Financial instruments and local government accounts

Introduction

IFRS 9 – Financial instruments was adopted by the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom (the Code) from 2018/19 and many of its requirements are now well embedded into local authority accounts. However, it's a complex standard, which raises the risk of potential errors in accounting, particularly where authorities participate in more unusual or complicated arrangements. There are also significant disclosure requirements due to the Code's adoption of IFRS 7 – Financial instruments: disclosures (and, where applicable, IFRS 13 – Fair value measurement).

Authorities need to ensure they fully understand the requirements of the Code and can apply them correctly to their financial instruments in all material respects. Being aware of some of the risks and red flags should help you identify more complex areas, and you can then get any technical support you need at the right time.

This can help:

- improve the quality of the authority's accounts
- reduce the risk of inappropriate accounting for more complex instruments, which can have unexpected consequences if the accounting treatment is not fully understood
- ensure any impact on the General Fund or Housing Revenue Account is fully understood.

The full accounting and disclosure requirements for financial instruments are set out in Section 7 of the Code. This report highlights some of the key requirements, and some examples of more complex situations and potential red flags to watch out for. It isn't a comprehensive guide, and practitioners should refer to the Code (and where appropriate to IFRS 9 and IFRS 7) for the full requirements. We focus on three elements of the accounting requirements: the identification of financial instruments, their classification, and their subsequent measurement. We also highlight the importance of the disclosures relating to financial instruments – the disclosure requirements are extensive and are key to a reader's understanding of the impact of financial instruments on an authority's accounts. Finally, we look at the elements of statutory accounting that are relevant to financial instruments.

Identification of financial instruments

The first step to getting both the accounting and disclosures for financial instruments right is to ensure all financial instruments are appropriately identified, and that all items that are out of scope (as set out in Chapter 7 of the Code, and IFRS 9.2 where applicable) are excluded.

A financial instrument is defined as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity". For local authorities, this encompasses cash, equity instruments in another entity, or either a contractual right to receive, or obligation to deliver, cash or another financial instrument (or to exchange financial instruments).

The key points are therefore that there must be a contract, and the contract must be settled via a transfer of either cash or another financial instrument (unless the instrument itself is either cash or an equity instrument).

This definition includes relatively straightforward items such as cash, trade debtors and trade creditors, and much more complex instruments such as derivatives. It excludes both non-contractual instruments, such as any balances relating to taxation, and items that won't be settled by a transfer of financial instruments (such as prepayments and receipts in advance).

There are several types of financial instrument which are captured by other accounting standards and therefore addressed by other sections of the Code rather than Chapter 7. These are detailed in Chapter 7 of the Code and include interests in subsidiaries, joint ventures and associates, and employers' rights and obligations under employee benefit plans. Balances relating to lease debtors and lease or PFI liabilities are captured by the disclosure requirements of Chapter 7 of the Code, but the accounting treatment is governed by other sections of the Code.

In most cases, it will be relatively straightforward to identify whether an item is captured by the requirements of Chapter 7 of the Code, but sometimes it may be more complex. Common examples where the situation may be more complex include financial guarantees, and arrangements that take the legal form of leases but where the substance may be that of a financing arrangement.

Scenario

Authority A enters into an arrangement to lease out an operational building in exchange for an upfront cash payment from the other party, and to then lease the building back from that third party in exchange for annual lease payments. The authority initially intends to account for this as two separate leases under Chapter 4.2 of the Code.

The authority obtains external accounting advice to verify this assessment, which identifies that the nature of the arrangement is in substance a financing arrangement rather than a series of leases and should therefore be accounted for under Chapter 7 of the Code (as a financial instrument, following the Code's adaptation of IFRS 9 requirements) rather than under Chapter 4.2 of the Code (as leases, following the Code's adaptation of IFRS 16 requirements).

This change in accounting treatment significantly changes the expected entries in the accounts.

