Leases in the financial statements of lessees

Finance leases

4.2.2.12 An authority, as lessee, shall recognise finance leases as assets and liabilities at amounts equal to the fair value of the property or, if lower, the present value of the minimum lease payments. The discount rate that shall be used is the rate implicit in the lease or, if it is not practicable to determine, the authority's incremental borrowing rate. Any initial direct costs of the authority are added to the value of the asset.

4.2.2.13 Minimum lease payments shall be apportioned between the finance charge (interest) and the reduction of the outstanding liability. The finance charge shall be calculated so as to produce a constant periodic rate of interest on the remaining balance of the liability; approximation may be used to simplify the calculation. Contingent rents shall be charged as expenses in the periods in which they are incurred.

4.2.2.14 Assets recognised under a finance lease shall be depreciated in accordance with paragraphs 4.1.2.38 to 4.1.2.44 of the Code. The depreciation policy for leased assets shall be consistent with the policy for owned assets. Where it is not certain that ownership of the asset will transfer at the end of the lease, the asset shall be depreciated over the shorter of the lease term and its useful economic life. After initial recognition, assets recognised under a finance lease are subject to revaluation in the same way as any other asset.

Operating leases

4.2.2.15 Lease payments under an operating lease shall be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the benefits received by an authority. In accordance with SIC 15, lease incentives shall be recognised as a reduction in the lease expense over the lease term, on a straight-line basis unless another systematic basis is more representative of the benefits received by an authority.

Leases in the financial statement of lessors

Finance leases

4.2.2.16 Lessors shall recognise assets held under a finance lease as a receivable at an amount equal to the net investment in the lease. The lease payment receivable shall be treated as repayment of principal and finance income. The finance income shall be calculated so as to produce a constant periodic rate of return on the net investment; approximation may be used to simplify the calculation.

Operating leases

4.2.2.17 An authority shall present assets subject to operating leases according to the nature of the asset. Costs, including depreciation, incurred in earning the lease income are recognised as an expense.

4.2.2.18 Income from operating leases shall be recognised on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which the benefit derived from the leased asset is diminished. An authority shall recognise the cost of any lease incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is more representative of the time pattern in which the benefit derived from the leased asset is diminished.

4.2.2.19 Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income.

4.2.2.20 The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

Sale and leaseback transactions

4.2.2.21 A sale and leaseback transaction involves an authority selling an asset and leasing back the same asset.

4.2.2.22 If a sale and leaseback transaction results in a finance lease, the arrangement is in substance one where the lessor is providing finance to the lessee. Any excess of sales proceeds over the carrying amount shall be amortised over the lease term, as it would not be appropriate to regard an excess of sales proceeds over the carrying amount as income.

4.2.2.23 If a sale and leaseback transaction results in an operating lease, and the sale and the lease are at fair value, any gain or loss on disposal shall be recognised immediately. If the sale price is below fair value, any gain or loss on disposal shall be recognised immediately, unless the loss is compensated for by future lease payments below market price, in which case it shall be deferred and amortised in proportion to the lease payments. If the sale price is above fair value, the excess over fair value shall be deferred and amortised over the period for which the asset is expected to be used.

4.2.2.24 For operating leases, if the fair value of the asset at the time of a sale and leaseback transaction is less than the carrying amount of the asset, the asset shall be re-valued to fair value and a loss equal to the amount of the difference between the carrying amount and fair value shall be recognised immediately. No such adjustment is required for finance leases unless the asset has been impaired, in which case section 4.7 of the Code and IAS 36 *Impairment of Assets* shall apply.

Arrangements containing a lease

4.2.2.25 A local authority may enter into an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset (eg an item of property, plant or equipment) in return for a payment or series of payments. Authorities shall determine, in accordance with IFRIC 4, whether such arrangements are, or contain, leases that should be accounted for in accordance with this section of the Code and IAS 17. IFRIC 4 applies whether the authority is acting as a lessee or as a lessor.

4.2.2.26 An authority shall not account for such arrangements in accordance with this section of the Code where the agreement falls within the scope of section 4.3 of the Code (PPP and PFI arrangements) or where the arrangement is, or contains, a lease excluded from the scope of this section of the Code and IAS 17.

4.2.2.27 Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset), and

b) the arrangement conveys a right to use the asset.

Fulfilment of the arrangement is dependent on the use of a specific asset

4.2.2.28 Although a specific asset may be explicitly identified in an arrangement, it is not the subject of a lease if fulfilment of the arrangement is not dependent on the use of the specified asset.

4.2.2.29 An asset has been implicitly specified if, for example, the supplier owns or leases only one asset with which to fulfil the obligation and it is not economically feasible or practicable for the supplier to perform its obligation through the use of alternative assets.

Arrangement conveys a right to use the asset

4.2.2.30 An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

Assessing or reassessing whether an arrangement is, or contains, a lease

4.2.2.31 The assessment of whether an arrangement contains a lease shall be made at the inception of the arrangement. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if any one of the following conditions is met:

a) There is a change in the contractual terms, unless the change only renews or extends the arrangement.

b) A renewal option is exercised or an extension is agreed to by the parties to the arrangement, unless the term of the renewal or extension had initially been included in the lease term.

c) There is a change in the determination of whether fulfilment is dependent on a specified asset.

d) There is a substantial change to the asset, for example a substantial physical change to property, plant or equipment.

Separating payments for the lease from other payments

4.2.2.32 If an arrangement contains a lease, an authority shall apply the requirements of this section of the Code and IAS 17 to the lease element of the arrangement. Accordingly, if an arrangement contains a lease, that lease shall be classified as a finance lease or an operating lease in accordance with this section of the Code.

4.2.2.33 In assessing the lease, payments and other consideration required by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease and those for other elements on the basis of their relative fair values. The minimum lease payments include only payments for the lease and exclude payments for other elements in the arrangement (eg for services and the cost of inputs). In some cases, this may require the use of an estimation technique.

4.2.2.34 If a purchaser concludes that it is impracticable to separate the payments reliably, it shall:

a) In the case of a finance lease, recognise an asset and a liability at an amount equal to the fair value of the underlying asset. Subsequently the liability shall be reduced as payments are made and an imputed finance charge on the liability recognised using the purchaser's incremental borrowing rate of interest. Payments in excess of the repayment of the liability plus the imputed finance charge shall be accounted for as payments for other elements of the arrangement.

b) In the case of an operating lease, treat all payments under the arrangement as lease payments, but:

    i) disclose those payments separately from minimum lease payments of other arrangements that do not include payments for non-lease elements, and

    ii) state that the disclosed payments also include payments for non-lease elements in the arrangement.

4.2.3 Statutory Accounting Requirements

4.2.3.1 There are no statutory accounting requirements in respect of operating leases.

Assets held by an authority (as a lessee) under a finance lease

4.2.3.2 Depreciation, impairment and gains or losses on revaluation charged to the surplus or deficit on the provision of services are not proper charges to the General Fund (see part 2 of Appendix B for the legislative basis). Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

4.2.3.3 Minimum Revenue Provision (England and Wales) and the repayment of the liability (Scotland and Northern Ireland) are proper charges to the General Fund, but do not appear in the Comprehensive Income and Expenditure Statement. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or repayment of the liability to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance (see part 2 of Appendix B for the legislative basis).

4.2.3.4 Gains and losses on the disposal of an investment property held under a lease are subject to the statutory accounting requirements set out in section 4.4.3 of the Code.

Assets disposed of by means of a finance lease

4.2.3.5 Gains and losses on the disposal of property, plant or equipment by way of a finance lease are subject to the statutory accounting requirements set out in section 4.1.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

4.2.3.6 Gains and losses on the disposal of an intangible asset by way of a finance lease are subject to the statutory accounting requirements set out in section 4.5.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

4.2.3.7 Gains and losses on the disposal of an investment property by way of a finance lease are subject to the statutory accounting requirements set out in section 4.4.3 of the Code. The proceeds on disposal are the amount recognised as a receivable.

4.2.3.8 A sale and leaseback arrangement that results in a finance lease is not a disposal for the purposes of this section of the Code.

4.2.3.9 Amounts received as part of the repayment of a finance lease that reduce the lessee's obligation are classed as capital receipts (see part 2 of Appendix B for the legislative basis). In Scotland, capital receipts fall to be defined in accordance with proper accounting practice. Authorities shall recognise the capital receipt by debiting the Capital Adjustment Account and crediting the Capital Receipts Reserve.

4.2.4 Disclosure Requirements

4.2.4.1 Disclosure of accounting policies in relation to leases is required (see section 3.4 of the Code).

4.2.4.2 Having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities (acting as lessees and/or lessors) shall, in addition to meeting the requirements of Financial Instruments: Disclosures (see chapter seven), disclose the following notes in relation to leases:

Lessee – finance leases:

1) For each class of asset, the net carrying amount at the Balance Sheet date.
2) A reconciliation between the total of future minimum lease payments at the Balance Sheet date, and their present value. In addition, an authority shall disclose the total of future minimum lease payments at the Balance Sheet date, and their present value, for each of the following periods:
    a) not later than one year
    b) later than one year and not later than five years
    c) later than five years.
3) Contingent rents recognised as an expense in the period.
4) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the Balance Sheet date.
5) In addition, the requirements for disclosure in accordance with property, plant and equipment, impairment of assets, intangible assets, investment property and agriculture apply to lessees for assets leased under finance leases.

