The 2022/23 Code of Practice on Local Authority Accounting in the United Kingdom

Invitation to comment

Contents

Invitation to comment

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 is in a position to issue mid-year updates to the Code. However, this will only be done in exceptional circumstances.

3. The edition of the Code that is applicable for a financial year is based on accounting standards in effect on 1 January prior to the start of the financial year. For the 2022/23 Code, this means that UK adopted accounting standards with an effective date of 1 January 2022 or earlier will need to be taken into account.[1]

4. This invitation to comment (ITC) sets out CIPFA/LASAAC's proposals for developing the new edition of the Code (the 2022/23 Code) to apply to accounting periods commencing on or after 1 April 2022 (Section B of this ITC). An executive summary (Section A) highlights the key areas being consulted on.

The consultation process

5. Where CIPFA/LASAAC is interested in specific issues, consultation questions have been included in the ITC. However, CIPFA/LASAAC also welcomes responses to individual questions or areas if these are of specific interest to an interested party and comments on any aspect of the draft 2022/23 Code. In order to assess comments properly, CIPFA/LASAAC would prefer respondents to support comments with clear accounting reasons, and where applicable preferred alternatives.

6. Responses to this ITC 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.

7. A copy of the exposure drafts of the 2022/23 Code in PDF format can be downloaded from the CIPFA website.

8. To assist interested parties in responding to the consultation, an online response form will be published on the CIPFA website in early September. We would be grateful if respondents to the consultation could use this as this will speed up the analysis.

9. Responses are required by **11 October 2021**.

10. While we would prefer that responses are made using the online form, they may also be sent to:

    The Secretary
    CIPFA/LASAAC Local Authority Accounting Code Board
    Policy and Technical Directorate
    CIPFA
    77 Mansell Street
    London, E1 8AN
    Email: **cipfalasaac@cipfa.org**

1 Now that the UK has withdrawn from the EU-adoption framework, the Code applies standards adopted for UK application under the terms of the International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/685).

Section A – Overview

11. The following tables provide an overview of the areas where stakeholder feedback would be greatly appreciated:

Exposure draft A: IFRS 16 *Leases* implementation	
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A2	Clarification of status of housing tenancies in transitioning to IFRS 16

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C1	Regulations on corporate joint committees under the Local Government and Elections (Wales) Act 2021

Exposure draft D: Other matters	
D1	IFRS 17 *Insurance Contracts* (future implementation)
D2	Review of capital financing requirement disclosures

12. CIPFA/LASAAC would also note that it is continuing to pursue improvement in areas that were consulted on in the 2021/22 ITC but are not included here, as follows:

- materiality
- improving the presentation of local authority financial statements
- narrative reporting.

13. It is planned that each of these will result in guidance or Code material that will be consulted on in the 2023/24 ITC. The project on improving the presentation of local authority financial statements takes forward previous initiatives in relation to streamlining and simplification, and key strands of its work will be consideration of whether the presentation of statutory adjustments can be improved, and the use of summary information to improve the understandability of the accounts, having regard to the recommendations of the Redmond Review. There will also be a CIPFA-led initiative to create a financial reporting hub, which will engage with key stakeholders to seek out and promote best practice looking at common themes and practical solutions.

Section B – 2022/23 Code – Detailed discussion

IFRS 16 *Leases* implementation	
A1	Service concession arrangements: measurement of the liability
A2	Clarification of status of housing tenancies in transitioning to IFRS 16

IFRS 16 *Leases*

14. CIPFA/LASAAC has carried out a specific consultation on the implementation of IFRS 16 *Leases* for local government (the **archived consultation** is available for reference). While material developed through that consultation was incorporated into the Code, in alignment with central government decisions, implementation has been deferred twice. Implementation has thus been deferred to 2022/23 (so is effective from 1 April 2022).

15. Full consultation on IFRS 16 *Leases* is not repeated in this ITC. However, the role of lease accounting in the liability measurement model for service concession arrangements (PPP/PFI, etc) is included in this ITC as a specific area for stakeholder consideration and feedback (see below).

A1	Service concession arrangements: measurement of the liability

Background

16. Successive consultations on the implementation of IFRS 16 have requested views on the approach to measurement service concession arrangement liabilities.

17. CIPFA/LASAAC considered three options for the measurement of the service concession arrangement liability:

- measurement as a financial liability using IFRS 9
- measurement using the IAS 17 *Leases* measurement provisions
- measurement in accordance with the IFRS 16 measurement of the lease liability.

18. The IFRS 9 option was rejected for a variety of reasons. Subsequent consultation has focused on whether continuation of an IAS 17 approach would provide a sufficiently good measure of the fair value of the liability, or whether an IFRS 16 approach should be adopted.

19. CIPFA/LASAAC's view was that these liabilities should be measured in accordance with the IFRS 16 lease liability requirements. This is the basis on which the Board has consulted in the ITCs for both the 2020/21 and 2021/22 Codes. The principal difference between IAS 17 and IFRS 16 that affects the liability is that where payments depend on an index or rate, lessees are required to remeasure the liability to reflect changes to payments arising from changes in the index or rate.

