

Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	<p>Update on CIPFA/LASAAC development of the <i>Code of Practice on Local Authority Accounting in the United Kingdom</i> (the Code) encompassing:</p> <ul style="list-style-type: none"> - A revised draft Code for 2022/23, incorporating the decisions made at CIPFA/LASAAC's November meeting - The preliminary decision of CIPFA/LASAAC to defer implementation of IFRS 16 <i>Leases</i> which would if progressed require amendments to the draft Code for 2022/23 (attached to this paper) - Information on a further consultation which CIPFA/LASAAC will be progressing in relation to accounting for infrastructure assets.
Impact on guidance:	<p>This report sets out the current position regarding the development of the 2022/23 Code.</p> <p>Depending on the outcome of consultation on accounting for infrastructure assets, narrow scope changes may need to be made retrospectively to previous editions of the Code</p>
IAS/IFRS adaptation?	<p>IFRS 16 <i>Leases</i> – The revised draft of the 2022/23 Code includes the adaptations as agreed with FRAB in previous years.</p>
Impact on WGA?	<p>The proposal to defer implementation of IFRS 16, <i>Leases</i> would have an impact on WGA.</p>
IPSAS compliant?	<p>No misalignment is anticipated. The current IPSAS 13 is aligned with IAS 17, while IPSASB has issued IPSAS 43, <i>Leases</i> which uses the same right of use model as IFRS 16; this has an effective date of 1 January 2025 but early application is permitted. Further development is being carried out by IPSASB in relation to public sector issues around concessionary leases and other matters and this will be reviewed in due course.</p>
Impact on budgetary regime?	<p>None – local authorities only.</p>
Alignment with National Accounts	<p>If progressed, the proposal to defer IFRS 16, <i>Leases</i> may require adjustments for National Accounts purposes</p>
Impact on Estimates?	<p>None – local authorities only.</p>

Recommendation:	This report requests that: <ul style="list-style-type: none">• FRAB agrees the revised text of the Code in Annex A, subject to the proposal to defer implementation of IFRS 16.• FRAB considers and provides a view on CIPFA/LASAAC's proposal to defer implementation of IFRS 16, <i>Leases</i> for a fixed period of 2 years.• FRAB notes that a further consultation will be carried out on accounting for infrastructure assets and provides any early comments on the possible issues arising.
Timing:	2022/23: The main revision and proposals are for the 2022/23 Code Any amendments made in relation to infrastructure assets may result in narrow scope changes to the Code for accounting periods from 2018-19 to 2022/23

DETAIL

Revised draft Code for 2022/23

1. FRAB Members received a report at its November meeting on the responses to the Invitation to Comment on the proposals for revision to the 2022/23 Code. At that time, CIPFA/LASAAC had not made its final decisions, particularly in relation to service concession arrangement liability.
2. CIPFA/LASAAC made its final determinations at its 22 November 2021 meeting, deciding among other things that service concession arrangement liabilities should be measured in accordance with the measurement requirements of IFRS 16.
3. The Board planned to provide the revised Code to FRAB for review in early 2022. This was delayed in the light of the DLUHC request for consideration of amendments to the 2021/22 Code, and the subsequent exceptional consultation, discussed in the next section.
4. A draft of the full 2022/23 Code has been prepared and is attached at Annex A. This is a track changes document, based on changes to the 2021/22 Code. This draft does not include any of the amendments considered in the consultation on emergency proposals for update of the Code. Implementation of proposals arising from the emergency consultation would require amendments to be made.

5. The principal changes encompass
 - a. Complete revision of Section 4.2 (Leases) to adopt the provisions of IFRS 16, including an interpretation on housing tenancies
 - b. Amendments to specify that the service concession arrangement liability is measured in accordance with the measurement requirements of IFRS 16.
 - c. Amendments to clarify and expand the applicability of the Code to Welsh authorities and bodies including corporate joint committees
 - d. Amendments to clarify the treatment of social benefits under IAS 37 and IPSAS 29.

