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) 2019/20
Impact on guidance:	Changes to the text of the 2018/19 Code to produce the Draft of the 2019/20 Code though this report will also cover CIPFA/LASAAC's decisions on IFRS 16. Therefore this report will consider: a) IFRS 16 Leases b) Narrow scope amendments to International Financial Reporting Standards and other minor amendments c) Legislative and policy amendments d) IFRS Conceptual Framework e) A number of amendments to clarify the approach to drafting the Code.
IAS/IFRS adaptation?	Two new adaptations are proposed for a) one to mandate the short term lease recognition exemption and the other to remove the cost model for subsequent measurement of the right-of-use asset. A new interpretation is included for the subsequent measurement of the leases of land see paragraphs 13 to 25 for the description of the adaptations and interpretations. For b) one new adaptation is proposed for the amendments to IFRS 9 for transactions where modifications or exchanges of financial liabilities do not result in derecognition; note this adaptation is only on transition to IFRS 9 in the 2018/19 Code. No adaptations are proposed for b), c), d) or e). CIPFA/LASAAC also proposes four adaptations to the transitional arrangements for IFRS 16 as outlined in paragraph 29 and in the Appendix to this report.
Impact on WGA?	The changes in a) may lead to WGA issues for the subsequent measurement of the right-of use asset and this is being considered by CIPFA/LASAAC. The amendments in b) to e) are unlikely to have an impact on WGA.
IPSAS compliant?	While IPSASB has yet to issue an IFRS 16 aligned leases standard, ED 64 *Leases* included proposals for a symmetrical approach to lessor accounting, which differs from the IFRS 16 aligned treatment which has been proposed (albeit with possible deferral) in the Code. The ED 64 proposals for concessionary leases also differ from those proposed for peppercorn leases. The issue of third party income for service concession arrangements is covered by IPSAS 32 *Service Concession Arrangements: Grantor* - the sub group referred to in paragraph 31 will consider the IPSAS treatment. IPSASB has issued ED 66 which relates to the amendments to Long-Term Interests in Associates and Joint

	Ventures and Prepayment Features with Negative Compensation. There is a separate conceptual framework for IPSAS. It is broadly aligned with the IFRS conceptual framework with exceptions for the public sector context.
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: 1) to approve the amendments to the Update to the 2018/19 Code and the 2019/20 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 2018/19 Code; 2) to note the areas where subsequent amendments may need to be reported to FRAB in an out of meeting paper.
Timing:	2018/19 (for the Code Update) and 2019/20

DETAIL

Background

1. The CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC) issued two Code consultations this year. The first consultation was a single issue consultation on IFRS 16 *Leases*. The consultation on IFRS 16 opened on 22 May 2018 and closed on 7 September 2018. Eighty responses were received to that consultation, a substantial increase on the normal number of responses to the annual consultation on the Code which in recent years has been just under 50 responses. CIPFA/LASAAC issued its second (annual) consultation on the Code on 18 July 2018. This consultation closed on 8 October 2018 and received 35 responses. CIPFA is of the view that the second consultation response rate was affected by the response rate to the consultation on leases.

2. The Exposure Drafts of the 2019/20 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) were considered by FRAB in June 2018. The Exposure Draft for the leases consultation was originally considered by FRAB in November 2017. However, this was updated following that meeting to reflect changes in circumstances and to align as much as possible with the approach in the FReM consultation. This was reported in the 2018 June meeting of FRAB and FRAB also received an out of meeting paper in July 2018 setting out the changes but focussing on the remaining differences between the FReM and the Code Exposure Drafts. Attached to this report at Annex 1 are CIPFA/LASAAC's latest deliberations on the Code's provisions for IFRS 16 but they may be subject to change following FRAB, currently the provisions are also still drafted for adoption as of 1 April 2019 but see paragraphs 7 to 11 below. If this is the case an out of meeting paper will be sent to FRAB.

3. CIPFA/LASAAC considered the consultation responses for both consultations at its meeting on 6 November 2018 and has provided its initial views on the Draft 2019/20 Code following the consultation. This report sets out briefly the substantive revisions made following the consultation process to the Exposure Draft(s) which were considered by FRAB in November 2017 and June 2018, highlighting areas where the Code takes a different approach from the FReM following the decisions CIPFA/LASAAC took at its meeting. Note that there are two issues in relation to IAS 19 and IFRS 9 amendments[1] which may be subject to further decisions by CIPFA/LASAAC. If this is the case an out of meeting report will be provided to FRAB to confirm the changes.

4. As CIPFA/LASAAC will review the attached Draft 2019/20 Code for its final approval there may be also be subsequent drafting refinements. It is anticipated that these will be minor issues. Any drafting amendments will be also be sent to the Board for final confirmation in an out of meeting paper. The updated Draft 2019/20 Code is attached to this report as Annex 2 for the Board's approval.

