CIPFA The Chartered Institute of Public Finance & Accountancy

report

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Committee	CIPFA/LASAAC
Venue	CIPFA Robert Street
Date	4 June 2014
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Subject	2015/16 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) – Proposed Exposure Draft and Invitation to Comment

The purpose of this report is to seek the Board's views on the 2015/16 Code of Practice on Local Authority Accounting (the Code) Exposure Drafts and Invitation to Comment

1 Summary

1.1 This report seeks confirmation from CIPFA/LASAAC of the issues that it wishes to include in the Exposure Drafts and Invitation to Comment on the 2015/16 Code.

1.2 Following deferral of IFRS 13 to adoption in the 2015/16 Code, CIPFA Secretariat in conjunction with HM Treasury has undertaken a conceptual review of the adoption of the Standard and the measurement of property, plant and equipment. The preferred option, based on the measurement of the service potential and the operating capacity of the asset is to measure operational property, plant and equipment at current use value ie the existing use value of the asset based on RICs definitions. With the exception of the change in the description of the definition as current use value as opposed to fair value this proposal does not change the measurement requirements for these assets.

1.3 As Surplus Assets are not operational the report recommends that Surplus Assets are measured at fair value. Currently they are measured by an existing use valuation based on their use before coming surplus.

1.4 The report recommends further consideration of the disclosure requirements for property, plant and equipment as the new measurement base takes the majority of property, plant and equipment outside the disclosure requirements of IFRS 13.

1.5 There are a number of narrow scope amendments that subject to EU adoption will need to be adopted by the 2015/16 Code.

1.6 IFRIC 21 *Levies* provides guidance on the recognition of liabilities to pay levies. In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the IFRIC specifies the obligating event as the activity that triggers the payment of the levy. Section 8.2 of the Code will be amended to confirm the relevance of the principles of the IFRIC.

1.7 The implications for the revisions to UK GAAP have to be considered for three sections of the Code (as the Code relies on current UK GAAP):

- Value Added Tax – it is not anticipated there will be any substantial changes to the Code;

- Heritage Assets – the relaxations for measurement in FRS 30 *Heritage Assets* are not included in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Relevant amendments are therefore proposed to the Code. The disclosures for heritage assets are largely unchanged under FRS 102, but the report includes proposals to delete the Code requirement for a five year analysis of transactions.

- Pensions Fund Accounting – the format of the Pension Fund Accounts is drawn from the Pensions SORP, which is currently subject to consultation. The proposals recommend retention of the current approach in the Code and that CIPFA/LASAAC review this again, next year, when the SORP is finalised.

1.8 The draft Code does not include any changes in relation to the following legislative or policy developments which are expected to impact on the 2015/16 financial statements but which have not been finalised at the time of drafting:

- Accounts and Audit (England) Regulations;

- Local Authority Accounts (Scotland) Regulations;

- Accounts and Audit (Wales) Regulations;

- Housing Revenue Account in Wales Self Financing.

Section 1.2 of the Code will also need to be amended for the impact of the new requirements in the Local Audit and Accountability Act 2014 on the relevant (English) authorities applying the Code. However, for the majority of local authorities this is a technical change and will not impact on the general requirement to apply the Code.

1.9 The ITC reminds interested parties of the Code's confirmation that the measurement requirements of the Code of Practice on Transport Infrastructure Assets will apply retrospectively from 2016/17. As a change in accounting policy, Appendix C of the 2016/17 Code will be drafted to include disclosure requirements for the 2015/16 financial statements for a change required by a new standard that has not yet been adopted.

recommendation

CIPFA/LASAAC is asked to provide its initial views on the:

1) Exposure Drafts of the 2015/16 Code; and
2) Invitation to Comment on 2015/16 Code.

DETAILED DISCUSSION

2. Introduction

2.1 At the CIPFA/LASAAC meeting held on 20 February 2014, the Board considered a report on the development of the 2015/16 Code, and agreed that the Secretariat should take forward a number of matters for inclusion in the Code. This report requests that CIPFA/LASAAC consider the first draft of the Invitation to Comment (ITC) and the Exposure Drafts of the 2015/16 Code. The most significant issues that are taken forward in the ITC and Exposure Drafts are summarised below.

2.2 The ITC includes an Executive Summary which is intended to be used by senior finance officers to gain an understanding of the key issues considered. In accordance with practice established last year an open letter from the Chair of CIPFA/LASAAC containing an "at a glance" summary will be sent to the Treasurer's Societies and held on the CIPFA/LASAAC pages of the website. This will be drafted following the finalisation of the text of the ITC and Exposure Drafts.

2.3 The ITC will need to be approved by PFMB following CIPFA/LASAAC's approval. CIPFA/LASAAC Members are aware that the Code consultation is a minimum period of eight weeks. The Secretariat recommends that the consultation take place as soon as possible after finalisation of the ITC and Exposure Drafts. The latest date for closure of the consultation, in order to have sufficient preparation time to produce papers for the Board is 11 October 2014. This is included in the draft ITC.

3 IFRS 13 Fair Value Measurement and the Measurement of Property, Plant and Equipment (ED 1)

Introduction and Background

3.1 CIPFA/LASAAC will be aware that it agreed to defer the adoption of IFRS 13 to the 2015/16 Code. At its November and February meetings the Board has debated the way forward for the measurement of property, plant and equipment as a part of its adoption of IFRS 13. The work since the consultation on the 2014/15 Code has been to consider the conceptual basis for the measurement of property, plant and equipment. The CIPFA Secretariat and HM Treasury colleagues considered the principles and produced a further paper for FRAB. This paper is attached at Appendix A to this report.

3.2 The Board is aware that the Code and the predecessor SORP have sought to measure the operating capacity and not the financial capacity of the assets providing services for public sector service recipients. As reported previously FRAB members suggested that if measurement of exit values (ie financial capacity) was not the most appropriate measurement base then the solution was not to adapt IFRS 13 but to adapt the standard which prescribed that measurement ie IAS 16. CIPFA/LASAAC also considered following the consultation responses that the approach to adoption needed to be clear for accounts preparers to apply. The Invitation to Comment (ITC) on the 2015/16 Code outlines the conceptual reasons for retaining this measurement base following the paper to FRAB.

The Measurement of Property, Plant and Equipment

3.3 The FRAB report suggested two options. The recommended option included in the draft ITC is that described at CIPFA/LASAAC's last meeting. Operational property, plant and equipment are measured at current (use) value which is a market based existing use value in accordance with the definitions included in the *RICS Valuation - Professional Standards*[1]. Thus for operational assets IAS 16 is adapted in the Code to include measurement at current use value. The Secretariat has previously described this for the Board as current value. This suggested change has been proposed by HM Treasury colleagues. The Secretariat considers that it is useful to use the same descriptions so interested parties can clearly see this is an across public sector approach. The Secretariat would seek CIPFA/LASAAC's views on this issue. This measurement approach does mean that for the majority of property, plant and equipment assets in the Code the measurement of these assets will not change as since the move to IFRS the Code interpreted fair value to be the same as this RICS measurement base.

