CIPFA\LASAAC

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) 2018/19 and the Exposure Draft of the 2019/20 Code for IFRS 16 *Leases*.
Impact on guidance:	Changes to the text of the 2017/18 Code to produce the Draft of the 2018/19 Code are proposed in relation to: a) IFRS 9 *Financial Instruments* b) IFRS 15 *Revenue from Contracts with Customers* c) Narrow scope amendments to International Financial Reporting Standards and other minor amendments, and d) Legislative amendments. Changes to the text of the 2018/19 Code to produce the Exposure Draft of the 2019/20 Code in relation to its adoption of IFRS 16 *Leases* are also proposed.
IAS/IFRS adaptation?	As discussed in FRAB 128 (06) and 130 (04) under a) CIPFA/LASAAC will add a new adaptation to the Code for hedge accounting by not permitting the accounting policy choices in IFRS 9 which allow entities to continue to use IAS 39 policies. Also as discussed in FRAB 128 (06) and 130 (04) CIPFA/LASAAC will also remove two adaptations on designation from the previous approach in IAS 39. CIPFA/LASAAC also proposes including a new interpretation for central and local government balances setting out that no expected credit losses impairment provisions shall be recognised for these balances. No adaptations are proposed for b) and c). Adaptations do not apply for d). Two new adaptations are proposed for the adoption of IFRS 16 i) to mandate the short-term lease recognition exemption and ii) to mandate current value measurement for the subsequent measurement of the right-of use asset where the underlying asset is an item of property, plant and equipment. CIPFA/LASAAC also proposes two adaptations to the transitional arrangements in the standard as outlined in paragraphs 24 and 25 below.
Impact on WGA?	The changes in a) are largely not anticipated to have a substantial effect on WGA as the changes either follow the approach in the current Code or align with the approach in the FReM. However, it is not clear whether there will be an impact where the Code has not adapted the simplified approach to impairment for debtors and contract assets with a significant financing component and lease receivables under a). Items b) to d) should not impact on WGA.

IPSAS compliant?	Item a) is not consistent with current IPSAS because the IPSASB project to converge with IFRS 9 is ongoing. IFRS 15 changes under b) are also not consistent with IPSAS but the IPSASB has a project on revenue. The narrow scope amendments are not yet reflected in IPSAS for c). IPSAS compliance does not apply to d). Note that currently IPSASB is considering a single lessor accounting model for its approach to the new Leases Standard in the current (Draft) of ED 64 Leases. CIPFA/LASAAC has retained the dual accounting model in IFRS 16.
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.
Recommendation:	The Board is requested: 1) to approve the amendments to the 2018/19 Code 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 2017/18 Code; 2) to note the areas where subsequent amendments will need to be reported to FRAB in an out of meeting paper.
Timing:	2018/19

DETAIL

Background

1. The CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC) issued its consultation on the 2018/19 Code on 7 July 2017. The consultation period closed on 6 October 2016. Forty-nine responses were received to the consultation. This is a positive response rate with an increase in 2 responses from last year. Overall the respondents were supportive of the proposals. A list of the respondents to the consultations is included at Annex 1.

2. The new Exposure Drafts of the 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) were considered by FRAB in June 2017. The Code Drafts for the 2018/19 Code for IFRS 9 and IFRS 15 have already been considered by FRAB at its November 2016 meeting. This report only considers the substantial issues which have been raised since then for those standards.

3. CIPFA/LASAAC considered the consultation responses at its meeting on 8 November 2017 and has provided its initial views on the Draft 2018/19 Code following the consultation. This report sets out briefly the substantive revisions made following the consultation process to the Exposure

Draft(s) which were considered by FRAB in June, highlighting areas where the Code takes a different approach from the FReM following the decisions CIPFA/LASAAC took at its meeting. Note that the timescale from the CIPFA/LASAAC meeting to the FRAB meeting is very short and therefore a small number of changes are in development and the CIPFA Secretariat will flag up these issues. The final resolution of these issues will be sent to the FRAB in an out of meeting paper.

4. As CIPFA/LASAAC is currently reviewing the attached Draft 2018/19 Code for its final approval there may be also be subsequent drafting refinements. It is anticipated that these will be minor issues. Any drafting amendments will be reported to FRAB in an out of meeting paper. The updated Draft 2018/19 Code is attached to this report as Annex 2 for the Board's approval.

5. The Annex (in the Code) which sets out the differences between the Code and the FReM is included in the Draft 2018/19 Code. This has been updated for changes to the Code for IFRS 9.

6. The main areas for change in the 2018/19 Code are:

a) IFRS 9 *Financial Instruments*
b) IFRS 15 *Revenue from Contracts with Customers*
c) Narrow scope amendments to International Financial Reporting Standards and other minor amendments, and
d) Legislative amendments.

