CIPFA The Chartered Institute of Public Finance & Accountancy

CIPFA BULLETIN 03

Closure of the 2018/19 Financial Statements

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The Local Authority Accounting Panel issues CIPFA Bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting, SeRCOP and Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but are not prescriptive and do not have the formal status of the Code, SeRCOP or Prudential Code.

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SECTION A: FINANCIAL INSTRUMENTS

INTRODUCTION

1. The 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) has adopted IFRS 9 *Financial Instruments*. Application Guidance on the adoption of IFRS 9 is principally included in CIPFA's publication *IFRS 9 Financial Instruments: An Early Guide for Local Authority Practitioners* CIPFA, December 2017 (the Early Guide to IFRS 9). This guidance was drafted on the basis of the separate publication which accompanied the 2017/18 Code *Forthcoming Provisions for IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers in the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 (Forthcoming Provisions)*.

2. The 2018/19 Code's provisions did not change in substance from the Forthcoming Provisions publication, with the exception of a new interpretation issued by CIPFA/LASAAC. This interpretation relates to the impairment of financial assets where the counterparty is central government or a local authority and statute prevents default[1], although this interpretation represents what was very likely to be the practical outcome for such financial assets.

3. There were, however, some edits to the structure of the Code's provisions and therefore the cross references to the Code in the early guide needed to be updated.

4. In addition the Welsh Government issued the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 (WSI 2018/326 W61) which removed the acquisition of loan capital and also investments in certain types of share capital (including money market funds) from the definition of capital expenditure.

5. CIPFA has issued an update sheet to bring the Early Guide to IFRS 9 in line with the changes, which includes a small number of other augmentations to the guidance. Publication subscribers and organisations who have purchased the Early Guide to IFRS 9 can find the update sheet in the 'Download PDF and Resources' folder, found in 'Contents' in the digital version (also as a direct link at the foot of the 'Background' page).

6. Guidance on IFRS 9 is also included in the 2018/*19 Code of Practice on Local Authority Accounting in the United Kingdom Guidance Notes for Practitioners 2018/19 Accounts* (Code Guidance Notes) which are now available.

7. Both these publications flagged the issue of a different accounting treatment which would be brought about by IFRS 9 *Financial Instruments*: Prepayment Features with Negative Compensation (IASB October 2017). This Bulletin principally covers the accounting treatment relating to modifications or exchanges of financial liabilities that do not result in derecognition (but also covers a small number of other issues relating to IFRS 9). These changes were brought forward by clarifications included in the Basis of Conclusions paragraphs BC4.252 and BC4.253.

[1] See the Code paragraph 7.2.9.1 and the footnote identifying the relevant local authority legislation. The identification of 'central government' bodies may not always be clear and, in the case of doubt, authorities may wish to refer to the ONS Public Sector classification guide. The NHS website describes NHS Trusts in England as "self-standing, self-governing organisations".

8. **It is important to note that these transactions do not relate to all exchanges of liabilities but only to those exchanges of liabilities that have not previously resulted in derecognition.** Historically the majority of these transactions appear to have applied to transactions prior to the application of the financial instruments standards in local authorities ie pre 1 April 2007. However, they might apply to any further restructure that takes place following that date where the original liability is not derecognised.

MODIFICATIONS OR EXCHANGES OF FINANCIAL LIABILITIES THAT DO NOT RESULT IN DERECOGNITION

9. The amendments to IFRS 9 clarify that an entity recognises any adjustment to the amortised cost of the financial liability arising from a modification[2] or exchange in profit or loss at the date of the modification or exchange and that the new amortised cost should be measured using the original and not the new effective interest rate.

10. CIPFA would note CIPFA/LASAAC does not propose to change the main provisions of IFRS 9 in the Code as IFRS 9 itself has not been amended. The clarification resides in the basis of conclusions paragraphs referred to in paragraph 7. It is recognised that this change is likely to bring about a change in accounting practice for authorities carrying balances that were not derecognised on modification or exchange. It will also mean a change to guidance on this issue in the Early Guide to IFRS 9 and the Code Guidance Notes.

11. The change to the Basis of Conclusions of IFRS 9 leads to the following anticipated treatment for a financial liability that is modified/exchanged but not derecognised. Local authorities will need to:

- calculate a new carrying amount by discounting the revised contractual cash flows with the original effective interest rate (resulting in a gain or loss on modification)
- take the difference between the new carrying amount and the old carrying amount to the Comprehensive Income and Expenditure Statement as a gain/loss on modification
- adjust the new carrying amount and recalculate the effective interest rate to amortise any other costs and fees incurred in the modification.

12. Under IAS 39 *Financial Instruments: Recognition and Measurement* as adopted by the Code it was possible to:

- retain the old carrying amount
- recalculate the effective interest rate using the revised cash flows.