20. The majority of responses to these consultations were supportive of this approach. There was however a balance of views, and some respondents expressed significant concern over the potential challenges of applying this approach. Having regard to concerns expressed in the 2020/21 consultation, CIPFA/LASAAC reviewed its analysis of the accounting requirements, and again determined that there was no suitable or appropriate alternative to adoption of IFRS 16 for the measurement of the liability.

21. The 2021/22 ITC outlined these considerations and set out the options in more detail.

22. The responses to the 2021/22 ITC consultation that **supported** the CIPFA/LASAAC proposals generally suggested that it better represented the value of the liability. The remeasurement of the liability in relation to indexation of payments was specifically noted as an improvement in IFRS 16.

23. The responses to the 2021/22 ITC consultation that **did not support** CIPFA/LASAAC's proposals variously suggested that:

- there would be practical difficulties in implementing the change, and this would be costly
- IFRS 16 does not apply because of scope exclusions in IFRIC 12
- lease accounting is not appropriate because service concessions are not leases
- Indexation in the unitary charges was primarily related to the service element of these arrangements, rather than being payment for the asset.

24. CIPFA/LASAAC reviewed these suggestions and constituted a working group to consider whether an IAS 17 approach might be considered to be appropriate, having regard to the need to accurately represent the liability and the costs of implementation.

25. The working group concluded the following:

- Neither IAS 17 nor IFRS 16 formally applies to these arrangements. Reporting is driven by a need to estimate the fair value of the liability, and while service concession arrangements are not leases, the nature of the arrangements was sufficiently similar to leases that the standards do provide a useful indicator of the fair value. The leasing measurement approach is being applied as an estimation method. There is therefore no case to answer in terms of scope exclusions.
- The question therefore is whether a specific method provides a good enough estimate of the fair value of the liability.
- The working group noted that IFRS 16 improves on the measurement approach in IAS 17 in a natural way. IFRS 16 represents the liabilities for lease arrangements more accurately than IAS 17, and they would also expect this to apply for arrangements with similar payment streams to leases.
- The working group also considered that there is insufficient evidence to support a case that indexation of service concession charges in local government primarily relates to provision of services, rather than relating to both provision of services and the service concession asset.

26. In line with the above, the working group confirmed CIPFA/LASAAC's choice of the IFRS 16 approach.

Implications of the changed requirements

27. The treatment of lease liabilities under IFRS 16 is quite similar to the treatment of finance leases under IAS 17. The principal difference is that where payments depend on an index or rate, lessees are required to remeasure the liability to reflect changes to payments arising from changes in the index or rate. Where relevant, this directly feeds through to the calculation of service concession liabilities.

28. This will not affect all service concession arrangements. Not all service concession arrangements incorporate indexation into the unitary charge, while in other cases there may be indexation, but it may not result in material changes to the payments which trigger remeasurement of the liability. However, remeasurement is expected to be necessary for many authorities, particularly those that have used PFI/PPP or similar approaches for schools.

29. The current approach based on IAS 17 determines an initial liability as the discounted value of future payments relating to the asset (rather than services or certain lifecycle replacement costs). It does not include any allowance for future increases in payments that depend upon an index or rate. Where changes to an index change the amount of payments for the asset, any increase is recognised as 'contingent rent' and is expensed.

30. Under IFRS 16, contingent rent is not simply expensed. The liability is adjusted to reflect the discounted value of future payments based on the current index or rate.

31. Broadly speaking, in a particular accounting period the increase in the liability under IFRS 16 will be proportional to the increase in the payment in that period. If the payment increases by 2% after the first year, the remaining liability will normally be 2% greater than under IAS 17. If similar increases have occurred over, for example, the first 20 years of a 35-year service concession arrangement, then annual payments would increase by nearly 50%, and this would need to be reflected in the remeasurement of the liability.

32. While the above provides an indication of the possible impact of the changed requirements, it will depend upon the specifics of the service concession arrangements at each authority. This will affect both the amount of the liability to be recognised, and the effort required to accurately calculate the liability. Background on these is provided at Appendix 1 to help respondents to the ITC understand the issues.

Additional guidance

33. Having regard to the above, the working group determined that CIPFA/LASAAC should facilitate the development of guidance to help local authorities implement the changes. It is anticipated that this would encompass, if applicable:

- consideration of de minimis cases when no action was required
- transitional provisions in IFRS 16 that apply equally to PFI/PPP and similar arrangements
- practical guidance to help preparers review and update internal PFI models where possible
- approaches to be used when documentation is not available.

A1 Service concession arrangements: measurement of the liability

Q1 Do you agree with the revised approach to measurement of the service concession arrangement liability? If not, why not? What amendments do you suggest?

Q2 Do you have any comments on the practical impact of the adoption of this approach? Are there any particular matters on which guidance would be helpful? Please provide details.