Lessee – operating leases:

6) The total of future minimum lease payments under non-cancellable operating leases for each of the following periods:
   a) not later than one year
   b) later than one year and not later than five years
   c) later than five years.
7) The total of future minimum sublease payments expected to be received under non-cancellable subleases at the Balance Sheet date.
8) Lease and sublease payments recognised as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments.

Lessor – finance leases:

9) A reconciliation between the gross investment in the lease at the Balance Sheet date, and the present value of minimum lease payments receivable at the Balance Sheet date. In addition, an entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the Balance Sheet date, for each of the following periods:
   a) not later than one year
   b) later than one year and not later than five years
   c) later than five years.
10) Unearned finance income.
11) The unguaranteed residual values accruing to the benefit of the lessor.
12) The accumulated allowance for uncollectible minimum lease payments receivable.
13) Contingent rents recognised as income in the period.
14) A general description of the lessor's material leasing arrangements.

Lessor – operating leases:

15) The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:
   a) not later than one year
   b) later than one year and not later than five years
   c) later than five years.
16) Total contingent rents recognised as income in the period.
17) A general description of the lessor's leasing arrangements.
18) In addition, the requirements for disclosure in accordance with property, plant and equipment, impairment of assets, intangible assets, investment property and agriculture apply to lessors for assets provided under operating leases. Authorities may combine these disclosures with owned assets, or present them separately.

4.2.5 Statutory Disclosure Requirements

4.2.5.1 There are no statutory disclosures required in relation to leases.

4.2.6 Changes since SORP 2009

4.2.6.1 The Code requires the land and buildings elements of a lease of land and buildings to be classified and accounted for separately. This requirement did not exist in the SORP, and a lease of land and buildings was classified and accounted for as a single lease.

4.2.6.2 One of the factors that indicates a lease is a finance lease is if 'the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset'. Under the SORP, 'substantially all' was quantified as 'normally 90% or more'. This quantitative test does not apply under the Code, and authorities will need to use professional judgement when assessing 'substantially all'.

4.2.6.3 Under the Code, finance income shall be calculated so as to produce a constant periodic rate of return on the net investment. Under the SORP, the finance income was calculated so as to give a constant periodic rate of return on the net cash investment. This difference in treatment may lead to income being recognised in different periods.

4.2.6.4 The Code requires initial direct costs to be added to the carrying amount of the asset in some circumstances. This was not covered by the SORP, but was a permissible (rather than required) treatment under SSAP 21 *Accounting for Leases and Hire Purchase Contracts*.

4.2.6.5 The Code specifies the accounting treatment for sale and leaseback transactions. The accounting treatment was not covered by the SORP, but was set out in SSAP 21. The requirements of the Code are consistent with those of SSAP 21.

4.2.6.6 The Code specifies the accounting treatment for arrangements containing a lease (IFRIC 4). This was not covered by the SORP, but similar results may have arisen from an application of FRS 5 *Reporting the Substance of Transactions*.

4.3 PFI AND PPP ARRANGEMENTS

4.3.1 Introduction

4.3.1.1 PFI, PPP and similar schemes shall 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). Additional disclosure requirements are specified in SIC 29 *Disclosure – Service Concession Arrangements*.

4.3.1.2 The following terminology is used throughout this section:

- **Infrastructure** is the term used in IFRIC 12 to refer to the assets used by the operator to deliver services (which may or may not be recognised on an authority's Balance Sheet). Examples include roads, street lighting, schools, telecommunications networks and non-current assets used for administrative purposes in delivering services to the public. Infrastructure has a different meaning in this section of the Code than that used in other sections of the Code.
- **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.

4.3.1.3 PPP and PFI arrangements typically involve a private sector entity (the operator) constructing or enhancing infrastructure used in the provision of a public service, and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement.

Scope

4.3.1.4 PPP and PFI arrangements involve the operator undertaking an obligation to provide infrastructure (and related services) that is used to provide services to the public (irrespective of who provides those services to the public). By extension, this includes providing infrastructure (and related services) for the direct use of a public sector entity where these services contribute to the provision of services to the public (eg office and administrative buildings).

4.3.1.5 Other features of PPP and PFI arrangements are:

- the entity granting the service arrangement (the grantor) is a public sector entity
- the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent of the grantor
- the contract sets initial prices levied by the operator and regulates price revisions over the period of the service arrangement, and
- the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

4.3.2 Accounting Arrangements

Application of PPP and PFI accounting arrangements

4.3.2.1 Section 4.3 of the Code applies to PPP and PFI arrangements (as defined in paragraphs 4.3.1.4 and 4.3.1.5) where:

a) the local authority controls or regulates what services the operator must provide with the infrastructure, 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 infrastructure at the end of the term of the arrangement.

4.3.2.2 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 section of the Code where the authority controls or regulates the services as described in the first condition.

4.3.2.3 Where the control tests described in paragraphs 4.3.2.1 and 4.3.2.2 above are not both met, paragraphs 4.3.2.8 to 4.3.5.1 of the Code do not apply. Paragraphs 4.3.2.4 to 4.3.2.6 below set out the accounting arrangements in these cases.

4.3.2.4 Where neither test is met, a local authority shall recognise expenditure as it is incurred.

4.3.2.5 Where test a) is met but test b) is not, the authority shall consider whether the arrangement meets the definition of a lease under section 4.2 of the Code, IAS 17 *Leases* and IFRIC 4

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Determining Whether an Arrangement Contains a Lease. Where the arrangement meets the definition of a lease, it shall be accounted for under section 4.2 of the Code.

4.3.2.6 Where test b) is met but test a) is not, the 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 PPP or PFI arrangement.

4.3.2.7 Where the control tests described in paragraphs 4.3.2.1 and 4.3.2.2 above are met, paragraphs 4.3.2.8 to 4.3.5.1 of the Code apply to all infrastructure acquired, constructed or enhanced by the operator for the purpose of the PPP or PFI arrangement, including infrastructure to which the local authority gives the operator access for the purpose of the PPP or PFI arrangement. Paragraphs 4.3.2.8 to 4.3.5.1 of the Code also apply to infrastructure provided by the operator that previously appeared on the operator's Balance Sheet.

Recognition

4.3.2.8 Infrastructure within the scope of section 4.3 of the Code shall be recognised as property, plant and equipment of the local authority because the contractual service arrangement conveys the right to control the use of the infrastructure. A related liability shall be recognised at the same time.

4.3.2.9 In line with section 4.1 of the Code and IAS 16 *Property, Plant and Equipment*, the infrastructure (and related liability) shall be recognised at the point that a) it is probable that future economic or service benefits associated with the infrastructure will flow to the local authority; and b) the cost of the infrastructure can be measured reliably. 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 IAS 16, separate assets shall be recognised in respect of land and buildings where appropriate.

4.3.2.10 Where the operator enhances infrastructure 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 infrastructure where the recognition criteria of IAS 16 are met (see paragraphs 4.1.2.16 to 4.1.2.19 of the Code). IAS 16 requires the different components of an asset to be accounted for separately if they have a different useful life, and this approach shall be adopted where appropriate. In doing so, an authority shall apply the derecognition requirements of IAS 16 (see paragraphs 4.1.2.48 and 4.1.2.49 of the Code) where components of the existing infrastructure are replaced. A new liability shall be recognised or the existing liability increased to reflect the authority's requirement to pay for the enhancement.

Measurement

4.3.2.11 Where a PPP or 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

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accounted for as if it were a finance lease. A contract may be separable in a variety of circumstances, including but not limited to the following:

a) The contract identifies an element of a payment stream that varies according to the availability of the property itself and another element that varies according to usage or performance of certain services.

b) Different parts of the contract run for different periods or can be terminated separately. For example, an individual service element can be terminated without affecting the continuation of the rest of the contract.

c) Different parts of the contract can be renegotiated separately. For example, a service element is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

4.3.2.12 Subsequent to initial recognition, the infrastructure shall be measured following the principles set out in section 4.2 of the Code and IAS 17 (ie following the arrangements for assets acquired under a finance lease). The liability shall be measured in a similar manner to the liability resulting from a finance lease, as set out in section 4.2 of the Code and IAS 17. The liability shall be reported as a financial liability but shall be measured under section 4.2 of the Code (leases) not chapter seven of the Code (financial instruments).

4.3.2.13 Where a PPP or PFI arrangement cannot be separated into a service element and a construction element, the infrastructure and related liability shall be measured initially at the fair value of the infrastructure.

4.3.2.14 Subsequent to initial recognition, the infrastructure shall be measured following the principles set out in section 4.1 of the Code and IAS 16 (ie following the arrangements for assets purchased or constructed by the authority). Scheduled payments under the arrangement shall be allocated between a) operating costs to reflect the service element of the arrangement, b) repayment of the liability, and c) an imputed finance charge (based on the interest rate implicit in the contract). 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. The liability shall be measured as a financial instrument based on elements b) and c) of the scheduled payments above, using the same actuarial method used for finance leases under section 4.2 of the Code and IAS 17.