13. The IAS 39 treatment had been carried forward into the Early Guidance to IFRS 9 example (A37), on the basis that IFRS 9 did not specify any new treatment for modified liabilities to contradict IAS 39 (although the specified treatment for modified financial assets in IFRS 9 would be inconsistent with it). The Code Guidance Notes also referred to this issue in paragraphs A13 and A14.

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[2] As indicated in paragraph 8 it is anticipated that the majority of debt restructurings would be considered likely to have failed the 'modification test' criteria and that de-recognition of the original debt would have applied. In these cases the guidance provided here would not normally apply.

14. The following text therefore replaces the relevant paragraphs in the Early Guide to IFRS 9 in relation to modifications and exchanges of financial liabilities where there is no derecognition.

REPLACEMENT TEXT FOR THE EARLY GUIDE TO IFRS 9 FINANCIAL INSTRUMENTS FOR MODIFICATIONS AND EXCHANGES OF FINANCIAL LIABILITIES WHERE THERE IS NO DERECOGNITION

A36 The assessment as to whether there has been an exchange or a modification is best understood by a worked example. The projected cash flows before and after the restructuring are scheduled out according to when payment is due and then discounted using the original effective interest rate (NB: the example below shows the premium being paid upfront, but other restructurings may feature (eg) a premium being wrapped up in the loan as an additional settlement sum or as a surcharge on the interest payable).

ILLUSTRATION: ASSESSMENT OF DEBT RESTRUCTURING EXERCISE

Blackwood Ho! Council had taken out a loan of £1m at a fixed rate of 8% that has four years to run. Interest rates have fallen. The lender offers to cancel the existing loan agreement provided that the council agrees to take out a replacement loan of £1m at 6% for eight years, with payment of a £100,000 premium payable on renegotiation. No arrangement fees were payable.

At the date of the restructuring, the projected cash flows for the original loan were as follows, with the contracted interest rate of 8% also being the effective interest rate for the loan:

	Principal £	Interest £	Total £	Discount factor	Present value £
Year 1	–	80,000	80,000	0.92592593	74,074
Year 2	–	80,000	80,000	0.85733882	68,587
Year 3	–	80,000	80,000	0.79383224	63,507
Year 4	1,000,000	80,000	1,080,000	0.73502985	793,832
			1,320,000		1,000,000

The calculation confirms that the amortised cost of the loan at the restructuring date is equal to the principal amount in the contract.

Under the new agreement to borrow £1m at 6%, the scheduled cash flows (discounted at the original rate of interest of 8%) are as follows:

	Principal £	Interest and Premium £	Total £	Discount factor	Present value £
Year 0	-	100,000	100,000	1.0000000	100,000
Year 1	–	60,000	60,000	0.9259259	55,556
Year 2	–	60,000	60,000	0.8573388	51,440
Year 3	–	60,000	60,000	0.7938322	47,630
Year 4	–	60,000	60,000	0.7350299	44,102
Year 5	–	60,000	60,000	0.6805832	40,835
Year 6	–	60,000	60,000	0.6301696	37,810
Year 7	–	60,000	60,000	0.5834904	35,009
Year 8	1,000,000	60,000	1,060,000	0.5402689	572,685
			1,580,000		985,067

As the present value of the new cash flows of £985,067 is only 1.49% less than the £1,000,000 amortised cost, the restructuring qualifies under the 10% rule as an exchange of instruments.

A37 The accounting treatment for modifications and exchanges is that a new carrying amount is established at the date of modification by discounting the new contractual cash flows by the original effective interest rate. The premium or discount in this example is treated as a new contractual cash flow to be reflected in the recalculation of the carrying amount.

Step 1 – Calculate the new carrying amount by discounting new contractual cash flows by original Effective Interest Rate (8%)

From the analysis in the preceding table, the new carrying amount of the loan (remaining cash flows discounted by the original effective rate) is £985,067.

Step 2 – Adjust carrying amount

The difference between the old carrying amount of £1,000,000 and the new carrying amount of £985,067 is balanced by a credit to the Comprehensive Income and Expenditure Statement (Financing and Investment Income and Expenditure line) of £14,933.

Step 3 – Adjust carrying amount for fees and costs

If any fees and costs have been incurred in relation to the facilitation or administration of the modification exchange, the carrying amount would be adjusted for them and a new effective interest rate calculated so that they are amortised over the revised loan term. No fees or costs have been incurred in this example. [See IFRS 9 Financial Instruments, for example B5.4.1 – B5.4.8 and B3.3.6, for details regarding effective interest calculations and the treatment of fees and costs].

