Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	Update on the Exposure Draft of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) 2016/17
Impact on guidance:	Changes to the text of the 2015/16 Code to produce the Exposure Drafts of the 2016/17 Code are proposed in relation to: (a) The measurement of the Highways Network Asset (Transport Infrastructure Assets) at Depreciated Replacement Cost, (b) A review of the Accounting and Reporting by Pension Funds section of the Code, (c) Narrow Scope Amendments to International Financial Reporting Standards, (d) 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,* (e) Legislative amendments, (f) Other minor and drafting amendments, and (g) Changes emanating from *Telling the Story - Improving the Presentation of Local Authority Financial Statements* consultation.
IAS/IFRS adaptation?	There is an extension of the current adaptation under IAS 16 for the measurement requirements of property, plant and equipment to the new Highways Network Asset and the measurement option under IAS 16 to measure property, plant and equipment at depreciated historical cost is now withdrawn for (a). The Code will also adapt the requirements of IAS 16 where the option for the treatment accumulated depreciation and impairment to be eliminated on revaluation is withdrawn for the Highways Network Asset and it will also bring forward interpretations of the measurement provisions of IAS 16 for the Highways Network Asset (see paragraph 3). A new adaptation is proposed for (b) to IFRS 13 *Fair Value Measurement* to remove the fair value disclosure scope exclusion for the investments of local authority pension funds. (c) the narrow scope amendments are proposed to be adopted without adaptation or interpretation with two exceptions: (i) CIPFA/LASAAC proposes adapting 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) CIPFA/LASAAC proposes not permitting 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 (d), (e), (f) and (g).
Impact on WGA?	The changes in respect of (a) are anticipated to be result in consistency with the FReM and should substantially contribute to the removal of one of the qualifications in WGA. The proposals in (b) to (g) are not expected to impact on WGA in respect of these standards or amended standards.
IPSAS compliant?	The adaptations and interpretations in (a) apply equally to IPSAS 17 *Property, Plant and Equipment*. There is no IPSASB equivalent of either IAS 26 *Retirement Benefits* or IFRS 13 so there are no issues of compliance. The interpretation of IAS 16 for (c) 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 the Concepts section for the provisions of the IPSASB Conceptual Framework is consistent with the Framework. The amendments in (e) and (f) are consistent with IPSASB standards. The proposals for (g) 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.
Recommendation:	The Board is requested to comment on the proposed approach to amendments for the 2016/17 Code.
Timing:	2016/17

DETAIL

Background

1. The CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC) considered an early draft of the Invitation to Comment (ITC) and Exposure Drafts on *the Code of Practice on Local Authority Accounting in the United Kingdom* (Accounting Code) at its meeting on 2 June 2015. This report sets out briefly the proposed substantive changes to the 2015/16 Accounting Code made in producing the Exposure Drafts of the 2016/17 Code. CIPFA/LASAAC anticipates consulting on these changes from mid-July to 9 October 2015. The main areas for change will be:

(a) The measurement of the Highways Network Asset (Transport Infrastructure Assets) in accordance with the CIPFA *Code of Practice on Transport Infrastructure Assets* (Transport Code) at Depreciated Replacement Cost (DRC),
(b) A review of the Accounting and Reporting by Pension Funds section of the Code,
(c) Narrow Scope Amendments to International Financial Reporting Standards,
(d) 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,*
(e) Legislative amendments,
(f) Other minor and drafting amendments, and
(g) Changes emanating from the *Telling the Story - Improving the Presentation of Local Authority Financial Statements (Telling the Story* consultation).

2. The Exposure Drafts of the 2016/17 Code are included in an Annex to this report.

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

(a) 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)

3. FRAB will be aware that the 2014/15 Accounting Code announced CIPFA/LASAAC's intention to move to measuring transport infrastructure assets in accordance with the methodologies specified in the CIPFA *Code of Practice on Transport Infrastructure Assets* (Transport Code) ie at a DRC measurement base. The 2016/17 Accounting Code therefore brings forward these requirements. The adoption of the relevant accounting policies in the Accounting Code should contribute to the removal of one of the qualifications in the Whole of Government Accounts.

4. A number of specific accounting policies are needed under the Code's adoption of IAS 16 *Property, Plant and Equipment* for transport infrastructure networked assets. CIPFA/LASAAC has established a separate section of the Code to distinguish the specific accounting provisions for the transport infrastructure network assets. These include:

- **Scope and definition** – the Accounting Code only proposes changes to the treatment of transport infrastructure assets as defined in the Transport Code. It has proposed that this class of asset (defined as a single asset) should be described as the Highways Network Asset as this term will be more easily understood by the users of local authority financial statements.

