The Secretariat has therefore included the relevant disclosures on collateral in the Code Draft. It has included new paragraph 7.3.2.9 (paragraph 15 of IFRS 7) and has reinstated references to collateral in paragraph 7.3.3.21. Note that this would also mean that paragraph 15 of IFRS 9 also needs to be added to the 2017/18 Code.

CIPFA/LASAAC is invited to agree that the disclosures on collateral being held by authorities should be added to the Code Drafts including the 2017/18 Code.

11. Presentation

11.1 The majority of respondents do not agree with CIPFA/LASAAC's proposals for the changes in presentation on the face of the Comprehensive Income and Expenditure Statement (which includes new line items for interest revenue calculated using the effective interest method; gains and losses arising from the derecognition of financial assets measured at amortised cost; impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with section 7.2.9 of the Code).

11.2 Two groups of respondents were opposed to the proposals as they were concerned that this level of detail may obscure the main messages in the Comprehensive Income and Expenditure Statement. The Secretariat concurs and this was in line with their original proposals presented to CIPFA/LASAAC at its June meeting. The Secretariat will also note that this does not align with the overall approach for the Comprehensive Income and Expenditure Statement which is to group all the financing transactions in one line ie the Financing and Investment Income and Expenditure line. The Secretariat would recommend therefore that these transactions are included in this line with the requirement to disclose these items on the face of the Comprehensive Income and Expenditure Statement or in the notes if these items are material (see new draft paragraph 3.4.2.40).

CIPFA/LASAAC is invited to consider the Secretariat's proposal at paragraphs 3.4.2.38 and 3.4.2.40.

Impact on the General Fund

11.3 A number of respondents were concerned about recognising the relevant gains or losses in the Surplus or Deficit on the Provision of Services on the General Fund. This is considered in more detail in section 14.

CIPFA/LASAAC is invited to note this comment and consider section 14.

Instruments Meeting the Definition of Capital Expenditure

11.4 A firm was concerned about the treatment of gains or losses on instruments which meet the definition of capital expenditure under statute. This will apply only to share capital in England or 'share or loan' capital in Northern Ireland and Wales. It is considered that most of the instruments that local authorities invest in will be outside of the statutory definitions of capital expenditure otherwise these investments will need to be financed from capital resources. However, the Secretariat has clarified that like property, plant and equipment movements in fair value and/or impairments would not be chargeable to the General Fund. It has included this clarification at paragraph 7.1.9.3.

CIPFA/LASAAC is invited to consider the proposed changes at paragraph 7.1.9.3.

12. Transition

12.1 The majority of respondents agreed the approach to transition in the Code ie including the option in IFRS 9 to not restate preceding year information.

12.2 Items of detail are considered at rows 27.1 to 27.3 of Appendix A.

CIPFA/LASAAC is invited to agree the approach to transition set out in section 7.4 of the Code Draft.

13. Impairment of Certain Investments - Statutory Accounting Requirements

13.1 The majority of respondents agreed that the statutory accounting requirements for the impairment of certain investments can be removed from the Code. The Secretariat proposes removing these from 2017/18 Code as well as Appendix F. Matters of detail are considered in rows 28.2 to 28.3 of Appendix A.

CIPFA/LASAAC is invited to agree the removal of the statutory accounting requirements from the 2017/18 Code and Appendix F.

14. Drafting Queries

14.1 A treasury advisor raised a number of drafting queries in relation to Appendix F of the Draft Code in response to question 34. These are listed at the end of Appendix A. The Secretariat would welcome any comments CIPFA/LASAAC might have on these queries.

CIPFA/LASAAC is invited to agree the approach to the drafting amendments listed at the end of Appendix A.

15. Impact on the General Fund

15.1 There were three questions in the consultation where respondents raised the issue of the impact of IFRS 9 on the General Fund:

1) the general question on the new classifications of financial assets

2) the question relating to the designation of equity instruments at fair value through other comprehensive income, and

3) the question relating to the presentation of gains and losses ie in the Surplus or Deficit on the Provision of Services which without any form of mitigation would be chargeable to the General Fund.

15.2 The responses were received from concerned authorities and treasury advisors. It is notable that not all respondents were concerned with the same issues. As generally local authorities are unlikely to hold financial instruments for sale then with the exception of those equity instruments designated to fair value through other comprehensive income all gains and losses will be recognised to the Surplus or Deficit on the Provisions of Services. Most of the respondents were concerned about the volatility, particularly of fair value movements. Some respondents were also concerned about any unrealised balances on the available-for-sale reserve having an adverse effect on transition.

15.3 From an accounting perspective the volatility being reported in the Surplus or Deficit on the Provision of Services is precisely one of the aims of the standard ie users can understand the risks being faced by holding such instruments. A number of respondents pointed out that the General Fund was normally protected from such volatility. The Secretariat would cite the example of pension funds. Others referred to the need to use the designation of equity instruments to fair value through other comprehensive income to avoid such volatility. However, as noted in section 3 and Appendix A question 15, there is a risk that at least some pooled funds may not meet the criteria for designation.

15.4 As the classification to the new classes of financial assets is not a straight crossover from the IAS 39 classes to the IFRS 9 classes then it would be very difficult to qualify the impact of this volatility. Some indication has been provided in relation to pooled funds in response to question 15. For example, one council indicated that:

'*the council's fund holdings recently fell by £800,000 within the space of three months but increased by £700,000 the following month*.'

Another authority stated that:

'*We currently hold £22 million in these type of funds (15% of our investment portfolio), and their capital values fluctuate with market conditions - we saw a reduction in the value of these funds of £658,000 in 2015/16, with only the property fund increasing by £371,000, therefore a net reduction of £287,000. Our interest receipt from these funds (all dividend paying) was £670,000 gross (£298,000 excluding the property fund)*'.

15.5 **CIIPFA/LASAAC is invited to consider whether it wishes to bring this issue formally to the attention of the relevant government departments or administrations that will all be in receipt of this report.** One respondent indicated that the statutory mitigation could take the form of abating the recognition of the gains and losses on the General Fund until the instruments are derecognised.

Recommendations

CIPFA/LASAAC is invited to consider the individual issues brought to its attention above in relation to the adoption of IFRS 9 in the Code and consider the 2017/18 Code for approval.

