

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) 2017/18 (excluding the detail on the Highways Network Asset and the Update to the 2016/17 Code).
Impact on guidance:	<p>Changes to the text of the 2016/17 Code to produce the Draft of the 2017/18 Code are proposed in relation to:</p> <ul style="list-style-type: none"> 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 <i>Financial Instruments</i>, and g) A new Appendix (G) including provisions for the Code's adoption of IFRS 15 <i>Revenue from Contracts with Customers</i>.
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: <ol style="list-style-type: none">1) to approve the amendments to the 2017/18 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 2016/17 Code;2) to agree to consider whether any further amendments to the Code can be delegated to the Chair or considered by FRAB in an out of meeting paper.
Timing:	2017/18 and 2018/19

DETAIL

Background

1. The CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC) issued its consultation on the 2017/18 Code on 15 July 2016. The consultation period closed on 7 October 2016. Forty-seven responses were received to the consultation. This is a positive response rate but it is not quite as good as last year's consultative process where the main consultation on the Code received 72 responses. Overall the respondents were supportive of the proposals. A list of the respondents to the consultations is included at Annex 1.
2. The Exposure Drafts of the 2017/18 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) were considered by FRAB in June 2016.
3. CIPFA/LASAAC considered the consultation responses at its meeting on 9 November 2016 and has provided its initial views on the Draft 2017/18 Code following the consultation. This report sets out briefly the substantive revisions made following the consultation process to the Exposure Draft which was 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 on 9 November 2016.
4. As CIPFA/LASAAC is currently reviewing the attached Draft 2017/18 Code for its final approval 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 2017/18 Code is attached to this report as Annex 2 for the Board's approval. In addition, as the separate report on the Highways Network Asset notes, CIPFA/LASAAC has also proposed to issue an Update to the 2016/17 Code: this is attached to report 128 (05) at Annex A.

5. A full list of the amendments in the Draft 2017/18 Code is included in Annex 3.
6. The Annex (in the Code) which sets out the differences between the Code and the FReM is included in the Draft 2017/16 Code. This list was updated in the 2016/17 Code to reflect the new reporting requirements for the Highways Network Asset. It is therefore reflected in the 2017/18 Code.
7. The main areas for change to the 2017/18 Code are:
 - 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*.

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

(a) Narrative Reporting

8. FRAB will be aware that CIPFA/LASAAC has determined that it wants to provide specific principles based requirements in the Code for narrative reporting derived by reference to 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.

9. The majority of respondents supported the approach to narrative reporting. A firm considered that the approach should be more prescriptive and commented that the wording in paragraph 3.1.1.4 could still be interpreted as recommendations rather than requirements for local authorities to follow. CIPFA/LASAAC debated this issue in detail but was content at the end of this debate that the wording in this paragraph was consistent with a principles based approach.

10. A small number of respondents considered that the approach in the Code should focus more on the financial aspects of a report which accompanied the financial statements and that the Code did not focus on the statutory reporting requirements in the Accounts and Audit Regulations 2015 for English authorities which required reports on the financial performance and position of an authority. Some minor augmentations have been included to add more focus on the financial issues. However, CIPFA/LASAAC was content with its approach in the Exposure Draft, which had a wider focus on the local authority as an organisation covering corporate strategies, principal risks etc and is consistent with other sectors. In addition the Regulations refer to demonstrating use of "resources" and not merely "financial resources", suggesting a wider reporting framework.

11. A small number of respondents suggested that the elements to establish the content of the Integrated Report could be more local government orientated. CIPFA/LASAAC concurred with this and made amendments to 3.1.1.6 to 3.1.1.10 and 3.1.1.15 and 3.1.1.16 to reflect local authority circumstances, for example, referring to the operational model (instead of business model) and including more emphasis on local authority service provision.