Step 4 – Programme accounting transactions for the revised loan term

The accounting arrangements for the remainder of the loan term will then be based on:

	Opening Principal	Effective Interest	Actual Interest and Premium	Closing Principal
Year 0	985,067	0	100,000	885,067
Year 1	885,067	70,805	60,000	895,873
Year 2	895,873	71,670	60,000	907,542
Year 3	907,542	72,603	60,000	920,146
Year 4	920,146	73,612	60,000	933,757
Year 5	933,757	74,701	60,000	948,458
Year 6	948,458	75,877	60,000	964,335
Year 7	964,335	77,147	60,000	981,481
Year 8	981,481	78,519	60,000	1,000,000

The Gain/Loss on Modification and the Premium

The total for revenue costs after modification is £580,000: £100,000 of premium payable plus actual interest of £480,000 (£60,000 x 8 years). The overall accounting debits and credits are:

	£000's
Gain/loss on modification	(14,933)
Effective interest debits	594,933
Total	580,000

This shows that the gain recognised in the Comprehensive Income and Expenditure Statement upon modification is a timing issue which arises from the requirement to use the old Effective Interest Rate to calculate a new carrying amount on modification. This gain will effectively be reduced by the subsequent interest charges. There is therefore reasonable justification for treating the credit cautiously when setting budgets. This example illustrates a gain on modification. It is also possible that a loss may be incurred.

IMPACT ON LOCAL AUTHORITIES AND TRANSITION

15. CIPFA is of the view that this is not a frequent transaction for local authorities. Local authorities do not normally undertake restructures which do not result in derecognition. However, as a result of the consultation on the 2018/19 Code, which included the amendments to IFRS 9, some evidence suggests that there are a relatively small number of authorities with transactions which are affected by the change in accounting treatment ie exchanges or modifications of loans which are not derecognised and these are particularly relating to pre 2007 loan restructures (ie at the point at which financial instruments standards were introduced to local

authorities). There is a possibility that there are more authorities with such transactions.

16. The change in accounting treatment as clarified in the amendments applies to IFRS 9 transactions and therefore will apply as of 1 April 2018. Local authorities with such transactions will need to remeasure the amortised cost of their loans using the original effective interest rate as set out in the examples above. Any material gains or losses on renegotiation would need to be recognised and in cases of transactions before 1 April 2018 a transition adjustment would be required. Using the example above the transaction would be as follows:

Adjustment Arising on Transition for Modifications and Exchanges of Financial Liabilities where there is no Derecognition	
	£'000
Amortised cost recognised under the previous practices following the Code's approach to IAS 39 *Financial Instruments: Recognition and Measurement* as at 1 April 2018 *(note the calculations for the old IAS 39 figures are not reproduced in this bulletin)*	909,497
New carrying amount following the Code's approach to IFRS 9 practices as at 1 April 2018	895,873
Difference (gain) loss to Reserves	**(13,624)**

Journal Entries on Transition	
	£'000
Dr Financial Liability (loan account)	13,624
Cr General Fund Balances*	13,624
Recognition of the gain on transition arising from the new accounting treatment for modifications and exchanges of financial liabilities where there is no derecognition. Please note the comments in Step 4 above regarding the 'timing difference' nature of this gain and the exercise of appropriate caution. * As discussed in paragraphs 17 and 18 below the presentation illustrated here of a modified/cumulative catch up retrospective adjustment to reserves approach is subject to confirmation by CIPFA/LASAAC.	

17. As there are no amendments to the provisions of IFRS 9 there are no specific transitional provisions relating to these transactions. Such a change in accounting practice would need to be recognised under standards retrospectively, and as no specific reliefs are included in IFRS 9, this would normally require full retrospective restatement. However, to be consistent with the approach to the adoption of IFRS 9 and to ensure that the reporting burden is minimised, CIPFA/LASAAC is considering an adaptation to IFRS 9 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* on transition to IFRS 9 in an Update to the 2018/19 Code by the middle of March. Subject to the decision by CIPFA/LASAAC this Update may

require a modified/cumulative catch-up approach to these transactions where they occur. This will mean that there is retrospective restatement (see the example entries above) but there is no requirement to restate the preceding year information. Only in the event that CIPFA/LASAAC does not confirm a cumulative catch up retrospective adjustment and the impact is material would restatement of the prior year be necessary. As noted in paragraph 15 these transactions are anticipated to be uncommon, and authorities should consider the application of materiality in determining the appropriate accounting treatment.

18. Subject to CIPFA/LASAAC's confirmation local authorities will recognise any difference between the previous carrying amount and the carrying amount at the beginning of the 2018/19 financial year as an opening adjustment to reserves. This opening adjustment will need to be presented in the Movement in Reserves Statement. Where these transactions are material the authority will need to disclose the change in accounting treatment, the impact on the 2018/19 reporting period and the line item affected by the adjustments. Consideration will also need to be given to whether the statutory reversals applicable in the authority's territory might apply, or whether some impact on fund balances may arise.

PREPAYMENT FEATURES WITH NEGATIVE COMPENSATION

19. The main changes to IFRS 9 are related to financial assets with prepayment features with negative compensation. Under the current IFRS 9 requirements, the solely payments of principal and interest condition is not met if the lender has to make a settlement payment in the event of termination by the borrower. The amendments to IFRS 9: *Prepayment Features with Negative Compensation* allow entities to measure particular financial assets with prepayment features with negative compensation* at amortised cost or at fair value through other comprehensive income if the relevant criteria are met, instead of at fair value through profit or loss.

