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Local Government Finance Circular 09/2022

<http://www.gov.scot/Topics/Government/local-government/17999/11203>

By e-mail:

Directors of Finance of Scottish Local Authorities
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COSLA

Our ref: A38902954
29 August 2022

Dear Director of Finance,

Statutory Override - Accounting for Infrastructure Assets

The CIPFA/LASAAC Code of Practice for Local Authority Accounting in the United Kingdom (the Code) requires infrastructure assets to be measured using the historical cost measurement basis and carried at depreciated historical cost.

Local government auditors in England have raised concerns with regards to subsequent expenditure on infrastructure assets. The Code requires that where a component of an asset is replaced, the carrying amount (i.e. net book value) of the old component shall be derecognised to avoid double counting and the new component shall be reflected in the carrying amount of the infrastructure asset.

Due to practical difficulties in applying component accounting for the recognition and derecognition of replaced components of infrastructure assets, in large part due to data limitations, the Scottish Government is aware that most local authorities have been unable to comply with the requirement to assess the net book value of the replaced component and will therefore have taken a network approach to the measurement of infrastructure assets and will have treated the amount of the replaced component as zero. This is because the replaced component is considered to have been fully used up at the point that it is replaced. The concern raised by auditors is that there may be a lack of evidence to support this assumption.

As a result, and without resolution, there is a significant risk that local authority financial statements could be subject to qualified audit opinions in this area.

CIPFA believe that this will now be an area of enhanced scrutiny for all local government auditors and have therefore requested a temporary statutory override with regards to infrastructure assets, whilst a permanent solution is developed.

It is the role of the CIPFA LASAAC Local Authority Accounting Code Board (CIPFA LASAAC) to consider the extent to which International Financial Reporting Standards should apply to local authorities and to adapt and interpret accounting standards to address the public sector context.

However, as yet CIPFA LASAAC has been unable to find a way forward that will satisfy both audit concerns and the requirement for high quality financial reporting. There is a risk that a solution may not be found within the necessary timeframe to satisfy the audit of 2021-22 annual accounts.

Statutory interventions are not intended to be utilised as a means of circumventing the requirement for consistent and transparent, high quality financial reporting. However, the Scottish Government recognises that this is a challenging, time-sensitive issue and has therefore agreed to provide a temporary statutory override whilst a permanent solution is developed within the Code.

This is a temporary override, applicable to 31 March 2024, and is provided as an isolated measure in recognition of the potential seriousness for local authorities. In future it is expected that the Code will deliver amendments that adequately reflect the public sector context.

The Scottish Government expects that Councils will begin to address information deficits to ensure adequate accounting records for the measurement of infrastructure assets and timely adoption of the Code requirements once a more permanent solution is delivered.

Yours faithfully



Elanor Davies
Head of Local Authority Accounting

ACCOUNTING FOR INFRASTRUCTURE ASSETS

Scottish Government

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Part 2 – Statutory guidance – Statutory Override to the Code for Infrastructure Assets

Part 1 of this document gives non-statutory guidance only and is not part of the guidance itself, which is contained in Part 2.

PART 1 – BACKGROUND AND NON STATUTORY GUIDANCE

Background

1. Infrastructure assets are inalienable assets, expenditure on which is only recoverable by continued use of the asset created (in other words there is no prospect of sale or alternative use). They are often homogenous assets that form part of a continuous network that is maintained in a relatively steady state though there may be distinctive components of this network, such as carriageways, structures, street lighting, street furniture and traffic management systems. They are largely assets with very long lives.

2. Infrastructure assets are one of the few categories of property, plant and equipment assets measured at historical cost rather than at an asset measurement described as 'current value' by the CIPFA/LASAAC Code of Practice for Local Authority Accounting (the Code). On the move to capital accounting in 1994 it was decided that there was limited use for measuring the 'worth' of infrastructure assets in the same way as other assets in the balance sheet. At that time, infrastructure assets were brought on to the balance sheet at undischarged capital amounts (this was net of revenue contributions and capital receipts applied and grants and contributions received before 1 April 1994/1996), and this was described as (depreciated) historical cost.

3. This measurement basis may have excluded infrastructure assets constructed before the authority's creation and may have included expenditure on assets which the authority has either never owned or no longer owns, but for which it took on financing responsibilities (for the transferred assets).

4. There are further information deficits to be addressed. This is particularly the case in relation to roads, where the engineering records that are useful for maintenance, and identification of replacement expenditure and new expenditure for the (highways) infrastructure assets have not been created to map against identifiable components.

5. In addition, prescriptions within historic versions of the Code limited the reporting of infrastructure assets. For example following the requirement of UK GAAP, the 2000 version of the Code (which was then a Statement of Recommended Practice), applicable from 1 April 2000, prohibited the capitalisation of expenditure on replacement parts of an asset unless the replaced parts had been accounted for as separate components, whereas the 2010/11 Code, applicable from 1 April 2010 to-date, requires all replacement costs to be capitalised and also requires the replaced component to be derecognised.

6. A move to a valuation process for these assets was deemed to be too costly when it was considered by CIPFA LASAAC from 2015 to 2017, and therefore infrastructure assets continue to be held in local authority balance sheets at depreciated historical cost.

7. There has been increased scrutiny of the audit of local authority accounts in recent years and there has been an acknowledged focus on the measurement and accounting of property, plant and equipment. One of the main concerns is that the derecognition provisions of the Code are difficult for local authorities to apply for infrastructure assets because the information deficits may mean that there is no balance for the derecognised asset or part thereof in the balance sheet to be removed.

