2.1 CONCEPTS

2.1.1 Introduction

2.1.1.1 Authorities shall prepare financial statements (including Group Accounts) in accordance with the International Accounting Standards Board (IASB) *Framework for the Preparation and Presentation of Financial Statements* as adapted by this section of the Code.

2.1.1.2 In September 2010 the IASB issued the first phase of its new *Conceptual Framework for Financial Reporting 2010* (the Conceptual Framework). Two chapters, chapter 1 'The Objective of General Purpose Financial Reporting' and chapter 3 'Qualitative Characteristics of Useful Financial Information', have been issued. These chapters replace the relevant paragraphs in the *Framework for the Preparation and Presentation of Financial Statements*. It should be noted that the objective of general purpose financial reporting set out in chapter 1 of the IASB Conceptual Framework (paragraph OB2) has been expanded to reflect public sector circumstances. The remaining paragraphs of this chapter would also need to be considered against needs of the users of public sector financial statements (but see also the specific issues relating to paragraph OB10 per paragraph 2.1.2.2).

2.1.1.3 Paragraphs 2.1.2.1 and 2.1.2.2 have also been drafted (using the hierarchy of standards that applied in the 2012/13 Code and which is also consistent with the process set out in paragraph 1.1.6 of the Code) from the ~~Accounting Standards Board~~Financial Reporting Council's *Statement of Principles for Financial Reporting Interpretation for Public Benefit Entities*, from the text of the Code in previous editions and ~~with support from the~~ the International Public Sector Accounting Standards Board's (IPSASB) ~~Exposure Draft~~ *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (IPSASB Conceptual Framework) issued in October 2014 ~~(Phase 1)~~[1].

2.1.1.4 The IPSASB Conceptual Framework provides additional guidance for local authorities on issues raised by section 2.1.

2.1.1.~~4~~5 In presenting information in their financial statements, authorities shall have regard to the:

a) objective of financial statements

b) underlying assumption

c) qualitative characteristics of financial statements

d) elements of financial statements

---

[1] The original wording of paragraphs 2.1.2.1 and 2.1.2.2 was originally drawn from the Exposure Draft of the IPSASB Conceptual Framework but is now more authoritatively drawn from the published document.

e) recognition of the elements of financial statements

f) measurement of the elements of financial statements.

2.1.1.~~5~~6 In particular, regard should be had to the qualitative characteristics in the selection and application of accounting policies and estimation techniques (see section 3.3 of the Code), and in the exercise of professional judgement. The Code specifies many of the accounting policies and estimation techniques to be adopted for material items. These policies and techniques have been selected to accord with the accounting concepts and principles set out in this section and, with International Financial Reporting Standards (as adapted for the public sector context, where necessary).

2.1.1.~~6~~7 Financial statements shall give a true and fair view of the financial position, financial performance and cash flows of an authority. A true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Code. Although the IASB framework does not deal directly with such a concept, the application of the principal qualitative characteristics and compliance with the Code is presumed to result in the financial statements that convey a true and fair view. Nevertheless it remains the responsibility of the authority to ensure that its financial statements present a true and fair view of the financial position, performance and cash flows of the authority.

2.1.2 Accounting Requirements

Objectives of financial statements

2.1.2.1 Authorities need to be familiar with the objective of the financial statements. ~~.~~ For local authorities, the objective of the financial statements is ~~also~~ to provide information about the authority's financial performance, financial position and cash flows that is useful to a wide range of users for assessing the stewardship of the authority's management and for making economic decisions. ~~.~~ The objective is also ~~of the financial statements is~~ to provide financial information about the reporting authority that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to it. ~~. For local authorities, the objective of the financial statements is also to provide information about the authority's financial performance, financial position and cash flows that is useful to a wide range of users for assessing the stewardship of the authority's management and for making economic decisions.~~ Financial reporting is not an end in itself. Its purpose is to provide information useful to users of the financial statements. The objectives of financial reporting are therefore determined by reference to the users of the financial statements, and their information needs. In the public sector, providing information that allows for an assessment of the stewardship and accountability of elected members and management for the resources entrusted to them is of paramount importance.

