CIPFA The Chartered Institute of Public Finance & Accountancy

# report

Paper CL 11 06-17

| | |
|---|---|
| Committee | CIPFA/LASAAC |
| Venue | CIPFA Mansell Street, London |
| Date | 6 June 2017 |
| Author | Sarah Sheen, CIPFA,<br>Technical Manager, Local Government Financial Reporting |
| Subject | Development of the 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom* |

## To approve the issues that need to be included in the consultation on the Code of Practice on Local Authority Accounting in the United Kingdom for 2018/19

## 1 Introduction

1.1 This report outlines the issues to be included in the 2018/19 *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code).

## 2 IFRS 9 Financial Instruments

2.1 The 2017/18 Code consultation included the approach to adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. CIPFA/LASAAC has issued the relevant provisions in a separate publication *Forthcoming Provisions for IFRS 9 Financial Instruments* and *IFRS 15 Revenue from Contracts with Customers in the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19*. This publication sets out CIPFA/LASAAC's agreed provisions following its consideration of the responses to the consultation.

*2.2* CIPFA/LASAAC members will be aware following the decisions it took at the last meeting that the Board agreed that the approach to the issue of the 2018/19 consultation papers was to consult only on a small number of issues where additional clarification was needed. Therefore the Invitation to Comment (ITC) does not revisit the overall approach to adoption. However, as a reminder, the ITC sets out in overview that the approach to the majority of the provisions remains unchanged from last year's consultation and indicates that the provisions for classification and measurement and hedge accounting are unchanged.

*Purchased or Originated Credit-Impaired Financial Assets*

2.3 The provisions in the separate publication on IFRS 9 specify that it is unlikely that a local authority will hold purchased or originated credit-impaired financial assets. The ITC comments on a view held by one respondent to last year's consultation ie that this might not be the case for some housing rents debtors and seeks interested parties' views. The ITC does not, as yet, propose changes to the provisions included in the separate publication but sets out that a small number of paragraphs will need to be updated if there is sufficient evidence that this is a material issue for local authority accounts preparers.

**CIPFA/LASAAC is invited to consider whether it is content with the approach outlined above for purchased or originated credit-impaired financial assets.**

*Simplified Approach to Impairment*

2.4 The Code has adopted the impairment provisions in the Standard without adaptation and interpretation. CIPFA/LASAAC agreed that it would consult on whether the Code should align to the anticipated approach in the FReM to mandate the simplified approach for impairment to:

- all trade receivables or contract assets that result from transactions within the scope of IFRS 15 and that contain a significant financing component in accordance with IFRS 15, and

- all lease receivables

in line with the anticipated approach by the FReM.

2.5 The approach in the ITC indicates that CIPFA/LASAAC is considering the issue but notes that because this might have an impact on the reported assets in question and will lead to a more substantial day one loss it has not as yet made changes to its agreed approach pending consideration of the consultation responses. For this reason there is no Exposure Draft on this issue.

**CIPFA/LASAAC is invited to consider whether it agrees to the approach to consulting on the simplified approach to impairment in the Code consultation.**

2.6 The ITC seeks views on whether interested parties consider that there might be any areas where the agreed approach to adoption in the Code might be augmented.

*Impact on the General Fund*

2.7 CIPFA/LASAAC will be aware that it has requested that the CIPFA Treasury and Capital Management Panel consider the impact on the General Fund of the new classification requirements of IFRS 9. The Panel has established a sub group to consider the issues in more detail.

2.8 The sub group has met and considered a number of issues but as yet does not have appropriate evidence to be able to quantify the impact on the General Fund of the adoption of the classification and measurement provisions. It is anticipated currently that the sub group will issue by means of a consultation process a questionnaire to obtain the relevant evidence. In addition, the sub group has also considered the potential impact of the expected credit loss model on the General Fund. The ITC makes general references to the work of the sub group and the issue of the questionnaire but also seeks the views of interested parties on the matters raised.