8. Concerns were raised by local government auditors that some authorities are not applying component accounting requirements appropriately when there is replacement expenditure. This was first identified by a local auditor in England but came to light via audit network discussions convened by the National Audit Office.

9. The issue raised by auditors relates to subsequent expenditure on infrastructure assets and specifically on whether local authorities should be assessing if there is any undepreciated cost remaining in the balance sheet for the replaced components that needs to be derecognised when the subsequent expenditure is incurred. This has led to issues relating to the reporting of gross historical cost and accumulated depreciation as elements of depreciated historical cost.

10. CIPFA offered to assist resolution by providing additional guidance and by pursuing possible augmentations to the Code. The CIPFA LASAAC Code Board undertook an urgent consultation on temporary changes to the code to resolve infrastructure assets reporting issues.

11. However, CIPFA LASAAC were unable to agree an approach, within the restricted timeframe required, that addressed the concerns of all stakeholders whilst also supporting high quality financial reporting.

NON-STATUTORY GUIDANCE

12. CIPFA LASAAC's consultation identified the requirement for temporary prescriptions on accounting/proper practices in two main areas:

1) The Reporting (Disclosure) of Gross Cost and Accumulated Depreciation:

CIPFA LASAAC has suggested that because of historical reporting requirements and information deficits local authorities are unlikely to have reliable, meaningful information to accurately report gross historical cost and accumulated depreciation. As such, disclosures should not be required at least up to and including the 2023/24 financial year.

2) The Accounting Transaction to Derecognise Replaced Components:

Historical information deficits and custom and practice mean that information required to evidence the derecognition of replaced components of infrastructure assets will not practicably be able to be produced.

13. The Scottish Government has agreed to permit a temporary statutory override to the Code in order to address these issues.

Statutory Override – Infrastructure Assets

14. This form of statutory override is unlike statutory mitigations which seek to ameliorate the short-term impact or volatility of accounting practices on the general fund and thus what is charged to council tax or housing rents.

15. A statutory override of this form instead confirms previous custom and practice and the economic position.

16. The statutory overrides permitted within this guidance are time limited for the periods from 1 April 2010 to 31 March 2024.

17. A local authority may choose whether or not to apply the statutory overrides set out in Part 2 of this guidance.

18. A local authority may also choose which statutory override to apply. A local authority may choose to only apply one of the two statutory overrides or to apply both statutory overrides.

19. If a local authority chooses not to apply Statutory Override 1 then gross historical cost and accumulated depreciation of infrastructure assets will be reported in line with the normal provisions of the Code.

20. If a local authority chooses not to apply Statutory Override 2 then infrastructure assets, including the derecognition of replaced components, will be accounted for in accordance with the normal provisions of the Code.

21. Statutory Override 1: This statutory override permits that, for accounting periods commencing from 1 April 2021 until 31 March 2024, a local authority is not required to report the gross cost and accumulated depreciation for infrastructure assets.

22. Statutory Override 2: This statutory override requires that, for the periods from 1 April 2010 to 31 March 2024, the carrying amount to be derecognised in respect of a replaced part of an infrastructure asset is a nil amount, and no subsequent adjustment shall be made to the carrying amount of the asset with respect to that part. This is required on the basis that parts of infrastructure assets are rarely replaced before the part has been fully consumed and should therefore, in most cases, be fully depreciated at the date of replacement.

ACCOUNTING FOR INFRASTRUCTURE ASSETS

Issued by Scottish Ministers under section 12(2)(b) of the Local Government in Scotland Act 2003

DEFINITIONS

23. **Local Authority** means a council constituted under section 2 of the Local Government etc. Act 1994 (c.39), regional transport partnerships and other bodies as set out in section 106 of the Local Government (Scotland) Act 1973.
24. **General Fund** means the fund as detailed in section 93(1) of the Local Government (Scotland) Act 1973.
25. **Proper accounting practices** are those practices as set out by section 12 of the Local Government in Scotland Act 2003
26. **Infrastructure assets:** The CIPFA/LASAAC Code of Practice for Local Authority Accounting describes infrastructure assets as “inalienable assets, expenditure on which is only recoverable by continued use of the asset created, ie there is no prospect of sale or alternative use; examples include highways, structural maintenance of highways, footpaths, bridges, permanent ways, coastal defences, water supply and drainage systems.
27. A **financial year** is one that commences on 1 April and ends on 31 March.

APPLICATION

28. This statutory guidance applies to all infrastructure assets of a local authority.
29. The statutory overrides set out below are time limited for the periods from 1 April 2010 to 31 March 2024.
30. A local authority may choose whether or not to apply the following statutory overrides. A local authority may choose to apply one or both of the statutory overrides. If a local authority chooses not to apply a statutory override then the normal provisions of the Code will apply in place of the statutory override.

STATUTORY OVERRIDE – INFRASTRUCTURE ASSETS

31. Statutory Override 1: For accounting periods commencing from 1 April 2021 until 31 March 2024 a local authority is not required to report the gross cost and accumulated depreciation for infrastructure assets.

32. Statutory Override 2: For accounting periods commencing from 1 April 2010 until 31 March 2024 the carrying amount to be derecognised in respect of a replaced part of an infrastructure asset is to be taken to be and accounted for as a nil amount. No subsequent adjustment shall be made to the carrying amount of the asset with respect to that part.

Disclosures

33. Where a local authority chooses to adopt either or both of the statutory overrides, this should be disclosed within the relevant note to the Annual Accounts.

***Scottish Government
Victoria Quay, Leith, Edinburgh EH6 6QQ
29 August 2022***