5. The Annex (in the Code) which sets out the differences between the Code and the FReM is included in the Draft 2019/20 Code. This has not been changed substantially.

6. This report will consider the main areas for change in the 2019/20 Code and will also set out CIPFA/LASAAC's decisions on the adoption of IFRS 16. Therefore this report will consider:

a) IFRS 16 *Leases*
b) Narrow scope amendments to International Financial Reporting Standards and other minor amendments,
c) Legislative and policy amendments
d) IFRS Conceptual Framework
e) A number of amendments to clarify the approach to drafting the Code.

Changes since the 2018/19 Code – Specific Issues included in the Exposure Draft

IFRS 16

(a) IFRS 16 Leases

Effective Date

7. FRAB members may be aware that following comments received from FRAB CIPFA/LASAAC agreed to follow the consultation approach adopted by HM Treasury in the FReM and sought views on a 2019/20 effective date. CIPFA/LASAAC debated the issue at its meeting on 6 November and at a subsequent meeting on 13 November. At its subsequent meeting CIPFA/LASAAC decided that following information from HM Treasury on Whole of Government Accounts information requirements it would defer, subject to final confirmation from Board members that were not able to attend the meeting.

8. The responses to the consultation took a similar form to those for HM Treasury ie that 65 per cent of respondents supported the proposed effective date of 1 April 2019 with 23 per cent of respondents disagreeing. This was set against 50 per cent of respondents agreeing that they will be ready for implementation with 21 per cent neither agreeing or disagreeing and the 8 per cent

[1] Amendments to IAS 19 Employee Benefits: Plan Amendment, Curtailment or Settlement and IFRS 9 Financial Instruments: Prepayment Features with Negative Compensation (IASB October 2017)

disagreeing or strongly disagreeing that they would be ready to implement the standard in response to CIPFA/LASAAC's readiness assessment questionnaire. CIPFA/LASAAC also considered information from CIPFA's impact assessment on whether local authorities would be ready to implement the standard.

9. Following its meeting on 6 November 2016. HM Treasury WGA team provided information to CIPFA/LASAAC on WGA information requirements. It indicated that if CIPFA/LASAAC decided not to defer and subject to the FRAB decision the possible information requirements would be:

- The adjustments made on transition to IFRS 16, so that these adjustments can be reversed in the Whole of Government Accounts.
- IAS 17 information for any new leases entered into in FY2019/2020.
- Specific standardised aspects of IFRS 16 disclosures, such as the maturity analysis for the lease liability and depreciation expense, that will be needed to produce IAS 17 information.

10. HM Treasury also confirmed that, in future years, there will be supplementary information requested from local government to adjust for any differences between Code and FReM requirements. Assuming decisions on subsequent measurement are confirmed, this will likely include cost information for right-of-use assets. This will likely also include information on key accounting estimates, such as the discount rates used for the lease liability.

11. CIPFA/LASAAC at its meeting on 13 November 2018 to consider the additional information provided by HM Treasury and additional feedback from CIPFA. CIPFA/LASAAC is of the view that local authorities may have been able to adopt IFRS 16 in accordance with the original timescales in the consultation paper but following its consideration of the dual reporting burden arising from WGA and further commentaries the Board is of the view that there is no longer a compelling case to proceed on the original timescales. CIPFA/LASAAC had eight members that agreed with this position and a further member that provided a similar view in writing and this would only just meet the quorum requirements for its decisions on the Code. So this decision is at the time of drafting this report subject to final confirmation, which is being sought for the avoidance of doubt.

Actions following the Deferral Decision

12. CIPFA/LASAAC would note that it is now reassessing its approach to adoption following this decision. It will also review its particular decision on subsequent measurement of the right-of-use asset as outlined below. It will meet to discuss these and other issues on 29 November 2018. The report below provides CIPFA/LASAAC's initial views of the approach to adoption of IFRS 16 given at the 6 November meeting.

13. CIPFA/LASAAC is aware that it has previously issued the agreed text of the Code for IFRSs 9 and 15 alongside the 2017/18 Code and will consider whether it will repeat this approach for IFRS 16. Annex 1 to this report includes the agreed decisions on IFRS 16 as at its meeting on 6 November 2018.

14. Annex 2 provides the 2019/20 Code Draft as agreed as at 6 November 2018 and excludes any changes for IFRS 16.

Adaptations and Interpretation of IFRS 16

15. The approach to the adoption of the standard in the Code will follow more or less the same approach outlined in FRAB 131 (04), FRAB 133 (04) and the out of meeting paper sent to the Board in July this year. Overall local authority respondents were supportive of the approaches outlined in the consultation papers.

