Financial Reporting Advisory Board Paper

Code of Practice on Local Authority Accounting

Issue:	Update on CIPFA/LASAAC development of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) encompassing: - a draft of the 2023/24 Code - an update on the CIPFA/LASAAC Strategic Plan for development of the Code - an update on the latest developments for infrastructure assets
Impact on guidance:	The 2023/24 Code will be the definitive guidance for local authority accounting in the relevant accounting periods, including the provisions on infrastructure assets which have already been agreed.
IAS/IFRS adaptation?	The draft 2023/24 Code includes amendments relating to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, IAS 1 *Presentation of Financial Statements*, IAS 12 *Income Taxes* and IFRS 3 *Business Combinations* without adaptation or interpretation. IFRS 16 *Leases* – the revised draft of the 2023/24 Code includes the adaptations as agreed with FRAB in previous years for those local authorities voluntarily adopting IFRS 16 in 2023/24.
Impact on WGA?	The deferral of mandatory implementation of IFRS 16 *Leases* will have an impact on WGA.
IPSAS compliant?	No misalignment is anticipated.
Impact on budgetary regime?	None – local authorities only.
Alignment with National Accounts	The deferral of mandatory implementation of IFRS 16 *Leases* will require adjustments for National Accounts purposes
Impact on Estimates?	None – local authorities only.

Recommendation:	This report requests that: • FRAB agrees the revised 2023/24 Code in Annex 1 • FRAB notes and provides comments on the CIPFA/LASAAC Strategic Plan • FRAB provides any indicative views on the option appraisal of the three options and the current Task and Finish Group's tentative views on the best option to resolve the current reporting issues for infrastructure assets.
Timing:	2023/24: The draft of the Code attached at Annex 1 sets out proposals following consultation for the Code which would be effective in 2023/24.

DETAIL

Background

1. CIPFA LASAAC met on 9 November 2022 to consider the outcomes of its annual consultation. The consultation on the 2023/24 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) was open from 4 August 2022 to 14 October 2022. In total there were 20 responses to the consultation. This is lower than last year's consultation response rate of 25 responses. This response rate may have been affected by the significant response rates to the two other consultations held this year where there were 216 and 83 respectively. The Secretariat is of the view that there is evidence that its stakeholders are engaged with Code processes. The consultation response rate may have also been affected by promise of a stable platform and the relatively uncontentious nature of the changes to the 2023/24 Code.

2. CIPFA LASAAC also took assurance from the outreach engagement in the form of a webinar held on 15 September 2022, which was attended by well over 200 delegates. An article on local authority financial reporting which referred to the Code consultation was also included in the Local Government Chronicle

3. A copy of the draft of the 2023/24 Code is attached to this report at Annex 1. It should be noted that the decisions outlined in this report are early decisions and they await the final approval of CIPFA LASAAC. CIPFA LASAAC has approved the changes in principle but is currently reviewing the full draft Code. Any significant changes that emanate from CIPFA LASAAC's final review will be presented to FRAB in an out of meeting paper.

Consultation Outcomes

4. The consultation on the 2023/24 Code covered the following issues:

   a) a stable platform for the Code following the IFRS 16 *Leases* deferral - an overwhelming majority (90% - 18 respondents) agreed with the stable platform, indicating that this was welcomed against the local audit background, and would allow some authorities to take forward the implementation of IFRS 16.

b) changes to standards for 2023/24 including:

Amended Standard	Consultation Outcomes
Definition of Accounting Estimates (Amendments to IAS 8) *(see amendments to section 3.3 of the 2023/24 Draft Code)*	Most of the respondents (85% - 17) supported the approach in the consultation paper and Exposure Draft to the introduction to the Code for Definition of Accounting Estimates. The respondents indicated: • the changes provide clarity to assist local authorities in distinguishing between accounting policies and accounting estimates • they expected the amendments will represent (incredibly) helpful guidance for local authorities in determining whether changes are to be treated as changes in estimates, changes in policies, or errors.
Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2) *see amendments to section 3.4 of the draft 2023/24 Code).*	The majority of respondents (75% - 15) indicated that Disclosure of Accounting Policies (Amendments to IAS 1 and IFRS Practice Statement 2) should be implemented in the Code as outlined in the consultation paper. Most comments focussed on mechanisms to improve understanding such as the exemplification of what the new Code requirements might mean including suggestions of reference to Practice Statement 2. CIPFA will be able to address these issues in application guidance.
Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12) *(as itemised in Appendix D of the draft 2023/24 Code)*	The majority of respondents (80% - 16) supported the Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12). The approach, as with previous editions in the consultation was not to amend the Code as this was only likely to apply to local authority group accounts.
Updating a Reference to the Conceptual Framework (Amendments to IFRS 3) *(as itemised in Appendix D of the draft 2023/24 Code)*	The majority of respondents (85% -17) agreed with the approach in the consultation paper with regard to Updating a Reference to the Conceptual Framework (Amendments to IFRS 3),

	setting out sometimes in detail that they agreed with the views expressed in the Code.

CIPFA LASAAC proposes inclusion of all the amendments to standards in the 2023/24 Code without adaptation or interpretation. The 'stable platform' included in the consultation was to only update the Code for amended standards or legislative changes. Note inclusion in the Code will be dependent on UK adoption by 1 January 2023.

c) legislative changes – the majority of the anticipated legislative changes for England and Wales have not yet been confirmed and so it is not possible to include them in the Code at this juncture. The CIPFA LASAAC Secretariat will agree with government footnotes to indicate whether legislation is anticipated to change. The consultation was not able to anticipate three pieces of Scottish legislation. These have now been included in the draft Code as set out in Annex 1 (see paragraphs 3.4.5.4 and 4.3.3.3).

d) IFRS 17 *Insurance Contracts*, where it is proposed that mandatory implementation be aligned with the central government timetables. CIPFA LASAAC proposed to address the implementation in a similar approach to IFRS 4 *Insurance Contracts* as local authorities do not regularly enter into such arrangements. Despite consulting on this for the last three years significant evidence has not been forthcoming. One particular issue for additional research is that a fire authority that approved of the changes and was a part of a mutual [insurance] arrangement queried the fact that each of the fire authorities in the mutual stands as guarantor in the fall-back position where the mutual is not able to service its liabilities to service insurance claims. Further research is needed in this area.

e) CIPFA LASAAC's strategic plan (see paragraphs 5 to 13 below), and

f) whether further guidance on any matter is required? A number of requests have been put forward by respondents including:

- *increasing specifications in the Code on the measurement requirements of property, plant and equipment* – CIPFA LASAAC does not consider this is necessary as there is substantial application guidance available and it spent some significant time considering this previously. However, CIPFA LASAAC can review whether further provisions may need to be included following the outcomes of the HM Treasury Thematic Review of operational property, plant and equipment.

- *the recognition provisions for grants* – the Secretariat is of the view that the Code is correct and that the issue raised was relating to the difference between the recognition of income and assets. Application guidance can be reviewed to ensure that the position is clear. It is unlikely that changes need to be made.

- *the IAS 37 Provisions, Contingent Liabilities and Contingent Assets specifications in the Code regarding discount rates and the comparison of the approach in the FReM* – note that since the move to IFRS in 2010/11 the Code has not adapted or interpreted IAS 37 in any way but has for clarity confirmed this explicitly to the Annex which presents the differences between the FReM and the Code.

- *Group Accounts transactions regarding the implementation of statutory reversals where some local authorities appear to be applying local authority statutory* *adjustments to the Group Accounts, which is unlikely to be appropriate* – this can be addressed initially through application guidance but may need to be addressed in next year's Code consultation.

Update on CIPFA LASAAC's Strategic Plan

5. The Code consultation also addressed its updated strategic plan and whether this needed to be amended to reflect changes in the financial reporting environment, particularly for local authorities. The strategic plan proposed seven projects for 2022 and beyond (the updated strategic plan projects are outlined at Annex 2):

i) Sustainability reporting

ii) Improving the presentation of local authority financial statements

iii) Annual development programme for the Code – this will be reported to the Board on an annual basis

iv) Infrastructure Assets longer-term solution

v) Implementation of IFRS 17– see paragraph 4 d)

vi) Horizon scanning – this is a part of each meeting of both CIPFA LASAAC and CIPFA's Accounting and Financial Reporting Forum

vii) Narrative reporting

viii) Review of the structure and format of the Code.

i) Sustainability reporting

6. Local authorities do not currently have an explicit requirement to produce a sustainability report. The consultation considered the accounting treatments for the impact of the environment on local authority financial reporting. The consultation responses indicated that there is broad support for CIPFA LASAAC to consider sustainability reporting in its strategic plan. However, CIPFA LASAAC is aware that sustainability reporting is not currently included in its Terms of Reference.