2.1.2.2 It should be noted that the IASB Conceptual Framework sets out that general purpose financial reports are not primarily directed to regulators and members of the public other than investors, lenders and other creditors (IASB Conceptual Framework, paragraph OB10). However, CIPFA/LASAAC is of the view that the nature of public sector financial statements would mean that this paragraph is not applicable to local authorities. It considers that, consistent with the views issued in previous editions of the Code, the presentation of the financial statements shall meet the common needs of most users, focusing on the ability of the users to make economic decisions, the needs of public accountability and the stewardship of an authority's resources.

2.1.2.3 Local authority financial statements are developed primarily to respond to the information needs of service recipients and resource providers who do not possess the authority to require local authorities to disclose the information they need for accountability and decision-making purposes. Local authority members and members of parliament are also primary users of local authority financial statements, when acting in their capacity as representatives of the interests of service recipients and resource providers. Therefore, for the purposes of Code, the primary users of the financial statements are service recipients and their representatives and resource providers and their representatives.

2.1.2.4 CIPFA/LASAAC would note that Government has prescribed the Code as a proper practice in legislation and relies on the assurance it obtains from local authorities producing a set of IFRS-based financial statements to ensure that local authority performance and financial position is accurately recorded and thus the Government across the four UK administrations may be described as an interested stakeholder in the local authority financial statements.

Financial performance reflected by accrual accounting

2.1.2.~~3~~4 An authority shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting, ie the authority recognises items as assets, liabilities, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Code. Accrual accounting depicts the effects of transactions and other events and circumstances on an authority's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period. This is important because information about an authority's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the authority's past and future performance than information solely about cash receipts and payments during that period.

Underlying assumption

2.1.2.4 **Going concern** – an authority's financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future. Transfers of services under combinations of public sector bodies (such as local government reorganisation) do not negate the presumption of going concern.

Qualitative characteristics of useful financial information

Fundamental qualitative characteristics

2.1.2.5 If financial information is to be useful it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable. Thus the fundamental qualitative characteristics of financial information are **relevance** and **faithful representation**. Information must be both relevant and faithfully presented to be useful.

2.1.2.6 **Relevance** – relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

2.1.2.7 Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value.

2.1.2.8 Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

2.1.2.9 **Materiality** – information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting authority. In other words, materiality is an authority-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual authority's financial statements. Consequently, the Code cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation. An authority need not comply with the Code, as to both disclosure and accounting principles, if the information is not material to the 'true and fair' view of the financial position, financial performance and cash flows of the authority and to the understanding of users.

2.1.2.10 **Faithful representation** – the financial statements represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent.[2] To be a perfectly faithful representation, a depiction would have three characteristics. It would be **complete, neutral** and **free from error**. The Code's objective is to maximise those qualities to the extent possible.

- A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations.
- A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users.
- Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

Enhancing qualitative characteristics

2.1.2.11 **Comparability, verifiability, timeliness** and **understandability** are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

2.1.2.12 **Comparability** – information about an authority is more useful if it can be compared with similar information about other authorities and entities and with similar information about the same authority for another period or another date. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not relate to a single item. A

---

2 Note that paragraph BC3.26 of the IASB Conceptual Framework states: *'Substance over form is not considered a separate component of faithful representation because it would be redundant. Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.'*

comparison requires at least two items. It should be noted that:

- Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal.
- Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different. Application of the terms of the Code, and of the *Service Reporting Code of Practice*, where relevant, will ensure adequate disclosure and consistency, and thus comparability.

2.1.2.13 **Verifiability** helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

2.1.2.14 Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation; for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology.

2.1.2.15 It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

2.1.2.16 **Timeliness** means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information, the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

2.1.2.17 **Understandability** – classifying characterising and presenting information clearly and concisely makes it understandable. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from the financial statements might make the information in those financial statements easier to understand. However, those statements would be incomplete and therefore potentially misleading.

2.1.2.18 The financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. Some economic and other phenomena are particularly complex and difficult to represent in local authority financial statements and some users may need to seek the aid of an advisor to assist in their understanding of them. All efforts should be undertaken to represent economic and other phenomena included in the financial statements in a manner that is understandable to a wide range of users. However, information should not be excluded from financial statements solely because it may be too complex or difficult for some users to understand without assistance.

2.1.2.19 Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or not faithfully represented.

