Emergency proposals for the update of the 2021/22 Code of Practice on Local Authority Accounting in the United Kingdom

Exceptional consultation on time-limited changes to the Code to help alleviate current delays to the publication of audited financial statements

Invitation to comment

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Introduction

1. Local authorities in the United Kingdom are required to keep their accounts in accordance with 'proper practices'. This includes, for the purposes of local government legislation, compliance with the terms of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code), prepared by the CIPFA/LASAAC Local Authority Accounting Code Board (CIPFA/LASAAC). The Code is reviewed continuously and is issued annually.

2. Under the oversight of the Financial Reporting Advisory Board, CIPFA/LASAAC can issue in-year updates to the Code. This is only done in exceptional circumstances. This consultation invites comments on time limited proposals to amend the 2021/22 Code, which would be presented as an update to that Code. The reasons for these proposals are set out in Section A.

3. This invitation to comment (ITC) sets out two proposals that CIPFA/LASAAC wishes to explore for revisions to the Code (the update to the 2021/22 Code) to apply to accounting periods commencing on or after 1 April 2021 (Section B of this ITC). It also includes consideration of the deferral of IFRS 16 *Leases*, which is due to be implemented in the 2022/23 Code.

The consultation process

4. Specific consultation questions have been included in the ITC. CIPFA/LASAAC also welcomes comments on the exploratory proposals. In order to assess comments properly, CIPFA/LASAAC would prefer respondents to support comments with clear accounting reasons and, where applicable, explanations of practical effects.

5. Responses to this invitation to comment will be regarded as on the public record and may be published on the CIPFA website. Copies of all correspondence and an analysis of responses may be provided to the Financial Reporting Advisory Board.

6. An exposure draft setting out proposed changes to the 2021/22 Code is attached at Annex 1.

7. In order that they can be considered by CIPFA/LASAAC in time to inform possible implementation, responses are required by **3 March 2022**

8. Please make responses by email to cipfalasaac@cipfa.org

SECTION A – INTRODUCTION

9. Everyone with an interest in local government financial reporting will be aware that a very significant majority (91%) of local bodies in England missed the statutory deadline of 30 September 2021 for publication of their audited 2020/21 accounts. Only 9% of audited accounts were published by the deadline. By the end of December 2021 publications had risen to 40%, and while this progress is to be welcomed, it still means that three months after the deadline more local bodies had failed to meet the statutory deadline than had met it. A considerable number of 2019/20 audits are also still outstanding.

10. There is general consensus that this is unacceptable, but there is disagreement as to the causes and the possible short-term solutions. This consultation is not seeking to determine whether the delays primarily reflect an 'audit problem' or a 'preparer problem' or arise from other factors. It is exploring whether there are short-term pragmatic interventions that could help the current situation.

11. There have been concerns over the audit and financial reporting regime in England for some time, although before the pandemic these had not resulted in such significant failures to meet deadlines. The Department for Levelling Up, Housing and Communities (DLUHC) has been seeking improvement by various means, in line with the government's response to the findings of the *Independent review into the oversight of local audit and the transparency of local authority financial reporting* (the Redmond Review) and other initiatives.

12. In December 2021 DLUHC announced a number of measures it was pursuing with various stakeholders to improve the situation around audit delays in England. DLUHC asked CIPFA/LASAAC to consider what short-term significant steps could be taken to address the ongoing timeliness issues. This included asking the Board to consider the merits of a time-limited change to the Code for 2021/22, acknowledging that in practice this might affect some future years.

13. In responding to this request, CIPFA/LASAAC's focus has been to consider what, if anything, might be done to amend the Code that might contribute towards an improvement in the position for 2021/22, and perhaps allow auditors and preparers to 'catch up'. In its announcement DLUHC made particular suggestions around the application of materiality and the valuation approach for operational property, plant and equipment.

14. The Board has tried to work within some important constraints. The starting point has been that the Code itself remains the right basis for local authority accounting and does not in itself require significant amendment. In line with this, CIPFA/LASAAC does not see the Code as being part of the problem, although improvements can always be made. CIPFA/LASAAC has an ongoing programme of work as part of its strategic plan. This includes consideration of how useful information can best be presented in the local authority financial statements (sometimes referred to as streamlining the accounts).

