

## Financial Reporting Advisory Board Paper

### Code of Practice on Local Authority Accounting

<b>Issue:</b>	Update on CIPFA/LASAAC development of the <i>Code of Practice on Local Authority Accounting in the United Kingdom</i> (the Code)
<b>Impact on guidance:</b>	<p>Future editions of the local government Code will be affected by the following CIPFA/LASAAC work activities:</p> <ul style="list-style-type: none"> <li>a) IFRS 16 <i>Leases</i></li> <li>b) Strategic direction</li> <li>c) Development of consultation proposals for the 20/21 Code</li> </ul>
<b>IAS/IFRS adaptation?</b>	<ul style="list-style-type: none"> <li>A) IFRS 16 <i>Leases</i>: Additional adaptation, to match FReM proposals regarding 'nil consideration' arrangements.</li> <li>B) Strategic direction: As part of the fundamental review, consideration of reliance on and adaptation / interpretation of standards is anticipated. Liaison and communication with FRAB will be ensured.</li> <li>C) Development of 20/21 Code consultation: <ul style="list-style-type: none"> <li>i. Specific considerations may arise regarding IAS 19 <i>Employee Benefits</i> (in year plan amendments etc); and the requirements for Service Concession Arrangements (SCA: PFI/PPP etc)</li> <li>ii. New and amended IFRS and IPSAS standards will be considered and liaison maintained with FRAB secretariat / HM Treasury staff on proposals.</li> </ul> </li> </ul>
<b>Impact on WGA?</b>	<ul style="list-style-type: none"> <li>A) IFRS 16 <i>Leases</i>: CIPFA/LASAAC proposals are envisaged to ensure appropriate alignment for WGA purposes, with no material differences from central government.</li> <li>B) Strategic direction: The review may identify aspects which would potentially relate to WGA requirements. Liaison with WGA, HMT and FRAB as key stakeholders will be ensured.</li> <li>C) Development of consultation proposals for 20/21 Code: Liaison with FRAB secretariat / HM Treasury staff to identify potential WGA consolidation issues (including SCA) is to be maintained.</li> </ul>

<b>IPSAS compliant?</b>	<p>A) IFRS 16 <i>Leases</i>: No additional proposals requiring reference to IPSAS.</p> <p>B) Strategic direction: As part of the fundamental review, consideration of reliance on and adaptation / interpretation of IPSAS standards is anticipated. Liaison and communication with FRAB will be ensured.</p> <p>C) Development of 20/21 Code consultation: New and amended IPSAS standards will be considered and liaison maintained with FRAB secretariat / HM Treasury staff on proposals.</p>
<b>Impact on budgetary regime?</b>	None – local authorities only.
<b>Alignment with National Accounts</b>	<p>A) IFRS 16 <i>Leases</i>: No additional National Accounts issues identified arising from the further proposals noted.</p> <p>B) Strategic direction: Liaison and communication regarding ONS / National Accounts is to be maintained.</p> <p>C) Development of 20/21 Code consultation: Liaison will be maintained with FRAB secretariat / HM Treasury staff on proposals (incl SCA) where National Accounts implications may arise.</p>
<b>Impact on Estimates?</b>	None – local authorities only.
<b>Recommendation:</b>	The Board is requested to comment on the proposed approach to Code development.
<b>Timing:</b>	<p>2019/20: IFRS 16 <i>Leases</i> early adoption consideration affects 2019/20</p> <p>2020/21 onwards: Vision statement and strategic plan</p> <p>2020/21: IFRS 16 <i>Leases</i>; and Development of Code 20/21 consultation proposals</p>

## **DETAIL**

### ***Background***

1. CIPFA/LASAAC met on 5 March 2019. Key items discussed included:

- a) IFRS 16 *Leases*
- b) Vision Statement and Strategic Plan
- c) Development of the 20/21 Code Consultation proposals

## **IFRS 16 Leases**

2. FRAB have previously reviewed the Code proposals for IFRS 16 Leases. On 5 March 2019 CIPFA/LASAAC considered some remaining aspects of implementation, noted below:

### **a. IFRS 16: Subsequent Measurement of Right of Use (RoU) Assets**

Following a request by FRAB for greater alignment between local and central government proposals using a principles based approach, HM Treasury and CIPFA/LASAAC secretariat staff co-ordinated on proposals. The FReM proposals were provided to FRAB in an out of meeting paper, and are a specific agenda item for this meeting.