A2 Clarification of status of housing tenancies in transitioning to IFRS 16

34. CIPFA/LASAAC carried out a consultation on housing tenancies during its development of the 2021/22 Code. On the basis of this, various amendments were made to Appendix F, which shows the planned Code content in relation to IFRS 16 *Leases* when this is implemented.

35. This includes the following interpretations at 4.2.1.5

The Code interprets IFRS 16 so that housing tenancies reported within the Housing Revenue Account (HRA) are deemed to be operating leases that shall be accounted for under this section of the Code. The Code interprets IFRS 16 to confirm that operating lease disclosures for housing tenancies reported in the HRA shall not apply.

36. The practical effect of this interpretation is that all housing tenancies are deemed to be operating leases, but otherwise there is no effect on the recognition, measurement or disclosure of housing tenancies. However, from a formal perspective, these arrangements do need to be 'reassessed' to determine that they are (operating) leases. An amendment is therefore proposed to paragraph 4.2.2.93 of Appendix F, which states that

As a practical expedient, an authority shall not reassess whether a contract is, or contains, a lease at 1 April 2022 except in relation to leases for nil consideration.

The proposed amendment will confirm that this exemption from reassessment does not apply to housing tenancies in the HRA.

Additionally, paragraph 4.2.2.30 of Appendix F is inaccurately framed as excluding Housing Revenue Account tenancies from the scope of lease accounting. This should instead exclude these tenancies from the **disclosure requirements** for lease accounting in line with the interpretation at 4.2.1.5. The proposed amendment explains that only the disclosure requirements are disapplied.

A2 Clarification of status of housing tenancies in transitioning to IFRS 16

Q Do you agree with CIPFA/LASAAC on the amendments to paragraph 4.2.2.30 and 4.2.2.93?

If not, why not? What alternatives do you suggest?

Exposure draft B: Changes to accounting standards	
B1	Annual improvements to IFRS standards 2018–2020
B2	Property, plant and equipment: proceeds before intended use (amendments to IAS 16)
B3	IPSAS standards: IPSAS 42 *Social Benefits*

B1 Annual improvements to IFRS standards 2018–2020

37. The IASB has published 'Annual Improvements to IFRS Standards 2018–2020'. It will, subject to confirmation of UK adoption, be effective from 1 January 2022. It affects the following standards, with effects as described.

IFRS 1 (First-time adoption)	This amendment relates to foreign operations of acquired subsidiaries transitioning to IFRS.
IAS 37 (Onerous contracts)	This amendment clarifies the intention of the standard.
IFRS 16 (Leases)	This amendment removes a misleading example that is not referenced in the Code material for IFRS 16.
IAS 41 (Agriculture)	IAS 41 is one of the small number of IFRSs that are only expected to apply to local authorities in limited circumstances, and no detailed requirements are set out in the Code.

38. CIPFA/LASAAC considers that the amendments may affect specific cases prospectively. No substantive amendments to the Code are proposed. No requirement for adaptation or interpretation for local government application have been identified.

B1 Annual improvements to IFRS standards 2018–20

Q Do you agree with the proposals for implementation of these amendments to standards?

B2 Property, plant and equipment: proceeds before intended use (amendments to IAS 16)

39. The IASB has published 'Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)'. It will, subject to confirmation of adoption, be effective from 1 January 2022.

40. This amendment clarifies the intention of IAS 16 and in practice does not affect PPE under the Code, which is measured at current value. No substantive amendments to the Code are proposed. No requirement for adaptation or interpretation for local government application have been identified.

B2 Property, plant and equipment: proceeds before intended use (amendments to IAS 16)

Q Do you agree with the proposals for implementation of this amendment to standards?

B3 IPSAS standards: IPSAS 42 *Social Benefits*

41. The IPSASB issued IPSAS 42 *Social Benefits* in January 2019. It has an effective date of 1 January 2022 and earlier adoption is encouraged.

42. Before the development of IPSAS 42, the IPSASB used the term 'social benefits' in a wide sense to encompass a wide range of 'benefits' provided either without consideration, or for a value much less than the value of cash, goods or services provided. When developing IPSAS 42, the IPSASB determined that where these benefits were delivered through the provision of goods or services, or through the relief of obligations to pay tax or other statutory charges, the accounting is straightforward, and IPSAS 19 applies without modification.

43. IPSAS 42 therefore defines social benefits narrowly as cash transfers paid to specific individuals and/or households to mitigate the effect of social risk and address the needs of society as a whole. Specific examples include state retirement benefits, disability benefits, income support and unemployment benefits.

44. Social benefits are relevant to local authorities, both in the 'wide' and 'narrow' senses. Council tax benefit and housing benefit fall within the wide sense. COVID-19 grant funding to small businesses appears to be a social benefit in the IPSAS 42 sense.

45. IPSAS 42 provides guidance on accounting for the narrower category of social benefits expenditure. It includes a general approach to recognition, measurement and disclosures of social benefits. It also includes an insurance approach to the accounting for social benefits, which entities are permitted to use if certain conditions are met. No social benefit schemes in the UK are constructed as insurance schemes as outlined in IPSAS 42.