15. CIPFA/LASAAC's view is therefore that any changes in response to the current timeliness issue will be time-limited. As a consequence, if implemented, any changes will be reversed after two or at most three years. In effect, this is a pragmatic strategy to pause some requirements to provide a breathing space for the system. This might enable the backlog to be cleared and resourcing issues addressed so that by 2023/24 or 2024/25 we could return to the current Code requirements with the strong expectation that the deadlines would be met.

16. It is worth emphasising that this is not a UK-wide problem. In the devolved administrations, although there are some issues arising from the pandemic, all or almost all of the audited accounts have now been published, so the systemic failures are really essentially an issue in England. As the Code applies to all of the UK, one obvious concern is that for the devolved administrations any changes might be argued to be unnecessary.

17. CIPFA/LASAAC reviewed a number of options that might be beneficial to provide the widest range of possible solutions. This list was wider than those suggested by DLUHC. Although the Board's remit is the Code, CIPFA/LASAAC also considered a number of other changes to the

overall reporting regime that could in principle be adopted. Because these are outside the remit of the Board these are not included in the consultation but are being pursued with relevant stakeholders and regulators. Information on the options considered by the Board is provided at Annex 2. This is drawn from a working paper provided for discussion with CIPFA/LASAAC board members.

18. CIPFA/LASAAC discussed the options at length. Some Board members did not support any changes being made to the Code, both as a matter of principle and reflecting concerns that it would not be possible to develop solutions that would be compliant with the standards adopted in the Code and had the intended effects for accounts preparation and audit processes. There were no options that were unanimously supported, and it was necessary to proceed on the basis of the Board's majority view that possible options should be explored through a consultation process.

19. CIPFA/LASAAC is clear that these measures have been proposed as a temporary expedient to help improve an unacceptable situation. These measures do not represent the best form of financial reporting that the Code seeks to promote in each edition. However, it remains important not to sacrifice high quality financial reporting. For that reason, CIPFA/LASAAC has considered approaches that follow the principles applied in the Code, and where the risk attached to adopting the approach for a short period is, in the Board's view, relatively low.

20. The Board has also been mindful only to put forward items where there might be a real potential for time saving, in accounts preparation, audit requirements or both. Making changes at short notice and with a much shorter consultation period than usual carries risks of unintended consequences. It follows that changes should only be made if the evidence CIPFA/LASAAC is able to gather gives reasonable confidence that any such change, if adopted, would materially reduce the time and resource needed to prepare and/or audit the accounts.

21. In parallel with this consultation CIPFA/LASAAC is exploring with government the potential to support any proposed change with a statutory direction, if this would be beneficial.

22. Based on consideration of the options available, the Board identified only two options that it might be possible to consult on and implement before the 2021/22 year-end, which are:

    - Pausing the requirements for professional valuation of operational property, plant and equipment assets in the 2021/22 Code and (at least) the 2022/23 Code, with the possibility of mitigating the effect of this through the application of centrally determined indices.

    - Deferring the implementation of IFRS 16 *Leases*, which is currently set to be implemented in the 2022/23 Code, thereby for a period freeing up preparer and auditor time relating to the preparation of opening balances and auditor verification around transition.

23. For the avoidance of any possible doubt, if the proposals consulted on were endorsed, one of the options being proposed would be effective for 2021/22 and so come into force shortly before 31 March 2022. The remaining option relates to the 2022/23 Code.

24. CIPFA/LASAAC acknowledges the proximity of this consultation to the year-end and is keen to understand the implications given this timing.

SECTION B – UPDATE TO THE 2021/22 CODE and 2022/23 CODE – PROPOSALS BEING EXPLORED

Valuation of operational property, plant and equipment	
B1	Pausing valuation and applying indexation to operational property, plant and equipment

Valuation of operational property, plant and equipment

25. CIPFA/LASAAC has considered this aspect of financial reporting because it understands that it is an area where significant effort is being made by both preparers and auditors, and that this has contributed to delays in the finalisation of audited financial statements. Improvement in this area could potentially have a significant beneficial effect on audit completion if it can be achieved without adverse effects on public accountability.

26. Paragraphs 4.1.2.30 to 4.1.2.39 of the Code set out requirements for measurement of assets after recognition, requiring that with the exception of infrastructure assets, operational property, plant and equipment is valued at current value, following the requirements of IAS 16 but as adapted for public sector circumstances. These operational assets do not include investment properties, surplus assets or assets held for sale, which are measured using fair value. Note that paragraph 4.1.2.32 also allows some assets with short lives or low values or both to be measured at depreciated historical cost as a proxy for current value.

