



CIPFA\

# Temporary Proposals for the Update of the Code of Practice on Local Authority Accounting in the United Kingdom

Infrastructure Assets

May 2022

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# Urgent consultation on changes to the Code to resolve issues relating to the reporting of infrastructure assets - invitation to comment

## 1. Introduction

1. Local authorities in the United Kingdom are required to keep their accounts in accordance with 'proper practices'. This includes, for the purposes of local government legislation, compliance with the terms of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code), prepared by the CIPFA LASAAC Local Authority Accounting Code Board (CIPFA LASAAC). The Code is reviewed continuously and is issued annually.
2. Under the oversight and advice of the Financial Reporting Advisory Board, CIPFA LASAAC can issue in-year updates to the Code. This is only done in exceptional circumstances. This consultation invites comments on time-limited proposals to amend the Code, which would be presented as an update to earlier editions of the Code. The reasons for these proposals are set out in Section A.
3. This invitation to comment (ITC) sets out a proposal for temporary revisions to the Code (the update to the Code) to apply to accounting periods commencing up to and including those commencing on 1 April 2022 (Section A of this ITC).

## 2. The consultation process

4. Specific consultation questions have been included in the ITC. CIPFA LASAAC also welcomes general comments on accounting for infrastructure assets. To assess comments properly, CIPFA LASAAC would prefer respondents to support comments with clear accounting reasons and, where applicable, explanations of practical effects.
5. Responses to this invitation to comment will be regarded as on the public record and may be published on the CIPFA website. Copies of all correspondence and an analysis of responses may be provided to the Financial Reporting Advisory Board.
6. An exposure draft setting out proposed changes to the Code is attached at Annex 1.
7. In order that they can be considered by CIPFA LASAAC in time to inform possible implementation, responses are required by **23:00 14 June 2022**.
8. Please make responses by email to [cipfalasaac@cipfa.org](mailto:cipfalasaac@cipfa.org).

## Section A

### 3. Background

9. At its March 2022 meeting CIPFA LASAAC became aware of an issue which arose in early March relating to the reporting of infrastructure assets which has led to delays in local authority audits in England, principally for highways authorities, though the issue is likely to impact on all infrastructure assets. It is also the case that the issue is one that impacts on Scotland and Wales.
10. The issue arises principally because of information availability relating to these assets and the difficulty of generating information which is decision useful for infrastructure assets and meets the needs of accounting standards.
11. Infrastructure assets are inalienable assets, expenditure on which is only recoverable by continued use of the asset created (ie there is no prospect of sale or alternative use). They are often homogenous assets that work as a part of a continuous network that is maintained in a relatively steady state though there may be distinctive parts of this network eg carriageways, structure (bridges etc), street lighting, street furniture and traffic management systems. They are largely assets with very long lives.
12. Accounting for infrastructure in local government has not historically been considered to be an area of significant audit risk, due to the inalienable nature of the assets and the use of the (depreciated) historical cost basis of accounting. However, concerns raised by a local government auditor that some authorities are not applying component accounting requirements appropriately have recently come to light via audit network discussions convened by the National Audit Office. The underlying issues appear to be more prevalent than anticipated and CIPFA LASAAC now understands this is an area of focus for all local audit firms.
13. The issue raised by auditors relates to subsequent expenditure on infrastructure assets and specifically on whether local authorities should be assessing if there is any undepreciated cost remaining in the balance sheet for the replaced components that needs to be derecognised when the subsequent expenditure is added. This may also lead to issues relating to the reporting of gross historical cost and accumulated depreciation as elements of depreciated historical cost.
14. While this is standard practice for many items of property, plant and equipment assets, it may not generally be being implemented for infrastructure assets, particularly highways assets because there are a variety of significant practical difficulties in applying the standard approach to such assets. This is, particularly in relation to roads, where the engineering records that are useful for maintenance, and identification of replacement expenditure and new expenditure for the (highways) infrastructure assets have not been created to map against identifiable components.
15. It was recognised during the development of the consultation on the Highways Network Asset which looked at the possibility of applying current values to the highways network asset in 2015 that it was not possible to typically identify components as the network was one asset and information on historical repairs is not available in a meaningful or identifiable way, particularly for the roads/carriageways parts of the highways network asset.