Changes since the 2017/18 Code – Specific Issues included in the Exposure Draft

(a) IFRS 9 Financial Instruments

7. FRAB will be aware that CIPFA/LASAAC consulted on its proposed approach to the adoption of IFRS 9 last year. Following the consultation process and review by FRAB at its November 2016 meeting[1] CIPFA/LASAAC issued its agreed amendments to the Code for the adoption of IFRS 9 in a separate publication which accompanied the publication of the 2017/18 Code. This was to allow local authority accounts preparers appropriate time to make effective preparation for application of the Standard. The separate publication does not have the authority of the Code and cannot be adopted early by local authorities.

8. CIPFA/LASAAC did not re-expose its agreed amendments to the Code as it needs to present a 'steady state' to allow local authorities clarity on the provisions so that accounts preparers can make adequate preparations for the IFRS 9. However, three issues were considered in the consultation on the 2018/19 Code.

9. The agreed position in the separate publication was that it was unlikely that local authorities would have purchased or originated credit-impaired financial assets (but where these did occur the Standard would need to be followed). Following a response to last year's consultation CIPFA/LASAAC sought views as to whether this was the case. Although a larger number of respondents (15 (31%)) considered that local authorities are unlikely to hold purchased or originated credit-impaired financial assets, CIPFA/LASAAC is of the view that there is enough evidence from the responses to indicate that such transactions do occur for local authorities with

[1] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/602404/FRAB_128__06__Nov_201718_LA_Code.pdf and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/602406/FRAB_128__06__Annex_2_201718_Code_including_Appendices_F_and_G.PDF

sufficient frequency to warrant the inclusion of the relevant IFRS 9 provisions on purchased or originated credit-impaired financial assets. Relevant paragraphs have been included in the Code Draft (see paragraphs 7.2.9.15 and 7.2.9.16).

10. The consultation papers referred to CIPFA/LASAAC's decision not to mandate the use of the simplified approach to impairment for all trade receivables or contract assets that result from transactions within the scope of IFRS 15 and that contain a significant financing component and all lease receivables that result from transactions that are within the scope of IAS 17 *Leases* and whether there are any consequences as a result of this decision. No substantial evidence was raised as a result of the consultation CIPFA/LASAAC debated this issue in some detail and was content with its previous position to follow the provisions of IFRS 9 and not to mandate the use of the simplified approach for these transactions. It considered that local authorities were best placed to decide for themselves the most appropriate presentation of the financial statements and therefore decided to maintain its position by following the standard.

11. A comment by HM Treasury highlighted that FRAB has determined that the risk of default is effectively nil for balances with government's central funds and other public sector bodies where legislation prevents default. CIPFA/LASAAC considered following the anticipated approach in the Government's Financial Reporting Manual (the FReM). After debate CIPFA/LASAAC agreed to include an interpretation in the Code to this effect. However, it considered that this was only likely to be relevant to central and local government bodies and decided to be specific about the relevant statutory provisions in local government legislation.

12. There have been a number of drafting augmentations and corrections to the provisions of IFRS 9. However, these have not required new adaptations or interpretations of the Code. In addition CIPFA/LASAAC requested more detail to be included in the Code on the definition of an equity instrument and further guidance on the provisions relating to 'solely payments of principal and interest' to assist local authorities with their classification decisions.

13. Only one new adaptation was included in the last year's consultation - to restrict the accounting policy choice for hedge accounting to the use of IFRS 9's hedge accounting provisions only. This was reviewed by FRAB in its meetings last year. In addition, the approach to adoption of IFRS 9 has removed two adaptations it previously included in the Code for IAS 39 *Financial Instruments: Recognition and Measurement*:

i) the prohibition against designations of financial instruments, and

ii) the adaptation for the treatment of 'regular way' trades of financial assets where the Code previously only permitted 'trade date' accounting to be used (and not "settlement date").

b) IFRS 15 Revenue from Contracts with Customers

14. Again FRAB will be aware that CIPFA/LASAAC also consulted on the approach to the adoption of IFRS 15 *Revenue from Contracts with Customers* last year. CIPFA/LASAAC's agreed approach to the adoption of IFRS 15 is also included in the separate publication which was issued with the 2017/18 Code. These amendments to the Code do not contain any adaptations or interpretations of IFRS 15 and have been reviewed by FRAB (see FRAB 128 (06)). CIPFA/LASAAC did not re-expose its agreed provisions to provide a 'steady state' for local authorities to allow them to prepare for adoption of the standard.

