

REPORT

Committee	CIPFA/LASAAC Local Authority SORP Board
Venue	London, Robert Street Offices 6 March 2009
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Subject	Analysis of responses to 2009 Invitation to Comment

PURPOSE

To report on the responses to the 2009 Local Authority SORP consultation exercise.

INTRODUCTION

- 1 In total there were 71 responses (listed at Appendix A) to the public consultation on the draft 2009 SORP. Respondents heavily or very heavily supported most proposals. Two proposals were rather less heavily supported but were still supported by about 70% or more of respondents. These concerned accounting for PFI and accounting for Council Tax in England.
- 2 The responses received are summarised below, question by question, followed by the Secretariat's comments and suggestions.
- 3 Copies of the responses received have been sent separately to Board members electronically.

SUMMARY OF RESPONSES

ACCOUNTING FOR PRIVATE FINANCE INITIATIVE (PFI) AND SIMILAR CONTRACTS

Q1 Do you agree with the proposals to base the accounting requirements for PFI and similar contracts on the FReM from 1 April 2009? If you do not agree please give reasons.

	No	%
Agree	31	76
Disagree	11	24

Most respondents who disagreed gave more than one reason for disagreeing. The reasons given for disagreeing were:

- (ii) The proposal may assist the WGA process but this in itself is not a sufficient reason to require authorities to change their accounting process a year earlier than originally planned (eight respondents).

- (iii) Do not agree that IFRS should be adopted selectively in a UK GAAP-based SORP (four respondents).
- (iii) Not convinced the early introduction of the change would smooth transition to IFRS (four respondents).
- (iv) Concern that there will be an impact on council tax notwithstanding that regulations to avoid this have been put in place in England and Wales and will be issued shortly for consultation in Scotland. Some suggested the need for 'worked examples' of IFRS-based accounting for PFI to demonstrate there would not be an adverse impact on authorities' resources.

The Audit Commission was one of the respondents that disagreed. The three other external audit bodies that responded (Audit Scotland, Wales Audit Office and PricewaterhouseCoopers) supported the SORP Board's proposal, as did CLG and HM Treasury. The Audit Commission's response is shown in full in Appendix B.

Q2 Do you agree that if, as discussions progress and events unfold, CIPFA/LASAAC concluded that the adoption of FReM-based accounting requirements for PFI would risk adverse impact on budget requirements and taxation, it should not proceed with implementing the proposal in 2009/10?

	No	%
Agree	42	95
Disagree	2	5

The two respondents that disagreed were the Audit Commission and a local authority. The Audit Commission commented: *"The Commission would not normally expect budget and taxation to determine accounting principles"*. The local authority commented: *"Disagree. Should it [ie risk of adverse impact on budget requirement and taxation] happen, any financial consequence should be offset by introducing a statutory override."*

Q3 Do you have any comments on the detail of the section on accounting for PFI and similar contracts of the 2009 Exposure Draft SORP?

Twelve respondents commented substantively on Q3. Six respondents commented in some or considerable detail on the accounting issues and the Exposure Draft text. These substantial responses are shown in Appendix C.

In addition, the FRAB has recently approved amendments to the FReM for 2009/10 in this area. Comments on these changes were made by the FRAB secretary in relation to the IFRS-based Code of Practice. These changes have also been considered for the 2009 SORP, and address some of the issues raised by respondents.

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON ACCOUNTING FOR PFI

The comments received from respondents have proved very useful in refining the Exposure Draft and a number of amendments have been made to it. The Secretariat's suggested amendments to the consultation Exposure Draft are shown in Appendix D. The key amendments proposed are:

- (a) Details of the appropriate accounting where a scheme does not meet the control tests have been added.
- (b) The text has been amended to clarify when assets and liabilities are recognised, and how these are to be measured. In particular, the reference to the finance lease treatment has been clarified.
- (c) In line with the amended FReM, the method of estimating the split of the unitary payment into three elements now requires authorities to first estimate the service charge element, then the repayment of the liability (based on the cost/fair value of the assets), with the interest element being the remainder. In the unusual circumstances that the interest element has to be estimated, the approach is now consistent with that required by the amended FReM. One of the key respondents (Leeds City Council) had also indicated that both changes would be desirable in practice.
- (d) Additional text has been added to clarify the approach to assets provided by the local authority but not used in the PFI/PPP arrangement and the approach to prepayments.
- (e) References to MRP have been amended to require authorities to comply with the regulations; previously the text required authorities to adopt a specific interpretation of the statutory guidance.

In addition, respondents identified two possible issues with MRP in England and Wales. The first relates to the adjustment of opening balances on transition to the new arrangements and the interaction with the MRP regulations. The second relates to the relationship of on-balance sheet PFI/PPP schemes with the HRA Item 8 Debit and Credit Determinations. It is proposed that both issues should be raised with CLG and the Welsh Assembly Government, with a view to establishing whether any amendments to regulations or statutory guidance are required, although it should be noted that authorities may already have on-balance sheet PFI / PPP schemes that will interact with the Item 8 Debit and Credit Determinations. Similar discussions may be required in Scotland, where new statutory guidance will shortly be issued for consultation.

A number of other issues that were raised by respondents (for example, the inclusion of additional guidance on the control tests) can best be addressed by the Guidance Notes, and it is recommended that these be raised with the LAAP secretary.

ACCOUNTING FOR NNDR IN THE CORE FINANCIAL STATEMENTS IN ENGLAND, SCOTLAND AND WALES

Q4 Do you agree that in England, Scotland and Wales billing authorities act as agents of their respective jurisdictions' Governments when collecting NNDR?

	No	%
Agree	44	94
Disagree	3	6

Two of the three respondents who disagreed advanced accounting principle based arguments. One commented that the accounting standard that covers the issue of principal and agent (Application Note G of FRS 5) is framed in the context of exchange transactions; the other argued that billing authorities do

act as principal because they are exposed to risk and reward via the interest income generated on cash balances held by them pending payment to the Government. The third respondent who disagreed felt the change would not make the accounts easier to understand and suggested that the matter could be covered as a note in the accounts of billing authorities.

Q5 Do you agree that a billing authority:

(a) Should not include income in its Income and Expenditure Account for the NNDR it collects from taxpayers?

	No	%
Agree	43	98
Disagree	1	2

The one respondent who disagreed did so on the ground that since the billing authority could gain from earning interest on cash collected and not yet paid over to the government, it acted as a principal when collecting NNDR.

(b) Should not include NNDR taxpayer debtor and creditor balances in its balance sheet?

	No	%
Agree	40	91
Disagree	4	9

The four respondents who disagreed did so because:

- (i) The billing authority issues the bills under statute and its role, as specified in regulations, should prevail rather than attempting to identify a different accounting 'substance' to the underlying transactions (two authorities).
- (ii) The billing authority does act as principal because it is exposed to risk and reward associated with earning interest on cash balances.
- (iii) The change would not make the accounts easier to understand.

(c) Should include a creditor in its balance sheet for NNDR cash collected from taxpayers at the balance sheet date but not yet paid to the Government ('national pool') or a debtor for cash overpaid to the Government?

	No	%
Agree	40	93
Disagree	3	7

One respondent who disagreed considered that cash balances held as an agent by the billing authority should be excluded altogether from the accounts since they belonged to the principal. The other two respondents who disagreed did so on the same grounds as they had disagreed with Q5(b) (see points (i) and (ii) above).

Q6 Do you agree with CIPFA/LASAAC's proposals for including NNDR cash flows in the Cash Flow Statement?

	No	%
Agree	36	82
Disagree	8	18

The reasons given by the authorities that disagreed were:

- (i) The cash inflows and outflows arising from NNDR are too large to be hidden away as a net amount in 'movement on liquid resources' and should be separately disclosed (three respondents).
- (ii) NNDR related cash flows should be excluded entirely from the Cash Flow Statement (one authority).
- (iii) As the billing authority acts as a principal, the cash flows should be in revenue activities (one respondent).
- (iv) Billing authorities do act as agents but NNDR cash flows should nevertheless be disclosed as revenue activities not in 'movement on liquid resources' as proposed (two respondents).

Q7 This ITC question asked respondents for any comments or suggestions for amending the Exposure draft text on accounting for NNDR. One substantive suggestion was received, which was that the treatment of 'surcharges' added to taxpayers' accounts (eg in respect of costs of pursuing debts) could usefully be clarified.

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON ACCOUNTING FOR NNDR

- 1 With regard to question Q4 concerning whether the billing authority acts as an agent, the Secretariat accept that Application Note G is framed in the context of commercial (exchange) transactions. This issue was discussed by CIPFA/LASAAC and it was agreed that it was reasonable to apply the principles of Application Note G by analogy. The Secretariat does not accept that being allowed to keep any interest earned on cash balances not yet paid over to Government means a billing authority acts as principal. Periodic (weekly, monthly) accounting by an agent for amounts due to the principal would be quite a normal arrangement and, in the Secretariat's view, does not change the nature of the relationship between the parties.
- 2 With regard to question Q5(a), the comments of the only authority that considered NNDR to be the income of the billing authority (on the grounds of earning interest on cash NNDR cash not yet passed on to the Government) have been considered in paragraph one above.
- 3 With regard to question Q5(b) concerning including NNDR taxpayers debtors and creditor balances on the billing authorities balance sheet; the reasons advanced for the view that these balances should remain on the billing authority's balance sheet have largely been considered under Q4 and Q5(a). However, one argument advanced by two respondents has not previously been considered, which is that the billing authorities role as specified under regulation should prevail rather than attempting to identify a different accounting substance. The Secretariat does not accept this; *FRS 5 Substance of Transactions* requires transactions and other events to be accounted for in accordance with their economic substance rather than legal form.

- 4 With regard to question Q5(c) concerning including a creditor in the billing authorities balance sheet for NNDR cash collected from taxpayers at the balance sheet date, the arguments of the respondents who disagreed have already been considered in the report under questions Q4 to Q5(b).
- 5 With regard to question Q6 concerning the proposals for including NNDR cash flows in the Cash Flow Statement under 'movement in liquid resources', the disagreement of two authorities are on grounds that have in effect been considered already under a number of other questions. Of the remaining five authorities which disagreed with the proposal three felt that NNDR cash flows were too large to be hidden away as a net amount in movement of liquid resources and two felt they should be disclosed in revenue activities even though they were not income of the billing authority.
- 6 The Secretariat has considered the matter further in the light of the provisions of both *FRS 1 Cash Flow Statements* and *IPSAS 2 Cash Flow Statements*. *IPSAS 2* specifically covers 'collection of taxes by one level of government for another'. *FRS 1* does not cover the matter as specifically as *IPSAS 2* but includes a section entitled *Value Added and Other Taxation*.
- 7 *IPSAS 2* requires classification of cash flows into only three classes, which are 'operating activities', 'investing activities' and 'financing activities'. In *IPSAS 2* the collection of taxes by one level of government for another is regarded as an investing and/or financing activity (not an operating activity), the cash flows are permitted but not required to be reported on a net basis.
- 8 FRS 1 says:

"40 Taxation cash flows other than those in respect of the reporting entity's revenue and capital profits and Value Added Tax, or other sales tax, should be included within the cash flow statement under the same standard heading as the cash flow that gave rise to the taxation cash flow, unless a different treatment is more appropriate in the particular circumstances concerned."
- 9 In the case of collecting NNDR as an agent and paying it over to Government, there is no "*cash flow that gave rise to the taxation cash flow*" (ie like a sale gives rise to VAT output tax), it is an entirely discrete event; and one that is not an 'operating activity' of the billing authority but accounted for within the balance sheet. In the Secretariat's view it would be inappropriate to disclose NNDR cash flows within operating activities particularly as this approach seems unlikely to be adopted in the IFRS-based Code. On balance the Secretariat considers the consultation proposal to include within 'movement of liquid resources' is the most satisfactory treatment and suggests no amendment to the consultation Exposure Draft should be made.
- 10 A suggestions was made for amending the consultation Exposure Draft concerning the treatment of 'surcharges' added to taxpayers' accounts (eg in respect of costs of pursuing debts), which the respondent felt could usefully be clarified.