16. The main area of difference between the Code and the FReM is that of the subsequent measurement of the right-of-use asset. FRAB members will be aware that following the principles adopted in the Code for the subsequent measurement of non-current assets CIPFA/LASAAC has decided to maintain current value measurement principles (subject to the benefits of this accounting policy outweighing the benefits) for the users of local authority financial statements. The consultation paper included two further options for current value measurement based on materiality (one based on the length of the lease term including a suggested/example lease term of 25 years and the other based on an undue cost and effort approach), both allowing the use of a cost based approach for these practical expedients.

17. When the FReM's proposals were finalised CIPFA/LASAAC recognised further issues raised by the FReM's proposals by agreeing to include the approach in the FReM for subsequent measurement of the right-of-use asset as a second option.

18. The consultation responses were very much in support of a current value measurement approach (ie CIPFA/LASAAC's original option 1) with 61% of respondents supporting this approach. Only 19 respondents wanted to follow the second option (ie to follow the approach proposed by the FreM). Most supporting respondents cited consistency with owned assets as the prime reason for this. CIPFA/LASAAC therefore decided to proceed with this approach.

19. CIPFA/LASAAC was clear that when proceeding with option 1 its final approach to the revaluation of right-of-use assets would need to be where the benefits of the measurement approach do not outweigh the costs. Option 1 in measurement and reporting terms is trying to maintain the benefits of the current position in terms of measurement and so the approach in the consultation documents was that at the point where the 'cost model' in IFRS 16 no longer provides an effective proxy for current value ie for longer-term leases or where there are no or infrequent points for rent reviews would be where current value measurement should be used.

20. The Code draft therefore:

- adapts IFRS 16 to remove the cost model option for subsequent measurement
- specifies that the cost model is used for plant and equipment and property leases of a lease term of less than 25 years
- requires current value for property leases with a lease term 25 years and above to be measured in accordance with the provisions in the Code for revaluation and is specific that it should be measured as if it were an owned asset
- following transition where finance leases assets are transferred at carrying value these assets would continue to be measured at current value, right-of-use assets which were previously held under operating leases whose remaining lease term on the date of initial application is 25 years or more will be measured at current value
- interprets IFRS 16 to measure leases of land using the cost model as the only way to measure the right-of-use asset for land would be to use the deprival concept ie measured using the lease payments/rental information.

21. CIPFA/LASAAC is aware that that this approach is a more rules based approach to drafting the Code than it would normally use. It considered two alternative more principle based approaches which offered options based on the lease term and the economic life of the right-of-use asset and another which required local authorities to make a judgement on reliable measurement. However, it decided to proceed with the approach outlined in paragraph 20 above:

- to ensure that it responds to issues that arise in relation to the difficulties of current value measurement for the right-of-use asset

- to maintain the valuable information that was available for the current value measurement of finance leased assets, and

- to ensure that as far as possible the reporting burden did not increase from that under IAS 17 *Leases*.

22. CIPFA/LASAAC was aware that this would mean a departure from the approach in the FReM but was clear that it wished to be consistent with owned assets and noted that it understood that this also reflected a different starting point from bodies using the FReM where reporting entities might not have previously used the current value model for finance leased assets. Since its meeting CIPFA/LASAAC has been provided with an update relating to the information requirements for WGA from HM Treasury (see paragraph 10) and therefore will review this decision in the light of this additional information at its meeting on the 29 November 2018.

Concessionary/Peppercorn Leases

23. The second area of potential difference between the FReM and the Code was the measurement of concessionary leases where the Code had originally followed the approach of the IPSASB in ED 64 *Leases*. CIPFA/LASAAC was of the view that the right-of-use asset for concessionary leases should be measured at fair value by discounting market based lease payments using market rates. Respondents supported this approach. However, a substantial number of respondents indicated that there would be difficulties in obtaining market rates for such leased assets. Additionally, it is not clear at this juncture whether the IPSASB approach will be maintained. Therefore CIPFA/LASAAC decided as far as possible to adopt the HM Treasury proposed approach to the measurement of peppercorn leases and treat the right-of-use asset in a manner akin to a donated asset. The right-of-use asset would therefore be recognised initially at fair value and a gain would also be recognised in the Comprehensive Income and Expenditure Statement in the same manner as donated assets.

Short-Term Leases

24. Respondents were also extremely supportive of the approach to the short-term lease recognition exemption with one exception (again similar to the response to the HM Treasury question). One respondent from an audit firm disagreed indicating that this was best left to individual entities, noting that the firm had had some indication from clients that this could actually lead to additional work because of the need to identify different sub classes. Subsequent enquiries with this respondent indicated that this was based on conversations with their private sector clients. The weight of the other responses have not indicated that this is the case for local authorities.