**CIPFA/LASAAC is invited to consider the approach in the ITC to the impact of the adoption of IFRS 9 on the General Fund.**

## 3 IFRS 15 Revenue from Contracts with Customers

*Overall Approach to Adoption of the Standard*

3.1 CIPFA/LASAAC will be aware that there were very few substantial amendments following the consultation on the Code in relation to the approach to adoption of IFRS 15. The amendments were minor drafting augmentations. The ITC sets out that this was the case and indicates that CIPFA/LASAAC does not intend reissuing the full provisions on IFRS 15 for consultation but seeks the views of interested parties on whether they consider the provisions of the Code might be augmented in any way.

*Approach to Disclosures – the Reliefs for Non Public and Not for Profit Entities in US GAAP*

3.2 CIPFA/LASAAC members will be aware that the separate publication on the Code does not list the disclosures required by IFRS 15 but instead requires local authority accounts preparers to make direct reference to the Standard and apply the requirements where the information relating to the disclosure is material to its financial statements.

3.3 However, CIPFA/LASAAC requested that the Secretariat undertake research on the reliefs on the disclosure requirements for non-public entities under US GAAP. Under the Accounting Standards Codification (ASC) *606 Revenue from Contracts with Customers*, non-public entities and certain not for profit entities[1] can choose to provide all of the disclosures required for public entities or to provide reduced disclosures. The Basis of Conclusions for the ASC 606 indicates that the FASB decided that some of the disclosure requirements should differ for non-public entities, primarily because the costs of providing them outweigh the benefits. It also noted that supplemental information may be available on revenue for users of the non-public entities financial statements.

3.4 There are detailed disclosure reliefs for a number of areas summarised in the table below (note that for the vast majority of the disclosure requirements ASC 606 disclosures are the same[2] as those in IFRS 15 and the table below sets out the equivalent paragraphs):

| **Disclosure Area** | **Summary of Relief Impact** |
|---|---|
| Disaggregation of Revenue, (paragraphs 114 and 115 of IFRS 15) | Non-public and not for profit entities may choose not to apply the full quantitative disaggregation of revenue required by paragraphs 606-10-50-5 and 6 but instead must disclose:<br><br>▪ at a minimum, quantitative revenue disaggregated according to the timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time |

[1] To be considered a non-public entity and use the reliefs an entity cannot be either of the following a) a public business entity or b) a not-for profit entity that has issued (or is a) a conduit bond obligor or an employee benefit plan that files financial statements with the SEC.

[2] For a small number of the disclosures where the requirements are not the exactly the same they are similar to that in IFRS 15.

| | |
|---|---|
| | and revenue from goods or services transferred to customers over time), and<br><br>▪ qualitative information about how economic factors (such as type of customer, geographical location of customers, and type of contract) affect the nature, amount, timing, and uncertainty of revenue and cash flows.<br><br>Quantitative information on the nature and amount and uncertainty does not have to be disclosed. |
| Contract Balances (paragraphs 116 to 118 of IFRS 15) | Non-public and not for profit entities may choose to disclose only the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed (ie paragraph 606-10-50-8(a)). Detailed disclosures on movements ie revenue recognised in period are optional. |
| Transaction price allocated to the remaining performance obligations | Non-public entities and not for profit entities may choose not to include disclosures relating to transaction price allocated to the remaining performance obligations. |
| Significant Judgements | A non-public entity must provide the main disclosures on significant judgements but may elect not to provide the following disclosures:<br><br>1 Paragraph 606-10-50-18(b) (IFRS 15 equivalent paragraph 125), which states that an entity shall disclose, for performance obligations satisfied over time, an explanation of why the methods used to recognise revenue provide a faithful depiction of the transfer of goods or services to a customer.<br><br>2 Paragraph 606-10-50-19 (IFRS 15 equivalent 124 b), which states that an entity shall disclose, for performance obligations satisfied at a point in time, the significant judgments made in evaluating when a customer obtains control of promised goods or services.<br><br>3 Paragraph 606-10-50-20 (IFRS 15 equivalent paragraph 126), which states that an entity shall disclose the methods, inputs, and assumptions used to determine the transaction price and to allocate the transaction price. However, if an entity elects not to provide the disclosures in paragraph 606-10-50-20, the entity is required to provide the disclosure in paragraph 606-10-50-20(b) (IFRS 15 paragraph 126 b), which states that an entity shall disclose the methods, inputs, and assumptions used to assess whether an estimate of variable consideration is constrained. |