- 11 In the Secretariat's view, if surcharges are added to the NNDR demand (or indeed issued separately) and the authority is not required to account for this income to the Government it is the billing authority's income. The Secretariat suggests that paragraph 3.65e of the consultation Exposure Draft is amended by adding a new bullet point (e) to the end of the section as follows:

3.65e

- (e) *"Amounts are sometimes billed to NNDR taxpayers over and above the NNDR due, usually to recover the billing authority's costs of pursuing unpaid NNDR debts. Any amounts charged to NNDR taxpayers in respect of amounts that the authority is not required to account for to the Government are income of the billing authority."*

ACCOUNTING FOR COUNCIL TAX IN THE CORE FINANCIAL STATEMENTS IN ENGLAND

- Q8 *Do you agree that in England a billing authority acts as an agent of its major preceptors when collecting the element of council tax relating to the major preceptors' council tax precepts?*

	No	%
Agree	25	81
Disagree	6	19

The reasons given by the respondents who disagreed were:

- (i) The billing authority issues the bills under statute and the relationship specified in regulations should govern the accounting rather than seeking to identify the 'substance' of the underlying transactions (three respondents).
- (ii) Not an agent because the accounting standard that covers the issue of principal and agent (Application Note G of FRS 5) is framed in the context of exchange transactions (one respondent).
- (iii) The billing authority acts as principal because it is exposed to risks and rewards associated with earning interest on cash balances (one respondent).
- (iv) The change would have the potential to adversely impact on the final accounts closedown timetable (one respondent).

- Q9 *Do you agree that:*

- (a) *A billing authority should not include any income in its Income and Expenditure Account for the council tax income relating to major preceptors' precepts?*

	No	%
Agree	24	89
Disagree	3	11

The reasons given by the respondents who disagreed were:

- (a) The billing authority acts as principal as it issues the bills under statute and the relationship specified in regulations should govern the accounting rather than seeking to identify the 'substance' of the underlying transactions (one respondent).
 - (i) The billing authority acts as principal because it is exposed to risks and rewards associated with earning interest on cash balances (one respondent).
 - (ii) The suggested change complicates the accounts and does not benefit accounts users (one respondent).

- (b) *For both billing authorities and major preceptors the council tax income credited to the Income and Expenditure Accounts should be their accrued council tax income for the year, and that the difference between this and the amount required by the Collection Fund regulations to be included in the General Fund should be included as a reconciling item in the Statement of Movement on the General Fund Balance?*

	No	%
Agree	20	77
Disagree	6	23

The reasons given by the respondents that disagreed were:

- (i) The difference between Council Tax income measured in accordance with GAAP and the amount permitted by regulation to be taken to the General Fund would not usually be material (one respondent).
- (ii) The change would complicate the accounts for very little benefit (two respondents).
- (iii) No reason given (three respondents).

- (c) *Council tax debtor and creditor balances are not wholly assets and liabilities of the billing authority but should be carried in the relevant proportions on the balance sheets of the billing authority and major preceptors?*

	No	%
Agree	19	73
Disagree	7	27

The reasons given by the respondents who disagreed were:

- (i) The billing authority acts as principal as it issues the bills under statute and the relationship specified in regulations should govern the accounting and therefore the Council Tax debtors are its assets (three respondents).
- (ii) The billing authority acts as principal because it is associated with the risks and rewards associated with earning interest on cash balances (one respondent).
- (iii) Billing authority acts as principal since the preceptors have no control over it.
- (iv) Agree proposed change is technically correct but it is not material.
- (v) Adds greater complexity to accounts without benefit to accounts users.

(d) *Relevant proportions of the net cash collected from council tax debtors belongs to the major preceptors and that at the balance sheet date creditors or debtors should be recognised by the billing authority for cash not yet paid or overpaid respectively to major preceptors?*

	No	%
Agree	18	69
Disagree	8	31

The reasons for disagreeing were essentially the same as for Q9(c) above.

(e) *Major preceptors should recognise a debtor or creditor for the net cash collected on their behalf by the billing authority from council tax debtors and creditors but not yet paid to them, or overpaid, at the balance sheet date?*

	No	%
Agree	18	75
Disagree	6	25

The reasons for disagreeing were essentially the same as for Q9(c) and Q9(d) above.

Q10 *Do you agree with CIPFA/LASAAC's proposals for including council tax cash flows in the Cash Flow Statement?*

	No	%
Agree	19	76
Disagree	6	24

The reasons given by the authorities that disagreed were:

- (i) The cash inflows and outflows arising from Council Tax are too large to be hidden away as a net amount in 'movement on liquid resources' and should be separately disclosed (three respondents).
- (ii) As a billing authority acts as a principal the cash flows should be in revenue activities (one respondent)
- (iii) Agree billing authority acts as an agent and that cash collected for major preceptors is not income of the billing authority but the cash flows should nevertheless be disclosed as revenue activities not in 'movement on liquid resources' as proposed (two respondents).

In addition, one respondent commented that the *"description under 'cash outflows for precepts paid needs expanding to point out that this excludes collection fund precepts to major preceptors."*

Q11 This ITC question asked respondents for any comments or suggestions for amending the Exposure draft text on accounting for Council Tax in England. The substantive suggestions received were:

- (a) **Paragraph 3.24e** – *we are not convinced that it is helpful for the SORP to specify a formula here and the paragraph could be deleted,*

especially as it appears to require the authority to know the result already in order to be able to calculate the constituent variables. Our understanding (which may be outmoded if there have been recent changes in statutory arrangements) is that the amount owing to or owed by an authority is calculated as (eg, for 2009/10):

- *the council tax surplus/deficit estimated for 2009/10 as part of the budget-setting process and advised by the billing authority, split according to the proportion of demands and precepts made for 2009/10*
 - *the difference between this estimate and the outturn calculated for the 2009/10 statement of accounts, split according to the proportion of demands and precepts made for 2010/11*
- (b) **Paragraph 3.24f** – *the SORP appears here to be condoning the use of information that an authority has no assurance is not out of date. The “finalised” figure for the billing authority’s accounts will itself only be an estimate, based as it is on bad debt provisions. We consider that authorities should be expected to apply the general principles of the SORP in relation to estimation and that this paragraph could be deleted.*
- (c) **Paragraph 3.24g** – *as per paragraph 3.24e, we do not find the specification of the use of this formula necessary (see also paragraph 3.24).*
- (d) **Paragraph 3.24i** – *it is not clear what the purpose of this paragraph is if the relationships between billing authority and preceptors are supposed to be on an accruals basis. The Collection Fund rules ensure that all cash due has to be paid by the end of a financial year and paragraph 3.24d establishes the accrual for surpluses/deficits otherwise arising.*

SECRETARIAT’S COMMENTS AND SUGGESTIONS ON ACCOUNTING FOR COUNCIL TAX IN ENGLAND

- 1 Many of the reasons advanced by respondents for disagreeing with the accounting for council tax proposals are very similar to those advanced for disagreeing with the similar ITC questions raised about the NNDR proposals. However, more authorities disagreed with the Council Tax proposals.
- 2 With regard to Q8 concerning whether a billing authority acts as the agent of its major preceptors, two of the arguments advanced for disagreeing that the billing authority acted as agent were the same as those made for Q4 the similar NNDR ITC question. These were:
 - (a) Not an agent because the accounting standard that covers the issue of principal and agent (Application Note G of FRS 5) is framed in the context of exchange transactions (one respondent).
 - (b) The billing authority act as principal because it is exposed to risks and rewards associated with earning interest on cash balances (one respondent).

The Secretariat does not accept that these comments are valid for the reasons stated in the NNDR section of the report.

- 3 One of the other reasons given for not agreeing that the billing authority acts as agent has already been considered under ITC question Q5(a), which is:

- (a) The billing authority issues the bills under statute and its role, as specified in regulations, should prevail rather than attempting to identify a different accounting 'substance' to the underlying transactions (two authorities).

The Secretariat does not accept that these comments are valid for the reasons stated in the NNDR section of the report.

- 4 The final reason given for disagreeing that the billing authority acted as agent was that the change would have the potential to adversely impact on the final accounts closedown timetable. The Secretariat accepts that the change could have this potential if the consultation proposals required major preceptors to await receipt of 'final' collection fund figures from the billing authority, however, it does not. The issue is covered in paragraph 3.24f of the consultation Exposure Draft as follows:

3.24f Where at the time it is ready to finalise its statement of accounts a major preceptor has been unable to obtain finalised Collection Fund information from the billing authority, it shall use the billing authority's latest estimate of the Collection Fund outturn and its share of the surplus or deficit on the Collection Fund.

- 5 With regard to ITC question Q9(a) on whether a billing authority should include Council Tax income in respect of amounts relating to major preceptors' precepts in its Income and Expenditure Account, the three reasons for disagreeing have all been considered in the context of NNDR earlier in the report and the Secretariat does not accept that these comments are valid for the reasons stated in the NNDR section of the report.
- 6 With regard to ITC question Q9(b) concerning the proposal that for both billing authorities and major preceptors the council tax income credited to the Income and Expenditure Account should be their accrued council tax income for the year, no respondent considered the accounting treatment proposed to be incorrect. All three respondents who stated a reason for disagreeing did so on the pragmatic grounds that the difference between Council Tax income measured in accordance with GAAP the and amount permitted by regulation to be taken to the General Fund would not usually be material or the change would complicate the accounts for little benefit. These same comments were raised initially by some CIPFA/LASAAC members when the Board deliberated the matter; following discussions the Board agreed to include the proposed changes in the Exposure Draft. In the Secretariat's view, therefore, these comments do not provide a compelling reason to amend the consultation proposals.
- 7 With regard to ITC questions Q9(c) to Q9(e) concerning respectively the proposals that:

- council tax debtor and creditor balances should be carried in the relevant proportions on the balance sheets of the billing authority and major preceptors;
- the relevant proportions of the net cash collected from council tax debtors belongs to major preceptors; and
- the proposal that major preceptors should recognise a debtor or creditor for cash collected on their behalf by the billing authority.

The reasons given by respondents for disagreeing with the proposal have been considered under either the NNDR section or earlier in this section. In the Secretariat's view, none of the reasons for disagreeing with the proposal are compelling.