25. On an ongoing basis therefore the Code will introduce two new adaptations and an interpretation on the adoption of IFRS 16. One adaptation consistent with the anticipated approach in the FReM is to mandate the short-term lease exemption. The second adaptation is to mandate the current value measurement for the right-of-use asset as is outlined above in

paragraph 20 but with the exception of the interpretation of the measurement of leases of land. Appendix 1 outlines the differences between the FReM and the Code in relation to IFRS 16.

Low Value Leases

26. There were significant responses to the consultation in relation to low value leases where respondents to the consultation supported the approach in the Code. Very much like the responses to the HM Treasury consultation respondents considered that the Code should provide some guidance on the amount or a threshold or should even indicate that the amount should be determined by an authority's de minimis. CIPFA/LASAAC did not consider that this would present a proper interpretation of the provisions of IFRS 16 for local authorities. Its sub group did consider whether the Code should include some reference to the IASB's commentary in the basis of conclusions in IFRS 16. However, the sub group was of the view that this could lead to confusion if this was taken out of context and was of the view that this issue was best addressed by means of application guidance.

Identification of a Lease

27. Local authorities also provided significant commentary in relation to the identification of a lease but again they supported the approach in the Exposure Draft of the Code.

Incremental Borrowing Rate

28. Another area of significant comment amongst respondents was the incremental borrowing rate. A number of respondents were of the view that the rate should be a rate from the Public Works Loan Board (sometimes citing the annuity rate) other respondents indicated that this rate was too low and that this would mean that the cost of the right-of-use asset and the lease liability could be artificially high. CIPFA/LASAAC and its sub group after substantial debate were of the view the IFRS 16 provided sufficient detail to guide local authorities to the correct rate and that this should be supported by appropriate application guidance.

Transition

29. The majority of respondents also supported the approach to transition outlined in the consultation papers. This includes:

- the adaptation to mandate the practical expedient in relation to the definition of a lease on transition

- the adaptation to remove the option for full retrospective restatement and to require local authorities to follow the modified/cumulative catch-up retrospective approach to transition

- CIPFA/LASAAC's decision to adapt IFRS 16 to require local authorities to measure the right-of-use asset on transition at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments

- its decision to require local authorities to use two of the practical expedients on transition offered under the standard ie to require local authorities to adopt the practical expedients relating to low value and short term leases.

30. On transition therefore there is only one small difference between the proposed approached in the Code and the FReM ie the Code Draft does not mandate the use of hindsight. A small

number of respondents suggested this. However, it is not clear whether there will not be cost implications for local authorities if this approach was mandated. CIPFA/LASAAC is of the view that this will not make a substantial difference for Whole of Government Accounts purposes (see Appendix 1 for the differences between the FReM and the Code).

Measurement of the Service Concession Arrangement Liability

31. CIPFA/LASAAC received a substantial negative response to its approach to the measurement of the service concession arrangement liability which the consultation proposed should be measured following the provisions of IFRS 16. There was therefore only a small majority of respondents in favour of the move. The respondents disagreeing with the response indicated that this change would mean that additional costs would be incurred and they could not see the benefits of such a change. As noted in the out of meeting paper sent to FRAB Members in July CIPFA/LASAAC did include a possible alternative in the consultation documents ie to retain the IAS 17 measurement provisions. However, CIPFA/LASAAC could not see a compelling case to move from the consultation approach and has decided to maintain the IFRS 16 measurement approach. It did agree a sub group could be established to review this and other issues relating to the reporting of service concession arrangements.

Main Code Consultation

32. The consultation on the main Code provisions was also considered at the meeting on 6 November.

b) Narrow Scope Amendments to IFRS

IFRS 9 Financial Instruments: Prepayment Features with Negative Compensation (IASB October 2017)

33. The approach in the Code consultation was to adopt the amendment to the standard without adaptation, although it was not considered likely that local authorities have transactions relation to prepayment features with negative compensation. The majority of respondents supported the approach as outlined in the Code consultation documents. However, a number of respondents indicated that some local authorities may lend to other entities with prepayment terms at a discount and the transaction may apply. These respondents indicated that to promote consistency between financial years and in accordance with the IASB's own approach the Code should allow for early adoption in 2018/19. CIPFA/LASAAC agreed with this approach.

Modifications or Exchanges of Financial Liabilities that do not Result in Derecognition.

34. The consultation did not anticipate that local authorities would substantially have transactions relating to modifications or exchanges of financial liabilities that no not result in derecognition. During the consultation exercise evidence was provided that a small number of authorities did have such transactions and may be affected by the clarifications offered in the Basis of Conclusions paragraphs on the issue.

