

Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	To consider the Draft <i>Code of Practice on Local Authority Accounting in the United Kingdom</i> (the Code) 2016/17 and Update to the 2015/16 Code, as they relate to the Highways Network Asset.
Impact on guidance:	Changes to the text of the 2015/16 Code to produce the Drafts of the 2016/17 Code (and the Draft Update to the 2015/16 Code) are proposed in relation to the measurement of the Highways Network Asset at Depreciated Replacement Cost.
IAS/IFRS adaptation?	There is an extension of the current adaptation under IAS 16 ¹ for the measurement requirements of property, plant and equipment for the new Highways Network Asset and the depreciated historical cost option under IAS is now withdrawn for the Asset. The Draft 2016/17 Code adapts the requirements of IAS 16 by withdrawing the option for accumulated depreciation and impairment to be eliminated on revaluation for the Highways Network Asset. The Draft 2016/17 Code will also bring forward interpretations of the measurement provisions of IAS 16 for the Highways Network Asset for the specification of annual depreciation in accordance with the Transport Code and the treatment of derecognition. On a transitional basis only the Draft 2016/17 Code will adapt IAS 1 ² so that on reclassification to the new Highways Network Asset there is no restatement of prior year figures and no requirement for a third balance sheet.
Impact on WGA?	The changes in respect of the Highways Network Asset are anticipated to be result in consistency with the FReM and should substantially contribute to the removal of one of the qualifications in WGA.
IPSAS compliant?	The adaptations and interpretations for the Highways Network Asset apply equally to IPSAS 17 <i>Property, Plant and Equipment</i> .
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.

¹ IAS 16 *Property, Plant and Equipment*

² IAS 1 *Presentation of Financial Statements*

Impact on Estimates?	None – local authorities only.
Recommendations:	The Board is requested 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 for the Highways Network Asset and the changes made since the 2015/16 Code.
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 the Code. This paper considers the amendments and proposals for the Highways Network Asset only. For overall Code approval purposes it should be read in conjunction with the paper on the remaining changes to the Draft 2016/17 Code ie FRAB 125 (09)(ii). The Draft 2016/17 Code is attached to both papers at Annex B.

2. 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.

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 implements 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. Overall responses to the consultation were positive with between 64% and 69% of respondents agreeing with the proposals summarised in four questions in the consultation paper. Within Highways Authorities this positive response rate was between 72% and 78%.

Transition

5. As a part of the preparations for implementation of the new measurement requirements for the Highways Network Asset CIPFA and CIPFA/LASAAC undertook a number of exercises to assess the level of preparedness of local authorities for full implementation. This included a separate questionnaire/survey issued by the Project Implementation Steering Group (PISG) which asked for detailed implementation information. In addition the audit working group which has been established by CIPFA with the support of the National Audit Office to consider the audit

aspects of the new measurement basis sought the view of auditors on the level of local authority preparedness.

6. Overall the outputs from the various sources showed good progress. Alongside the CIPFA/LASAAC consultation PISG consulted on preparedness obtaining 70 responses. Most authorities had identified the components of the Highways Network Asset, completed an initial consideration of materiality and reviewed asset data. In that consultation less than half of authorities had completed a systems audit, although over 60% had undertaken a gap analysis. Over three quarters of authorities had engaged with key stakeholders and whilst only just over half had developed a project plan over 65% had set up a project group which included finance and highways professionals. Most authorities (57, or 81%) were either very confident or slightly confident about being able to implement the requirements for 2016/17. That said, authorities highlighted that successful implementation still required plans to be achieved and relied on the availability of key resources.

7. However, a number of respondents to the Code consultation indicated that there was significant risk around information on the opening balances for full retrospective restatement. Some were concerned with the ability to undertake full retrospective restatement. One firm with a substantial share of the audit market in England commented *“at a practical level, based on our discussions with clients we have concerns over the state of preparation at some authorities which would enable full retrospective restatement in the 2016/17 financial statements. We have particular concerns with regards to establishing the inventory and condition at 1 April 2015 and the benefits to local authorities of compiling this historic data.”* The firm suggested that implementation should be from 1 April with no requirement to restate. An audit body recommended focussing on the requirements for revaluations in paragraph 17 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* the initial application of a policy to revalue assets in accordance with IAS 16 is a change in an accounting policy to be dealt with as a revaluation rather than in accordance with the general approach in IAS 8. However, the move to the Highways Network Asset is also a reclassification, which would normally require full retrospective restatement under IAS 1 *Presentation of Financial Statements*.

8. CIPFA/LASAAC was concerned with the significant risk for the retrospective restatement identified by the consultation on the Code. CIPFA/LASAAC debated its options for implementation in detail and was concerned to maintain the progress for implementation in the 2016/17 financial statements. When evaluating the risk of the lack of information and particularly for retrospective restatement it focussed on the advantages of following the IAS 8 policy on revaluation identified by the audit body. CIPFA/LASAAC therefore decided that it would adapt IAS 1 on implementation in the 2016/17 financial statements and that the Code would not require comparative information for 1 April 2015 or 2015/16 preceding year information. FRAB Members will be aware that similar approaches and relaxations on full preceding year information in the transitional approaches available in IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*.

