Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	To consider the Draft *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) 2016/17 (excluding the detail on the Highways Network Asset and the Update to the 2015/16 Code.
Impact on guidance:	Changes to the text of the 2015/16 Code to produce the Drafts of the 2016/17 Code are proposed in relation to*: (a) A review of the Accounting and Reporting by Pension Funds section of the Code, (b) Narrow Scope Amendments to International Financial Reporting Standards, (c) Augmentation of the Code's provisions on Concepts following the issue of the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities,* (d) Legislative amendments, (e) Other minor and drafting amendments, and (f) Changes emanating from *Telling the Story - Improving the Presentation of Local Authority Financial Statements* consultation. *The detail on the Highways Network Asset is included in a separate report.
IAS/IFRS adaptation?	A new adaptation is proposed for (a) to IFRS 13 *Fair Value Measurement* to remove the fair value disclosure scope exclusion for the investments of local authority pension funds. For (b) the narrow scope amendments are proposed to be adopted without adaptation or interpretation with two exceptions: (i) the Draft 2016/17 Code adapts IAS 16 to withdraw the option for the treatment of accumulated depreciation and impairment where gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset; (ii) the Draft 2016/17 Code in an interpretation does not permit local authorities to apply equity accounting in the single entity (separate) financial statements per the amendments to IAS 27 *Separate Financial Statements* (2011). There are no new adaptations or interpretations proposed as a result of (c) to (f).
Impact on WGA?	The proposals in (a) to (f) are not expected to impact on WGA in respect

	of these standards or amended standards.
IPSAS compliant?	There is no IPSASB equivalent of either IAS 26 *Retirement Benefits* or IFRS 13 so there are no issues of compliance for (a). The interpretation of IAS 16 for (b) applies equally to IPSAS 17. The majority of the remaining narrow scope amendments to IFRS have not yet been adopted by IPSASB, with the exception of the amendments to IAS 27 *Separate Financial Statements*, Equity Method in Separate Financial Statements. This has been adopted in IPSAS 34 *Separate Financial Statements* and therefore would be an interpretation also of IPSAS 34. The additional guidance in the Concepts section for the provisions of the IPSASB Conceptual Framework is consistent with the Framework. The amendments in (d) and (e) are consistent with IPSASB standards. The proposals for (f) are difficult to assess as IPSAS 18 was developed in 2002 and has not been updated for the requirements of IFRS 8.
Impact on budgetary regime?	None – local authorities only.
Alignment with National Accounts	The current position regarding alignment with National Accounts is not expected to change.
Impact on Estimates?	None – local authorities only.
Recommendations:	The Board is requested: 1) To approve the amendments to the 2016/17 Code and the 2015/16 Code Update for the local authority context arising from the proposals set out in this paper (including the Annex to the Code setting out the differences from the FReM) and the changes made since the 2015/16 Code; 2) To agree to consider whether any further amendments to the Code can be delegated to the Chair or considered by the FRAB in an out of meeting paper.
Timing:	2015/16 and 2016/17

DETAIL

Background

1. The CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC) issued the two consultations on the Code on 24 July 2015. The consultation period closed on 9 October 2015. Seventy-two responses were received to the main consultation on the Code whilst eighty-nine responses were received to the *Telling the Story, Improving the Presentation of Local Authority Financial Statements* consultation. This is an extremely positive response rate and is the largest since the move to the IFRS based Code in 2010/11. Overall the respondents were

very supportive of the proposals. A list of the respondents to the consultations is included at Annex A.

2. The Exposure Drafts of the 2016/17 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) were considered by the FRAB in June 2015.

3. CIPFA/LASAAC considered the consultation responses at its meeting on 4 November 2015 and has provided its initial views on the Draft 2016/17 Code following the consultation. This report sets out briefly the substantive revisions made to the Exposure Draft considered by FRAB following the consultation process, highlighting areas where the Code takes a different approach from the FReM following the decisions CIPFA/LASAAC took at its meeting on 4 November 2015.

