The Chartered Institute of Public Finance & Accountancy

report

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Subject	Development Programme for the Code: IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*

To consider the development process and issues for the Code relating to the implementation of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers.*

1 Introduction

Introduction and Background

1.1 This report is intended to highlight the work of the relevant authorities with regard to the implementation of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. CIPFA/LASAAC will be aware that the Invitation to Comment (ITC) on the 2016/17 Code includes an overview of both standards and sought interested parties views on the approach to adoption. The report therefore also includes commentary on the feedback from the consultation questions (28 and 29) on the standards and identifies areas for consideration for CIPFA/LASAAC in preparation for implementation in the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code).

IFRS 9 *Financial Instruments*

1.2 The IASB has developed IFRS 9 in phases. It was first issued in 2009 with a new classification and measurement model for financial assets followed by additions in 2010 relating to requirements for financial liabilities and derecognition. In 2013, the Standard was amended to include anew hedge accounting model. It was finalised in July 2014 with the final version of the Standard, superseding all previous versions. The new standard has an effective date of 1 January 2018.

IFRS 15 *Revenue Recognition from Contracts with Customers*

1.3 IFRS 15 was issued in May 2014. The Standard will replace IAS 18 *Revenue* and IAS 11 *Construction Contracts* and a number of related interpretations. Following a consultation by the IASB on deferral, the effective date of the standard is 1 January 2018. IFRS 15 applies to all contracts with customers (except those within the scope of IAS 17 *Leases*, IFRS 9 *Financial Instruments*, the Group

Accounts Standards and IFRS 4 *Insurance Contracts* and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers).

2 Relevant Authorities

Technical Working Groups

Background

2.1 CIPFA/LASAAC Members will be aware that the Secretariat has been working with HM Treasury and the other relevant authorities on the adoption of both IFRS 9 and IFRS 15.

2.2 Following the June FRAB meeting under the new ways of working with the relevant authorities HM Treasury established two technical working groups (TWGs) on which CIPFA is represented. These groups met very rapidly over the summer to discuss the issues arising and particularly transitional issues.

Local Authority Practitioner Input/Representation (IFRS 9)

2.3 The Secretariat was particularly concerned to arrange local authority practitioner representation on the group to discuss the issues arising on IFRS 9 and was able (at short notice) to gain support from an authority with the likelihood of having the more complex financial instruments ie Transport for London, Ms Rachel Shaw.

2.4 The Secretariat is of the view that the practitioner representatives needed to have substantial treasury management experience as well an effective knowledge of the accounting issues that arise as a result of this complex standard. The Secretary understands that significant help was received from the Capital and Treasury Management Panel on the adoption of the financial instruments standards in the Code's predecessor publication (the SORP) in 2007. It was also opportune that the Capital and Treasury Management Panel met at the end of July. We have therefore secured two volunteers via that Panel: Ms Karen Gilfoy from Manchester City Council and Mr Dean Pletts from Basingstoke and Deane Council (a previous CIPFA/LASAAC Member) though unfortunately Mr. Pletts could not attend the last meeting.

Consultation issued to Finance Directors of Central Government Departments

2.5 Following the discussions of the TWGs HM Treasury has issued consultation papers which were sent to Finance Directors of Government Departments on 1 October 2015. These consultation papers include some of the issues identified by the TWGs and are attached to this report at Appendix A. The Secretariat would stress that the consultation papers do not present the views or any decisions made by HM Treasury as the relevant authority but the feedback from this initial impact assessment will be reported to the FRAB in November. The CIPFA Secretariat had an opportunity to comment informally on the consultation papers.

2.6 CIPFA/LASAAC members may find it useful to read the consultation papers as they provide a summary of the standards and implementation issues identified by the TWGs.

3 Consultation Responses

IFRS 9

Classification of Financial Assets

3.1 The IFRS 9 question received more responses than the IFRS 15 paper and 28 respondents provided substantial comments from local authorities, with two respondents choosing only to respond to this question in the ITC. The relevant commentary has been included in Appendix B to this report so that CIPFA/LASAAC can see the detail of the responses and the concerns that they raise. It is notable of these 28 responses six responses were very similar and therefore the Secretariat has included detailed comments from only one of the respondents as representative of all six.