15. CIPFA/LASAAC did consult on the approach to disclosures, which was not to include them explicitly in the Code but to cross refer to IFRS 15. Two respondents considered that they would

prefer the provisions to be in the Code as this was the primary source of reference for local authority accounting and reporting requirements. CIPFA/LASAAC agreed with this and has therefore included the disclosures that are relevant to local authorities in the Code.

c) i) Narrow Scope Amendments to IFRS

16. The draft 2018/19 Code adopts the following narrow scope amendments (and the IFRIC) in the Code without adaptation or interpretation.

- IAS 7 *Statement of Cash Flows* (Disclosure Initiative)
- IAS 12 *Income Taxes* (Recognition of Deferred Tax Assets for Unrealised Losses)
- IAS 40 *Investment Property* (Transfers of Investment Property)
- *Annual Improvements to IFRS Standards 2014 – 2016 Cycle*, and
- IFRIC 22 *Foreign Currency Transactions and Advance Consideration.*

FRAB is invited to note that the amendments to IAS 7 and IAS 12 were included in the consultation on the 2017/18 Code. However, these amendments were not adopted by the European Union in time for inclusion in the 2017/18 Code and have therefore been rolled forward into the 2018/19 Code. The inclusion of the narrow scope amendments in the Code will need to be subject to EU adoption.

e) Legislative Developments

17. The consultation papers and Exposure Drafts included relevant updates for legislative developments, with proposed updates reflecting the relevant statutory requirements. The changes to the 2018/19 Code include the amendments as a result of *The Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017*.

Other issues arising from the Code Consultation and Development Programme

18. CIPFA/LASAAC has agreed to remove the disclosure requirements analysing debtor and creditor balances across the public sector as these had been previously removed from the FReM. However, at the same time it has decided to augment the Code's provisions on subclassification of debtor and creditor balances in paragraph 3.2.4.63 of the Code. This augmentation does not introduce any new adaptations or interpretations of IAS 1 *Presentation of Financial Statements*.

19. CIPFA/LASAAC has also started to review its *Telling the Story - Improving the Presentation of Local Authority Financial Statements* project changes to the 2016/17 Code and will need to provide clarifications to the approach to the service analysis at the top section of the Comprehensive Income and Expenditure Statement and some clarifications are also needed in relation to the presentation of the Expenditure and Funding Analysis. These provisions are being developed and again the CIPFA Secretariat will update the FRAB in an out of meeting paper.

IFRS 16 Leases

20. The consultation papers also included a separate Appendix providing interested parties with an overview of IFRS 16 *Leases*. The papers set out that CIPFA/LASAAC has established a sub group on the implementation of the leasing standard which will assist CIPFA/LASAAC with the

development of its consultation paper and Exposure Draft on the adoption of the standard in the Code.

21. Following the initial consultation the sub group has developed a set of consultation papers on the approach to the adoption of IFRS 16 and the Exposure Draft on the changes to the Code are attached to this report as Annex 3. CIPFA/LASAAC only considered the paper in overview and additional drafting comments may be provided to the CIPFA Secretariat. Again any substantial changes will be reported to FRAB in an out of meeting paper. However, CIPFA/LASAAC has agreed the overall approach to the consultation.

22. CIPFA/LASAAC proposes mandating the short-term lease exemption as it considers that this will ease some of the reporting burden for local authority accounts preparers, although the early consultation provided some feedback that local authority accounts prepares would take this accounting policy choice in any event.

23. In accordance with its general approach to the measurement of non-current assets in the Code CIPFA/LASAAC is also consulting on adapting the standard to require that the right-of-use asset where the underlying asset is an item of property, plant and equipment is measured at current value. This approach was largely supported by respondents to the early consultation to IFRS 16 although a number of practical issues were raised. CIPFA/LASAAC is concerned to assess the practical impacts and the costs/benefits of such a move. It is therefore also proposing a materiality based approach to this measurement principle to ensure that the costs of such a move do not outweigh the benefits. Again the final provisions for this materiality based approach have yet to be finalised and the CIPFA Secretariat will send the relevant provisions to FRAB in an out of meeting paper.

24. CIPFA/LASAAC proposes to adapt two of the transitional reporting requirements. Firstly, it proposes to adopt the cumulative catch-up approach to retrospective restatement because this will reduce the reporting burden on adoption of the new standard for local authorities and it is consistent with CIPFA/LASAAC's agreed approach on transition for IFRSs 9 and 15. This was supported by the majority of respondents to the early consultation on IFRS 16.

25. CIPFA/LASAAC is also proposing to mandate the transitional option for measuring the right-of-use asset for leases originally classified as operating leases on transition ie to use an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the Balance Sheet before the date of initial application. This proposal had no dissenting views in the early consultation on the standard.