4. As CIPFA/LASAAC is currently reviewing the attached Draft 2016/17 Code for its final approval there may be subsequent drafting refinements. It is anticipated that these will be minor issues. The CIPFA/LASAAC Secretariat recommends that these be subject to delegated approval by the FRAB Chair. In the unlikely event that the further changes are substantial it is recommended that an out of meeting paper be sent to FRAB Members. The updated Draft 2016/17 Code is attached to this report as Annex B for the Board's approval. In addition, as the separate report on the Highways Network Asset notes, CIPFA/LASAAC has also proposed on an exceptional basis to issue a 2015/16 Code Update: this is included at Annex C. A full list of the amendments in the Draft 2016/17 Code is included in Annex D.

5. The Annex which sets out the differences between the Code and the FReM is included in the Draft 2016/17 Code. This list has been updated to reflect the new reporting requirements for the Highways Network Asset.

Changes since the 2015/16 Code – specific issues included in the Draft 2016/17 Code

The measurement of the Highways Network Asset (Transport Infrastructure Assets) in accordance with the CIPFA Code of Practice on Transport Infrastructure Assets ie at Depreciated Replacement Cost (DRC)

6. This is dealt with in the separate paper on the Highways Network Asset ie FRAB 125 (09) (ii).

(a) A review of the Accounting and Reporting by Pension Funds section of the Code

7. CIPFA/LASAAC has undertaken a review of the Accounting and Reporting by Pension Funds section of the Code to coincide with the issue of the *Financial Reports of Pension Schemes – A Statement of Recommended Practice 2015*. The proposals in the consultation papers were supported by respondents and subject to minor clarifications on the format of the Pension Fund Account the Draft 2016/17 Code is largely unchanged. The most substantial change in the consultation was an adaptation to IFRS 13 *Fair Value Measurement* to remove the scope exclusion for disclosures of retirement benefit plan investments measured at fair value. This was supported by the vast majority of responses for that question in the consultation.

8. There was less support for the recommended disclosure on transaction costs, where the responses focused on a lack of understanding on what that might mean and particularly the definition of transaction cost. However, other than clarifying that transaction costs were those defined in IAS 39 *Financial Instruments: Recognition and Measurement CIPFA*/LASAAC decided to proceed with the disclosure, as it considered that this was an area subject to substantial scrutiny across sectors. CIPFA/LASAAC was also of the view that it wanted to review whether it might mandate this disclosure in the 2017/18 Code.

(b) Narrow Scope Amendments to International Financial Reporting Standards

9. The Draft 2016/17 Code adopts the following narrow scope amendments to IFRS:

- Amendments to IAS 1 *Presentation of Financial Statements* (IASB Disclosure Initiative).
- Amendments to IAS 19 *Employee Benefits* (Defined Benefit Plans: Employee Contributions).
- *Annual Improvement to IFRSs 2010 – 2012 Cycle.*
- *Annual Improvement to IFRSs 2012 – 2014 Cycle.*
- *Amendments to IFRS 11 Joint Arrangements – Accounting for Acquisitions of Interests in Joint Operations.*
- *IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture.*
- *Amendments to IAS 27 Separate Financial Statements - Equity Method in Separate Financial Statements.*

10. The majority of these amendments have been adopted without any adaptation or interpretation (except for local government terminology). This is with two exceptions cited below.

11. CIPFA/LASAAC decided during its debates on the Annual Improvement to IFRSs 2010 – 2012 cycle to withdraw the IAS 16 option for the treatment of accumulated depreciation and impairment where the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset (except for the Highways Network Asset). There were no technical accounting responses that require change from the Exposure Draft and therefore for property, plant and equipment (other than the Highways Network Asset) the Draft Code includes the adaptation of IAS 16 as featured in the Exposure Draft to remove the non-elimination option for the treatment of accumulated depreciation and impairment.

12. CIPFA/LASAAC has also agreed not to take forward the option in the amendments to IAS 27 *Separate Financial Statements* ie equity accounting for a local authority's interest in subsidiaries, associates or joint ventures. CIPFA/LASAAC agreed this as the IAS 27 change had not been required for technical accounting reasons and for local authorities the single entity financial statements take precedence over the group accounts. The reliability of these statements is paramount. CIPFA/LASAAC has agreed to review this position following the IASB's conceptual review of equity accounting.