| | |
|---|---|
| Assets recognised from the costs to obtain or fulfil a contract with a customer | Non-public and not for profit entities may disclose information about assets recognised from the costs to obtain or fulfil a contract, but this information is not required. Note that the Secretariat and the technical working group with HM Treasury on IFRS 15 have previously argued that these disclosures are unlikely to apply in local government and the public sector more widely. |

3.5 The Secretariat has previously observed that revenue recognition is of paramount importance for many commercial entities. It would contend, for local authorities that expenditure on services is a competing priority for the users of local authority financial statements. Following the rationale for the reliefs under ASC 606 (ie a cost benefit basis) the Secretariat would suggest an approach in the Code where those disclosures not required by the US standard could be excluded from the Code.

3.6 If CIPFA/LASAAC agree with the Secretariat's suggestions this would require an adaptation to IFRS 15. The Exposure Draft for these amendments has been included without track changes for clarity. The Secretariat is of the view that as the ASC 606 reliefs apply to not for profit entities that this would be an appropriate source of appropriate guidance to apply under the Memorandum of Understanding between the Relevant Authorities (see the operational framework Appendix at CL 09 06-17), particularly as the ASC was developed alongside IFRS 15.

3.7 The Secretariat has not included the reliefs in ASC 606 for disaggregation of revenue as this requires a different disclosure rather than a choice not to apply and this may lead to inconsistency with the rest of the public sector. The ITC does, however, seek the views of interested parties on whether there are any practical difficulties in providing this disclosure.

**CIPFA/LASAAC's views are sought on the suggested approach to the adoption of the IFRS 15 disclosures outlined above.**

**CIPFA/LASAAC's views are sought on the approach to IFRS 15 in the 2018/19 Code consultation papers.**

## 4 Narrow Scope Amendments

*IAS 7 Cash Flow Statements* (Disclosure Initiative) and Amendments *to IAS 12 Income Taxes (Recognition of Deferred Tax Assets for Unrealised Losses)*

4.1 CIPFA/LASAAC is aware that Amendments to IAS 7 *Cash Flow Statements (Disclosure Initiative)*, issued on 29 January 2016 and Amendments to IAS 12 *Income Taxes* (Recognition of Deferred Tax Assets for Unrealised Losses) issued on 19 January 2016 were not adopted by the EU in time for inclusion in the 2017/18 Code. The Secretariat has issued an Exposure Draft based on the approach agreed by CIPFA/LASAAC in the Code Drafts following the November 2016 meeting of CIPFA/LASAAC and includes commentary on the consultation responses in the ITC. However, like the approach in the Code Drafts the amendments relating to IAS 12 are only referred to in Appendix D (New or Amended Standards included in the 218/19 Code) as the amendments will only be relevant for the Group Accounts.

*IAS 40 Investment Property* (Transfers of Investment Property)

4.2 The ITC proposes that IAS 40 Investment Property (Transfers of Investment Property) applies to local authorities and would be adopted by the Code. However, as the amendments refer to paragraphs not directly included in the Code then no amendments will be made and again the only changes to the Code will be the relevant listing in Appendix D.