2.1.2.20 Local authorities derive their powers from statute and their financial and accounting framework is closely controlled by primary and secondary legislation. It is a fundamental principle of local authority accounting that, where specific legislative requirements and accounting requirements conflict, legislative requirements shall apply. However, the Code deals with such conflicts by showing the position required by the Code's accounting requirements in the Comprehensive Income and Expenditure Statement, and the effect of the legislative requirements in the Movement in Reserves Statement.

Elements of financial statements

2.1.2.21 The elements directly related to the measurements of financial position in the Balance Sheet are assets, liabilities and reserves. The elements directly related to the measurement of the financial performance in the Comprehensive Income and Expenditure Statement are income and expenses. The presentation of these elements is shown in section 3.4 of the Code. The Cash Flow Statement reflects elements in both the Comprehensive Income and Expenditure Statement and the Balance Sheet.

2.1.2.22 In assessing whether an item meets the definition of an asset, liability or reserve, attention needs to be given to its underlying substance and economic reality and not merely its legal form.

2.1.2.23 **Assets** – a resource controlled by the authority as a result of past events and from which future economic benefits or service potential are expected to flow to the authority.

2.1.2.24 **Liabilities** – are present obligations of the authority arising from past events, the settlement of which is expected to result in an outflow from the authority of resources embodying economic benefits or service potential.

2.1.2.25 **Reserves** – the residual interest in the assets of the authority after deducting all its liabilities. The Movement in Reserves Statement shows the true economic cost of providing the authority's services, represented by the line 'Surplus or (deficit) on the provision of services'. Some income and expenditure is required to be recognised on a different basis or in a different accounting period (ie in accordance with legislation) in the General Fund and Housing Revenue Account. These differences are shown in the line 'Adjustments between accounting basis and funding basis under regulations'. Voluntary transfers to or from the General Fund Balance and Housing Revenue Account Balance also affect the amount to be funded from council tax or council dwelling rents; these are shown in the line 'Transfers to or from reserves available to fund services'. The Movement in Reserves Statement also shows Other Comprehensive Income and Expenditure, for example revaluation gains.

2.1.2.26 **Income** – is the gross inflow of economic benefits or service potential during the reporting period when those inflows or enhancements of assets or decreases of liabilities result in an increase in reserves. Income includes both revenue arising in the course of ordinary activities and gains such as the revaluation of fixed assets.

2.1.2.27 **Expenses** – are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or increases of liabilities that result in decreases in reserves. Expenses include expenses that arise in the course of the ordinary activities and losses such as revaluation of fixed assets.

Recognition of the elements of financial statements

2.1.2.28 Recognition is the process of incorporating in the Balance Sheet or Comprehensive Income and Expenditure Statement an item that meets the definition of an element and satisfies the criteria for recognition. The relevant sections of the Code set out the criteria for recognition of the elements of financial statements.

Measurement of the elements of financial statements

2.1.2.29 Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the Balance Sheet and Comprehensive Income and Expenditure Statement. The relevant sections of the Code set out the basis of measurement for the elements of financial statements. The interpretation of fair value varies from section to section of the Code; the interpretations are summarised below.

Fair value

2.1.2.30 The concept of fair value is used throughout the Code. International Financial Reporting Standards now have a consistent definition of fair value introduced by IFRS 13 *Fair Value Measurement.* The measurement and disclosure requirements of the standard are included in section 2.10.

Current value measurement of property, plant and equipment

2.1.2.31 The Code has introduced the concept and definition of current value to the measurement of property, plant and equipment. Current value measurements reflect the economic environment prevailing for the service or function the asset is supporting at the reporting date (see paragraph 4.1.2.4).

2.1.2.32 The 2015/16 Code does not require infrastructure assets (eg roads) to be carried at current value. Infrastructure assets are carried at depreciated historical cost. See Appendix D for the Code's future approach to the measurement of transport infrastructure assets.

Measurement at fair value or the different current value measurements of property, plant and equipment

2.1.2.33 The following table demonstrates for accounts preparers when fair value or one of the property, plant ~~and~~ and equipment current value measurement bases[3] apply to the main income, expenditure, assets and liabilities classifications within local authority financial statements.