3.2 A number of the respondents raised the issue cited in the consultation that the introduction of IFRS 9 will see the removal of the Available for Sale classification in the Code (which is the "default category" under IAS 39) and allowed gains and losses to be held in reserves until realised. The respondents were concerned that the default category under IFRS 9 is "fair value through profit or loss" and thus adoption may result in gains and losses through the Comprehensive Income and Expenditure Statement hitting the Surplus or Deficit on the Provision of Services as they arise.

3.3 The respondents considered that paragraph 5.7.5 of IFRS 9 permits entities to irrevocably elect to recognise to on equity instruments as "fair value through other comprehensive income". The respondents highlighted the current prohibitions against designation in the Code and commented that if the Code does not permit the designations in paragraph 5.7.5 there may be unwanted volatility if these instruments were to be classified as "fair value through profit or loss".

3.4 Unfortunately, this commentary does not set out the full position of IFRS 9. The Secretariat understands from the discussions at the TWG that the designation was originally intended for investments held in equity instruments that were held for strategic purposes and not for investment returns. It should be noted that designation in this category will mean that gains and losses are not recycled on disposal. The cumulative fair value changes are required to remain in Other Comprehensive Income and are not recycled to profit or loss. Entities have the ability to transfer amounts between reserves within equity. For local authorities the equivalent would be a transfer to the General Fund Balance via the Movement in Reserves Statement.

3.5 The Secretariat considers that this designation might be appropriate for some strategic investments held by local authorities (eg in bus or airport companies) but there is a question of whether not recognising gains or losses on disposal in the Comprehensive Income and Expenditure Statement will truly reflect the economic reality of the investments discussed by the respondents (pooled bond funds[1]). Paragraph 5.7.5 requires that the equity instruments so designated should not be held for trading. From the descriptions provided by respondents it appears that they do meet that criterion. However, it is not clear that these instruments should be classified in a measurement class where gains or losses are not recognised in the Comprehensive Income and Expenditure Statement. There is a counter argument that this is permitted by IFRS and there appear to be no other

[1] A number of authorities commented on their use of pooled funds which included the use of Money Market Funds and noted the efficiency of these investment mechanisms including the wide diversification of risk.

qualifications about the purpose for which the investment is held ie there is no qualification test that the investment has to be held for strategic purposes and therefore authorities should be allowed to make their own decisions under the standard.

3.6 The commentaries on the classification focus on the treatment of the pooled bond funds which respondents deem to be equity instruments. They do not consider the IFRS 9 classification tests ie the business model tests (hold to collect/or hold to trade) and the 'solely payments of principal and interest' (SPPI) contractual cash flow characteristics tests. Interestingly the consultation papers to Finance Directors in Government Departments includes an observation of the TWG that "*Preparers should not start from the assumption that there will be an effortless mapping from IAS 39 and they should be considering how instruments are managed and the contractual cash flows (and variations of cash flows) of the instruments*."

Expected Impairment Loss Model

3.7 There seem to be a reasonably diverse range of views on the impact of the expected loss model on the financial instruments held by local authorities. Some respondents consider that this will not overly change the profile of impairment recognition. Other respondents indicated that the lifetime expected model on trade receivables will be significant for authorities and that the 12 month expected losses model might be significant for some authorities particularly in times of economic down-turn. A number of respondents cited the possible impact on the collection fund for non-domestic rates and council tax receivables.

3.8 IFRS 9 includes within its scope rights and obligations within the scope of IFRS 15 *Revenue from Contracts with Customers*. Council Tax and income from National Non Domestic Rates itself do not meet the definition of income under IFRS 15 and instead meet the definitions of Tax in IPSAS 23 *Revenue from Non-Exchange Transactions* (Taxes and Transfers).

3.9 The Code currently includes an adaptation of IAS 39 "*ie revenue relating to such things as council tax, general rates, etc shall be measured at the full amount receivable (net of any impairment losses) as they are non-contractual, non-exchange transactions and there can be no difference between delivery and payment dates*". This adaptation still includes impairment losses. CIPFA/LASAAC will need to consider whether the expected impairment loss model will be consistent with the economic effect of council tax income streams or whether the non-financial asset receivable should be impaired under another standard.