46. Except for social benefits constructed as insurance schemes, IPSAS 42 recognises liabilities in the same way as IPSAS 19 and IAS 37, taking the view that a liability for social benefit is recognised when all of the eligibility criteria are satisfied, and in practice these only apply to the next payment of benefit. This is also the view taken in the UK public sector, and results in the current treatment outlined in the Code, which considers these part of the 'natural' accrual process.

47. Having regard to the clarification provided by IPSAS 42, it no longer seems appropriate to frame the treatment of social benefits, whether in the wide or narrow sense, as not being within the scope of Section 8.2 of the Code, or in the scope of IAS 37. Adopting an approach also aligns the Code with the approach used by central government departments such as the Department for Work and Pensions using the Government Financial Reporting Manual: the benefits paid by the DWP fall squarely within the scope of IPSAS 32, and benefit provisions are reported on in line with IAS 37.

48. For these reasons, CIPFA/LASAAC proposes that the text in the first bullet of paragraph 8.2.1.3 is deleted. This sub paragraph scopes social benefits out of Section 8.2, and as explained above, this does not seem to clearly capture the accounting requirements, which follow IAS 37.

49. This does not affect the accounting requirements or current practice, which are unchanged.

50. This deletion is shown in exposure draft B.

B3 IPSAS standards: IPSAS 42 *Social Benefits*

Q1 Do you agree with the proposal to redraft paragraph 8.2.1.3?

Q2 Do you consider that any further explanation is needed or would be helpful to explain how the accounting for social benefits applies under IAS 37?

Exposure draft C: Legislation	
C1	Regulations on corporate joint committees under the Local Government and Elections (Wales) Act 2021

Exposure draft D: Other matters	
D1	IFRS 17 *Insurance Contracts* (future implementation)
D2	Review of capital financing requirement disclosures

C1 Regulations on corporate joint committees under the Local Government and Elections (Wales) Act 2021

51. The **Local Government and Elections (Wales) Act 2021** provides the framework for the establishment via regulations of a new mechanism for collaboration and regional working by local authorities – corporate joint committees (CJCs).

52. Four such CJCs are in the process of being established. The **Accounts and Audit (Wales) Regulations 2014** have been amended and material on CJCs is included at 20A.

53. In the early stages of this initiative, CJCs seem likely to be smaller relevant bodies where the applicability of the Code is described in 1.3.10.

54. In later years, CJCs may have more significant expenditures, and might fall to be included under 1.3.9 in the description of typical local authorities covered by these requirements. However, at this stage, no amendment to the Code is proposed.

C1 Regulations on corporate joint committees under the Local Government and Elections (Wales) Act 2021

Q Do you agree with the proposal not to include references to corporate joint committees in the Code at this stage?

D1 IFRS 17 *Insurance Contracts* (future implementation)

55. IFRS 17 *Insurance Contracts* has been issued, and after some amendments has a revised effective date of 1 January 2023. Subject to UK adoption, the earliest year for local government adoption would therefore be 2023/24.

56. CIPFA/LASAAC is participating in a working group established by HM Treasury to consider early implementation issues. Among other things, this has examined the scope of IFRS 17 and the extent to which the public sector may have contracts meeting the relevant criteria.

57. IFRS 17 *Insurance Contracts* will supersede IFRS 4 *Insurance Contracts*. IFRS 4 is one of the small number of IFRSs that are only expected to apply to local authorities in limited circumstances. The Code does not include detailed accounting requirements for such standards, which are simply listed in Appendix A (IFRSs with limited application to local authorities) with a brief explanation.

58. Accounting for insurance contracts is complex, whether under IFRS 4 taken together with UK requirements, or under IFRS 17.

59. The IASB is clear that IFRS 17, like IFRS 4, is designed for insurance companies. In its fact sheet it indicates:

> *IFRS 17 applies to insurance contracts. Although this means that IFRS 17 affects any company that writes insurance contracts, such contracts are generally not written by companies outside of the insurance industry. (IASB, May 2017)*

60. Key aspects of IFRS 17 are as follows:

- An insurance contract is one in which the issuer accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

- Significant insurance risk is a risk, other than a financial risk, transferred from the holder of the contract to the issuer (ie from the policyholder to the insurer). Significant insurance risk is measured only by reference to the scale of the potential compensation. The probability of the event occurring is not considered: even an extremely unlikely event can be a 'significant insurance risk' and require reporting to follow IFRS 17.
- IFRS 17 may apply to contracts that are not specifically titled as insurance contracts and/or are not considered to be primarily concerned with 'insurance'.
- Several scope exclusions are specified where other standards are considered to be applicable.

61. The final point is the main reason why IFRS 17 does not apply to large numbers of contracts for the sale of goods and services, which will normally fall to be accounted for using IFRS 15 *Revenue from Contracts with Customers*. Alternatively, IFRS 9 or IAS 37 may be applicable.