3.4 A further drafting issue to bring to the Board's attention is that using this adaptation is likely to mean that there is less prescription and detailed guidance available for the definition of current use value (existing use value) compared to fair value under IFRS. The Secretariat therefore recommends that paragraph 4.1.2.37 which refers to valuations normally being undertaken by professional valuers is retained even though it has been removed by IFRS 13 from IAS 16.

Surplus Assets

3.5 This leaves the measurement of Surplus Assets ie those property, plant and equipment assets which are not operational but do not meet the criteria to be held for sale. As these assets are not operational then there can be no argument for measuring them at their operating capacity. The Secretariat recommends that these assets are measured at fair value. The definition of fair value is therefore retained in section 4.1 of the Code but this definition has been changed to accord with IFRS 13.

Disclosures of Property, Plant and Equipment

3.6 As the new definition of current use value moves a large part of the property, plant and equipment assets outside the requirements of IFRS 13 then this means that the disclosures required by the standard will not apply. However, the Secretariat would contend that the objective set out for fair value measurement disclosures (ie to understand the valuation techniques and inputs used to develop those measurements and the impact of the changes of those techniques) is important and could be considered to apply for local authority circumstances. In theory the current disclosures in section 4.1 of the Code are already seeking to do this. However, a limited examination of local authority financial statements in the first consultation on the Code indicated that this objective is not always achieved.

3.7 The Secretariat has proposed adding the objective in paragraph 4.1.4.2 but has not added any new disclosures from IFRS 13. The Secretariat understands that HM Treasury has not proposed this option and is seeking CIPFA/LASAAC's views on this suggested addition. The Secretariat would add that this addition is not seeking to add significant additional disclosures but to augment the qualitative information provided.

3.8 During its debates on fair value the Board has been clear that whilst the information on exit values might not be the most appropriate measurement for public sector property, plant and equipment, it is still very useful information. Information about the measurement of assets in the highest and best use is (often) identified as a part of the valuation process and therefore the Secretariat

[1] Issued by the Royal Institution of Chartered Surveyors (RICS) January 2014

has added a disclosure to set out that where this information is available as a part of the valuation processes that it should be disclosed. The Secretariat is aware that this does add to the disclosure requirements of the authority but considers that this would only be for material differences and provided that this was not at an additional cost. The Secretariat understands that HM Treasury colleagues have not yet added this disclosure but are seeking the views of the relevant authorities on this issue.

3.9 The Secretariat would highlight that it has raised the issue of disclosures under IAS 16 as one for CIPFA/LASAAC to debate at the meeting.

Proposed Amendments to the 2015/16 Code

3.10 The Exposure Draft relating to fair value and current use value measurement takes the same approach as previous consultations. It:

- introduces a new section on fair value measurement ie 2.10 (note that the Secretariat has included some further definitions from IFRS 13 ie inputs, market participants, most advantageous market, orderly transaction and principal market) – this section has been drafted using the major provisions in the Standard;
- includes the introduction of the concept of current use value in section 4.1 Property, Plant and Equipment;
- does not include any direct adaptations to IFRS 13, the provisions on assets and liabilities and the disclosures follow the requirements of the standard (these are covered in overview in the ITC as they have been subject to consultation in the 2013/14 and 2014/15 Code consultations);
- amends the table at paragraph 2.31 which now illustrates when fair value and current use value measurements are used;
- includes the substantive consequential changes to other sections of the Code; and
- includes one of the changes introduced by the Annual Improvements to IFRSs 2010-2012 Cycle (see section 3 below) as this ED exposes a large proportion of Section 4.1 of the Code.

CIPFA/LASAAC is invited to consider the proposals for:

- **the approach to the adoption of IFRS 13;**
- **the adaptation to IAS 16 for the measurement of property, plant and equipment at current value;**
- **the measurement of surplus assets at fair value in accordance with IFRS 13;**
- **the additional disclosure requirements in IAS 16; and**

4 Narrow Scope Amendments to IFRS

4.1 There are a number of narrow scope amendments that subject to EU adoption will need to be adopted by the 2015/16 Code.

- Amendments to IAS 19 Employee Benefits (Defined Benefit Plans: Employee Contributions).

- Annual Improvement to IFRSs 2010 – 2012 Cycle.

- Annual Improvement to IFRSs 2011 – 2013 Cycle.

4.2 The ITC and Appendices A and B set out the proposed changes to the Code.

CIPFA/LASAAC is invited to consider the proposals for the adoption of the narrow scope amendments to IFRS in the Code.

5 IFRIC 21 Levies

5.1 The IFRIC provides guidance on accounting for levies in the financial statements of the entity paying the levy. This IFRIC will apply to local authorities that pay levies. The Secretariat is of the view that the accounting treatments described in the IFRIC accords with the normal practices of local authorities. The normal approach to the inclusion of IFRICs in the Code is to refer to them within the relevant introductory section and not to repeat their prescriptions. This approach accords with the approach to drafting agreed in the CIPFA/LASAAC review. As the amendment to the Code is only a sentence specifying that the IFRIC applies an Exposure Draft has not been produced.

5.2 Although the accounting specified in the IFRIC appears to accord with the normal accounting practices of local authorities. The Secretariat has noted that early debate on this IFRIC is indicating that it might have wider effects than anticipated and may affect non income taxes. The Secretariat has not yet identified any substantial issues for local authorities but would welcome the Board's views.

CIPFA/LASAAC is invited to consider the proposals for the adoption of the IFRIC 21 in the Code

6 Other Standards issued by The IASB

6.1 The ITC also includes some commentary about other standards issued by the IASB. Most of these have an effective date which will not coincide with that of the 2015/16 Code.

6.2 This section of the ITC also covers the amendments to IFRS 9 *Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39*. These enable entities to change the accounting treatment of liabilities that they have elected to measure at fair value, before applying any of the other requirements in IFRS 9. The last meeting of CIPFA/LASAAC indicated that it might be useful to consider whether or not this amendment would have a significant application to local authorities. However, the most recent EFRAG endorsement status report indicates that EU endorsement is postponed. As it is not clear when EU endorsement will take place, this has not been included as a consultation issue in the ITC.

CIPFA/LASAAC is invited to consider the commentary in the ITC on other standards issued by the IASB.

7 FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

7.1 At its last meeting CIPFA/LASAAC requested that the Secretariat review FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* for any practice that might contribute to an improvement in the provisions of the Code. The relevant sections of FRS 102 on which the Code will need to rely are discussed in more detail below and included in the ITC.

7.2 The other sections of FRS 102 which relate to EU adopted IFRS eg employee benefits, lease accounting, financial instruments on which the Code is based are already covered extensively in the Code and/or contain more extensive guidance than is included in FRS 102. The Secretariat would therefore not recommend any changes to the Code. However, when new or amended standards are adopted in the Code FRS 102 will remain a useful source of reference under the *Memorandum of Understanding between the Relevant Authorities* (MoU).

7.3 This leaves the section in FRS 102 which covers Specialised Activities (Section 34). The table below sets out these provisions and the Secretariat's comments.