Payments

4.3.2.15 By definition, where a PPP or PFI arrangement can be separated into construction and service elements, the payments for each element will be readily identifiable. The service element shall be charged as expenditure as incurred. The construction element shall be allocated into an element relating to the repayment of the liability and an interest element in accordance with the arrangements for a finance lease (see section 4.2 of the Code and IAS 17). The interest element shall be charged to the Surplus or Deficit on the Provision of Services as incurred, with the balance of the payment used to reduce the outstanding liability on the Balance Sheet.

4.3.2.16 Where the PPP or PFI arrangement cannot be separated into construction and service elements, payments by the local authority to an operator shall be separated into three elements – the service charge, repayment of the liability, and interest.

4.3.2.17 The service element of the payments shall 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 infrastructure (the cost to purchase the infrastructure) 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). 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.

Local authority assets

4.3.2.18 A PPP or 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 infrastructure provided by the operator in accordance with paragraph 4.3.2.8 to 4.3.2.10 of the Code.

4.3.2.19 A local authority may provide the operator with access to existing assets of the authority that are not to be used in the PPP or 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 PPP or PFI arrangement).

4.3.2.20 Where the arrangement involves a permanent transfer of an asset to the operator, the local authority shall derecognise the asset in accordance with paragraphs 4.1.2.45 to 4.1.2.51 of the Code and IAS 16. 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 infrastructure 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 Surplus or Deficit on the Provision of Services.

4.3.2.21 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 under section 4.2 of the Code and IAS 17. 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 granting of the operating lease is one element of the consideration provided to the operator for the provision of the infrastructure and services.

4.3.2.22 Over the period of the operating lease, the authority shall recognise income from the operating lease in Surplus or Deficit on the Provision of Services. At the point that the income is recognised, the authority shall recognise a corresponding expense in Surplus or Deficit on the Provision of Services in respect of a reduction in the liability to pay for the infrastructure.

4.3.2.23 Where the asset provided by the authority is provided in the form of a finance lease, the local authority shall derecognise the asset in accordance with section 4.2 of the Code and IAS 17. 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 infrastructure 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 Surplus or Deficit on the Provision of Services.

4.3.2.24 Where the arrangement involves either a finance lease or an operating lease, any payments to be made by the operator for use of the asset are to be taken into account when measuring the assets and liabilities to be recognised on the Balance Sheet.

Prepayments and capital contributions

4.3.2.25 PPP and PFI contracts may be structured to require payments to be made (either as part of a unitary payment or as a lump sum contribution) before the related infrastructure is recognised as an asset on the Balance Sheet. Such payments shall be recognised as prepayments.

4.3.2.26 At the point that the infrastructure is recognised as an asset, the related liability shall also be recognised, in accordance with paragraphs 4.3.2.8 to 4.3.2.10 of the Code. The prepayments shall be applied to reduce the outstanding liability.

4.3.2.27 Any prepayments and contributions shall be taken into account when estimating the fair value of the asset and liability and the separation of payments into the liability, interest and service charge elements.

Depreciation and impairment

4.3.2.28 Assets recognised under a PPP or PFI arrangement shall be depreciated and revalued in accordance with paragraphs 4.1.2.28 to 4.1.2.44 of the Code. In assessing the economic life of the asset, consideration shall be given to the terms of the arrangement, for example where the arrangement requires assets to be replaced at specific points during the arrangement.

4.3.2.29 Where there is evidence that an asset recognised under a PPP or PFI arrangement may have been impaired, an impairment review shall be carried out in accordance with section 4.7 of the Code. Where an asset has been impaired, an authority shall account for the impairment in accordance with section 4.7 of the Code.

Income received

4.3.2.30 A local authority shall recognise any income received as a result of a revenue-sharing clause within the PPP or PFI arrangement as it is earned (ie when the requirements of section 2.7 of the Code and IAS 18 *Revenues* have been met).

4.3.2.31 A local authority shall also recognise any income due from the operator under the PPP or PFI arrangement as it is earned over the life of the agreement. Income will normally be earned as a result of providing assets to the operator; until the assets are provided to the operator, any income will not have been earned and any payments received shall be accounted for as prepayments.

Guarantees

4.3.2.32 A local authority may give financial guarantees as part of a PPP or PFI arrangement. Such guarantees should be recognised and measured in accordance with section 7.2.4 of the Code and IAS 39.

4.3.3 Statutory Accounting Requirements

4.3.3.1 Regulations in England and Wales permit capital receipts to be used to repay borrowing (see part 2 of Appendix B for the legislative basis). Capital receipts may therefore be applied to make capital contributions that reduce the liability. In Scotland, guidance has yet to be finalised.

4.3.3.2 Depreciation, impairment, and gains and losses on revaluation charged to Surplus or Deficit on the Provision of Services are not proper charges to the General Fund (see part 2 of Appendix B for the legislative basis). Such amounts shall be transferred to the Capital Adjustment Account and reported in the Statement of Movement in Reserves Statement.

4.3.3.3 Minimum Revenue Provision (England and Wales) and the repayment of the liability (Scotland) are proper charges to the General Fund, but do not appear in Surplus or Deficit on the Provision of Services. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or repayment of the liability to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance (see part 2 of Appendix B for the legislative basis).

4.3.4 Disclosure Requirements

4.3.4.1 Disclosure of accounting policies in relation to PPP and PFI arrangements is required (see section 3.4 of the Code).

4.3.4.2 Having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to PPP and PFI arrangements:

1) The value of assets held under PFI arrangements at each Balance Sheet date, and an analysis of the movement in those values.
2) The value of liabilities resulting from PFI arrangements at each Balance Sheet date, and an analysis of the movement in those values.
3) Details of the payments due to be made under PFI arrangements (separated into repayments of liability, interest and service charges):
   a) within one year
   b) within two to five years
   c) within six to ten years, and
   d) in each additional five-year period.

4.3.4.3 The following disclosures shall be provided individually for each arrangement or in aggregate for each class of arrangements:

1) A description of the arrangement.
2) Significant terms of the arrangement that may affect the amount, timing and certainty of future cash flows (eg the period of the arrangement, re-pricing dates and the basis upon which re-pricing or renegotiation is determined).
3) The nature and extent (eg quantity, time period or amount as appropriate), where significant, of:
   a) rights to use specified assets

b) rights to expect provision of services
c) obligations to acquire or build items of property, plant and equipment
d) rights to receive specified assets at the end of the concession period
e) renewal and termination options, and
f) other rights and obligations (eg major overhauls), and

4) Changes in the arrangement occurring during the period.

4.3.5 Statutory Disclosure Requirements

4.3.5.1 There are no statutory disclosures required in relation to PPP and PFI arrangements.

4.3.6 Changes since SORP 2009

4.3.6.1 There have been no changes in accounting for PPP and PFI arrangements since SORP 2009.

4.3.6.2 However, the adoption of IFRS means that the accounting arrangements for group accounts have changed. The operator for a PFI and PPP arrangement may be a special purpose entity (SPE). SIC 12 *Consolidation – Special Purpose Entities* requires an authority to consolidate an SPE where the substance of the relationship between the authority and the SPE indicates that the SPE is controlled by that authority. Whilst it is considered unlikely that an authority will control the SPE, it will need to satisfy itself that this is the case; and will need to consolidate the SPE (in accordance with chapter nine of the Code) where it does have control.

4.4 INVESTMENT PROPERTY

4.4.1 Introduction

4.4.1.1 Authorities shall account for investment property in accordance with IAS 40 *Investment Property*, except where interpretations or adaptations to fit the public sector are detailed in the Code. IPSAS 16 *Investment Property* is based on IAS 40, and provides additional guidance for public sector bodies. Recent changes to IAS 40 have yet to be reflected in IPSAS 16, and in these cases the Code requires authorities to follow IAS 40 rather than IPSAS 16.

Interpretation for the public sector context

4.4.1.2 IPSAS 16 includes a public sector interpretation of the definition of investment property. Under this definition, an investment property is one that is used solely to earn rentals or for capital appreciation or both. Property that is used to facilitate the delivery of services or production of goods as well as to earn rentals or for capital appreciation does not meet the definition of an investment property under IPSAS 16, and is accounted for as property, plant and equipment. The Code adopts this definition of investment property.

4.4.1.3 The Code requires investment property to be accounted for under the fair value model. The option under IAS 40 and IPSAS 16 to use the cost model is not permitted.

4.4.2 Accounting Requirements

4.4.2.1 This section of the Code applies to the measurement of investment property interests held under a lease and to investment property provided to a lessee under an operating lease.

Other aspects of lease accounting are covered by IAS 17 *Leases* and section 4.2 of the Code. These include:

- classification of leases as finance leases or operating leases
- recognition of lease income from investment properties
- measurement in a lessor's financial statements of its net investment in a finance lease.

Property provided to a lessee under a finance lease is outside the scope of this section of the Code and shall be accounted for in accordance with section 4.2 of the Code and IAS 17.