   *Negative compensation arises where the contractual terms permit the borrower to prepay the instrument before its contractual maturity, but the prepayment amount could be less than unpaid amounts of principal and interest.

20. CIPFA/LASAAC's consultation papers took the view that local authorities did not have such transactions. However, a number of respondents to the Code consultation indicated that some local authorities may lend to other entities with prepayment terms at a discount and the transaction may exist. These respondents indicated that to promote consistency between financial years and in accordance with the IASB's own approach the Code should allow for early adoption in 2018/19. CIPFA/LASAAC agreed with this approach and therefore local authorities will be permitted to apply this amendment on transition to IFRS 9. Local authorities will therefore need to consider whether they have such transactions when considering its classification of financial assets under IFRS 9.

PRESENTATION OF IMPAIRMENT LOSSES OR GAINS

21. The CIPFA Finance Advisory Network (FAN) has provided a series of workshops on IFRS 9. FAN has issued an update to delegates focussing on Frequently Asked Questions. One of those questions related to the presentation of movements in the impairment allowance for bad debts in the Comprehensive Income and Expenditure Statement (CIES). This question was raised so regularly CIPFA has included the discussion on the issue in this Bulletin.

22. The 2018/19 Code paragraphs 3.4.2.38 (c) and 3.4.2.40 indicate that the following list of the IFRS 9 transactions should be included in Financing and Investment Income and Expenditure (FIIE) line:

- interest revenue calculated using the effective interest method

- gains and losses arising from the derecognition of financial assets measured at amortised cost

- impairment losses[3] (including reversals of impairment losses or impairment gains).

Note that paragraph 3.4.2.40 indicates that where these transactions are material they should be disclosed either on the face of the Comprehensive Income and Expenditure Statement or in the Notes.

23. The Financing and Investment Income and Expenditure treatment would be consistent with the concept of debtors no longer being purely amounts due for the provision of goods and services, but having now become credit facilities to be treated like loans. Any loss from bad debts (impairment or derecognition) which are considered to relate to the provision of credit facilities would thus now be a loss of principal, rather than a non-payment for the goods/services. On this basis, recognising in the Financing and Investment Income and Expenditure line is the default treatment.

24. Authorities may of course manage and establish their own internal arrangements for the responsibility and control of impairment (eg bad debts). Any material presentation difference between the internal arrangements, as reported to management, and those required for compliance with the Code in terms of presentation in the Financing and Investment Income and Expenditure line in the CIES should be reflected through adjustments in the middle column(s) of the Expenditure and Funding Analysis.

25. The expectation is that compliance with the Code will provide a 'true and fair view' however if authorities consider that a presentation of impairments in service segments better reflects the economic reality of the transaction they may determine this under the general reporting requirements of the Code[4].

26. Where an authority is considering a materially different presentation of impairment losses in the CIES the authority will need to develop a case for the alternative treatment. There is a new requirement for a note breaking down the movement in loss allowances over the year, so in reporting terms there is no compulsion to have the total figure in FIIE as well.

27. Authorities should however note that such a departure would generally be exceptional, requiring a clear disclosure of this including the rationale and impact of the departure (see Code paragraph 3.4.2.22) and the policy adopted (see also Code paragraphs 3.3.2.9 -13 regarding determining accounting policy). Evidence will be required to support the judgement made. Liaison with auditors is suggested as they will be obliged to consider the impact on their audit opinion and to address the matter in their report to those charged with governance.

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[3] Note – The term 'bad debt provision' is no longer a recognised term in the context of the Code's requirements. In the context used here the presentation requirement generally refers to impairments losses (including reversals of impairment losses or impairment gains) (see Code paragraph 3.4.2.38 c)). Where relevant the terminology related to taxation income used in the Code, for example paragraph 2.8.2.1 b), is "impairment allowance for doubtful debts".

[4] See the Code paragraph 2.1.1.7 which outlines the expectations but which notes "it remains the responsibility of the authority to ensure that its financial statements present a true and fair view of the financial position, performance and cash flows of the authority." See also paragraph 3.4.2.22 regarding the disclosures required.

PRESENTATION OF IMPAIRMENT LOSSES OR GAINS – HOUSING REVENUE ACCOUNT (HRA)

28. Where an authority in accordance with the Code includes HRA financial asset impairment losses in the Comprehensive Income and Expenditure Statement FIIE line, it may appropriately consider presenting the impairment losses in the HRA Income and Expenditure Statement as follows:

    Per Code paragraph 3.5.3.1

    HRA share of the operating income and expenditure included in the whole authority Comprehensive Income and Expenditure Statement:

    s) interest payable and similar charges

29. Where an alternative approach is adopted, for instance following the illustration in the Guidance Notes Module 3 paragraph J8 and the accompanying text in J18, this may mean that the expenditure and income in the HRA Income and Expenditure Statement does not agree to the figures in the CIES. In that event an explanation and reconciliation may be provided.