Specialised Activity	**Secretariat Comments**
Agriculture	Not a significant issue for local authorities covered in paragraph A.1.5 of the Code. **Recommend no further amendment to the Code.**
Extractive Industries	Not a substantial issue for local authorities – see paragraph A.1.8 of the Code. **Recommend no further amendment to the Code.**
Service Concession Arrangements	The provisions of Section 4.3 of the Code are consistent with the guidance in FRS 102 although Section 4.3 does not cover the accounting treatment of the operator. **Recommend no further amendment to the Code.**
Financial Institutions	NA
Retirement Benefit Plans	See below – (section 8 of this report)
Heritage Assets	See below – (section 8 of this report)
Funding Commitments	This section sets out guidance on accounting for commitments to provide cash or resources to other entities. The Code does not include direct provisions in this area. Authorities would account for these transactions in accordance with IAS 37 *Provisions, Contingent Liabilities and*

	Contingent Assets and the concepts included in section 2.1 of the Code. This is not an issue which has been raised by authorities as a part of the consultative process on the Code. **The Secretariat does not consider that this is an area which needs further guidance in the Code.**
Incoming resources from non-exchange transactions	This is covered extensively by sections 2.3 (Government and Non-Government Grants) and 2.7 (Revenue Recognition) of the Code. This includes the adoption of IPSAS 23 *Revenue from Non Exchange Transactions* in section 2.3 the Code. The provisions in FRS 102 are consistent with the Code. **Recommend no further amendment to the Code.**
Public Benefit Entity Combinations	This was considered last year when the Board reviewed the prescriptions of section 2.5 (Local Government Reorganisation and Other Combinations). The provisions in this section need to align with other public sector bodies and the FReM rather than public benefit combinations. **Recommend no further amendment to the Code.**
Public Benefit Entity Concessionary Loans	The Code and the application guidance in the Code have extensive provisions on this area developed on the introduction of the financial instruments standards to the SORP. The Secretariat considers that this guidance has not been subject to challenge since its introduction. It may be appropriate to review this guidance on adoption of IFRS 9 *Financial Instruments*. **Recommend no further amendment to the Code at this juncture.**

8 Changes to UK GAAP and Accounting for Value Added Tax, Heritage Assets and Pension Funds

Value Added Tax

8.1 Under the MoU the Code currently follows the requirements of SSAP 5 *Accounting for Value Added Tax*. FRS 102 includes provisions at paragraph 29.20 on Value

Added Tax which are consistent with the provisions in the Code. The Secretariat therefore considers that there is no need to make any amendment (beyond reference to FRS 102 as opposed to SSAP 5) in the Code.

CIPFA/LASAAC is invited to consider the approach in the 2015/16 Code consultation to VAT.

Heritage Assets

8.2 The Code currently follows the prescriptions of FRS 30 *Heritage Assets* in Section 4.10 of the Code. Section 34 provides new prescriptions on the measurement of Heritage Assets which do not include the provisions of paragraphs 21 and 22 which allow valuations by any means relevant but instead rely on the general prescriptions of FRS 102 for the measurement of property, plant and equipment where relevant. The draft 2015/16 Code has therefore mirrored these provisions as applicable for local authority circumstances and the proposals of measurement of property, plant and equipment. It also makes provisions on the use of cost where a valuation cannot be achieved at an appropriate cost. This allows the provisions of the Code to rely on FRS 102, which would allow heritage assets to be measured using the cost or the revaluation model but indicates a preference for current (use) value. The Secretariat would note that the *Accounting and reporting by charities: Statement of Recommended Practice* Exposure Draft appears to be retaining an approach similar to FRS 30.

8.3 FRS 102 also makes no specific prescription for the treatment of depreciation in its section on heritage assets, unlike FRS 30 which indicates that depreciation does not need to be charged for heritage assets with an indefinite life. The Code no longer makes this prescription but does comment that depreciation would not be anticipated on assets of an indefinite useful life to assist accounts preparers. The Secretariat anticipates that this would be consistent if local authorities applied the Code's provisions on depreciation in section 4.1 of the Code.

8.4 The Code and the Exposure Draft also include transitional provisions on this change in accounting policy, in the event that this might mean a material change for some authorities. The Secretariat considers that if this amendment to the Code does result in a change in accounting policy for local authorities it is most likely to lead to derecognition of assets recognised by virtue of the relaxation of the measurement principles in FRS 30. However, this is likely to be an application issue and not necessarily one for the Code.

CIPFA/LASAAC is invited to consider and approve for consultation the amendments to the Code's provisions on the measurement of Heritage Assets.

8.5 The disclosure requirements for Heritage Assets in FRS 102 have not changed substantially but have been refined. Appropriate amendment has been made in the Exposure Draft of the Code. The Secretariat has, however, suggested that the disclosures in (new) paragraph 4.10.2.3 on an authority's transactions for heritage assets should only include the current year and the preceding year and not a five year history of transactions. The Secretariat has proposed this because:

- the issue of the impact of heritage assets disclosures was raised in the *consultation on simplifying and streamlining the presentation of local authority financial statements;*
- IFRS already includes precedent for not including five years of disclosures (as set out in the ITC);

- Heritage Assets are not normally a particularly material transaction in local authority financial statements.

CIPFA/LASAAC is invited to consider its approach to its disclosures on Heritage Assets in the Exposure Draft of the 2015/16 Code.

Accounting and Reporting by Pension Funds

8.6 The accounting for pensions funds in Section 6.5 of the Code is based on EU adopted IFRS; this specifically includes IAS 26 *Accounting for Retirement Benefit Plans*. The adoption of IAS 26 is supported by specific requirements in IFRS by other standards to the extent that this is not superseded by IAS 26. The two most relevant are likely to be IAS 19 *Employee Benefits* and the financial instruments standards.

8.7 IAS 26 does not provide specifically for the format of the pensions account or the net asset statement. The Code (as did the preceding UK GAAP based SORP) draws upon the format of the accounts in the *Statement of Recommended Practice: Financial Reports of Pension Schemes* (the Pensions SORP). The Pensions SORP is currently subject to consultation and is anticipated to have an effective date of 1 January 2015. The consultation period will close on 16 July 2014.

8.8 The Pension SORP in turn relies of FRS 102 which includes high level prescription ie a minimum line analysis for a statement of changes in Fund Assets (which also may be called a Fund Account). The Pensions SORP then provides for more detail to be provided in the disclosures. The Code includes the minimum line detail required by FRS 102 and then includes some of the additional analysis for local authority circumstances which it requires to be included in the notes and on the face of the Statement. It is suggested that as the Pensions SORP is subject to consultation no changes be made at this juncture. The Code is consistent with the Pensions SORP in relation to the Net Assets Statement for local authority circumstances.

8.9 The Secretariat would note that as the Pension Fund financial statements for local authorities are supported by the full reporting and disclosure requirements of EU adopted IFRS as adopted by the Code this represents a robust reporting framework equal to that of the pension SORP. This was supported by the Board considering the *Local Government Pension Scheme Fund Accounts 2012/13 example accounts and disclosure checklist* and when considering whether this should be included in the development programme for the 2014/15 Code. This comment excludes the format of the Fund Account and the Net Assets Statement but the Secretariat is not aware that the format needs substantial review and as noted above is consistent with the requirements of FRS 102.