Definitions

4.4.2.2 **Carrying amount** is the amount at which an asset is recognised in the balance sheet.

4.4.2.3 **Fair value** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction. For this section of the Code, fair value is to be interpreted as the amount that would be paid for the asset in its highest and best use, ie market value. The fair value of investment property held under a lease is the lease interest.

4.4.2.4 **Investment property** is property (land or a building, or part of a building, or both) held solely to earn rentals or for capital appreciation or both, rather than for:

a) use in the production or supply of goods or services or for administrative purposes, or
b) sale in the ordinary course of operations.

If earning rentals were an outcome of a regeneration policy, for example, the properties concerned would be accounted for as property, plant and equipment rather than investment property. Social housing is delivering a service and shall be accounted for as property, plant and equipment.

4.4.2.5 **Owner-occupied property** is property held (by the owner or by the lessee under a finance lease) for use in the delivery of services or production of goods or for administrative purposes.

Classification

4.4.2.6 Property held by a lessee under an operating lease may be accounted for as an investment property if, and only if, the property would otherwise meet the definition of an investment property. This classification is available on a property-by-property basis. The lease shall be accounted for as if it were a finance lease.

4.4.2.7 Owner-occupied property shall be accounted for as property, plant and equipment (see section 4.1 of the Code and IAS 16 *Property, Plant and Equipment*).

4.4.2.8 Where an authority leases property to a subsidiary, the property is accounted for as an investment property in the authority's accounts if it meets the definition in paragraph 4.4.1.2. The property is not accounted for as an investment property in the group accounts, because from the group perspective the property is owner-occupied.

Recognition and measurement

4.4.2.9 Investment property shall be recognised as an asset when, and only when:

a) it is probable that the future economic benefits that are associated with the investment property will flow to the entity, and

b) the cost or fair value of the investment property can be measured reliably.

4.4.2.10 An authority shall evaluate the costs of an investment property when they are incurred. The costs include acquisition costs and costs incurred subsequently to add to, replace part of or service an investment property, but do not include day-to-day repairs and maintenance. Where part of an investment property is replaced, an authority shall recognise in the carrying value of the investment property the cost of the replacement; the carrying amount of those parts that are replaced is derecognised.

4.4.2.11 Investment property shall be measured initially at cost. The cost of an investment property includes its purchase price, transaction costs and directly attributable expenditure. Where an investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition. The initial cost of a lease interest classified as an investment property shall be as prescribed for a finance lease (see section 4.2 of the Code). Where an investment property is acquired in exchange for a non-monetary asset, the cost of the investment property is its fair value at the time of the exchange, or, where this cannot be reliably determined, the carrying amount of the asset given up.

4.4.2.12 After initial recognition, investment property shall be measured at fair value. The use of the cost model allowed under IAS 40 is not permitted. A gain or loss arising from a change in the fair value of investment property shall be recognised in Surplus or Deficit on the Provision of Services for the period in which it arises. The fair value of investment property shall reflect market conditions at the Balance Sheet date; this means that a periodic revaluation approach (see paragraph 4.1.2.35) may only be used where the carrying amount does not differ materially from that which would be determined using fair value at the Balance Sheet date. An investment property under construction shall be measured at fair value once an authority is able to measure reliably the fair value of the investment property, and at cost before that date. Investment properties held at fair value are not depreciated.

4.4.2.13 Exceptionally, there may be evidence when an authority first acquires an investment property (or the property first becomes an investment property following a change of use) that the fair value of the investment property is not reliably determinable on a continuing basis. In such cases, an authority shall account for that property using the cost model in IAS 16 and section 4.1 of the Code (ie the investment property is depreciated over its useful life). The residual value of the investment property shall be assumed to be zero.

Transfers

4.4.2.14 IAS 40 details the accounting arrangements that apply where assets are reclassified as investment property or are reclassified from investment property. Where such reclassifications take place, authorities shall follow the accounting arrangements set out in paragraphs 57 to 65 of IAS 40.

Disposals

4.4.2.15 An investment property shall be derecognised on disposal (by sale or by entering into a finance lease) or when the investment property is permanently withdrawn from use and no future economic benefits or service potential are expected from its disposal. Gains or losses arising from the retirement or disposal of investment property shall be recognised in Surplus or Deficit on the Provision of Services (unless IAS 17 and section 4.2 of the Code requires otherwise on a sale and leaseback) in the period of the retirement or disposal.

4.4.2.16 Compensation from third parties for investment property that becomes impaired, lost or is given up is recognised in Surplus or Deficit on the Provision of Services when it becomes receivable.

4.4.3 Statutory Accounting Requirements

4.4.3.1 Statute and proper practice restrict the use of capital receipts, and prescribe the charges that can be made to the General Fund (see part 2 of Appendix B for the legislative basis). To comply with these restrictions, the gain or loss on derecognition of an investment property shall be reversed out of the General Fund. The General Fund shall be debited (in the case of a gain) or credited (in the case of a loss) with an amount equal to the gain or loss on derecognition of the investment property (excluding any costs of disposal which are a proper charge to the General Fund). The double entries are a credit to the Capital Receipts Reserve of an amount equal to the disposal proceeds and a debit to the Capital Adjustment Account equal to the carrying amount of the investment property (less any balance transferred from the Government Grants Deferred Account).

4.4.3.2 These entries will be reflected in the Movement in Reserves Statement.

4.4.3.3 Gains or losses on fair value debited or credited to Surplus or Deficit on the Provision of Services are not proper charges to the General Fund (see part 2 of Appendix B for the legislative basis). Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

4.4.3.4 Minimum Revenue Provision (England and Wales) and Loans Fund Charges (Scotland and Northern Ireland) are proper charges to the General Fund, but do not appear in Surplus or Deficit on the Provision of Services. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or Loans Fund Charges to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance (see part 2 of Appendix B for the legislative basis).

4.4.4 Disclosure Requirements

4.4.4.1 Disclosure of accounting policies in relation to investment property is required (see section 3.4 of the Code).

4.4.4.2 Having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to investment property:

1) Whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.
2) The amounts recognised in the Comprehensive Income and Expenditure Statement for:
   a) rental income from investment property
   b) direct operating expenses (including repairs and maintenance) arising from investment property

where these amounts are not disclosed on the face of the Comprehensive Income and Expenditure Account.

3) The existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal.
4) Contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.
5) A reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:
   a) additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised in the carrying amount of an asset
   b) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with chapter section 4.9 of the Code and other disposals
   c) net gains or losses from fair value adjustments
   d) transfers to and from inventories and owner-occupied property, and
   e) other changes.

The disclosures above apply in addition to those applicable to leases (see section 4.2 of the Code). In accordance with leases the owner of an investment property provides lessors' disclosures about leases into which it has entered. An authority that holds an investment property under a finance or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.

4.4.5 Statutory Disclosure Requirements

4.4.5.1 There are no statutory disclosures required in relation to investment property.

4.4.6 Changes since SORP 2009

4.4.6.1 SORP 2009 required investment property to be carried at market value. The Code requires investment property to be carried at fair value; as fair value will normally be based on market value, this change is not expected to result in any material change to the carrying amount of investment property.

4.4.6.2 SORP 2009 required revaluations of investment property to be adjusted through the revaluation reserve in the first instance. The Code requires changes to fair value to be taken to Surplus or Deficit on the Provision of Services (and then reversed out to the Capital Adjustment Account).

4.4.6.3 SORP 2009 required investment property under construction to be accounted for at cost. The Code requires investment property under construction to be accounted for at fair value once an authority is able to measure reliably the fair value of the investment property.

4.4.6.4 SORP 2009 required investment property held under a lease to be depreciated where the unexpired term was 20 years or less. This requirement has been removed in the Code, although the requirement to fair value the lease interest will have a similar effect.

4.5 INTANGIBLE ASSETS

4.5.1 Introduction

4.5.1.1 Authorities shall account for intangible assets in accordance with IAS 38 *Intangible Assets*, except where interpretations or adaptations to fit the public sector are detailed in the Code.

4.5.1.2 Intangible assets may be contained in or on a physical substance (eg a compact disc for software). Authorities will need to use judgement to determine whether an asset that incorporates both intangible and tangible elements is accounted for as an intangible asset or as property, plant and equipment.

4.5.1.3 This section of the Code does not cover financial assets (see chapter seven), intangible assets held for sale in the ordinary course of business (see chapter five), leases (see section 4.2 of the Code), assets arising from employee benefits (see chapter six) or non-current assets classified as held for sale (see section 4.9 of the Code).

4.5.2 Accounting Requirements

Definition

4.5.2.1 An intangible asset is an *identifiable* non-monetary asset without physical substance. It must be *controlled* by the authority as a result of past events, and *future economic or service benefits* must be expected to flow from the intangible asset to the authority. The most common class of intangible asset in local authorities is computer software.

4.5.2.2 If an item does not meet the definition of an intangible asset (identifiability, control and future economic benefits), expenditure to acquire it or generate it internally is recognised as an expense when it is incurred.