The proposed text to incorporate the combined proposal, and ensure mutual alignment between the FReM and the Code, was discussed. CIPFA/LASAAC approved the proposed text.

A copy of the proposed text is provided as Appendix A for FRAB review.

### **b. IFRS 16: Comparison with FReM Proposals**

CIPFA/LASAAC reviewed areas of difference from the FReM proposals.

- i The FReM now proposes adapting the IFRS 16 definition of a lease to include arrangements with 'nil consideration'.

CIPFA/LASAAC noted that the code consultation had not raised this as a proposal for local government feedback, and reviewed whether the IFRS 16 definition should be retained for local government, which would be a difference from the FReM.

It was particularly noted that the existing position would create a significant difference in treatment between arrangements at £1 annual rental, and those at £0. It was considered that amending the definition would support faithful representation in those cases where a RoU asset may arise in a 'nil consideration' arrangement.

CIPFA/LASAAC concluded that the Code should align to the FReM and extend the definition of a lease to include 'nil consideration' arrangements.

Text is to be drafted for CIPFA/LASAAC approval and subsequent FRAB review.

- ii The FReM proposes to mandate the use of hindsight on transition (for example in assessing the lease term). The Code proposals, in accordance with IFRS 16, allow the use of hindsight as an option.

CIPFA/LASAAC debated the difference from the FReM. It was noted that:

- mandating of hindsight had not featured in the Code consultation

- the Code proposal to allow the option was supported by consultation respondents
- stakeholders had indicated that the decision of whether to apply hindsight was appropriately undertaken at an entity level (eg for cost / benefit considerations)
- it was expected that in the majority of cases hindsight would be applied in practice
- the potential impact on WGA consolidation should be considered.

[Note: Subsequently the WGA team were contacted. Detailed WGA arrangements for transition have not yet been developed and there is currently no identified issue arising for WGA.]

CIPFA/LASAAC concluded that an adaptation to mandate the use of hindsight on transition was not necessary for local government and was not expected to give rise to significant WGA consolidation concerns.

Appendix B provides an analysis of the differences, by exception, between the FReM and Code proposals for IFRS 16.

**c. IFRS 16: Service Concession Arrangements (SCA)**

As a result of significant stakeholder responses regarding the use of IFRS 16 Leases as the basis for SCA (eg PFI/ PPP etc) liability measurement CIPFA/LASAAC agreed to establish a working group.

The working group will consider wider aspects of SCA accounting, including assignment of third party revenues, as well as liability measurement. Proposals and questions are to be developed for the 20/21 Code consultation.

**d. IFRS 16: Early Adoption Request**

Transport for London (TfL), which reports under the local government Code, has requested the ability to early adopt IFRS 16 in its 2019/20 accounts. TfL has a large number of group entities which report under EU adopted IFRS and which have significant lease arrangements. This largely parallels the situations in which the FReM proposals would allow early adoption.

Prior to a decision CIPFA/LASAAC are investigating the implications, particularly regarding

- WGA and ONS National Accounts requirements
- the potential for other entities to request early adoption
- treatment of Service Concession Arrangements
- RoU Asset revaluation requirements for TfL RoU assets

### ***Vision Statement and Strategic Plan***

3. Following a strategy review event, which included stakeholder feedback and consideration of recent practical experience of standards implementation (eg IFRS 9), CIPFA/LASAAC has initiated a process to strengthen strategic direction and to implement changes which support this.
4. The key elements of the process are:
  - a. **Vision Statement**

A vision statement is being agreed to state the strategic goal for UK local authority accounts.
  - b. **Strategic Plan**

To support vision statement achievement a strategic plan was discussed based on three main themes:

    - Clearly articulating key financial messages in the annual accounts
    - Stakeholder engagement, including raising awareness and understanding
    - Review of operations, including Code format
  - c. **Work Streams**

A number of workstreams aligned to the themes are being established. Objectives include:

    - Identification of key messages
    - Stakeholder engagement and outreach actions
    - Disclosures and materiality behaviours
    - Narrative reporting
    - Code format
  - d. **Planned outputs**
    - Early proposals where possible for inclusion in the 20/21 Code consultation
    - Development of plans and direction for the 21/22 Code
    - Potential structural and format changes of the Code for 21/22
  - e. **Differential Reporting Arrangements**

CIPFA/LASAAC reviewed an early research paper on examples of differential reporting arrangements (eg by size of entity). A discussion paper is proposed for issue in summer 2019, with recognition that WGA requirements will be a consideration factor.
  - f. **Comparison of Code and FReM Requirements**

To inform both CIPFA/LASAAC's strategic plan actions, and the FReM review process, CIPFA/LASAAC and FRAB secretariats propose undertaking a comprehensive comparison of the current requirements for local and central government.