62. CIPFA/LASAAC has engaged with stakeholders to discuss the applicability of IFRS 17, and has included consultation questions in the ITCs for the 2020/21 and 2021/22 Codes.

63. Very few responses were made to the consultation questions, and the analysis of these responses did not provide a convincing case that IFRS 17 warrants provision of detailed material in the Code. For that reason CIPFA/LASAAC is working on the assumption that the Code should continue the current approach, designating IFRS 17 as one of the small number of IFRSs that are only expected to apply to local authorities in limited circumstances, and limiting the content of the Code.

64. However, precisely because the number of responses was very low, CIPFA/LASAAC is seeking further information to test this assumption.

65. CIPFA will be engaging with the small number of respondents to the 2021/22 ITC who provided detail on IFRS 17, but is also seeking further information in the ITC for the 2022/23 Code.

66. Appendix 2 provides a note on feedback received from previous consultations on those matters where potential issues for local authorities had been identified, and provides guidance on those matters that respondents might consider when making their response.

D1 IFRS 17 *Insurance Contracts* (future implementation)

Q1 Do you consider that the Code should set out detailed requirements on the application of IFRS 17 *Insurance Contracts*, having regard to the limited evidence from previous consultations and the guidance in Appendix 2?

Please explain your answer. If you consider that detailed Code material is required in relation to one of the categories below, please provide further information explaining why such material is would be helpful for your authority or clients, and the extent to which you consider this will apply to more than a small number of local authorities.

Q2 Pension guarantees: some pension guarantees are framed in a way that requires them to be accounted for in line with IFRS 4 *Insurance Contracts* under the current Code. It is anticipated that these will need to be accounted for under IFRS 17 when that standard is adopted.

Do you consider that detailed accounting requirements setting out the treatment of these should be specified in the Code? Please explain your answer.

Q3 Mutual insurance and other transactions explicitly framed as insurance: are you aware of mutual insurance activities or other insurance activities carried out by local authorities that would, prima facie, fall to be accounted for using IFRS 17 *Insurance Contracts*? Please provide details.

Q4 Economic development support: are you aware of guarantees associated with economic development support that satisfy the definition of an insurance contract under IFRS 17?

If yes, please provide details of the nature and terms of the guarantees.

Continued on the next page

D1 IFRS 17 *Insurance Contracts* (future implementation) – continued

Q5 Intermediaries: do you consider that there are cases where local authorities are providing insurance while acting as an intermediary in a way which needs to be accounted for under IFRS 17?

If yes, please provide details of the nature and terms of the guarantees.

Q6 Academy school guarantees: are you aware of guarantees associated with academy school commercial transfer agreements that satisfy the definition of an insurance contract under IFRS 17?

If yes, please provide details of the nature and terms of the guarantees.

Q7 Do you consider that there are cases where local authorities are providing warranties in a way that needs to be accounted for under IFRS 17, rather than being in the scope of IFRS 15?

If yes, please provide details of the contracts and warranties involved.

D2 Review of capital financing requirement disclosures

67. The consultation on the 2021/22 Code indicated that some local authorities were having difficulty measuring the capital financing requirement as required by paragraph 4.1.4.3 5) of the Code.

68. The capital financing requirement is defined in paragraph 79 of the Prudential Code as the underlying need for the local authority to borrow to fund its capital expenditure. The components of the capital financing requirement are specified in paragraph 79 and should be extracted from information in the local authority's Balance Sheet.

69. CIPFA/LASAAC is seeking views on whether paragraph 4.1.4.3 5) of the Code should simply refer to "the actual capital financing requirement as specified by the Prudential Code" or whether, for example, preparers should be referred to more detailed guidance by cross referencing to paragraph 79 of the Prudential Code.

70. CIPFA/LASAAC has confirmed that this would be referred to as the 'actual' capital financing requirement because prudential indicators in the Prudential Code also require estimated information.

71. The proposed amendment to paragraph 4.1.4.3 5) is shown in exposure draft D.

D2 Review of capital financing requirement disclosures

Q1 Do you agree with CIPFA/LASAAC on the amendment to paragraph 4.1.4.3 5) that the Code should refer to the actual capital financing requirement as specified by the Prudential Code?

If not, why not? What alternatives do you suggest?

Appendix 1

Moving to IFRS 16-based measurement of the service concession lease liability

Background: application of IFRS 16 to finance leases under indexation

1. The most significant change in IFRS 16 is that assets and liabilities are recognised for most leases, and the accounting is similar to that for finance leases under IAS 17. There are however some differences in the treatment of leases previously classified as finance leases.
2. Under IAS 17, finance lease liabilities are not remeasured when the value of future payments changes in a way that is not predetermined in the lease contract; for example, where payments are increased in line with an inflation index such as RPI. The increase in payments arising from indexation is simply expensed in the period to which the payment relates. This additional payment is known as 'contingent rent'.
3. A key change under IFRS 16 is that where indexation or other changes are made that affect future payments, the lease liability is remeasured. This remeasurement reflects only indexation or other changes that have already occurred and result in a change to the payment amount. It **does not encompass** anticipated movements in the index that have not happened yet, or other undetermined changes in future years.