35. CIPFA/LASAAC is of the view that the Code's provisions do not need to change as accounting standards have not themselves changed. However, CIPFA/LASAAC has considered the transitional reporting requirements in the separate meeting on 13 November. As the change in accounting treatment is not specifically addressed in IFRS 9 CIPFA/LASAAC is of the view that if there is a change of practice as a result of this change, IFRS this would require full retrospective restatement. CIPFA/LASAAC decided to produce an Update to the 2018/19 Code which adapts

IFRS 9 and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* this to reduce the reporting burden for local authorities on adoption of IFRS 9 and to be consistent with the other transitional arrangements under the standard. Unfortunately CIPFA/LASAAC was not quorate when this decision was made but the decision will hopefully be confirmed by the time that FRAB meets. The Update to the 2018/19 Code is included as Annex 3 to this report.

Amendments to IAS 19 Employee Benefits: Plan Amendment, Curtailment or Settlement

36. The Code consultation approach was to adopt the standard without adaptation or interpretation. An actuary and a number of authorities indicated that they strongly disagreed because of the impact of the very regular transfers of local authority maintained schools to academy status. CIPFA/LASAAC is seeking the views of other actuaries but has currently maintained the approach in the Exposure Draft and is of the view that the remeasurements required under the amendments to IAS 19 would only apply for material transactions. Further information will be provided to FRAB if CIPFA/LASAAC decides it is necessary to change this approach.

Other Narrow Scope Amendments to IFRS

37. The following amendments to standards and IFRICs will be adopted in the Code without adaptation or interpretation:

- Amendments to IAS 40 *Investment Property*: Transfers of Investment Property Annual Improvements to IFRS Standards 2014 – 2016 Cycle

- Amendments to IAS 28 *Investments in Associates and Joint Ventures*: Long-term Interests in Associates and Joint Ventures

- *Annual Improvements to IFRS Standards 2015-17 Cycle*

- IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

- IFRIC 23 *Uncertainty over Income Tax Treatment.*

38. The first two narrow scope amendments (ie IAS 40 and the Annual Improvements to IFRS 2014 to 2016) and IFRIC 22 were consulted on as a part of the consultation process for the 2018/19 Code. However, they were not adopted by the EU in time for inclusion in the 2018/19 Code ie 1 January 2018 and therefore the approach to adoption in the 2018/19 Code will be rolled over and will be adopted in the 2019/20 Code.

39. The amendments to IAS 19, the Annual Improvements to IFRS Standards 2015- 2017 Cycle have still to be adopted by the EU by 1 January 2019 to be adopted in the 2019/20 Code. Currently the EFRAG endorsement status report indicates that they will be.

c) Updates for the IASB IFRS Conceptual Framework

40. As reported to FRAB 133 (04) the Concepts section of the Code includes relevant elements of the IASB IFRS Conceptual Framework. The revised Framework is effective immediately for the IASB and the IFRS Interpretations Committee. For preparers, the revised Conceptual Framework is effective for annual reporting periods beginning on or after 1 January 2020, with earlier application permitted.

41. Although the amendments to the Code could have been deferred to the 2020/21 Code CIPFA/LASAAC has determined that the revised IASB Conceptual Framework should be reflected in Section 2.1 of the 2019/20 Code. The main areas of amendment are:

- updates to the provisions of the Code on the objectives of the financial statements to align it to the new Framework, including the detail of the scope of the financial statements, adapting the terminology for local government circumstances

- updates to the qualitative characteristics of useful financial information for the new text in relation to prudence, measurement uncertainty and substance over form

- inclusion of the new definitions of the elements of the financial statements, adapted for local government terminology, but as with the current edition of the Code to include appropriate reference to service potential, reflecting the different economic substance of resource utilisation by public sector service providers

- updates to include the revised process and criteria for recognition and the Framework's new provisions on derecognition

- amendments to include the new definition of measurement basis but further detail is supported by the existing individual sections of the Code.

42. This was substantially supported by the respondents to the consultation but two clarifications have been made in relation to the users of the financial statements and measurement bases.

d) Legislative and Other Policy Developments

43. CIPFA/LASAAC will make changes to the Code for a number of legislative and policy developments:

- Scottish local authority presentation of transfers to or from statutory reserves in the Movement in Reserves Statement and the Expenditure and Funding Analysis – these amendments reflect Scottish local authorities' reporting requirements, the statutory permission to hold 'other statutory usable reserves' (eg an Insurance Fund) and to transfer funds between these reserves and the General Fund.