(c) Augmentation of the Code's provisions on Concepts following the issue of the IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

13. These amendments which focus on the definition of public sector users and understandability of information have proceeded as outlined in the consultation papers and Exposure Draft. They received support from the majority of respondents.

(d) Legislative Developments

14. The 2016/17 Code has been updated for legislative developments. These comprise:

- The Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015 (for English authorities),
- The Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015, and
- The issue of Statutory Guidance produced by the Scottish Government on Equal Pay and Severance (see item (f) below).

15. The Accounts and Audit Regulations 2015 include new prescription that the narrative statement ie that it "*must include comment by the authority on its financial performance and economy, efficiency and effectiveness in its use of resources over the financial year*". Respondents were generally supportive of the approach to the amendments for the Narrative Statement as a result of the Accounts and Audit Regulations 2015. Two firms considered that the Code should not just encourage authorities to follow the FReM but should require authorities to follow it. Two respondents considered that the principles in the Narrative Report went further than the requirements in the Accounts and Audit Regulations 2015. CIPFA/LASAAC considered that it was establishing principles for Narrative Reporting and those principles are based on generally accepted guidance throughout the UK.

16. Other than minor corrections and drafting improvements there have been no other substantive changes since the Exposure Draft as a result of legislative developments.

(e) Other minor and drafting amendments

17. The minor amendments related substantially to legislative developments.

18. Section 3.8 of the Draft 2016/17 Code (Statement Reporting Reviews of Internal Controls) is amended for the changes to the *Delivering Good Governance in Local Government: Framework (2016)* published by CIPFA and SOLACE which has been amended following review and consultation.

19. No other substantive changes have been made to the Code under minor and drafting amendments since the Exposure Draft.

(f) Changes emanating from Telling the Story - Improving the Presentation of Local Authority Financial Statements.

20. The responses to the Telling the Story consultation provided broad support for the approach and the amendments proposed. The Draft 2016/17 Code introduces a new Expenditure and Funding Analysis which brings together the accounting and funding frameworks, giving council taxpayers and other users' comparable information about each set of accountabilities. A small number of respondents preferred the status quo or other options which would require the removal of the statutory funding framework.

21. The supporting respondents agreed with the views offered by CIPFA/LASAAC in the consultation paper and commented that this would improve accountability, be more transparent and follow the performance framework of the authority. There were a number of responses which commented on the practicalities of the statement and improvements and simplifications have been added. As the Analysis focuses on the way in which an authority operates and how

services are provided it also meets many of the segmental reporting requirements and is therefore included in the main financial statements.

22. The Draft 2016/17 Code specifications for the Comprehensive Income and Expenditure Statement now include a segmental (functional) analysis based on the way in which an authority manages its services and not as previously defined in the CIPFA *Service Reporting Code of Practice*. Again this proposal received broad support (70 per cent of respondents) with some negative respondents indicating that they supported the status quo and that because the segmental analysis was no longer standardised that comparability would be reduced. Some respondents commented that an alternative proposal would be to opt instead for a nature of expenses form in the performance statement. The Secretariat made this suggestion in the Working Group that guided the developments and this was rejected (as it had been rejected by the Working Group responsible for this development of the performance statements) as providing services is the prime objective of local authorities.

23. The proposals for amendment of the Movement in Reserves Statement were largely supported by the respondents to the consultation. A small number respondents considered that both the Surplus or Deficit on the Provision of Services line and Other Comprehensive Income and Expenditure line should be included on the face of the Movement in Reserves Statement in accordance with IAS 1 paragraph 106 d) i) and ii). However, CIPFA/LASAAC was content with the approach in the Exposure Draft because the Code's treatment of usable and unusable reserves automatically splits this analysis between the Surplus and Deficit on the Provision of Services and Comprehensive Income and Expenditure. The majority of respondents did not support the removal of earmarked reserves from the face of the statement. The main reason for this was the importance of these reserves to local authorities. However, these reserves have no separate status in statute or financial reporting and therefore the Code does not support the inclusion of them on the face of the statement.