b) Going Concern Reporting

12. Following a respondent's comments in last year's consultation on the Code, CIPFA/LASAAC has reviewed its going concern reporting specifications. The majority of respondents were content with the approach in the Code. A firm considered that local authorities still need to consider whether there is any material uncertainty that the body itself cannot continue as a going concern for at least 12 months after the balance sheet date (see IAS 1 *Presentation of Financial Statements*, paragraph 25). CIPFA/LASAAC did not concur following the rationale set out in its consultation documents ie most local authorities cannot be discontinued without statutory prescription meaning that there can be no material uncertainties related to events or conditions that can cast significant doubt upon their ability to continue to report on a going concern basis. CIPFA/LASAAC did consider that there were a small number of bodies (which are not local authorities but which are required to follow the Code) which could be discontinued without statutory prescription. It therefore decided to reflect this in paragraph 3.4.2.23 of the Code.

c) Other Amendments to the Code

13. The 2017/18 Code includes amendments as a result of issues raised in last year's consultation process and on review of the Code's provisions :

- *Accounting Policies* – The Code consultation 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 was reduced and instead was included in an Annex to Section 3.4. A number of respondents pointed out that the reduced list might have omitted an accounting policy that was significant to an individual authority so CIPFA/LASAAC has now decided to remove the list altogether. CIPFA/LASAAC was of the view that individual sections of the Code provide a reference point for which policies may be significant.
- *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. The Code consultation responses raised the wider debate around the transparency and reporting investment management expenses and the difficulties of agreeing the definitions of these costs. After discussion CIPFA/LASAAC agreed to proceed with the transaction costs disclosure as these are clearly defined in IFRS (in IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*).
- *Amendment to the disclosure of investment asset concentration* - in a review of application guidance on pension fund reporting it was considered that the information required under IAS 26 no longer provided materially relevant disclosures and therefore the disclosure at paragraph 6.5.5.1 m) now refers to '*Details of any single investment exceeding either 5% of the net assets available for benefits*, this is consistent with the approach in the *Financial Reports of Pension Schemes – A Statement of Recommended Practice 2015*.

- *Review of the structure of chapter one (Introduction) of the Code* - Chapter one has been restructured to reflect more clearly the relevant provisions across the four UK administrations. With the exception of the relevant legislative changes the provisions of this chapter are substantially unchanged from the 2016/17 Code. The consultation responses raised a number of minor issues relating to legislative prescription and amendment has been made to paragraphs 1.3.7, 1.3.8 and 1.4.2 since the Exposure Draft.
- *Other minor or consequential amendments* – these are included in the listing in Annex 3 to this report.

d) *Narrow Scope Amendments*

14. CIPFA/LASAAC proposed 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).

This was supported by the majority of respondents.

e) *Legislative Developments*

15. The consultation papers and Exposure Drafts included relevant updates for legislative developments with proposed updates reflecting the relevant statutory requirements. The changes to the 2017/18 Code mainly focus on the Housing Revenue Account (Accounting Practices) Directions 2016 (English authorities), and the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. As noted in report 128 (05) these amendments are also included in the Update of the 2016/17 Code.

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

IFRS 9 - Approach to Adoption

16. Following the consultation process CIPFA/LASAAC confirmed that it will 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.

IFRS 9 - Classification and Measurement of Financial Assets

17. The Code consultation proposed adopting the new classification and measurement provisions for financial assets without adaptation or interpretation. The majority of respondents agreed with this approach but a number of respondents raised the issue of the impact of the loss of the available-for-sale class of financial assets and the impact of the new classifications which will mean revaluation gains or losses being charged against the Surplus or Deficit on the Provision of Services (the equivalent to profit or loss) as they arise. They were concerned about the potential volatility that this would have on council tax and housing rents. CIPFA/LASAAC has requested that the CIPFA Treasury and Capital Management Panel, which has the relevant

expertise, consider the impact and attempt to quantify its effect on the local authority General Fund.

IFRS 9 - New Impairment Model

18. The Code consultation proposed adopting the new impairment provisions in IFRS 9 without adaptation or interpretation. The majority of respondents to the consultation agreed with the approach with only a small number of respondents disagreeing. One respondent commented on the impact on council tax of the new reporting requirements, pointing out that it considered there would be an increased reporting burden.