8.10 The Secretariat recommends therefore that no changes be made to the Code at this juncture but that a review takes place next year following the finalisation of the Pensions SORP. This will also allow a question to be raised in the ITC for any issues interested parties consider should be included in the review.

CIPFA/LASAAC is invited to consider whether it agrees to the approach to the review of the pension fund section of the Code.

9 Statutory Amendments to Local Authority Financial Reporting

9.1 The ITC highlights other possible changes to legislation that would impact on the reporting requirements in the Code but for which the final legislative provisions have not been issued. It is therefore not currently possible to draft the amendments to the Code. It is possible that a number of these will not be available before the Code Exposure Draft needs to be issued. Amendments to the Code as a result of the legislation should be a matter of fact and therefore should not require a consultative process.

The Impact of the Local Audit and Accountability Act 2014

9.2 The Local Audit and Accountability Act 2014 (the LAA Act) gained Royal Assent in January this year. It is anticipated that the Accounts and Audit (England) Regulations may lead to more general changes to the Code. These regulations are therefore covered by paragraph 7.1 above. However, the Act itself is also likely to impact on the introductory provisions of the Code for English authorities. Paragraphs 50 and 51 of Schedule 12 of the LAA Act amend sections 21 of the Local Government Act 2003.

9.3 Section 21 provides a definition of proper practices in relation to accounts and gives the Secretary of State a power to define accounting practices by regulation. These powers have been used in the Local Authority (Capital Finance and Accounting) (England) Regulations to define the Code and the *Service Reporting Code of Practice* as a proper practice for local authorities. Paragraphs 50 and 51 extend the list of bodies to which sections 21 and 22 apply to include all relevant authorities under section 2 of the LAA Act. This now includes bodies such as Passenger Transport Executives.

9.4 The LAA Act now provides a complete list of bodies that apply the proper practices specified under section 21. This is likely to mean that most of the same authorities that currently apply the Code will to continue to apply the Code. In addition the LAA Act specifies that a smaller authority will be authorities that have an income or expenditure of £6.5million or less. It is unlikely that many categories of bodies currently applying the Code will be defined as a smaller body but some may fall under this definition.

9.5 Smaller bodies have different reporting requirements in the Accounts and Audit (England) Regulations and are not required to provide a true and fair view. The smaller bodies under the current Accounts and Audit Regulations have a choice as to whether or not they follow the practices for larger bodies which could be deemed to include the Code. Therefore these bodies will have a choice on whether or not to follow the practices in the Code. The Code currently stipulates that it does not apply to parish councils as alternative guidance applies to them (also defined as a proper practice under the capital finance and accounting regulations). This section of the Code (1.2) therefore will need to be redrafted for English authorities but this would be best done following the issue of the Accounts and Audit (England) Regulations.

Local Authorities (Capital Finance and Accounting) (England) Regulations

9.6 The exception to the approach to amending the Code is likely to be amendment to the Local Authorities (Capital Finance and Accounting) (England) Regulations which the Secretariat anticipates will allow for spreading of the cost of providing for refunds of back dated appeals for non-domestic rates. The Secretariat anticipates that this permission will need to make use of the Collection Fund Adjustment Account. At the time of drafting this report the final regulations are not yet issued and therefore the Secretariat has not made the relevant amendments to Section 2.8 of the Code.

CIPFA/LASAAC is invited to provide its initial views on the approach in the ITC for statutory changes affecting local government financial reporting.

10 CIPFA Code of Practice on Transport Infrastructure Assets

10.1 CIPFA/LASAAC will be aware that last year it decided to confirm its approach to the future measurement of transport infrastructure assets in the 2014/15 Code and a new Appendix D was introduced in order to do this. This Appendix confirms that the measurement of transport infrastructure assets will be at Depreciated Replacement Cost for the 2016/17 year (on a full retrospective basis).

10.2 Last year CIPFA/LASAAC confirmed that it viewed this change as a equivalent to a change in IFRS and therefore has indicated[2] that Appendix C of the 2015/16 Code will require the disclosures necessary for a change required by a new standard that has been issued but not yet adopted. The normal process for introducing these changes is to include them in Appendix C in the year that this change is introduced. It is suggested that to avoid confusion that this process should not change as the anticipated disclosures are included in the Code in Appendix D. The ITC does raise a question on whether interested parties have any comments on this disclosure.

10.3 The Secretariat has also reiterated the position set out in Appendix D of the 2014/15 Code that authorities should use this time for preparation for the move and has referred to the LAAP Bulletin which will include a project plan to assist authorities with their preparations for such a move.

CIPFA/LASAAC's views are invited on the approach to the proposed wording in the Exposure Drafts and the ITC on the measurement of transport infrastructure assets.

11 Minor Amendments

11.1 The consultation responses to the accounting for schools consultation and subsequent enquiries have identified confusion in relation to the recognition of non-current assets. The Secretariat has already issued an informal technical alert on the issue but suggests that there should be some further clarification to Appendix E paragraph E.1.2. The technical alert is available here: http://www.cipfa.org/-/media/Files/Policy%20and%20Guidance/Panels/Local%20Authority%20Accounting%20Panel/Technical%20Accounting%20Alert%20%20Accounting%20for%20Schools%20Interim%20Clarification.pdf.

12 Other Issues

12.1 The Streamlining and Simplification project is considered at item 6 on this agenda. An outline of CIPFA/LASAAC's approach has been included in the ITC.

12.2 This and earlier consultations have sought respondents' views on improvements, rationalisation of accounting and disclosure requirements and other areas for further guidance in the Code. This section has therefore been retained in the ITC.

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[2] See 2014/15 Code Appendix D

recommendation

CIPFA/LASAAC is asked to provide its initial views on the:

1) Exposure Drafts of the 2015/16 Code; and
2) Invitation to Comment on 2015/16 Code.

HM TREASURY

FRAB (120) 02
3 April 2014

CIPFA The Chartered Institute of Public Finance & Accountancy

Financial Reporting Advisory Board Paper

IFRS 13 Fair Value Measurement

Issue:	At FRAB 119 the Board recommended that HM Treasury and CIPFA carry out further work on their proposals for distinguishing assets which should be subject to valuation using IFRS 13 and those that should not. This paper refines the approach proposed at that meeting to recommend a new principles-based approach for determining the use of IFRS 13 across the public sector.
Impact on guidance:	Yes, the FReM, Code and other Manuals would require amendment.
IAS/IFRS adaptation?	Yes. Adaptations are proposed to IAS 16 and IAS 38. No adaptations are proposed to IFRS 13.
Impact on WGA?	Yes
IPSAS compliant?	The draft IPSAS Conceptual Framework allows a range of measurement bases dependent on what is most appropriate for holding the entity to account and for decision making purposes. The proposals outlined in this paper are consistent with IPSAS.
Interpretation for the public sector context?	The proposed approach would require interpretations of IAS 16 and, if the approach is agreed, by analogy to IAS 38, for the public sector context.
Impact on budgetary regime?	Changes in asset values would impact on depreciation charges.
Alignment with National Accounts	Proposals retain alignment with national accounts. Current market prices are used for assets in the national accounts, but alternative valuation methods are allowed where an active market does not exist.
Impact on Estimates?	Changes in asset values would impact on depreciation charges.
Recommendation:	HM Treasury and CIPFA ask the Board to comment on the proposed approach to accounting for property, plant and equipment in the FReM and the Code following the introduction of IFRS 13, and the proposed next steps to support introduction in 2015-16.
Timing:	Adoption is proposed for 2015-16 to allow time for due process consultation with users and preparers this summer.