SUMMARY OF CONSULTATION RESPONSES

Note – a group of interested parties best described as professional accounting firms that audit local authorities is abbreviated in this Appendix to "firm" or "firms"

Financial Instruments - Include Provisions in the 2017/18 Code

Question	Agree	Disagree	No Comment
13 Do you agree with the proposed approach to include the provisions of IFRS 9 in the 2017/18 Code (but with an effective date of 1 April 2018) so that accounts preparers have adequate time to prepare for this substantial new standard? If not, why not? What alternatives do you suggest?	42 (89%)	0 (0%)	5 (11%)

	Issue	**Secretariat Response**
	Question 13– Include Provisions in the 2017/18 Code	
13.1	The inclusion of the provision of IFRS 9 requirements in the 2017/18 Code was welcomed by the majority of respondents, a number of which commented that this would permit time for local authorities to prepare for the changes and to consider the financial instruments they hold. They also commented that this would allow time for the sector to discuss or debate the financial reporting implications.	No comment. **No changes proposed to the Code Draft.**
13.2	Four respondents (including an independent consultant) included almost exactly the same response and stated: '*For the avoidance of doubt, I think the Code needs to emphasise that the change is prospective from 1 April 2018, thus avoiding ambiguity of interpretation'*.	The amendments to the Code under the requirements of IFRS 9 will not be prospective but retrospective. However, the Code Draft of Appendix F makes it clear that early adoption is not permitted. **No changes proposed to the Code Draft.**

	Issue	**Secretariat Response**
13.3	A firm noted that, whilst agreeing with the proposal: *'We do however have some concerns as to the timing, specifically that the Treasury has only recently closed its consultation on the application of IFRS9 and the outcome is not yet known. In our view the Code should be consistent with the FREM (except for approved differences). Therefore there is a risk that the relevant paragraphs of the Code may need to be updated following the publication of the 2018/19 FREM (expected in December 2017). As part of our FREM consultation response we have suggested that the relevant FREM requirements should be published in advance of the FREM and noted the Code consultation proposal to allow practitioners time to prepare for implementation.'*	The Secretariat recognises that this might be a risk but is a member of the Technical Working Group that works on IFRS 9 and will ensure that group is aware of the provisions in the new Appendix F. It would also note that the risks of inconsistency are likely to be substantially outweighed by the benefits of allowing local authorities adequate time to prepare for this substantial standard. **No changes proposed to the Code Draft.**
13.4	A firm commented: '*We agree with this approach for IFRS 9 and IFRS 15 as they are significant new accounting standards however we would encourage CIPFA to refrain from following such an approach for smaller changes in the future'*.	The Secretariat concurs. In order to avoid confusion about effective dates for other amendments to IFRS this approach should only be adopted for substantial changes such as a new standard. The amendments to IFRS 9 meet this criterion. **No changes proposed to the Code Draft.**

New Classifications of Financial Assets

Question		Agree	Disagree	No Comment
14	Do you agree with the proposed approach to the adoption of IFRS 9 for classification and measurement of financial assets? If not, why not? What alternatives do you suggest?	36 (77%)	5 (11%)	6 (13%)

<table>
<tr><th></th><th>Issue</th><th>Secretariat Response</th></tr>
<tr><td></td><td colspan="2">Question 4 – New Classifications of Financial Assets</td></tr>
<tr><td>14.1</td><td>A number of respondents were concerned about the loss of the available –for-sale classification and

1) the potential volatility that gains and losses would have on the Surplus or Deficit on the Provision of Services in future years, and

2) the potential for any unrealised gains and losses already included in the available -for-sale financial instrument reserve to be written out to the General Fund.

A number of respondents indicated that they considered that some form of statutory mitigation or override should be in place for the impacts of this change on the General Fund. Some respondents noted with concern the budgetary implications with one indicating they would not support the changes if they impacted in this way on the General Fund. Another respondent noted that this might impact on their Treasury Management Strategies and the financial instruments they hold.</td><td>The Secretariat concurs that the loss of the available-for-sale classification of financial instruments may lead to more volatility in the Surplus or Deficit on the Provision of Services and on transition any unrealised gains or losses would hit the General Fund Balance if there were not any form of statutory mitigation.

CIPFA/LASAAC is invited to consider whether it wishes to discuss this issue with the relevant administrations across the UK.</td></tr>
<tr><td>14.2</td><td>A firm commented:

‘We think that the vast majority of local authority financial assets will be measured at amortised cost give the business model that local authorities operate under and the contractual cash flow characteristics of the financial assets they hold. In order to reduce the burden of complying with this standard we suggest that the Code adapts the provisions of IFRS 9 to make it a rebuttable presumption that financial assets should be measured at amortised cost. Authorities could then concentrate on classifying financial</td><td>The Secretariat would note that from the other responses in the consultation it cannot be assumed that the vast majority of financial assets will be measured at amortised cost.

A number of respondents have indicated that due to low interest rates they have had to diversify their investments. The Secretariat is therefore is of the view that classification of all financial assets should be made in accordance with IFRS 9.

CIPFA/LASAAC’s views are sought on this issue.</td></tr>
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	Issue	Secretariat Response
	assets that fall outside the normal business model'.	
14.3	A group of respondents agreed. However, this was subject to their concerns raised for question 15.	See question 15.

Designation of Equity Instruments to Fair Value through Other Comprehensive Income

Question		Agree	Disagree	No Comment
15	Do you agree with CIPFA/LASAAC's view that the designation of equity instruments at fair value through other comprehensive income should only be used for strategic investments held by a local authority? If not, why not? What alternatives do you suggest?	21 (45%)	16 (43%)	33 (21%)

	Issue	Secretariat Response
	Question 15 – Designation of Equity Instruments to Fair Value through Other Comprehensive Income	
15.1	A group of approximately 11 respondents (including a treasury advisor) provided similar and sometimes identical commentary. A number of respondents again referred to the impact that any prohibition or restriction of the ability to designate might have on the General Fund. The following response provided below best represents their comments: '*We agree that the designation is best suited to long-term investments, but we do not agree that this option should be only be available for strategic investments such as airport and bus companies. The main disagreement is in the meaning of the word "strategic".* '*It is increasingly common for local authorities to make long-term strategic investments in corporate bonds and property via pooled investment funds, which meet the definition of an equity instrument in IFRS 9. To put the issue in context, around £2 billion of local authority cash is now invested in pooled funds whose*	

