



Capital Accounting Review Workshop

SUMMARY NOTE OF
CONCLUSIONS REACHED BY
THE WORKSHOP

JUNE 2003



CIPFA is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulations through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work (often at the most senior level) in public service bodies, in the national audit agencies and major accountancy firms. They are respected throughout for their high technical and ethical standards, and professional integrity. CIPFA also provides a range of high quality advisory, information and training and consultancy services to public service organisations. As such, CIPFA is the leading independent commentator on managing and accounting for public money.

**Contact: Sarah Stacey
Technical Manager,
Local Authority Accounting and Financial Reporting
Policy and Technical
CIPFA
3 Robert Street
London, WC2N 6RL**

e-mail sarah.stacey@cipfa.org

Summary Note of Conclusions Reached by the CIPFA/LASAAC Joint Committee Workshop - 19 March 2003

INTRODUCTION AND BACKGROUND

In 2002 the CIPFA/LASAAC Joint Committee initiated the Capital Accounting Review. Seven project briefs were drafted with responsibility for action being allocated to various members of the CIPFA Secretariat and CIPFA Scotland. The project briefs covered the following areas:

- €# a reconsideration of the existing accounting mechanisms, an assessment of the extent to which capital accounting has improved asset management, and an evaluation of the barriers to more effective use of capital accounting;
- €# an evaluation of the links between capital accounting and the prudential framework;
- €# a re-examination of the treatment of infrastructure assets in the SORP;
- €# an evaluation of the current approach to the treatment of non-operational and community assets;
- €# a review of the basis for determining notional interest rates for capital charges capital accounting;
- €# whether the scope of capital charging should embrace current assets and liabilities; an evaluation of the advantages and disadvantages of replacing the existing consolidated revenue account with statements based on Schedule 1 - Summary of Resource Outturn and Schedule 2 - Operating Cost Statement - from the central government Resource Accounting Manual (RAM).

The Joint Committee held a Workshop with interested parties including practitioners, HM Treasury, Office of the Deputy Prime Minister, Welsh Assembly Government, the Scottish Executive the Audit Commission, Audit Scotland and Local Government Audit – Northern Ireland in March 2003.

The Workshop's objective was to review the outcomes of the projects and to make recommendations to the Joint Committee on the best approach to improve the current capital accounting arrangements and provisions of *the Code Of Practice on Local Authority Accounting in the United Kingdom A Statement of Recommended Practice (the SORP)* in the light of current and proposed legislation and the changing accounting and financial reporting environment.

The Workshop discussed the outcomes of the first phase of the Capital Accounting Review. It formed a number of views on the way forward, including areas where early change is feasible and areas where further work is necessary prior to decisions on change. The Workshop also considered the appropriate timescales for changes.

The conclusions of the Workshop are currently under consideration by the CIPFA/LASAAC Joint Committee and they have prioritised those changes required for the 2004 SORP. Early indications of the Joint Committee's views on the conclusions of the Workshop have been included in the Summary Note. This Summary Note does not form a part of the formal consultation process on the 2004 or future SORPs.

The Joint Committee is keen to encourage debate on the issues raised in the Capital Accounting Review and would welcome any comments on the review or this Summary Note.