Recognition and measurement

4.5.2.3 An intangible fixed asset shall be recognised if it is probable that the expected future benefits attributable to the asset will flow to the authority. An intangible asset shall be measured initially at cost.

4.5.2.4 Expenditure incurred on an intangible asset after it has been recognised will normally be charged to Surplus or Deficit on the Provision of Services as incurred. Only rarely will subsequent expenditure meet the recognition criteria in the Code. Where this occurs, an authority shall recognise the expenditure in the carrying amount of the intangible asset. Further details can be found in IAS 38.

4.5.2.5 Paragraphs 33 to 41 of IAS 38 deal with the acquisition of intangible fixed assets as part of a business combination. These paragraphs do not apply to the single entity accounts of local authorities, as local authorities are deemed to be under common control and therefore outside the scope of IFRS 3 *Business Combinations*. Where authorities are reorganised, intangible assets are accounted for using the merger accounting approach rather than the IFRS 3 approach. Paragraphs 33 to 41 of IAS 38 may be relevant to an authority's group accounts where acquisitions take place.

Government grants

4.5.2.6 An intangible asset may be acquired (either in full or in part) by way of a government grant or other contribution. Where an authority acquires an intangible asset in this way, both the asset and the grant or contribution shall be recognised initially at fair value. The option within IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to recognise the asset at nominal value is not allowed by the Code.

Internally generated assets

4.5.2.7 IAS 38 requires strict criteria to be met before an internally generated intangible asset may be recognised. These criteria are met where an authority can demonstrate:

- the technical feasibility of completing the asset so it will be available for use or sale
- its intention to complete the asset
- its ability to use or sell the asset
- how the asset will generate future economic benefits or deliver service benefits (either by demonstrating a market for the asset or the usefulness of the asset)
- the availability of adequate resources to complete the asset, and
- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Provided these criteria are met, an authority shall recognise an internally generated intangible asset. The generation of the asset is classified into a research phase and a development phase. The cost of an internally generated intangible asset is the sum of expenditure incurred in the development phase of the project, only after it has become probable that the expected future benefits attributable to the asset will flow to the authority. Further details can be found in IAS 38.

Development of websites

4.5.2.8 SIC 32 *Intangible Assets – Web Site Costs* applies to the development of websites. The development of a website for internal or external use creates an intangible asset where the recognition criteria for internally generated intangible assets are met (see 4.5.2.7).

4.5.2.9 To qualify as an internally generated internal asset, an economic or service benefit must arise from the operation of the web site. SIC 32 states that this cannot be demonstrated for a website that is solely or primarily intended to promote or advertise an entity's goods or services. For local authorities, a website whose primary purpose is to provide information about services and objectives does not provide an economic or service benefit. Expenditure on such a website shall not be recognised as an intangible asset, but shall be charged to Surplus or Deficit on the Provision of Services as it arises.

4.5.2.10 The planning of a website is equivalent to the research phase in 4.5.2.7, and expenditure incurred in planning a website is expensed as incurred. The development of a website is equivalent to the development phase in 4.5.2.7, and expenditure incurred in the development of a website shall be included in the cost of a website recognised as an intangible asset. Further details can be found in SIC 32.

Past expenses not to be recognised as an asset

4.5.2.11 Expenditure on an intangible item that was initially recognised (ie in a prior year) as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

Measurement after recognition

4.5.2.12 IAS 38 allows an intangible asset to be carried at a revalued amount only where its fair value can be determined by reference to an active market. This is unlikely to apply to the single entity accounts of local authorities, and an intangible asset will therefore normally be carried at its cost less any accumulated amortisation and any accumulated impairment loss.

4.5.2.13 Where an active market for an intangible asset exists, an authority shall carry that intangible asset at fair value (less any accumulated depreciation and impairment). Where an intangible asset is carried at fair value, all assets in that class shall be carried at fair value unless there is no active market for an asset. Further details can be found in IAS 38.

Useful life

4.5.2.14 An authority shall assess whether the useful life of an intangible asset is finite or indefinite, and, if finite, the length of that life. The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of these rights (unless they can be renewed, when the useful life shall include the renewal period only if there is evidence to support renewal by the authority).

Amortisation

4.5.2.15 An intangible asset with a finite useful life is amortised; an intangible asset with an indefinite useful life is not.

4.5.2.16 The depreciable amount of an intangible asset with a finite useful life shall be amortised on a systematic basis over its useful life, beginning when the intangible asset is available for use. The amortisation method used shall reflect the expected pattern of use of the economic benefits. If the pattern cannot be determined reliably, the straight-line method shall be used. The amortisation period and method shall be reviewed at least at each financial year-end, and the amortisation amended where required.

4.5.2.17 The depreciable amount of an intangible asset with a finite life is determined after deducting its residual value; in the single entity accounts of a local authority this residual value will normally be zero.

4.5.2.18 An intangible asset with an indefinite life shall not be amortised, but shall be tested for impairment annually, and whenever there is an indication the asset may be impaired. The useful life of the asset shall be reviewed annually. A change to a finite useful life may be an indication that the asset has been impaired.

Retirements and disposals

4.5.2.19 An asset shall be derecognised on disposal or when no future economic benefits are expected from the asset. The gain or loss arising from the derecognition of an intangible asset is the difference between the net disposal proceeds (if any) and the carrying amount of the asset;

this gain or loss shall be recognised in Surplus or Deficit on the Provision of Services when the asset is derecognised.

4.5.3 Statutory Accounting Requirements

4.5.3.1 Statute and proper practice restrict the use of capital receipts, and prescribe the charges that can be made to the General Fund and Housing Revenue Account (see part 2 of Appendix B for the legislative basis). To comply with these restrictions, the gain or loss on the derecognition of an intangible fixed asset shall be reversed out of the General Fund or Housing Revenue Account. The General Fund or Housing Revenue Account shall be debited (in the case of a gain) or credited (in the case of a loss) with an amount equal to the gain or loss on derecognition of the intangible asset. The gain or loss that is reversed out of the General Fund or Housing Revenue Account excludes any costs of disposal which either cannot be capitalised under regulation or statutory guidance or which the authority has chosen not to capitalise. The double entries are a credit to the Capital Receipts Reserve of an amount equal to the disposal proceeds and a debit to the Capital Adjustment Account equal to the carrying amount of the intangible asset.

4.5.3.2 In addition, where the intangible asset was carried at fair value, any balance on the Revaluation Reserve in relation to the intangible asset will need to be transferred to the Capital Adjustment Account. The entries required are debit Revaluation Reserve, credit Capital Adjustment Account.

4.5.3.3 These entries will be reflected in the Movement in Reserves Statement.

4.5.3.4 General Fund service revenue accounts, central support services, trading accounts and the Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice)* shall be charged with a provision for amortisation and, where required, any related impairment loss (in excess of any balance on the Revaluation Reserve in relation to an intangible asset), for all intangible assets used in the provision of the service.

4.5.3.5 The reversal of an impairment loss on an intangible asset is only permitted to be recognised in the limited circumstance that the increase in value is attributable to the unexpected reversal of the external event that caused the original impairment to be recognised (see paragraph 4.7.2.17).

4.5.3.6 Amortisation and impairment charged to Surplus or Deficit on the Provision of Services are not proper charges to the General Fund or Housing Revenue Account (see part 2 of Appendix B for the legislative basis). Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

4.5.3.7 Minimum Revenue Provision (England and Wales) and Loans Fund Charges (Scotland and Northern Ireland) are proper charges to the General Fund, but do not appear in Surplus or Deficit on the Provision of Services. Such amounts shall be transferred from the Capital Adjustment Account and reported in the Movement in Reserves Statement. The amounts of Minimum Revenue Provision or Loans Fund Charges to be charged to the General Fund for the year are set out in the appropriate regulations and statutory guidance (see part 2 of Appendix B for the legislative basis).

4.5.4 Disclosure Requirements

4.5.4.1 Disclosure of accounting policies in relation to intangible assets is required (see section 3.4 of the Code).

4.5.4.2 Having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to intangible assets:

1) An authority shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:
   a) whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used
   b) the amortisation methods used for intangible assets with finite useful lives
   c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period
   d) the line item(s) of the income statement in which any amortisation of intangible assets is included
   e) a reconciliation of the carrying amount at the beginning and end of the period showing:
      i) additions, indicating separately those from internal development, those acquired separately, and those acquired through business combinations
      ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with section 4.9 of the Code and other disposals
      iii) increases or decreases during the period resulting from revaluations in accordance with section 4.5 of the Code and from impairment losses recognised in or reversed in Other Comprehensive Income or Expenditure and taken to the Revaluation Reserve in accordance with section 4.7 of the Code (if any)
      iv) impairment losses recognised in Surplus or Deficit on the Provision of Services during the period in accordance with section 4.7 of the Code (if any)
      v) impairment losses reversed in Surplus or Deficit on the Provision of Services during the period in accordance with section 4.7 of the Code (if any)
      vi) any amortisation recognised during the period, and
      vii) other changes.
2) In accordance with section 3.4 of the Code an authority discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For intangible assets, such disclosure may arise from changes in estimates with respect to:
   a) residual values
   b) an assessment of an intangible asset's useful life, and
   c) amortisation methods.
3) For an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the authority shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.