	Issue	Secretariat Response
	values fluctuate with market conditions, with several district councils having invested more than £50 million each. The most volatile funds can gain or lose 15% in a matter of months, although over the long-term they tend to exhibit more modest capital growth, and the majority of the return is paid via regular dividends. The use of pooled funds is sound treasury management practice, since it enables greater diversification of risks and the professional management of investments. In recognition of this, capital finance regulations give favourable treatment to pooled funds that are structured as equity instruments. '*Fluctuations in the fair values of directly held corporate bonds and investment properties do not impact on the General Fund under either the old or new Codes; nor do fluctuations in the fair values of pooled funds in the current Code. However, restricting the designation of equity instruments as FVOCI will cause fluctuations in their fair values to impact upon the General Fund in future, which will be a significant disincentive to good treasury management. The low interest rate environment is forcing local authorities to invest in bonds and property to generate additional investment income to support local public services. It would be unfortunate if an unnecessary adaptation of IFRS 9 caused local authorities to make higher risk direct investments into these asset classes, or to cut public services, rather than to invest in pooled funds*. '*The current Code does not permit local authorities to show fluctuations in the fair value of pooled investment funds in the General Fund, since it does not allow them to be designated as FVPL even though IAS 39 contains this option. It would therefore be quite odd if the new Code forced authorities to show fluctuations in the General Fund by disapplying the option in IFRS 9 to designate them as FVOCI. Both accounting standards allow both treatments; it is not at all clear why the Code should force them to change treatment*. '*Finally, we suspect that CIPFA/LASAAC may, like the IASB, have difficulty in framing a sufficiently robust definition of a strategic investment. Most people would agree that a shareholding in any company that pays a regular income and is held for many years should be classed as a strategic investment, irrespective of the company's activities*. *'In summary, we believe that local authorities should be free to account for their investments according to the IASB's published IFRS 9, and not to an interpretation of the IASB's original intentions. We suggest that the irrevocable nature of the FVOCI designation and the substantial additional disclosure requirements will be sufficient to deter frivolous use of this designation.'*	
15.1R	**Secretariat Response** CIPFA/LASAAC raised this issue in the ITC as it was raised during the development of IFRS 9. Also a group of respondents raised the same issue relating to money market and other pooled funds in response to last year's consultation. During the Secretariat's research on this issue it found commentaries by one of the accounting firms that they did not consider that	

	Issue	Secretariat Response
	money market funds met the definition of equity instruments. This therefore might cast some doubt whether such funds would be able to be designated to fair value through other comprehensive income in accordance with IFRS 9. The ITC also raised this issue so that it could consider it in more detail by interested parties but it did not suggest adapting the Code in any way and the Exposure Draft maintained the definitions in IFRS 9 without any form of adaptation. Considering the description above it might be the case that some of the pooled funds might meet the criteria in the standards to permit such a designation. However, local authorities will need to be careful that such instruments meet the criteria and the substance as well as the form of the definition of an equity instrument. **CIPFA/LASAAC's views are sought on the issue above and whether any further provisions need to be included in the Code.**	
15.2	A firm commented and stated that: *'the ability to designate equity instruments at fair value through other comprehensive income should be left to the discretion of the local authority, taking into account the Basis for Conclusion paragraphs of the standard'.*	This was the approach in the ITC and Exposure Draft. As stated in the response at 15.1 above CIPFA/LASAAC was using the consultation process to investigate the designation of these instruments but did not propose to adapt the Code in any way. **No changes proposed to the Code Draft.**
15.3	A second firm commented that: *'We are not particularly convinced by the argument presented in the ITC that the designation of financial assets at fair value through OCI in IFRS 9 was intended for equity instruments held for strategic purposes. Paragraph B4.1.4B of IFRS 9 states that "compared to a business model whose objective is to hold financial assets to collect contractual cash flows this business model will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the business model's objective instead of being only incidental to it". We acknowledge that IFRS 9 then goes on to state that there is no threshold for the frequency and value of sales that*	The Secretariat recognises the criteria for classification of financial assets through other comprehensive income. However, the ability to designate equity instruments sits outside the classification criteria for financial assets. **No changes proposed to the Code Draft.**

	Issue	Secretariat Response
	must occur in this business model, but we doubt that sales of equity interests in airports and other strategic investments would be frequent enough to justify classification at fair value through OCI.	
15.4	A number of respondents considered that to support CIPFA/LASAAC’s view there would need to be a definition of a strategic investment developed in the Code. One respondent cited other examples of what they might consider to be strategic investments including ‘*assisted purchase housing schemes, where authorities take a percentage equity stake in the homes purchased’*. A nother example cited was ‘equity investments *in a company providing services for the Council and other local authorities*’.	As noted above the ITC did not propose to interpret or adapt the provisions in IFRS 9 on this issue. The examples provided in the ITC were intended to clearly identify the principles under which CIPFA/LASAAC considered that the designation should be applied. **CIPFA/LASAAC’s views are sought on this issue.**

Designation of Financial Instruments (to Fair Value through Profit or Loss)

Question		Agree	Disagree	No Comment
16	Do you agree that the Code should remove the adaptation for designations of financial instruments? If not why not? What alternatives do you suggest?	33 (70%)	6 (13%)	8 (17%)

Question 16 - Designation of Financial Instruments (to Fair Value through Profit or Loss)		
	Issue	**Secretariat Response**
16.1	The majority of respondents who made comments supported the proposals indicating that whilst they agreed that the circumstances for such designations were rare in local authorities they considered that all options available to entities in the standard should be available to local authorities.	No comments. **No changes proposed to the Code Draft.**
16.2	Three respondents who disagreed and provided identical responses stated: '*Designation will be a significant accounting policy. The Code needs to emphasise that this is applied consistently between years and across all entities in which the authority has an interest*. '*The risk is that some authorities may be tempted to "cherry pick" in order to take unrealised gains to CIES, but carry forward unrealised losses on the balance sheet*. '*The alternative is continue with the present prohibition of the option to designate. This would avoid the risk of financial performance being manipulated and would promote consistency of reporting across the sector*.'	The Secretariat does not consider that there should be any need to provide additional provisions outside of those included in IFRS 9. The substantial disclosure framework that is included in the standards should discourage inconsistent use of its provisions **No changes proposed to the Code Draft.**
16.3	A firm stated: '*We agree that the Code should allow authorities the option of designating investments as financial assets at fair value through profit and loss. We believe this should be accompanied by clearer guidance on the accounting treatment of fair value movements in circumstances where the underlying investment is expenditure for capital*	The Secretariat has not had this issue raised by many authorities prior to the consultation. It is considered that local authorities do not use these types of investments for their treasury management activities because if an equity or financial instrument does meet the definition of capital expenditure then it would also need to be financed by capital resources. If the equity instrument does meet the

