CIPFA The Chartered Institute of Public Finance & Accountancy

report

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Board	CIPFA/LASAAC Local Authority Accounting Code Board
Venue	CIPFA, Mansell Street, London
Date	9 November 2016
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Subject	Analysis of Responses to Consultation on the 2017/18 Code - IFRS 15 *Revenue from Contracts with Customers*

Purpose

To report on the responses to the consultation on the Draft 2017/18 *Code of Practice on Local Authority Accounting in the United Kingdom* on IFRS 15 *Revenue from Contracts with Customers* and seek approval of the 2017/18 Code.

1 Introduction

1.1 CL 06-11-16 summarised the number of responses received to the 2017/18 *Code of Practice on Local Authority Accounting in the United Kingdom* (Code) consultation and analysed the first twelve questions. This report addresses questions 29 to 33 relating to IFRS 15 *Revenue from Contracts with Customers* and the principles of revenue recognition.

1.2 The responses received in relation to the questions on IFRS 15 and the principles of revenue recognition are summarised in the remainder of this report with more detailed analysis in Appendix A, section by section, followed by the Secretariat's comments and suggestions. Issues of principle are considered in the main body of the report. The statistical analysis of all the responses and individual comments are included in Appendix A. Minor corrections or other minor issues are not included in this analysis but may be included in amendments to the Exposure Draft of the Code.

1.3 Note that unless stated otherwise the references in this report to Code paragraphs or sections are those included in the Draft Appendix G for the 2017/18 Code.

1.4 The Secretariat would highlight that overall there were fewer comments but there appeared to be a general consensus from respondents with the approach in the Code. Some respondents indicated that they considered that detailed issues of application might arise when implementing the requirements.

2 Inclusion of IFRS 15 Provisions in New Appendix G (*Provisions in the 2018/19 Code for Revenue from Contracts with Service Recipients*)

2.1 An overwhelming majority of respondents agreed with the approach in the Invitation to Comment (ITC) and Exposure Draft; that is, to include the provisions on IFRS 15 in the 2017/18 Code but with an effective date for the 2018/19 Code ie 1 April 2018.

2.2 A firm agreed with the proposal but did note the potential concerns over the timing and the potential for there to be differences with the Government's Financial Reporting Manual (The FReM) – the relevant edition (the 2018/19 FReM) would be published in December 2017. The Secretariat recognises that this might be a risk but considers that this risk is outweighed by the substantial benefits of issuing the Code requirements in time for local authorities to prepare for the changes. It would also note that the Secretariat is a member of the Technical Working Group on IFRS 15 and will be able to ensure that HM Treasury is aware of the provisions in Appendix G.

2.3 Matters of detail on the approach to adoption and the Secretariat's response are included in Appendix A, rows 29.1 and 29.3.

CIPFA/LASAAC is invited to agree its approach to the adoption of IFRS 15 in the Code ie to include the provisions in an Appendix in the 2017/18 Code with an effective date of 1 April 2018.

3. The Approach to Adoption of IFRS 15 *Revenue from Contracts with Customers*

3.1 The majority of respondents agreed with the general approach to adoption of IFRS 15.

3.2 One respondent that disagreed but indicated that they agreed with the overall approach raised the issue of exchange and non-exchange transactions and their application. These definitions have not changed in the Code. The Secretariat would highlight that on the margin the definition of a non-exchange transaction can be difficult and will require judgement on behalf of the authority. The approach to non-exchange transactions has also been clarified by the additional provisions in section 2.1 of the Code, including the flow chart. The definitions of exchange and non-exchange contracts were originally derived from IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers).* The Secretariat has included additional cross-reference to IPSAS 23 which should further help to illustrate the more difficult issues.

3.3 The respondent also raised an issue about whether the provisions in section 2.7 apply to exchange or non-exchange transactions. The Secretariat is of the view that they apply primarily exchange transactions and has included this clarification at paragraph 2.7.1.4. It has also included the comment that where the relevant provisions can be applied to non-exchange transactions, a local authority may find it useful to do so.

3.4 Matters of detail are considered at rows 30.1 to 30.2 and 30.3 of Appendix A to this report.

3.5 The same respondent also raised an issue in relation to the overlap of the scope of both IFRS 9 and IFRS 15. The Secretariat is not precisely clear on the nature of the query but would highlight that the provisions included in the Code on both IFRS 9 and IFRS 15 have followed the provisions in both those standards (with the exception of references to council tax, non-domestic rates and district rates). The

Secretariat would add that Section 2.7 is supposed to exclude contracts to the extent that they are financial instruments.