If accounted for as two separate leases, key elements of the accounting treatment would have included:

- entries relating to disposal (via finance lease) of the original owned asset plus recognition of the 'new' right of use asset at cost
- recognition of a lease liability, based on future lease payments discounted at the rate implicit in the lease (or, if not able to be readily determined, the lessee's incremental borrowing rate)subsequent measurement of the liability based on increases to reflect interest, reductions to reflect lease payments made and any remeasurements required under chapter 4.2 of the Code

Under the revised accounting treatment as a financing arrangement, key elements of the accounting treatment would include:

- no change to the related asset which would remain as an owned asset
- initial recognition of a financing liability at fair value subsequent measurement likely to be at amortised cost using the effective interest rate method.

Over the life of the arrangement there are likely to be other differences, depending on the exact nature of the arrangement. For example, if the payments vary depending on a rate or index then when accounted for as a lease the liability would only be remeasured once the changes take effect, whereas if accounted for as a financial instrument the effective interest rate used to calculate the amortised cost of the instrument would need to take account of estimates of future inflation rates.

Challenge questions

- Has the authority identified all its arrangements that fall within the IFRS 9 boundary and those which don't?
- Has the authority identified any complex arrangements (including but not limited to financial guarantees and arrangements taking the legal form of a lease)?
- Has the authority understood the rationale for such arrangements, identified and understood any associated risks including those involving judgements made about the future, and properly considered value for money?
- Has the authority sought appropriate financial and legal advice to support judgements made prior to entering into the arrangement?
- Are the accounting and financial implications fully understood before entering into the arrangement?
- Have appropriate governance arrangements been followed when making decisions about entering into significant arrangements, including member approval where relevant?
- Does the authority have the required accounting expertise in-house or is external expert support required?
- Where arrangements are novel, complex or involve significant judgements, has the authority sought to engage with their external auditor at an early stage to enable the auditor to raise any queries or challenges about the proposed treatment?
- Has a detailed accounting paper been prepared setting out key points including rationale for the transaction, relevant Code requirements and any significant judgements?

Classification of financial instruments

Financial assets

The Code requires financial assets to be classified as held at either 'amortised cost', 'fair value through other comprehensive income (FVOCI)' or 'fair value through profit and loss(FVTPL)'. This classification is based on the business model used for managing the asset, and the contractual cashflows for the asset – whether they meet the definition of 'solely payments of principal and interest (SPPI)'.

- Amortised cost – business model is to hold assets to collect contractual cashflows, and contractual cashflows are SPPI
- FVOCI – business model is to both hold assets to collect contractual cashflows and to sell assets, and contractual cashflows are SPPI
- FVTPL – all other financial assets

At initial recognition, authorities may also irrevocably designate investments in equity investments to FVOCI that would otherwise be measured at FVTPL, provided they aren't held for trading. The equity FVOCI classification is one where fair value gains or losses are included in OCI and aren't reclassified to the surplus or deficit on the provision of services (SDPS) on disposal. This designation is only relevant where the instrument meets the definition of equity from the issuer's perspective.

While for some financial assets the classification may be relatively straightforward, for others the classification may be more complex. For example, the definition of SPPI is a key part of this assessment and there are examples of financial assets where a more detailed review of the contractual cashflows identifies that they aren't SPPI. Examples of potential complexities include convertible loans, payments which are linked to performance or profits, non-recourse loans, and loans which involve simple rather than compound interest.

Scenario

Authority B holds units in a pooled investment fund. It initially assesses that these meet the definition of equity and intends to classify them as designated to FVOCI.

The equity definition is only met where the issuer (the fund in this example) has an unconditional right to avoid any payments in cash or another financial asset (whether via dividend or redemption) until the date of liquidation. Investments in pooled investment funds may meet the definition of 'puttable' instruments. These are investments where the holder (the local authority in this example) has a right to require the issuer (the fund in this example) to repurchase or redeem the instrument for cash or another financial asset. In simple terms, if the authority demands that the fund repurchases the investment or repays the principal amount, then the fund doesn't have an unconditional right to refuse. Such investments may appear to give an authority a residual interest in the net assets of the issuer, but because of the repurchase or redemption rights they may not meet the definition of equity.