27. CIPFA/LASAAC proposes that local authorities should have the opportunity to ‘pause’ normal expectations that most operational property, plant and equipment are measured once every five years for each class of assets. Many local authorities have rolling programmes of revaluations to manage the process.

28. Some CIPFA/LASAAC members suggested that authorities should simply pause valuation, having regard to the temporary nature of this proposal. Taking this approach would result in a possibly significant difference from the IAS 16 revaluation approach, which in principle reflects full revaluation of all assets.

29. CIPFA/LASAAC further considered that where this temporary expedient is taken, there is a risk that affects the reader’s understanding of the overall value of assets in the financial statements. To mitigate this risk, CIPFA/LASAAC proposes that operational property, plant and equipment is subject to indexation, applied to the carrying value of assets at the start of the financial year, and subject to the normal adjustments for asset disposals, depreciation and impairment. It is recognised that this is a further temporary expedient: indices are not regularly used or supported by CIPFA/LASAAC as a means of arriving at IAS 16 figures (as adopted by the Code) and do not resolve any potential IAS 16 compliance issues.

30. A key element of fair presentation in financial statements is faithful representation, which requires that information must faithfully represent the substance of what it purports to represent. Under the pause plus indexation option, the measurement for these assets would be declared to reflect the indexation adjusted calculation, rather than being an estimate of the IAS 16 revaluation basis figure, which would be achieved with full revaluation of all assets.

31. A key element of either of these options is that the approach chosen from the permitted options would need to be declared in the financial statements as an accounting policy. This is not the financial reporting that would obtain under the application of IAS 16 under either the historical cost approach or the valuation approach, though it is arguable that the ‘pause’ option is unlikely to be substantially different from measurement under the Code’s adoption of IAS 16. The proposals are though a temporary expedient that will be adopted for a short-term period, after which reporting will be carried out under the full requirements of IAS 16 as adopted in the Code.

32. Clarity over the nature of the measurement is critical from an audit perspective, as it affects the baseline against which information might be considered misleading and/or affect decisions made by the users of the financial statements. Having said this, we would note that operational property,

plant and equipment are generally held for the long term and are not frequently sold or traded. Short-term movements in the current value of operational property, plant and equipment may not be immediately relevant to decision making. In contrast, this reasoning does not apply to investment property or assets held for sale, where the short-term value may be immediately relevant. It should be noted that any measurement of property, plant and equipment has an impact on the information reported in the Balance Sheet but also in the reported results in the Comprehensive Income and Expenditure Statement.

33. The above discussion is particularly important as it affects the extent to which the changed treatment will affect the amount of work required for audit. CIPFA/LASAAC hopes that verification procedures can focus on substantiating the measure provided, rather than by reference to the normal IAS 16 revaluation approach, which it does not purport to reflect. Otherwise the quantum of audit work may not be reduced.

34. CIPFA/LASAAC also proposes that the declaration should provide sufficient information for the readers of the financial statements, recognising that this is not the best possible financial information that could be provided under the standards adopted in the Code, but a temporary expedient adopted for a limited period. There is no need to provide comparative information under IAS 8 *Accounting Policies,* as measurement has been paused based on that comparative information. Otherwise, there would again be little reduction in the quantum of preparer and auditor work. Detailed text on this has not been provided in the exposure draft but subject to the consultation process and CIPFA/LASAAC's due processes there will be a need to cross-refer to the temporary expedient in Section 3.3 of the Code.

35. The above paragraphs set out potential implications for audit. While CIPFA/LASAAC has members representing audit firms and the UK public sector audit agencies, it does not have responsibility for audit matters. For this reason, responses to the consultation from auditors will therefore be vital. CIPFA/LASAAC will also be engaging directly with auditors to obtain views on the proposed approach.

36. Subject to the results of consultation, any implementation of the paused valuation and indexation approach will need to be supported by properly chosen indices. Parallel to the consultation process, CIPFA/LASAAC is also engaging with RICS and other stakeholders to determine the best way forward.

37. The proposal set out in the exposure draft is that:

    - local authorities can choose to retain their current approach, based on a regular cycle of professional valuations; or

    - they can opt to pause professional valuation and apply an approved index.

    As noted at paragraph 28, if an approach is taken to only pause without taking the indexation option, then this may result in a greater difference from an IAS 16 measure that in principle reflects full revaluation of all assets.

38. Additionally, CIPFA/LASAAC would note that if a temporary expedient is included in the Code, this will by definition be temporary. Both preparers and auditors need to be aware that these options will not be available in future editions of the Code, and that adjustments are likely to be needed to get back to normal, and these will need to be appropriately supported by evidence.