Remeasuring the liability on an ongoing basis

4. Remeasurement is only necessary when a change in an index results in a change in the payment stream. If indexation is applied annually, remeasurement will be annual. If changes are made, for example, in five-yearly reviews, then remeasurement will follow that schedule.
5. For a lease where payments vary only due to indexation, the calculation of the reassessed liability is relatively straightforward. The value of the liability corresponds to the present value of future payments, and if a factor reflecting a change in the value of an index is applied to all future payments, the liability for future payments increases by the same factor. If indexation increases future payments by 2%, then the liability will increase by 2%.

Remeasuring the liability on transition in 2022/23

6. IFRS 16 includes a number of practical expedients that aim to help preparers transition from IAS 17. One of these is the 'modified retrospective' approach. The proposed Code mandates the 'modified retrospective' approach.
7. Instead of restating balances in previous years, for leases accounted for as finance leases the opening balance of the lease liability on 1 April 2022 is simply read across from the closing balance in the previous financial statements. Remeasurement of the lease liability is thereafter applied prospectively, when a requirement to reassess the liability is triggered by a change in future payments.

8. Applying the 'modified retrospective' approach means that preparers do not need to recalculate the opening balance of the lease liability, and they can defer subsequent remeasurement until a change in future payments is triggered. For example, where rental uplifts are on a five-yearly schedule, remeasurement may not be required for some time. However, where changes are made on an annual basis through annual indexation, remeasurement will be needed for the closing balance of the lease liability at 31 March 2023. For example, if future payments have increased by 50% due to index movements since the inception of the lease, this would normally be reflected in a 50% increase in the liability.

Application of IFRS 16 to service concession liabilities

9. The same features of the transition from IAS 17 to IFRS 16 apply to service concession arrangements where the unitary charge is subject to indexation. The liability captures the net present value of future payments of the unitary charge, to the extent that these represent payments for the asset. Under the IAS 17 approach, this is calculated at the inception of the contract, and amortised evenly over the life of the contract. Any additional payments for the asset are treated as 'contingent rent' and expensed in the accounting period to which they relate. By contrast, using the IFRS 16 approach the liability is remeasured when payments are increased due to indexation, and amortisation is applied to this larger liability.

10. Remeasurement of the liability will normally need to be carried out separately for each service concession arrangement and can be more complex than simply applying a factor based on an index.

11. Service concession arrangements are often complex, and multiple parameters and performance measures may feed into the calculation of the unitary charge, and apportionment of this into payments relating to the asset and payments relating to services. Indexation may also be applied in ways which are very straightforward or more complex.

12. In addition to identifying contingent rent in current year transactions, local authorities provide note disclosure of future commitments under PFI and similar arrangements; some local authorities separately disclose contingent rent in these projections. But while local authorities have quite a lot of information on the profile of future payments for the service concession asset, further work will normally be required to calculate the adjusted liability under IFRS 16.

13. If the effect of applying the current index or indices is to apply a constant factor to the charge for the asset, and the same factor would be applied to charges in future accounting periods if there were no further changes from indexation, then the adjusted liability can be straightforwardly calculated using this multiplier.

14. If the effect of indexation does not apply uniformly in future years, then unless the effect is not material, it will be necessary to explicitly calculate the liability by reference to the present value of future charges using current indexation. The effort required to do this will depend on the complexity of the model, and how well the model is understood by finance teams.

Indexation in typical service concession arrangements in UK local government

15. Service concession arrangements are quite varied in nature and specific implementation. It is however possible to find common themes for projects which provide similar services such as education, social housing, street lighting, waste collection etc.

16. To inform consideration of the ITC, we carried out a desk review of a small number of local authority financial statements and spoke to some preparers and consultants about the service concessions that are shown in their accounts. Key aspects we considered were whether asset components of projects were significant, and whether indexation has given rise to significant amounts of contingent rent that will need to be reflected in the service concession liability under IFRS 16. It proved easier to obtain information on some types of service concession arrangement than others.