Question 16 - Designation of Financial Instruments (to Fair Value through Profit or Loss)		
	purposes under the Local Government Act 2003 and associated regulations (principally investments in the share capital (and in Wales loan capital) of companies that are not subsidiaries, associates or joint ventures).'	definition of capital expenditure then like movements in current value in property, plant and equipment these would not be chargeable to the General Fund. **The Secretariat has added this commentary to paragraph 7.1.9.3.**

Reclassification of Financial Assets

Question		Agree	Disagree	No Comment
17	IFRS 9 includes substantial provisions on reclassifications of financial assets and has amended IFRS 7 *Financial Instruments: Disclosures* to include similarly substantive disclosures on this issue. CIPFA/LASAAC is of the view that local authorities will rarely need to reclassify their financial assets and has therefore included minimal references to these provisions in IFRS 9 and IFRS 7. Do you agree with this approach? If not, why not? What alternatives do you suggest?	38 (81%)	2 (4%)	7 (15%)

	Issue	**Secretariat Response**
	Question 17 – Reclassification of Financial Assets	
17.1	The majority of respondents commenting agreed with the approach set out in the ITC and Exposure Draft.	No comments. **No changes proposed to the Code Draft.**
17.2	Two respondents who disagreed indicated that local authorities should have access to all the provisions of IFRS 9.	These are still available to local authorities but would require direct reference to IFRS 9 and IFRS 7 *Financial Instruments: Disclosures.* **No changes proposed to the Code**

	Issue	Secretariat Response
		Draft.
17.3	A firm made a wider response and considered that this approach should be adopted across the Code.	This response is considered in more detail in Appendix C to CL 06-11-16. **No changes proposed to the Code Draft.**

Impairment of Financial Assets

Question		Agree	Disagree	No Comment
18	Do you agree that the Code should not adapt the provisions for the measurement of impairment losses under IFRS 9? If not, why not? What alternatives do you suggest?	31 (66%)	3 (6%)	13 (28%)

	Issue	Secretariat Response
	Question 18 – Impairment of Financial Assets	
18.1	The majority of respondents agreed with the approach in the ITC and the Exposure Draft.	No further comment. The Secretariat would note that there were not as many substantial commentaries made on this question as with other questions. **No changes proposed to the Code Draft.**
18.2	Two authorities and a confidential respondent raised substantial concerns about the application of the new requirements, particularly the resource implications of the new requirements. With one respondent commenting: '*We do not feel that in the current financial climate it would be acceptable for a change in accounting standards to lead to an additional burden on council*	The Secretariat agrees that there is likely to be additional preparation and work processes required to measure the impairment losses under the standard and it has been making local authorities aware of this issue for some time. It is also likely that the impairment losses will need to be written back where they do not transpire. Similar issues are likely to take place across the public sector

	Issue	Secretariat Response
	tax payers and rentpayers. Whilst impairment provisions where there is evidence of credit deterioration are an appropriate charge to council tax payers, a 'stage 1' loss provision as described does not seem to be justifiable as a charge to taxpayers and rentpayers, as it is anticipating a loss which may never occur.' The authority continued: '*It is difficult to quantify the likely impact without a clear picture of how probabilities are to be assigned, but to illustrate the potential costs, at the close of 2015/16 [the authority] had £85.8m of debtors and investments which this change would apply to, with provisions of £10m. It would only take a small percentage increase in the provision level to have a significant impact on the revenue account bottom line.'* '*Consideration needs to be given to housing rent debtors, which could be considered credit impaired on acquisition*.' '*Specific consideration also needs to be given to loans made for capital purposes, where the entire value of the loan already has to be funded over time through the statutory capital requirements*.' Another authority raised the issue that the disclosures appeared onerous.	and in the private sector. **CIPFA/LASAAC is invited to note the potential financial implications suggested by the respondents.** The Secretariat does not consider that it is definitely the case that local authorities would acquire credit impaired housing tenant (it is not aware that authorities purchase or acquire housing tenants in rent arrears) **and would seek the Board's views** but it has included the relevant provisions on purchased or originated credit impaired financial assets in the Code Draft (see paragraph 7.2.9.15). The ITC and Exposure Draft had been drafted from the perspective that it was unlikely that local authorities would acquire or purchase credit impaired debtors on acquisition and **therefore the relevant provisions have been added to the Code Draft (see paragraph 7.2.9.15).** In terms of loans given for capital purposes these would be included in the statutory financing arrangements and the relevant impairment provisions are not proper charges to the General Fund. **The relevant amendment has been made to the Code Draft paragraph 7.2.10.1.**
18.3	A firm responded that in accordance with IFRS 9: '*…the Code proposes a simplified approach for trade receivables or contract assets that result from transactions within the scope of IFRS 15 and do not contain a significant*	The Secretariat would note that the Exposure Draft on the FReM proposals states that '*HM Treasury are considering mandating this approach for eligible assets (i.e. for trade receivables, contract assets and lease receivables) in order to reduce application issues, streamline*

	Issue	Secretariat Response
	financing component but allowing an accounting policy choice for trade receivables/contract assets that contain a significant financing component and for lease receivables. This differs from the current FREM proposal to mandate the simplified approach for all eligible assets (trade receivables, contract assets and lease receivables). This is an example of a potential inconsistency where we would usually expect the Code to be consistent with the FREM which is not clearly explained.'	*implementation and improve comparability across the public sector*.' At this stage, the proposal is only being considered. In the development of the Exposure Draft the Secretariat could see no clear reason why such an adaptation would be necessary in local government and therefore did not propose one. Note that the FReM Exposure Draft states that '*Utilising this approach would remove the need for a constant assessment for impairment but is likely to result in a significant 'day one' loss*.' The Secretariat will liaise with HM Treasury to understand the direction that the FReM may take. This proposal was suggested by a member of the Government's Financial Reporting Advisory Board (FRAB) at the FRAB meeting in June. **CIPFA/LASAAC is invited to consider whether it wishes to pursue this approach which will:** **1) limit the choices available to an authority,** **2) result in a more significant 'day one' loss, but** **3) would simplify the reporting burden for local authorities.** The Secretariat would note that there is a risk that there may be differences between the FReM and the Code. However, these risks are outweighed by the benefits of allowing local authorities the appropriate time to prepare for the changes. These risks are also mitigated by the fact that CIPFA/LASAAC has not proposed any substantial adaptations to IFRS 9.

