FRAB 122 (08)
27 November 2014

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) 2015/16.
Impact on guidance:	Changes to the text of the 2015/16 Code are proposed in relation to: (a) IFRS 13 *Fair Value Measurement* (b) Narrow scope amendments to IFRS (c) IFRIC 21 *Levies* (d) Changes to UK GAAP (e) Other minor and drafting amendments.
IAS/IFRS adaptation?	The current adaptation of IAS 16 is clarified for (a). No adaptations are required for (b) and (c). IFRS does not contain any direct provisions for Heritage Assets. The Code currently relies on FRS 30 *Heritage Assets* for recognition, measurement and disclosure requirements for heritage assets. The current relaxation of the measurement requirements in FRS 30 is not explicitly included in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* but for the avoidance of doubt CIPFA/LASAAC wishes to maintain these provisions, which may require an interpretation of FRS 102 (and IAS 16) for (d). The minor amendments include the adaptation for the single entity financial statements to include the transactions of local authority maintained schools in (e) as agreed previously for the 2014/15 Code. CIPFA/LASAAC is also proposing to introduce an interpretation for the frequency of valuation of property, plant and equipment (see paragraph 23).
Impact on WGA?	Amendments to the Code in respect of (a) to (e) are expected to be consistent with WGA requirements.
IPSAS compliant?	Amendments in respect of (a) have yet to be reflected in IPSAS. The IPSASB Conceptual Framework includes consideration of measurement approaches consistent with both IFRS 13 (ie measures of financial capacity) and the proposed approach to measurement outlined in the Code, which is based on measuring the operational capacity of the non-current assets used by services. The narrow scope amendments (b) and IFRIC 21 (c) are yet to be included in IPSAS.

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 2015/16 Code and the 2014/15 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 2014/15 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:	2014/15 and 2015/16

DETAIL

Background

1. The CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC) issued the consultation on the Code on 25 July 2014. The consultation period closed on 10 October 2014. Thirty-nine responses were received. This is a disappointing result as there had been a growing trend in previous years. However, the respondents were very supportive of the proposals overall. A list of the respondents to the consultation is included at Annex A.

2. The Exposure Drafts of the 2015/16 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) were considered by the FRAB both in June and in an out of meeting paper sent to the Board on 8 July 2014.

3. CIPFA/LASAAC considered the consultation responses at its meeting on 5 November 2014 and has provided its initial views on the draft 2015/16 Code following the consultation. This report sets out briefly the substantive revisions made to the Exposure Draft considered by the 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 5 November 2014.

4. As CIPFA/LASAAC is currently reviewing the attached 2015/16 Draft Code for its final approval of the Code 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 2015/16 Code is attached to this report as Annex B for the Board's approval. In addition as paragraph 21 notes CIPFA/LASAAC has also proposed on an exceptional basis to

issue a 2014/15 Code Update: this is included at Annex C. A full list of the amendments in the Draft 2015/16 Code is included in Annex D.

5. The Annex which sets out the differences between the Code and the FReM are included in the 2015/16 Draft Code. There have been no additions to this list that have arisen as a result of the amendments to the Code.

Changes since the 2014/15 Code – specific issues included in the Exposure Draft

a) ***IFRS 13 Fair Value Measurement and the Measurement of Property, Plant and Equipment***

6. FRAB will be aware that the approach in the Exposure Drafts of the 2015/16 Code was to adopt IFRS 13 *Fair Value Measurement* without adaptation. However, following the HM Treasury and CIPFA/LASAAC conceptual review of the approach to measurement of property, plant and equipment, the Code has clarified the 2014/15 adaptation to the measurement of property, plant and equipment (PPE) and proposes that operational PPE is measured at existing use value bases in accordance with the definitions in the Royal Institution of Chartered Surveyors (RICS) publication *Valuation - Professional Standards*, where no market exists or the assets are specialised the service potential of the asset is measured at Depreciated Replacement Cost (DRC).

7. The measurement requirements of the Code for operational assets therefore remain unchanged. FRAB will also be aware that the Exposure Draft has proposed to change the measurement requirement for Surplus Assets. These assets are measured at fair value in accordance with the requirements of IFRS 13.

8. As a part of its conceptual approach to the measurement of property, plant and equipment CIPFA/LASAAC decided to introduce the concept of current value to its measurement requirements for PPE. Under this overarching concept the Code introduces four current value measurement bases existing use value, existing use value - social housing, DRC and fair value.