DETAIL

Background

1. The Treasury published Exposure Draft 13(01) on IFRS 13 in July 2013 which proposed that IFRS 13 should be adapted such that it did not apply to assets which were subject to restrictions on geographic location. After considering the responses to the exposure draft, the Treasury put forward a recommendation that IFRS 13 should be adopted in full with no adaption, but with enhanced guidance in the FReM to explain the restrictions that are likely to apply in the public sector.

2. The key issue identified by some FRAB members at the October 2013 meeting was that if the public sector is applying IFRS 13, then it is also necessary to subscribe to the principle of exit values which IFRS 13 is based on. The Treasury and CIPFA agree that exit values are not appropriate for most public sector assets, because they are specifically held for their service potential.

3. IFRS 13 could be used to produce valuations for assets held for their service potential, but, if fair value is not appropriate, then FRAB members suggested that the way forward could be to adapt other standards, in particular IAS 16, so that fair value is only used when it is appropriate. The key question is therefore 'when should fair value valuations be applied', rather than how IFRS 13 could be applied in all situations.

4. At the last FRAB meeting in December 2013 the Board were provided with a joint CIPFA/HMT paper which provided:

   - An overview of the current approach to the valuation of property, plant and equipment (PPE) in the FReM and the Code;
   - A summary of the objectives of the valuation basis for PPE; and
   - A suggested approach that could be taken forward to consultation to allow the introduction of IFRS 13 in 2015-16.

5. The paper proposed that the measurement objective for public sector assets that are used to provide services directly to the public should be to value their service potential and not their fair value. Conversely, the paper proposed that the measurement objective for public sector assets that are not used to provide services directly to the public, and which are not subject to restrictions which prevent the reporting entity from selling them, should be fair value in accordance with IFRS 13.

6. This approach has a number of practical difficulties which were identified by some FRAB members at the December 2013 meeting. In particular, there were questions about determining the boundary of assets providing services directly to the public, the unit of account and dealing with mixed-use assets, and handling changes in use.

7. This paper refines the approach put forward at the FRAB meeting in December 2013 to address practical difficulties, whilst still ensuring that the objectives of the valuation basis for PPE are met. The following sections set out the valuation objectives in more detail before considering how they can be best met. Two options are set out, including HM Treasury and CIPFA's final proposal that IAS 16 is adapted such that IFRS 13 applies to assets which are not held for their service potential and to surplus assets which can be disposed of.

Valuation objectives

8. The public sector has three primary objectives in valuing assets. These are:

   i. To provide incentives to support good asset management (in the past this also included an asset charging regime and this is still in place for the NHS);

   ii. To support intergenerational fairness by providing transparency over resources consumed; and

   iii. To align with the requirements in National Accounts to measure assets at current values.

9. To these we can add the broader objectives of financial reporting which are:

   iv. To provide financial information that is useful to those who provide resources; and

   v. To provide information that is useful to a wide range of users to permit them to assess the stewardship and accountability of management for the resources entrusted to them.[1]

10. The FReM and the Code currently adapt IAS 16 to remove the option to hold most assets at historical cost and to effectively require the valuation of all other assets on the basis of either existing use value (for non-specialised assets) or depreciated replacement cost (for specialised assets). These adaptations were made in order to support the objectives above and, in implementing IFRS 13, the Treasury and CIPFA are seeking to ensure that performance against these objectives is not reduced, and is enhanced where possible.

11. All of the options being considered by the Treasury and CIPFA maintain the use of current values and therefore valuation objectives (ii) and (iii) will continue to be met. This paper assesses the two options being considered against the remaining objectives, which are expanded on below, and based on whether they can be implemented in a clear and transparent way.

Incentives to support good asset management

12. The measurement of PPE in the UK public sector since the introduction of accrual accounting has sought to value the service potential or operational capacity of assets used to deliver goods and services. Service potential is of primary interest when managing public sector assets because the purpose of acquiring and holding assets within the public sector is to enable the delivery of services. This is therefore the basis on which those charged with the stewardship of assets and the management of these scarce resources are held to account.

13. Although management of service potential has been the primary driver of financial reporting, that doesn't mean that other aspects of good asset management are not relevant. For example, there will be cases where value for money could be improved by using assets differently, by disposing of surplus assets or by using an asset with a lower specification. It would be useful to have financial information to support these considerations. Local decision makers may choose to carry out property reviews to target their resources at those assets which are most likely to be available for sale.

14. It's worth noting in this context that the public sector has other sources of information in addition to financial statements and other controls and incentives to support good asset

[1] 2014-15 Financial Reporting Manual, paragraph 2.2.1

management. Therefore the options for financial reporting need to considered as part of a package of measures to support good asset management.

15. For example, the Government Property Unit (GPU) was created in 2010 and works across the public sector to deliver savings and to reduce the number of properties in the public sector estate, focusing on the central civil estate (i.e. office buildings). The GPU oversee national property controls, which do not allow lease renewals, sales or acquisitions on new properties without the Minister for the Cabinet Officer's approval. They work with departments to rationalise the central government estate and they have begun pilots with the Local Government Association to develop programmes of disposals in local authority areas. The GPU makes use of private sector benchmarking information for office costs and explicitly identifies that many departments may be able to operate just as effectively from a cheaper peripheral location as from the city centre. Since 2010, annual running costs of the central civil estate have reduced by £454 million.[2]

16. The budgeting system within central government also incentivises good asset management. Departments are allowed to re-invest the book value of assets disposed of and can use profits on disposal either to benefit their resource budget (up to a limit set by the Treasury for departments or unlimited for NHS bodies) or for capital investment. At Spending Round 2013 the Government announced that it would dispose of £5 billion of land and property between 2015 and 2020 and departments have signed up to individual targets which will be factored into their future settlements.

17. Local authorities have similar financial incentives for good asset management as it provides opportunities for efficiency gains, capital receipts and income streams. Measures have been taken to remove statutory restrictions on local authorities where they acted as disincentives for optimal decision making on capital programmes. For example, controls on the use of non-housing capital receipts have been abolished and the prudential system has been introduced.

Provision of information that is useful to those who provide resources

18. In the public sector, resources are provided by Parliament and, in the case of local authorities, also by local taxpayers. These resources are provided to allow organisations to deliver public services. Therefore, in order to be useful financial information needs to communicate the cost of delivering public services and information about the asset base used to deliver those services. Decisions on whether to provide resources for capital expenditure will be based on what is needed to support service delivery, taking into consideration opportunities for re-deploying or disposing of existing assets.

Provision of information for assessing the stewardship and accountability of management

19. Public sector organisations are accountable to Parliament, the general public, and other stakeholders. Organisations need to provide information to demonstrate that they are using public resources wisely. For assets, this will include information about whether the organisation is maintaining the required capacity to support service delivery, minimising losses and making the best use of assets.