Question		Yes	No	No Comment
19	Do you have any financial guarantee contracts which should be accounted for as insurance contracts under IFRS 4 *Insurance Contracts*? Please provide a reason for your response	0 (0%)	14 (30%)	33 (70%)

	Issue	Secretariat Response
	Question 19 – Financial Guarantee Contracts	
19.1	No respondents considered that they had financial guarantee contracts that should be accounted for under IFRS 4 Insurance Contracts.	No comments. **No changes proposed to the Code Draft.**
19.2	One firm responded that they agreed that they had no clients where this was applicable, but commented: '*However, the Code does not currently refer to IFRS 4 as potentially applicable in a local authority context. We believe there may be scenarios where this standard is applicable for example in relation to a guarantee where the non-financial risks are greater than the financial risks, thus suggesting treatment as an insurance contract under IFRS 4. We would expect the treatment to be based on the client's judgement on what the most significant risks are in relation to the guarantee in determining the accounting treatment. This is potentially an area where we may see more examples in the future as local authorities enter into more numerous and diverse Alternative Delivery Models which may involve guarantees.*'	The Secretariat raised this issue to discover whether there might be any implementation issues arising from implementing IFRS 9, before implementing the replacement Standard for IFRS 4 *Insurance Contracts*. This was the subject of an amendment to IFRS 4 issued in September 2016. As there is no evidence that local authorities currently account for financial guarantee contracts under IFRS 4 then these will not arise. Additionally the Code does not indicate that IFRS 4 will be applicable. It is suggested that the Code development programme considers whether there is a need for local authorities to account for financial guarantee contracts under IFRS 4. **No changes proposed to the Code Draft.**

Impairment Allowance for Council Tax, Non-Domestic Rates and District Rates

Question	Agree	Disagree	No Comment
20 Do you agree with the proposed approach to the impairment allowance for council tax, non-domestic rates and district rates? If not, why not? What alternatives do you suggest? Please provide the reasoning for your response.	35 (74%)	6 (13%)	6 (13%)

	Issue	**Secretariat Response**
	Question 20 – Impairment Allowance for Council Tax, Non-Domestic Rates and District Rates	
20.1	The majority of respondents agreed with the proposals and concurred that council-tax, non-domestic rates and district rates are outside of the financial instruments standards.	No comments. **No changes proposed to the Code Draft.**
20.2	A number of respondents raised the issue of other non-exchange contracts and particularly housing benefits overpayments, noting again that these debtors do not arise from contracts. One authority also referred to parking fines and suggested that the Code should use this treatment for all non-exchange transactions.	The Code Draft focussed on the current adaptation in the Code which related to the treatment of council tax, non-domestic rates and district rates under IAS 39 *Financial Instruments: Recognition and Measurement*. The Secretariat concurs that provided that there is no contract the transactions do not represent financial instruments. The Secretariat therefore proposes to extend the approach to other transactions which are not contracts. The Secretariat concurs that if housing benefits overpayments are not contracts then they would not be a financial instrument. The Secretariat would also highlight that a small number of respondents indicated that they did not consider that housing benefits overpayments were contracts. However, the Secretariat would note that the FReM consultation on IFRS 15 sets out that fines and penalties are to be accounted for under IFRS 15 which would imply that there is a contract for

	Issue	Secretariat Response
		those transactions. The Secretariat considers that this should not be an issue for consistency if the local authority has assessed that there is no contract. **CIPFA/LASAAC's view is sought on this issue.**
20.3	Two firms considered that the impairment loss model to be used should be that of IFRS 9 both commenting that the expected loss model is deemed to provide better information. One firm stating that: '*The Standard permits the use of 'practical expedients' such as a 'provision matrix' potentially using historical credit loss experience (adjusted as necessary to reflect current conditions*).' '*The impairment requirements of IFRS 9 are more forward-looking and recognition of impairment no longer depends on first identifying a credit loss event. Instead an entity will estimate an 'expected loss' considering a broader range of information, including*: - *past events, such as experience of historical losses* - *current conditions* - *reasonable and supportable forecasts that affect the expected collectability of the future cash flows.'* This firm also commented that the simplified approach to the impairment model could be used. The second firm commented: '*Should CIPFA/LASAAC decide to retain an incurred loss model then full guidance will need to be provided*	Council tax, non-domestic rates and district rates are not financial instruments and therefore do not have to be measured under the expected loss model. The responses summarised in row 20.2 above highlight the additional burden of applying the expected credit loss model to local authority financial instruments. This includes the need to write back the losses where they do not occur. The Secretariat would note that it would be very difficult to measure expected credit losses for these debtor balances under IFRS 9. The Secretariat considers that there are difficulties measuring under the 'expected credit loss model' where the definition of expected credit loss is based on contractual cash flows (which will not exist). The measurement of credit losses is based on credit losses for financial instruments again which do not exist. The incurred loss model is based on objective evidence of default. In terms of the provisions for the incurred loss model, these are already included in the Code. The Secretariat concurs that the Code will need to stipulate the relevant disclosures for any impairment on non-contractual debtors. These have been included in the debtors section (ie paragraph 5.2.4.2, 3). **CIPFA/LASAAC's views are sought whether any additional provisions need to be included.**

	Issue	Secretariat Response
	within the Code as it will no longer be possible to cross refer to an underlying accounting standard.' A firm also referred to the need to specify a disclosure framework for these losses.	

