CIPFA The Chartered Institute of Public Finance & Accountancy

report

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Committee	CIPFA/LASAAC
Venue	CIPFA Robert Street
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Subject	2014/15 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) – Proposed Exposure Draft and Invitation to Comment

The purpose of this report is to seek the Board's views on the 2014/15 Code of Practice on Local Authority Accounting (the Code) Exposure Drafts and Invitation to Comment

1 Introduction

1.1 At the CIPFA/LASAAC meeting held on 5 March 2013, the Board considered a report on the development of the 2014/15 Code, and agreed that the Secretariat should develop a number of matters for inclusion in the Code. With the exception of the most significant issues - the development programme for the 2014/15 Code is listed in Appendix A to this report, including a brief summary of how these issues have been taken forward in the 2014/15 and future editions of the Code. The most significant issues are summarised below.

1.2 The CIPFA/LASAAC Review noted that the last Invitation to Comment (ITC) was long with numerous questions. Whilst recognising that the Board is acting as a standard setter for local authorities the Review suggested that consideration be given to making the ITC more accessible to interested parties. In order to facilitate this, fewer questions have been raised and an Executive Summary has been included in the ITC.

2 IFRS 13 *Fair Value Measurement*

Introduction and Background

2.1 CIPFA/LASAAC will be aware that it agreed to defer the adoption of IFRS 13 to the 2014/15 Code. The Secretariat has been working closely with colleagues in HM Treasury and has been developing a conceptual approach to adoption of the Standard for property, plant and equipment assets. CIPFA/LASAAC Members received a conceptual paper in March 2013 and this included a FRAB paper from HM Treasury. A small working group with two FRAB Members (including the CIPFA Policy and Technical Director), HM Treasury colleagues and members of CIPFA Secretariat considered the principles and produced a further paper for

FRAB. From this paper a consultation paper has been developed, jointly with HM Treasury colleagues including an approach to the measurement of property, plant and equipment. However, a version (drafted for central government purposes) still needs to be considered by FRAB. Appendix A of the ITC represents a draft from a local authority perspective. CIPFA/LASAAC's views are invited on this early draft but the final version will be available to them at as soon as possible and the same time as FRAB Members.

2.2 The consultation paper provides an analysis of the application of IFRS 13 to property, plant and equipment, including consideration of the conceptual approach to fair value measurement. The analysis sets out that for certain types of asset application of IFRS 13 would mean no change to measurement (route 2). It proposes that the Standard is adapted for assets where service prescriptions and geographical restrictions mean that the authority cannot access the economic benefits available to market participants in its highest and best use (route 3). The adaptation will limit fair value measurement to the asset's current or existing use (see paragraph 2.10.1.20of the Exposure Draft of the 2014/15 Code).

2.3 The paper proposes that for assets where authorities take the same decisions as private sector entities (eg office accommodation for administrative purposes) there will be remeasurement (route 1). It also proposes that for a period of three years where remeasurement is required an adaptation is included to allow authority's to make "directors valuations" ie using appropriate indices. This will allow authorities time to make adjustments to their valuation programmes with minimal additional costs.

2.4 Members of FRAB have also raised the issue of liability measurement under IFRS 13 and this is issue is being considered with HM Treasury and therefore the text in this section may be subject to further drafting. The Secretariat's view is that in accordance with CIPFA/LASAAC's previous approach this is not an issue requiring adaptation and is not a major issue for local authorities as the financial instruments held or owed by local authorities are not normally complex. However, the disclosures of fair value measurements for PWLB debt may need to be considered as these financial instruments do not typically have transfer values - this currently is an issue under IFRS 7 as adopted by the Code.

2.5 The consultation paper will also include consideration of the approach to disclosures which would be onerous for entities applying the Standard that use a level 3 measurement (unobservable outputs) for an asset or a liability. This is likely to be a relatively rare occurrence for the liabilities of local authorities but on consideration of the application to the Standard many of the assets that are currently measured on a DRC basis would be subject to the detailed disclosures of the Standard (see for example, paragraph 2.10.4.1, 3) of the Exposure Draft of the 2014/15 Code). As any adaptation to the Standard will need to align with the disclosure requirements used by the FReM, the options for adaptation will need to be agreed with HM Treasury. A separate paper for CIPFA/LASAAC will follow as soon as possible.