COUNCIL TAX AND NON DOMESTIC RATES IMPAIRMENTS – PRESENTATION AND POLICY (ENGLAND)

30. Impairments relating to council tax and non-domestic rates are not required to be presented in the Financing and Investment Income and Expenditure line in the CIES. The Code paragraph 3.4.2.38 c) refers only to "impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with section 7.2.9 of the Code".

31. Authorities which have used, or plan to use, the 'accounting policy' wording from the Code Guidance Notes should note that the following text of page 394 is incorrect (relevant part noted in bold):

    Incorrect text: "Where debtor balances for the above are identified as impaired because of a likelihood arising from a past event that payments due under the statutory arrangements will not be made (fixed or determinable payments), the asset is written down and **a charge made to the Financing and Investment Income and Expenditure line in the CIES**….."

32. The text should be amended to:

    Replacement text: "Where debtor balances for the above are identified as impaired because of a likelihood arising from a past event that payments due under the statutory arrangements will not be made (fixed or determinable payments), the asset is written down and **a charge made to the Collection Fund**……."

FINANCIAL INSTRUMENTS (CHAPTER SEVEN / IFRS 9) AND REVENUE FROM CONTRACTS WITH SERVICE RECEIPIENTS (SECTION 2.7/ IFRS 15) TRANSITIONAL DISCLOSURES

33. Authorities should be aware that the implementation of both IFRS 9 *Financial Instruments* and Revenue from Contracts with Service Recipients (IFRS 15) will require specific consideration of the transitional disclosures appropriate for their readers.

34. The 2018/19 Code transitional disclosure requirements for IFRS 9 are specified in Code paragraphs 7.4.3.16 – 7.4.3.24. To support implementation practitioners may wish to refer to:

    - The Disclosure Checklist For 2018/19 Accounts (England NFS 122-130 Scotland / Wales NFS 121-129)

    - IFRS 9 Financial Instruments: An Early Guide for Local Authority Practitioners – page 131 onwards –includes example disclosure notes

35. The 2018/19 Code transitional disclosure requirements for IFRS 15 are specified in paragraph 2.7.4.20. To support implementation practitioners may wish to refer to

    - The Disclosure Checklist For 2018/19 Accounts (England 18/19 (England NFS 76B Scotland / Wales NFS 75B)

    - Guidance Notes For Practitioners 2018/19 Module 2 G130 – G137 – shows example transitional disclosures

36. For both Financial Instruments (IFRS 9) and Revenue from Contracts with Service Recipients (IFRS 15) authorities may wish to be prepared to evidence that they have made materiality assessments as to whether disclosure is required for the following:

- Provision of accounting policy explanations for each year;

- The provision of comparators for 2018/19 showing balances described under the old standard (for example as part of the transition disclosures – see references provided above), and;

- The extent of the need to provide disclosures for 2017/18 information and specific information for 2018/19. For example Code paragraph 7.4.3.20 requirements relating to IFRS 9 regarding some reclassifications.

- Authorities should consider the materiality of these for the readers of the accounts in the context of the specific disclosure objectives stated in the new Code requirements for financial instruments (for example see the 2018/19 Code paragraph 7.3.2.1) and revenue from contracts with service recipients (for example see the 2018/19 Code paragraph 2.7.4.1-4).

DESIGNATION OF EQUITY INSTRUMENTS AS FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVOCI)

37. Where authorities intend to designate an equity instrument to FVOCI (see Code paragraph 7.1.5.9) evidence should be established to ensure that the necessary criteria are met. The *IFRS 9 Financial Instruments: An Early Guide for Local Authority Practitioners* provides more detail in this respect. Authorities may also wish to be aware of these IFRS website items:

    - IFRS 9 and equity investments (see particularly the section headed 'Reporting value changes in profit or loss gives better information about value creation over time')
    - IFRIC Update September 2017 –the IFRIC decision confirmed that the IAS 32 *Financial Instruments: Presentation* definition of an equity instrument has to be met. Proceeding to the full update provides more detail.

MEASUREMENT OF INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES AND INTERESTS IN JOINT VENTURES – SINGLE ENTITY FINANCIAL STATEMENTS

Code Requirements

38. The Code paragraphs 9.1.2.61-63 address measurement requirements for investments in subsidiaries and associates and interests in joint ventures. This includes the following:

"9.1.2.61 Within the reporting authority's single entity financial statements, investments in subsidiaries and associates and interests in joint ventures that are not classified as held for sale (see section 4.9 of the Code) shall be accounted for either:
- at cost, or
- in accordance with chapter seven (Financial Instruments)."

"9.1.2.62 The reporting authority shall apply the same accounting for each category of investments."