4) A description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the authority's financial statements.
5) The amount of contractual commitments for the acquisition of intangible assets.
6) If intangible assets are accounted for at revalued amounts, an authority shall disclose the following:
    a) by class of intangible assets:
        i) the effective date of the revaluation
        ii) the carrying amount of revalued intangible assets, and
        iii) the carrying amount that would have been recognised had the revalued class of intangible assets been measured after recognition using the cost model
    b) the amount of the revaluation surplus that relates to intangible assets at the beginning and end of the period, indicating the changes during the period and any restrictions on the distribution of the balance to shareholders, and
    c) the methods and significant assumptions applied in estimating the assets' fair values.
7) For intangible assets acquired by way of a government grant and initially recognised at fair value:
    a) the fair value initially recognised for these assets
    b) their carrying amount, and
    c) whether they are measured after recognition under the cost model or the revaluation model.

4.5.5 Statutory Disclosure Requirements

4.5.5.1 There are no statutory disclosures required in relation to intangible assets.

4.5.6 Changes since SORP 2009

4.5.6.1 Following FRS 10, the SORP 2009 stated that internally developed intangible assets shall only be capitalised where there was a readily ascertainable market value, which was unlikely to occur in local authorities. IAS 38 recognises a wider range of intangible assets, and internally generated intangible assets may be recognised provided the criteria in IAS 38 are met.

4.5.6.2 The SORP 2009 stated that there was a rebuttable presumption that the economic lives of intangible assets are limited to periods of 20 years or less. No such presumption is now made.

4.5.6.3 The SORP required impairment arising from the consumption of economic benefits to be charged to the Income and Expenditure Account in all cases. All impairments are now taken to the Revaluation Reserve in the first instance, and will only be charged to Surplus or Deficit on the Provision of Services once the balance on the reserve in relation to the intangible asset has been reduced to zero.

4.6 REVENUE EXPENDITURE FUNDED FROM CAPITAL UNDER STATUTE

4.6.1 Introduction

4.6.1.1 Legislation allows some items to be funded from capital resources that under IFRS and normal accounting practice would be charged to Surplus or Deficit on the Provision of Services. This section of the Code defines the accounting arrangements for these items.

4.6.2 Accounting Requirements

4.6.2.1 Revenue expenditure funded from capital under statute shall be accounted for in accordance with proper practice under the rest of the Code, and effect shall be given to the statutory requirements by making the adjustments set out in 4.6.3 below. No IFRS or IAS deals with these items as they are a statutory departure from normal accounting practice.

4.6.3 Statutory Accounting Requirements

4.6.3.1 Legislation in England and Wales (see part 2 of Appendix B) allows some expenditure to be classified as capital for funding purposes when it does not result in the expenditure being carried on the Balance Sheet as a fixed asset. The purpose of this is to enable it to be funded from capital resources rather than be charged to the General Fund and impact on that year's council tax. These items are generally grants and expenditure on property not owned by the authority, and amounts directed under section 16(2) of Part 1 of the Local Government Act 2003.

4.6.3.2 Similarly, there is also legislative provision in Scotland for certain grants to community bodies to be funded from capital resources with the agreement of the Scottish Government (see part 2 of Appendix B for the legislative basis).

4.6.3.3 Such expenditure shall be charged to Surplus or Deficit on the Provision of Services in accordance with the general provisions of the Code. Any statutory provision that allows capital resources to meet the expenditure shall be accounted for by debiting the Capital Adjustment Account and crediting the General Fund Balance and showing as a reconciling item in the Movement in Reserves Statement.

4.6.4 Disclosure Requirements

4.6.4.1 Disclosure of items charged to Surplus or Deficit on the Provision of Services shall follow the general provisions of the Code.

4.6.5 Statutory Disclosure Requirements

4.6.5.1 Disclosure of accounting policies in relation to revenue expenditure funded from capital under statute is required (see section 3.4 of the Code).

4.6.5.2 Revenue expenditure funded from capital under statute shall be included in the note on capital expenditure and financing (see paragraph 4.1.4.3 note 5).

4.6.6 Changes since SORP 2009

4.6.6.1 There have been no changes in accounting for revenue expenditure funded from capital under statute since SORP 2009.

4.7 IMPAIRMENT OF ASSETS

4.7.1 Introduction

4.7.1.1 Authorities shall account for impairments in accordance with IAS 36 *Impairment of Assets*, except where interpretations or adaptations to fit the public sector are detailed in the Code. The objective of the standard is to ensure that assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the standard requires the recognition of an impairment loss. Downward revaluations resulting from changes in market value do not necessarily result in impairment (see section 4.1 of the Code in relation to revaluation losses).

4.7.1.2 IPSAS 21 *Impairment of Non-cash-generating Assets* and IPSAS 26 *Impairment of Cash-generating Assets* are based on IAS 36, and introduce no additional accounting requirements, although they provide additional guidance for public sector bodies. Assets falling under the definition of cash-generating assets (ie assets held for the primary objectives of generating a commercial return) may not be common within local authorities. Where authorities deem they have assets under this definition they should refer to IAS 36 and IPSAS 26 in relation to impairment.

4.7.1.3 This section of the Code does not cover impairment of assets in relation to employee benefits (see chapter six), financial instruments (see chapter seven), investment property (see section 4.4 of the Code), insurance contracts (see Appendix A, paragraph A.1.7, non-current assets classified as held for sale (see section 4.9 of the Code), inventories (see section 5.1 of the Code) and construction contracts (see section 5.2 of the Code).

4.7.1.4 IAS 36 *Impairment of Assets* applies to financial assets classified as subsidiaries, associates and joint ventures (see chapter nine).

Interpretation for the public sector context

4.7.1.5 The following interpretation of IAS 36 (as defined in IPSAS 21) for the public sector context apply.

Recognition and measurement

- Where an asset is not held for the purpose of generating cash flows, *value in use* is assumed to equal the cost of replacing the service potential provided by the asset, unless there has been a reduction in service potential.

4.7.2 Accounting Requirements

Definitions

4.7.2.1 **Impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

4.7.2.2 **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

4.7.2.3 **Recoverable amount** of an asset is the higher of fair value less costs to sell (ie net selling price) and its value in use.

4.7.2.4 **Fair value less costs to sell** is the amount obtainable from the sale of an asset in an arm's-length transaction between knowledgeable, willing parties, less costs of disposal.

4.7.2.5 **Historical cost** is deemed to be the carrying amount of an asset as at 1 April 2007 (ie b/f from 31 March 2007) or at the date of acquisition, whichever date is the later, and adjusted for subsequent depreciation or impairment (if applicable).

4.7.2.6 **Value in use** of a non-cash-generating asset is the present value of the asset's remaining service potential. Value in use of a cash-generating asset is the present value of the future cash flows expected to be derived from an asset.

4.7.2.7 Further definitions, including definitions of active market, cost of disposal and useful life are contained in IAS 36, IPSAS 21 and IPSAS 26.

4.7.2.8 IAS 36 refers to cash-generating units; this definition may not be relevant to local authorities in the majority of cases. Where authorities deem they have assets under this definition they should refer to IAS 36 and IPSAS 26.

When to assess for impairment

4.7.2.9 At the end of each reporting period an assessment shall take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount shall be estimated having regard to the application of the concept of materiality in identifying whether the recoverable amount of an asset needs to be estimated. If no indication of an impairment loss is present, the Code does not require a formal estimate of recoverable amount, with the exception of intangible assets.

4.7.2.10 An intangible asset with an indefinite useful life or not yet available for use shall be assessed annually at any time during the year, irrespective of whether there is any indication that it may be impaired.

Examples of impairments

4.7.2.11 Examples of events and changes in circumstances that indicate an impairment may have incurred include (this list is not intended to exhaustive):

- a significant decline (ie more than expected as a result of the passage of time or normal use) in an asset's carrying amount during the period, that is specific to the asset
- evidence of obsolescence or physical damage of an asset
- a commitment by the authority to undertake a significant reorganisation, and

- a significant adverse change in the statutory or other regulatory environment in which the authority operates.

4.7.2.12 If there is an indication that an asset may be impaired, this could indicate that the useful life, the depreciation method or the residual value need to be reviewed, even if no impairment loss is recognised.

Recognition of impairment

4.7.2.13 Impairment shall be recognised on assets carried at a re-valued amount and historical cost.

4.7.2.14 An impairment loss on a re-valued asset shall be recognised in the Revaluation Reserve (these entries will be reflected in the Movement in Reserves Statement) to the extent that the impairment does not exceed the amount in the Revaluation Reserve for the same asset (ie up to the historical cost of the asset) and thereafter in Surplus or Deficit on the Provision of Services.

4.7.2.15 An impairment loss on a non-revalued asset (ie an asset with a carrying value based on historical cost) shall be recognised in Surplus or Deficit on the Provision of Services.

Reversing an impairment

4.7.2.16 At the end of each reporting period an assessment shall take place as to whether there is any indication that an impairment loss recognised in earlier periods for an asset may no longer exist or have decreased. If any such indication exists, authorities shall estimate the recoverable amount of that asset.