- **Recognition requirements** – consistent with the approach in the Highways Agency and Transport Scotland accounts, and as permitted by the FReM (2015/16 FReM, paragraph 7.1.23), the Code has defined the Highways Network Asset as a single asset. This is due to the nature of the asset as a homogenous interconnected network of assets elements whose the service potential is dependent on being linked to other elements of the network.

- **Measurement** – the Accounting Code will follow the requirements of the Transport Code for measuring the service potential in the assets in a similar approach to the FReM.

- The Transport Code measures consumption of the asset on a whole of life approach and assumes the performance of the asset is replaced by means of capital expenditure; the specifications of annual depreciation are included in the Transport Code. For the avoidance of doubt the Accounting Code includes the latter as an interpretation of IAS 16.

- The Code also restricts the methodology for the treatment of accumulated depreciation impairment to the option in IAS 16 where the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. This is an adaptation of IAS 16.

- Condition – the change in accumulated depreciation that relates to condition cannot currently be separately identified in the systems that measure the accumulated depreciation. In line with the Transport Code, the actual deterioration of the asset between years is not compared to the annual depreciation as this data is not currently readily available for authorities. However, the balance sheet position would reflect the accumulated depreciation and would represent the estimate under the Transport Code of the DRC of the asset.

- **De – recognition** – as it will be very difficult to measure the Gross Replacement Cost of the expenditure being replaced. It is assumed to equal the amount of the replacement expenditure unless the authority can provide more accurate measures of the replaced amount of Gross Replacement Cost and accumulated depreciation. The assets replaced and derecognised are also assumed to have reached the end of its useful economic life.

5. CIPFA/LASAAC is taking a close interest in the level of preparedness of local authorities for the new requirements. CIPFA has issued a Local Authority Accounting Panel Bulletin which includes a project plan to assist local authorities with their implementation. CIPFA/LASAAC has invited the Project Implementation Steering Group that oversees the development of the Transport Code to undertake a separate consultative exercise to test the preparations and readiness of authorities for such a substantial change in accounting policies. November 2015 when the review of the 2014/15 WGA returns will be available will be a critical review point in terms of local authorities' preparedness.

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

6. CIPFA/LASAAC announced in the 2015/16 consultation on the Accounting Code that it would undertake a review of the Accounting and Reporting by Pension Funds section of the Accounting Code to coincide with the issue of the 2015 Pension SORP[1]. The review suggested a number of minor changes to the format of the pension fund account and net asset statement to improve the presentation of the statement and where possible and relevant to improve consistency and further requirements on the reporting of management costs for pension funds. More substantially the review proposes an adaptation to IFRS 13 *Fair Value Measurement* to remove the scope exclusion for disclosures of retirement benefit plan investments measured at fair value. CIPFA/LASAAC considered that as the users of local authority pension fund financial statements are concerned about investment performance effective financial reporting that the IFRS 13 fair value disclosures should be extended to pension fund assets.

(c) Narrow Scope Amendments to International Financial Reporting Standards

[1] Financial Reports of Pension Schemes, A Statement of Recommended Practice (2015) (2015 Pension SORP)

7. The draft of the 2016/17 Accounting 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.*

8. 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.

9. CIPFA/LASAAC has 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). CIPFA/LASAAC considers that the changes to IAS 16 for the methodology which allows the grossing up of values for non-DRC measurements are counterintuitive for local authorities where certified values are provided for assets measured under market based or income based measurements. CIPFA/LASAAC also considered that for non-highways assets it would not be appropriate for local authorities to mix methods for this treatment within the specified asset classes for local authority property, plant and equipment.

10. 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.

(d) 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

11. The 2016/17 Code includes provisions in its Concepts section from the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (IPSASB Conceptual Framework) This does not require any adaptations or interpretation to the Code's provisions on accounting or financial reporting standards.

(e) Legislative Developments

12. The consultation papers have also 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)

13. The Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015 (English Authorities) – the amendments largely bring forward factual changes to the Code as a result of the introduction of the new requirements which were not introduced in time for inclusion in the 2015/16 Accounting Code. The main substantive change to the Accounting Code has been as a result of the regulations introducing a new requirement for a narrative statement. FRAB will be aware that CIPFA/LASAAC has kept the issue of the production of a narrative report/management commentary under review since 2012/13 Code. This was to await the confirmation of the approach of the four UK administrations.

14. The Accounts and Audit Regulations 2015 include new prescription that the narrative statement "*must include comment by the authority on its financial performance and economy, efficiency and effectiveness in its use of resources over the financial year*". CIPFA/LASAAC has agreed that the Code should provide principles of narrative reporting to support this new provision and therefore has included provisions based on the Financial Reporting Council's guidance on strategic reporting[2] interpreted for local government circumstances.

15. The proposed amendments for the 2016/17 Accounting Code also include provisions for The Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015. These are predominantly factual changes to the Code and include the requirement to provide a Remuneration Report.