39. 'Single entity financial statements', as referenced above, is defined in the Code paragraph 9.1.2.23 and, in particular:

- a footnote states "IAS 27 uses the term 'separate financial statements' but this has been changed for the purposes of the Code to 'single entity financial statements'."; and

- the Code also states "In the context of the Code, an authority's single entity financial statements are deemed to be separate financial statements."

40. Chapter 9 of the Code does not indicate any adaptation or interpretation of IAS 27 *Separate Financial Statements* other than that in paragraph 9.1.1.4 (the withdrawal of the option for single entity financial statements to equity account for such investments).

IFRS 9 Financial Instruments: An Early Guide for Local Authority Practitioners

41. The *IFRS 9 Financial Instruments: An Early Guide for Local Authority Practitioners* (paragraph A14 first bullet point) includes "If group accounts are not prepared, interests are accounted for fully in accordance with Chapter 7." The relationship between this and the apparent option of choice in Code paragraph 9.1.2.61 (see above) has been queried.

42. The Early Guide statement is based on IAS 27 requirements notably:

- Paragraph 6 of IAS 27 notes that 'separate financial statements'[5] in IAS 27 are statements which are generally presented *in addition to* consolidated (i.e. group) financial statements.
- Paragraph 7 of IAS 27 reinforces this by stating "The financial statements of an entity that does not have a subsidiary, associate or joint venturer's interest in a joint venture are not separate financial statements."
- Paragraph 8 does however allow in some situations that separate financial statements may be the only financial statements provided.

[5] Note also that paragraph 4 (definitions) indicates that 'separate financial statements' are those where the option, subject to criteria, to account for at cost, in accordance with IFRS 9 financial instruments or using the equity method is permitted.

- Paragraph 10 only allows the options for the accounting treatment of the investments (eg at cost or under IFRS 9) to be exercised for the separate financial statements

43. The effect of the IAS 27 requirements may potentially be regarded as allowing that IFRS 9 measurement is not required in 'separate financial statements' where consolidated (group) statements provide a clear view of the overall economic situation for the group.

    Code Implementation Considerations

44. It has been suggested that, where an authority does not prepare group accounts due to materiality considerations, alternative interpretations of the Code requirements may be construed to permit these to be carried at cost in the single entity statements.

45. In considering the appropriate application of the Code requirements authorities may wish to note the following:

    - The provision of group accounts would establish beyond any doubt that the option of 'cost or financial instrument' is applicable. It is however appreciated that due to cost-benefit considerations this may only be undertaken where the issue is of significance for the authority.

    - Authority choice of accounting policy should be made in accordance with the requirements of the Code paragraphs 3.3.2.9 -13.

    - Measurement of investments or interests as financial instruments may be helpful to the readers of the annual accounts

    - The Code statement (noted above) that "In the context of the Code, an authority's single entity financial statements are deemed to be separate financial statements." may potentially be argued to support the view that all authority single entity statements, regardless of whether group accounts are prepared, are separate financial statements and therefore qualify for the 'cost or financial instrument' option in the Code paragraph 9.1.2.61.

    - Where material subsidiaries (for example[6]) are included in the group accounts and carried at cost, ensuring a consistent accounting policy is applied to each category of investment in the single entity statements may mean that

        - non-material subsidiaries which are excluded from group accounts should also be carried at cost, or
        - all investments in subsidiaries are measured as financial instruments.

    - Where presentation of group accounts is not considered material for readers of the accounts an assessment of whether the presentation of a financial instrument based amount for the interest or investment in single entity financial statements would be material may be appropriate.

    - If cost is used as the measurement basis, and group accounts are not prepared disclosures to reconcile the carrying amount to the financial instrument requirements of Chapter 7 of the Code may be helpful to readers of the annual accounts

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[6] The same logic and principles apply to investments in associates and interests in joint ventures

- Where investments in subsidiaries, associates or interests in joint ventures are carried at cost, they are not exempt from impairment (see Section 4.7 of the Code).

46. In considering the above authorities will wish provide appropriate evidence to support the treatment. Disclosure of the accounting policy, any significant judgements arising, and early discussion with auditors may be considered appropriate.

LOCAL AUTHORITY BUDGET SETTING: MITIGATING THE IMPACT OF FAIR VALUE MOVEMENTS ON POOLED INVESTMENT FUNDS (ENGLAND)

47. In November 2018 the government issued its response to the consultation for local authorities in England on Local authority budget setting: mitigating the impact of fair value movements on pooled investment funds.

48. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2018 (SI 2018/1207) subsequently came into force on 19 December 2018. See particularly the amendments which insert regulation 30K. The regulation applies to 2018/19 accounts and ceases on 31 March 2023.

49. Authorities should note that where the relevant criteria are met for fair value gains and losses on a pooled investment fund the authority "must charge that amount to an account established, charged and used solely for the purpose of recognising fair value gains and losses in accordance with this regulation."