4.7.2.17 The reversal of an impairment loss of an asset (previously recognised in Surplus or Deficit on the Provision of Services) is only permitted to be recognised if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. Indications of the potential decrease of an impairment loss mainly mirror (but are not limited to) the indications of a potential impairment loss set out in paragraph 4.7.2.11.

4.7.2.18 If there is an indication that the impairment loss recognised for an asset may no longer exist or may have decreased, this may indicate that the useful life, the depreciation method or the residual value need to be reviewed, even if no impairment loss is reversed for the asset.

4.7.2.19 The reversal of an impairment loss previously recognised in Surplus or Deficit on the Provision of Services shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. Any excess above the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years shall be treated as a revaluation gain and charged to the Revaluation Reserve.

4.7.2.20 The Code does not allow the reversal of an impairment loss for goodwill. Goodwill may not be relevant to local authorities in the majority of cases. Where authorities conclude they have assets under this definition they shall refer to IAS 36.

4.7.3 Statutory Accounting Requirements

4.7.3.1 General Fund service revenue accounts, central support services, trading accounts and the Housing Revenue Account (as defined in CIPFA's *Best Value Accounting Code of Practice)* shall be charged with an impairment loss (in excess of any balance on the Revaluation Reserve) and reversal of an impairment loss (net of amortisation or depreciation).

4.7.3.2 Impairment loss and reversal of impairment loss charged to Surplus or Deficit on the Provision of Services are not proper charges to the General Fund (see part 2 of Appendix B for the legislative basis). Such amounts shall be transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

4.7.4 Disclosure Requirements

4.7.4.1 Disclosure of accounting policies in relation to impairments of assets is required (see section 3.4 of the Code).

4.7.4.2 Having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to impairment of assets:

1) An authority shall disclose the following for each class of assets:
   a) the amount of impairment losses recognised in Surplus or Deficit on the Provision of Services, during the period in which those impairment losses are included
   b) the amount of reversals of impairment losses recognised in Surplus or Deficit on the Provision of Services, during the period in which those impairment losses are reversed
   c) the amount of impairment losses on revalued assets recognised in Other Comprehensive Income and Expenditure and taken to the Revaluation Reserve during the period
   d) the amount of reversals of impairment losses on revalued assets recognised in Other Comprehensive Income and Expenditure and taken to the Revaluation Reserve during the period.
2) An authority shall disclose the following for each material impairment loss recognised or reversed during the period for an individual asset:
   a) the events and circumstances that led to the recognition or reversal of the impairment loss
   b) the amount of the impairment loss recognised or reversed
   c) for an individual asset:
      i) the nature of the asset, and
      ii) the reportable segment to which the asset belongs, in line with the format of segmental reporting in section 3.4 of the Code
      iii) whether the recoverable amount of the asset is its fair value less costs to sell or its value in use
      iv) if the recoverable service amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market)

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v) if the recoverable service amount is value in use, the approach used to determine value in use.

3) Cash-generating units containing goodwill or intangible assets with indefinite useful lives may not be relevant to authorities in the majority of cases. Where authorities deem they have assets under this definition they should refer to IAS 36 for disclosures.

4.7.5 Statutory Disclosure Requirements

4.7.5.1 There are no statutory disclosures required in relation to impairments.

4.7.6 Changes since SORP 2009

4.7.6.1 The Code requires that an annual assessment shall take place as to whether there is any indication that an asset may be impaired. If any indication exists, the recoverable amount shall be estimated. There is no longer a specific requirement to undertake an impairment assessment of assets when either a) no depreciation charge is made on the grounds that it would be immaterial (either because of the length of the estimated remaining useful life or because the estimated residual value of the fixed asset is not materially different from the carrying amount of the asset), or b) the estimated remaining useful life of the fixed asset exceeds 50 years. In addition IAS 36 does not exempt non-depreciable land from impairment reviews.

4.7.6.2 IAS 36 makes no distinction between impairments due to the clear consumption of economic benefit and other impairments (ie general fall in prices specific to the asset). In line with IAS 36, the Code requires **all** impairment losses on re-valued assets to be recognised in the Revaluation Reserve up to the amount in the Revaluation Reserve for each respective asset. The SORP 2009 required an impairment loss due to the clear consumption of economic benefits on a re-valued asset to be recognised in Surplus or Deficit on the Provision of Services, (previously called the Income and Expenditure Account). As a result of this change the accounting entry between the Revaluation Reserve and the Capital Adjustment Account to reflect the difference between impairment based on historical cost and the re-valued amount is no longer required.

4.7.6.3 The events or circumstances that indicate that a previous impairment can be reversed are the same for both intangible and tangible assets under IAS 36. In contrast FRS 11 set out the events or circumstances separately for intangible and tangible fixed assets.

4.8 BORROWING COSTS

4.8.1 Introduction

4.8.1.1 Authorities shall account for borrowing costs in accordance with IAS 23 *Borrowing Costs*, except where interpretations or adaptations to fit the public sector are detailed in the Code. IPSAS 5 *Borrowing Costs* is based on the previous version of IAS 23. Whilst the Code does not follow IPSAS 5, the accounting treatment in the Code is consistent with the requirements of IPSAS 5.

Adaptation and interpretation for the public sector context

4.8.1.2 IAS 23 requires borrowing costs in respect of qualifying assets to be capitalised. The Code permits (but does not require) authorities to select an accounting policy of expensing these costs.

4.8.2 Accounting Requirements

4.8.2.1 Where an authority has an accounting policy of capitalising borrowing costs, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense. Where an authority has a policy of expensing borrowing costs, all borrowing costs are recognised as an expense as they are incurred.

4.8.2.2 Borrowing costs in respect of a qualifying asset measured at fair value or inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis are not covered by this section of the Code and shall be recognised as an expense.

Definitions

4.8.2.3 The following terms are used with the meanings specified:

- **Borrowing costs** are interest and other costs that an entity incurs in connection with the borrowing of funds.
- A **qualifying asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

4.8.2.4 Borrowing costs may include:

- interest expense calculated using the effective interest method, and
- finance charges in respect of finance leases.

4.8.2.5 Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

Recognition (capitalisation policy)

4.8.2.6 Paragraphs 4.8.2.7 to 4.8.2.12 apply to authorities which have adopted an accounting policy of capitalising borrowing costs in relation to qualifying assets. Paragraph 4.8.2.13 applies to authorities which have adopted an accounting policy of expensing borrowing costs.

4.8.2.7 A local authority shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset, when it is probable that they will result in future economic benefits or service potential to the authority and the costs can be measured reliably. A local authority shall recognise other borrowing costs as an expense in the period in which it incurs them.

4.8.2.8 To the extent that a local authority borrows funds specifically for the purpose of obtaining a qualifying asset, the authority shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

4.8.2.9 To the extent that an authority borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the authority shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an authority capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

Capitalisation

4.8.2.10 A local authority shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the authority first meets all of the following conditions:

- it incurs expenditures for the asset
- it incurs borrowing costs, and
- it undertakes activities that are necessary to prepare the asset for its intended use or sale.

4.8.2.11 An authority shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset.

4.8.2.12 An authority shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. When an authority completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the authority shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

Recognition (expense policy)

4.8.2.13 Borrowing costs shall be recognised as an expense in the period in which they are incurred. Borrowing costs are interest and other costs that an authority incurs in connection with the borrowing of funds.

4.8.3 Statutory Accounting Requirements

4.8.3.1 There are no statutory accounting requirements in relation to borrowing costs.

4.8.4 Disclosure Requirements

4.8.4.1 Disclosure of accounting policies in relation to borrowing costs is required (see section 3.4 of the Code).

4.8.4.2 Where an authority has adopted an accounting policy of capitalising borrowing costs in relation to qualifying asset, and having regard to paragraph 3.4.2.25 of the Presentation of Financial Statements section of the Code, authorities shall disclose the following notes in relation to borrowing costs:

- the amount of borrowing costs capitalised during the period, and
- the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

4.8.4.3 Where an authority has adopted an accounting policy of expensing borrowing costs, borrowing costs expensed will be disclosed within interest payable.

4.8.5 Statutory Disclosure Requirements

4.8.5.1 There are no statutory disclosures required in relation to borrowing costs.

4.8.6 Changes since SORP 2009

4.8.6.1 There are no changes since SORP 2009.

4.9 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

4.9.1 Introduction

4.9.1.1 Authorities shall account for assets held for sale and present and disclose discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, except where interpretations or adaptations to fit the public sector are detailed in the Code. The standard specifies that:

- assets held for sale should be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on those assets should cease, and
- assets held for sale should be presented separately, on the face of the Balance Sheet, and the results of discontinued operations should be presented separately in Surplus or Deficit on the Provision of Services and Balance Sheet.

4.9.1.2 The classification and presentation requirements of this section of the Code (also see IFRS 5) apply to all recognised non-current assets and to all disposal groups of an authority that are to be sold and such assets are excluded from the scope of section 4.1 (also see IAS 16) and section 4.5 (also see IAS 38) of the Code.