[2] Source: Government's Estate Strategy, published June 2013

Restrictions versus constraints

20. Throughout this paper, references to 'restrictions' are taken to include statutory requirements for public consultations, fulfilment of regulatory obligations and Secretary of State approval. HM Treasury and CIPFA are clear that restrictions always need to be taken into consideration when valuing an asset. This happens at present and is also a requirement of IFRS 13.

21. The FRAB has previously discussed other constraints faced by public sector entities, which, although not based legislation, limit options for sale. These constraints include the need to provide a service within a specified area (e.g. schools), and political and public opposition to a sale.

22. The Treasury and CIPFA are concerned that if constraints are allowed to be considered in the choice of the valuation methodology, or the valuation produced, that this could add subjectivity to asset valuations. There is a risk that this subjectivity could be exploited and that it could result in significant difficulties for auditors.

Valuation options

23. In principle, the Treasury and CIPFA agree with the use of fair value when it is the appropriate measurement objective to support robust financial reporting. Treasury and CIFPA are conscious, however, that there are significant restrictions and constraints on accessing markets for many public sector entities and assets, and, in the case of restrictions, these need to be reflected in asset valuations.

24. At the October 2013 FRAB meeting, the Treasury suggested that IFRS 13 could be applied to all assets. This option was subsequently discounted on the basis that if IFRS 13 is being used to fair value assets then it is necessary to subscribe to exit values as the measurement objective which is a significant departure from previous public sector accounting practice. Further details on the rationale for not pursuing this option are provided in Appendix A.

25. At the December 2013 meeting, the Treasury and CIPFA proposed that assets that are used to deliver services directly to the public could be valued based on their service potential and other assets would measured at fair value in accordance with IFRS 13. However, as a number of Board members identified, there are significant practical difficulties with determining an appropriate boundary. The Treasury and CIPFA have concluded that such a boundary cannot be defined without introducing an unacceptable level of subjective judgement about whether an asset, or a component of an asset, is delivering services directly to the public.

26. Since the December 2013 meeting, the Treasury and CIPFA have considered what would be an appropriate, principles-based, boundary for categories of PPE that should be measured at current value, defined through adaptations to IAS 16, and those categories that should be measured at fair value in accordance with IFRS 13 without adaptation. This is set out as a final recommendation below and has been assessed based on the valuation and financial reporting objectives previously noted and practical considerations for implementation.

27. An alternative approach has also been considered which approaches the problem from the perspective of what valuation outcome is desirable for categories of asset (in particular "generic" office buildings) and setting requirements within IAS 16 to achieve this. This option is not recommended on the basis that it mimics exit values within IFRS 13, even though the option of applying IFRS 13 without adaptation has been dismissed on the basis that exit

values are not the measurement objective on which valuation methodologies should be based for assets held for their service potential within the public sector.

Option 1 – Adapt IAS 16, apply IFRS 5/IAS 40 to assets which are not held for their service potential and IFRS 13 for surplus assets on which there are no restrictions on sale (recommended)

28. HM Treasury and CIPFA's final proposal is to focus on whether an entity is holding an asset primarily for its service potential as an operational asset, or for financial returns either as an investment property or through being held for sale.

29. Assets are therefore first classified based on whether they are held for their service potential or not. Assets which are held for their service potential are then assessed as being in use or surplus.

30. All assets which are not held for their service potential are deemed to be being held for financial objectives and will be valued in accordance with IFRS 5 or IAS 40 depending on whether the asset is or is not being held for sale. References to fair value within IFRS 5 and IAS 40 will not be adapted and IFRS 13 will be applied in full. The existing FReM interpretation which withdraws the option of the cost model within IAS 40 will continue.

31. Assets which are held for their service potential will be assessed as being either in use or surplus. Assets which are held for their service potential and are in use will be valued in accordance with the existing adaptations of IAS 16 to determine a current value of their service potential. For non-specialised assets such as office blocks this will be market value in existing use. For specialised assets, this will be depreciated replacement cost on a modern equivalent asset basis.

32. The valuation of assets which are held for their service potential and are surplus will depend on whether there are restrictions on the asset's use or disposal. Restrictions here are taken to include public sector specific requirements such as the legal duty to consult on the disposal of an asset. If there are restrictions which would prevent the entity from freely disposing of the asset at the statement of financial position date by accessing the market, then the asset will be valued at current value in line with the existing adaptations to IAS 16. If there are no restrictions and the entity could access the market then the asset will be held at fair value under IFRS 13.

33. The rationale for valuing surplus assets which are subject to restrictions at current value based on their previous use under IAS 16 and not fair value under IFRS 13 is that this is likely to result in a higher valuation. Given the restrictions in place on surplus assets an IFRS 13 valuation reflecting those restrictions could result in a very low value. The benefit of this higher valuation is that it retains the financial management incentive to dispose of surplus assets.

34. This approach provides a useful distinction between assets which will continue to be held for their service potential and those which are being held for financial gain or are surplus and can be disposed of. Exit values are appropriate for this second group of assets which allows Treasury and CIPFA to commit to the principles of IFRS 13, IFRS 5 and IAS 40 and apply the standards in full when valuing this group. In particular, entities have access to the market for these assets and can therefore use market information for decision making. This approach does not force market valuations where an entity cannot freely access the market or when decisions about the utilisation or disposal of the asset would be primarily based on information about its service potential.

35. There are some practical difficulties to this approach but these are significantly less pervasive than with the proposal that was put to the Board at the December 2013 meeting. For example, assets may move between valuation categories when they are temporarily surplus. Where an asset has a history of moving between operational and non-operational use, or has only recently been made non-operational and the future status is uncertain, then clearly a strong argument for maintaining current value would exist.

36. Another consideration is multi-use buildings. While it is not expected that there will be a large number of examples of multi-use buildings which are partly used for their service potential (either to deliver front or back office services) and partly held for financial return it is clear that they do exist, for example where part of a building is used to earn rental income. Where they do exist, the guidance on multi-purpose properties in IAS 40 is relevant. If part of a building is not being used for operational reasons, there are no restrictions, and that part of the building can be separately sold or leased, then if material it should be recognised as an investment property under IAS 40 and held at fair value under IFRS 13.