- 8 With regard to ITC question Q10 concerning the consultation proposals for including council tax cash flows in the cash flow statement, the comments received from the respondents that disagreed with the consultation proposals were essentially the same as for NNDR and the Secretariat's conclusions are the same. On balance the Secretariat considers the consultation proposal to include Council Tax cash flows within 'movement of liquid resources' is the most satisfactory treatment and suggests no amendment to the consultation Exposure Draft should be made.
- 9 ITC question Q11 requested any comments on or suggestions for amending the section of the consultation Exposure draft covering Council Tax in England. Quite extensive and valid drafting comments were received from one respondent. After considering these, the Secretariat was persuaded that this very complex section of the Exposure Draft could be considerably simplified and shortened. The Secretariat's suggested amendments (track changed) are contained in Appendix E. The Secretariat also suggests that a respondent's suggestion for amending one of the lines of the proposed Cash Flow Statement is implemented. The suggested amendment shown in mark-up is:

Revenue activities

Cash outflows

Cash paid to and on behalf of employees (if direct method used)

Other operating cash payments (if direct method used)

Housing benefit paid out (if direct method used)

Precepts paid (if direct method used) (excluding payments to major preceptors in England)

Payments to the Capital Receipts Pool (in England and Wales only) (if direct method used)

ACCOUNTING FOR COUNCIL TAX IN THE CORE FINANCIAL STATEMENTS IN WALES

Q12 Do you agree that in Wales a billing authority acts as principal when collecting the element of council tax relating to the major preceptors' council tax precepts?

	No	%
Agree	8	100
Disagree	0	0

Q13 Do you agree that a billing authority in Wales:

(a) Should include the whole accrued council tax income for the year in its Income and Expenditure Account, including the amounts raised to cover major preceptors' (ie Police Authorities') precepts?

	No	%
Agree	8	100
Disagree	0	0

(b) Should carry the council taxpayers' debtor and creditor balances, including amounts relating to the major preceptor precepts, in its balance sheet?

	No	%
Agree	8	100
Disagree	0	0

Q14 Do you agree with CIPFA/LASAAC's proposals for including council tax cash flows in the Cash Flow Statement?

	No	%
Agree	9	100
Disagree	0	0

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON ACCOUNTING FOR COUNCIL TAX IN WALES

1 There was no disagreement with the proposal for accounting for Council Tax in Wales, however, one substantive comment was received, which suggested some drafting amendments to avoid unnecessary repetition. The Secretariat agrees that these suggestions simplify and improve the clarity of the text. The Secretariat suggests that paragraphs 3.24r and 3.24s are revised as follows:

3.24r ~~Unlike in England there is not a Collection Fund in Wales and major preceptors do not share with the billing authority the risk that actual council tax collection outturn will be greater or lesser than that assumed when setting the billing authority's council tax demand and major preceptors' precepts~~ Billing authorities in Wales do not maintain a Collection Fund. Under regulation major preceptors in Wales (in effect Police Authorities), like community councils receive the exact amount of their precept. ~~In contrast, the billing authority's council tax income for the year will not be the exact amount of its council tax demand since it will be affected by the council tax income accruing in~~

~~the year being more or less than that assumed when setting the billing authority's council tax demand and preceptors' precepts~~ Major preceptors do not therefore share with the billing authority the risk that actual council tax collection outturn will be greater or lesser than assumed when setting council tax requirements.

3.24s ~~Since the billing authority bears the whole risk of council tax income being higher or lower than estimated, it is acting as a principal rather than an agent in relation to major preceptors. and all~~ All council tax income is therefore the income of the billing authority and shall be included as council tax income in the billing authority's Income and Expenditure Account. Council tax debtors or creditors and impairment allowance for doubtful debts shall be included wholly in its balance sheet. The major preceptors' precepts shall be included as expenditure in the billing authority's Income and Expenditure Account. The council tax income for the year included in a major preceptor's Income and Expenditure Account shall be its council tax precept for the year. ~~Since in Wales the billing authority acts as principal in collecting council tax, council tax debtors or creditors and impairment allowance for doubtful debts shall be included wholly in its balance sheet.~~

ACCOUNTING FOR COUNCIL TAX IN THE CORE FINANCIAL STATEMENTS IN SCOTLAND

Q16 *Do you have any comments on or suggestions for amending paragraph 3.24q of the consultation SORP Exposure Draft, which covers council tax income in Scotland? If so, please give them. It would be helpful if reasons are given and alternatives suggested for matters with which you disagree.*

The only substantive comment was a suggestion for improving the clarity of drafting. It was suggested that the penultimate sentence of paragraph 3.24q of the Exposure Draft, which says "It is understood that the SORP requirements accord with the accounting policies usually followed by authorities in Scotland" should be replaced with:

"It is understood that the pre-existing accounting policies usually followed by authorities in Scotland accord with the 2009 SORP's new requirements".

SECRETARIAT'S COMMENTS AND SUGGESTIONS ACCOUNTING FOR COUNCIL TAX IN SCOTLAND

The Secretariat suggests that the above drafting amendment is adopted.

ACCOUNTING FOR RATES IN THE CORE FINANCIAL STATEMENTS IN NORTHERN IRELAND

Q17 *Do you agree that the income credited to the Income and Expenditure Account in respect of rates for the year should be the amount receivable for the year from the Land and Property Services Agency?*

	No	%
Agree	3	100

Disagree	0	0
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Q18 Do you agree that a debtor or creditor for the 'actual penny rate product' adjustment for the year that will be made by the Land and Property Services Agency in the following year should be included as a debtor or creditor?

	No	%
Agree	3	100
Disagree	0	0

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON ACCOUNTING FOR RATES IN NORTHERN IRELAND

Only three respondents replied to Q17 and Q18 both of whom agreed with the consultation proposals.

REMOVAL OF LARGER PARISH AND COMMUNITY COUNCILS FROM THE APPLICATION OF THE SORP

Q19 Do you agree that the larger parish and community councils should be removed from the application of the SORP if an appropriate alternative source of 'proper practices' becomes available to take its place for the 2009/10 year of account?

	No	%
Agree	28	97
Disagree	1	3

Thirteen Town Councils and the National Association of Local Councils responded to the consultation as well as 15 other respondents. The respondent that disagreed was a town council. It wanted the SORP to continue to apply to large parish councils because:

"councils dealing with £1 million and upwards of income or expenditure should be required to justify their actions to a professional standard through the application of the Statement of Recommended Practice (the professionally recognised level of best practice)". And

"constant changes within the accounting practices of Councils are not viewed positively by the public, as it leads to difficulty comparing one financial year with another."

Q20 Do you agree that in England the Joint Practice Advisory Group and the Local Authority Audit Liaison Group in Wales, which are currently the bodies that prepare the non-statutory 'proper practices' guidance for the preparation of accounts by all local and community councils except the 40 or so larger parish and community councils, are the appropriate bodies to prepare guidance for the larger parishes and community councils? If not, please give your reasons and preferred alternative.

	No	%
Agree	27	100
Disagree	0	0

Q21 Do you agree that paragraph 3.76 of the SORP should be amended to delete references to "town, parish and community councils" and "internal drainage boards"?

	No	%
Agree	27	100
Disagree	0	0

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON REMOVAL OF LARGER PARISH AND COMMUNITY COUNCILS FROM THE APPLICATION OF THE SORP

1 Two respondents made the same comment, one was the Audit Commission, which said:

"The Commission feels that it would be most helpful if the disapplication applied to other bodies for which the SORP represents proper practices (per Appendix A of CLG Circular 03/2006) and not just the larger local councils (eg Joint Committees, Port Health Authorities, Conservation Boards)."

2 In the Secretariat's view there is not enough time to undertake the appropriate consultation and other due process to allow this suggestion to be incorporated in the 2009 SORP. The Secretariat suggests the matter should be considered as part of developing the 2010 Code.

3 Given the very strong support for removing larger parish and community councils from the application of the SORP, the Secretariat suggest no changes are made to Exposure Draft.

ACCOUNTING FOR REORGANISED LOCAL AUTHORITIES

Q22 Do you agree that local government reorganisation should be treated as a "machinery of government" change, and accounted for in the same manner as a group restructuring using merger accounting?

	No	%
Agree	32	100
Disagree	0	0

Q23 Do you agree that transfers should be reported in a restated opening balance sheet, and not through the Income and Expenditure Account?

	No	%
Agree	32	100
Disagree	0	0

Only one substantive comment was received, which was as follows:

"Agreed. However, the proposal that paragraph 3.65a should require transfers to take place at the carrying amount as at the transfer date may not be appropriate. Our expectation is that where assets and liabilities are being transferred from a relinquishing authority to a new unitary authority, negotiations will take place as to transfer values and that these will not

necessarily be bound by the amounts that are being carried in the 31 March Balance Sheet of the relinquishing authority.

Practically, it is to be hoped that this will be the situation, with the relinquishing authority preparing its accounts to reflect the conclusions arrived at in the negotiations. But if the SORP were to require carrying amounts to be used, then this might constrain the ability of authorities to negotiate in line with their statutory duties."

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON ACCOUNTING FOR REORGANISED LOCAL AUTHORITIES

- 1 The Secretariat accepts that the above comments are valid and suggest that paragraph 3.65a of the Exposure Draft is amended as follows:

3.65a Public sector bodies such as local authorities are deemed to be under common control. The combination of two or more local authorities into one new authority, or the transfer of functions (in full or in relation to a geographic area) from the responsibility of one authority to another, shall be accounted for using the principles that apply to group reorganisations. Assets and liabilities shall normally be transferred at their carrying amount as at the transfer date; it is assumed that where authorities have agreed revised amounts in respect of some or all assets and liabilities (in accordance with their statutory duties), these will be reflected in the carrying amounts as at the transfer date. In the exceptional circumstance that revised amounts are agreed after the Statement of Accounts for the year before reorganisation has been issued, assets and liabilities shall be transferred at their agreed amounts, and the difference between these agreed amounts and their previous carrying amounts shall be disclosed in a note to the accounts.

FINANCIAL REPORTING STANDARDS

- Q24 Do you agree that there are no financial reporting standards developments that need to be included in amendments to the SORP?

	No	%
Agree	38	100
Disagree	0	0

- Q25 Do you agree that if Improvements to Financial Reporting Standards is issued shortly as an FRS, CIPFA/LASAAC should consider further whether there are any matters that could usefully be included as minor clarifying amendments in the 2009 SORP?

