Appendix A Item 8 LASAAC 27/02/19

ACCOUNTING

FOR INTERNAL TRANSACTIONS

AND INSURANCE ARRANGEMENTS

ADVISORY NOTICE

Public Consultation Draft
Closes 8 March 2019

Please send any comments or suggested amendments to:
lasaac@cipfa.org

Any and all comments are welcome. LASAAC has however noted some aspects where specific stakeholder would be particularly appreciated.

Consultation Draft

LASAAC is funded by:

The Scottish Government

The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) is funded by the Chartered Institute of Public Finance & Accountancy (CIPFA), Audit Scotland and the Scottish Government.

The members of LASAAC are volunteers representing the funding bodies or participating as appointed or co-opted members. LASAAC is primarily concerned with the development and promotion of proper accounting practices for Scottish local authorities. A key task in achieving this is LASAAC's contribution to the development of the 'Code of Practice on Local Authority Accounting in the United Kingdom' ('the Code').

Further information about LASAAC can be obtained at http://www.cipfascotland.org.uk/technical/lasaac.cfm

The Chartered Institute of Public Finance and Accountancy (CIPFA) provide secretariat support for LASAAC. If you would like to contact LASAAC please communicate with

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Date of Application

1. This guidance applies to the 2018/19 financial year and all future years until amended or withdrawn.

Status of Guidance

2. This advisory notice is intended to assist practitioners and other stakeholders in implementing the requirements of the Local Authority Code of Practice. It does not change or amend those requirements and is not mandatory guidance.

3. This guidance replaces an initial LASAAC Advisory Notice "Internal Transactions and Operating Segments Reporting 2017/18" which was issued in April 2018.

Internal Transactions in the Financial Statements

4. The Code of Practice on Local Authority Accounting (the Code) in the UK 2018/19[1] includes the following:

    - "Income is the 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."[2]

    - "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."[3]

5. The Code[4] also states explicitly that:

    - "As the service segments in the Comprehensive Income and Expenditure Statement are not intended to cover the reporting requirements for IFRS 8 then transactions between segments are not permitted in the service analysis section of the Statement"

6. As a consequence internal transactions are not to be included in the Comprehensive Income and Expenditure Statement (CIES). A description of different forms of internal transactions, based on text initially provided in the 2017/18 advisory notice, is provided in Appendix A.

7. The Code requirements for 2018/19 now clearly prohibit the inclusion of income and expenditure on a trading basis between segments in the CIES. The apportionment of costs between segments, as the re-allocation of underlying expenditure, in the CIES is however allowed.

8. As a further consequence of the Code requirements, previous LASAAC guidance on accounting for insurance[5] is withdrawn. As a result the presentation of a surplus or deficit on internal trading arrangements, for example from the use of an Insurance Account, is no longer permitted in the Comprehensive Income and Expenditure Statement.

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[1] References cited are to the 2018/19 version unless otherwise stated.
[2] The Code 2018/19 para 2.1.2.28
[3] The Code 2018/19 para 2.1.2.29
[4] The Code 2018/19 para 3.4.2.39
[5] "Accounting For Insurance In Local Authorities In Scotland" (LASAAC, December 2005)

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9. In relation to Insurance Fund arrangements transfers to and from the Insurance Fund should therefore be presented as a 'transfer to or from other statutory reserves' in the Movement in Reserves Statement. This will be necessary where, for example:

    - a balance on the Insurance Fund is utilised to fund external insurance premiums which have been recognised in the CIES and consequently charged to the General Fund or HRA
    - a decision has been made to increase the balance on the Insurance Fund by a contribution from the General Fund or HRA.

Internal Transactions for Management Purposes

10. The requirements noted above relate to the presentation of an authority's financial performance in the financial statements. This does not preclude authorities from recording, for management and control purposes, internal transactions during the year.

11. Where an authority, for management purposes, records internal transactions during the year adjustments will be required to achieve the required presentation in the financial statements.

12. Adjustments which reconcile an authority's segment management control arrangements, such as those presented in budget monitoring reports during the year, to the required presentation in the Comprehensive Income and Expenditure Statement (CIES) should be made in the Expenditure and Funding Analysis[6]. This may therefore include the elimination of internal insurance charges.

Apportionment or Allocation of the Underlying Expenditure Incurred

13. Where, for statutory purposes a specific fund such as the Housing Revenue Account (HRA) is responsible and accountable for charges, such as insurance costs, in its own right, the segment line for that fund (eg the HRA) may legitimately include the underlying expenditure incurred. Where the authority considers that adopting the same approach for non-HRA General Fund segments would be materially useful to the readers of the financial statements and is in accordance with the Code requirements, the same principle may be applied i.e. the underlying relevant expenditure can be included in non-HRA General Fund segment lines.