9. As the proposals no longer include changes to the 2015/16 comparative information appropriate amendments need to be made to the Code's requirements for the 2015/16 financial statements to disclose information relating to new standards issued but not yet adopted by the Code. The Secretariat has proposed to CIPFA/LASAAC that this will need to be communicated in the form of an Update to the 2015/16 Code, which is available at Annex C.

10. In terms of amendments made since the Exposure Draft for the Highways Network Asset:

- **Scope and definition and recognition requirements** – two respondents particularly queried the definition of the Highways Network Asset as a single asset. One referred to

the bodies following the FReM that treat the asset as a single asset indicating that this was because it is a single type of carriageway maintained to the same standard. CIPFA/LASAAC considered these same bodies recognise other components as a single asset. Another respondent argued that this is not consistent with paragraph 9 of IAS 16. However, the relevant sentence in IAS 16 is; “*This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment*”. The Draft 2016/17 Code therefore remains in accordance with CIPFA/LASAAC’s decisions in the Invitation to Comment ie that the Highways Network Asset is as a homogenous interconnected network of assets elements whose the service potential is dependent on being linked to other elements of the network. As noted in FRAB 124 (09) this approach accords with the approach in the Highways Agency and Transport Scotland accounts, and as permitted by the FReM (2015/16 FReM, paragraph 7.1.23)

- **Measurement** – the Accounting Code will follow the requirements of the CIPFA *Code of Practice on Transport Infrastructure Assets* (Transport Code) for measuring the service potential in the assets in a similar approach to the FReM.
 - There were comments from a number of respondents about the structure of the Transport Code and the Accounting Code and the ability of auditors to distinguish the requirements from guidance, with some respondents commenting on the complexity and indicating that they considered that more detail should be in the Accounting Code. CIPFA/LASAAC is content with the current approach in the Accounting Code as it has always been the intention that the detail of the prescription of the measurement methodologies should be included in the Transport Code. The Transport Code is a CIPFA Code of Practice and has been subject to full consultation twice. However, CIPFA/LASAAC will refer this issue to PISG and it is anticipated that that Group will redraft that Code to clarify those specifications that are principles.
 - The Draft 2016/17 Code also restricts the methodology for the treatment of accumulated depreciation and 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. As reported in FRAB 124 (09) this is an adaptation of IAS 16. A small number of respondents raised concerns as this was different from the approach for other property, plant and equipment. However, the Board was clear that for the measurement of the Highways Network Asset this provided better information (particularly by showing the movements from Gross Replacement Cost) than the elimination method.
 - A firm focussed on the treatment of annual depreciation expressing the view that the presumption that the performance of the Highways Network Asset is maintained by replacement is not reasonable and was concerned that the treatment of changes to the estimated age of the asset was a revaluation movement. As was set out in the consultation papers there is a clear definition of annual depreciation. Condition is used as a proxy for age in order to establish where the assets sit on the depreciation line. Age is used to estimate accumulated depreciation and the adjustment is recognised as a revaluation movement.
- **Derecognition** – there was less debate on this section of the Draft 2016/17 Code in relation to the Highways Network Asset. Two respondents did not consider that there was a need for a rebuttable presumption that the asset had reached the end of its useful life as

adequate information should be available to measure any service potential remaining in the component being replaced. CIPFA/LASAAC did not concur as due to the interconnected nature and the variety of different ways in which a component will be replaced it will be difficult to measure any service potential remaining in a component and normally the replacement event should be because the component is worn out. One respondent considered that the rebuttable presumption should be an adaptation. However, CIPFA/LASAAC considers that the rebuttable assumption is a reasonable interpretation of the standard.

Impact on disclosures in the financial statements

11. There will be increased disclosures as a new class of asset will be introduced.

IAS/IFRS compliance

12. 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 depreciated historical cost option under IAS is now withdrawn for the Asset. The Draft 2016/17 Code adapts the requirements of IAS 16 by withdrawing the option for accumulated depreciation and impairment to be eliminated on revaluation for the Highways Network Asset. The Draft 2016/17 Code will also bring forward interpretations of the measurement provisions of IAS 16 for the Highways Network Asset for the specification of annual depreciation per the Transport Code and on the treatment of derecognition. On a transitional basis only the Draft 2016/17 Code will adapt IAS 1 so that on reclassification to the new Highways Network Asset there is no restatement of prior year figures and no requirement for a third balance sheet.

Impact on WGA

13. The changes in respect of the Highways Network Asset are 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.

IPSAS compliance

14. The adaptations and interpretations to IAS 16 for the Highways Network Asset apply equally to IPSAS 17 *Property, Plant and Equipment*.

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

15. 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

16. 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

17. 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 as they relate to the measurement of the Highways Network Asset.

18. The Board is requested 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 for the Highways Network Asset and the changes made since the 2015/16 Code.

CIPFA/LASAAC
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