	No	%
Agree	40	95
Disagree	2	5

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON FINANCIAL REPORTING STANDARDS

- 1 Only one of the two respondents who disagreed with Q25 gave a reason, which was they did not want “*further changes to the SORP*”. However, some of respondents that supported the proposal commented that any amendments made should not be substantive but only “minor clarifying amendments” as indicated in the ITC question.
- 2 Two candidates for amendment have been identified. The first concerns SORP paragraph 4.32, which deals with the situation where the estimate of the cash flows on which the initial effective interest was calculated is revised. The SORP says the carrying amount of the instrument shall be re-calculated by computing the present value of estimated future cash flows at the instrument’s **original** effective interest rate. However, FRS 26 now requires the **revised** effective interest rate to be used where the financial instrument is being accounted for under hedge accounting. The second proposed amendment concerns when dividends payable should be recognised, which is covered in the entry that briefly summarises *FRS 21 Events After the Balance Sheet Date* contained in SORP Appendix A *Application of Accounting Standards*.
- 3 It is suggested that the following changes, shown in mark-up, are made to the Exposure Draft:

4.32 If the estimate of cash flows on which the initial effective interest rate was calculated is revised (eg by revising the expected life of the financial instrument) the carrying amount of the financial instrument should be revised to reflect actual and revised estimated cash flows. This is done by computing the present value of estimated future cash flows at the instrument’s original effective interest rate. The adjustment to the carrying amount is recognised as income or expense in the Income and Expenditure Account. Such an adjustment to a loan debt could have a large effect on the amount of finance cost taken to the Income or Expenditure Account in the year the adjustment is made. However, it should be noted that where the instrument is accounted for under the hedging accounting requirements the revised effective interest rate is used. In such as situation the matter is accounted for in accordance with FRS 26. Paragraphs 92 and AG8 of FRS 26 are of key relevance.

***Dividends** declared by a company after the Balance Sheet date but before the financial statements are authorised for issue, are ~~required not to be~~ recognised as a liability at the Balance Sheet date because no obligation exists at that time. Such dividends are disclosed in the notes.*

UNAPPLIED GRANTS RESERVE

Q26 *Do you agree with changing the name of the unapplied grant reserve to unapplied grant account?*

	No	%
Agree	33	100
Disagree	0	0

Two comments were received:

- (i) *For completeness, the SORP should include 'Unapplied Grants Account' in the items to be included in the 'Information to be included in the Balance Sheet'.*
- (ii) *What is the basis for advising [in paragraph 3.103 of the SORP] that amounts of unapplied grant can be credited directly to the Capital Adjustment Account if they have been applied to new expenditure? When would a government grants deferred approach not be the appropriate treatment?*

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON UNAPPLIED GRANTS RESERVE

- 1 The Secretariat agrees with comment (i) and suggests that a line for Unapplied Grants Account should be added to the "Information to be included in the Balance Sheet" following Government Grants Deferred.
- 2 In the Secretariat's view response (ii) has identified an error in paragraph 3.103. It is not appropriate to make a direct transfer to the Capital Adjustment Account; grant should always be credited to Government Grants Deferred Account when applied, then amortised to the Income and Expenditure Account in line with amortisation of expenditure. The Secretariat suggests that paragraph 3.103 is amended as follows:

3.103 In Wales the Major Repairs Allowance should be credited to an unapplied grant account when it becomes receivable. When the account is applied to new expenditure, the authority should ~~consider whether it would be relevant to transfer the amount to Government the Grants Deferred Account – otherwise it will be credited to the Capital Adjustment Account.~~

MATTERS NOT COVERED BY THE 2009 SORP INVITATION TO COMMENT

- Q27 *Do you consider that there are additional amendments that need to be made to the 2009 SORP? If so, please give details of the matter.*

The matters raised by respondents were as follows:

- (a) Paragraphs 3.30 and 3.31 should be amended to reflected the terms of the LASAAC guidance on the authorised for issue date.
- (b) The 2008 SORP Guidance Notes (on page 590) encourage authorities to operate an Investment Revaluation Reserve for investment properties, and allow a negative balance. There is no basis for operating such a reserve in the SORP. It would be helpful if the SORP covered this point explicitly.
- (c) The SORP Guidance Notes (on page 731) encourage accrued interest on financial instruments to be disclosed as part of long-term liabilities rather than current liabilities. It would be helpful if the SORP specifically covered this point and confirmed that accrued interest should be disclosed under current liabilities along with other current elements of the loan.

- (d) The SORP's disclosure requirements for 'members' allowances' does not cover changes in remuneration arrangements that have come into force for members in Scotland. These require all authorities to publish information on councillors' salaries, allowances and expenses.
- (e) There is a typographical error in SORP paragraph 5.35 note 43(iv). The last word of the note says "unfunded" but it should say "funded".
- (f) The Charity Commission takes the view that it could never be appropriate for a local authority to consolidate a charity in its group accounts. It has requested that drafting amendments should be made to the SORP in order to embed this view in the SORP. To achieve this the Charity Commission suggest the definitions of 'Benefit' and 'Interest' in the SORP Chapter on *The Group Accounts* are amended:
- to include in the first paragraph of the definition of 'benefits' the sentence:

"It should be noted that where the local authority acts as trustee or appoints all or the majority of trustees, benefit cannot arise due to the requirements of trust law,"
 - to include in the definition of 'interest' the sentence:

"It should be noted that where the local authority acts as trustee or appoints all or the majority of trustees, no interest can arise due to the requirements of trust law."

SECRETARIAT'S COMMENTS AND SUGGESTIONS ON MATTERS NOT COVERED BY THE 2009 SORP INVITATION TO COMMENT

(a) Authorised for issue date in Scotland

- 1 The respondent suggested the following amendment to SORP paragraph 3.31 to reflect the LASAAC guidance.

~~In Scotland, the date the Statement of Accounts was authorised for issue and who gave that authorisation should be disclosed~~ a statement should be disclosed on the face of the balance sheet in the final published financial statements stating the date the unaudited accounts were issued; and the date the audited accounts were authorised for issue. The authorised for issue date should be consistent with the date the audit certificate is signed.

- 2 The Secretariat suggests that the respondent's proposed amendment should be included in the 2009 SORP.

(b) Investment Revaluation Reserve

- 3 The SORP Guidance Notes do accurately reflect the requirements of SSAP 19 Investment Properties and the SORP does not. *SSAP 19* requires changes in the value of investment properties including those taking the carrying amount below cost to be taken to the STRGL as a movement on an 'Investment

Revaluation Reserve' unless the loss in value is expected to be permanent, in which case it should be taken to profit and loss of the period. The Standard also requires the Investment Revaluation Reserve to be "displayed prominently in the financial statements".

- 4 The Secretariat would like CIPFA/LASAAC to consider two options. The first option is that the Exposure Draft could be amended as follows:

6.125 *Except for investment properties, ~~W~~where a fixed asset is included in the Balance Sheet at current value, the increase over the previous carrying amount at which that asset was included in the Balance Sheet immediately prior to the latest (re-)valuation should be credited to the Statement of Total Recognised Gains and Losses and taken to the Revaluation Reserve except to the extent it reverses revaluation losses (after adjusting for depreciation) on the same asset that were previously recognised in the Income and Expenditure Account (or Consolidated Revenue Account Net Operating Expenditure), when it should be recognised in the Income and Expenditure Account.*

3.126 *Except for investment properties, ~~W~~where on revaluation there has been a decrease over the previous carrying amount an impairment loss has occurred. It should be considered whether the loss has been caused by clear consumption of economic benefits and any such loss should be recognised in the Income and Expenditure Account. The amount of the decrease in value not associated with a clear consumption of economic benefit should be recognised in the Statement of Total Recognised Gains and Losses until the asset's carrying amount reaches its depreciated historical cost and is taken to the Revaluation Reserve; and thereafter in the Income and Expenditure Account.*

3.126a *For investment properties changes on revaluation whether increases or decreases shall be taken to the Statement of Total Recognised Gains and Losses as a movement on the Investment Revaluation Reserve, unless any decrease below historical cost (or its reversal) on an individual investment property is expected to be permanent, in which case it should be charged (or credited) to the Income and Expenditure Account.*

- 5 The second option is being put forward for pragmatic reasons. Asset management systems may not be set up to support separate treatment of investment properties; and under IFRS investment properties are accounted for at fair value through profit or loss – so this would be a one-year change. Authorities could be given an option of having an accounting policy of assuming all changes below depreciated historical cost are permanent – this would be prudent – but also maintain the existing accounting for those who want to do so. This might be implemented by adding the following new last sentence to 3.126a:

"There is an element of subjectivity in making the assumption that a fall in value below depreciated historical will not be permanent, it would therefore

be permissible to have a policy of presuming the fall is permanent unless the presumption is rebutted by clear evidence that it is not."

(c) *Accrued interest on financial instruments*

- 6 The Secretariat has not been able to establish definitively within UK accounting standards, whether the part of the carrying amount of a long-term liability at the balance sheet date that represents interest accrued and payable within 12 months of the balance sheet should be presented within current liabilities. FRS 25, which deals with financial instruments presentation, devotes six paragraphs to defining 'current liabilities' but does not cover the matter. However, on the general principle of a current liability being a liability that is due to be settled within twelve months after the balance sheet date, it would seem appropriate to present interest accrued payable within 12 months of the balance sheet date as a current liability. However, IFRS does explicitly cover the matter. Paragraph 71 of *IAS 1 Presentation of Financial Statements* says the "current portion of a non-current liability" shall be presented as a current liability. In the absence of a definitive UK standard it would be appropriate to follow IFRS requirements. It is suggested that SORP paragraph 4.105 should be amended as follows:

4.105 An authority should regard its financial liabilities as due to be settled within 12 months after the Balance Sheet date, and classify them as current, even if:

- (a) the original term was for a period longer than 12 months, and*
- (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the Balance Sheet date and before the financial statements are authorised for issue.*

Examples are bank overdrafts, the current portion of long-term financial liabilities, dividends payable, trade creditors and other creditors due to be settled within 12 months after the balance sheet date.

(d) *Disclosure of members' allowances in Scotland*

- 7 The Secretariat agree that the current SORP disclosure requirements regarding members' allowances no longer cover the position in Scotland adequately and suggest note 14 be amended as follows:

(14) The totals of members' allowances paid in the year. In Scotland all elements of members remuneration and reimbursement of actual expenditure under the heads of salaries, allowances and expenses.

(e) *Typographical error in SORP paragraph 5.35 note 43(iv)*

- 8 The respondent is correct and the typographical error will be corrected in the 2009 SORP.

(f) *Consolidation of charities into local authority group accounts*

- 9 The Charity Commission has made similar representation to HM Treasury, the Audit Commission and National Audit Office on the matter of consolidating charities into public bodies' accounts; and the matter was discussed at the February 2009 meeting of FRAB. Concern was expressed widely by FRAB members at the Charity Commission's position and by all the key stakeholders that had been contacted by the Charity Commission; and FRAB took the view that the best way forward was to pursue a coordinated approach to discussing this issue with the Charity Commission rather than individual sectors such as NHS, local government and central government pursuing separate discussions.
- 10 The Secretariat suggests that this is not a matter that could be brought to a conclusion at present and should be pursued through the co-ordinated approach suggested by FRAB.
- 11 In addition to the matters put forward by respondents to the consultation exercise, a matter has come out of the 'Back to Basics' consultation that the Secretariat considers could usefully be implemented in the 2009 SORP. This concerns relieving the statement of accounts from unnecessary or low priority note disclosures. The notes identified for possible removal were:
- (a) Discretionary expenditure (England, Northern Ireland and Wales)
 - (b) Expenditure on publicity (England, Northern Ireland, Scotland and Wales)
 - (c) Building Control Account (England and Wales)
 - (d) Business Improvement District Schemes (England, Scotland and Wales)
 - (e) Local Authority Goods and Services Act (England, Northern Ireland, Scotland and Wales)

One point to note is that that in England and Wales their respective Accounts and Audit Regulations require to be included in the statement of accounts:

"(d) any other statements relating to each and every other fund in relation to which the body is required by any statutory provision to keep a separate account;".