Workshop Participants

John Layton	<i>Chair CIPFA/LASAAC</i>
Nick Bennett	<i>Chair LASAAC</i>
Nick Armor	<i>Welsh Assembly Government</i>
Ian Arnott	<i>East Ayrshire</i>
John Buchanan	<i>Local Government Audit – NI</i>
Ian Carruthers	<i>HM Treasury</i>
Graham Coulter	<i>Banbridge DC</i>
Professor Hugh Coombs	<i>University of Glamorgan</i>
Tim Day	<i>Independent Consultant</i>
Kenny Dick	<i>Tayside Fire Board</i>
Paul Dobson	<i>Lancashire County Council</i>
Robert Dowey	<i>Newry and Mourne DC</i>
Brenda Dunthorne	<i>Highland Council</i>
Graham Fletcher	<i>Office of the Deputy Prime Minister</i>
Paul Field	<i>Solihull MBC</i>
Russell Frith	<i>Audit Scotland</i>
Robert Gibson	<i>Fife Council</i>
Derek Glover	<i>Scottish Executive</i>
Derrick Hart	<i>Falkirk Council</i>
Lisa James	<i>Welsh Assembly Government</i>
Paul King	<i>Audit Commission</i>
David Loweth	<i>HM Treasury</i>
Peter Marsh	<i>Glasgow City Council</i>
Paul O'Brien	<i>Audit Scotland</i>
Kieran Rix	<i>HM Treasury</i>
Ian Robbie	<i>Ernst and Young</i>
Stephen Sheen	<i>PricewaterhouseCoopers</i>
Arthur Whatling	<i>RICS</i>
Carolyn Williamson	<i>Inverclyde Council</i>
Peter Worth	<i>Audit Commission Operations Directorate</i>
Cathy Wylie	<i>Henderson Loggie</i>
Sarah Stacey	<i>CIPFA (Secretary, Joint Committee)</i>
Don Peebles	<i>CIPFA Scotland</i>
John Stanford	<i>CIPFA</i>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>A</p> <p>Component</p> <p>1.</p> <p>Asset Management Revenue Account (AMRA)</p>	<p>There was a consensus at the Workshop that this account (AMRA) did not contribute to asset management and its description was therefore misleading. The Workshop also concluded that consideration of removal of the AMRA needed to be linked with the potential introduction of new performance statements (item E below) and as a consequence this element would need to be deferred until discussions on these statements had been concluded.</p> <p>The Workshop agreed that was that there was no clear requirement for the Asset Management Revenue Account (AMRA). There may potentially be fixed asset accounting adjustments required on the face of the Consolidated Revenue Account to ensure reconciliation to UK GAAP performance statements.</p> <p>The potential removal of notional interest rates (see item B) would mean that this would reduce the number of significant entries in it.</p> <p>The Capital Accounting Review Workshop concluded that there would need to be more research to ensure that the removal of the AMRA did not conflict with the statutory requirements of the Housing Revenue Account in England, Scotland and Wales and the accounting requirements for government grants deferred.</p>	<p>2005 SORP</p> <p>(linked to the potential impact of change in the performance statements)</p>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>B Components 1, 4 and 5</p> <p>Notional Interest Element of Capital Charge</p>	<p>The Workshop concluded that, as there is no requirement for a notional interest charge in UK GAAP, this element of the capital charge should be removed from financial statements (this is supported by the Discussion Paper issued by the Accounting Standards Board (ASB) on 2 May 2003 <i>Statement of Principles for Financial Reporting Proposed Interpretation for Public Benefit Entities</i>). The Workshop also considered that the repeal of CCT across the UK has removed much of the rationale for the notional interest charge.</p> <p>The removal of the notional interest charge from the capital charge would allow depreciation to be charged straight to services rather than to the AMRA.</p> <p>The Workshop accepted that the notional interest rate charge was likely to be more useful as a management accounting tool. The Workshop recommended that a Group similar to the previous CIPFA CAWG/CARG Groups might be established to develop good practice in this area.</p> <p>Further Issues of Note:</p> <p>Following the reduction of notional interest rates in October 2002 for 2003/04 financial year CIPFA Secretariat was contacted by a number of practitioners unhappy at such a late change in notional interest rates. Practitioners made it clear that notional interest rates should be set earlier. As this change will not be able to be confirmed to practitioners until March 2004 (on SORP approval) then practitioners would set their budgets on the current interest rates. This is an issue which will need to be set out in the consultation paper as an option for 1 April 2004 or 2005.</p> <p>Since the Workshop a number of key stakeholders have raised concerns over the impact of the removal of notional interest rates for internal and external trading operations or other services for which the total cost of a service needs to be calculated. The Joint Committee has concluded that this issue will be raised in the consultation on the proposed changes to the 2004 SORP.</p>	<p>2004 SORP</p>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>C Component 1 Fixed Asset Restatement Reserve and the Capital Financing Reserve</p>	<p>There was a general agreement that both “reserves” are problematical. However, there was no consensus (at the Workshop) that the best solution is to amalgamate the reserves on the grounds that such an approach may lead to the loss of information which might be needed if a decision is taken at a later date to move to a GAAP based revaluation reserve. The Workshop concluded that more research on properly constituting the Fixed Asset Restatement Reserve (to become a revaluation reserve) and the Capital Financing Reserve would need to take place and more research into less rigorous alternatives would also be required.</p> <p>The Workshop did agree that there was considerable confusion with users of the accounts as these reserves are not distributable reserves and do not constitute usable resources for local authorities. The Joint Committee is happy that the potential of using more appropriate terminology that reflected this should be considered for the 2004 SORP.</p>	<p>A change in terminology for these reserves will be considered for 2004 SORP</p> <p>Any proposals for more significant change will be after research and not before 2005 SORP</p>
<p>D Component 1 Deferred Charges</p>	<p>The Workshop concluded that there was no requirement to change the SORP’s accounting policy on deferred charges, which requires them to be amortised to revenue over an appropriate period in a consistent and prudent manner. However the Joint Committee has subsequently concluded that the SORP’s provisions on deferred charges will need to be reviewed (for 2004 SORP) in accordance with the terminology in FRS 18 <i>Accounting Policies</i>.</p> <p>The Secretary of the Local Authority Accounting Panel (LAAP) would raise the issue whether or not any guidance on the application of the SORP on deferred charges should be issued by LAAP. If LAAP considered that this guidance was required then this would be added to its work programme and prioritised.</p>	<p>Minor amendments 2004 SORP</p> <p>If more guidance on the application of the SORP is required this will be subject to LAAP work programme</p>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>E Component 1 Valuation Costs</p>	<p>The Workshop concluded that the SORP should and does follow the requirements of FRS 15 <i>Tangible Fixed Assets</i>. Any proposals to extend the current five year period between valuations would need to be considered by the ASB.</p> <p>The Workshop concluded that such proposals would need to be supported by detailed evidence across the United Kingdom (i.e. for all four territories covered by the SORP (including an assessment of the regional differences within these territories)) which proved that longer periods between valuations could be supported by the use of indexation and that the valuations remained materially accurate though the use of such indexations.</p>	<p>This would be dependent on the outcome of research.</p>
<p>F Component 6 New Performance Statement</p>	<p>The Workshop concluded that, in principle, a move to a split performance statement that separates service expenditure from funding is a good way forward.</p> <p>The Workshop considered two options:</p> <ol style="list-style-type: none"> 1. A two statement format based on the central government schedule 1 and 2 approach which splits the statement into a Operating Financial Statement and a Statement of Tax Funding and; 2. A variant that will create an income and expenditure account and will rely on an increased use of the Statement of Movements on Reserves. <p>The Workshop concluded that further research should be carried out into these two options with a view to potential implementation in the 2005 SORP.</p> <p>The Workshop noted that summarised financial statements had been considered by the Joint Committee and could be a useful way of engaging the interest of the public in the performance statements of the authority. The Workshop agreed that this issue should be considered further by the Joint Committee.</p>	<p>2005 SORP on consideration by the CIPFA/LASAAC Joint Committee</p>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>F Component 7 Community Assets</p>	<p>The Workshop accepted that there are ambiguities in aspects of the current definition and that there is a difference between the central government classification of heritage assets and community assets.</p> <p>However, the Workshop did not consider this to be an issue that required amendment to the SORP in the near future. In the interim it was concluded that additional guidance on the application of the SORP may clarify the treatment of community assets. This guidance on the application of the SORP would need to be referred to LAAP.</p>	<p>More guidance on the application of the SORP probably required – this issue to be referred to LAAP.</p> <p>Timing for any guidance on the application of the SORP will be subject to the LAAP work programme</p>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>G Component 2 Infrastructure Assets</p>	<p>The Workshop accepted that there is a case for moving to a current value measurement basis. However, a number of Workshop participants, particularly those working in local authorities, consider that a move from historical cost to current value would be a lengthy and costly task for many local authorities as in many instances the information required to convert from historical cost to current value is not readily available.</p> <p>The Workshop also noted that the use of indexation for valuation purposes in the central government sector has experienced some problems. It also considered the uncertainty over the future of renewals accounting in the light of international accounting developments.</p> <p>The Workshop concluded that there was a need for the second phase of the project to undertake more work (using the experience of the recent Canadian (CICA) research publication on infrastructural assets).</p> <p>The Workshop also recommended that a small group with experience in infrastructure asset maintenance experience should be established to consider the issues and practice required to revalue infrastructure assets to current value.</p>	<p>2005 In accordance with phase 2 of this project component</p>