2.6 IFRS 13 has been adopted by the European Union (EU).

CIPFA/LASAAC is invited to consider:

- **the approach to the application of the measurement requirements for property, plant and equipment under IFRS 13 and the proposed Appendix to the ITC,**

- **the proposals for the adaptations of the Standard for the measurement of property, plant and equipment,**

- **whether it considers there needs to be any further prescriptions for the measurement of liabilities under the Standard, and**

- **whether it has any views on the potential for adaptation of the disclosures for property, plant and equipment measured using level 3 inputs.**

3 Group Accounts Standards

3.1 The Group Accounts standards[1] have also been considered as a part of the new working processes with HM Treasury and the Relevant Authorities. These Standards have been considered by the Technical Accounting Group (TAG). Further analysis from the TAG on the Group Accounts standards may need to be added to the ITC and Exposure Draft of the Code. However, the comments below on IFRS 10 are consistent with the TAG debates thus far.

3.2 With two exceptions described below (the interpretation of returns and the disclosures for unconsolidated structured entities) the Secretariat considers that the Group Accounts standards can be applied with minimal interpretation and with an approach that was consistent with the previous approach used in Chapter Nine of the Code.

3.3 The ITC provides the detail of this approach and identifies where the significant proposed amendments to the Code have been made. There are three areas to bring to the attention of CIPFA/LASAAC

- The interpretation of the exemplification of returns (this is consistent with the approach agreed by the TAG).

- That the definition of Investment Entities does not apply to local authorities and therefore the amendments to the standards *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* IASB October 2012 is not included in the Exposure Draft of the 2014/15 Code.

- One of the minor adaptations to the Code (previously to IAS 31 Interests in Joint Ventures- see paragraph 9.1.1.3) has been removed in the Exposure Draft as the Secretariat is of the view that the relationship of an investor in a joint venture is now defined in IFRS 11 and the Exposure Draft of the Code as a joint venture (see paragraph 9.1.2.13). This is supported by the classification of a joint venture as is specified in the new provisions in IFRS 11 and therefore this is not considered a necessary adaptation as outlined in the draft ITC (see paragraphs 9.1.2.45 to 9.1.2.47 of the Exposure Draft to the 2014/15 Code).

3.3 Unconsolidated structured entities are those structured entities that are not controlled by the entity (authority) that has the interest in it. IFRS 12 introduces disclosures about unconsolidated structured entities that were not required previously under IAS 27. One of the objectives of the standard is to increase

[1] IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* (as amended in 2011) and IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011). These standards and the June 2012 amendments to the Standards (transitional arrangements) have been adopted by the EU.

transparency about investees that are not consolidated. For public benefit reasons, the support given by authorities is often by means of grant funding or other on-going financial support including the donation of assets or the provision of financial guarantees. This type of support may be given to entities meeting the definition of unconsolidated structured entities. The introduction of these new disclosure requirements may result in an additional reporting burden for local authorities and there are also likely to be costs to this burden in terms of systems required to capture the information.

3.4 Adding further volume to the financial statements will have implications for cutting clutter in financial statements. This may to some degree be mitigated by clear indications in the Standard that these disclosures need to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation (see paragraphs B2-B6 of IFRS 12). The Secretariat therefore proposes an adaptation at paragraph 9.1.4.24 of the ED of the Code. CIPFA Secretariat considers this adaptation is a minor one which is in line with the objectives of IFRS 12. CIPFA/LASAAC is therefore invited to consider whether it wishes to include the proposed adaptation in the Exposure Draft 2014/15 Code. This adaptation has not yet been considered by the TAG or the FRAB as it has been proposed by the CIPFA Secretariat between TAG and FRAB meetings. It will need to be considered by both these bodies before the Code consultation.

CIPFA/LASAAC is invited to consider:

- **the current approach in the ITC to the consultation on the Group Accounts standards,**
- **the Exposure Draft of the 2014/15 Code for Chapter, Nine Group Accounts,**
- **the removal of the adaptation in paragraph 9.1.1.3. in the Exposure Draft of the 2014/15 Code, and**
- **the proposals for the adaptation in relation to the disclosures on unconsolidated structured entities.**

4 IAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*

4.1 CIPFA/LASAAC will be aware that the 2013/14 Code included the amendment to IFRS *7 Financial Instruments: Disclosures* in relation to offsetting financial assets and liabilities. In December 2011 the IASB also issued amendments to IAS 32 *Financial Instruments: Presentation*. The amendments to the standard are described in the ITC and apply to any authority with such transactions. The amendments to IAS 32 only amend the application guidance in the standard. The Secretariat does not consider that local authorities undertake significant transactions that meet the requirements of offsetting as prescribed by IAS 32. It therefore recommends that minimal amendment be applied to the Exposure Draft of the Code and that it only includes appropriate cross-references to the new application guidance. These amendments have been adopted by the EU.