4.9.1.3 This section of the Code does not cover the measurement of assets in relation to employee benefits (see chapter six), financial instruments (see chapter seven), investment property (see section 4.4 of the Code) and insurance contracts (see Appendix A, paragraph A.1.7). IFRS 5 also refers to other areas where the standard does not apply in terms of measurement; however, these areas may not be common, if relevant at all within authorities, ie deferred tax assets and agriculture. Authorities should refer to IFRS 5 for these areas.

4.9.1.4 The criteria in accordance with this section of the Code must be met in order for a non-current asset to be classified as held for sale. Non-current assets that meet the criteria to be classified as held for sale shall be presented as either current assets or non-current assets in line with section 3.4 of the Code.

Adaptation and interpretation for the public sector context

4.9.1.5 The following interpretations of IFRS 5 for the public sector context apply.

Recognition and measurement

- Where an asset is not held for the purpose of generating cash flows, *value in use* is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.
- In order to qualify as 'discontinued operations', the activities must cease completely; that is, responsibilities transferred from one part of the public sector to another (such as machinery of government changes – see section 2.5 of the Code) are not discontinued operations.

Definition

- For this section of the Code, fair value is to be interpreted as the amount that would be paid for the asset in its highest and best use, ie market value.

4.9.2 Accounting Requirements

Definitions

4.9.2.1 **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation and impairment losses.

4.9.2.2 **Costs to sell** are the incremental costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs.

4.9.2.3 **Current asset** is an asset that is intended to be sold within the normal operating cycle; the asset is held primarily for the purpose of trading or the authority expects to realise the asset within 12 months after the reporting date.

4.9.2.4 **Discontinued operation** is an activity of an authority that must cease completely; that is, responsibilities transferred from one part of the public sector to another are not discontinued operations.

4.9.2.5 **Disposal group** is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

4.9.2.6 **Fair value** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction. For this section of the Code, fair value is to be interpreted as the amount that would be paid for the asset in its highest and best use, ie market value. Fair value for social housing being disposed of under Right to Buy (RTB) legislation is the discounted RTB value.

4.9.2.7 **Historical cost** is deemed to be the carrying amount of an asset as at 1 April 2007 (ie b/f from 31 March 2007) or at the date of acquisition, whichever date is the later, and adjusted for subsequent depreciation or impairment (if applicable).

4.9.2.8 **Non-current asset** is an asset that does not meet the definition of a current asset.

4.9.2.9 **Recoverable amount** of an asset is the higher of fair value less costs to sell (ie net selling price) and its value in use.

4.9.2.10 **Value in use** of a non-cash-generating asset is the present value of the asset's remaining service potential. Value in use of a cash-generating asset is the present value of the future cash flows expected to be derived from an asset.

4.9.2.11 Further definitions, including the definition of firm purchase commitment are contained in IFRS 5.

Classification of non-current assets (or disposal groups) as held for sale

4.9.2.12 An authority shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continued use.

4.9.2.13 The following criteria have to be met before an asset can be classified as held for sale under this section of the Code:

- The asset (or disposal group) must be available for immediate sale in its present condition subject to terms that are usual and customary for sales of such assets (or disposal groups).
- The sale must be highly probable; the appropriate level of management must be committed to a plan to sell the asset (or disposal group) and an active programme to locate a buyer and complete the plan must have been initiated.
- The asset (or disposal group) must be actively marketed for a sale at a price that is reasonable in relation to its current fair value.
- The sale should be expected to qualify for recognition as a completed sale within one year[6] of the date of classification and action required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

4.9.2.14 If all the above criteria are not met the asset shall continue to be accounted for in accordance with the relevant section of the Code, ie section 4.1 and section 4.5.

4.9.2.15 Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance in accordance with section 4.1 of the Code (also see IAS 16 *Property, Plant and Equipment*).

4.9.2.16 If after the reporting period but before authorising of the financial statements (see section 3.8 of the Code), the criteria for recognition are met, as set out in paragraph 4.9.2.13, authorities shall disclose the information within the notes to the accounts, as set out in sub-section 4.9.4.

4.9.2.17 Assets that are to be abandoned or scrapped shall not be classified under this section of the Code. This is because the carrying amount of such assets will not be recovered from 'sale' but from continued use up to the point of being scrapped or abandoned.

6. Events or circumstances may extend the period to complete the sale beyond one year, for example the delay in the completion of the sale is beyond the authority's control and there is sufficient evidence that the authority remains committed to the plan to sell the asset (or disposal group). Further information regarding the 'extension of the period required to complete the sale' is given in Appendix B of IFRS 5.

Measurement of non-current assets (excluding disposal groups) classified as held for sale

4.9.2.18 Authorities shall measure a non-current asset classified as held for sale at the lower of its carrying value and fair value less costs to sell at initial reclassification and at the end of each reporting date (ie 31 March), subject to recognising any gains as detailed in paragraph 4.9.2.21.

4.9.2.19 When the sale is expected to occur beyond one year, authorities shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time represents the unwinding of the discounting and shall be presented in Surplus or Deficit on the Provision of Services as a financing cost.

4.9.2.20 Immediately before the initial classification of an asset as held for sale, the carrying amount of the asset shall be measured in accordance with the relevant section of the Code.

4.9.2.21 Authorities shall recognise a revaluation gain for any initial or subsequent increase in fair value less costs to sell an asset following reclassification, but not in excess of the cumulative impairment loss or revaluation loss (adjusted for depreciation) that have been recognised in the Surplus or Deficit on the Provision of Services under this section of the Code or previously in accordance with section 4.7 or section 4.1 of the Code. In practice this will mean using a gain to reverse previous impairment or revaluation losses that have been recognised in the Surplus or Deficit on the Provision of Services (adjusted for depreciation that would have been charged had the impairment losses or revaluation losses not occurred).

4.9.2.22 Authorities shall recognise an impairment loss or revaluation loss for any initial or subsequent decrease to fair value less costs to sell following reclassification, in the Surplus or Deficit on the Provision of Services (even where there is balance on the asset's Revaluation Reserve).

4.9.2.23 An authority that is committed to a sale plan involving loss of control of a subsidiary (see chapter nine) shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraph 4.9.2.13 are met, regardless of whether the authority will retain a minority interest in its former subsidiary after the sale.

Measurement of disposal groups classified as held for sale

4.9.2.24 Where authorities deem they have a disposal group they should refer to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*

Depreciation

4.9.2.25 A non-current asset (or disposal group) classified as held for sale shall not be depreciated (or amortised in relation to intangible assets).

Derecognition

4.9.2.26 A revaluation gain or loss not previously recognised in the carrying amount of a non-current asset (in accordance with paragraphs 4.9.2.21 and 4.9.2.22) by the date of sale (or disposal group) shall be recognised in Surplus or Deficit on the Provision of Services as part of the gain or loss on disposal at the date of derecognition. The requirements relating to derecognition including accounting for gains or losses on disposal are set out in section 4.1 of the Code in relation to property, plant and equipment and section 4.5 of the Code in relation to intangible assets.

Changes to a plan of sale

4.9.2.27 If the criteria in paragraph 4.9.2.13 are no longer met, the authority shall cease to classify the asset (or disposal group) as held for sale and shall value the asset at the lower of:

- its carrying amount before the asset (or disposal group) was classified as held for sale; adjusted for depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale, and
- its recoverable amount at the date of the decision not to sell.

4.9.2.28 For an asset previously carried at historical cost (in accordance with section 4.1 of the Code – property, plant and equipment and section 4.5 of the Code – intangible assets) before classification as held for sale, any adjustment to the carrying amount arising from paragraph 4.9.2.27 above shall be recognised in Surplus or Deficit on the Provision of Services, in the period that the criteria are no longer met.

4.9.2.29 For an asset previously carried at a re-valued amount (in accordance with section 4.1 and section 4.5 of the Code) before classification as held for sale, any adjustment to the carrying amount arising from paragraph 4.9.2.27 shall be treated as a revaluation increase or decrease and recognised in the Revaluation Reserve in the period that the criteria are no longer met (note: a revaluation decrease is recognised up to the balance on the Revaluation Reserve and thereafter in the Surplus or Deficit on the Provision of Services).

4.9.2.30 The measurement of a disposal group where an individual asset or liability is removed is not expected to be common for authorities. Where authorities deem they have this occurrence they should refer to IFRS 5.

4.9.2.31 Where the criteria in paragraph 4.9.2.13 are no longer met, the authority will need to consider reclassifying the asset to property, plant and equipment or investment property having regard to the respective definitions in section 4.1 and section 4.4 of the Code respectively.

Presentation of discontinued operations

4.9.2.32 Where an authority deems it has a transaction(s) that meets the definition of a discontinued operation, it shall present this transaction(s) separately on the face of the Comprehensive Income and Expenditure Statement and Balance Sheet.

4.9.2.33 Prior periods presented in the financial statements shall be restated for discontinued operations, so that the current and prior periods relate to all operations that have been discontinued by the end of the reporting period being presented. Where an authority ceases to classify a transaction as a discontinued operation, the transaction, including prior periods, shall be reclassified as continued operations.