Results of exceptional consultation: preliminary decision of CIPFA/LASAAC to defer implementation of IFRS 16

6. FRAB Members received an out-of-meeting report in late January explaining how CIPFA/LASAAC came to develop an emergency consultation to update the 2021/22 Code and changes which might affect future years. A fast-track Invitation to Comment and Exposure Draft were subsequently issued on 3 February 2022 with a 4 week consultation period, exploring stakeholders views on
 - Modifying asset valuation approaches for operational Property, Plant and Equipment
 - Delaying the implementation of IFRS 16.
7. CIPFA/LASAAC also engaged directly with key stakeholders including auditors and regulators, and through two webinars which attracted about 360 participants. The consultation attracted 216 responses, including responses from a number of representative bodies providing views for a larger constituency. It is notable that this was the largest response received since the move to the IFRS based Code.
8. CIPFA/LASAAC met on 9 March 2022 to consider responses to the consultation to decide whether to progress options explored. A copy of CIPFA/LASAAC's note of preliminary decisions and feedback statement is attached at Annex B.

Decision on asset valuation

9. CIPFA/LASAAC decided not to progress any option to pause professional valuation of operational property, plant and equipment, or to apply indexation to otherwise paused balances.
10. As explained in the feedback statement, these proposals were not strongly supported by stakeholders (and therefore CIPFA/LASAAC did not have an evidence base to ensure that the benefits of the exploratory proposals would outweigh the costs), and various technical issues were raised which might not be possible to resolve. CIPFA/LASAAC therefore decided not to pursue these for 2021/22, and also not to consult on them in slower time.

Decision on deferring implementation of IFRS 16

11. CIPFA/LASAAC decided that it would pursue the option of deferring implementation in the Code of IFRS 16, *Leases*. This deferral would be for a fixed period of two years and apply to all UK jurisdictions. In line with the proposals in the ITC, the Code requirements would revert to IAS 17.
12. CIPFA/LASAAC was very clear that this is a *preliminary* decision subject to further consideration by other stakeholders in the governance process for UK public sector financial

reporting including the FRAB, and that the outcome of these considerations is not a foregone conclusion. For this reason preparers were advised not to suspend work on IFRS 16 implementation in anticipation of deferral.

13. CIPFA/LASAAC has indicated that it anticipates the final decision being available in the first week of April.

14. It should be noted that CIPFA/LASAAC was exploring the proposal with considerable reluctance, and several Board members were of the view that no changes should be made to the Code.

15. As explained in the feedback statement, an overwhelming numerical majority of responses to the consultation supported deferral of IFRS 16. Nevertheless, the decision to take this forward was not a straightforward one.

16. After reviewing the consultation responses, CIPFA/LASAAC was unable to reach a consensus view and the decision was made based on a majority vote which passed by the narrowest possible margin. This reflects the fact that all CIPFA/LASAAC members support the implementation of IFRS 16 which is an improved standard that supports better financial reporting. However, those that voted for deferral expressed a view that deferring would be a pragmatic response to alleviating audit timeliness issues by removing the additional resource requirement anticipated by both auditors and preparers as part of implementing the new standard.

17. The feedback statement notes that many responses set out why deferral would be beneficial to both auditors and preparers. This included particular difficulties faced by local authorities in the context of the COVID-19 crisis, working from home, and in some cases having regard to the pressure on finance teams in relation to the audits of their 2019/20 and 2020/21 financial statements, which had not yet been completed. Local government is of course not unique in facing pressures as a result of the pandemic, and some of these points may be equally applicable to finance teams in the NHS or government sectors which are progressing full implementation in 2022/23.

Further information on deferral of IFRS 16 : mandatory deferral

18.

19. Prior to issuing the consultation, CIPFA/LASAAC considered a variety of approaches to deferral, encompassing mandatory and voluntary approaches or, for example only requiring implementation by larger authorities where (a) preparers and auditors might be better prepared and (b) would reflect the greater part of associated flows and balances, and thereby reduce the effect on WGA. However, while there was some support for the other options, only mandatory deferral attracted the required majority vote. (NB. It should be noted that this would not affect the reporting for TfL, who have already adopted IFRS 16 in line with other early adoption in UK government by entities with significant consolidations of companies reporting under IFRS). The proposal was therefore to explore deferral of IFRS 16 on a mandatory basis across all UK jurisdictions.