CIPFA/LASAAC is invited to consider the commentary in the ITC and the 2014/15 Exposure Draft as it relates to IAS 32 and agree with the approach to the proposed amendments.

5 Annual Improvements to IFRSs 2009 – 2011 Cycle

5.1 At the time of drafting only the annual improvements to IFRSs 2009 to 2011 Cycle has been issued by the IASB. The Draft ITC Appendix C includes the Secretariat's analysis of the application of the amendments to local authorities. The ITC sets out that only the amendments that relate to paragraphs 3.4.2.17 and 3.4.2.29 (ie the changes related to IAS 1) require amendment to the Exposure Draft of the 2014/15 Code. This set of annual improvements has been adopted by the EU.

CIPFA/LASAAC is invited to consider whether it agrees to this approach.

6 IFRIC 21: *Levies* and *Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)*

6.1 In May 2013 the IASB has issued IFRIC 21: *Levies* and *Recoverable Amount Disclosures for Non-Financial Assets* (Amendments to IAS 36). The IFRIC and the amendments to IAS 36 *Impairment of Assets* both have an effective date of 1 January 2014 and therefore would apply to the 2014/15 Code. However the European Financial Reporting Advisory Group (EFRAG) endorsement status report sets out that it does not anticipate that the IFRIC and the Amendments to IAS 36 will be adopted by the European Union until the first quarter of 2014 ie after the effective date of the Code. Therefore the ITC only notes the issue of the IFRIC and the Amendments to IAS 36 and has not included this in the Exposure Draft of the 2014/15 Code. This is in line with the approach in last year's ITC.

CIPFA/LASAAC's views are sought on this proposed approach.

7 Local Government and Other Public Sector Combinations – Merger Accounting

7.1 CIPFA/LASAAC agreed at its June meeting to include in its development programme consideration of the amendments to the FReM arising from its consultation. The ITC sets out the issues that the Secretariat considers need to be included in the Code as a result of the new provisions in the FReM. These include

- the definition of transfer of a function;
- the clarification of the requirements described as transfer by absorption;
- the recognition of gains or losses incurred as a result of the transfer of a function;
- explicit recognition of provisions relating to transfers by merger; and
- the accounting requirement for part year transfers of functions.

7.2 The arguments for the treatment in the Code are included in the ITC. There are three specific issues that the Secretariat considers need to be brought to the attention of CIPFA/LASAAC:

1) The treatment of the gains and losses on transfer of functions – the recognition of gains and losses is consistent with the approach used previously by local authorities in the Code but not consistent with the provisions of the FReM.

2) The explicit recognition of full merger accounting in the Code – as previously reported, to the Board, most local government transactions had previously been recognised and measured using the principles of merger accounting but on the basis of transfer by absorption.

3) The accounting treatment for part-year transfers previously Section 2.5 of the Code had been drafted from an assumption of 1 April transfers.

CIPFA/LASAAC's views are sought on the approach in the ITC and the Exposure Draft of the 2014/15 Code and explicitly on the three issues itemised in paragraph 7.2.

8 Minor Amendments

8.1 Items 1, 6 and 7 in Appendix A to this report cover the proposed approach to the minor amendments to the Exposure Draft of the 2014/15 Code and ITC.

8.2 Appendix A to this report also provides the Secretariat's response to the issues included in the development programme.

CIPFA/LASAAC is invited to provide its initial views on the minor amendments and other issues considered in Appendix A.

9 Post-Implementation Review – Review of the Movement in Reserves Statement

9.1 At CIPFA/LASAAC's last meeting an observer Member of the Board raised the issue of the complexity of the Movement in Reserves Statement (MiRS). As a key user of local authority financial statements this is a relevant issue for consideration by CIPFA/LASAAC and the Board requested that a review of the MiRS be initiated. The Secretariat has therefore raised this issue in the ITC and has included relevant questions to obtain evidence for the proposed review.