The Approach to Adaptations of IFRS 9 in the Code

Question		Agree	Disagree	No Comment
21	The Exposure Draft of the Code has largely maintained the current adaptations and interpretations included for IAS 39 *Financial Instruments: Recognition and Measurement*. This is with the exclusion of the approach to designations of financial instruments (see also questions 15 and 16 above) and the regular way trades of financial instruments and the addition for hedge accounting (see question 23 below). Do you agree with this approach? If not, why not? What alternatives do you suggest?	36 (77%)	0 (0%)	11 (23%)

	Issue	Secretariat Response
	***Question 21* – The Approach to Adaptations of IFRS 9 in the Code**	
21.1	The majority of respondents agreed with the ITC and Exposure Drafts provisions relating to the current approach to adaptations. This approach is with the exclusion of the approach to designations of financial instruments (see also questions 15 and 16 above) and the regular way trades of financial instruments and the addition for hedge accounting (see question 23 below).	No comments. **No changes proposed to the Code Draft.**

	Issue	Secretariat Response
21.2	Two firms queried the current 'adaptation' for Lender Option Borrower Option Loans (LOBOs). One stated that it was '*confused by the adaptation relating to LOBOs which states that the authority shall not separately account for the derivatives embedded in a LOBO, whilst allowing authorities the option to do just that if they feel that the terms of the loan justify it*'.	The Secretariat considers that this is not an adaptation but an interpretation. Paragraph 7.1.1.2 e) states: '*options embedded in a LOBO shall not be separately accounted for unless after considering the contractual terms of the instrument the authority concludes that IAS 39 would require the embedded options to be accounted for separately*'. The first set of 'options' referred to in this interpretation is not referring to derivatives but other lender/borrower options such as the option to call on the facilities under the contract. Where an option under a LOBO takes the form of an embedded derivative it would need to be accounted for as such under the Code. **The Secretariat will confirm that that this is an interpretation in the 2017/18 Code Draft and Appendix F.**

Hedge Accounting

Question		Agree	Disagree	No Comment
22	The Exposure Draft of the Code only includes cross-reference to the IFRS 9 hedge accounting provisions rather than including the provisions directly in the Code (CIPFA/LASAAC is particularly interested in whether this might have any implications for local authority Group Accounts). Do you agree with this approach? If not, why not? What alternatives do you suggest?	33 (70%)	0 (0%)	14 (30%)

23	Do you agree with CIPFA/LASAAC's approach to adapt the Code to not allow local authorities to apply the hedge accounting requirements of IAS 39? If not, why not? What alternatives do you suggest?	29 (62%)	2 (4%)	16 (34%)

	Issue	Secretariat Response
	Question 22 – Hedge Accounting	
22.1	The majority of respondents agreed with the approach in the ITC ie that cross-reference only to the hedge accounting provisions in IFRS 9 should be made. The majority of respondents indicated that hedge accounting was rare and this included the group accounts.	No comments. **No changes proposed to the Code Draft.**
22.2	A firm with a large proportion of the local authority client base indicated that it was '*unaware of any local authority or authority group financial statements which apply hedge accounting'*.	No comments. **No changes proposed to the Code Draft.**
	Question 23 – Adaptation for Hedge Accounting Provisions	
23.1	The majority of respondents agreed with the proposals in the consultation paper to not permit the option in IFRS 9 for local authorities to apply the hedge accounting policies in IAS 39 as local authorities had largely not yet undertaken hedge accounting.	No comments. **No changes proposed to the Code Draft.**
23.2	Four respondents (including an independent consultant) commented: '*The Code should clarify whether the prohibition from hedging accounting also applies to local authority pension funds. In practice, virtually all local authority pension funds engage in some form of hedging through the use of derivatives to manage risk eg*	The provisions in Exposure Draft of the Code's would apply to pension funds as well as the authority. The Secretariat would note that the prohibition only applies to the use of the IAS 39 accounting policies. The Secretariat was aware that pension funds needed to hedge their risk but was not aware that any pension fund undertook hedge accounting. If local

	Issue	**Secretariat Response**
	through currency overlays using forward foreign exchange derivatives to manage exchange rate risk.'	authority pension funds do undertake hedge accounting then the rationale in the ITC to restrict the options for hedge accounting only to those in IFRS 9 may not be appropriate. **CIPFA/LASAAC's views are sought on this issue.**
23.3	A firm and a local authority could not see a reason for restricting this accounting policy choice in the Code.	The rationale for the approach was set out in the ITC. It set out that CIPFA/LASAAC was of the view that the accounting policies for hedge accounting in IFRS 9 are superior to those in IAS 39. The accounting policy choice is available in IFRS 9 until the IASB has completed its macro hedging project. CIPFA/LASAAC was of the view as local authorities have to date rarely undertaken hedge accounting that this restriction in accounting policy choice would not have any adverse impacts on local authorities. The Secretariat would, however, refer CIPFA/LASAAC to the previous row's comments on whether pension funds use hedge accounting.

Disclosures of Financial Instruments

Question		Agree	Disagree	No Comment
24	IFRS 9 has introduced substantial new disclosure requirements to reflect the changes in the standard for classification and measurement. CIPFA/LASAAC has not included those disclosures that it considers will rarely apply. Do you agree with this approach? Are there any other disclosures that will not normally apply to local authorities which can therefore be removed from the Code? Please give	37 (79%)	1 (2%)	9 (19%)

	reasons for your response.			
25	The Exposure Draft has been written from the perspective that local authorities seldom hold or are required to provide collateral and therefore the relevant disclosure requirements have been removed. Do you agree with this approach? If not, why not? What alternatives do you suggest?	20 (43%)	18 (38%)	9 (19%)

	Issue	Secretariat Response
	Question 24 – Approach to Disclosures	
24.1	The majority of respondents agreed with the approach in the ITC and Exposure Draft and that the Code should not include those disclosures that rarely apply.	No comments. **No changes proposed to the Code Draft.**
24.2	Seven respondents (including a treasury advisor) provided very similar and sometimes identical responses which stated: '*We do not expect local authorities to hold financial liabilities that are subject to a master netting agreement, and therefore parts of paragraph 7.3.2.8 could be removed. Also, we do not expect local authorities to default on their loans payable, so paragraphs 7.3.2.10-11 could be removed*.'	Although the Secretariat concurs that local authorities are unlikely to be subject to master netting agreements. It considers that it would not be appropriate to partially edit paragraph 7.3.2.8. The Secretariat is also of the view that there is low expectation of default. However, if such a default were to occur this would be such an important issue that local authorities should be sure of their reporting requirement and therefore the Secretariat has decided to retain the disclosures at paragraphs 7.3.2.10 to 7.3.2.11. **No changes proposed to the Code Draft.**
24.3	A firm stated: "*we believe the current approach to*	The Secretariat does not concur. The draft provisions do not 'summarise the requirements'. This is particularly