CIPFA/LASAAC is invited to agree the approach to the adoption of IFRS 15 in Appendix G (note that disclosures and transition are included separately in sections four and five of this report below).

4. IFRS 15 Disclosure Requirements

4.1 The ITC and Exposure Draft set out that CIPFA/LASAAC was of the view that local authorities should only include those disclosures for revenue from contracts with service recipients if the information relating to the disclosure is material to its financial statements and at that juncture direct reference would need to be made to IFRS 15.

4.2 The majority of respondents agreed to the approach to disclosure requirements in the ITC and the Code. A number of the comments noted that local authorities should only include disclosures if they are material. Matters of detail are covered in rows 31.2 and 31.3 of Appendix A.

4.3 CIPFA/LASAAC members will be aware that the disclosure requirements under IFRS 15 are detailed and have the potential to add clutter to the financial statements. This was the reason that CIPFA/LASAAC did not include the disclosure requirements in the Code but instead required local authorities to only include those disclosures that are material to a local authority's financial statements.

4.4 The Secretariat has previously observed that revenue recognition is for many commercial entities of paramount importance. It would contend, for local authorities that expenditure on services is a competing priority for the users of local authority financial statements. This difference in emphasis should be reflected in the financial statements and should impact on any assessment of materiality.

4.4 CIPFA/LASAAC members will also be aware that IFRS 15 was developed at the same time as the US Generally Accepted Accounting Principles (US GAAP) ASC[1] 605 *Revenue Recognition*. US GAAP includes a different model for disclosure for non-public entities[2]. The reduced disclosure framework covers disaggregated revenue, reconciliation of contract balances, performance obligations and significant judgements. This disclosure framework might provide a more measured model for local authorities where revenue recognition is not such a substantial issue as in commercial entities.

CIPFA/LASAAC's view is sought on whether it wishes the Secretariat to investigate the US GAAP approach in more detail.

4.5 Other than the possibility of investigating in more detail the US GAAP approach to reduced disclosures, the Code Draft remains unchanged from the Exposure Draft.

CIPFA/LASAAC is requested to confirm the approach to the IFRS 15 disclosures in the Code (see section 2.7.4).

5. Transition

[1] Accounting Standards Codification
[2] Non-public entities in US GAAP include private companies and not for profit organisations.

5.1 The ITC and The Exposure Draft proposed to follow the option in IFRS 15 which requires retrospective restatement with adjustments made to the appropriate opening balances (on 1 April 2018) of the current period (ie without restating previous year information).

5.2 The majority of respondents agreed with the approach set out in the ITC and Exposure Draft. A firm raised a query on the approach in paragraph 2.7.2.48. However, this paragraph includes the provisions introduced by the amendments to IFRS 15 issued in April 2016.

CIPFA/LASAAC is requested to confirm the approach to transition for IFRS 15 in the Code Draft (see paragraphs 2.7.2.46 to 2.7.2.48).

6 Principles of Revenue Recognition

6.1 The majority of respondents agreed with the approach to revenue recognition in section 2.1 with a small number of respondents welcoming the new provisions.

6.2 There were a small number of drafting amendments as a result of comments made in see row 30.4 of Appendix A. A small number of detailed application issues are included at rows 33.2 and 33.3 of Appendix A.

CIPFA/LASAAC is invited to agree the amendments to the Code for the principles of revenue recognition in section 2.1 of the Code.

Recommendations

CIPFA/LASAAC is invited to consider the individual issues brought to its attention above in relation to the adoption of IFRS 15 in the Code and consider the 2017/18 Code for approval.

SUMMARY OF CONSULTATION RESPONSES – Revenue Recognition

Note – a group of interested parties best described as professional accounting firms that audit local authorities is abbreviated in this Appendix to "firm" or "firms"

IFRS 15 *Revenue Recognition from Contracts with Customers* (Service Recipients) – Inclusion in the 2017/18 Code

Question		Agree	Disagree	No Comment
29	Do you agree with the proposed approach to include the provisions of IFRS 15 in the 2017/18 Code (but with an effective date of 1 April 2018) so that accounts preparers have adequate time to prepare for this substantial new standard? If not, why not? What alternatives do you suggest?	35 (74%)	0 (0%)	12 (26%)

