CIPFA The Chartered Institute of Public Finance & Accountancy

# LAAP Bulletin 103 - Supplementary Informal Commentary relating to the Treatment of Losses on Non-Current Assets Derecognised as a Result of a Transfer to Academy Status

## Background

Questions have arisen as to the powers that permit the reversal of losses that result from the derecognition of non–current assets used by foundation schools following their transfer to Academies from the General Fund (revenue account) balance to the Capital Adjustment Account.

This supplementary informal commentary provides CIPFA's guidance in respect of accounting for the de-recognition.

## Circumstances which may have led to Original Recognition

This informal commentary relates to non-current assets that would have been originally recognised as a result of an authority's decision[1] that a non-current asset used by a foundation school is the asset within the control of the school[2]. Appendix E of the Update to the 2014/15 Code requires local authorities to account for schools as financial reporting entities[3] and under the adaptation in Appendix E[4] consolidate them into the single entity financial statements.

This initial recognition would have resulted in a debit to non – current assets for the fair value of the asset with a corresponding credit to the capital adjustment account.

## Subsequent Derecognition

As a result of the transfer of the school to Academy status, local authorities are likely to derecognise those non-current assets originally recognised in the local authority balance sheet, this normally resulting in

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[1] For further guidance on a the recognition of non-current assets used by foundation schools within the local authority boundary see LAAP Bulletin 101 *Accounting for Non-Current Assets Used by Local Authority Maintained Schools*.

[2] ie in circumstances where the school has control over the resources inherent in the asset as a result of rights that are both enforceable and substantive.

[3] See Update to the 2014/15 Code paragraph E.1.1

[4] See Update to the 2014/15 Code paragraph E.1.3

a related loss on disposal. Questions have been raised as to where the power exists to permit that loss to be reversed from such transfers from the General Fund (revenue account) balance as, it is argued by the parties raising the question that, in theory, this is a group consolidation issue and therefore might be deemed to differ from the usual derecognition transactions for non-current assets.

## Supplementary Informal Commentary

LAAP 103 states:

*"23 …If local authorities consider that, as a result of the transfer arrangements, the asset should be derecognised from local authority balance sheets then this derecognition transaction is no different from any other asset derecognition.*

*24. Any non-current asset is likely to either:*

- *Come within the scope of the Prudential Framework as their cost will have been treated as capital expenditure of the authority on its own property; or*

- *Have been recognised under the transitional provisions in the Update of the 2014/15 Code and therefore the transaction may be reversed.*

*25. For capital financing purposes, the transfer of the non-current assets results in no additional gains or losses. Any amounts debited or credited to the Comprehensive Income and Expenditure Statement should therefore be capable of reversal to the Capital Adjustment Account in the Movement in Reserves Statement."*

As with most of the capital financing statutory reversals there is no specific reference to an item of income and expenditure, or gain or loss which needs to be reversed, this includes, for example, the treatment of depreciation, capital grants, impairment losses and gains and losses on disposals of non-current assets. The reversals are, however, based on what is chargeable to Council Tax. Section 31A of the Local Government Finance Act (LGFA) 1992[5], specifies the Council Tax raising rules forming the basis for the calculation of the General Fund Balance as a revenue account balance.

The elements of the Council Tax requirement include:

- The expenditure the authority estimates that it will charge to a revenue account ((see Section 31A subsection 2(a)) LGFA 1992).

[5] As amended by Section 74 of the Localism Act 2011

- Income the authority estimates it will accrue and credit to a revenue account ((see Section 31A subsection 3(a)) LGFA 1992).

An additional clear inference is that the losses on the derecognition of these assets would be as a result of capital transactions and not charges to the General Fund ie a revenue account.

No capital expenditure is therefore chargeable to a revenue account unless the authority so determines:

- in accordance with statutory requirements, or

- via its assessment of its Minimum Revenue Provision.

Any loss arising as a result of derecognition of a non-current asset being transferred to an academy does not meet these definitions.

Losses on academy transfers of non-current assets will be attributable to previous transactions in the local authority balance sheet ie:

- capital expenditure where (if) a local authority originally funded the purchase or acquisition of the non-current asset;

- assets which have been recognised under the transitional provisions in the Update to the 2014/15 Code in a manner akin to a donated asset or schools assets that are donated assets; and

- valuation gains.

None of these losses are items of revenue income or expenditure which is chargeable to a revenue account in accordance with the LGFA 1992, as amended.

The Capital Adjustment Account is a specific accounting mechanism that is used to reconcile the different rates at which assets are depreciated under proper accounting practice and are financed through the capital controls system. If the losses are not reversed when any expenditure the authority has incurred has been fully financed then this account will not balance to zero (as a result of consolidation of the schools transactions in the single entity financial statements).

Some commentators have indicated that the schools transactions are only included in the local authority accounts through the Code adaptation to include recognition of the non-current assets owned by some schools in the single entity accounts and if this adaptation was not in place then the commentators consider such statutory reversals would not exist and have raised the issue of whether or not a legal view is required.

There are a number of responses to these comments.

1) It is difficult to hypothesise what would happen if the adaptation did not exist, as clearly it does. However, even if the schools transactions were recognised in a hypothetical group accounts scenario then such transactions would still not be chargeable to a revenue account in accordance with the LGFA 1992. If the adaptation to include schools transactions in the single entity accounts had not been made they would have been included in Group Accounts. However, Group Accounts have always been regarded as being outside of the Prudential (Capital Finance) Framework.

2) The counter argument would be offered that CIPFA is not aware of any statutory provision which would *allow* these gains or losses to be chargeable to a revenue account and thus the General Fund.

Other comments have raised the issue whether this treatment might be extended to gains and losses that might be recognised on the derecognition of other subsidiaries. However, disposal of shares on the derecognition of other subsidiaries is wholly within the scope of the capital finance and accounting regulations.

Finally, although CIPFA provides general accounting guidance on issues it cannot provide legal advice for local authorities.