9. The responses to the consultation were in the vast majority of cases supportive of the approach to the adoption of IFRS 13 and the measurement of PPE with only one respondent (an audit firm) not supporting this conceptual approach. Two respondents did not consider fair value to be a current value measurement. However, the Board considered that fair value as a current cost is supported by the latest staff draft of the IASB Conceptual Framework[1] and therefore the Board agreed to proceed with this approach.

10. A number of respondents raised concerns about the level and complexity of IFRS 13 disclosures, their application to local government circumstances and particularly their potential for overburdening the financial statements with excessive detail which would obscure the key messages in relation to the fair value measurement of transactions. CIPFA/LASAAC debated this issue in detail and considered the option of including rebuttable presumptions on application and materiality. However, the Board decided to adopt the disclosures without any substantial changes but to include a statement on materiality at the beginning of the disclosure section on IFRS 13 (see Draft 2015/16 Code paragraph 2.10.4.1).

11. The Exposure Draft also included the objectives of IFRS 13 disclosure requirements in the section of the Code which adopts IAS 16 (see paragraph 4.1.4.2). However, this raised further

[1] Conceptual Framework for Financial Reporting.

concern from respondents about the level of detail included in the financial statements from a substantial number of respondents. CIPFA/LASAAC decided not to proceed with this approach and to include instead a requirement for local authority financial statements to include in their accounting policies on PPE the measurement techniques for significant categories of assets.

b) *Narrow scope amendments to IFRSs*

12. The Exposure Draft included relevant changes to adopt the following narrow scope amendments without the need for adaptation:

- Amendments to IAS 19 *Employee Benefits* (Defined Benefit Plans: Employee Contributions);
- *Annual Improvement to IFRSs 2010 – 2012 Cycle*; and
- *Annual Improvement to IFRSs 2011 – 2013 Cycle*.

  (the inclusion of the above listed narrow scope amendments in the 2015/16 Code will also be subject to EU adoption by 1 January 2015.)

c) IFRIC 21 *Levies*

13. The Exposure Draft on the 2015/16 Code included IFRIC 21 without adaptation.

14. CIPFA/LASAAC's consideration of the consultation responses for b) and c) did not lead it to change its approach with a majority of responses supporting the consultation.

d) *Changes to UK GAAP FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland*

15. The Code draws on UK GAAP including the Pensions SORP[2] for three areas:

- Accounting for VAT,
- Accounting for Heritage Assets, and
- Accounting and Reporting by Pension Funds particularly the format of the Pensions Fund Account and Net Assets Statement.

16. The consultation papers did not propose any changes for the accounting for VAT or the pensions accounting statements (but CIPFA/LASAAC will review the reporting requirements for pensions next year against the new pensions SORP requirements). However, the consultation did confirm CIPFA/LASAAC's view on the measurement requirements for Heritage Assets ie that valuations "… may be made by any method that is appropriate and relevant".

17. CIPFA/LASAAC has confirmed its intention to include an interpretation of FRS 102 to maintain the current provisions in the Code on the measurement of Heritage Assets which were

[2] *The Statement of Recommended Practice: Financial Reports of Pension Schemes* (the Pensions SORP).

based on FRS 30 Heritage Assets. There is support in UK GAAP for this as the Charities SORP[3] has similar provisions to the Code[4].

18. The amendments to the Code also included a reduction in the reporting requirements for heritage assets transactions from the current year and four preceding years to the current year and preceding year (see paragraph 4.10.4.5).

19. The approach to the measurement and disclosure requirements for heritage assets was supported by the vast majority of respondents to the Code consultation.

e) *Other Minor and Drafting amendments – Accounting for Local Authority Maintained Schools in England and Wales*

20. The consultation included minor amendments to Appendix E of the Code; Accounting for Local Authority Maintained Schools in England and Wales. The minor amendments did not change the accounting requirements introduced in the 2014/15 Code based on the Joint HM Treasury and CIPFA/LASAAC Working Group report and were clarifications only. Some further augmentations were made to Appendix E following comments made by respondents.