	Issue	**Secretariat Response**
	Question 29 – Inclusion in the 2017/18 Code	
29.1	The overwhelming majority of respondents agreed with the approach set out in the ITC and the Exposure Drafts of the Code with a number of respondents welcoming the approach which they indicated would give them time to prepare for the changes. One respondent stated: '*Analysing all revenue streams and contracts following the 5 step approach will take time so early notification of the requirements is helpful for practitioners*.'	No comments. **No changes proposed to Code Draft.**
29.2	A firm noted that whilst agreeing with the proposal: '*We do however have some concerns as to the timing, specifically that the Treasury has only recently closed its consultation on the application of IFRS15 and the outcome and*	The Secretariat recognises that this might be a risk but is a member of the Technical Working Group that works on IFRS 15 and will ensure that group is aware of the provisions in the new Appendix G. It would also note that the risks of inconsistency are likely to be substantially outweighed by the benefits

	Issue	Secretariat Response
	expected changes are not yet known. In our view the Code should be consistent with the FREM (accept for approved differences). Therefore there is a risk that the relevant paragraphs of the Code may need to be updated following the publication of the 2018/19 FREM (expected in December 2017). As part of our FREM consultation response we have suggested that the relevant FREM requirements should be published in advance of the FREM and noted the Code consultation proposal to allow practitioners time to prepare for implementation.'	of allowing local authorities adequate time to prepare for this substantial standard. **No changes proposed to the Code Draft.**
29.3	A firm commented: '*We agree with this approach for IFRS 9 and IFRS 15 as they are significant new accounting standards however we would encourage CIPFA to refrain from following such an approach for smaller changes in the future*.'	The Secretariat concurs. In order to avoid confusion about effective dates for other amendments to IFRS this approach should only be adopted for substantial changes such as a new standard. The amendments to IFRS 15 meet this criterion. **No changes proposed to the Code Draft.**

Proposed Approach to Adoption

Question		Agree	Disagree	No Comment
30	Do you agree with the proposed approach to the adoption of IFRS 15 for recognition and measurement of revenue from contracts with service recipients? Do you agree that the Code does not need adaptation or interpretation for revenue recognition under IFRS 15? If not, why not? What alternatives do you suggest?	29 (62%)	1 (2%)	17 (36%)

	Issue	Secretariat Response
	Question 30 – Proposed Approach to Adoption	
30.1	A respondent said '*the term service recipient: is that one entity or a multiple entities if we have an industrial estate'*.	The Secretariat would note that the term service recipient has the same meaning as a 'customer' under IFRS 15 for a local authority. **No changes proposed to the Code Draft.**
30.2	Two respondents noted the impact on the Group Accounts with one stating: '*Consideration is also needed in relation to Group Accounts, where group entities are currently accounting under FRS 102 and therefore will not be required to comply with the requirements of IFRS 15 to the same timescale as the parent local authority*.'	The FRC has indicated that it will be consulting on changes to FRS 102 for revenue recognition. These changes are anticipated to have an effective date for 1 January 2019; there will therefore be a timing difference to implementation. However, it is difficult to assess whether there would be substantial differences between the revenue recognised between the two frameworks. If there were this would need to be a consolidation adjustment. This is an application issue. **No changes proposed to the Code Draft.**
30.3	An authority responded: '*The definitions in the draft Code for exchange and non-exchange transactions appear to place income from contracts which have any form of subsidy in the non-exchange transactions category. This could include things as diverse as social care, leisure centre charges and housing rents. It is not clear whether this is deliberate, as it is not referred to in the Invitation to Comment. Further, although section 2.7.2.40 specifically refers to non-exchange transactions, sections 2.7.2.12 onwards say they refer only to contracts and not explicitly to contracts for exchange transactions. Para 2.7.2.13 d further adds to the confusion on how subsidised*	The definitions for exchange and non-exchange transactions are those that are currently in the Code and are based on IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. IPSAS 23 is clear that judgement will need to be applied to determine whether some transactions are exchange or non-exchange transactions. Also the principles applied to non-exchange transactions are covered by the new guidance on the principles of revenue recognition in section 2.1. Appropriate cross-reference is therefore provided in paragraph 2.7.2.7. The reference to lower than market rates not negating the criteria in paragraph 2.7.2.13 for recognising a contract is similar to references in paragraph 11 of IPSAS 23.