17. Local authorities will need to assess their own arrangements having regard to their specific circumstances, but the apparent themes emerging from the review were as follows:

- **Schools:** indexation was a noticeable feature of all the schools PFI/PPP and similar arrangements that we reviewed. These arrangements generally have large service and asset components. Significant amounts of contingent rent are shown in the financial statements of some local authorities. While some projects are nearing the end of the contract term, many will run into the 2030s or beyond. The movement in the liabilities on transition to IFRS 16 is expected to be significant for many local authorities that have entered into these arrangements.
- **Social housing:** indexation was a feature of the social housing arrangements that we reviewed. These arrangements had large service and asset components. Significant amounts of contingent rent are shown in the financial statements of some local authorities. The movement in the liabilities on transition to IFRS 16 is expected to be significant for some local authorities that have entered into these arrangements.
- **Social care:** indexation was a feature of some of the social care arrangements that we reviewed. These arrangements had service and asset components. We were not able to separately determine the amount of contingent rent payable but we would expect this to be significant. We would therefore expect remeasurement of the liability to be required.
- **Street lighting**: indexation did not seem to be a feature of the street lighting arrangements that we reviewed, except sometimes during an initial build phase with no ongoing effect on the unitary charge. The arrangements were asset dominated with relatively small service components. As far as we could tell there was no contingent rent, and we would not expect the liabilities to be subject to remeasurement.
- **Road construction and maintenance:** indexation did not seem to be a feature of the road arrangements that we reviewed, except sometimes during an initial build phase with no ongoing effect on the unitary charge. The arrangements have both asset and service components. As far as we could tell there was no contingent rent, and we would not expect the liabilities to be subject to remeasurement.
- **Waste collection and waste processing:** the extent to which indexation applies to these arrangements and the extent to which this affects the payment for the assets varies. There were some arrangements for which indexation did not seem to be a feature; these arrangements were service-dominated with relatively small asset provision. As far as we could tell there was no contingent rent, and we would not expect the liabilities to be subject to remeasurement. There were other cases where indexation was applied but did not impact on the payments for the asset; these were again service-dominated. Indexation was a feature of one waste processing arrangement that we reviewed, which was set up through a waste authority providing a service to several local authorities. The arrangements had significant service components, but also had quite substantial asset components. Significant amounts of contingent rent were shown in the financial statements. The movement in the liabilities on transition to IFRS 16 would therefore be expected to be significant.

18. These examples may provide an indication of the impact on reporting on service concession liabilities at your local authority, but you will need to consider the specific features of each arrangement. Even for projects for similar services at the same local authority, there have been changes over time in how arrangements are structured, reflecting evolving business practices and reframed statutory and regulatory frameworks.

Appendix 2

Guidance to inform responses of whether IFRS 17 *Insurance Contracts* is likely to impact on local authority financial statements

Background: results of previous consultations

1. CIPFA/LASAAC has engaged with stakeholders to discuss the extent to which IFRS 17 is relevant to local authority transactions and has included consultation questions in the ITCs for the 2020/21 and 2021/22 Codes. These sought to inform consideration of whether issues in particular transactions warrant the inclusion of detailed accounting guidance in the Code, in the following areas:
   - pension guarantees
   - mutual insurance
   - economic development support
   - insurance where an authority is acting as an intermediary
   - academy school guarantees
   - warranties.
2. Very few responses have been made to the consultations on these matters. The majority of the responses suggested that the transactions in these areas would not involve insurance risk or would not fall to be accounted for under IFRS 17 rather than other standards such as IFRS 9, IFRS 15 or IAS 27.
3. An exception to this pattern was in relation to mutual insurance, where attention was drawn to Local Government Mutual, which is a mutual insurance company owned by its (local government) members and offers insurance products. However, it appears that Local Government Mutual will use FRS 102 together with FRS 103 *Insurance Contracts*. Local authority interests in the mutual are expected to be reported on in the same way as other investments.
4. Additionally, while the majority of respondents considered that pension guarantees would not fall to be accounted for as insurance contracts, CIPFA/LASAAC is aware from other work on pension guarantees that some pension guarantees are constructed in this way, and are currently reported on using IFRS 4 *Insurance Contracts,* rather than as financial instruments using IFRS 9 or provisions under IAS 37. Given the relative lack of comment on this issue, while it seems likely that IFRS 17 will apply to these cases, it is not clear that this is an issue that affects a significant number of local authorities, or that there is particular benefit in setting out detailed accounting in the Code.
5. However, before going forward on this basis, CIPFA/LASAAC is seeking to confirm this assumption, and would welcome comments on matters arising at your local authority (or client authority) or other local government bodies on which you have relevant information.

Comments and points to consider relating to the areas previously consulted on

Pension guarantees

6. These guarantees are generally given where previous local authority staff have transferred to a separate organisation under Transfer of Undertaking (Protection of Employment) (TUPE) arrangements, for example where an authority has established a subsidiary or associate to undertake activities, such as a leisure trust to run a sports centre.

7. The responsibility for pension entitlements in relation to past service normally remains with the local authority and will generally continue to be accounted for under IAS 19. The entity to whom staff are transferred will generally take responsibility for subsequent service, but may be given cover by the local authority against the risk that they are unable to support the pension obligation. This might be a contingent liability for the local authority under IAS 37, but where the transfer arrangements are contractual, consideration needs to be given as to whether these should be accounted for under IFRS 9 *Financial Instruments* or IFRS 4 *Insurance Contracts*.