*Annual Improvements to IFRSs 2014-2016 Cycle*

4.3 The ITC also sets out that some of the Annual Improvements to IFRSs 2014-2016 Cycle will apply to local authorities. The approach to application of each of the improvements has been included in an Appendix to the ITC. Again it should be noted that none of the amendments will require substantial changes to the Code. However, an Exposure Draft has been issued for the amendments to IFRS 12 *Disclosure of Interests in Other Entities* as this relates to a scoping issue and as indicated in the ITC it is important that the Code should clearly establish the scope of application of any standard adopted by the Code.

*IFRIC 22 Foreign Currency Transactions and Advance Consideration*

4.4 IFRIC 22 provides requirements about which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance. IFRIC 22 does not apply widely to local authorities but may impact on pension fund accounts. The ITC sets out that other than by inclusion in Appendix A, the Code will not refer to IFRIC 22.

*IFRS 4 Insurance Contracts Applying IFRS 9 Financial Instruments*

4.5 In September 2016, the IASB issued the amendments to its existing insurance standard IFRS 4 *Insurance Contracts*. The amendments address concerns arising from implementing the new financial instruments Standard, IFRS 9, before implementing the replacement Standard that the Board has developed for IFRS 4 (the IASB has recently issued IFRS 17 *Insurance Contracts*). The ITC addresses this amendment in the section on IFRS 9 and indicates that this amendment will not apply to local authorities as the Code has precluded accounting for financial guarantee contracts under IFRS 4.

**CIPFA/LASAAC is invited to agree the approach to the narrow scope amendments in the ITC and Exposure Drafts.**

# 5 Telling the Story of Local Authority Financial Statements - Amendments to the Debtors and Creditors Disclosures

5.1 CIPFA/LASAAC may be aware that the FReM no longer includes an analysis of debtors and creditors across public sector bodies. This disclosure is not required by IFRS and therefore it is proposed that these are also removed from the Code (see paragraphs 5.3.4.2, 1) and 8.1.4.2, 1)).

**CIPFA/LASAAC is invited to agree the approach to the removal of the disclosures at paragraphs 5.3.4.2, 1) and 8.1.4.2, 1).**

## 6 Legislative and Policy Developments

**Amendments to the Accounts and Audit Regulations 2015 for English Authorities, the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, and the Accounts and Audit (Wales) Regulations 2014**

7.1 The Secretariat recommends including commentary on the amendments to the Accounts and Audit Regulations in England and Wales and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended. However, during the period prior to the general election government officials are not able to include formal commentary on policy (a period known as purdah). Therefore these sections will be updated after 8 June 2017.

**The Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017**

7.2 CIPFA/LASAAC will be aware that the Item 8 Credit and Item 8 Debit (General) Determination (Item 8 Determination) from 1 April 2017was issued in January this year. The only references in the Code to the Item 8 Determination relate to the entries for depreciation and therefore the references to the ability to limit depreciation to the amount of the notional Major Repairs Allowance will need to be removed. The ITC refers to this removal and the relevant Exposure Draft has been included in the papers. At this current juncture the Secretariat does not consider that it is necessary to issue an update to the 2017/18 Code for this limited amendment but has indicated in the ITC that it will keep this issue under review.

**Pooling of Pension Fund Investments**

7.3 CIPFA/LASAAC will be aware that in the Summer Budget 2015 the Chancellor announced the Government's intention to invite the 89 administering authorities in England and Wales to bring forward proposals for pooling Local Government Pension Scheme investments. CIPFA/LAAAC agreed at its last meeting to include confirmation in the ITC that there is no need to amend the Code as the existing Code provisions for investments in other entities will cover the reporting requirements. The ITC seeks the views of interested parties on this issue.

**CIPFA/LASAAC's views are sought on whether it agrees to the approach to the Pooling of Local Government Pension Scheme investments in the ITC and consultation papers.**

## 8 IFRS 16 Leases – Initial Consultation

7.1 The ITC includes an overview on the leasing standard highlighting the main areas which will impact on its application to local authorities. It covers initial recognition and measurement and subsequent measurement for lessees. It also provides an overview of the transitional arrangements, disclosures and the approach in the standard for lessors.