24. Both the Expenditure and Funding Analysis and the Comprehensive Income and Expenditure Statement provide a segmental analysis. The Expenditure and Funding Analysis also includes a reconciliation to the Surplus and Deficit on the Provision of Services (the local authority equivalent of profit or loss. As a part of the streamlining agenda CIPFA/LASAAC was concerned not to introduce a third segmental analysis. It also considered that the majority of income and expenditure listed in paragraph 23 of IFRS 8 was not regularly reported by authorities on a segmental basis. A small number of respondents indicated that they did and therefore would need to comply with this paragraph; this has been clarified in the Draft 2016/17 Code. The amendments to the Code under the Telling the Story consultation also rationalise the segmental reporting requirements for local authorities.

Impact on disclosures in the financial statements

25. There are likely to be increased disclosure requirements under (a) with the removal of the scope exclusion from IFRS 13. There may be new disclosure requirements under the proposals for (b) resulting from amendments to IAS 1 though this is more likely to result in more effective disclosures. More disclosures may also be necessary under the *Annual Improvements to IFRSs 2010 - 2012 Cycle*. There should be more effective disclosures as a result of the provisions in (c). There are no new reporting requirements specified by CIPFA/LASAAC under (d); these additional reporting requirements are specified in legislation. The changes introduced by (f) are intended to improve the presentation of local authority financial statements and where possible streamline the reporting requirements (but see paragraphs 19 to 23 for a summary of the amendments in the Draft 2016/17 Code which will include a new Expenditure and Funding Analysis).

IAS/IFRS compliance

26. A new adaptation is proposed for (a) to remove the fair value disclosure scope exclusion for measurements of fair value investments for local authority pension funds.

27. The narrow scope amendments to IFRS for (b) are proposed to be adopted within the Code without adaptation or interpretation with two exceptions:

- A new adaptation of IAS 16 has been introduced for the treatment of accumulated depreciation and impairment of property, plant and equipment assets where the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset is withdrawn.

- A new interpretation has also been introduced to IAS 27 *Separate Financial Statements* as CIPFA/LASAAC proposes not to permit local authorities to adopt equity accounting in the single entity (separate) financial statements.

28. There are no new adaptations or interpretations proposed as a result of (c) to (f).

Impact on WGA

29. The proposals in (a) to (f) are not expected to impact on WGA in respect of these standards or amended standards.

IPSAS compliance

30. There is no IPSASB equivalent of either IAS 26 *Retirement Benefits* or IFRS 13 and therefore no issues of compliance for (a). The adaptation of IAS 16 for (b) applies equally to IPSAS 17. The majority of the remaining narrow scope amendments to IFRS have not yet been adopted by IPSASB. This is with the exception of the amendments to IAS 27 *Separate Financial Statements*, Equity Method in Separate Financial Statements. This has been adopted in IPSAS *34 Separate Financial Statements* and therefore would be an interpretation also of IPSAS 34. The additional guidance in (c) for the Concepts section for the provisions of the IPSASB Conceptual Framework is consistent with the Framework. The amendments in (d) and (e) are consistent with IPSASB standards. The proposals for (f) are difficult to assess as IPSAS 18 was developed in 2002 and has not been updated for the requirements of IFRS 8.

Proposed text for the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)

31. The proposed text of the Draft 2016/17 Code is attached in the Annex to the report. It is still subject to review and any substantive changes will be reported to the Board.

Impact on the budgetary regime

32. The proposals relate to the Code of Practice on Local Authority Accounting in the United Kingdom and therefore do not impact on the budgetary regime.

Summary and recommendation

33. This report sets out details of proposed amendments to the 2016/17 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) and to the 2015/16 Code Update.

34. The Board is requested:

1) To approve the amendments to the 2016/17 Code and the 2015/16 Code Update for the local authority context arising from the proposals set out in this paper (including the Annex to the Code setting out the differences from the FReM) and the changes made since the 2015/16 Code;

2) To agree to consider whether any further amendments to the Code can be delegated to the Chair or considered by the FRAB in an out of meeting paper.

CIPFA/LASAAC
November 2015