IFRS 15

3.10 There was much less commentary provided in relation to IFRS 15 with most of the detailed commentaries supporting CIPFA/LASAAC's initial view that there was no substantial need to adapt or interpret IFRS 15 for local government circumstances. No respondents raised any particular application issues of the type mentioned in the ITC ie around issues where practice may change and particularly in situations where there is uncertainty about whether revenue should be recognised at a point in time or over time.

3.11 One respondent agreed with CIPFA/LASAAC that local authorities would need to start considering the contracts on their contracts register to evaluate any issues that might arise. This same respondent considered that with the need to look for other sources of income local authorities may need to have a closer regard for the provisions of IFRS 15. A small number of respondents noted the preparations that would need to be made for the new disclosure requirements with one respondent indicating concern at the increase in disclosures.

Transition for both IFRS 9 and IFRS 15

3.12 An issue not considered by respondents to both consultations is the transition requirements of both standards. This is considered in more detail in the HM Treasury consultation papers attached at Appendix A. The Secretariat would note that the transitional requirements for IFRS 9 are complex. The main transitional provisions are outlined in the HM Treasury papers.

3.13 The Secretariat's early views coincide with the views given in the consultation papers as for both standards they ease the burden for accounts preparers and there are valid technical arguments supporting the approaches. However, the Secretariat has made it clear at the various meetings that these are not the views of CIPFA/LASAAC as the Board is in the early stages of consideration of the feedback from interested parties to the consultation. In addition, CIPFA/LASAAC could decide to implement in accordance with the standard and leave the decision with accounts preparers.

4 Classification Summary

4.1 The Secretariat has undertaken an early analysis of the classification of local authority financial assets and liabilities. This is available at Appendix C. It has identified the current treatment of the main classes of financial assets and liabilities and compared it with the possible classifications under IFRS 9. This has largely been a desk top exercise developing from the current approaches in CIPFA application guidance but it has also examined a number of treasury management strategies to identify the types of financial assets used. The Secretariat would agree with the views of the Technical Working Group that it is not a simple transfer from one class of assets to another.

CIPFA/LASAAC's views are sought on this early assessment.

5 Future Approach to Adoption in the Code

5.1 The Secretariat would highlight that both IFRS 9 and IFRS 15 will require some significant lead in time for authorities to effectively apply the standards to the 2018/19 financial statements.

5.2 IFRS 9 is a very complex standard and even its transitional requirements are detailed and will need careful consideration by local authorities. It is likely that local authorities will need time to consider their financial instruments for reclassification purposes and will need to develop system and information requirements to be able to estimate the expected loss model which may have a budgetary impact on local authorities.

5.3 New information requirements and collection systems will be needed under IFRS 15 for the disclosures and as noted in the ITC on the Code local authorities should review their contracts registers to ensure that if the new standard does have any budgetary impact the authority will be able to make relevant changes.

5.4 The Secretariat therefore considers that it will be important that local authorities are made aware of these changes and to enable them to prepare effectively that the standards should be included in the 2017/18 Code in an Appendix (with a clear application date for 2018/19).

Recommendation

CIPFA/LASAAC's is invited to provide its views on the application issues contained in this report and the Appendices. Its views are also sought on the approach to adoption in the Code for these two substantial standards.

Responses to Question 29

Do you consider that there will be any particular application issues for the adoption of IFRS 9 *Financial Instruments* with regard to the financial instruments held by local authorities? Please set out what you consider these issues will be and the potential impact on adoption of the standard by the Code.

