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) 2017/18
Impact on guidance:	Changes to the text of the 2016/17 Code to produce the Exposure Drafts of the 2017/18 Code are proposed in relation to: a) Narrative reporting, b) Going concern reporting, c) Other amendments to the Code, d) Narrow scope amendments to International Financial Reporting Standards, e) Legislative amendments, f) A new Appendix (F) including the provisions for the Code's adoption of IFRS 9 *Financial Instruments*, and g) A new Appendix (G) including provisions for the Code's adoption of IFRS 15 *Revenue from Contracts with Customers*.
IAS/IFRS adaptation?	There are no new adaptations proposed to the Code for a) to d). Adaptations do not apply to e). CIPFA/LASAAC proposes removing two adaptations for f) ie i) removing the restriction to the use of 'trade date' for regular way trades of financial assets and ii) removing the prohibitions against designations of financial instruments. It also proposes introducing a new adaptation by not permitting local authorities to use the accounting policy choices in IFRS 9 to continue to use IAS 39 accounting policies for hedge accounting. No adaptations are proposed for the adoption of IFRS 15.
Impact on WGA?	The changes in a) to e) are not anticipated to have an effect on WGA. The general approach to amendments under f) should promote consistency and therefore should not have an effect on WGA. The introduction of the adaptation for hedge accounting under f) will promote consistency between local authorities and therefore should assist WGA reporting requirements. The amendments proposed by g) are not anticipated to have an effect on WGA.
IPSAS compliant?	The work of the International Integrated Reporting Council (framework) has not been directly reflected in IPSAS pronouncements for a). Item b) is expected to be consistent with IPSAS. The transaction cost disclosure is not reflected in IPSAS but the other items in c) are consistent with IPSAS. For d) - the narrow scope amendments are not yet reflected in IPSAS. Amendments (f) and (g) are also not yet reflected in IPSAS. However, the IPSASB has a project on updating its financial instruments standards to converge with IFRS. The IPSASB also has a project on

	revenue.
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 2017/18 Code.
Timing:	2017/18 and 2018/19

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* (Code) at its meeting on 7 June 2016. This report sets out briefly the proposed substantive changes to the 2016/17 Code made in producing the Exposure Drafts of the 2017/18 Code based on CIPFA/LASAAC's early decisions. The decisions, the consultation paper and Exposure Drafts are still subject to approval and confirmation by CIPFA/LASAAC. If there are any substantial changes as a part of the approval process FRAB will be updated in an out of meeting paper or note. CIPFA/LASAAC anticipates consulting on these changes from mid-July to 7 October 2016. The main areas for change will be:

a) Narrative reporting
b) Going concern reporting
c) Other amendments to the Code
d) Narrow scope amendments to International Financial Reporting Standards
e) Legislative amendments
f) A new Appendix (F) including the provisions for the Code's adoption of IFRS 9 *Financial Instruments*, and
g) A new Appendix (G) including provisions for the Code's adoption of IFRS 15 *Revenue from Contracts with Customers*.

2. The Exposure Drafts of the 2017/18 Code are included in an Annex to this report.

Changes since the 2016/17 Code – Specific Issues included in the Exposure Draft

(a) Narrative Reporting

3. FRAB will be aware that the Narrative Reporting requirements in the Code for England, Northern Ireland and Wales have included an encouragement approach to follow the Government's Financial Reporting Manual's (FReM) requirements for a strategic report. In Scotland the Narrative Reporting requirements are specified by statutory guidance and not the Code. CIPFA/LASAAC has determined that it wants to provide specific principles based

requirements in the Code derived by reference to the principles in the work carried out by the International Integrated Reporting Council (IIRC) and based on the elements that are the required content of the Integrated Report. Reference has also been made to the Financial Reporting Council's (FRC) Guidance on the Strategic Report (FRC July 2014) when setting out principles for reporting performance within this framework.

4. CIPFA/LASAAC considers that although not taking the same form as the Government's Financial Reporting Manual (the FReM) this approach should mean that it meets the major reporting requirements of the FReM.

b) Going Concern Reporting

5. Following a respondent's comments in last year's consultation on the Code, CIPFA/LASAAC has reviewed its going concern reporting specifications. CIPFA/LASAAC is content that the current provisions in the Code reflect the economic and statutory environment in which local authorities operate as they cannot be created or dissolved without statutory prescription and it would not therefore be appropriate for their financial statements to be provided on anything other than a going concern basis. It has included a minor amendment to the Code to reflect this view.