Circumstance	Fair Value or Current Value Measurement of Property, Plant and Equipment
Revenue recognition; this is the general definition that applies unless a more specific definition applies	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10).
Property, plant and equipment	For non-specialised assets, current value should be interpreted as existing use value. In the RICS *Valuation – Professional Standards*, this is market value based on the assumption that property is sold as part of the continuing enterprise. This requirement is met by providing an existing use valuation in accordance with UKVS 1.3 of the RICS *Valuation – Professional Standards*. For specialised assets where no market exists, current value should be interpreted as the present value of the assets' remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential. Under these circumstances, property, plant and equipment is measured at Depreciated Replacement Cost. The current value of council dwellings shall be measured using

3 The Surplus Assets class of Property, Plant and Equipment is measured at fair value as a current value measurement base.

Circumstance	Fair Value or Current Value Measurement of Property, Plant and Equipment
	existing use value–social housing (EUV–SH). The fair value of surplus assets is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10).
Leases	On initial recognition, fair value will be defined in accordance with section 4.2 of the Code. Subsequent measurement, at current value will follow the appropriate class of property, plant and equipment. Intangible assets are measured at fair value where relevant.
Service concession (PFI and PPP) arrangements	On initial recognition, fair value is the estimated cost to purchase the asset. Subsequently, the asset is measured at current value, which will follow the appropriate class of property, plant and equipment. Fair value measurement will apply, where relevant for intangible assets acquired under service concession arrangements.
Investment property	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10). As a non-financial asset an investment property shall be measured at highest and best use. The fair value of investment property held under a lease is the lease interest.
Intangible assets	IAS 38 allows an intangible asset to be carried at a revalued amount only where its fair value can be determined by reference to an active market. Where there is no active market, assets are carried at cost less any accumulated amortisation and any accumulated impairment loss. Where an intangible asset is required under section 4.5 of the Code to be measured at fair value, the definition in section 2.10 of the Code will apply.
Non-current assets held for sale	Non-current assets held for sale shall be measured in accordance with the measurement requirements of section 4.9 of the Code and IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations,* ie the lower of its carrying amount and fair value less costs to sell. Fair value in section 4.9 is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see

Circumstance	Fair Value or Current Value Measurement of Property, Plant and Equipment
	Section 2.10). When applying the definition of fair value, as non-financial assets, non-current assets held for sale shall be measured at highest and best use. Fair value for social housing being disposed of under Right to Buy (RTB) legislation is the discounted RTB value.
Heritage assets	Heritage assets are carried at valuation rather than current or fair value, reflecting the fact that sales and exchanges of heritage assets are uncommon. Valuations may be made by any method that is appropriate and relevant. There is no requirement for valuations to be carried out or verified by external valuers, nor is there any prescribed minimum period between valuations. In some cases it may not be practicable to establish a valuation for a heritage asset, in which case the asset is carried at historical cost if this information is available. Authorities may elect to use this basis for community assets.
Inventories	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10).
Debtors	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10).
Financial instruments	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10).
Creditors	Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see section 2.10).
Employee benefits	Plan assets measured at fair value in accordance with sections 6.1 to 6.4 of the Code and IAS 19 *Employee Benefits* apply the definition and measurement requirements of fair value in accordance with chapter six of the Code and with the definition of fair value included in section 2.10 of the Code.
Pension fund plan investments	Retirement benefit plan investments measured at fair value in accordance with section 6.5 Accounting and Reporting by Pension Funds of the Code apply the definition and measurement

Circumstance	Fair Value or Current Value Measurement of Property, Plant and Equipment
	requirements of fair value in accordance with chapter six of the Code and with the definition of fair value included in section 2.10 of the Code.

2.1.3 Statutory Accounting Requirements

2.1.3.1 There are no statutory accounting requirements regarding the concepts and principles.

2.1.4 Disclosure Requirements

2.1.4.1 Authorities shall apply the objective, underlying assumption and qualitative characteristics of useful financial information, in the selection and application of accounting policies and estimation techniques (see section 3.3 of the Code).

2.1.5 Statutory Disclosure Requirements

2.1.5.1 There are no statutory disclosure requirements in relation to the concepts and principles.

2.1.6 Changes since the ~~2014~~2015/~~15~~ 16 Code

2.1.6.1 The ~~2015/16~~2016/17 ~~-~~Code ~~includes an overview of the application of fair value and current value to the assets and liabilities held by local authorities following the Code's adoption of IFRS 13 and the confirmation of the concept of current value measurement for property, plant and equipment in section 4.1 of the Code~~has been updated for the issue of the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, particularly with regard to the users and the understandability of local authority financial statements.