Detailed Commentaries
We believe that there could be significant implications for the adoption of IFRS 9. We don't think that the move to an "expected loss" model for the Impairment of Financial Assets will be beneficial in respect of investments. Expected loss on investments cannot be estimated in the same way as for trade receivables. Whilst it may be possible to make an overall assessment of the likely "expected loss" for trade receivables, the smaller number of investment balances and diverse nature of the organisations with whom local authorities invest, means that any assessment of expected loss will be largely an academic exercise. One way that authorities might make the assessment is to apply an average default rate by credit rating type. This is unlikely to reflect investment loss in any particular organisation. As things stand existing reporting requirements on the credit risk of Financial Instruments ought to suffice. We understand that under IFRS 9 the default category for equity instruments would be "fair value through profit or loss". If this resulted in the fluctuation in the value of equities held for operational purposes being taken to revenue there would be unwelcome volatility (both "positive" and "negative") within the General Fund. In recent years Council equity investments have been re-valued by approximately £50m.
The application of IFRS9 (as per para 133 of the ITC) could have an adverse impact upon the collection fund and LA's breaking the capping criteria and having to go for a referendum. For example, we all assume a collection rate for calculating the council tax base. Some LA's might have a policy to maximise the income immediately, aware of the potential council tax deficit the following year. As we are looking at the expected loss model and we a charging the 'working poor' (and we know that the benefit changes will have an adverse impact upon their levels on income) a percentage of council tax and we know the collection of that is poor, or actual overall collection rates are poor, this would have to be reflected in the taxbase. This has ramifications upon not only the billing authority, the county, police and fire authorities as less money will be generated. At present we utilise the historical appeals information provided by the VOA to determine the likely impact upon the billing authority of business rate appeals. If IFRS9 was implemented, how would we calculate the potential reduction in business rate yield. This could have significant impact upon the total yield generated and require the government to borrow money to fund services in the short term. This issue will certainly raise its head and financial impact both on the 2017 revaluation and the 2020 re-set of baseline/nndr funding levels. Whereas we have some reliance upon the current 'settled' (agreed, dismissed, withdrawn etc), basis of calculation, potentially each local authority would have its own methodology and that may also increase the level of audit work, assurance and of course the amount of audit fees. It will be interesting to see this model demonstrated either at a relevant technical update day. or by FAN at some future session as it could have a significant impact and might be something that has to be included within the narrative report.

The Council holds a wide range of investment instruments (pooled funds, including money market funds, bond and equity funds) that will fall within the IFRS 9 definition of an equity investment. These investments are held with a 3-5 year investment horizon as the longer period is the only way to judge individual performance on these funds. These funds are currently accounted for as Available for Sale instruments (IAS 39 category). The very nature of the variable net asset value of these pooled funds means they can have significant swings not only between years but between days or weeks. By taking the value at an arbitrary single day, in this case the 31st March, and taking their fair value through P&L as is proposed under IFRS 9, significant volatility will be experienced in the general fund. An unrealised profit of around £1m in 2014/15 across all funds is, due to 'mark-to-market' valuation, showing a negative in 2015/16 to end of September of around £400K. Unrealised gains and losses currently do not affect the General Fund. CIPFA's 2016/17 Code, as currently drafted, does not seem to allow present unrealised gains and losses on equity instruments in Other Comprehensive Income despite paragraph 5.7.5 of IFRS entitling a body to make such an election albeit irrevocably. This is an extremely unwelcome effect and will add to considerable volatility to the General Fund. I am very concerned that the overly prescriptive adoption of IFRS 9 will lead to a loss of appetite for pooled funds as authorities seek to minimise short term accounting risk against long term gains due to the variable net asset value of these funds. Despite their relative volatile nature (arising from their variable net asset value (VNAV) and the variability in the daily mark-to-market), they have significant treasury management advantages and avoid many of the problems and risks associated with direct investments such as the case when authorities were investing directly in Icelandic Banks. A spread of investment risks militates against this likelihood as well as ensuring expert professional management. It is also perverse if pooled funds are required to be taken to the General Fund when changes to directly owned bonds and properties are not. Indeed it could be argued that this does not present a fair view of the Council's financial affairs in any one year. I am further concerned that a full implementation without transition will see the need for an immediate establishment of a volatility reserve to smooth out the likely swings in pooled funds. Not only will this be difficult to establish in the light of the constraints on public finances, the scale of the reserve will be difficult to quantify, but without this a prudent view of potential unrealised losses on these funds would mean some caution when establishing the council tax for any year and no doubt further criticism from Government either over the level of cuts or the scale of reserves. This again will put political pressure on withdrawing from these funds even if professionally and prudently they are the right investment for this Council and other local authorities.
The change for equities and pooled funds could see unrealised gains and losses that were previously taken through Other Comprehensive Income and Expenditure being taken to Financing and Investment Income and Expenditure instead (thereby resulting in volatility in charges against the General Fund). It is not clear whether, as a consequence of adopting the 'expected loss' model for impairments, authorities would be required to provide for impairment losses on the basis of the historical default rates, even if there is no other evidence to indicate that default is likely.
On one hand there is the removal of volatility in other comprehensive income in changes in credit risk to financial instruments held at fair value. However, the expected loss impairment model could introduce more volatility if expected credit losses are recognised earlier before being incurred (and are themselves subject to fluctuations).