7. CIPFA LASAAC is also of the view that it would need to ensure that government is supportive of it taking forward sustainability reporting requirements, not least because there are already some initiatives underway. Government is currently separately consulting on proposals to require Local Government Pension Scheme (LGPS) administering authorities in England and Wales to assess, manage and report on climate-related risks, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). The Welsh Government has also issued its Welsh Public Sector Net Zero Carbon Reporting Guide which is applicable to local authorities in Wales (and most of the rest of the public sector) for the 2021/22 financial year. Additionally, CIPFA LASAAC would wish to ensure that its approaches are consistent with the rest of the public sector, though there is likely to be an element of catch-up for this (see earlier

comments that there are no explicit sustainability reporting requirements for local authorities in the Code).

8. The Secretariat would note that CIPFA LASAAC is uniquely qualified to consider the standard setting process for local government but also considers that it is necessary to discuss the issue first with DLUHC, the devolved administrations across the UK and HM Treasury and whether there would be a need for this to be supported in statutory provisions.

ii) Improving the presentation of local authority financial statements and vi) narrative reporting

9. The consultation highlighted that CIPFA LASAAC's Strategic Plan would focus on ensuring that the key messages of the financial statements are communicated to their users. It also noted that the CIPFA Financial Reporting Hub (FRHub) had on its work plan Group Accounts, separation of the pension fund from the local authority financial statements and IFRS 16 disclosures and was considering work on the presentation of the collection fund and associated disclosures. Overall, the respondents seemed to support this but offered several themes in addition.

- A small number of local authorities and other stakeholders suggested that CIPFA LASAAC's Strategic Plan should look to 'simplify' or 'streamline' local authority financial statements. The Strategic Plan will consider key mechanisms to better present the complex areas of the financial statements, and this is anticipated to present the key messages more clearly. The FRHub will also consider ways in which local authorities can best present the key messages in local authority financial statements. It is difficult to say how much this will 'simplify' the accounts of complex bodies such as local authorities. Streamlining will emanate from better presentation but it is unlikely that this will significantly reduce demands on account preparer resources.

- An audit body suggested that CIPFA LASAAC should consider asset valuation and statutory adjustments under its strategic plan. CIPFA has extensive guidance on asset valuation in its Code Guidance Notes. It is suggested that this be revisited after the outcomes of the HM Treasury Thematic review on operational property, plant and equipment. Other than their presentation (project 2) and the detailed accounting treatment statutory adjustments themselves are not an issue which CIPFA LASAAC can directly influence.

- An audit firm suggested focusing on performance reporting – CIPFA LASAAC has agreed with this, and this can be prioritised as a part of its work on the narrative reporting (this will include the presentation of summary financial information).

- A firm repeated previous comments that the Comprehensive Income and Expenditure Statement should analyse expenditure on a nature of expenses basis and prioritise income. The 2016/17 Telling the Story Review considered this, and the response was very clear that the top half of the statement should focus on service expenditure (a segmental analysis) in line with how local authorities provide their services. This firm indicated that the Expenditure and Funding Analysis should be moved to the Narrative Report. CIPFA LASAAC debated this issue in detail (in producing the changes to the

2016/17 Code) and decided against this because of its importance but because the EFA also provides the segmental analysis under IFRS 8 *Operating Segments* that this note should be included in the financial statements.

- An authority noted that infrastructure assets should be added to the strategic plan – CIPFA LASAAC concurs that it should be explicitly included.