- The reporting of statutory adjustments relating to Scottish local authorities – consideration of the treatment of the revaluation element of the depreciation gain being treated outside of the statutory adjustment process (ie the voluntary transaction allowed by IAS 16 *Property, Plant and Equipment* paragraph 41) – with the inclusion of a new line in the Movement in Reserves Statement to treat this as a separate adjustment. Note that the consultation process identified that this voluntary transfer is not a statutory adjustment for Scottish local authorities and the text would therefore need to be moved to the relevant part of the Code's provisions on IAS 16. The wording of the relevant provisions have also been drafted to be more closely aligned to the text of paragraph 41.

- Apprenticeship Levy – CIPFA/LASAAC has decided to follow the approach and treatment in the FReM and the Department of Health and Social Care Group Accounting Manual to provide the relevant application guidance in the Code and has introduced a new section to do this. The majority of respondents supported this approach.

- Consideration of the need to make changes to the accounting requirements for non-domestic rates. In December 2017 the Local Government Finance Settlement announced a second wave of non-domestic rate retention pilots (piloting 100 instead of 50 percent rates retention) leading to approximately 150 pilot authorities in total. It is unlikely that there will need to be any substantial changes to the Code. Respondents substantially supported this approach.

- Carbon Reduction Commitment (CRC) Scheme and Landfill Allowances – updates to reflect the closure of the CRC Scheme.

- Changes to legislation (mainly updating of the relevant references to the legislation in the Code).

e) Other Amendments to the Code to Set Out the Approach to Drafting the Code

44. To ensure effective communication of the principles under which the Code is produced CIPFA/LASAAC has included new paragraphs to describe what an adaptation or an interpretation to IFRS means in Chapter One (Introduction) of the Code. Similarly, it has decided to clarify the basis for the accounting requirements for the statutory adjustments in the Code. These have again been clarified in Chapter One. It also included more descriptive commentary on two of the reserves affected by the statutory adjustments. The majority of respondents have agreed with this approach.

45. On the change to the Memorandum of Understanding between the Relevant Authorities in 2012 (MoU) it appeared that the Manuals under the MoU would only refer to adaptations and therefore in 2013/14 most of the references to 'interpretation' were removed and these were replaced by the term 'adaptations'. This was not the case and the Code has introduced a small number of interpretations. Following the clarification of the terms 'adaptation' and 'interpretation' CIPFA/LASAAC has reinstated the previous references to interpretations where relevant.

CIPFA/LASAAC Post-Implementation Reviews of the Group Accounts Standards and Service Concession Arrangements

46. As reported to at FRAB 133 (04) CIPFA/LASAAC sought views in the consultation papers on the following issues:

- the prominence of the Group Accounts in local authority financial statements and the disclosures

- whether more guidance was required on business combinations under IFRS 3 *Business Combinations* or relating to public sector combinations and IPSAS 40 *Public Sector Combinations*

- Service Concession Arrangements - third party payments/ grant of the right of the operator model.

Group Accounts

47. The majority of respondents (over 20, primarily local authorities) were of the view that the current approach in the Code for Group Accounts allowed local authority circumstances to be properly reflected. They indicated that:

- users should be able to understand the primary sovereign nature of local authorities as a part of the council tax setting process – local authorities are not like other public sector organisations in this regard

- where Group Accounts become more prominent local authorities have the ability to reflect those circumstances.

48. There were some comments principally from auditors that there may be issues particularly relating to disclosures. CIPFA/LASAAC is of the view that the issues appeared to be largely issues of application and not for the Code but will keep this issue under review and include a specific review of in its work programme.

Public Sector and Business Combinations

49. Largely the Code consultation responses did not provide any indication that more provisions were required in the Code for business or public sector combinations but again CIPFA/LASAAC will keep the issues under review. CIPFA/LASAAC was also content with its provisions on local government reorganisations and other combinations.

Service Concession Arrangements

50. The responses to the Code consultation were divided but there was a slight majority in favour of providing specific guidance on third party income for service concession arrangements. CIPFA/LASAAC has agreed that a sub group be established to consider this issue.

Trading Operations Disclosure

51. CIPFA/LASAAC under its streamlining initiatives sought views on the removal of the trading operations disclosure as it is not a requirement of statutory provision or IFRS. The response was finely balanced with a larger number of respondents finding the information on trading operations useful. A number of respondents did not. CIPFA/LASAAC on balance decided to remove the disclosure for English, Northern Irish and Welsh local authorities as it was related to an old statutory requirement and was of the view if local authorities considered that the information relevant to the users of the financial statements then they could still disclose such information under the fair presentation requirements of paragraph 3.4.2.40 of the Code.