8. Some respondents to Code consultations suggest that these will normally be financial guarantees, where the local authority is standing ready to provide funding if the entity to whom staff have transferred defaults on payment. These fall to be accounted for under as a financial instrument under IFRS 9 unless the authority has previously asserted explicitly that it regards such contracts as insurance contracts and has used the accounting guidance applicable to insurance contracts. However, the nature of the guarantee will depend on the specific terms of the pension guarantee, which might be framed in terms other than default.

9. It is known that some pension guarantees are currently reported on using IFRS 4, but we do not have information to suggest that there are a significant number of these.

10. CIPFA/LASAAC's working assumption is that these are not widespread, but it would be helpful if respondents could consider if they have any information that would challenge this assumption. If your authority (or audit or consultancy client) has pension guarantees that are currently reported on using IFRS 4 please provide information on this. It would be useful to know how widespread these are and whether there are any specific matters on which it would be useful to provide Code material when IFRS 17, beyond explaining that IFRS 17 applies to some of these transactions (which could be noted in Appendix A).

Mutual insurance and other transactions explicitly framed as insurance

11. As noted above, Local Government Mutual is a mutual insurance company owned by its (local government) members and offers insurance products. This entity clearly issues and needs to report on insurance contracts. However, Local Government Mutual is reporting under UK GAAP and will use FRS 102 together with FRS 103 *Insurance Contracts*. Local authority interests in the mutual are expected to be reported on in the same way as other investments.

12. In line with the above, CIPFA/LASAAC has no information to suggest that Local Government Mutual gives rise to a need for material in the Code.

13. However, if you disagree, or you have information about other mutual insurance or local authority activity explicitly framed as insurance (other than acting as an intermediary), please provide information on this.

Economic development support

14. No specific examples of guarantees made in relation to economic development support have been provided by respondents to Code consultations, and this issue might mainly relate to circumstances where a local authority guarantees a commercial loan to a company.

15. In these cases, there is a question as to whether the exposure of the local authority arises from a contract with the lender. If it is determined that there is a contract, then this will represent a financial guarantee contract, which will fall to be accounted for under as a financial instrument under IFRS 9 unless the authority has previously asserted explicitly that it regards such contracts as insurance contracts and has used the accounting guidance applicable to insurance contracts.

16. However, some of the responses made to Code consultations suggested that support arrangements can involve wider categories of underwriting or compensation for specific events. This would seem likely to reflect insurance risk and not be scoped out of IFRS 17, and we will be investigating this further.

17. If you consider that economic development support in your local authority may in some cases have given rise to guarantees that are not financial guarantee contracts, then please provide information on the nature of these guarantees, or other information that will help us review whether this issue is sufficiently widespread to warrant the inclusion of material in the main body of the Code.

Local authorities acting as intermediaries

18. Respondents on this question mainly noted that their local authority was purchasing insurance on behalf of tenants of local authority property or local authority schools. In some cases the local authority collects insurance premiums on behalf of the insurer, while in other cases charges are made to recover the cost of an insurance contract between the council and an insurer. They did not consider that they were acting as an insurer.

19. CIPFA/LASAAC is inclined to accept these representations but would be interested to know if there are cases where you consider that local authorities are providing insurance while acting as an intermediary in a way that needs to be accounted for under IFRS 17.

Academy school guarantees

20. No specific examples in relation to guarantees made to academy schools have been provided that are considered to be insurance contracts or contain insurance risk. However, some respondents have noted that the terms of commercial transfer agreements vary considerably, and it is possible that these could include guarantees that involve insurance risk.

21. `Looking at the standard formulations of commercial transfer agreements it seems that these mainly contain indemnities that intended to have the effect of keeping certain responsibilities and the associated potential liabilities with the local authority. They do not on the face of it appear to expose the authority to insurance risk as a result of a contract. However, it is conceivable that different approaches could result in guarantees rather than the retention of existing responsibilities, and where these are not financial guarantees there might be a need to account for these using IFRS 17.

22. If you are aware of guarantees associated with academy school transfers in your local authority that are not financial guarantee contracts, then please provide information on the nature of these guarantees, or other information that will help us review whether this issue is sufficiently widespread to warrant the inclusion of material in the main body of the Code.

Warranties

23. No specific details were provided of contracts with implied or express warranties that fall to be accounted for using IFRS 17. Some respondents noted that contracts for goods or services containing warranties will normally fall to be accounted for using IFRS 15 *Revenue from Contracts with Customers* and are scoped out of IFRS 17.

24. However, we understand that concerns have been raised in respect of warranties against latent defects in housing stock in large scale voluntary transfers to housing associations. Such warranties could be formulated as warranties within the scope of IFRS 15, but it is possible that they might not. We understand that in many cases the transferring authority has taken out insurance policies to cover the risk that they might be required to make good or provide compensation for latent defects to transferred housing stock.

25. CIPFA/LASAAC would therefore be interested in views on warranties in relation to large scale voluntary transfers at your local authority (or audit or consultancy client) that have not expired through the passage of time.

26. CIPFA/LASAAC would also be interested in information on any other warranties that you consider might fall to be accounted for using IFRS 17 rather than IFRS 15 or other standards.

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