### ***Development of the 20/21 Code Consultation proposals***

5. The consultation process is central to the Code development process. Significant amendments after the proposals are issued may be open to stakeholder challenge or require further public consultation.
6. Consequently FRAB review of the 20/21 consultation proposals will be critical in supporting mutual alignment, and recognition and agreement of divergences, between the Code and the FReM.
7. CIPFA/LASAAC expects to review an initial draft of the consultation on 4 June 2019.
8. On 5 March CIPFA/LASAAC considered initial aspects of the 20/21 Code consultation to be considered in developing the draft consultation proposals:

#### Legislative Developments

- England: Capital Finance and Accounting regulations amendments (including Pooled Investment Funds)
- Wales: planned regulations re Pooled Investment Funds

#### Post Implementation Review Items

- Pension Guarantees
- Service Concession Arrangements

#### Policy and other Developments:

- Impact of EU withdrawal on UK accounting standards
- NAO Code of Audit Practice

#### Items previously consulted on in the 19/20 Code ITC:

- No significant indication of a requirement to re-consult on the proposals for Amendments to IAS 12 (Income Taxes); IAS 28 (Associates & JVs); or IAS 23 (Borrowing Costs)
- Stakeholder feedback warrants development of proposed treatment and specific consultation regarding IAS 19 (Employee Benefits) re in-year plan amendments etc

#### LGPS Pensions SORP alignment:

- Some minor amendments to ensure alignment of classifications etc

#### New and amended IFRS

- IAS 1 and IAS 8 – Definition of materiality
- IFRS 3 – definition of a business
- Conceptual Framework

#### IFRS not yet effective or not yet EU endorsed

- IFRS 14 *Regulatory Deferral Accounts*: No action planned
- IFRS 17 *Insurance Contracts*: Co-operation and collaboration with HMT working group planned. Initial focus expected to be on establishing possible

scope of impact (applicable arrangements) in local government.

IFRS Amendments in Development: to be reviewed when issued

- IAS 1 – current / non-current classification of liabilities
- IFRIC 14 / IAS 19 – Limit on a defined benefit plan asset etc
- IAS 16 – PPE proceeds before intended use

IPSAS Standards

- IPSAS 41 Financial Instruments: to be reviewed, no significant impact currently envisaged
- IPSAS 42 Social Benefits: Minor revisions anticipated.

9. Liaison is planned with FRAB secretariat and MH Treasury staff as part of the consultation proposals development.

10. A number of items are also proposed for the forward work plan:

Item	Target Code Year
Capital Accounting	Code 22/23
Group Accounts	Code 22/23
Charities Consolidation	Code 22/23
IFRS 13 <i>Fair Value Measurement</i> (Review)	Code 23/24
IFRS 9 <i>Financial Instruments</i> (Review)	Code 23/24
IFRS 15 <i>Revenue From Contracts with Customers</i> (Review)	Code 23/24
IPSAS 23 update - revenue – non exchange transactions (IPSAS 23 update)	Code 23/24
IPSASB – Revenue non exchange expenses (IPSASB project)	Code 24/25
IPSASB Heritage Asset (IPSASB Project)	Code 25/26

### **Summary and recommendation**

11. This report sets out details of CIPFA/LASAAC proposals regarding

1. IFRS 16 Leases implementation
2. Strategic direction
3. Development of the consultation proposals for the 20/21 *Code of Practice on Local Authority Accounting in the United Kingdom*.

12. The Board is requested to comment on the proposals affecting the development of future editions of the Code.

**CIPFA/LASAAC**  
**April 2019**

## Appendix A – Extract of Draft Code 20/21 re IFRS 16 Leases

### Adaptation for the public sector context

4.2.14 The following adaptations of IFRS 16 apply:

#### Recognition

The Code adapts IFRS 16 to require local authorities to apply the recognition exemption to short-term leases (see paragraph 4.2.2.30).