- An accounting institute suggested that FRHub provided guidance on how local authorities will present current risks such as the cost-of-living crisis, inflation and Ukraine in the reports that accompany the financial statements. It is agreed that this is important. This work can be taken forward by the CIPFA Accounting and Financial Reporting Forum in the Year End CIPFA Bulletin.

ix) Format and Structure of the Code

10. The format and structure of the Code is also a part of CIPFA LASAAC's Strategic Plan. This work involves consideration of the digitisation of the Code and is mindful of the need to promote high quality financial reporting and to support local authorities in ensuring that they can communicate the key messages of the financial statements to their users.

11. The Code consultation outlined the objectives for the review of the format and structure of the Code particularly considering that CIPFA is assessing the process for moving to an electronic platform. The updated objectives are included in Annex 3 for ease of reference.

12. Again, there was overall support for CIPFA LASAAC's plans with the following additional comments:

- the Code should focus on decluttering the accounts – the Secretariat is of the view that this is more about the content of the Code and the work of the FRHub

- there was encouragement to support local authorities, local auditors and central government and include IPSASB pronouncements – the Secretariat is of the view that the first is implicit and the second is covered by the relevant authority memorandum of understanding (terms of reference) hierarchy at paragraph 19

- that the Code could be clearer about the specific provisions in IFRS standards that the Code adapts or interprets – this can be considered though the Code should be structured to assist with this

- an audit firm was of the view the prevalence of local authorities having interests in other entities meant more emphasis should be put on this in the Code – the Secretariat is of the view that the overarching objectives for the format and structure of the Code should not focus on one specific area.

CIPFA LASAAC's objectives for the review of the structure and format of the Code is included in Annex 3.

Infrastructure Assets Temporary and Longer-Term Solution

Temporary Solution

13. FRAB will be aware that it has agreed the Update to the Code for the temporary relief for the disclosure of the gross cost and accumulated depreciation. The final wording of the temporary relief was agreed by the FRAB Chair following the Board's single-issue meeting in September. The Update to the Code has completed almost all its due processes and has been sent to the FRAB Chair for the Chair's signature to the statement (which is included in the front of each Code). Hopefully by the time of the meeting the Update will have been issued.

14. DLUHC has issued a call for evidence on a draft Statutory Instrument (the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2022) which deals with the treatment of the amount to be derecognised when there is replacement expenditure. The Welsh Government has also commenced a consultative process on a very similar SI. The explanatory memorandum sets out that the Draft SI has the effect of allowing local authorities to elect to treat any component of any infrastructure asset which they own as having a value of nil when it is replaced. Local authorities are not required to use this accounting treatment.

15. The survey closed on 7 November 2022. If DLUHC proceed with the statutory prescription, then the draft SI indicates that it will come into force on 25 December 2022. The Welsh Government consultative process closed on 14 November 2022. The changes to the Welsh regulations are anticipated to come into force on 2 December 2022. FRAB is aware that statutory guidance has been issued for Scottish local authorities.

Longer-term Solution

16. FRAB has already received the outline recovery plan at its 21 September 2022 meeting. As a reminder, key highlights are:

- First outline option analysis – October 2022
- CIPFA to research the cost of solutions – October/November 2022
- Option appraisal reported to CIPFA LASAAC and FRAB in November 2022
- Task and Finish Group interpretation of the outcomes/conclusions of the thematic review against the remaining options – January 2023
- Options appraised and lead option proposed to CIPFA LASAAC at a single-issue meeting – April 2023
- CIPFA LASAAC to agree the specifications and changes to the Code in Exposure Draft Form – July 2023
- Consultation on final proposal – August to October 2023
- CIPFA LASAAC to meet to consider consultation outcome – end November 2023

- Changes to Code specified for the 2025/26 Code but included in the 2024/25 Code – February 2024
- Implementation as of 1 April 2025.

17. As reported to FRAB previously the options for the longer-term solution emanated from CIPFA LASAAC's consultation in May to June this year. Although there were varied and detailed responses many highlighted difficulty in resolving the issue and emphasised that the solution to the current issues must be such where the benefits to the users of the accounts are not outweighed by its costs. In addition, a significant number of responses highlighted resource issues within finance teams at local authorities but also competing pressures of the many policies that local authorities must deliver.