The primary change will be the removal of the Available for Sale option for financial assets, effectively leaving only Loans and receivables and Fair Value through the P&L. For those who use the Available for Sale option it protects the CIES from fluctuations in market value, showing these in a balance sheet reserve, as opposed to the Fair Value through the P&L, whereby losses and gains hit the CIES in year. If local authorities hold assets in Available for Sale, such as property funds, they will need to be aware of, and have explained to Members, that any change in value my incur revenue losses. If this aspect is unpalatable then the instruments should perhaps not be used.
Based on an initial review, we do not consider there will be any significant application issues for the adoption of IFRS 9 Financial Instruments. We are aware that some local authorities hold investments in unit trusts that are currently classified as Available for Sale under IAS 39. These councils will need to review the terms and conditions of their investment to determine if the investment meets the definition of equity and hence can continue to be account for the instrument as fair value through OCI (in which case changes will be less significant) or otherwise measurement at fair value through profit and loss will be required. As IAS 26 requires pension funds to hold their investments at fair value we do not expect to see significant change in pension fund annual accounts.
Based on our early consideration of IFRS 9 in the local authority context we have not identified any substantial issues that would require interpretation or adaptation in the Code. We note and support CIPFA's view that local authorities start to consider their contractual arrangements and consider that further guidance may be required to enable preparers to consider the implications. One of the key issues identified by CIPFA relates to the "expected loss impairment model" resulting in earlier and more timely recognition of expected credit losses. A number of local authority debts are not financial instruments as they arise from statute rather than contract eg council tax and business rate debtors. CIPFA may wish to consider whether the principles in IFRS 9 should be applied to non-financial instrument debtors.
We do not envisage any particular application issues for local authorities or local government pension schemes in adopting IFRS 9.
The application of IFRS9 (as per para 133 of the ITC) could have an adverse impact upon the collection fund and LA's breaking the capping criteria and having to go for a referendum. For example, we all assume a collection rate for calculating the council tax base. Some LA's might have a policy to maximise the income immediately, aware of the potential council tax deficit the following year. As we are looking at the expected loss model and we a charging the 'working poor' (and we know that the benefit changes will have an adverse impact upon their levels on income) a percentage of council tax and we know the collection of that is poor, or actual overall collection rates are poor, this would have to be reflected in the tax base. This has ramifications upon not only the billing authority, the county, police and fire authorities as less money will be generated. It will be interesting to see this model demonstrated either at a relevant technical update day. or by FAN at some future session as it could have a significant impact and might be something that has to be included within the narrative report.
Classification and Measurement: We hold many investments that would fall under the classification of an equity

investment. These include Money Market Funds - balance at 31 March 2015 was £6 million, although this does fluctuate so could be significantly higher, and several Pooled funds (including a property fund) - balance at 31 March 2015 was £16.6 million. We do not currently have direct holdings of company shares, but anticipate we will in future. Any unrealised gains or losses are currently transferred to the Available for Sale reserve and as such do not go through the Surplus or Deficit on the Provision of Services, as would be required under IFRS9. If the change comes in as stated in IFRS9 without any changes to the 2017-18 Code to allow us to elect to present unrealised gains and losses in Other Comprehensive Income, we are subject to volatility to the General Fund and therefore Council Tax. This is clearly something we would want to avoid. We chose to invest in pooled bond and property funds to increase the diversification of risks in our portfolio and by employing specialists who manage those funds, we are allowing experts in the field to manage some of our cash. The fair value of directly owned property (which we do have) and bonds are not subject to this accounting change. Why would they be treated separately? - by using the funds we are able to access parts of the market we would not otherwise be able to, and we should not be penalised for spreading our investments. Expected loss model: Moving from the incurred loss model to the expected loss model in IFRS9 will mean we will have large allowances for losses on debtors and investments charged to the General Fund. We believe that we mitigate risks of losses across these areas. For example, we have bad debt provisions already going through the General Fund. Bad debt provisions are specific to our experiences, and are based on our knowledge of our services and historical performance. We believe that by applying a wholescale loss formula is overly prudent. With regards to leases we mitigate risk by checking the financial standing of our tenants, insist on rent deposits and charge rent in advance. With regards to investments, we have a number of risk measures, and a detailed investment policy approved at Council on an annual basis, with regular reviews, aimed at reducing the risk of credit losses. We believe the cost to the General Fund will have a direct impact on our services, in an already challenging time for Local Authorities.
The new criteria for financial assets could give rise to issues for loans and investments which are made for service delivery purposes rather than for treasury management purposes, i.e. where the objective is not to collect cash flows. it would seem inappropriate to measure these at fair value.
Potential impact on CIES of removal of Available for Sale category which is currently used for Airport Company. Any changes in valuation will impact on the bottom line of the CIES.
If the available for sale category is no longer available the effect of changes in value of these assets will be recorded in the year they occur rather than the year of sale - could lead to increased volatility in charges to the CIES. Clarification will be required on whether investments in group entities (including those excluded on materiality grounds) will continue to be able to be held at cost rather than value. This could have significant implications. Change in recognition of impairment of assets could have implications for the CIES resulting in costs being recognised earlier.