6. This is consistent with the 2016-17 FReM which in paragraph 2.2.3 states:

"*In presenting information in their financial statements, preparers should also have regard to the:*

- *underlying assumption (financial statements shall be prepared on a going concern basis)*;…"

7. CIPFA/LASAAC is also concerned that an authority clearly sets out for the users of its financial statements the circumstances and events facing a local authority, particularly in relation to the budgetary pressures that they are currently faced with, and that adequate disclosure of these issues should be made using the reporting requirements in the Code ie the Narrative Report and the liquidity reporting requirements in section 7.4.3[1] of the 2017/18 Code.

c) Other Amendments to the Code

8. The consultation paper on the changes for the 2017/18 Code includes amendments and Exposure Drafts to reflect three issues raised in last year's consultation process:

- *Accounting Policies – CIPFA*/LASAAC has removed the list of accounting policies at paragraph 3.4.2.87 of the Code and included additional guidance from IAS 1 *Presentation of Financial Statements*. This list has been reduced at the request of CIPFA/LASAAC and has instead been included as a suggested list but in an Annex to Section 3.4.

- *Accounting and Reporting by Pension Funds – Investment Transaction Costs* – in the 2016/17 Code CIPFA/LASAAC indicated its intention to mandate the recommended disclosure on pension fund investment transaction costs. CIPFA/LASAAC is therefore taking forward this proposal.

- *Review of the Structure of chapter one (Introduction) of the Code* - Chapter one has been restructured to more clearly reflect the relevant provisions across the four UK

[1] This section of the 2016/17 Code includes the current provisions in IFRS 7 *Financial Instruments: Disclosures* on liquidity risk.

administrations. The provisions of this chapter with the exception of the relevant legislative changes are unchanged.

d) Narrow Scope Amendments

9. CIPFA/LASAAC proposes to adopt the following narrow scope amendments in the Code without adaptation or interpretation.

- IAS 7 *Statement of Cash Flows* (Disclosure Initiative), and
- IAS 12 *Income Taxes* (Recognition of Deferred Tax Assets for Unrealised Losses).

e) Legislative Developments

10. The consultation papers and Exposure Drafts have also included relevant updates for legislative developments with proposed updates reflecting the relevant statutory requirements. These comprise:

- the Cities and Local Government Devolution Act 2016
- the Housing and Planning Act 2016
- the Housing Revenue Account (Accounting Practices) Directions 2016 (English authorities), and
- the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.

Some minor amendments have also been made as result of a review of the statutory accounting requirements for Scottish local authorities.

f) A new Appendix (F) including the Provisions for the Code's Adoption of IFRS 9 Financial Instruments

IFRS 9 - Approach to Adoption

11. CIPFA/LASAAC has agreed to include the provisions required to adopt IFRS 9 *Financial Instruments* in a new Appendix F to the 2017/18 Code to allow local authorities adequate preparation time for implementation. The provisions in this Appendix will only apply from 1 April 2018. Early adoption will not be permitted under the proposals.

IFRS 9 - Classification and Measurement of Financial Assets

12. CIPFA/LASAAC proposes adopting the new classification and measurement provisions for financial assets without adaptation or interpretation.

13. In relation to classification more generally, CIPFA/LASAAC proposes, removing the current adaptation of IAS 39 in the Code which prohibits designations of financial instruments on the grounds of ensuring comparability.

IFRS 9 - New Impairment Model

14. CIPFA/LASAAC also proposes adopting the new impairment provisions in IFRS 9 without adaptation or interpretation. It is seeking interested parties' views on the practical effects of the provisions in IFRS 9.

Impairment of Council Tax, National Non Domestic Rates and District Rates

15. CIPFA/LASAAC is of the view that council tax, national non-domestic rates and district rates are outside the scope of both IFRS 9 and IFRS 15 as no contract exists between the local authority and the tax payer. For the avoidance of doubt it has retained the adaptation included in the Code for IAS 39 for IFRS 9.