18. There was a separate question on the use of Depreciated Replacement Cost (DRC) measurement, and it should be noted that there was significant opposition from most stakeholders on this issue. Even where it was acknowledged by respondents that this might resolve the issues highlighted in the consultation, represent a fairer presentation of the value of infrastructure assets to local authorities and reflect their condition, there were (often significant) difficulties cited alongside such a move which are outlined below.

19. Many authorities (including the Society of County Treasurers) indicated that CIPFA LASAAC had considered this issue previously from 2015 to 2017 and had decided not to proceed because of the costs of the move (note that this was principally due to the issues relating to central rates for gross replacement cost). Respondents commented that the issues identified at that time had not been removed. The Secretariat would note that to an extent that is the case. However, the breadth of the difficulties of the current form of historical cost reporting had not been fully understood at that time (historical cost was deemed to be a viable alternative under IFRS) and so the cost benefit equation has significantly changed.

20. Respondents also cited numerous other issues that had been identified when considering the move to DRC:

- The substantial work required to collate and maintain inventory records for highways infrastructure. One authority commented that this would give rise to issues such as resources, capacity, skills and knowledge, prioritisation, legacy systems, the availability of reliable data, buy in from engineers and the mutual understanding between accountants and engineers. There were also comments that this would divert resources from necessary policy initiatives.
- The impact on DRC measurement and the sensitivity of minute variances in inventory inputs (such as carriageway width).
- The impact on local authority balance sheets of carrying value of infrastructure assets on a DRC basis (i.e. infrastructure assets measured on a DRC basis would completely 'dwarf' everything else in local authorities' balance sheets).
- Whether external auditors would be able to gain enough assurance over carrying values determined on a DRC measurement basis.

21. There were some positive comments about the move to DRC including:

- (possible) alignment with central government practice
- a clearer link between asset management practice and information with financial reporting information
- a more meaningful measure of the value of the assets of the individual authority

One authority commented that once established DRC measurement could become the easiest option to maintain going forwards. However, this would only be true if recognised industry standard indices (e.g. value per km of road) could be agreed with auditors nationally in advance to determine the DRC.

22. The Task and Finish Group has considered the following for its analysis of the initial options which it reduced from four to three. The three options were reported to FRAB at its single-issue meeting on the issue. They include

- extend the temporary solution
- a 'Deemed Cost' reset
- a move to DRC

The following tables sets out the advantages and disadvantages of the three options:

Option 1 – Extend the temporary solution

Advantages	**Disadvantages**
Easy option, maintains status quo.	Unlikely to be supported by key parts of the CIPFA LASAAC due process (CIPFA, CIPFA LASAAC, FRAB and Government) as this does not follow the detailed prescriptions of IAS 16 *Property, Plant and Equipment.* It does not resolve the information deficits.
Lowest cost solution, no changes to systems or information requirements.	There will be a debate about whether this represents high quality financial information though the information deficits would indicate that it would not - though accounts preparers might indicate that this is sufficient for user expectations.
Potentially easy to understand for the users of the accounts, though this understandability will be limited by the information deficits and that it doesn't comply with IAS 16 information needs.	This will need to be supported by statutory prescription – this might be unlikely in the longer term.

Advantages	Disadvantages
Likely to be supported by local authorities based on the costs not outweighing the benefits.	Does not provide a detailed understanding of the state of local authority networks and does not support effective stewardship.
Subject to the decisions made by auditors this is not likely to resolve the underlying local audit difficulties.	This will not allow for alignment with the rest of the public sector.

Option 2 – A 'Deemed Cost' Reset

Advantages	Disadvantages
This should allow local authorities to prospectively meet the requirements of IAS 16 as adopted by the Code.	This will require significant resources to establish and will need to be estimated on a DRC basis so the arguments of stakeholders against DRC will apply – it is unlikely to convince local authorities that the benefits of this approach to users will outweigh the cost of implementation.
Although there will be significant resource implications the remeasurement exercise would only take place once.	For the first year of implementation this will be current cost measurement but thereafter the disadvantages of historical cost measurement for assets with extremely long-lives will become apparent.
This will require and therefore encourage improvements in information and systems.	As it uses a deemed cost this will be a different modified form of historical cost which will be difficult to explain to users. It will also create a new reserve to accommodate the increase in net worth.
It will remove the impact of the information deficits in the financial statements	A move to a modified form of historical cost will require significant information requirements and systems to maintain but with little further advantages to users in understanding what the information represents and few advantages for asset management.