There may be significant application issues regarding adoption of IFRS9 for local authorities as many LAs will hold investments that fall within the IFRS9 definition of an equity instrument. Due to the changes this could lead to volatility to the General Fund and hence Council Tax.

Transition from the incurred loss model for impairments in IAS39 to the expected loss model in IFRS9 may see a large allowance for losses on debtors and investments charge to the General Fund.

Further work would need to be done on the expected value of the impact for LAs.

No major issues. We understand that the three main areas of change relate to Available for Sale financial assets, where gains and losses will have to be recognised each year; Impairment of financial assets, where expected losses will be reported rather than incurred losses; and hedge accounting, which is not expected to have a significant impact on local authorities.

There are two main issues with IFRS 9 that we believe could have a million pound impact upon individual local authorities' General Funds.

1. Financial Assets – Classification and Measurement

Many local authorities hold investments that fall within the IFRS 9 definition of an equity instrument, including money market funds, bond funds and property funds, as well as direct holdings of company shares for service purposes. The default category for equity instruments in IFRS 9 is "fair value through profit or loss", which requires unrealised gains and losses to be posted to the Surplus or Deficit on the Provision of Services. This is a change to current practice, since the current Code requires such instruments to be categorised as "Available for Sale", where unrealised gains and losses are presented in Other Comprehensive Income and posted to an unusable reserve.

However, paragraph 5.7.5 of IFRS 9 permits entities to irrevocably elect to present unrealised gains and losses on equity instruments in Other Comprehensive Income. The current Code does not permit local authorities to make several of the elections in IAS 39; however if the 2017/18 Code does not permit local authorities to make this election it will add much unwelcome volatility to the General Fund and hence Council Tax.

There are distinct treasury management advantages to owning pooled bond funds and property funds over direct ownership of bonds and investment properties, including the wide diversification of risks and expert fund management. It would be counterintuitive if the overly restrictive adoption of IFRS 9 disadvantaged pooled funds, requiring changes in their fair value to be taken to the General Fund when changes in the fair value of directly owned bonds and properties are not.

2. Impairment of Financial Assets

The transition from the incurred loss model for impairments in IAS 39 to the expected loss model in IFRS 9 may see a large allowance for losses on debtors and investments charged to the General Fund. Accounting for lifetime expected losses on trade receivables will probably be significant for all authorities at all times, while accounting for 12-month expected losses on investments and lease receivables may be significant at the time of the next recession for some authorities. We are aware that some authorities already create a general provision for doubtful debtors on initial recognition, which while not consistent with IAS 39 may provide some protection against the new arrangements. Some form of transitional protection