16. Infrastructure assets are one of the few categories of property, plant and equipment assets measured using the historical cost basis of accounting rather than at the asset measurement described as 'current value'. The valuation process for these assets was deemed to be too costly, and therefore infrastructure assets are held in local authority balance sheets at depreciated historical cost.
17. Infrastructure assets were first recognised in conventional local authority balance sheets when the Code aligned reporting on assets more closely with other UK GAAP, moving from older capital accounting systems based on financing requirements. This was on 1 April 1994 for English local authorities, 1 April 1994 in Scotland and 1 April 1996 in Wales. At that time, infrastructure assets were brought on to the balance sheet at undischarged capital amounts and this was described as historical cost.
18. For many local authorities, further information deficits have arisen on transfer of balances of infrastructure assets as a result of local government reorganisation where information has not been available to disaggregate the carrying value which has transferred.
19. The requirement to measure the Highways Network Asset at current value was not in practice implemented due to issues around the funding of the valuation process, and the accounting for transport infrastructure therefore remained on a depreciated historical cost basis, in contrast to other material property, plant and equipment on local authority balance sheets. Following the process to explore the use of current values no changes were made to the accounting requirements for infrastructure assets.
20. In the 2015 (Accounting) Code consultation process around the valuation of the Highways Network Asset the consultation paper included a rebuttable presumption that when parts of the Highways Network Asset were being replaced, this was because the part of the asset being replaced had been fully consumed. In essence it is considered that this is largely a proper description of the transaction for infrastructure assets and that largely the net book value of the assets that do not include regular deductions for derecognised parts should be able to be relied upon.
21. Auditors have, however, recently raised concerns about the reporting of gross historical cost and accumulated depreciation (both are reported in the Code's IAS 16 *Property, Plant and Equipment* disclosures). The derecognition transactions have for large numbers of authorities not been made for the reporting of gross historical cost and accumulated depreciation or made on an uncertain basis. These amounts will then increase until they are materially overstated.
22. As a result, the issue of the opinion of some local authority accounts has been delayed and they are at the risk of audit qualifications, though it is notable that this may become a risk for all local authorities in subsequent years if the issues are not resolved.
23. CIPFA and CIPFA LASAAC have agreed to try to assist in the resolution of the issue and have established a joint task and finish group on the reporting of infrastructure assets to consider the issue of both guidance and whether any augmentations of the Code might assist the current reporting position and with the representation of meaningful information for the users of local authority financial statements.

## Question – Background to infrastructure assets

Q1	Has the above description set out all the technical and practical difficulties for reporting infrastructure assets? If not, please provide further information and details for CIPFA LASAAC and the Task and Finish Group.
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## 4. Deliberations by the Task and Finish Group and CIPFA LASAAC

24. The Task and Finish Group for Infrastructure Assets (the Group) considered the current situation described in section 3 and whether it would be possible to resolve the information deficits and improve the reporting of gross historical cost and accumulated depreciation. It was considered that this would be complex. Arguably the information deficits relating to the initial recognition in the early 1990s could be resolved by proper description of what is and what is not included in the balance. It would be more difficult to resolve the information deficits relating to any transferred balances on local government reorganisation. The Group did generally agree that the net book value should be able to be relied on, *if* depreciation policies had been effective.
25. The Group also questioned the usefulness of the reporting of gross historical cost and accumulated depreciation in the disclosures required by the Code and IAS 16. The Group noted that majority of the items of property, plant and equipment are reported at current value as this is deemed to be useful for the operational economic decisions that might be made by the users of the accounts and other stakeholders but also this information was the most useful for accountability and stewardship.
26. The Group though focussed on the usefulness of gross historical cost and accumulated depreciation for infrastructure assets. Firstly, gross historical cost bearing in mind the information deficit might be described as the amount spent to acquire the assets currently held by the authority (this was net of revenue contributions and capital receipts applied and grants and contributions received before 1 April 1994/1996, but not after). But this was (possibly) excluding infrastructure assets constructed before the authority's creation and including expenditure on assets which the authority has either never owned or no longer owns but for which it took on financing responsibilities (for the transferred assets).
27. The relatively long life of the assets also means that much of the recorded cost is measured at amounts that have no comparison to current costs.
28. Gross historical cost is therefore likely to mean very little to the user of the accounts or other stakeholders based on the current assessment of the cost of those assets to the authority and the need for replacement expenditure. It does not reflect the significant value of the assets to local authorities nor the condition.
29. Similar arguments might be had for the accumulated depreciation based on historical cost. Accumulated depreciation is the amount of Gross Historical Cost described above, that has to date been charged on the Comprehensive Income and

Expenditure Statement and reversed out of the local authorities' General Funds and posted to the Capital Adjustment Account. Again, this information is not particularly decision useful to the users of local authority accounts or other stakeholders and does not bear relation to the financing of the assets ie via grants or borrowing.