"*ie revenue relating to such things as council tax, general rates, etc shall be measured at the full amount receivable (net of any impairment losses) as they are non-contractual, non-exchange transactions and there can be no difference between delivery and payment dates".*

16. CIPFA/LASAAC does not consider that the expected credit loss model is an appropriate model to measure a loss allowance as it is not feasible to measure expected credit losses for the relevant taxpayers. It therefore proposes to retain the incurred loss model for impairment of these income streams.

IFRS 9 - Approach to Adaptations

17. CIPFA/LASAAC is only proposing one new adaptation for hedge accounting (see paragraph 18 below). It has removed two adaptations from those 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 the settlement date).

Otherwise CIPFA/LASAAC proposes retaining its remaining adaptations and interpretations currently included in the 2016/17 Code for IAS 39. This is because the relevant provisions in IFRS 9 have not been subject to significant change that would affect these adaptations (see ED8 paragraph 7.1.1.3 in the Annex to this report).

IFRS 9 - Hedge Accounting

18. The Code has not traditionally included substantial provisions on hedge accounting as the view set out in the Code was that local authorities seldom undertook hedge accounting. This approach has been retained in the Exposure Draft for IFRS 9. Where an authority has hedge accounting transactions it is required to refer directly to IFRS 9.

19. FRAB Members will be aware that until the macro hedge accounting project is complete IFRS 9 allows an entity to apply either the hedge accounting model in IFRS 9 or IAS 39 in its entirety, with the additional choice to apply IFRS 9 but to use IAS 39 for macro hedges. Following

comments from a FRAB Member during the Technical Working Groups debates, CIPFA/LASAAC agreed that the hedge accounting provisions in IFRS 9 are improved over those in IAS 39. The Exposure Draft therefore only permits local authorities to follow the hedge accounting policies in IFRS 9 and does not permit the use of IAS 39. CIPFA/LASAAC's additional reasoning for this is that to date only a small number of authorities have adopted the IAS 39 provisions for hedge accounting and they would also not normally undertake macro hedging. CIPFA/LASAAC is testing these assertions with interested parties in the consultation.

IFRS 9 - Transition

20. CIPFA/LASAAC proposes adopting the option in the transitional provisions in IFRS 9 which requires retrospective restatement without restating preceding year information. It has opted for this on the basis of the resource implications for local authorities and that there are technical arguments for using this option eg IFRS 9 does not permit application to financial instruments that have been derecognised at the date of initial application. The remaining transitional provisions have been drafted in the Code from that starting point.

IFRS 9 - Disclosures

21. The Exposure Draft section for disclosure of financial instruments does not include any adaptations or interpretations in the Code but does omit detail in relation to certain disclosures. It has been drafted from the perspective of the common or typical transactions occurring in local authorities, for example, few local authorities either require or pledge collateral against or in support of the financial instruments they hold. The Code is clear, however, that where an uncommon transaction occurs that local authorities should refer directly to IFRS 9 for the relevant disclosures.

g) A new Appendix (G) including Provisions for the Code's Adoption of IFRS 15 Revenue from Contracts with Customers

IFRS 15 - Recognition and Measurement

22. In a similar approach to IFRS 9, CIPFA/LASAAC proposes a new Appendix G in the 2017/18 Code to include the provisions of IFRS 15 *Revenue from Contracts with Customers* to allow local authorities time to make effective preparations to adopt the standard. Early adoption will not be permitted under the proposals. CIPFA/LASAAC does not consider that there is any need to adapt or interpret the provisions in IFRS 15 for recognition and measurement for local authority circumstances.

23. CIPFA/LASAAC has been selective in the provisions of IFRS 15 which have been included in the Exposure Draft and has included those provisions it considers are most likely to be commonly applied by local authorities and where relevant has included exemplifications in the new Appendix G. For example, it has included more detail on the provisions for the accounting treatment of significant financing transactions as deferred payments agreement schemes for residential care fees are becoming a substantial issue for local authorities. It has, however, changed references to 'customers' in IFRS 15 to 'service recipients' as it considers this better reflects the transactions in local authority financial statements. However, the provisions relating to 'customers' in IFRS 15 are unchanged.