would appear appropriate.
This is an area we have raised during our seminars and with clients over a number of years. The primary change will be the removal of the Available for Sale option for financial assets, effectively leaving only Loans and receivables and Fair Value through the P&L. For those who use the Available for Sale option it protects the CIES from fluctuations in market value, showing these in a balance sheet reserve, as opposed to the Fair Value through the P&L, whereby losses and gains hit the CIES in year. If clients hold assets in Available for Sale, such as property funds, they will need to be aware of, and have explained to Members, that any change in value my incur revenue losses. If this aspect is unpalatable then the instruments should perhaps not be used.
Further clarity on the accounting on unrealised gains or losses on equity investments would be required as these would appear to have an impact on the CIES and may make accounting for fairly simple investments overly complicated. Also, would anticipate a significant adjustment to be required for the transition to the expected loss model and would require further guidance on how this would affect local authority accounting.
Unless an election is made that movement in the value of equity instruments (currently classed as available for sale) is posted to Other Comprehensive Income and Expenditure then changes in market value is likely to see large fluctuations in revenue gains or losses posted to Surplus or Deficit on Provision of Services each year.
By removing Financial Assets Available Sale will mean that those financial instruments ie LA Property Fund, shares in Municipal Bond Agency, bonds etc, will be FV through P&L, will result in any gains and losses impacting on the CIES. This is not consistent with other assets held at valuation ie non-current assets, pensions fund assets and currently FA Available For Sale where they are reflected in reserves.
The potential impact on the Council would be limited as we currently don't have any investments classified as Available for Sale. However, our concern would be the level of volatility of what may go through the CIES as a result of the change. As fluctuations in market value would hit the CIES.

Financial Instruments held by Local Authorities

Financial Assets

Financial Asset (Type of Instrument)	**Current Code Classification (under IAS 39)**	**Measurement**	**Anticipated IFRS 9 Measurement**	**Impairment**
Loans and cash deposits (*Local authority and pension fund financial statements*)	Currently classified as **Loans and receivables**	Initially recognised at **fair value** and subsequently at **amortised cost** less an impairment for losses where incurred.	**Amortised cost** *No change* (It is anticipated that for these financial instruments that both the 'business model' and 'cash flow characteristics' tests will be met)	Expected impairment model will apply. This is likely to have a budgetary effect on local authorities.
Investments held by local authorities, examples include: ▪ Investments in gilts ▪ Term deposits from UK government and local authorities ▪ Term deposits held by banks, ▪ Money market funds ▪ Reverse repurchase agreements, ▪ Debt securities, ▪ Loans, bonds and bills issued or guaranteed by national governments, regional and local	Currently the Code would assume that these investments should be classified as **available for sale financial assets** The Code prohibits designation to fair value under profit or loss for consistency. Local authorities are not expected to hold investments purely for the purpose of trading in them.	**Fair Value** (movements held on revaluation reserve until the gain/loss is realised or until impairment is incurred)	Either: ▪ **amortised cost** if the authority meets the 'business model' and 'cash flow characteristics' tests, or ▪ less commonly **fair value through profit or loss,** and ▪ in even more rare circumstances and where the business model applies **fair value through other comprehensive income**. *Depending on the results above this could lead to a change in accounting policy and reclassification. This may have budgetary consequences.* The local authorities TM strategies reviewed aimed to ensure: ▪ security of the sums invested ▪ cash (and resources) are available to support expenditure plans over the short and longer-	Expected impairment model will apply to those (other than fair value through profit or loss), this is likely to have a budgetary effect on local authorities with the exception of those financial instruments measured at fair value through profit or loss.

Financial Asset (Type of Instrument)	Current Code Classification (under IAS 39)	Measurement	Anticipated IFRS 9 Measurement	Impairment
authorities and multilateral development banks, ▪ Corporate bonds, and ▪ Commercial papers.			term ▪ investment returns are maximised commensurate with the authority's policy of minimising risks to the security of capital and its liquidity position This above approach may mean that local authorities' TM strategies will meet both the hold to collect model and the contractual cash flows test and therefore measurement should move to amortised cost. There are sales of financial assets (at least infrequently) and local authorities will need to demonstrate that they meet both elements of the amortised cost measurement categorisation test. If they do not meet that test under an unadapted IFRS 9 local authorities would also have to consider whether they meet the business model test for fair value through other comprehensive income for debt instruments ie by both collecting contractual cash flows and selling financial assets. It is considered unlikely that most local authorities would meet this test but if so they would be classified as fair value through other comprehensive income (for debt instruments). However, local authorities have to assess under which model they hold the investments. If they meet neither of the business model tests the financial instruments should be held at fair value through profit or loss.	