21. It appears that local authorities may need to recognise at least some non-current assets as a result of the changes in accounting policy introduced by Appendix E. It will be difficult for authorities to recreate these transactions as this might require in some cases consideration of original acquisition of schools as entities as far back as 1998. CIPFA/LASAAC is therefore proposing that local authorities recognise the assets at fair value (under the 2014/15 Code) and treat this fair value as a deemed cost. As this is a transitional issue CIPFA/LASAAC considers that on an exceptional basis that a 2014/15 Code Update needs to be issued. This 2014/15 Code Update includes the same text as the 2015/16 Code and a new transitional paragraph for the recognition of these assets from 1 April 2013 – see paragraph E.1.5 in Annex C.

Frequency of Valuation of Local Authority Assets

22. CIPFA/LASAAC's IFRS post implementation review raised the issue that it was possible that some authorities considered that the references in the Code to a five year valuation was a reference to a minimum rather than a maximum period that in some cases might have the potential to override the need to ensure that property, plant and equipment balances were materially accurate. Although the 2012/13 Code did not include an adaptation in this area CIPFA/LASAAC included the relevant requirements of IAS 16 *Property, Plant and Equipment* directly in the Code. The consultation responses from a number of authorities and an auditor raised the issue that some auditors were interpreting references to short period for the revaluation of a class of assets in IAS 16 as being written in such a way that a short period is expected to be within the reporting year.

23. CIPFA/LASAAC does not consider that this is the case as the IASB would not have referred to short period but would have instead referred to reporting period and would not have had any reason to use the words "rolling basis" and "up to date" in paragraph 38 of IAS 16. CIPFA/LASAAC also considers that if local authorities meet the minimum reporting requirements of balances being materially accurate at the reporting date there is no further benefit for decision

[3] *Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland* (FRS 102) (Charities SORP).
[4] *Charities may adopt any reliable valuation technique to estimate the fair value of a heritage asset"* Charities SORP paragraph 18.15.

makers in valuations being concurrent for a whole class of assets particularly when assessed against the affordability of annual revaluations. Therefore CIPFA/LASAAC has proposed adding the following interpretation to the Code.

"*A short period for property, plant and equipment therefore is interpreted to mean that assets are normally measured once every five years for each class of assets, provided that current value meets the requirements of paragraph 4.1.2.37 [ie that the current value property, plant and equipment is materially accurate at the balance sheet date]. Valuations shall be carried out at intervals of no more than five years.*"

Legislative Changes

24. The Draft 2015/16 Code includes the requirements of The Local Authority Accounts (Scotland) Regulations 2014 which came into force in October this year. This has meant changes to the draft but only reflect the reporting requirements of the new regulations. The relevant changes have been principally made to chapter one and chapter three. It is anticipated that two more sets of regulations (the Accounts and Audit Regulations in both England and Wales) will be issued before the end of the calendar year to be effective for the 2015/16 (England) and 2014/15 Wales.

25. CIPFA/LASAAC has requested that these regulations be included in the 2015/16 Code if this is possible within the publication deadlines of the Code. As these changes are normally only changes of fact then they would not need to be subject to consultation. However, if there are any changes that will need amendment to the Code then this will be brought to CIPFA/LASAAC and FRAB's attention.

26. The Welsh Government is also planning to move to self-financing for local housing authorities in Wales. This will mean the removal of the housing subsidy system for the eleven remaining Welsh authorities with a Housing Revenue Account. This will mean minimal amendments to the Code. However, these amendments can only be made when the final statutory arrangements have been confirmed.

27. As the legislative changes will only be matters of fact and not otherwise change the requirements of the Code it is recommended that consideration of these changes be subject to the delegated approval outlined in paragraph 4 above.

Simplification and Streamlining of the Presentation of Local Authority Financial Statements

28. The Simplification and Streamlining of the Presentation of Local Authority Financial Statements has been progressed by CIPFA and CIPFA/LASAAC during the period since the last report to FRAB. The Board has undertaken a review of a sample of local authority financial statements and a second consultation has been undertaken on the Simplification and Streamlining the Presentation of Local Authority Financial Statements. This consultation focussed on the performance statements and narrative reporting requirements of local authorities.

29. The review demonstrated that when presented effectively the two performance statements achieve the aims in the Code and are compliant with IFRS. However, there are a small number of disclosures that support the Movement in Reserves Statement (MiRS) and the Comprehensive Income and Expenditure Statement CIES that are presented in substantial detail. These notes explain the statutory adjustments line and the movements in earmarked reserves lines in the MiRS. CIPFA/LASAAC has therefore added further commentary in paragraph 3.4.2.40 to

encourage authorities to focus on the materiality of these disclosures. The review has also identified the need to consider the disclosure objectives of the segmental reporting notes. This will be considered in more depth by the review.