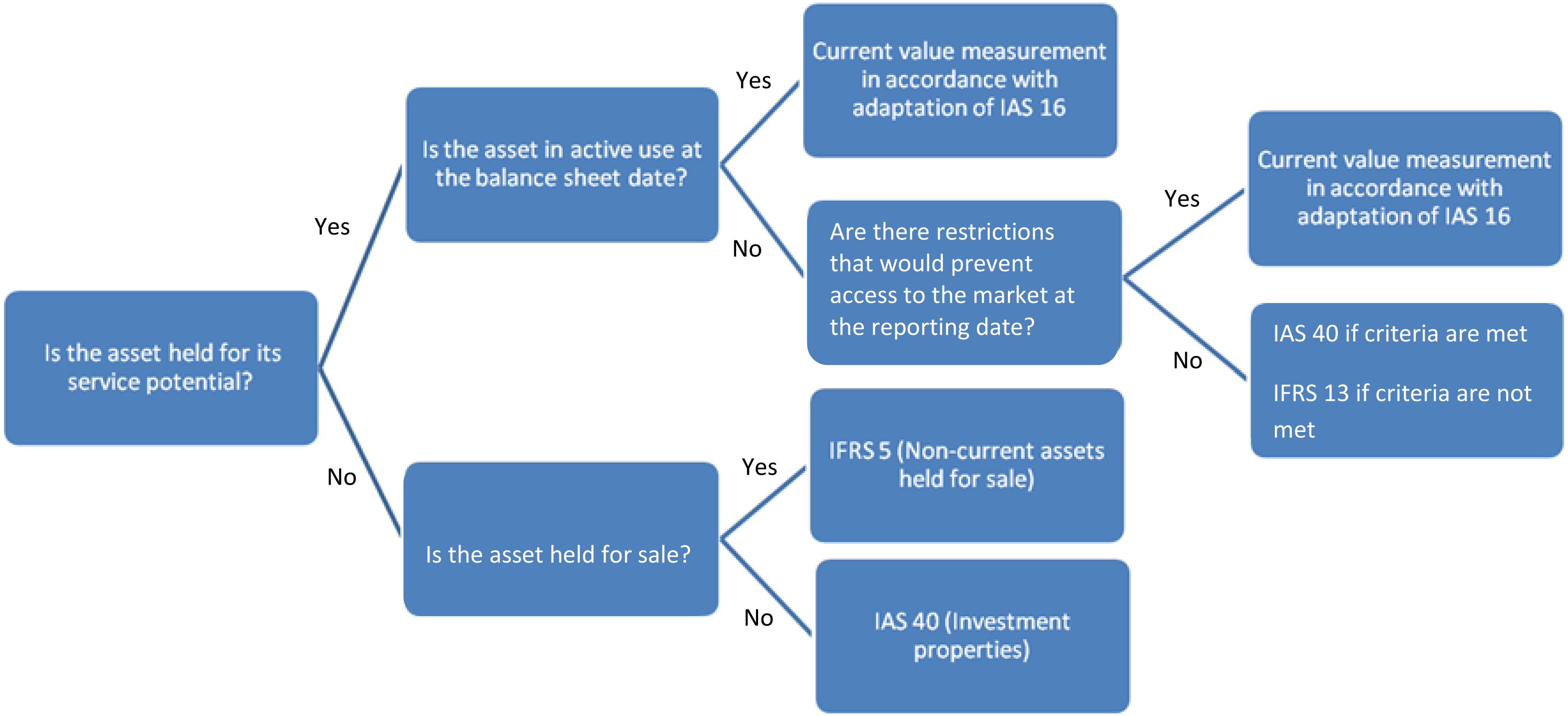
37. One perceived disadvantage of this approach that is recognised is that the values of non-specialised assets based on their current market value in existing use will sometimes be lower than an IFRS 13 "highest and best use" valuation. This may mean that incentives around the use or disposal of office buildings in prime locations may not be as strong as they would otherwise be. This is a necessary compromise in order to achieve a robust principles-based approach and to avoid subjective judgements about which valuation methodology should be applied. In practice, however, the current value in existing use may not be materially different to an IFRS 13 valuation and, even if significantly lower, would still signal to users of financial statements that the location is valuable. As noted open market valuations are also available to those who are making strategic decisions on the most efficient and effective use of the government's property portfolio.

38. On balance, this final proposed approach meets the accountability and decision making objectives of financial reporting by providing the right incentives for good asset management, particularly when supplemented by the other asset management controls and incentives which exist in the public sector.

39. A similar treatment would also be used for intangible assets. The existing interpretation in the FReM to IAS 38 removes the cost option and requires entities to adopt a revaluation model. The Code allows intangible assets for which there is no active market to be carried at cost less any accumulated amortisation and impairment loss, with those for which there is an active market being held at fair value. HM Treasury and CIPFA propose that IAS 38 is adapted to require intangible assets to be held at current value at the reporting date rather than fair value in their respective manuals. For the FReM this will either be market value or, where no active market exists, entities should revalue the asset to the lower of depreciated replacement cost and value in use where the asset is income generating. Where there is no market value in existing use, the asset should be valued using depreciated replacement cost. For the Code this will be market value where there is an active market or cost less accumulated amortisation and impairment where no market exists. If an intangible asset is held for sale then it will be accounted for under IFRS 5.

40. The decision tree for this option is set out on the following page.

Option 1 – Decision tree



Option 2 – Adapt IAS 16 to mirror valuations under IFRS 13, but without applying IFRS 13 directly (not recommended)

41. The perceived disadvantage of option 1 is that the values of non-specialised assets based on their current value in existing use will sometimes be lower than an IFRS 13 valuation. This second option is not recommended by the Treasury and CIPFA but has been developed to demonstrate how the disadvantage of option 1 could be overcome.

42. Under this option, IAS 16 would be adapted to set the valuation methodology for property, plant and equipment. This methodology asks three questions:

    - Are there any constraints or restrictions on the disposal of the asset?
    - Do these constraints or restrictions concern unique characteristics or legal restrictions?
    - Is there clear evidence that constrained by service needs to provide asset in a particular location or asset's market restricted by geographical limitations?

43. This methodology effectively mirrors IFRS 13 but with the additional consideration of constraints. All assets would therefore be valued based using the principles of IFRS 13 as imported into IAS 16 and taking into consideration any constraints on the asset. The outcome would be expected to be broadly similar to option 1, but with non-specialised assets such as offices valued based on their highest and best use if they are not subject to restrictions. This is illustrated on the following page.