14. Such expenditure however should not be presented in the CIES as an internal transaction, which would give rise to income for another segment.

15. Such expenditure should be presented as an apportionment or allocation of the original underlying expenditure incurred. The following provides an example of the management reporting presentation that may be used internally, and the presentation in the CIES that would be required for the financial statements.

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[6] See The Code 2018/19 paras 3.4.2.98-3.4.2.102

Specific area for potential stakeholder consideration and comment

The consultation draft has been prepared with the intention of supporting the Code requirements, including consistency with:

- The description of the purpose of the CIES provided in Code paragraph 3.4.2.37.
- The CIES requirements noted in Code paragraph 3.4.2.39
- The description of the Expenditure and Funding Analysis in Code paragraph 3.4.2.98

Stakeholder comments on whether the drafting of paragraphs 13-15 above adequately achieves this would be welcome. For example the draft allows that:

a. Cost apportionments may be made to ensure that the HRA gross expenditure figure included in the CIES reflects the position that such expenditure is fundamentally incurred by the HRA due to the legislative requirement to fund the expenditure from rents (i.e. where the rental income is expected to support / fund the expenditure) and may therefore be appropriately presented on the same CIES line as HRA rental income.

b. Cost apportionments to other General Fund services may require consideration of whether this presentation would be 'materially useful to the readers of the financial statements and is in accordance with the Code requirements'. For example where a segment has effectively been responsible, through a 'controllable budget' arrangement (see Appendix A), presentation of the underlying related expenditure as part of its gross expenditure may be regarded as helpful for readers to show the consumption of resources. This would result in a reduction in the gross expenditure of the segment which initially procured the resources.

16. The example is based on a situation where a 'Corporate Services' segment line includes income of £1.0m, which exactly recovers £1.0m of externally incurred insurance premium charges, from service departments. This includes £0.2m charged to the HRA with the balance of £0.8m charged to non-HRA General Fund services. The Council has determined that expenditure on non-HRA general fund services is most appropriately reported in the 'Corporate Services' segment.

Example Management Reporting Information			
Segment	**'Income'**	**'Expenditure'**	**'Net'**
Corporate Services	£1.0m	£1.0m	£0.0m
HRA		£0.2m	£0.2m
Non-HRA General Fund Services		£0.8m	£0.8m
Total (incl. internal transactions)	**£1.0m**	**£2.0m**	**£1.0m**

Example Presentation in the CIES			
Segment	**Income**	**Expenditure**	**Net**
Corporate Services		£0.8m	£0.8m
HRA		£0.2m	£0.2m
Total (excl. internal transactions)		**£1.0m**	**£1.0m**

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Restatement of 2017/18 Presentation

17. For comparative purposes, where the effect is material, prior year comparatives for example relating to the CIES and Expenditure & Funding Analysis will be expected to be restated. The change in presentation should be briefly explained.

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Description of Internal Transactions

A	Internal Recharges which are part of a service manager's 'controllable budget'.	In this situation the service recipient is held accountable during the year for the use of these services (eg financial monitoring reports show the charge as expenditure within the control of the manager i.e. as part of a manager's 'controllable budget'). Examples may include the Education service charging the Social Work service for the use of accommodation and facilities in the provision of Social Work services. In such a situation typically the (internal to the council) income for the Education service is regarded as 'controllable budget' income; and the (internal to the council) spend for Social Work is regarded as part of their 'controllable budget' expenditure.
B	Internal Recharges which are not part of a service manager's 'controllable budget'.	In this situation the service recipient is not held accountable during the year for the use of these services (eg financial monitoring reports do not regard these as part of a manager's 'controllable budget'; budget matching or re-alignment may be undertaken at the year-end without consultation with the service manager). Typically some central support costs may be treated in this manner (eg where the charges are calculated on a pre-set 'price per item' basis rather than a year end allocation or apportionment)
C	Cost apportionments or allocations which are not part of a service manager's 'controllable budget' and which are presented as income for one segment and expenditure for another	In this situation the service recipient is not held accountable during the year for the use of these services (eg financial monitoring reports do not regard these as part of a manager's 'controllable budget'; budget matching or re-alignment may be undertaken at the year-end without consultation with the service manager). Typically some central support costs may be treated in this manner eg those apportioned at the year end.

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