We are discussing with CLG and the Wales Assembly Government whether this requirement would apply to any of the following notes to the accounts. The Secretariat believes it is probable that the requirement does not apply and the Secretariat's comments on the five notes to the accounts below are based on this view.

Discretionary Expenditure

- 12 Note 5 to the accounts says:

"Expenditure required to be disclosed in England by s137 of the Local Government Act 1972 (as amended) and in Northern Ireland by s15 of the Local Government Act (Northern Ireland) 1972."

- 13 Section 137 originally allowed a local authority to spend a limited amount on activities for which it has no specific power, but which the authority considered *“will bring direct benefit to the area, or any part of it or all of some of its inhabitants”*. The majority of the provisions of section 137 of the Local Government Act 1972 have been repealed by the “well-being” powers contained in Part 1 of the Local Government Act 2000. This gives principal local authorities a discretionary power to do anything they consider likely to promote or improve the economic, social or environmental well-being of their area. Nearly all the expenditure that formerly relied on s137 powers is now incurred under well-being powers, however, principal authorities still rely on powers under s137(3) to incur expenditure on donations to charities and not-for-profit bodies and mayoral appeals.
- 14 Expenditure under s137 powers would now rarely be significant for a principal local authority. Authorities are still required to disclose s137 expenditure but there is no requirement that this is within the statement of accounts. Before the advent of well-being powers s137 was potentially significant, but now that it is not it is doubtful whether the information still warrants disclosure in a note to the accounts.

Expenditure on Publicity

- 15 Note 6 to the accounts says:

“Expenditure on publicity required to be recorded by s5 of the Local Government Act 1986 and in Northern Ireland by s115(c) of the Local Government Act (Northern Ireland) 1972.”

The Acts two key provisions are that:

- (1) A local authority shall keep a separate account of their expenditure on publicity.
- (2) Any person interested may at any reasonable time and without payment inspect the account and make copies of it or any part of it.

There is no requirement for the information to be published. In the Secretariat’s view such information does not warrant disclosure in financial statements.

Building Control Account

- 16 Note 7 to the accounts says:

“The nature, turnover and profit/losses of the building control account required by the Building Act 1984 and specifically the local Authority to SI 1988/3129 Building Control Charges Regulations (SI 1998/3129) (England and Wales only).”

Regulation 5(6) of the regulations contains the following requirement to prepare accounts:

“6) A local authority shall, at the end of the financial year within which the local authority makes a scheme and immediately after the end of each

successive financial year, prepare a statement which shall set out fully the scheme made by it and the amount of the income and proper costs."

- 17 There is no requirement to publish the 'statement'. Regulation 12 contains provisions concerning 'Publicity' but does not refer to the statement, rather it is wholly concerned with publishing details of the charging scheme.

Business Improvement District Scheme (BID)

- 18 Note 10 to the accounts says:

"An explanation of the nature of any Business Improvement District Schemes and the BID revenue accounts for all BID projects."

- 19 The note relates to the requirement for the BID billing authority to keep a BID Revenue Account under section 14 of the Business Improvement Districts (England) Regulations 2004 and very similar regulations for Scotland and Wales. The respective Schedule 3 of all three sets of regulations specifies the credits and debits that shall be made to the BID Revenue Account. The requirement is to keep a BID Revenue Account in accordance with Schedule 3, there is no requirement under regulations to publish the account.

Local Authority (Goods and Services Act) 1970

- 20 Note 10 to the accounts says:

"Income from bodies under the Local Authorities (Goods and Services) Act 1970 and the related expenditure."

Further research by the Secretariat suggests that this is not in fact a candidate for removing as a note disclosure, since section 2(2) of the Act would seem to require Goods and Services Act activities to be disclosed as a separate account in the "abstract of accounts" (ie the Statement of Accounts). Section 2(2) says:

"The accounts of a local authority by whom agreements in pursuance of the said section 1 are entered into under which the authority are to provide any such property or service or do such work as is mentioned in subsection (1) of that section shall include a separate account in respect of the agreements; and subsections (4), (6) and (7) of section 283 of the Local Government Act 1933 and sections 101 and 105 of the Local Government (Scotland) Act 1973] (which relate to the inspection and taking of copies of the abstract of accounts of authorities) shall have effect as if any reference to an abstract of the accounts of an authority included a reference to such a separate account as aforesaid."

- 21 One other amendment to the SORP that likely legislative developments would make desirable, would be to paragraph 5.35, note 15, which deals with officers' remuneration, this embeds the current legislative requirements in the SORP text. It seems likely that the legislative requirements will change during the currency of the of the 2009 SORP. The Secretariat suggests that the note should be amended to refer to the requirements more generically so that they would apply equally to amended legislation, as follows:

~~The number of officers whose remuneration in the year was £50,000 or more, grouped in rising bands of £10,000 at the levels specified by regulation and such other disclosures as the legislation may require. For Welsh authorities the Accounts and Audit Regulations (Wales) 2005 require the remuneration starting point to be £60,000.~~

APPENDIX A

THE ORGANISATIONS AND INDIVIDUALS THAT RESPONDED TO THE 2009 SORP INVITATION TO COMMENT

ENGLISH AUTHORITIES

Ashford BC	Merton LBC
Basingstoke & Deane DC	Mid-Suffolk DC
Bexley LBC	Newcastle City Council
Brighton & Hove	Norfolk CC
Calderdale MBC	Rotherham
Cheshire CC	Sefton
East Riding of Yorkshire CC	Sevenoaks DC
Guildford BC	Solihull MBC
Hampshire CC	Stockport MBC
Harrogate	Staffordshire CC
Havering LBC	Suffolk CC
Islington LB	Tonbridge & Malling DC
Kent CC	Wakefield
Lancashire CC	Walsall MBC
Leeds City Council	West Wiltshire FRSA
Malvern Hills DC	

ENGLISH PARISH COUNCILS

Bodmin TC	Haverhill TC
Chesham TC	Littlehampton TC
Chippenham TC	Peterlee TC
Devizes TC	Tavistock TC
East Grinstead TC	Trowbridge TC
Great Aycliffe TC	Woodley TC
Hatfield TC	

SCOTTISH LOCAL AUTHORITIES

Aberdeenshire	Glasgow City Council
Argyle & Bute Council	Inverclyde Council
Dundee City Council	North Lanarkshire
East Ayrshire Council	South Lanarkshire
Fife Council	

WELSH LOCAL AUTHORITIES

Cardiff	Powys
Conwy	Rhonda Cynon Taff
Gwynedd	

OTHER ORGANISATIONS

Audit Commission	Hereford and Worcester Treasurers Association
Audit Scotland	NALC
Butlers	PricewaterhouseCoopers
Department for Communities and Local Government	Scottish Local Government Directors of Finance Section
Hants CFOs and Chief Accountants	Sector Treasury Services
H M Treasury	Wales Audit Office

APPENDIX B

THE AUDIT COMMISSION'S RESPONSE TO QUESTION ONE OF THE ITC

Q1 *Do you agree with the proposals to base the accounting requirements for PFI and similar contracts on the FReM from 1 April 2009? If you do not agree please give reasons.*

The Commission does not agree with the proposals to base the accounting requirements for PFI and similar contracts on the FReM from 1 April 2009.

Issues of principle

The proposals would result in the SORP being based on UK GAAP but selectively following the principles set out in International Financial Reporting Standards (IFRS) for PFI and related contracts. The financial reporting framework should be based on a coherent set of accounting standards. At a time when there has been increasing convergence between the SORP and UK GAAP, the Commission sees the proposals as a backwards step. This is illustrated by the acknowledgement in the ITC that the ASB might need to comment on the matter in their statement of negative assurance or even qualify their statement.

Practical considerations

The Commission recognises that the proposal to base the accounting requirements for PFI and similar contracts on the FReM is driven by practical considerations. The Commission appreciates the importance of an accounting framework that is capable of being implemented but notes that some practical issues support the continued use of UK GAAP for PFI and similar contracts.

From 2009/10 Treasury Note No 1 (TTN1) will, in effect, be withdrawn. Although local authorities do not fall within the scope of TTN1, it is referred to in the SORP guidance notes and has been a key document for local authorities in determining the accounting treatment of PFI and similar contracts. The Commission considers that in the absence of TTN1 there would be little practical difference between the accounting entries required by FRS 5 and those required by IFRIC 12. Rather than introduce IFRS principles into a SORP based on UK GAAP, the same result would be achieved by applying FRS 5 without reference to TTN1. The guidance notes for the 2009 SORP could include some worked examples to demonstrate this.

The main rationale for CIPFA/LASAAC's proposal is to enable financial statements to be prepared on the same basis as WGA returns. WGA returns require a lower level of detail than the financial statements and a higher level of materiality. Preparing the WGA entries based on the FReM may not, therefore, be as onerous as expected.

As noted in the exposure draft, the proposals would be likely to result in local government bodies with material PFI schemes having to treat the change in accounting policy as a prior year adjustment. This is a significant task for which some local government bodies may not be fully prepared.

APPENDIX C

THE SIX KEY RESPONSES TO ITC QUESTION 3

Q3 Do you have any comments on the detail of the section on accounting for PFI and similar contracts of the 2009 Exposure Draft SORP?

AUDIT SCOTLAND

Exposure draft para 4: The last sentence of this paragraph could helpfully state what the general provisions of the SORP are, or perhaps cross-refer to a specific paragraph.

Exposure draft para 6: The SORP requires components to be accounted for separately where the useful lives are *substantially* different. The second sentence of this paragraph should include this word.

Exposure draft para 7: The last sentence seems unnecessary given it simply repeats a sentence in paragraph 5. Also its existence in this paragraph implies that there should be separate lease calculations (and hence separate liabilities) for land and buildings but this is unlikely to be necessary.

Exposure draft para 8: It might be worth clarifying that this paragraph refers to the value of the assets when originally bought into use. It might be useful to add 'In the rare circumstances' to the start of the last sentence.

Prepayments 14: There may be merit in clarifying how the prepayment should be treated once the asset is bought onto the balance sheet

Disclosure: It might be helpful to clarify whether additional financial instruments disclosures are required in relation to PFI liabilities

21 Capital Financing Requirement (England & Wales): It's not clear why this paragraph does not apply to Scotland.

23: The cross reference in the last sentence of this paragraph should be to paragraph 24.

Payments 24: Further guidance would be helpful on reversing the previous accounting treatment. Particular difficulties might arise where part of the previous payments were in respect of funding the acquisition of the residual interest in the asset, and treated as a capital item.

It would be helpful to cover the treatment of development costs that were previously written of (as they related to property not on the balance sheet) where the property has now been brought on to the balance sheet.