(f) Other minor and drafting amendments

16. The minor amendments include further legislative changes due to Scottish Finance Circular 4/2015 and minor amendments due to Accounting for Schools. Note the latter are not deemed to be a change in the provisions for accounting for schools.

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

17. FRAB is aware that CIPFA/LASAAC has consulted twice previously on the streamlining and simplification of the presentation of local authority financial statements. CIPFA/LASAAC now proposes the introduction of a new Funding Analysis which brings together the accounting and funding frameworks, giving council taxpayers and other users' comparable information about each set of accountabilities. CIPFA/LASAAC has debated this issue in some detail and has considered that this Analysis should be included in the Narrative Report as this will allow local

[2] Financial Reporting Council (FRC) Guidance on the Strategic Report, FRC June 2014

authorities freedom to provide additional explanation alongside the statement and reports of budgetary performance which will improve accountability.

18. CIPFA/LASAAC considers that although this would add another reporting requirement, the approach in the Code for segmental reporting is replaced by the inclusion of the segmental analysis in Comprehensive Income and Expenditure Statement (CIES). The CIES will now not be reported on the basis of the segmental analysis in the Service Reporting Code of Practice[3] but on the basis of the way in which the authority normally reports on its budget and resource decisions. The structure of the CIES reconciles the authority's segments to Surplus and Deficit on the Provision of Services, the equivalent of profit or loss for local authority performance statements.

19. CIPFA/LASAAC also proposes rationalisation of the format of the Movement in Reserves Statement as a result of the review. It has removed the requirements to report earmarked reserves and only requires line analysis for total comprehensive income and expenditure because it'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.

20. The proposals in the improving the performance of the financial statements review also improve the presentation of one of the Notes to support the Movement in Reserves Statement and reduces the segmental reporting requirements outlined above.

Impact on disclosures in the financial statements

21. There may be increased disclosures under (a) as a new class of asset will be introduced. There are likely to be increased disclosure requirements under (b) with the removal of the scope exclusion from IFRS 13. There may be new disclosure requirements under the proposals under (c) resulting from amendments to IAS 1 though this is more likely to result in more effective disclosures. More disclosures may also be needed under the Annual Improvements to IFRSs 2010 - 2012 Cycle. There should be more effective disclosures as a result of the provisions in (d). There are no new reporting requirements specified under by CIPFA/LASAAC under (e); these additional reporting requirements are specified in legislation. The changes introduced by (g) are intended to improve the presentation of local authority financial statements and where possible streamline the reporting requirements (but see paragraphs 17 to 20 for a summary of CIPFA/LASAAC's proposals which will include a new Funding Analysis).

IAS/IFRS compliance

22. There is an extension of the current adaptation under IAS 16 for the measurement requirements of property, plant and equipment to the new Highways Network Asset and the measurement option under IAS 16 to measure property, plant and equipment at depreciated historical cost is now withdrawn for (a). A new adaptation has been introduced for (a) where the option under IAS 16 for the treatment of accumulated depreciation and impairment to eliminate depreciation has been withdrawn. There are also interpretations of the measurement requirements as discussed in paragraph 3.

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

[3] The Service Reporting Code of Practice (SeRCOP) specifies the format of the segmental analysis on the face of the CIES and in the segmental reporting notes. SeRCOP is also used by government departments across the UK administrations for budgetary and outturn reports of defined cost of services. Local authorities may not operate or budget on this basis.

24. The narrow scope amendments to IFRS for (c) 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.

25. There are no new adaptations or interpretations proposed as a result of (d), (e) (f) and (g).

Impact on WGA

26. The changes in respect of (a) is anticipated to be reflected or be similar to those of the FReM and should substantially contribute to the removal of large parts of one of the qualifications in WGA. The proposals in (b) to (g) are not expected to impact on WGA in respect of these standards or amended standards.

IPSAS compliance

27. The adaptations and interpretations to IAS 16 for (a) apply equally to IPSAS 17 *Property, Plant and Equipment*. There is no IPSASB equivalent of either IAS 26 Retirement Benefits or IFRS 13 and therefore no issues of compliance for (b). The adaptation of IAS 16 for (c) 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 (d) for the Concepts section for the provisions of the IPSASB Conceptual Framework is consistent with the Framework. The amendments in (e), (f) are consistent with IPSASB standards. The proposals for (g) 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 2016/17Code of Practice on Local Authority Accounting in the United Kingdom (the Code)

28. 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

29. 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

30. This report sets out details of the proposed amendments to the 2016/17 *Code of Practice on Local Authority Accounting in the United Kingdom*.

31. The Board is requested to comment on the proposed approach to the amendments for the 2016/17 Code.

CIPFA/LASAAC
June 2015