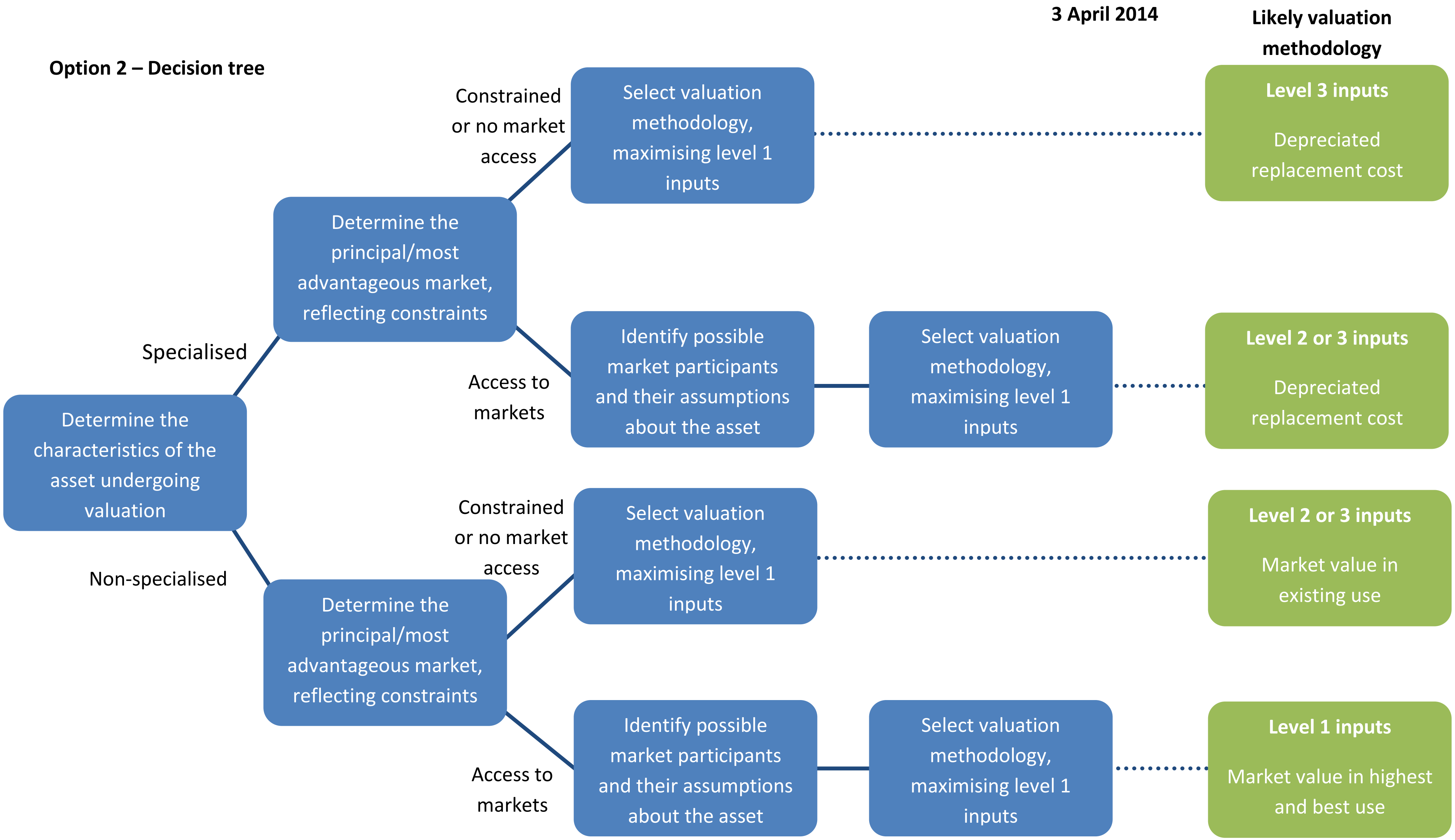
44. Although this valuation methodology may produce what may initially appear to be a preferable outcome for the valuation of non-specialised assets to support good asset management, the Treasury and CIPFA are unable to recommend it. The use of IFRS 13 without adaptation was discounted as an option on the basis that the public sector does not, on the whole, subscribe to exit values as assets are maintained in order to deliver services. Mirroring IFRS 13 within IAS 16 in this way and adding a consideration of constraints would result in the public sector applying a rules-based system without agreeing the exit value principle which those rules are based on.

45. The Treasury and CIPFA have sought to deliver a principles-based solution in option 1 that is based on the objective of holding an asset for its service potential, a long-standing principle of financial reporting in the public sector. There is no alternative principle behind option 2 if the principle of exit values continues to be discounted.

46. We are uncomfortable with setting valuation rules within IAS 16 which, without the exit value principle underpinning them, appear to be arbitrarily set to deliver a particular valuation outcome. In particular, this may lead to inconsistencies over time if the valuation rules have to be revisited or expanded. Therefore it will be necessary to retain this principle in order to guarantee that the methodology will continue to be internally consistent and rational.

47. Overall, this option is not fundamentally different to the option considered at the October 2013 FRAB meeting. Since then, the Treasury and CIPFA have gone back to first-principles, considering why fair values were first introduced in the public sector, and what the valuation and financial reporting objectives are. We consider that the valuations that this methodology would produce would support the achievement of valuation and financial objectives. However, the principle of exit values is in conflict with the primary reason that we introduced fair values into the public sector, which was to reflect service potential.

Option 2 – Decision tree



Comparison with the private sector

48. The typical valuation methodology that will arise from each of the two options that we have considered is set out below:

	Current valuation	Option 1	Option 2
Specialised assets	Remaining service potential, typically DRC	Remaining service potential, typically DRC	Mirrors IFRS 13 valuation, will typically give DRC
Non-specialised assets	Fair value in existing use	Dependent on whether assets are operational, see below	Mirrors IFRS 13 valuation, will reflect any restrictions and constraints
➔ Operational assets			
➔ Restrictions on the asset		Market value in existing use	Market value in existing use
➔ No restrictions on the asset		Market value in existing use	Highest and best use
➔ Non-operational assets			
➔ Restrictions on the asset		Market value in existing use	Market value in previous use
➔ No restrictions on the asset		Highest and best use	Highest and best use

49. The degree to which market information will continue to be used in valuing public sector assets compares well to the private sector where assets can be carried at cost less accumulated depreciation and impairment. The majority of UK firms elect to use historical cost accounting with impairment testing for property, plant and equipment after IFRS adoption.[3] Therefore, in recommending option 1, we expect that the public sector reporting will continue to demonstrate good practice and transparency in its valuation of assets.

Comparison with IPSASB

50. IPSASB issued their third exposure draft on the Conceptual Framework for general purpose financial reporting by public sector entities in November 2012. This exposure draft covers the measurement of assets and liabilities. For asset valuations, the exposure draft proposes that measurement bases may use either entry of exit values and concludes that the following measurement bases may be used:

- Historical cost
- Market value

[3] *Does Fair value Accounting for Non-Financial Assets Pass the Market Test?* (Christensen and Nikolaev, University of Chicago, November 2012) reported that in a sample of 934 UK companies subject to mandatory IFRS, only 5% of companies used fair value for at least one class within property, plant and equipment and no companies used fair value for any class of intangible assets.

- Replacement cost
- Net selling price
- Value in use

51. Following a review of consultation responses, IPSASB have agreed on the following measurement objective: *'To select those measurement bases that most fairly reflect the financial capacity, operational capacity and cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes'*.

52. The Treasury and CIPFA are satisfied that the option proposed meets IPSASB's criteria for selecting appropriate measurement bases.

Next steps

53. The Treasury and CIPFA intend to run a due process consultation over the summer to seek the views of users and preparers with the intention of incorporating IFRS 13 into the 2015-16 versions of the FReM and the Code. An illustrative Exposure Draft is included in Appendix B. The purpose of this illustrative Exposure Draft is to set out how the proposed changes could be incorporated into the FReM. The Exposure Draft will be reviewed by the FRAB Working Group before it is issued.

54. The Treasury and CIPFA will also work with the other relevant authorities to assess the likely impact of the proposed changes on valuations across central government, local government and health. An update will be provided at the next FRAB meeting.

Recommendation

55. The Treasury and CIPFA ask the Board to comment on the final recommended approach to accounting for property, plant and equipment in the FReM and the Code following the introduction of IFRS 13 on which exposure drafts will be developed, and the proposed next steps to support introduction in 2015-16.

HM Treasury and CIPFA

3 April 2014