EAST RIDING OF YORKSHIRE

We have been advised, by Paul Mason at CIPFA, to start taking action now, but the guidance is not clear in a number of areas for us to be able to do that:

Para 5

a) 'The related liability shall be calculated following the principles of a finance lease under SSAP 21' - not very prescriptive. I initially took this literally but now presume it only applies to use of the actuarial method to split the principal/interest element, not to work out the interest rate implicit in the lease by estimating the construction payments to the end of the contract and discounting these to the estimated fair value at the same point, the discount rate being the IRR and then applying the IRR to the contract payments. In a normal finance lease the resulting present value would become the value of the asset and liability.

Para 5 - If the assets are recognised in accordance with FRS 15, do we have to recalculate the liability when the assets are revalued?

Para 6 - 'Where the operator enhances property already recognised on the balance sheet of the local authority' - Does this relate to previously contributed assets once they are reversed back onto the local authority balance sheet, or only those that have been there all along?

Para 8 - What does paragraph 3.113 of the SORP say in relation to measuring fair value - if it is the same as para 3.113 of SORP 2008 we are going to need more direction than this - schools are valued on a DRC not MV basis. Grant Thornton indicated the operators construction costs may be proxy, but they are unlikely to give us that information.

Paragraph 8 of the Exposure Draft - should this refer to property or asset?

The disclosure requirements for 'the value of liabilities resulting from PFI arrangements at each balance sheet date, and an analysis of movement in those values'. Is this in current price terms or will we have to discount the expected payment stream?

With regard to the prior year adjustment steps:

Presumably step 1, para 23 refers only to assets that have never appeared on the local authority balance sheet? (not very clear).

Para 24 directs to allocate the payments made from the inception of the arrangement to 31/03/08 to the three elements and reverse the original accounting treatment. Do we assume that we then have to then apply the accounting treatment under the new rules from inception to 31/03/08?

Step 2 para 29 - same comment as for para 24 - if we reverse the 2008/09 UK GAAP accounting treatment for the unitary payment and split the unitary payment into the 3 elements, presumably we then need to apply the IFRIC 12 requirements? A possibly pedantic point but it isn't clear, and reading comments on TISonline, some people do need it spelling out! Does this apply to authorities with contributed assets or just those recognised for the first time in step 1?

Para 30 - applying depreciation and reversing previous accounting treatment - what about deciding between MRP or unitary payment as the charge?

LEEDS CITY COUNCIL

We have three major concerns over the proposals:

(i) Splitting of the unitary charge

This is likely to be the most difficult exercise in practice for local authorities. Paragraph 7 starts with the suggestion that the unitary charge may be readily separable between services and assets. However, the whole point of PFI schemes was that the unitary charge should not be separable, and local authorities will have gone to great lengths to ensure that it cannot be separated. Paragraph 8 then goes on to say that as an alternative, the unitary charge should be separated using the fair value of the assets acquired and the interest rate implicit in the contract. However, the interest rate implicit in the contract (in the usual meaning of this term) can only be calculated if the service element has already been separated out. In the case of most authorities, this would therefore result in the third option of using their own incremental borrowing rate and the fair value of the assets to calculate the principal repayment and finance charge. As the authority's borrowing rate would have been considerably lower than the contractor's, this results in artificially low liabilities and some very expensive-looking services. We note that the IFReM currently specifies the use of a standard risk-free market rate as the interest rate for the contract. Whilst this may not be the most appropriate index to use, we would suggest that it would be better for all parts of the public sector to be using the same approach to this issue, and that this should be the use of a market index which realistically reflects the typical cost of borrowing for private sector contractors at the relevant time.

(ii) Contracts for enhancements to existing assets

Some contracts for enhancements to existing assets are for a large number of small works over a period of several years. For example, a contract for management and improvement of housing stock may require a programme of various component replacement works to be undertaken over the first 5 years of the contract. Presumably in theory an authority should only recognise such improvements in the year in which they are carried out, but this would require an extensive data gathering exercise. Furthermore, it would be complex and extremely difficult to calculate liabilities for each year's improvements, as this would require some method of further splitting of the unitary charge between the various elements of work done. There is a need for the SORP to address how this problem should be approached, since it is clear that some form of broad estimation would be needed.

(iv) Retrospective adjustments to MRP

Paragraphs 28 and 33 refer to retrospective restatement of MRP for the comparator year and for earlier years. The legality of this proposal is dubious. The MRP is a statutory charge and not an accounting entry, and there is no provision in statute for MRP that was correct in the year it was made to be retrospectively amended. Although IFRS may require accounting entries to be made as if IFRIC 12 had applied from the start of schemes, this does not cover amending a statutory charge. Further, for years 2006/07 and earlier, the MRP rules applicable were different from the current rules (which have been designed to equalise MRP to the principal repayment element of the unitary charge), and it is difficult to see on what legal basis the application of current MRP rules to restated earlier years' balances could be justified. In general, if MRP is subsequently found to have been incorrect, the correcting amendment would have to be made in the year that the error is found.

Following this principle, it could be an option for the SORP to *recommend* that authorities make additional voluntary MRP in 2009/10 to the value of the net impact

on GF of the accounting adjustment (although this would still leave a GF reserve change in the comparator year). However, there is a further barrier to this – Regulation 29, designed to protect authorities with ‘adjustment A’ problems says “Where in any financial year beginning before 1st April 2007, the amount of minimum revenue provision charged is less than the amount required for that year (whether by reason of an error or otherwise)” then “the amount so charged shall be treated as correct and shall not be reconsidered in any circumstances”. Although designed to address a specific issue, the broad scope of the wording used in this regulation would appear to prevent any subsequent adjustment to MRP for 2006/07 and earlier.

In summary we feel that discussions need to be held with DCLG on the subject of retrospective amendment of MRP, and it may be that a change to the Audit & Accounts regulations is required.

We would also like to make the following points in relation to the wording used in the draft SORP, which would benefit from clarification:

Paragraph 3 simply quotes the tests set out in IFRIC 12 for the recognition of assets acquired under a service concession contract. We feel that it would be useful for the SORP to expand on and clarify these tests with some of the issues in Appendix A of IFRIC 12. For example, the fact that the control or regulation referred to in test (a) should be taken to include control via an agreed contract rather than complete control by the local authority is not obvious from reading the test itself. Also the fact that ‘price’ is intended to refer to the price charged to service users, but does include the case where the local authority buys all of the output from the asset, is not clear. Further clarification of what is meant by ‘control’ of the residual interest in test (b) would also be useful, ie does this refer to a right to receive the value of the residual interest, or a right to decide what happens to the asset itself. (This point would be crucial if, for example, a local authority has the right to buy an asset at the conclusion of a contract, but at its full market value).

Paragraph 5 of Appendix E states that the liability arising under a PFI contract should be calculated ‘following the principles of a finance lease under SSAP 21’. We feel that this reference to a UKGAAP leasing standard is unnecessarily confusing, and may mislead readers into thinking that the liability should be accounted for as a lease. The meaning would be clearer if the text first clearly stated that the liability is a financial instrument, and then said that the value of the liability subsequent to its initial recognition should be calculated using the same actuarial method as is used for finance leases.

Paragraph 8 refers to using the fair value of assets in accordance with paragraph 3.113 of the SORP. We feel that this should be expanded, as it is far from clear how the definition of fair value (ie value in an arm’s length transaction) should be applied to specialist asset such as a school. Is the fair value the value that an authority could buy the school for (ie DR) or the value it could sell a school site for (MV)?

LONDON BOROUGH OF MERTON

- (a) Accounting: Under IFRS, we will put the PFI liability on the Balance Sheet. Will this entry be CR PFI liability DR CAA and if so, what is the justification for the CAA entry? The charge to revenue is reduced because a proportion of the rental

is debited to the PFI liability? Is this a windfall to the GF or should we subsequently DR SMGF CR CAA and will this CAA over the life of the contract offset the CAA entry when the PFI liability is established?

- (b) Absolute size of PFI liability: This point is related to (a). We have been paying this liability through the PFI payment. Suppose, we have 20 years left to pay. Logically, the Balance Sheet entry should derive from that element of the PFI charges which relates to the PFI liability for the remaining 20 years, but until this has been confirmed to me, how do I know it will?
- (c) We have had a schools' PFI for several years. Under FRS5, this has led to the creation of some very esoteric assets (*) and we would prefer than these be replaced with real ones. We have always been sceptical about the fact that neither LBM nor our PFI provider recorded the schools' assets in their balance sheets.
- (*) Deferred consideration-value of school buildings transferred to PFI provider, being amortised over life of contract.
- (**) Prepayment- capital receipts given to PFI provider in lieu of higher PFI unitary payment- amortised over life of contract.
- Our proposal is to transfer the deferred consideration to the CAA and offset the prepayment to the PFI liability.
- (d) We believe that the conversion adjustments should be laid out more clearly. In particular, they should follow this order:
- (i) Remove current PFI assets
 - (ii) Substitute IFRS-compliant assets and liabilities.
 - (iii) Impact on revenue
- (e) We also have concerns about the degree to which we need to go back to previous years. For instance if we brought the liability on at the beginning of the PFI scheme then a significant part of the unitary payment would be a repayment of principal and not charged to revenue. This would result in an apparent windfall to the in general fund. (See (a)).

PRICE WATERHOUSECOOPERS

We have the following detailed comments to make about the Exposure Draft:

- Paragraph 3 – in order to be consistent with the other provisions of the SORP, the reference should be to enhancing property rather than upgrading it.
- Paragraphs 5 and 6 – references are provided here to following FRS 15 and SSAP 21. As the SORP has adopted these provisions, the more appropriate and helpful reference would be to the recognition requirements of the SORP, in order to secure consistency with the usual treatment of fixed asset acquisitions and enhancements.
- Paragraph 5 – it would be useful to confirm the treatment of recognition where an authority does bear an element of construction risk.
- Paragraph 12 – this paragraph should stop after the first sentence as the remainder of the paragraph implies either a one sided entry or a new asset and liability being recognised which we consider is not appropriate.
- Paragraphs 17 and 21 – we are not convinced of the wisdom of including guidance on MRP and the Capital Financing Requirement in the SORP,

particularly as these summaries over-simplify the statutory requirements (see also paragraphs 23 and 25). The SORP should be restricted to setting out the accounting treatment to be followed when MRP is chargeable – ie, consideration of reconciling entries in the Statement of Movement.

- Paragraphs 23 and 28 – we have raised concerns about references to MRP in previous paragraphs, but there will be particular issues about the ability of an authority to restate MRP for previous years of account. This cannot be done as a simple accounting adjustment, but must comply with the statutory provisions in place for the particular year. An authority will need to resolve some complex issues such as whether a change in accounting practice can cause a credit arrangement to come into existence if it were not previously recognised as such, and, if so, when the credit arrangement is taken to come into existence – when the fixed assets would first have been recognised or when they are now first recognised. Even when this is established, any retrospective MRP would have to be calculated in compliance with the statutory provisions in place for that particular year, which will result in two substantial problems:
 - how to calculate MRP in the years before the Statutory Guidance came into force – presumably 4% reducing balance
 - the extent to which authorities might be able now to exercise discretions in MRP calculations that were not actually taken up in the year they were available.