26. FRAB Members will be aware that the Code like the FReM measures service concession arrangement liabilities by following the IAS 17 measurement requirements for finance leases. As this is no longer an extant standard CIPFA/LASAAC proposes moving the measurement requirements to those of IFRS 16 for the lease liability. However, CIPFA/LASAAC consulted on changing these measurement provisions when it consulted on augmenting the Code's provisions on service concession arrangements as a result of the issue of IPSAS 32 *Service Concession Arrangements: Grantor* in the 2013/14 Code. This consultation received a large number of local authority responses concerned about the costs of changing the measurement requirements. So CIPFA/LASAAC has included in its consultation papers the option of maintaining the IAS 17 measurement requirements.

27. A substantial number of the respondents to the early consultation raised the issue of the reporting burden and the amount of work required to prepare for IFRS 16. A member of the CIPFA/LASAAC sub group noted that the IASB from the issue of the standard allowed accounts preparers three years to adopt the standard. CIPFA/LASAAC is keen to assess the level of

preparedness of local authority accounts preparers so will include a readiness assessment questionnaire in the consultation papers.

28. CIPFA/LASAAC agreed to issue the consultation papers in December 2017.

Post-Implementation Reviews of IAS 19 Employee Benefits, the Group Accounts Standards and Service Concession Arrangements

29. The first post-implementation review of the IFRS-based Code took place in 2012/13 based on the provisions in the Code from the first IFRS-based Code to date. FRAB Members may be aware that the Code adopted the substantial amendments to IAS 19 *Employee Benefits* (June 2011 amendments) in the 2013/14 Code and the Group Accounts standards[2] in the 2014/15 Code. The 2013/14 Code also included augmentations of the Code's provisions on service concession arrangements. CIPFA/LASAAC will issue a call for evidence in December 2017 to initiate a post-implementation review into these three areas of new amending standards and will seek interested parties' views on their application in the Code. It will allow four months for respondents to ensure that it receives appropriate feedback from interested parties.

Impact on disclosures in the financial statements

30. Substantial new disclosures are introduced by IFRS 9 and IFRS 15 under a) and b). A new disclosure is introduced under the amendments to IAS 7 to enable users of the financial statements to evaluate changes to liabilities arising from financing activities for c).

IAS/IFRS compliance

31. As discussed in FRAB 128 (06) and 130 (04) under a) CIPFA/LASAAC will add a new adaptation to the Code for hedge accounting by not permitting the accounting policy choices in IFRS 9 which allow entities to continue to use IAS 39 policies. CIPFA/LASAAC also proposes including a new interpretation for central and local government balances setting out that no expected credit losses impairment provisions shall be recognised for these balances. Also as discussed in FRAB 128 (06) and 130 (04) CIPFA/LASAAC will also remove two adaptations on designation from previous approach in IAS 39. No adaptations are proposed for b) and c). Adaptations do not apply for d).

32. Two new adaptations are proposed for the adoption of IFRS 16:

i) to mandate the short-term exemption, and

ii) to mandate current value measurement for the subsequent measurement of the right-of use asset where the underlying asset is an item of property, plant and equipment.

33. CIPFA/LASAAC also proposes two adaptations to the transitional arrangements in the standard as outlined above in paragraphs 24 and 25.

[2] IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interest in Other Entities*, IAS 27 (May 2011) *Separate Financial Statements*, IAS 28 (May 2011) *Investments in Associates and Joint Ventures*

Impact on WGA

The changes in a) are largely not anticipated to have a substantial effect on WGA as the changes either follow the approach in the current Code or align with the approach in the FReM. However, it is not clear whether there will be an impact where the Code has not adapted the simplified approach to impairment for debtors and contract assets with a significant financing component and lease receivables under a). Items b) to d) should not impact on WGA.

IPSAS compliance

34. Item a) is not consistent with current IPSAS because the IPSASB project to converge with IFRS is ongoing. IFRS 15 changes under b) are also not consistent with IPSAS but the IPSASB has a project on revenue. The narrow scope amendments are not yet reflected in IPSAS for c). IPSAS compliance does not apply to d).

35. Note that currently IPSASB is considering a single lessor accounting model for its approach to the new Leases Standard in the current (Draft) of ED 64 *Leases*. CIPFA/LASAAC has retained the dual accounting model in IFRS 16.

Proposed text for the 2018/19 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)

36. The proposed text of the Exposure Drafts of the 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

37. 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

38. This report sets out details of the proposed amendments to the 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom*.

39. The Board is requested:

1) to approve the amendments to the 2018/19 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 2017/18 Code;

2) to note the areas where subsequent amendments will need to be reported to FRAB in an out of meeting paper.

CIPFA/LASAAC

November 2017