Where this is the case, these assets wouldn't be able to be designated to FVOCI but would need to be classified as FVTPL. Changes in valuation would therefore be charged to SDPS in the first instance. If the investment met the requirements to be eligible for statutory adjustments then these would be accounted for via the Movement in Reserves Statement (MIRS). For years up to and including 2024/25, statutory adjustments apply to all investments that meet the definition of pooled investments as set out in the relevant regulations. From 2025/26, the statutory adjustments only apply to investments that were taken out prior to 1 April 2024.

The accounting will therefore vary depending on the scenario. As an illustration, for financial year 20XX/XY, the authority identifies a loss on fair value of £X million.

If the investment met the definition of equity and was eligible for the FVOCI designation, the expected accounting entries would be:

- Dr OCI £X million (this would also be Dr Financial Instruments Revaluation Reserve)
- Cr investments £X millions

If the investment didn't meet the definition of equity it would fall to be classified at FVTPL and the expected accounting entries would be:

- Dr SDPS £X million (this would also Dr General Fund or HRA)
- Cr Investments £X million

If the investment was accounted for at FVTPL and it met the requirements to apply the statutory adjustments, the additional expected accounting entries would be:

- Dr pooled investment funds adjustment account £X million
- Cr general fund or HRA £X million

If the investment didn't meet the requirements to apply statutory adjustments then the impact of the fair value loss would instead be a real charge to General Fund or HRA.

Financial liabilities

There are two main categories for financial liabilities:

- Amortised cost
- FVTPL

The vast majority of financial liabilities held by local authorities (for example PWLB borrowings) will be classified as held at amortised cost. FVTPL applies to liabilities held for trading and to derivatives (for example swaps, forwards, options). There are also some other specific circumstances that may apply, and for which the measurement requirements are detailed in the Code / IFRS 9 - designation at FVTPL, financial guarantees and contingent consideration to which IFRS 3 applies.

While PWLB borrowing may generally be relatively straightforward in IFRS 9 terms, non-PWLB borrowing may include additional complexities requiring consideration in terms of the existence of any potentially separable embedded derivatives. Embedded derivatives are required to be separated and carried at FVTPL where they aren't closely related to the host contract. Closely related embedded derivatives aren't separated. The Code refers the reader to IFRS 9 which sets out tests which determine whether embedded derivatives are closely related for some particular situations. For example, IFRS 9 has a particular test for embedded interest rate floors (contractual provisions that prevent a variable interest rate falling below a specified level) and another test for embedded prepayment options. Potential indicators of complexity could include prepayment options (particularly those with a penalty attached), borrowings where the interest rate can vary based on certain performance tests (such as meeting specific environmental, social and governance targets), or any other arrangements where the contractual cash flows may change over the life of the arrangement.

Scenario

Authority C holds long-term borrowings which include an option to repay early, but which aren't a lender option borrower option (LOBO) loan.

A prepayment option is an embedded derivative. Authority C therefore needs to follow the requirements of the Code and IFRS 9 to assess whether the option is required to be separated from the host liability contract and accounted for separately as a derivative (at FVTPL), or not.

If the option is required to be accounted for separately, then the authority would need to account for two separate instruments – one being the main loan contract (likely to be accounted for at amortised cost), with the other being the embedded derivative accounted for at FVTPL.

If the option isn't required to be accounted for separately, then the authority would only need to account for a single instrument – the main loan contract (likely to be accounted for at amortised cost).

Note that the Code includes an interpretation for LOBO loans which means that for the majority of LOBOs the options shouldn't be separately accounted for (rather the LOBO should be accounted for as a single instrument at amortised cost). Therefore, the treatment for LOBOs may be different to any other loan contracts containing an embedded derivative (such as a prepayment option).

Challenge questions

- Have all financial assets been assessed under the IFRS 9 model to identify the appropriate classification?
- Have financial liabilities been assessed to identify embedded derivatives and whether or not they're closely related to the host?
- Has the authority classified investments in collective investment vehicles (eg CCLA, money market funds) appropriately?