19. A firm was concerned that the FReM included a proposal to mandate the simplified approach to impairment (for trade receivables, contract assets and lease receivables) and that there would be a discrepancy between the FReM and the Code. During the development of the Exposure Draft CIPFA/LASAAC could see no reason for restricting the choice of local authorities. At its November 2016 meeting it could not see any further advantages of adapting the Code in this manner but it decided that it would review this following the decisions made in relation to the FReM taking into account the arguments to support such an adaptation.

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

20. The Code consultation proposals put forward 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. The related debtor balances are not therefore financial instruments and therefore the expected credit loss model would not apply. As discussed in the report to FRAB in June 2016/17 the Exposure Draft of the Code therefore proposed that the incurred loss model was retained.

21. A number of respondents considered that it was not just council tax and non-domestic rates debtor balances which did not meet the definition of a financial instrument, for example, housing benefit overpayments. CIPFA/LASAAC agreed that the Code should adopt a principles based approach to these debtor balances and therefore the provisions for the incurred loss model are now included in section 5.2 of the Code, which in 2018/19 will be the debtors section.

22. Two firms were critical of the use of the incurred loss model approach included in the Exposure Draft and were of the view that the impairment loss model to be used for the non-financial instruments debtor balances should be the expected loss model under IFRS 9 as it is deemed to provide better information. CIPFA/LASAAC considered the issue and was of the view that there are difficulties measuring under the expected credit loss model where the definition of expected credit loss is based on contractual cash flows (which will not exist). The measurement of credit losses is based on credit losses for financial instruments, again which do not exist. It considered that the incurred loss model is based on objective evidence of default. CIPFA/LASAAC therefore decided to continue with the use of the incurred loss model for debtor balances which are not financial instruments. One of the firms noted that if the Code maintained the incurred loss model approach that it would need to provide full provisions, including relevant disclosures for the incurred loss model, as these would not be provided in extant accounting standards. The draft of the 2017/18 Code therefore includes augmented provisions at paragraphs 5.2.2.11 to 5.2.2.16 of Appendix F with the relevant disclosure requirements at 5.2.4.2, 3).

IFRS 9 - Approach to Adaptations

23. In its approach to the adoption of IFRS 9, CIPFA/LASAAC is only proposing one new adaptation for hedge accounting (see paragraph 26 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 paragraph 7.1.1.3 in Appendix F in Annex 3 to this report).

24. The approach to adaptations was supported by the majority of respondents. However, two firms raised the issue of the clarity of the adaptation in relation to Lender Option Borrower Option (LOBO) loans at 7.1.1.3 c) first bullet. CIPFA/LASAAC has agreed that this 1) was an interpretation and 2) only related to call options under the contract. Any embedded derivative would be reported in accordance with the requirements of IFRS 9. This also meant consequential amendments to paragraphs 7.1.7.8 and 7.2.5.6. As an authority would follow the general provisions in the Code and IFRS 9 for embedded derivatives the deleted text was therefore not required. Similar amendments are made to the 2017/18 Code as the same principles apply to IAS 39 (these are included in the list at Annex 3).

IFRS 9 - Hedge Accounting

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

26. Following FRAB 124 (09) FRAB Members will be aware that CIPFA/LASAAC agreed that the hedge accounting provisions in IFRS 9 are improved over those in IAS 39. The Exposure Draft therefore only permitted 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 had no responses which indicated that hedge accounting was used widely by local authorities and therefore has decided to retain the adaptation.

IFRS 9 - Presentation

27. The Code consultation included the relevant new lines introduced by the IFRS 9 amendment to IAS 1, but only those lines that applied regularly to local authorities (ie IAS 1 paragraph 92 - the separate presentation of interest revenue calculated using the effective interest method, gains and losses arising from the derecognition financial assets measured at amortised cost and impairment losses (including reversals) determined in accordance with section 5.5 of IFRS 9). This was not supported by the majority of respondents, with a number of noting that this would add clutter to the face of the Comprehensive Income and Expenditure Statement. On review

CIPFA/LASAAC also considered that this was not consistent with its approach to the Comprehensive Income and Expenditure Statement which has included this type of income and expenditure in a separate Financing and Investment Income and Expenditure line. CIPFA/LASAAC therefore decided to include these items in the Financing and Investment Income and Expenditure line with a new paragraph at paragraph 3.4.2.40 which requires that where these items are material they should be disclosed separately on the face of the Comprehensive Income and Expenditure Statement or in the notes. This is not considered to be an adaptation of IAS 1 but an extension of the approach to IAS 1 outlined in paragraph 3.4.1.4 of the Code.