20. Mandatory deferral has the advantage of consistent treatment and comparability between authorities. A deferral period of two years is proposed as it provides additional time during which resources can be devoted to 'catching up'. It will also allow time for other stepped improvements to the local audit framework in England, and for appointments under new audit contracts which commence on 1 April 2023 to bed in.

21. As noted in the feedback statement, there was overwhelming support for deferral of IFRS 16 from preparers, and many of these stressed the desirability of consistent and comparable reporting. Responses from those authorities in Scotland and Wales that supported deferral also reflected on consistency and comparability.

Further information on deferral of IFRS 16: jurisdictional application

22. Prior to issuing the consultation CIPFA/LASAAC considered whether deferral should be applied to England only, to all UK jurisdictions, or based on the views of the government in each jurisdiction. While the greatest support among those in favour of any deferral was for UK-wide application, there was also support for a jurisdiction-by-jurisdiction approach. The consultation therefore proposed mandatory deferral across all UK jurisdictions but asked for comments on application by jurisdiction.

23. Very few English respondents disagreed with UK wide application but many did not feel qualified to comment on application to other jurisdictions.

- All but one of the Welsh authorities supported UK wide application
- All but three of the Scottish authorities supported UK wide application (One of these was neither supportive nor unsupportive, but would support the measure if it was widely supported)

Some of the responses supporting UK wide application specifically raised issues around comparability and consistency

Further information on deferral of IFRS 16: impact on WGA

24. Deferral of IFRS 16 would of course mean that local government was reporting on a different basis to other parts of the UK public sector. While implementation of IFRS 16 will affect all leases, the effect on leases currently treated as finance leases is not expected to be significant in WGA terms, at least for the fixed two year period envisaged. These would be brought on to the balance sheet at their carrying value at the transitional date and the accounting effects would be unlikely to be significantly different over that period.

25. Greater effects would be expected in relation to

- Leases currently classified as operating leases
- Service concession liabilities, to the extent that these include 'contingent rent'

26. Precise information on the effect of these is not available, but we would note that local government operating lease commitments shown in the 2018-19 WGA amounted to £5.4 billion of the £21.3 billion total commitments., £1.8 billion of these relate to TfL (which has since adopted IFRS 16). This would leave £3.6 billion of operating lease commitments.

27. Service concession liabilities in relation to local government were £29 billion out of a total of £69.4 gross liability (£39 billion net). The extent to which this would change is difficult to assess. For many service concessions the effect would be minimal or zero, while for others (particularly some schools PFI nearing the end of their term) the effect could be significant.

Planned further consultation on accounting for infrastructure assets

28. CIPFA/LASAAC expects to issue a further consultation in the near future. This is not something the Board would do lightly, particularly after recently carrying out the exceptional consultation. However, CIPFA/LASAAC has been made aware of an issue which is delaying the issuing of audit opinions for a large number of authorities. Without resolution it has potential to result in qualification of significant numbers of authorities' financial statements.

29. The Board is addressing this issue to the extent that is relevant to the Code, and will be exploring clarification of the requirements of the Code and application guidance. A note of key points is provided at Annex C.

Summary and recommendation for the Code of Practice on Local Authority Accounting in the United Kingdom

30. This report requests that:

- FRAB agrees the revised text of the Code in Annex A, subject to further consideration of CIPFA/LASAAC's decision on the emergency consultation.
- FRAB considers and provides a view on CIPFA/LASAAC's proposal to defer implementation of IFRS 16, *Leases* for a fixed period of 2 years.
- FRAB notes that a further consultation will be carried out on accounting for infrastructure assets and provides any early comments on the possible issues arising.

CIPFA/LASAAC
March 2022