39. As noted in the introduction, this consultation is seeking to alleviate problems that have only become significant in England. Other jurisdictions have not encountered the same level of problems, although timelines have been adjusted in the light of the COVID-19 pandemic. For this reason, CIPFA/LASAAC is interested in views on whether the proposed changes should be made for the whole of the United Kingdom, or restricted in scope to English local authorities. Respondents should note that if changes are implemented it is anticipated that they will continue to be applicable in 2022/23, subject to ratification through further consultation. The question of wider applicability could be revisited in subsequent consultation.

B1	Valuation of operational property, plant and equipment
Q1a	Do you agree with the proposal that preparers should have the option to pause professional revaluation? If not, why not? Please provide reasons for your view.
Q1b	Additionally, do you agree with the proposal that preparers should have the option to pause professional revaluation and adopt an indexation approach to 2021/22? If not, why not? Please provide reasons for your view.
Q1c	If you support this proposal but the impacts for 2021/22 are minimal, so that audit timeliness issues remain, would you support either of these changes being explored for the 2022/23 Code?
Q2	Do you have any comments on the impact of the adoption of this approach on preparers or auditors? If so, please provide more information.
Q3	If you support this approach, do you consider that the approach should be available to all local authorities, restricted to England, or determined on a jurisdiction basis reflecting the view of the relevant government?
Q4	If you support this approach in principle, do you consider that it is appropriate for all operational property plant and equipment, including for example, Housing Revenue Account assets?
Q5	Do you have any other comments on the proposal?

Deferred implementation of IFRS 16	
B2	Further deferral of the implementation of IFRS 16 *Leases*

Deferred implementation of IFRS 16 *Leases*

40. As noted in the introduction, CIPFA/LASAAC considered a wider range of proposals than those suggested by DLUHC. One of these was further deferral of the implementation of IFRS 16 *Leases* in the Code.

41. Stakeholders in public sector financial reporting will appreciate that the implementation of IFRS 16 has already been deferred three times. This initially reflected issues around the readiness of government's statistical reporting, which is sourced from public sector accounting systems, and subsequently reflected capacity issues for many public sector preparers, particularly in the context of the COVID-19 pandemic.

42. CIPFA/LASAAC knows that local authority finance teams have been facing many pressures in the last two years, and there will be some that despite additional time are not as well prepared for IFRS 16 implementation as they would ideally be.

43. CIPFA/LASAAC is also responding to concerns over the capacity of auditors to progress the substantial verification requirement for the transition from IAS 17 *Leases* to IFRS 16 in the Code in addition to current requirements. This additional workload could significantly impact the ability of auditors to 'catch up' and get the audit cycle back on schedule.

44. CIPFA/LASAAC is seeking views on an option to defer implementation of IFRS 16 for at least a year. If such a measure is taken, CIPFA/LASAAC is minded to have a consistent approach across the local government sector, so this would apply to all local authorities.

45. This would not directly affect the 2021/22 Code and therefore no exposure draft text is provided. Deferral would of course significantly affect the 2022/23 Code, which would require similar changes to those effected after deferral in previous years.

46. CIPFA/LASAAC is exploring this proposal with a significant degree of reluctance, given that IFRS 16 provides significantly better information than IAS 17. It will also result in misalignment with other public sector reporting in other sectors that are expected to achieve implementation during 2022/23, which increases its concerns. The lack of audited figures on an IFRS 16 basis will also be problematic for Whole of Government Accounts and government financial statistics.

47. However, the benefit of improved information and consistency with group policies is of little consequence if audits are not completed in a timely manner. For this reason, the Board is seeking views on possible delays in implementation.

B2	Deferred implementation of IFRS 16
Q6	Do you support the further deferral of IFRS 16 implementation to reduce auditor/preparer workload? If not, why not? Please provide reasons for your view.
Q7	Do you have any comments on the practical impact of the adoption of this approach? Please provide details to support your view.
Q8	Do you have any comments on the jurisdictional application of this approach?
Q9	Do you have any other comments on the proposal?

Other comments on the proposals and issues around the timeliness of publication of audited financial statements

48. In addition to the specific questions on the proposals, CIPFA/LASAAC welcomes more general comments.

Further comments	
Q10	Do you have any other comments on the issue of the timeliness of the publication of audited financial statements in local government and the impact on the Code?