50. The adjustment noted above does not apply to impairment losses, sale or disposals related to pooled investment funds.

51. Neither government nor CIPFA/LASAAC has yet specified a name for the account required. In order to assist consistency of terminology CIPFA suggests that an appropriate title would be the "**Pooled Investment Funds Adjustment Account**" until or unless a mandatory title is specified.

52. In the event that any investments are capital in nature, and therefore fall under the Prudential Code framework, the existing capital accounting arrangements (eg Capital Adjustment Account) would be anticipated to apply.

53. If you have any comments on the accounting requirements for this statutory override please provide them to financial.reporting@cipfa.org.

54. Please note that this Bulletin only comments on the statutory position in England. CIPFA is aware that the issue has also been considered by the devolved administrations in Scotland and Wales.

LEGAL DEFINITION OF MONEY MARKET FUNDS (ENGLAND, WALES)

55. Authorities should note that The Local Government (Miscellaneous Amendments) (EU Exit) Regulations 2018 (SI 2018/1386) have been issued and are, per the instrument, effective on "exit day" which may therefore be before 31 March 2019.

56. Commentators, including treasury advisors, have noted that regulation 5 of the instrument changes the definition of "money market fund" in the underlying Capital Finance and Accounting regulations (SI 2003/3146). It has been indicated that the change is potentially significant and will affect investments in non-UK EU domiciled

funds, which are currently a significant element of the money market fund marketplace.

57. In particular it has been noted that all or many of these non-UK domiciled funds have been, or will be, granted temporary marketing permission under other legislation to allow them to continue to be invested in by UK investors. Potentially ensuring that such funds are included in the SI 2003/3146 definition of money market funds will primarily address the issue.

58. It is understood that for English and Welsh authorities the respective governments have indicated that they are aware of the position and that there is no intention to change the existing policy regarding the definition and treatment of such investments. The respective governments are understood to be currently reviewing and planning legislative measures to address the situation, to avoid uncertainty and to ensure no significant change arises on exit day.

COUNCIL TAX AND NON-DOMESTIC RATES (NON-FINANCIAL ASSET DEBTORS) DISCLOSURES

59. Queries have been noted regarding the disclosure requirements for non-financial asset debtors specified in the 2018/19 Code paragraph 5.2.4.2 3). For the disclosures specified in 5.2.4.2 3a) and 3b) authorities will wish to assess the materiality of these disclosures for the readers of the accounts.

60. Where the disclosure in 5.2.4.2 3) a) is considered to be material the example disclosure number 21 in the 2018/19 Guidance Notes for Practitioners on page 462 may be assisted by adding the following sentence underneath:

> "The analysis above only shows those balances where assessment has indicated that, by exception, no impairment is required."

SECTION B: OTHER TOPICS AFFECTING THE CLOSURE OF THE 2018/19 ACCOUNTS

STREAMLINING THE ACCOUNTS: GUIDANCE FOR LOCAL AUTHORITIES

61. Developed by CIPFA's Local Authority Accounting Panel and the Society of London Treasurers this streamlining the accounts guidance is intended to support authorities and auditors. Areas addressed include:

    - applying materiality
    - streamlining accounting policies
    - streamlining presentation and layout
    - streamlining the closure process
    - working papers and audit trail
    - the chief finance officer's responsibilities
    - an auditor's view of streamlining

    Appendices include
    - materiality example
    - disclosure notes
    - streamlining closure processes
    - working papers and pre-audit review
    - key tasks for chief finance officers

CODE SECTION 2.7 (IFRS 15) REVENUE FROM CONTRACTS WITH SERVICE RECIPIENTS

62. Authorities will be aware that IFRS 15 *Revenue from Contracts with Customers* has been adopted by the 2018/19 Code, primarily in Section 2.7, and applies from 1 April 2018.

63. As a consequence, amendments were also implemented in the Code Section 2.1 to more clearly illustrate the revenue recognition treatment for different revenue streams, including non-exchange transactions.

64. The Code requirements to the assessment of agency and principal in Section 2.6 are also now based on IFRS 15 criteria.

65. Authorities may anticipate that evidence will be required to support implementation, including adjustments to opening balances where arising, contract assets and liabilities where material, and the treatment of complex or long-term contracts.

66. Authorities should also review and determine the materiality and applicability of the disclosures noted in the Code for the readers of their accounts. The Guidance Notes For Practitioners 2018/19 Module 2 paragraph G5 onwards, provide a suggested framework for undertaking this assessment.

TRANSACTIONS BETWEEN SEGMENTS PROHIBITED

67. Authorities are reminded that the Code paragraph 3.4.2.39 now explicitly prohibits transactions between segments from being presented in the Comprehensive Income and Expenditure Statement. Where an authority includes such transactions in its management reporting arrangements, they should be eliminated in the middle column(s) of the Expenditure and Funding Analysis.