	Issue	Secretariat Response
	the Code which seeks to summarise the requirements of the IFRS rather than requiring practitioners to refer to the standards creates the risk that users of the Code: - *follow the Code but fail to follow the underlying standard* - *do not consider the detailed requirements of the IFRS not covered by the Code.* *"However as it currently stands practitioners expect to be able to rely significantly on the Code in preparing the financial statements. We therefore consider that under its current form, the Code should at least signpost that not all the disclosures required are included in the Code and that practitioners will need to refer to the standard in considering whether other disclosures are relevant and required where material."*	the case for disclosures. The Code Drafts include those disclosures which would normally apply to local authorities. However, the Code Draft makes clear cross references to those disclosures that do not regularly apply and requires that where a local authority has such a transaction direct reference is made to the standard. **No changes proposed to the Code Draft.**
24.4	The same firm continued: "*We also note that the financial instrument disclosures required by IFRS (largely IFRS 7, which is not the subject of the consultation) can be onerous, particularly for smaller public sector organisations with limited exposure to financial instrument risks. We note that FRS101 the Reduced Disclosure Framework, exempts entities from applying the IFRS 7 Financial Instruments: Disclosures in certain circumstances which envisages cost savings in the preparation of financial statements, without reducing the quality of financial reporting. CIPFA/LASAAC may wish to consider whether there may be opportunities to reduce onerous disclosure requirements on smaller entities in the future*."	CIPFA/LASAAC will be aware of the reduced disclosure framework under FRS 101 *Reduced Disclosure Framework, Disclosure exemptions from EU-adopted IFRS for qualifying entities*. However, the reduced disclosures will only apply to the individual financial statements of a qualifying entity but not the consolidated financial statements. Thus the information required by IFRS 7 would be provided in the consolidated financial statements and therefore an accountability framework is retained. The same framework would not be available for many of the smaller local authorities as with the exception of Chief Constables, local authority 'bodies' are the parent entity. This would mean that if smaller local

	Issue	Secretariat Response
		authorities applied the exemption approach in FRS 101 the financial accountability offered by IFRS 7 disclosures would no longer exist. For information the qualifying entity is defined in FRS 101 as: "A *member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation*." **CIPFA/LASAAC's views are sought on this issue.**
	Question 25 – Inclusion of Collateral	
25.1	Twelve respondents (including a treasury advisor) provided very similar responses and typically commented: '*We believe that local authorities will increasingly hold collateral by investing in reverse repurchase agreements, and that paragraph 15 of IFRS 7 should therefore be included in the Code*.' This was supported by another group of respondents who stated '*Local authority pension funds will hold collateral if they have engaged in stocklending or futures. Therefore in my view the Code should retain these requirements*.'	Based on this evidence the Secretariat will add the disclosure provisions on collateral in the Code Draft. The Secretariat considers that these disclosures should also be added to the 2017/18 Code. **CIPFA/LASAAC is invited to consider the responses to question 25 and that paragraph 15 of IFRS 7 should be included in the Code Draft of Appendix F and the 2017/18 Code.**
25.2	A number of respondents indicated that they supported the position in the ITC ie a local authority will seldom hold or pledge collateral.	No comments. **No changes proposed to the Code Draft.**

Presentation

Question	Agree	Disagree	No Comment
26 Do you agree with the approach to the presentation of the gains and losses on financial instruments on the face of the Comprehensive Income and Expenditure Statement? If not, why not? What alternatives do you suggest?	17 (36%)	18 (38%)	12 (26%)

	Issue	**Secretariat Response**
	***Question 26* – Presentation**	
26.1	The majority of respondents do not agree with CIPFA/LASAAC's proposals for the presentation of gains and losses on the face of the Comprehensive Income and Expenditure Statement.	No comments. **No changes proposed to the Code Draft.**
26.2	Seven respondents (including a treasury advisor) provided the same response, often using the same wording: '*the draft Code faithfully reproduces the requirements of IAS 1, save for the double counting of interest income in paragraph 3.4.2.38 c) and ca). But we feel that this level of detail may obscure the main messages of the CI&ES and we suggest that authorities are reminded that line items ca) to cc) where not material can be consolidated into item c) to aid decluttering the accounts*.' At the same time four respondents (including an independent consultant) provided the same response noting that this '*runs counter to the de-cluttering agenda*' indicating that they would prefer the line items ca) to cc) to be included in a note. A number of additional respondents referred to the amount of detail on the face of the	The Secretariat concurs that this additional line detail will make the Comprehensive Income and Expenditure Statement more detailed and potentially more cluttered. It had proposed to include this detail in line c) ie Financing and Investment Income and Expenditure. However, CIPFA/LASAAC wanted to follow the prescriptions of IAS 1 *Presentation of Financial Statements* and this was the option proposed in the Exposure Draft. The Secretariat would note that this approach does not easily align with the general approach of CIPFA/LASAAC in the Code to the Comprehensive Income and Expenditure Statement ie to keep all financing transactions in the Financing and Investment Income and Expenditure line. The Secretariat would recommend that these items are included in the

	Issue	**Secretariat Response**
	statement which they considered would be better presented in a note. One authority queried whether ca – cc was a subset of the Financing and investment income and expenditure line c).	Financing and Investment Income and Expenditure line with the provisions requiring local authorities to disclose these transactions either on the face of the Comprehensive Income and Expenditure Statement or in the Notes, if these items are material. **The Secretariat proposes adding a new paragraph 3.4.2.40 to the Code Draft.**
26.3	A number of respondents were concerned about recognising these gains and losses in the top section in the Comprehensive Income and Expenditure Statement with one commenting '*but there is real potential for volatility in markets impacting on Comprehensive Income and Expenditure Statement both positively or negatively and potentially being a large number'.* A number of these respondents considered that there was a need for a statutory override to protect the General Fund against this volatility. One confidential respondent said: '*We would suggest that CIPFA/LASAAC and local authority bodies lobby central government to consider the implementation of relevant regulations mitigating the impact of such changes on the Surplus or Deficit on the Provision of Services and to allow such balances to be held on the Balance Sheet until any gains or losses are actually recognised upon sale/de-recognition*.'	The Secretariat agrees that the new classifications will mean that more gains and losses will be recognised in the Surplus or Deficit on the Provision of Services. This will particularly be the case for the new 'default' classification 'fair value through profit or loss' where fair value gains and losses will be chargeable to the General Fund if there is no form of statutory mitigation. As there is no clear crossover from the current classifications from IAS 39 to IFRS 9 it would be difficult to quantify what the impact on the General Fund will be. This issue is closely related to the issue of designation of equity instruments to fair value through other comprehensive income where respondents are arguing for this classification in part to protect the General Fund against the effect of such volatility (see question 15 above). **CIPFA/LASAAC is invited to note these responses and consider whether they wish to bring this issue formally to the attention of the relevant government administrations.**
26.4	A firm stated:	This only applies to share and loan