Hopefully these issues will be resolvable, but the evidence is not provided in the consultation documents that there is sufficient assurance for the SORP to be able provide that "... the General Fund shall be charged with MRP from the inception of the PFI arrangement until 31 March 2008 ..." (paragraph 23).

Paragraph 25 – the fourth sentence of this paragraph is potentially contradictory in saying that "... the value of an asset shall then be revalued ..." if the fixed asset would have been recognised in the last five years, as the authority's accounting policies might not have required revaluation before 1 April 2008.

SECTOR TREASURY SERVICES

The accounting treatment for PFI and similar contracts is dependant on a number of control tests which may be subject to some interpretation and inconsistent application by practitioners. It is not clear what degree of LA control or regulation of services is required. Section 3 b of overview of basis principles refers to a significant residual interest in the asset at the end of the term. It is not made clear how this would be measured.

Section 5 refers to recognition of assets and liabilities it mentions FRS 15 (IAS 16) and SSAP 21 (IAS 17) will these be replaced by the equivalent IAS or IFRS - does this impact on the proposals contained SORP 2009 or will SORP be revised when IAS 16 is incorporated in SORP from 2010/11.

MRP - the proposed SORP refers to the requirement to charge MRP in the same way as other assets acquired using other forms of borrowing. Presumably an authority would reverse out the depreciation and impairment and replace this with the MRP charge. If the asset provided under the PFI arrangement is assessed to have a useful

life which is longer than the PFI contract presumably the LA would retain the the power to reduce the annual revenue charge. This would be in line with the existing MRP arrangements provided by statutory guidance.

Capital Financing Requirement - The ITC exposure draft states that where a PFI scheme or similar arrangement is brought onto the Balance Sheet, it would form part of the Capital Financing Requirement. Sector is concerned that this may have a material impact on the Statutory Item 8 debt recharging mechanism and may result in significant GF costs for Housing Authorities. We would expect that any impact would be dealt with via an amendment to the Item 8 determination or the introduction of regulation to override any adverse impact to the General Fund/Council Tax payer. We presume that the 2008/09 comparative figures would be re-stated and these would be included in the CFR used for MRP and Item 8 recharges in 2009/10. Again we would suggest that any impact on the Item 8 recharge is reviewed to ensure that there is no General Fund/Council Tax impact arising from this process.

Appendix E: Accounting for PFI Transactions and Similar Contracts

- 1 The purpose of this Appendix is to set out the requirements for accounting for PFI schemes and similar contracts. Previous editions of the SORP required these to be accounted for in accordance with FRS 5 Substance of Transactions. SORP 2009 requires these contracts to be accounted for in a manner that is consistent with the adaptation of IFRIC 12 Service Concession Arrangements contained in the government's Financial Reporting Manual (FReM) as this will assist in the transition to IFRS for 2010/11. IFRIC 12 is the interpretation of IFRS that applies to operators of PFI contracts, and is expected to form part of UK GAAP in due course. The 2009 SORP is consistent with the accounting treatment required of other public sector bodies in the UK set out in the FReM and approved by the Financial Reporting Advisory Board.

TERMINOLOGY

- 2 The following terminology is used throughout this Appendix:

Property is the term used to refer to the assets used by the operator to deliver the PFI services (which may or may not be recognised on an authority's balance sheet); examples include roads, street lighting, schools, telecommunications networks and fixed assets used for administrative purposes in delivering services to the public.

Construction payments / element refers to the finance lease elements of the payment made; only applies where the service element and the construction element (liability and interest) can be separated rather than estimated.

Asset is reserved for assets recognised on the local authority balance sheet.

OVERVIEW OF BASIC PRINCIPLES

Identifying Arrangements To Which This Appendix Applies

3PFI arrangements typically involve a private sector entity (the operator) constructing or ~~upgrading~~ enhancing property used in the provision of a public service, and operating and maintaining that property for a specified period of time. The operator is paid for its services over the period of the arrangement. The accounting treatment set out in this Appendix shall apply where:

- (a) the local authority controls or regulates what services the operator must provide with the property, to whom it must provide them, and at what price; and where

- (b) the local authority controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the property at the end of the term of the arrangement.

Where the property is used for its entire life, and there is little or no residual interest, the arrangement would fall within the scope of this Appendix where the authority controls or regulates the services as described in the first condition.

- 4 Where these control tests are met, this Appendix applies to all property acquired, constructed or enhanced by the operator for the purpose of the PFI arrangement, including property to which the local authority gives the operator access. This Appendix also applies to property provided by the operator that previously appeared on the operator's balance sheet. Where the control tests are not met, the arrangement shall be accounted for in accordance with the general provisions of the SORP:

Where neither test is met, expenditure shall be recognised as it is incurred.

Where test (a) is met but test (b) is not, an authority shall consider whether the arrangement is in substance a lease, and if so shall account for it as such.

Where test (b) is met but test (a) is not, an authority shall recognise as an asset the excess of the expected fair value of the infrastructure at the end of the arrangement over the amount it will be required to pay the operator upon reversion. This asset shall be built up from payments made by the authority to the operator over the life of the arrangement.

Recognising Assets And Liabilities

- 5 Property used in a PFI arrangement shall be recognised as an asset or assets of the local authority. A related liability shall also be recognised at the same time. The asset shall be recognised in accordance with the SORP FRS 15; this will be when the asset is made available for use unless the local authority bears an element of the construction risk, which will not be the case where standard PFI contract terms are used. Where an authority does bear the construction risk, it shall recognise an asset under construction prior to the asset being made available for use where it is probable that the expected future benefits attributable to the asset will flow to the authority. In accordance with FRS 15 the SORP, separate assets shall be recognised in respect of land and buildings where appropriate. The related liability shall initially be measured at the value of the related asset, and subsequently shall be calculated following the principles of using the same actuarial method used for a finance leases under SSAP 21 the SORP.

- 6 Where the operator enhances property already recognised on the balance sheet of the local authority, the local authority shall recognise the fair value of the enhancement in the carrying value of the property. ~~FRS 15~~ The SORP requires the different components of an asset to be accounted for separately if they have a substantially different useful life, and this approach shall be adopted where appropriate. A new liability shall be recognised or the existing liability increased to reflect the authority's requirement to pay for the enhancement.
- 7 Where a PFI arrangement can be separated into a service element and a construction element, the service element shall be expensed as incurred, and the construction element accounted for as if it were a finance lease. ~~In accordance with paragraph 5 of this Appendix, separate assets shall be recognised for land and buildings.~~
- 8 Where a PPP or PFI arrangement cannot be separated due to commercial reality, the service element of the payments must be estimated, which could be achieved by obtaining information from the operator or by estimating the fair value of the services. The fair value of the property (the cost to purchase the property) determines the amount to be recorded as an asset with an offsetting liability. The total unitary payment is then divided into three: the service charge element, repayment of the liability and the interest element (using the interest rate implicit in the contract). ~~into a service element and a construction element, the property and related liability shall be measured at the fair value of the property in accordance with paragraph 3.113 of the SORP. Payments under the arrangement shall be allocated between (a) repayment of the liability, (b) an imputed finance charge (based on the interest rate implicit in the contract), and (c) operating costs to reflect the service element of the arrangement. Where it is not possible to determine the rate implicit in the contract, the authority shall use its cost of capital rate (including inflation). It is expected that this situation would be rare. incremental borrowing rate shall be used.~~

SPECIFIC ISSUES

Existing Local Authority Assets Used in the PFI Arrangement

- 9 A PFI arrangement may make use of the existing assets of a local authority. A local authority shall recognise enhancements to those assets and any additional property provided by the operator.

Existing Local Authority Assets Not Used in the PFI Arrangement

- 10 A local authority may provide the operator with access to existing assets of the authority that are not to be used in the PFI arrangement in exchange for reduced or eliminated payments. This may involve a permanent transfer of the assets to the operator, or may allow the operator access for a specified period (which may or may not be the same as the period of the PFI arrangement). Where the arrangement involves a permanent transfer of an asset to the operator, the local authority shall account for the disposal of the asset. The authority shall also recognise on the balance sheet the consideration received for the asset transferred to the operator. Depending on the circumstances of the arrangement, this may be the reduction or

elimination of an existing liability; a prepayment; or property provided by the operator. Any difference between the carrying value of the asset given up and the consideration received from the operator shall be recognised in the Income and Expenditure Account.

- 11 Where the arrangement does not involve a permanent transfer of the assets to the operator, a local authority shall account for the arrangement as a lease.
- 12 Where the asset provided by the authority is provided in the form of an operating lease, there is not a disposal of the asset, which remains on the authority's balance sheet. ~~The authority's consideration for granting the operating lease is in the form of property provided by the operator. Such property shall be recognised on the authority's balance sheet along with a matching liability, representing the obligation of the authority to pay for the property.~~ The granting of the operating lease is one element of the consideration provided to the operator for the provision of the property and services. Over the period of the operating lease, the authority shall recognise income from the operating lease in the Income and Expenditure Account along with a corresponding expense in the Income and Expenditure Account in respect of a reduction in the liability to pay for the property.
- 13 Where the asset provided by the authority is provided in the form of a finance lease, the local authority shall account for the disposal of the asset. The authority shall also recognise on the balance sheet the consideration received from the operator. Depending on the circumstances of the arrangement, this may be the reduction or elimination of an existing liability; a prepayment; or property provided by the operator. Any difference between the carrying value of the asset given up and the consideration received from the operator shall be recognised in the Income and Expenditure Account.

Prepayments

- 14 PPP and PFI contracts may be structured to require payments to be made (either as part of a unitary payment or a lump sum contribution) before the related property is recognised as an asset on the balance sheet. Such payments shall be recognised as prepayments. At the point that the infrastructure is recognised as an asset, the related liability shall also be recognised. The prepayments shall be applied to reduce the outstanding liability.

Depreciation, Impairment and Revaluation

- 15 Once recognised on the balance sheet, property under a PFI contract is depreciated, impaired and revalued in the same way as for any other fixed asset.

Income Earned

- 16 Any income earned by the local authority as part of a PFI arrangement and not reflected in the unitary charge (for example, where the authority is entitled to a share of any third party income earned by the operator) shall be

accounted for in accordance with the provisions of the SORP for income recognition.

MRP (England and Wales)

- 17 Assets acquired under a PFI arrangement are subject to MRP in the same way as assets acquired using other forms of borrowing. ~~Under regulations and statutory guidance, these charges can match the repayment of the liability. The amounts of MRP to be charged to the General Fund for the year shall be in accordance with the appropriate regulations and statutory guidance. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Statement of Movement on the General Fund Balance.~~

18 **Loans fund charges (Scotland)**

Editorial Note:

A separate public consultation is being undertaken by LASAAC on whether Loans Fund accounting applies or not to the liability to pay for the PFI asset recognised on the balance sheet. A key issue is whether such PFI contract related liabilities are or are not borrowing within the meaning of paragraphs 2 (1) and 12 (1) of Schedule 3 of the Local Government (Scotland) Act 1975. The consultation closing date was 17 October 2008 and LASAAC will consider a report on the matter at its 10 November 2008 meeting. The outcome of the consultation and any conclusions reached by LASAAC will be considered by CIPFA/LASAAC in reaching its conclusions on the matter.