Option 3 – Depreciated Replacement Cost

Advantages	Disadvantages
This will allow compliance with the requirements of IAS 16 as implemented in the Code.	Local authority stakeholders perceive this as being too costly and resource intensive so it will be difficult to convince them that the cost of the proposed move will not outweigh the benefits to users (see paragraphs 19 to 20 above).
This will allow for improvements in systems and record keeping and allow for the resolution of the information deficits.	Appropriate development time is likely be longer than most other options.
Current value measurement allows for proper stewardship of assets rather than information just being provided at a point in time. It will provide a proper representation of the operational value of the assets to local authorities.	Although there are substantial benefits to the users of the accounts in-terms of best representing such a significant asset it may be difficult to demonstrate that this is the case.
It provides meaningful information for the user of the financial statements who will be able to see the impact in the accounts of capital maintenance expenditure and have a better understanding of the condition of the roads and the effect this will have on the value of these assets to the authority. This will also promote the effective stewardship these assets.	The sensitivity of small changes in measurement is an issue which would need to be addressed.
This may allow for the removal of the WGA qualification.	It is unlikely that this change should be introduced before there are significant changes in the local audit system.
The move to depreciated replacement cost will need to align with and improve asset management and provide for more information to assist decision-making in this area.	
An effective DRC measurement process may be less onerous than a reset form of modified historical cost.	

23. It is recognised though that a methodology for establishing DRC and the information and systems necessary to allow affective measurement to take place are likely to take some time and will need to be carefully established to minimise any costs of implementation. The

recovery plan indicates that a solution will need to be issued by 1 April 2024 to allow for a year to prepare for implementation. The Secretariat is of the view that in accordance with the authority's response in paragraph 23 this could be significantly easier than other solutions and have other benefits, once established. However, any move to DRC will need to be assessed against the issues in local audit and should ensure that the current issues are not significantly exacerbated, particularly until the current crisis is resolved.

24. The Task and Finish Group is being reconstituted to make sure its terms of reference fully allow for a through appraisal of the longer-term solution and that its objectives are set out to achieve an effective solution with the appropriate expertise. But the current Task and Finish Group has tentatively agreed that the best way forward would be to proceed with Option 3 a move to depreciated replacement cost. One Task and Finish Group Member indicated that option 3 is the best option indicating:

   '*There will be significant work involved in option 2 or 3, but 2 would simply be trying to alleviate weaknesses in the historical cost model whereas 3 offers an improved outcome*. The Secretariat agrees with this comment.

25. The Task and Finish Group and CIPFA LASAAC are aware that there will need to be some significant outreach work to promote the benefits of such a move to local authority finance leaders bearing in mind the negative reaction in the consultation. CIPFA LASAAC considered this at its November meeting. CIPFA LASAAC is committed to recovery in the timescales planned but intends to do this in a credible way. CIPFA LASAAC is aware that local authorities had taken part in a move to DRC previously and there had been significant implementation difficulties. It is also noted that the resources issues cited by local authorities to the original consultation are likely to be significantly exacerbated because of the worsening cost of living crisis and the impact of inflation. At the meeting it was agreed that CIPFA would consider some form of assessment to better understand the implementation issues and whether the recovery plan was achievable for local authorities in the plan timescales. CIPFA committed to evaluating this and will report back to FRAB at its March meeting.

26. As there is very limited time to develop a new approach to DRC The Task and Finish Group's early thoughts are that the starting point could be the previous Code of Practice on the Highways Network Asset and that efforts to simplify the process to alleviate the resource burden will be sought.

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

27. This report requests that:

   - FRAB agrees the revised 2023/24 Code in Annex 1

   - FRAB notes and provides comments on the CIPFA/LASAAC Strategic Plan

- FRAB provides any indicative views on the option appraisal of the three options and the current Task and Finish Group's tentative views on the best option to resolve the current reporting issues for infrastructure assets.

CIPFA/LASAAC
November 2022