	Issue	Secretariat Response
	'we believe there is a particular need to ensure that there is clear guidance on the application of the statutory override to the treatment of gains or losses on financial assets (whether held at amortised cost, FVOCI or FVP&L) that are treated as expenditure for capital purposes. This is referred to 7.1.9.3 but the Code simply states that "Authorities will need to determine whether any acquisitions or disposals of financial assets are share or loan capital within the meaning of the legislation and account for the statutory requirements.'	capital defined in statute. **Relevant provisions have been added to paragraph 7.1.9.3.** However, as noted earlier local authorities are unlikely to use such financial instruments as a larger part of their treasury management strategies as, if the financial instruments they hold meet the definition of capital expenditure, they will need to be financed by capital resources.

Transition

Question	Agree	Disagree	No Comment
27 Do you agree with the approach to transition included in the Code, including the option to not restate preceding year information? If not, why not? What alternatives do you suggest?	40 (85%)	1 (2%)	6 (13%)

	Issue	Secretariat Response
	Question 26 –Transition	
27.1	One respondent who disagreed was concerned with the potential for additional work if a group entity did not adopt the same transitional requirements.	The Secretariat recognises that this might be an issue but considers that this is likely to be outweighed by the reduced burden relating to the option which does not require restatement of preceding year information. **No changes proposed to the Code Draft.**
27.2	A firm that agreed with the approach in the Exposure Draft and the ITC. It	The Secretariat would note that the Code Draft includes those transitional

	Issue	Secretariat Response
	stated: '*We also note that the not all the IFRS9 transition requirements are in the Code. As mentioned previously we consider that this will lead to risks that users of the Code* - *follow what is set out in the Code, but fail to follow the underlying standard* - *do not fully consider all elements of relevant IFRS where more detailed requirements in the IFRS are not specifically covered by the Code.*	provisions relating to the normal transactions of local authorities and for other transactions cross refers to the Standard. **No changes proposed to the Code Draft.**
27.3	A firm stated: 'In our view it would be helpful if para 7.4.3.10 specified that the adjustment should be to opening reserves (general fund) within the Movement in Reserves Statement.'	Although not included in the Standard the Secretariat concurs. **It has made the relevant amendments to paragraph 7.4.3.10.**

Statutory Accounting Requirements – Impairment of Certain Investments

Question		Agree	Disagree	No Comment
28	Do you agree that the Code no longer needs to include provisions on the statutory accounting requirements for the impairment of certain investments? If not, why not? What alternatives do you suggest?	36 (77%)	0 (0%)	11 (23%)

	Issue	Secretariat Response
	Question 28 – Impairment of Certain Investments	

	Issue	**Secretariat Response**
28.1	A number of respondents supported the proposal to remove the provisions on the statutory accounting requirements for the impairment of certain investments.	No comment. **No changes proposed to the Code Draft.**
28.2	A group of four respondents (including an independent consultant) provided the same response and stated: '*In the Changes to the Code section of the Code there should be an explanation of what these certain investments are (i.e. Icelandic bank deposits, in the main) and what to do with any residual balance in the FIAA*.'	The Secretariat does not concur. The detail of the accounting requirements for the impairment of these investments has been a matter for application guidance. The Secretariat will refer the matter to the Local Authority Accounting Panel though it is unlikely that detailed application guidance would be needed for the residual balance arising from the statutory reporting requirements for the impairment of these investments. This will be a decision for the authority. **No changes proposed to the Code Draft.**
28.3	A number of respondents including an audit body and a firm indicated that they considered that there were no longer statutory adjustments relating to the impairment of certain investments.	No comment. **No changes proposed to the Code Draft.**

Drafting Amendments

	Issue	**Secretariat Response**
Para	***Question 34 –Drafting Issues*** ***A treasury advisor had the following drafting issues***	
7.1.4.7	*Exchange between an existing borrower and Lender* It is unclear whether this test is the only reason why the terms would be substantially different, or if it is one reason among several. Other reasons	The Secretariat retained this test as application guidance in the Code, which has been in place for some time. It does not consider that it can extend the criteria further. **No changes proposed to the Code**

	Issue	Secretariat Response
	might include a change from fixed to variable rate, for example. Additional guidance would be appreciated.	**Draft.**
7.1.6.2	*Fair Value Measurement on Initial Recognition* I think the following should be added at the end: "except for soft loans which shall be accounted for in accordance with paragraphs 7.1.6.4 to 7.1.6.9."	**Agreed and amendments made.**
7.1.6.4	*Soft Loans Advanced* Note that, in the current interest rate environment, a nil interest rate might not be below the market rate.	**The Secretariat concurs and has included a note to this effect in the Code.**
7.1.7.5	*Embedded Derivatives/Hybrid Contracts* Embedded derivatives in local authority financial assets are not that rare – e.g. equity linked deposits, structured deposits with caps and floors, LOBOs lent. Maybe clarify that these are likely to be accounted for as FVTPL since their cash flows are not solely payments of principal and interest.	The Code Draft is not saying that embedded derivatives are rare but that hybrid (combined) contracts with financial asset hosts are rare. **CIPFA/LASAAC's views are sought on this issue**. **No changes proposed to the Code Draft.**
7.2.6.5	*Assets Measured at Fair Value through Other Comprehensive Income* It may be helpful to state the name of the reserve to which the gains/losses taken through OCI should be posted to.	This will be a revaluation reserve for those movements in fair value. The Secretariat does not concur that this paragraph should refer to this. This is not consistent with the approach in IFRS 9. It was also not the approach to drafting under IAS 39. **No changes proposed to the Code Draft.**
7.4.3.7	The final sentence assumes that the acquisition of the equity instruments in question was capital expenditure, but this is not necessarily the case for all such instruments in all jurisdictions at all times in the past.	The Secretariat considers that this might be a possibility but that it is more likely that the equity instruments were as a result of a capital financing transaction. **However, this paragraph now**

	Issue	Secretariat Response
		provides for both alternatives.