#### Measurement

The Code adapts IFRS 16 and requires that the subsequent measurement of the right-of-use asset where the underlying asset is an item of property, plant and equipment is measured in accordance with section 4.1 of the Code (see paragraph 4.2.2.50). **This adaptation includes the use of the cost model in IFRS 16 as a proxy for current value for most right of use assets.**

### Subsequent measurement

#### Subsequent measurement of the right-of-use asset

4.2.50 After the commencement date a lessee shall measure the right of use asset in accordance with section 4.1 for property, plant and equipment at current value in accordance with the following:

- a) On an asset by asset basis, for right of use assets which are measured at current value per Section 4.1 as a practical expedient the cost model in b) shall be used as a proxy for current value unless paragraph c) applies..
- b) to apply a cost model, a lessee shall measure the right-of-use asset at cost as defined in this section of the Code:
  - i) less any accumulated depreciation and any accumulated impairment losses, and
  - ii) adjusted for any remeasurement of the lease liability specified in paragraph 4.2.2.52 c).

Note that the latter adjustment would follow the same accounting treatment (including the statutory accounting requirements) as subsequent expenditure (ie additions to cost) on owned assets under section 4.1 of the Code.

- c) for some right of use assets the use of the cost model in b) as a proxy for current value will be inappropriate. This is anticipated, subject to rebuttal, to be the case



where both of the following conditions are met:

- i. A longer-term lease has no provisions to update lease payments for market conditions (such as rent reviews), or there is a significant period of time between those updates;
- and
- ii. There is a significant risk that the fair value or current value in existing use of the underlying asset will fluctuate significantly due to changes in market prices. This is particularly likely to be the case with property assets.
- d) following the transitional arrangements specified in paragraph 4.2.2.95 the lease asset will be transferred at its carrying amount for finance leases which commenced prior to the date of initial application ie 1 April 2020. From that date such right-of-use assets may continue to be measured in accordance with the revaluation provisions in section 4.1.
- e) for the avoidance of doubt a local authority with property, plant and equipment right of use assets which are measured using valuation shall apply the requirements of Section 4.1 regarding remeasurement.

**4.2.2.50A** Subject to the requirements of IFRS 16 paragraph 32 of IFRS 16 the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. A lessee shall apply the requirements of section 4.7 to determine whether the right of use asset is impaired.

## Other Consequential Amendments

### 4.1.4 Disclosure Requirements

**4.1.43** Having regard to paragraph 3.4.2.27 of the Presentation of Financial Statements section of the Code, which permits authorities not to provide a specific disclosure if information is not material, authorities shall disclose the following notes in relation to property, plant and equipment:

- 1) The financial statements shall disclose, for each class of property, plant and equipment:
  - a) the measurement bases used for determining the gross carrying amount
  - b) that the IFRS 16 cost model has been used as a proxy for valuation of right of use

assets within the class, if this is the case, and the reasons why

- c) the depreciation methods used
- d) the useful lives or the depreciation rates used
- e) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period, and
- f) a reconciliation of the carrying amount at the beginning and end of the period showing:

## APPENDIX B – Differences between FReM and Code Proposed IFRS 16 Leases Implementation

The table below provides a brief overview of FReM treatments which are not currently included in the Code proposals<sup>1</sup>, and the status of each item.

<b>Difference (FReM Implementation Proposals not included in the Code)</b>	<b>Status</b>
a. Permits restricted early adoption in 2018/19	Under review
b. Includes intra UK Government non-legally binding arrangements	Previously accepted
c. Peppercorn leases: <ul style="list-style-type: none"> <li>• RoU assets may be recognised at EUV instead of Fair Value</li> <li>• Specifies treatment for heritage assets</li> </ul>	Previously accepted
d. Interest rate specified by government where own incremental rate or implicit rate unavailable.	Previously accepted
e. Right of Use Asset subsequent measurement	Alignment proposed (subject to FReM finalisation per the 4 April Agenda)
f. Transition: use of hindsight, for instance in determining the lease term, is mandatory	FRAB requested clarification. CIPFA/LASAAC re-considered the code proposals and concluded that there was insufficient stakeholder backing and evidence to support interpretation for local government, and that the difference in approach was not anticipated to pose a significant WGA consolidation risk.

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<sup>1</sup> i.e. the table is on an 'exception reporting' basis