30. There were 51 respondents to the Simplification and Streamlining consultation. The responses are being considered in more detail by a Working Group of CIPFA and CIPFA/LASAAC. The Working Group and CIPFA/LASAAC are considering a wide range of options under CIPFA/LASAAC's instruction. One of the key messages from the consultation is that the statements do not reflect local authority financial performance in accordance with the traditional measures that local authorities use ie that those items of income and expenditure that have to be met from taxation.

31. Some substantial objections to the use of the Service Reporting Code of Practice (SeRCOP) were raised which specifies the segmental reporting requirements on the face of the CIES and is also the basis of government statistical returns on service budgets and outturns. However, the consultation responses and the Working Group comments have challenged the need to include this analysis in local authority financial statements.

Measurement of Transport Infrastructure Assets

32. FRAB will be aware that the 2016/17 Code will require local authority transport infrastructure assets to be measured on a DRC basis. The 2015/16 Code will require authorities to report this change in accounting policy in the same way as a change in IFRS (this was announced in the 2014/15 Code). These issues were both signalled in the consultation. There were not a large number of detailed responses on this issue but respondents did mention the substantial impact on local authority balance sheets and concern about the preparations for accounting for a network of assets.

33. CIPFA, CIPFA/LASAAC and the Project Implementation Steering Group (PISG) contributed to the issue of a Local Authority Accounting Panel (LAAP) Bulletin with a project implementation plan to assist local authorities with their planning processes. In addition, detailed application guidance is being prepared by PISG and CIPFA/LASAAC has considered detailed implementation issues in relation to the definition of an asset following the approach in the FReM[5], the treatment of accumulated depreciation and derecognition of components. CIPFA/LASAAC remains concerned about the level of preparation for the move to DRC measurement at local authorities and remains concerned to see the returns on the Whole of Government Accounts information and questionnaire that local authorities completed for the 2013/14 financial statements.

Impact on disclosures in the financial statements

34. There are increased disclosure requirements under (a) IFRS 13, clarifications of the reporting requirements under (b) IFRS 8 *Operating Segments* and a new disclosure per IAS 24 *Related Party Disclosures* under the Annual Improvements to IFRSs 2010 – 2012 Cycle. There are no new disclosure requirements under (c) IFRIC 21. The disclosure requirements under (d) FRS 102 for heritage assets are also clarified but see also the comments in paragraphs 18 above. There are no new disclosure requirements under (e).

[5] See 2014-15 FReM paragraph 7.1.13

IAS/IFRS compliance

35. The current adaptation under IAS 16 for the measurement requirements of property, plant and equipment is clarified. A new interpretation (for the avoidance of doubt) is be required for (d) in relation to the measurement requirements for heritage assets. No new adaptations are required for the remaining changes.

Impact on WGA

36. The changes in respect of (a) to (e) are anticipated to be reflected or be similar to those of the FReM. As such, no impact on WGA is expected in respect of these standards, amended standards or the IFRIC.

IPSAS compliance

37. The Memorandum of Understanding requires relevant authorities to consider whether an adaptation of EU adopted IFRS is required where different or additional guidance is contained in an IPSAS. The following paragraphs are intended to demonstrate that due consideration has been given to this requirement.

38. The Code amendments include a number of updated standards and IFRIC 21 that have yet to be reflected in IPSAS. Consequently the Code will not be fully IPSAS compliant in these areas until the relevant IPSASs are updated in line with the IPSASB 'rules of the road'. The new IPSASB Conceptual Framework[6] includes consideration of measurement approaches consistent with both IFRS 13 (ie measures of financial capacity) and the proposed approach to measurement outlined in the Code, which is based on measuring the operational capacity of the non-current assets used by services.

Proposed text for the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)

39. The detailed proposals included in the 2015/16 Draft Code and Draft 2014/15 Code Update are included in Annexes B and C.

Impact on the budgetary regime

40. 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

41. This report sets out details of a proposed amendments to the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) and to the 2014/15 Code Update.

42. The Board is requested:

1) To approve the amendments to the 2015/16 Code and the 2014/15 Code Update for the local authority context arising from the proposals set out in this paper

[6] *IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, IPSASB,* October 2014

(including the Annex to the Code setting out the differences from the FReM) and the changes made since the 2014/15 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 2014