ANALYSIS OF DEBTORS AND CREDITORS

68. Authorities should note that the requirement to analyse debtors and creditors now permits authority judgement as to the categories presented. See the Code paragraphs 3.4.2.63; 5.2.4.2 and 8.1.4.2.

EU WITHDRAWAL (BREXIT)

69. Dependent on events the impact of the UK's withdrawal from the European Union, reference in the annual accounts may require consideration. Events may indicate otherwise, and authorities should assess the relevance of the following in relation to their organisation's own specific circumstances and the needs of the readers of their annual accounts.

70. Potential areas for consideration by authorities will include:

    - Narrative Report (Management Commentary in Scotland): The formal requirements differ across the UK, however narratives may, where appropriate, include commentary on the potential forward impact on income, expenditure and the balance sheet, and key risks and opportunities arising for the authority.

    - Estimation uncertainty and judgements: Disclosure or explanation of any additional estimation uncertainty and judgements made.

    - Market volatility: This may affect various assets, including pension assets, government bonds and property values (both operational and investment). Financial liability fair values may also be affected. This may affect the extent of reliance placed on early estimation. *(Note: 29 March 2019 is a Friday and the potential for market value changes to occur between then and the 31 March 2019 may exist)*.

    - Events after the reporting period: Potentially Brexit events during the closure period, or even the audit process, may need to be reflected in the accounts.

GUARANTEED MINIMUM PENSION (GMP)

71. Guaranteed Minimum Pension (GMP) requirements relate to, in summary, situations where a pension scheme was 'contracted out' of additional state pension arrangements eg SERPs or S2P. If the contracted out pensions benefits are less than the pensioner would have received if the contracting out had not applied the pension scheme would be required to increase the pension paid to reach the GMP.

72. The UK government website states that :

    "Defined benefit pensions schemes that were Contracted-out Salary Related (COSR) schemes before contracting-out ended on 6 April 2016 need to provide a Guaranteed Minimum Pension (GMP) to members for contracted-out service between 6 April 1978 and 5 April 1997.

    The GMP is payable at age 60 for a woman and at age 65 for a man."

73. It is currently unclear whether estimates of impact are available for all public sector pension schemes and whether there is sufficient basis for the recognition of a 'past service cost' for each scheme. Actuaries are understood to be assessing the impact

on LGPS funds and other schemes however this may not be sufficiently advanced to affect the formal pension liability reports.

74. Authorities should liaise with their relevant pension schemes' administrators and consider what evidence is available regarding the potential impact to inform a relevant accounting treatment for 2018/19, for instance disclosure of a contingent liability. Following initial information collation, early discussion with external auditors is suggested.

PENSIONS TRANSITION ARRANGEMENTS AGE DISCRIMINATION

75. Authorities should note that a legal ruling has been made regarding age discrimination arising from pension scheme transition arrangements. Court of Appeal judgements were made in cases affecting judges pensions (eg McCloud) and firefighter pensions (eg Sergeant) which had previously been considered by employment tribunals.

76. The ruling may have implications for other pension schemes which have implemented transitional arrangements for benefit changes. As a consequence the government has paused the 'cost cap' arrangements for a number of schemes.

77. It is currently unclear whether estimates of impact are available for all pension schemes. Authorities should liaise with their relevant pension schemes' administrators.

78. Consideration of the evidence available will inform a decision regarding the relevant accounting treatment for 2018/19, for instance disclosure of a contingent liability. Following initial information collation, early discussion with external auditors is suggested.

LOANS FUND REPAYMENT (SCOTLAND)

79. The Local Authority (Capital Finance and Accounting)(Scotland) Regulations 2016 (SSI 20169/123) came into force on 1 April 2016 and replaced the provisions in the Local Government (Scotland) Act 1975 in respect of the loans fund with a prudent approach. Statutory guidance with finance circular 7/2016 applies.

80. Although the Scottish Government has announced that the regulations and statutory guidance will be amended to allow pre-April 2016 advances to be repaid under the new prudent approach, the amendment is not expected until sometime in 2019/20; and will not apply to the 2018/19 financial year. The impact of the amendment will therefore be in 2019/20.

ACCOUNTING STANDARDS THAT HAVE BEEN ISSUED BUT HAVE NOT YET BEEN ADOPTED

81. Standards that have been issued but not yet adopted, which may require disclosure in 2018/19 accounts, are anticipated to be listed in Appendix C of the 2019/20 Code when it is published. In the interim potentially relevant standards include:

    - Amendments to IAS 40 *Investment Property: Transfers of Investment Property*
    - *Annual Improvements to IFRS Standards 2014 - 2016 Cycle*
    - IFRIC 22 *Foreign Currency Transactions and Advance Consideration*
    - IFRIC 23 *Uncertainty over Income Tax Treatments*
    - Amendments to IFRS 9 *Financial Instruments: Prepayment Features with Negative Compensation*