Measurement of financial instruments

Financial instruments are initially recognised at fair value (and for those not classified at FVTPL, plus or minus directly attributable transaction costs). Subsequent measurement depends on the classification of the financial instrument.

Amortised cost

The Code requires the use of the effective interest method to calculate amortised cost. As well as providing a calculation of the amortised cost for the financial asset or liability, this also impacts the timing and amounts of interest revenue / expense recognised in the Comprehensive Income and Expenditure Statement (CIES).

The effective interest rate (EIR) is the rate that exactly discounts the estimated future cash payments or receipts expected through the life of a financial asset or liability. When calculating the EIR an authority should estimate the future cash flows by considering the contractual terms of the instrument – for example this would include any prepayment, extension, call or similar options, but shouldn't consider expected credit losses. The calculation should include all fees and amounts paid that are integral to the EIR as well as transaction costs and any other premiums or discounts. The Code has an interpretation which permits immaterial transaction costs to be written off to the SDPS immediately, and a further interpretation relating to calculating the EIR for LOBOs.

Where an entity has taken out or issued a fixed rate loan and there are no scheduled variations, no premiums or discounts and no transaction costs included in the initial measurement, the interest rate in the contract will usually be the same as the EIR. Therefore, amortised cost for such instruments will usually be the outstanding principal plus accrued interest. For example, this scenario tends to apply to PWLB loans. However, it's important to be aware that for more complex arrangements the amortised cost may not be the same value as this amount and the amortised cost will require calculating. A common challenge in amortised cost measurement is whether changes in future estimated cash flows are via IFRS 9 B5.4.5, which applies to floating rate changes, and IFRS 9 B5.4.6, which applies to other changes. IFRS 9 B5.4.6 involves a catch-up type adjustment to the carrying amount based on a net present value calculation with immediate gains and losses recognised in SDPS when changes in estimates arise.

Scenario

Authority D enters into a financing arrangement where repayments increase each year based on RPI, subject to a cap.

The authority is required to estimate future cash flows, which means they must include in the EIR an estimate of future inflation rates. Therefore, the initial EIR should reflect expectations for future inflation. At each year-end, the EIR will require re-estimating if these estimates of future inflation have changed.

The inclusion of estimates of future inflation in the EIR is likely to result in interest expenses initially being recognised in the SDPS (and therefore impacting the General Fund) earlier than the cash payments are required to be made.

The authority will also need to make a judgement about the appropriate approach to accounting for such changes, as there are two potential options. Either the EIR will need to be amended (with no immediate gain or loss), or the EIR will remain the same and an immediate gain or loss will be recognised.[1]

1 In IFRS, interpretation is supported by the IFRS interpretations committee in the IFRS foundation (IFRIC). In July 2008, IFRIC considered whether changes in inflation index are via IFRS 9 B5.4.5 (previously referred to as IAS 39.AG7) or IFRS 9 B5.4.6 (previously referred to as IAS 39.AG8). IFRIC concluded that whether B5.4.5 or B5.4.6 applied was subject to judgement. If IFRS 9 B5.4.5 applied then the change in estimated cash flows revises the EIR, but with no immediate gain or loss. If IFRS 9 B5.4.6 applied then the EIR stays unchanged (based on what was determined on inception), but an immediate gain or loss is recognised from the change in estimated cash flows.

Fair value

The Code's requirements in terms of fair value measurement are set out in section 2.10 and are based on IFRS 13 - Fair value measurement. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (in other words, it's an exit price). The Code highlights four key areas that require consideration when calculating a fair value: the asset or liability, the transaction, market participants and the price.

The Code requires the use of appropriate valuation techniques, which should be consistent with either the market approach, the cost approach or the income approach. It also requires any valuation to maximise the use of observable inputs, and to minimise the use of unobservable inputs.