Issue/Project Component	Conclusions of the Workshop	Appropriate Implementation Date
<p>H Component 7</p> <p>Non operational assets</p>	<p>There may only need to be minor definitional changes to the SORP's requirements to clarify that assets used to support the objectives of the authority (even those with a rental income) were operational assets. Additional clarification of assets not used in services i.e. investment properties, surplus properties and assets under construction could also be included in the SORP.</p> <p>It was considered by a number of Workshop participants that the term "non operational" did not assist authorities with the classification of these types of assets.</p> <p>The CIPFA/LASAAC Joint Committee has agreed that minor changes to clarify the definition of non – operational assets can be made to the 2004 SORP.</p> <p>It was agreed that the use of clear examples in guidance on the application of the SORP may also assist authorities with the issue of distinguishing investment properties and properties used to deliver service objectives or in the delivery of services.</p>	<p>Minor definitional changes – 2004 SORP.</p> <p>Additional guidance on the application of the SORP subject to LAAP's work programme</p>
<p>I Component 1</p> <p>Residual Values</p>	<p>Some of the practitioners questioned the practice of estimation of residual values particularly on those assets with a long economic life.</p> <p>The SORP's requirements are in accordance with FRS 15 <i>Tangible Fixed Assets</i>. The Workshop concluded that LAAP would be invited to consider whether any guidance on the application of the SORP in relation to residual values was required.</p>	<p>Any guidance on the application of the SORP issued by LAAP subject to LAAP work programme</p>
<p>J Component 1</p> <p>Depreciation</p>	<p>The Workshop concluded that the SORP follows the requirements of FRS 15</p>	<p>NA</p>