IFRS 9 - Transition

28. CIPFA/LASAAC included the transitional provisions in IFRS 9 which require retrospective restatement without restating preceding year information. This was supported by the majority of respondents.

IFRS 9 - Disclosures

29. The Code 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. The Code is clear, however, that where an uncommon transaction occurs local authorities should refer directly to IFRS 9 for the relevant disclosures. This principle was continued on review of the consultation responses which indicated that whilst it is unlikely that authorities will pledge collateral they may hold collateral and therefore the disclosure from paragraph 15 of IFRS 7 has been reinstated in the Code.

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

30. In a similar approach to IFRS 9, the consultation on the Code proposed 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. The provisions will apply from 1 April 2018. Early adoption will not be permitted under the proposals.

31. 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. The consultation responses supported the proposals for adoption.

32. One respondent was concerned about the application of the provisions in section 2.7 for non-exchange transactions. CIPFA/LASAAC was of the view that these provisions had not been changed from the 2016/17 Code and the new principles of revenue recognition provided additional guidance in this area. The same respondent questioned whether the provisions of IFRS 15 applied to non-exchange transactions. The Code, paragraph 2.7.1.4 in Appendix G clarifies that the IFRS 15 provisions apply to exchange transactions but where relevant local authority accounts preparers may apply the principles to non-exchange transactions.

IFRS 15 - Disclosures

33. 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. 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. This approach was supported by the majority of respondents.

IFRS 15 - Transition

34. CIPFA/LASAAC included the transitional provisions in IFRS 15 which require retrospective restatement without restating preceding year information. This was supported by the majority of respondents.

Principles of Revenue Recognition

35. The Code's provisions on revenue recognition include a new section on the principles of revenue recognition in section 2.1 (Concepts) for the major revenue streams earned by an authority, including both exchange and non-exchange transactions. Non-exchange transactions are outside the scope of IFRS 15. However, section 2.1 has been augmented using the principles in IFRS 15 to include provisions to identify the recognition event (see also paragraph 32 above). The principles of revenue recognition from exchange transactions follow those in IFRS 15. The majority of respondents to the consultation supported the proposals in the Code consultation.

Presentation of Appendices F and G to the 2017/18 Code

36. Appendices F and G which amend chapter seven (Financial Instruments) and section 2.7 (Revenue Recognition) have largely retained the presentation they had in the Exposure Draft ie that the amendments to the Code are not tracked. Amendments following the consultation have been tracked for ease of reference. The consequential amendments to the Code as a result of the adoption of IFRSs 9 and 15 will be presented as tracked changes ie inserted text underlined and deleted text being struck through.

IFRS 16 Leases

37. CIPFA/LASAAC also included very brief commentary in the consultation papers on IFRS 16 Leases and sought 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. Currently only a small number of volunteers have come forward to join the project group. CIPFA/LASAAC will review its approach to the adoption of IFRS 16 at its March meeting but has been updated about the reports sent to FRAB to date.

Impact on disclosures in the financial statements

38. 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) new disclosure requirements are 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

39. 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 23 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

40. 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

41. 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)

42. The proposed text of the Draft of the Code is attached in the Annex 2 to the report. It is still subject to review and any substantive changes will be reported to the Board.

Impact on the budgetary regime

43. 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

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

45. The Board is requested:

- 1) to approve the amendments to the 2017/18 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 2016/17 Code,

- 2) to agree to consider whether any further amendments to the Code can be delegated to the Chair or considered by FRAB in an out of meeting paper.

CIPFA/LASAAC

November 2016