7.2 The ITC includes a number of questions relating to the above areas. Some of the questions are general to seek views on application. Others seek more specific views based on CIPFA/LASAAC's early views on the approach to adoption. Two of these areas include subsequent measurement and the general approach to transition where CIPFA/LASAAC has already provided its early views.

7.3 There are three other areas where the Secretariat is recommending that CIPFA/LASAAC might provide their early views:

- The short-term exemption - the Secretariat is of the view that in order to minimise the reporting burden most local authorities will adopt the short-term exemption. It therefore recommends that CIPFA/LASAAC mandates accounting policy choice in the Code. This will promote consistency and will reduce the number of judgements need to be made by accounts preparers and therefore reduce the reporting burden. The Secretariat would note that this is also likely to promote consistency across the public sector because it understands that the HM Treasury technical working group is also considering taking this approach.

- The accounting policy choices for transition on the approach to the practical expedients ie on:

  - the identification of a lease on transition - ie permitting an authority to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 and not to apply this Standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4. This approach to transition will again reduce the reporting burden for local authorities on transition.

  - the approach to measuring the right-of use asset for leases previously classified as operating leases ie requiring local authorities to measure that right-of-use asset at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments. This choice would be based on cost/ benefits advantages and understandability.

    These two choices are based on the views of the HM Treasury technical working group.

- The approach to lessor accounting – the Secretariat can see no economic reason why local authorities would not apply this section of the standard in the same way as private sector entities. However, there are changes to the requirements for sub-leases and sale and lease back transactions and the ITC seeks to ascertain whether this is a substantial issue for local authorities.

7.4 The section in the ITC on IFRS 16 is intended to seek views on the application of the standard and identify other issues which CIPFA/LASAAC might need to consider in the issue of the full consultation on the approach to the adoption of the Standard in the 2019/20 Code. Therefore the ITC seeks views on the approach to the measurement of the liability and particularly the discount rate. It also sets out the initial views of CIPFA/LASAAC's sub group on leases on potential areas of difficulty on adoption of the Standard and requests comments from interested parties on whether there are further issues the CIPFA/LASAAC and the sub group should consider.

**CIPFA/LASAAC's views are sought on the approach to the initial/early consultation on IFRS 16 in the ITC.**

## 8 Post Implementation Reviews of Amendments to the Code

8.1 CIPFA/LASAAC agreed that it would initiate its post implementation reviews on the amendments to IAS 19 *Employee Benefits* included in the 2013/14 Code and for the Group Accounts amendments included in the 2014/15 Code and therefore a section has been included in the ITC to cover this issue. The ITC also includes reference to ensuring that the disclosure requirements for these two issues are accessible to the users of local authority financial statements.

8.2 In addition, the ITC indicates that the amendments to the Code for the 2013/14 changes in relation to service concession arrangements will be included in the consultation for the 2019/20 Code. This timing was intended to align with the adoption of IFRS 16.

**CIPFA/LASAAC's views are sought on the approach to post-implementation reviews in the ITC and consultation papers.**

## 9 Call for Feedback to Assist with the Consultation on the 2018/19 Code

9.1 CIPFA/LASAAC members will be aware that at its last meeting it sought views from interested parties on issues which might need consideration in the 2018/19 Code. The call for feedback was included on the CIPFA/LASAAC landing pages of the CIPFA website and in an article by Alison Scott *How to Make a Code of Practice* issued in April PF http://www.publicfinance.co.uk/opinion/2017/03/how-make-code-practice. Unfortunately, only one response was received and this is discussed at item 12 on the agenda.

## Recommendation

**CIPFA/LASAAC is asked to approve the developments that need to be included in the consultation papers for the 2018/19 Code**.