Financial Asset (Type of Instrument)	**Current Code Classification (under IAS 39)**	**Measurement**	**Anticipated IFRS 9 Measurement**	**Impairment**
Investments held by pension funds	Currently most pension fund financial assets (that are not derivatives) are measured at fair value through profit or loss.	**Fair value through profit or loss**	The Treasury Management policies/activities for pension funds are different from those of the main local authority TM activities/policies Sales of financial assets are not likely to be considered infrequent for pension funds and therefore measurement is unlikely to be at amortised cost. It is also unlikely that the business model is precisely to hold to collect and sell/trade as the business model for pension funds is not specifically to trade and therefore measurement is unlikely to be fair value through other comprehensive income. It is likely therefore that the classification of financial assets will be at fair value through profit or loss as the residual category.	
Derivatives (with the exception of TfL CIPFA is not aware that local authorities undertake hedge accounting).	Not many local authorities hold derivatives. Where they do they will be classified as **held for trading**.	**Fair value through profit and loss**	*No change* **Fair Value through profit or loss**	
Derivatives held by pension funds	**Held for trading**	**Fair value through profit and loss**	**Fair value through profit and loss**	

Financial Asset (Type of Instrument)	**Current Code Classification (under IAS 39)**	**Measurement**	**Anticipated IFRS 9 Measurement**	**Impairment**
Equity investments	**Available for sale**	**Fair Value**	**Fair value through profit or loss** However, CIPFA/LASAAC might wish to consider whether it wishes to permit authorities that hold these shares to designate them as Fair Value through other Comprehensive Income (NB this is an irrevocable designation).	
Equity investments held by pension funds	**Available for sale**	**Fair Value**	**Fair Value through profit or loss**	

Financial Liabilities Recognised in Local Authority Balance Sheets under IAS 39 and IFRS 9 (local authority financial statements and pension fund statements)

Financial Liability (Type of Instrument)	**Current Code Classification (under IAS 39)**	**Measurement**	**Anticipated IFRS 9 Measurement**
Loans: The main lender to local authorities is the Public Works Loan Board though some authorities do obtain loans from banks. With the exception of derivatives with a negative value and financial guarantees all other financial liabilities recognised in local authority balance sheets are measured at amortised cost.	Trade and other payables Under IAS 39, an entity can also choose to designate a financial liability as at fair value through profit and loss that would not by definition be required to be so classified, but the Code does not permit this.	**Amortised cost**	**Amortised Cost**

Financial Liability (Type of Instrument)	**Current Code Classification (under IAS 39)**	**Measurement**	**Anticipated IFRS 9 Measurement**
Derivatives with negative values (few local authorities hold derivatives)	Financial liabilities measured at fair value through profit or loss.	**Fair value through profit or loss**	**Fair value through profit or loss**
Financial Guarantee Contracts	Financial Guarantee Liabilities (or provisions if measured in accordance with IAS 37)	Initially measured at fair value, then at the higher of the amount initially recognised and the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Assets, less cumulative amortisation.*	Initially measured at fair value, then the higher of: ▪ The amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* ▪ The amount initially recognised, less (when appropriate) cumulative amortisation recognised in accordance with IFRS 15.

Fuller list of financial assets held by authorities

Deposits with the Debt Management Agency Deposit Facility
Treasury Bills, UK Government Gilts and Gilt funds
Term deposits – UK government and other Local Authorities
Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks
Temporary deposit with an approved institution of the Bank of England or with any other approved organisation for investment (see below)

Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations.
Term Deposits with UK Banks and Building Societies (fixed or variable rate/long (in excess of a year) or short term)
Term deposits with variable rate and variable maturities up to one year e.g. structured investment products (with banks)
Bank and building society overnight call account deposits
Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies
Certificates of deposit with banks and building societies
Bonds issued by Multilateral Development Banks
Collective Investment Scheme structures - Money Market Funds (AAA-Rated Money Market Funds/Other Money Market Funds and Collective Investment)
Other Collective Investment Schemes structures - e.g. enhanced cash funds
Corporate Bonds
Commercial Paper
Diversified Credit Funds
Supranational bonds up to 10 years
Term deposit with financial institutions in accordance with the Council’s Local Authority Mortgage Scheme