30. To find a solution the Group considered (and continues to assess) a number of options including increased guidance based on the current provisions of the Code, an amnesty on recorded information, a form of reset (providing an estimate of the gross historical cost and accumulated depreciation or other resets) as of the earliest opening balance where accounts have not been audited, and moving to accounting for transport infrastructure assets potentially by a formally accounting for this as a single highways network asset. Note that options for a formal amnesty were not supported by CIPFA LASAAC.
31. All options have both advantages and disadvantages, particularly considering the information deficits, and the group is clear that for any solution the costs must not outweigh the benefits to the users of the financial statements and other stakeholders. Furthermore, infrastructure assets are likely to be a significant item in the accounts and the Group is wary of producing a solution which might have unintended consequences, so is of the view that a short urgent consultation as permitted by CIPFA LASAAC's Terms of Reference may not be able to identify all the impacts to local authorities and their information systems.
32. The Group has therefore recommended to CIPFA LASAAC that a temporary solution be identified to allow local authority accounts to be closed and thereafter to subject their solution (or possible options for solution) to CIPFA LASAAC's full consultative processes ie as a part of its annual consultation in July 2022 and for a period of at least eight weeks. It is also notable that HM Treasury is commencing a thematic review of the measurement of operational property, plant and equipment in the public sector and therefore any longer-term proposals should consider the outcomes of this review.
33. CIPFA LASAAC's objective is to maintain high quality financial information in the local authority financial statements and so supports the aim of the Group with regard to the cost benefit analysis and would be concerned to avoid unintended consequences. It therefore agrees with the recommendations of the Group.

<b>Question – Deliberations by the Task and Finish Group and CIPFA LASAAC</b>	
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Q2	Has the above description of the deliberation of the Task and Finish Group considered all the relevant issues for the reporting infrastructure assets? If not, please provide further information and details for CIPFA LASAAC and the Task and Finish Group.
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## 5. Temporary Solution for the Reporting of Infrastructure Assets

34. The temporary solution for an amendment to the Code up to and including the 2022/23 Code would be to remove the need to derecognise and report gross historical cost and accumulated depreciation.
35. Paragraph 4.1.2.51 of the Code is (and has been) applied in such a way that '*the carrying amount of a replaced or restored part of the asset is derecognised*', at a nil amount where expenditure has taken place to renew or replace any part of an infrastructure asset. This is consistent with the approach previously consulted on by CIPFA LASAAC, ie that local authorities to a material extent only replace parts of infrastructure assets when they have been fully consumed.
36. This fits the economic model because local authorities have not had sufficient resources to do anything other than undertake replacement or renewal expenditure when parts of infrastructure assets are worn out. Even though some replacement expenditure simply covers the surface of the asset this meets the same economic position as replacement because what is beneath this resurfacing expenditure is either impaired or now forms a part of the new expenditure and so no derecognition is required (or is able to be measured).
37. It will also be appropriate for the rare occurrences that an asset is impaired, eg where expenditure on a replacement has been deemed to be subject to defect and must be replaced. This is because the impairment measurement provisions are inappropriate for infrastructure assets as value in use is the present value of an asset's remaining service potential and value in use is likely to be significantly more than depreciated historical cost.
38. A temporary interpretation could have been (and was initially) proposed to confirm this position. However, some auditors have indicated that depreciation may not have been effective for some assets. So, for the avoidance of doubt, the commentary in paragraph 4.1.2.51 is proposed as an adaptation and this will support the assumption that derecognition has taken place at zero amounts even where depreciation policies may not have been effective. It is believed this is sufficient support for current approaches and allows for alternative treatment, but the consultation seeks views of stakeholders on this matter.
39. An adaptation is also proposed to be made to provide that the disclosure in paragraph 4.1.4.3 1 d) is not required for infrastructure assets from 1 April 2010 to the financial year commencing 1 April 2022. This is from the move to the IFRS-based Code. This may require some changes to the formatting of local authorities' current notes on property plant and equipment.
40. CIPFA LASAAC is of the view that the combination of the proposed adaptations should significantly reduce the risk of audit qualifications while maintaining useful financial information for infrastructure assets.
41. CIPFA LASAAC and the Task and Finish Group are of the view therefore that local authorities should ensure that their accounting policy for infrastructure assets properly represents the consumption of economic benefits (note this description does not refer to service potential as assets are measured at depreciated historical cost).