24. As with the previous version of this section of the Code the new draft also includes reference to non-exchange transactions which the Code has since its inception accounted for under IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers).*

IFRS 15 - Disclosures

25. CIPFA/LASAAC is of the view that for most local authority transactions revenue from contracts with service recipients is not complex and no particular difficulties are anticipated to arise as a result of its recognition and measurement. This was also a view shared by respondents to last year's consultation on IFRS 15. CIPFA/LASAAC has therefore emphasised in its provisions that transactions should only be disclosed where information related to the disclosure is material to the local authority financial statements. It has not included the disclosures in the proposed new section on revenue recognition and requires that an authority refers directly to IFRS 15 where it has such material transactions.

IFRS 15 - Transition

26. The Exposure Draft for the amendments introduced by IFRS 15 follows the transitional approach in IFRS 15 which requires retrospective restatement but does not require restatement of preceding year information. CIPFA/LASAAC has chosen this option on the basis of consistency with the IFRS 9 approach and recognising the resource implications for local authorities.

Principles of Revenue Recognition

27. CIPFA/LASAAC also decided to augment the Code's provisions on revenue recognition generally and proposes including a new section on the principles of revenue recognition in section 2.1 (Concepts) of the Code for the major revenue streams earned by an authority, including both exchange and non-exchange transactions. This section does not change the revenue recognition accounting treatment for the revenue streams that are non-exchange transactions as they were previously based on IPSAS 23. These provisions would be outside the scope of IFRS 15 as non-exchange transactions but have, however, been augmented using the principles in IFRS 15 to include provisions to identify the recognition event. The principles of revenue recognition from exchange transactions follow those in IFRS 15. To further assist local authorities a flow chart has been added to summarise the accounting treatment of the main revenue streams; this is included at the end of Exposure Draft (ED) 9.

IFRS 16 *Leases*

28. CIPFA/LASAAC has also included very brief commentary in the consultation papers on IFRS 16 *Leases* and has decided to seek volunteers to be a part of a project group it wishes to establish to prepare for the adoption of the standard in the 2019/20 Code.

Impact on disclosures in the financial statements

29. There may be increased disclosures under a) as the new principles based approach sets out a wider framework for Narrative Reporting. There are no changes to the disclosure requirements under b). Disclosures may be reduced under c) as the new reporting guidance should ensure that local authorities only disclose accounting policies relevant to their individual circumstances. The proposals also mandate a new disclosure for transaction costs for pension fund investments. For d) 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. No new disclosures are included under e). Substantial new disclosures are required under both f) and g).

IAS/IFRS compliance

30. No new adaptations are proposed for a) to d). IFRS does not include disclosures for transaction costs for pension fund investments for c). Adaptations do not apply to e). CIPFA/LASAAC proposes removing two adaptations from f) – see paragraph 17 above. It also proposes adding 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 hedge accounting policies. No adaptations are proposed for the adoption of IFRS 15 under g).

Impact on WGA

31. The changes in a) to e) are not anticipated to have an effect on WGA. The general approach to amendments under f) should promote consistency and therefore should not have an effect on WGA. The introduction of the adaptation for hedge accounting under f) will promote consistency between local authorities and therefore should assist WGA reporting requirements. The amendments proposed by g) are not anticipated to have an effect on WGA.

IPSAS compliance

32. The work of the IIRC has not been directly reflected in IPSAS pronouncements for a). Item b) is expected to be consistent with IPSAS. The transaction cost disclosure is not expected to be reflected in IPSAS but the other items in item c) are consistent with IPSAS. The narrow scope amendments are not yet reflected in IPSAS for e). Amendments f) and g) are also not yet reflected in IPSAS. However, the IPSASB has a project on updating its financial instruments standards to converge with IFRS. The IPSASB also has a project on revenue.

Proposed text for the 2017/18 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)

33. 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

34. 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

35. This report sets out details of the proposed amendments to the 2017/18 *Code of Practice on Local Authority Accounting in the United Kingdom*.

36. The Board is requested to comment on the proposed approach to the amendments for the 2017/18 Code.

CIPFA/LASAAC
June 2016