Complex Financial Instruments

52. CIPFA/LASAAC sought views on whether there were any complex financial instruments that required specific provisions in the Code. One accounting firm particularly requested that the interpretation on contracts with Lender Option Borrower Option (LOBO) clauses should be rearticulated in respect of the call options to which it refers and the contracts to which it applies. CIPFA/LASAAC has included the approach in its clarification statement on the issue in paragraph 7.1.1.3.

53. CIPFA/LASAAC's clarification statement referred to the need for local authorities to consider application guidance. A new paragraph has been added to the introduction of the Code to confirm the position for local authorities at paragraph 1.2.13.

IASB Materiality Practice Statement

54. CIPFA/LASAAC indicated that although useful that as the statement was not mandatory it would not include reference to the statement in the Code. It found no compelling evidence as a part of the consultation process to change from this position.

CIPFA/LASAAC Review (and Away Day)

55. CIPFA/LASAAC decided that the breadth of the technical financial reporting issues it had considered in recent years had meant that it had not recently had time to take stock of the future and direction of local authority financial reporting. In September this year it therefore held an Away Day to consider its strategic approach to Code development and other issues. It is currently reviewing its Vision Statement and strategic themes and will update FRAB once it has completed its review. CIPFA/LASAAC also decided that emanating from its vision and themes it will develop a five year work programme which will also be subject to consultation and include development issues/areas arising from its annual consultation processes but also longer term strategic issues. It also decided to consider various approaches including an open email address to increase its engagement with stakeholders and importantly users of local authority financial statements.

Impact on disclosures in the financial statements

56. New disclosures are introduced under IFRS 16. The other changes are unlikely to lead to substantial new disclosure requirements.

IAS/IFRS compliance

57. Two new adaptations are proposed for a) one to mandate the short term recognition exemption and the other to remove the cost model for subsequent measurement of the right-of-use asset. A new interpretation is included for the subsequent measurement of the leases of land see paragraphs 13 to 25 for a description of the adaptations and interpretation. For b) one new adaptation is proposed for the amendments to IFRS 9 for transactions where modifications of exchanges of financial liabilities which do not result in derecognition, note this adaptation is only on transition to IFRS 9 in the 2018/19 Code. No adaptations are proposed for b) to e), though local authority terminology is used for d).

58. CIPFA/LASAAC also proposes four adaptations to the transitional arrangements as outlined in paragraph 29 and in the Appendix to this report.

Impact on WGA

59. The changes in a) may lead to WGA issues for the subsequent measurement of the right-of use asset and this is being considered by CIPFA/LASAAC. The amendments in b) to e) are unlikely to have an impact on WGA.

IPSAS compliance

60. While IPSASB has yet to issue an IFRS 16 aligned leases standard, ED 64 Leases included proposals for a symmetrical approach to lessor accounting, which differs from the IFRS 16 aligned treatment which has been proposed (albeit with possible deferral) in the Code. The ED 64 proposals for concessionary leases also differ from those proposed for peppercorn leases. IPSASB has issued ED 66 which relates to the amendments to Long-Term Interests in Associates and Joint Ventures and Prepayment Features with Negative Compensation. There is

a separate conceptual framework for IPSAS. It is broadly aligned with the IFRS conceptual framework with exceptions for the public sector context.

Proposed text for the Update to the 2018/19 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) and the 2019/20 Code

61. The proposed text of the Update to the 2018/19 Code (Annex 3) and the 2019/20 Code (Annex 2) is attached to this report. This text is still subject to review and any substantive changes will be reported to the Board.

Impact on the budgetary regime

62. 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

63. This report sets out details of the proposed amendments to the Update to the 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) and the 2019/20 Code.

64. The Board is requested:

1) to approve the amendments to the Update to the 2018/19 Code and the 2019/20 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 2018/19 Code;

2) to note the areas where subsequent amendments will need to be reported to FRAB in an out of meeting paper.

CIPFA/LASAAC

November 2018

Appendix 1

Table of Differences between the FReM and the Code Exposure Drafts on the Adoption of IFRS 16 Leases