	Issue	Secretariat Response
	contractual income is to be treated…'	**The Secretariat has therefore added appropriate cross-references at paragraph 2.7.2.7.** The Secretariat has added relevant provisions to indicate that IFRS 15 principally applies to exchange transactions. It has added the commentary that where relevant local authorities may wish to apply the provisions to non-exchange transactions. **See the additions at paragraph 2.7.1.4.**
30.4	The same authority noted that '*It was also concerning to see the 'granting' of licences described as an example of a contract for goods or services in paragraph 2.7.2.17d, and again in 2.12.1.43, which also refers to planning fees. As drafted, this implies that the fee is paid as consideration for the granting of the licence or planning permission, but that is fundamentally not the case*. '	**The Secretariat has made the relevant amendments ie to refer to the application for licences rather than the 'granting of licences' to paragraph 2.1.2.43.** **For the avoidance of doubt it has removed paragraph 2.7.2.17 d).**
30.5	The same authority commented. '*Finally there seems to be a contradiction on applicability between this and the financial instruments draft chapter. Para 2.7.1.3 excludes contractual rights within the scope of Chapter 7, and Chapter 7 includes Trade receivables, which would appear to have the effect of excluding most exchange transactions (where income is received after the goods/services are supplied) from the scope of Chapter 2.7.'*	The Code Exposure Draft has taken the same approach to the scope exclusions as IFRSs 9 and 15 (with the exception of the exclusion of council tax, non-domestic rates and district rates). Section 2.7 is supposed to exclude contracts to the extent that they are financial instruments. Therefore the Secretariat does not concur. **No changes proposed to Code Draft.**

IFRS 15 Disclosure Requirements

Question	Agree	Disagree	No Comment
31 Do you agree with CIPFA/LASAAC's approach to the disclosure requirements in IFRS 15? If not, why not? What alternatives do you suggest?	30 (64%)	0 (0%)	17 (36%)

	Issue	Secretariat Response
	Question 31 – Disclosure Requirements	
31.1	The majority of respondents agreed to the approach to disclosure requirements in the ITC and the Code. A number of the comments noted that local authorities should only include disclosures where material.	No comments **No changes proposed to Code's Draft.**
31.2	One respondent commented: '*Guidance on exclusion of items that are, for example, immaterial is greatly appreciated. As this will help discussions with auditors who seem very reluctant to agree to the removal of any information, regardless of whether or not it is material / significant*.'	No comments **No changes proposed to Code's Draft.**
31.3	A firm made the point that it makes annually for the Code consultation ie that this approach should be extended to the rest of the Code.	**See comments in CL 6-11-16 Appendix C.**

Transition

Question	Agree	Disagree	No Comment
32 Do you agree with the approach to transition included in the Code including	32	1	14

the option to not restate preceding year information? If not, why not? What alternatives do you suggest?	(68%)	(2%)	(30%)

	Issue	Secretariat Response
	Question 32 – Transition	
32.1	The majority of respondents agreed with the approach to transition in the Code.	No comments. **No changes proposed to the Code Draft.**
32.2	A firm stated that it agreed with the proposal but: '*C7 requires that "If an entity elects to apply this Standard retrospectively in accordance with paragraph C3(b) , the entity shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application. Under this transition method, an entity shall apply this Standard retrospectively only to contracts that are not completed contracts at the date of initial application (for example, 1 January 2017 for an entity with a 31 December year-end)." It is not clear that the proposed paragraph 2.7.2.48 meets these requirements*.'	The requirements of paragraph C7 are included in paragraph 2.7.2.47. Paragraph 2.7.2.48 brings together the amendments to IFRS 15 issued in April 2016 ie C5 c) and C7A. **No changes proposed to the Code draft.**

Principles of Revenue Recognition

Question		Agree	Disagree	No Comment
33	Do you agree with the principles for revenue recognition set out in section 2.1 of the Code? If not, why not? What alternatives do you suggest?	29 (62%)	0 (0%)	18 (38%)

	Issue	Secretariat Response
	Question 33– Principles of Revenue Recognition	
33.1	The majority of respondents agreed with the approach to revenue recognition in section 2.1 with a small number of respondents welcoming the addition. For example a firm stated: '*We welcome the proposed revisions to Section 2.1 of the Code set out in ED9 and think they will be of use to preparers and auditors alike*. '	No comments. **No change proposed to Code Draft.**
33.2	A respondent queried: '*The one area that is missing from the graphical exchange or non-exchange is rental income from investment properties (pre the new leasing standard)*.'	This is an area of application. The flow chart could not cover all possible examples. Rental income from investment properties is an exchange transaction – a service provided by the authority. The Secretariat considers that this is an issue best addressed by application guidance. **No change proposed to Code Draft.**
33.3	The same respondent queried: '*You have mentioned CIL; would the same approach occur with S106 agreements?*'	The accounting for S106 agreements would be similar to capital grants. S106 income is not referred to in the Code as it is a matter of application of the Code's principles. This is an issue best addressed by application guidance. **No change proposed to Code Draft.**