Guarantees

- 19 Any guarantees given as part of a PFI arrangement shall be accounted for in accordance with the requirements of the SORP.

Disclosure

- 20 The following information shall be disclosed in relation to PFI arrangements, in addition to the disclosures relating to assets and liabilities required elsewhere in the SORP:

- The value of assets held under PFI arrangements at each balance sheet date, and an analysis of the movement in those values.
- The value of liabilities resulting from PFI arrangements at each balance sheet date, and an analysis of the movement in those values.
- Details of the payments due to be made under PFI arrangements (separated into repayments of liability, interest and service charges):
 - within one year
 - within 2 - 5 years
 - within 6 - 10 years; and
 - in each additional 5 year period.

Capital Financing Requirement ~~(England and Wales)~~

- 21 Where PFI schemes and similar arrangements come 'on-balance sheet' as a result of the FReM based approach, there will be a requirement to adjust liability that would be recognised would form part of the Capital Financing Requirement, and authorities will therefore need to ensure their authorised limits and operational boundaries are set accordingly.

PRIOR YEAR ADJUSTMENT

- 22 The new FReM based approach to accounting for PFI and similar arrangements introduced by the 2009 SORP shall usually require prior period adjustment and restatement of the 2008/09 corresponding amounts in accordance with the provisions of the SORP. The steps required to implement this are shown below.

Step 1 - Restate Opening Balance Sheet as at 1 April 2008

Recognition of Assets and Liabilities

- 23 Where a PFI scheme that was previously off balance sheet for the local authority meets the control tests in this Appendix, a local authority shall recognise an asset (or assets) and a related liability. The authority will need to establish the fair value (see SORP paragraph 3.113) of the asset (ie the cost to purchase the property) at the point the asset was made available for use. The fair value of the asset shall be used in the initial measurement of both the asset and liability. The value of the asset shall then be revalued if required by in accordance with the authority's accounting policy and paragraphs 3.124 – 3.132 of the SORP. Depreciation on the assets acquired under the PFI arrangement will need to be charged from the commencement of the arrangement until 31 March 2008. This should be in accordance with an authority's depreciation policies, and shall be reversed out of the General Fund to the Capital Adjustment Account. In England and Wales ~~any~~ MRP that is required by regulation or statutory guidance to be charged to the General Fund ~~shall be charged with MRP from the inception of the~~ in respect of the PFI arrangement until prior to 31 March 2008 shall be transferred from the Capital Adjustment Account. [*Editorial note:* the position in Scotland with regard to Loans Fund charges has not yet been determined see paragraph 18]. The value of the liability shall be adjusted for payments made up to 31 March 2008 (see paragraph ~~24~~ 23 of this Appendix).

Payments

- 24 Payments made from the inception of the PFI arrangement until the 31 March 2008 will need to be allocated to three elements - repayment of the liability, interest and the service charge. The previous accounting treatment will need to be reversed.

Contributed Assets

- 25 As part of the PFI arrangement, the local authority may have transferred assets to the operator for use in the PFI arrangement, and accounted for these as a disposal. Where these assets meet the control tests in this Appendix, the previous disposal will need to be reversed. As with assets acquired under a PFI arrangement, depreciation in accordance with the authority's accounting policies will need to be charged. The previous disposal of the asset would not have changed the amount of MRP to be paid in England and Wales, so no adjustments to MRP will be required in respect of contributed assets. Authorities may also have recognised reversionary interest to reflect the fact that these assets would be returned at the end of

the arrangement. Accounting for the reversionary interest will need to be reversed. The SORP permits authorities not to reinstate balances of Government Grant Deferred where these were previously written off to the Income and Expenditure Account on the previous disposal of the assets.

Dowry Payments

- 26 Authorities may have made lump sum contributions to the PFI arrangement, either at its inception or at a later date. These payments will have been recognised as a prepayment. These payments should now be recognised as reducing the liability, and the previous accounting treatment should be reversed. Where a dowry payment exceptionally related to a prepayment of services, no change to the previous accounting treatment would be required.

Step2 - Restate Comparative Figures for 2008/09 (PFI schemes commencing prior to 1 April 2008)

- 27 Where assets used in PFI arrangements have been recognised as part of step 1, the comparative figures for 2008/09 will also need to be restated to reflect the accounting arrangements for these assets.

Recognition of Assets and Liabilities

- 28 Where assets and liabilities were recognised in Step 1, depreciation and, where required by regulation or statutory guidance, MRP charges in England and Wales will need to be recognised in the restated 2008/09 accounts. Depreciation charged to the Income and Expenditure Account shall be credited to the General Fund and debited to the Capital Adjustment Account; any MRP charges shall be debited to the General Fund and credited to the Capital Adjustment Account. These transfers shall be reported in the Statement of Movement on the General Fund Balance.

Payments

- 29 Payments made during 2008/09 will need to be allocated to three elements - repayment of the liability, interest and the service charge. The previous accounting treatment will need to be reversed.

Contributed Assets

- 30 Where contributed assets were reinstated in Step 1, depreciation will need to be recognised in respect of those assets. The previous accounting treatment will need to be reversed.

Dowry Payments

- 31 Where a dowry payment previously recognised as a prepayment is now recognised as reducing the long term liability, the previous accounting entries will need to be reversed. Where a dowry payment exceptionally related to a prepayment of services, no change to the previous accounting treatment would be required.

Step 3 - Restate Comparative Figures for 2008/09 (PFI schemes taken out during 2008/09)

- 32 Where PFI schemes that were taken out during 2008/09 are required to be restated, a similar approach to Steps 1 and 2 will be required. The opening Balance Sheet (1 April 2008) will not require amendment, but the 2008/09 performance statements and the balance sheet as at 31 March 2009 shall be restated. Separate entries will be required for the service revenue accounts and corporate accounts (e.g. interest payable) when adjusting the 2008/09 performance statements.

Recognition of Assets and Liabilities

- 33 Entries will be required to recognise the asset and liability, and to recognise any depreciation and, where required by regulation or statutory guidance, in England and Wales MRP charges in England and Wales for the year. Whether depreciation and MRP charges are required will depend on when the assets were acquired and the accounting policies of the authority. Depreciation charged to the Income and Expenditure Account shall be credited to the General Fund and debited to the Capital Adjustment Account; any MRP charges shall be debited to the General Fund and credited to the Capital Adjustment Account. These transfers shall be reported in the Statement of Movement on the General Fund Balance.

Payments

- 34 Payments made during 2008/09 will need to be allocated to three elements - repayment of the liability, interest and the service charge. The previous accounting treatment will need to be reversed.

Contributed Assets

- 35 Where assets were contributed in 2008/09, the contribution will need to be reversed, along with any entries relating to the recognition of the expense and the unwinding of the reversionary interest.

Dowry Payments

- 36 Where a dowry payment previously recognised as a prepayment is now recognised as reducing the long term liability, the previous accounting entries will need to be reversed. Where a dowry payment exceptionally related to a prepayment of services, no changes to the previous accounting treatment would be required.

ACCOUNTING FOR COUNCIL TAX IN THE CORE FINANCIAL STATEMENTS OF ENGLISH AUTHORITIES

(Suggested revised text in mark-up following public consultation)

Accounting for Council Tax in the Core Financial Statements

3.24b Up to 2008/09 the SORP required the council tax income included in the Income and Expenditure Account to be the amount that under regulation was required to be transferred from the Collection Fund to the General Fund of the billing authority, or, in the case of major preceptors, the amount that under regulation was paid from the Collection Fund to the major preceptor. From the year commencing 1 April 2009, for both billing authorities and major preceptors, the council tax income included in the Income and Expenditure Account for the year shall be the accrued income for the year ~~calculated in accordance with the provisions of paragraph 3.24c, which reflects the general provisions of the SORP (and GAAP) for accruing income.~~ Each major preceptor's share of the accrued council tax income would be available from the information that is required to be produced in order to prepare the Collection Fund Statement.

3.24c For both the billing authority and major preceptors, the difference between the income included in the Income and Expenditure Account and the amount required by regulation to be credited to the General Fund shall be taken to the Collection Fund Adjustment Account and included as a reconciling item in the Statement of Movement on the General Fund Balance.

~~3.24d The Collection Fund regulations effectively specify the 'share' of the accrued council tax income for the year attributable to the billing authority and major preceptors (albeit that it is included in the General Fund partly in the following year). The shares of the accrued income under regulation are very slightly different from the completely accurate amounts that would result from keeping separate 'sales ledgers' for the billing authority and each major preceptor. The very slight difference arises because the Collection Fund surplus or deficit (which is normally only a small fraction of the accrued council tax income for the year) is required by regulation to be shared in proportion to the following year's precepts and demands rather than being based on the precise historically accurate share of council tax billings. The~~

~~effect of the regulations is that the billing authority's and each major preceptors' percentage share of the accrued council tax income for the year can be calculated by formula:~~

~~3.24e The billing authority's and each major preceptor's share of the accrued council tax income for the year (as recorded in the Collection Fund) shall be calculated in accordance with the following formula:~~

$$\text{—————} \frac{(A+B+C)}{(D+E+F)} * G$$

~~Where:~~

~~**A** = authority's share of the Collection Fund surplus or deficit for the previous year net of the community charge adjustment (enter a surplus as a positive amount and a deficit as a negative amount)~~

~~**B** = authority's precept or demand for the year (enter as a positive amount)~~

~~**C** = authority's share of the Collection Fund surplus or deficit for the year net of the community charge adjustment (enter a surplus as a positive amount and a deficit as a negative amount)~~

~~**D** = Collection Fund surplus or deficit for the previous year net of the community charge adjustment (enter a surplus as a positive amount and a deficit as a negative amount)~~

~~————— **E** = the total of all major preceptors precepts for the year plus the billing authority's demand for the year (enter as a positive amount)~~

~~————— **F** = the Collection Fund surplus or deficit for the year net of the community charge adjustment (enter a surplus as a positive amount and a deficit as a negative amount):~~

~~————— **G** = Council tax income for the year as recorded in the Collection Fund.~~

~~3.24f Where at the time it is ready to finalise its statement of accounts a major preceptor has been unable to obtain finalised Collection Fund information from the billing authority, it shall use the billing authority's latest estimate of the Collection Fund outturn and its share of the surplus or deficit on the Collection Fund.~~

~~3.24g Since the billing authority is acting as an agent, the council taxpayer debtor and creditor balances and associated provision for bad debts are not solely balance sheet items of the billing authority; rather they shall be proportionately attributed to the billing authority and the major preceptors. The billing authority's and each major preceptor's percentage share of the movement in the council tax balance sheet items (ie council taxpayers' debtor and creditor balances and the impairment allowance for doubtful debts) shall be calculated in accordance with the formula:~~

$$\text{(A+B+C) / (D+E+F).}$$

~~3.24d^h Since the collection of council tax is in substance an agency arrangement, the cash collected by the billing authority from council tax debtors belongs proportionately to the billing authority and the major preceptors. There will therefore be a debtor/creditor position between the billing authority and each major preceptor to be recognised since the net cash paid to each major preceptor in the year will not be its share of cash collected from council taxpayers; rather it will be the amount the Collection Fund regulations require.~~