	Proposed Approach in the FReM	Proposed Approach in the Code	Difference Due to Local Government Circumstances or Transactions?
1	*The Definition of a Lease*		
	The FReM Exposure Draft proposes to adapt the definition of a contract so that it includes such intra-government agreements that were not technically legally enforceable, but in substance were expected to be honoured and in all other aspects should be considered a lease.	As sovereign independent bodies the circumstances that require adaptation in the FReM do not exist and therefore the Code consultation papers under the Memorandum of Understanding between the Relevant Authorities (MoU) do not need to include proposals for adaptation of the definition of a lease.	**The difference is due to local government circumstances** - the difference exists due to the nature of local authorities.
2	*Incremental Rate of Borrowing*		
	Where entities cannot readily obtain the interest rate implicit in the lease, they should use the HM Treasury discount rate promulgated in PES papers. There are only a limited number of circumstances where a central government body would borrow externally. Additionally as there are no interest rates levied to supply-funded bodies and the interest rates charged upon the Exchequer are irrespective of the reasons for the borrowing, the FReM Exposure Draft proposes to introduce a central internal rate of borrowing for entities to apply, when they cannot obtain the rate implicit in the lease contract.	The circumstances that apply to central government bodies do not apply to local authorities. They can borrow externally. Additionally, the Code applies to over 550 local authorities/local government bodies in the UK with varying circumstances and debt profiles (with some authorities not having any external debt). It would therefore be extremely difficult (if not impossible) to set a rate which would properly interpret the standard for local authority circumstances. The Code in accordance with the MoU requires local authorities to follow the standard. Note it is an accepted difference (between the FReM and the Code) that since the adoption of	**The difference is due to local government circumstances** – the difference is due to the number, varying nature and circumstances of local authorities.

	Proposed Approach in the FReM	Proposed Approach in the Code	Difference Due to Local Government Circumstances or Transactions?
		the IFRS-based Code the Code does not set discount rates but requires local authorities instead to follow the standard, see, for example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.	
3	*Subsequent Measurement of the Right-of-Use Asset*		
	The FReM Exposure Draft proposes the IFRS 16 cost model as an expedient for subsequent right-of-use asset measurement. While the IAS 16 *Property, Plant and Equipment* cost model is withdrawn from the FReM, the IFRS 16 cost model is different from the IAS 16 equivalent (for example it allows revaluations based on changes to lease terms as a result of market rent reviews).	Local authorities have followed the requirements of IAS 16 to measure assets procured under finance leases in the same way as other items of property, plant and equipment – whilst discussions with HM Treasury suggest this has not been so widely applied for entities that follow the FReM. Therefore local authorities with finance leases have followed the Code’s requirement to measure finance leased assets at current value as with other items of property, plant and equipment – and consistently with the general principles adopted by the Code. In order not to lose that useful financial information the Code proposals CIPFA/LASAAC had mandated that right-of-use asset is measured at current value but that leases of plant and equipment and property leases of less than 25 years are to use the cost model as a proxy for current value. CIPFA/LASAAC has	Although this decision is currently under review following more information from HM Treasury, there will be a difference for assets which were previously measured as finance leases (although this may be a current difference) and for property leases of 25 years and above. CIPFA/LASAAC is of the view that it wanted to maintain the position to be consistent with owned assets.

	Proposed Approach in the FReM	Proposed Approach in the Code	Difference Due to Local Government Circumstances or Transactions?
		also included the interpretation that right-of – use assets for leases of land will be measured using the cost model.	
4	*Peppercorn/Concessionary Leases (Lessees)*		
	The consultation papers propose that leases with concessions or for nominal (i.e. peppercorn) consideration will measure the liability including the concession, while PPE will be measured as if no concession had been provided. As the lease unwinds, the difference between PPE and the lease liability is posted to income.	CIPFA/LASAAC now anticipates following a very similar approach to the FReM. It will treat concessionary leases in a manner akin to a donated asset. On initial recognition the right-of use asset will be recognised at fair value. The gain on initial recognition will be recognised in the Comprehensive Income and Expenditure Statement.	**A small difference on initial recognition but this difference follows local authority recognition for donated assets.**
5	*Practical Expedients on Transition*		
	The option available to implement the following transition options in IFRS 16 has been withdrawn and instead all entities must apply the following transition: ▪ No requirement to adjust for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a))	The option available to implement the following transition options in IFRS 16 has been withdrawn and instead local authorities are required apply the following: ▪ No requirement to adjust for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a))	**A very minor difference exists on transition –** CIPFA/LASAAC could not see the advantage of mandating the use of hindsight and was of the view that local authorities were best placed to judge taking into account their individual circumstances whether hindsight should or could be used. Some respondents to the consultation did suggest that hindsight could be

Proposed Approach in the FReM	Proposed Approach in the Code	Difference Due to Local Government Circumstances or Transactions?
▪ A lessee may elect not to transition to leases for which the lease terms ends within 12 months of the initial date of application (C10 (d)). ▪ A lessee may use hindsight, such as determining the lease term if the contract contains options to extend or terminate the lease (C10 (e))	▪ A lessee may elect not to transition to leases for which the lease terms ends within 12 months of the initial date of application (C10 (d)). The CIPFA/LASAAC proposals do not mandate the use of hindsight.	used but it was not clear that this might not be at a cost to local authorities. **CIPFA/LASAAC is of the view that this is not a substantial difference.**