Where this requires improvement (and this could include improvement to the financial statements that have not yet completed their audits) such a change in the measurement of depreciation would be a change in estimation process and would be prospective. Alongside this consultation paper a draft CIPFA Bulletin provides some guidance on what might represent an effective approach to the estimation of depreciation for infrastructure assets.

42. CIPFA LASAAC appreciates that an effective depreciation accounting policy is a challenge for networked and inalienable assets like infrastructure assets so has decided to add guidance in the Code to assist with the development of local authority accounting policies in this area. It has indicated that the pattern of consumption of economic benefits might be facilitated by, for example, using weighted averages based on typical parts of the network such as carriageways, roads etc. Again, see the Draft CIPFA Bulletin for example approaches. CIPFA LASAAC is of the view that the estimation process should be such that the costs of any approach do not outweigh the benefits to the users of the accounts and other stakeholders.

Questions – Temporary Solution for the Reporting of Infrastructure Assets	
Q3	Do you agree that the net book value of infrastructure assets is generally capable of being relied on? If not, why not? Please provide your views on why this might be the case?
Q4a	Do you agree that replacement expenditure takes place when parts of assets have been fully consumed so that the proposed adaptation (included for the avoidance of doubt) is appropriate? If not, why not? Please provide your views on why this might be the case?
Q4b	Do you agree with the proposed wording of the adaptation ie that:  <i>‘...the carrying amount of the part of the asset derecognised may be a zero amount...’</i>  or do you consider that the wording should be more affirmative and indicate that it <i>is</i> a zero amount?  Please provide the rationale for your response.
Q5	Do you agree that, temporarily, the gross historical cost and accumulated depreciation need not be reported? If not, why not? What alternatives do you suggest?
Q6	Do you agree with CIPFA LASAAC’s new sentence providing additional guidance for the depreciation of infrastructure assets? If not, why not? What alternatives do you suggest?
Q7	Do you agree with the time period for the amendments to the Code ie from 1 April 2010 to the financial year commencing 1 April 2022? If not, why not? What alternatives do you suggest?  (Note that this change is from the move to the IFRS-based Code as of 1 April 2010.)

## 6. Possible Longer-Term Solutions

43. Paragraph 30 sets out an overview of the possible options being considered by the Group. Both the Group and CIPFA LASAAC would be interested in stakeholders' views on the proposals at a high level and any other alternatives that might be considered.
44. In addition, many if not all the issues would be resolved by a move to measuring infrastructure assets at Depreciated Replacement Cost. CIPFA LASAAC recognises that this proved to be too prohibitively costly when considered previously but would be interested in stakeholders' views on the use of this measurement base for infrastructure assets and how this might be pursued.

Questions – Possible Longer-Term Solutions	
Q8	What are your views on the possible solutions to the approach to derecognition and the reporting of infrastructure assets? Please set out the rationale for your response.
Q9	What are your views on the measurement of infrastructure assets at depreciated replacement cost? Please set out the rationale for your response.

## 7. Other Infrastructure Assets

45. The issues described in this consultation largely focus on transport infrastructure assets, but it is very possible that similar issues might arise for other infrastructure assets such as coastal defences and water supply and drainage systems. CIPFA LASAAC would be interested to hear from local authorities with significant other infrastructure assets and whether additional guidance on, for example, depreciation would be useful for these assets.

Question – Other Infrastructure Assets	
Q10	Please outline the other types of infrastructure assets and comment on whether more guidance might be needed for these assets. Please set out the rationale for your response.