10 Statutory Changes to Local Government Financial Reporting

10.1 The ITC considers a number of legislative changes that might impact on the financial reporting requirements in the Code. These include:

- Amendments to the Community Infrastructure Levy Regulations
- The Local Authorities (Capital Finance and Accounting)(England) (Amendment) Regulations

The Secretariat can see no clear reason currently to amend the Code (with the exception of legislative references, where applicable) and has therefore made not proposals for amendment.

10.2 The ITC mentions other possible changes to legislation that would impact on the reporting requirement in the Code ie Local Authority Accounts (Scotland) Regulations 1985 (as amended) and the Accounts and Audit Regulations (Wales) 2005 (as amended).

CIPFA/LASAAC is invited to provide its initial views on the approach to statutory changes affecting local government financial reporting.

11 Accounting for Schools in Local Authorities (England and Wales)

11.1 An update on accounting for schools is included elsewhere on the CIPFA/LASAAC agenda. However, interested parties are likely to be keen to understand current progress on the groups that are considering the accounting treatment and an understanding of the process and timescales for the consideration of any changes to current treatment. CIPFA Secretariat has discussed the overall approach with the Chair and has included a proposed commentary and way forward. This indicates that CIPFA/LASAAC need to consult in the autumn on the proposed accounting treatment for maintained schools in England and Wales for the 2014/15 Code.

CIPFA/LASAAC's views are invited on the proposed wording in the ITC.

12 CIPFA Code of Practice on Transport Infrastructure Assets

12.1 An update on the Code of Practice on Transport Infrastructure Assets is also considered elsewhere on the agenda. The Secretariat considers it would like to discuss options for the commentary to be included in this year's ITC on the potential future adoption of the measurement requirements in the (Transport Infrastructure) Code for transport infrastructure assets in the (Accounting) Code ie a move from Depreciated Historical Cost to Depreciated Replacement Cost with the Board and therefore the text for this section of the ITC has yet to be drafted.

12.2 CIPFA/LASAAC will be aware that it has consulted on the 1) voluntary adoption and 2) a future date for adoption (2014/15 Code with retrospective restatement) in the last two consultations on the Code. As background information, the first two editions of the Code stated:

"The Code does not require infrastructure assets (eg roads) to be carried at fair value. Infrastructure is carried at depreciated historical cost although this will be reconsidered in future once the CIPFA project on infrastructure assets has been completed (2010/11 and 2011/12 Code paragraph 2.1.2.27)."

Currently the 2013/14 Code states:

"The Code does not require infrastructure assets (eg roads) to be carried at fair value. Infrastructure is carried at depreciated historical cost. CIPFA/LASAAC will consider options for a possible move to a depreciated replacement cost (DRC) measurement basis (based on the CIPFA Code of Practice on Transport Infrastructure Assets) following consideration of the progress of the provision of DRC information as a part of the Whole of Government Accounts process (paragraph 2.1.2.31)."

CIPFA/LASAAC's views are invited on the approach to the proposed wording in the ITC

13 Other Code Development Issues

13.1 This section of the ITC covers two areas which have been covered in previous consultations on the Code ie service concession arrangements and the accounting for Carbon Reduction Commitment (CRC) Energy Efficiency Scheme.

13.2 CIPFA/LASAAC will be aware that last year the consultation analysis was inconclusive in relation to the treatment of the liability. The Secretariat considers that it may be a more effective approach to consider the treatment following the issue of the new Leasing Standard which has been recently re-exposed. The Exposure Draft is available by means of the following link http://www.ifrs.org/Alerts/ProjectUpdate/Pages/IASB-and-FASB-propose-changes-to-lease-accounting-May-2013.aspx

13.3 The ITC also covers the accounting treatment of the grant of the right to the operator model. As there are opposing views on this model and the Secretariat is not aware of any transactions that local authorities are faced with under it the Secretariat has not taken forward any further changes in the Code.

13.4 The ITC also brings to the attention of interested parties that the accounting treatment of CRC Allowances remains under review. The Secretariat is not aware that authorities are either trading in the allowances or are retaining material allowances at the end of the financial year. The Secretariat therefore recommends noting this issue in the ITC.

CIPFA/LASAAC's views are invited on the approach to the proposed wording in the ITC

14 Further guidance

14.1 This and earlier consultations have sought respondents' views on improvements, rationalisation of accounting and disclosure requirements and other areas for further guidance in the Code. This section has therefore been retained in the ITC.

recommendation

CIPFA/LASAAC is asked to provide its initial views on the:

1) Exposure Draft of the 2014/15 Code; and
2) Invitation to Comment on 2014/15 Code.