For some financial instruments it may be relatively straightforward to calculate a fair value – for example, if units in a pooled fund are actively traded on a daily basis, then a quoted price for those units as at the measurement date should be available, and there will be very limited judgement required. For other types of instruments, a fair valuation can be much more complicated. This is particularly the case where there are limited observable inputs available, and the valuation must rely on unobservable inputs which may be based on subjective assumptions. In some cases, expert input may be required to calculate a reasonable estimate of fair value.

Scenario

Authority E holds a material equity investment in a private company. The authority holds 10% of the company's shares and has assessed that it doesn't fall within the group boundary and isn't an associate. The authority has designated the investment to FVOCI on initial recognition.

As the company's shares aren't traded, the authority is unable to obtain a quoted price. The authority determines that observable inputs are also not available, and that a valuation based on unobservable inputs will need to be prepared. The authority identifies that it doesn't have sufficient expertise to calculate this in-house and it engages an external expert to assist in calculating fair value.

Once the fair valuation is obtained, fair value gains and losses should be recognised in OCI, with accumulated gains/losses held in the Financial Instruments Revaluation Reserve.

Impairment and expected credit losses

The Code requires authorities to recognise a loss allowance for expected credit losses (ECL) for financial assets held at either amortised cost or FVOCI (excluding equity investments designated to FVOCI), lease receivables and contract assets. The key exclusion to this is the Code interpretation which requires local authorities not to recognise a loss allowance where the counterparty is central government or where it's another local authority. Apart from this, authorities should calculate and recognise ECL for all financial assets held at amortised cost or FVOCI, lease receivables and contract assets, including balances with subsidiaries. There are also specific requirements for loan commitments and financial guarantee contracts.

The general model for ECL is based on the idea of deterioration of credit quality, with three potential stages (performing, under-performing and non-performing). When there has been no significant deterioration in credit quality, the impairment recognised is the 12-month ECL (based on lifetime ECL but using the probability of those occurring in the next 12 months). When there's a significant deterioration in credit quality (stage 2), authorities must move to recognising lifetime ECL. When there's objective evidence at the reporting date of a credit loss event (stage 3), lifetime ECL are still recognised but interest is now calculated based on the net carrying amount rather than gross. It can be a challenge to identify the appropriate transition point between stages, particularly for longer-term loans where this will require more judgement in forecasting the future, as the assessment shouldn't be based solely on historic performance but should also take into account forward-looking information. This is in contrast to the approach for taxation and other non-contractual debts which aren't in scope of IFRS 9 and for which the Code permits the 'incurred loss' model for impairment which doesn't take into account expected losses as a result of future events.

A simplified model is available for trade receivables, contract assets and lease receivables, which requires recognition of a lifetime loss allowance based on lifetime ECL from origination. The use of the simplified model is mandatory for trade receivables and contract assets where there's no financing component but is an accounting policy choice for trade receivables and contract assets with a significant financing component and lease receivables.

ECL are defined as the weighted average of credit losses with the respective risks of default occurring as the weights. Credit losses are the difference between the contractual cash flows due and the cash flows that the entity expects to receive. The Code doesn't mandate a particular method to calculate ECL but requires authorities to consider the following: an unbiased probability-weighted amount based on the evaluation of a range of possible outcomes, the time value of money, and the use of reasonable and supportable information, which includes information about past events, current conditions and future forecasts. Key considerations might therefore include what risks are faced and the contractual periods involved. A key challenge for local authorities may be obtaining access to appropriate data to support such calculations.

Scenario

Authority F has a subsidiary company, which is currently loss-making. In addition to the investment in the subsidiary, which is held at cost in the single entity accounts, the authority has issued a material loan to the subsidiary, which is due for repayment in five years time.

The authority identifies that in the single entity accounts, it's required to recognise a loss allowance for expected credit losses despite the loan being within the authority's own group. It therefore must estimate the ECL. The authority doesn't have sufficient in-house data about defaults to calculate a reliable estimate of future expected credit losses for this specific loan and therefore engages external expert support to assist in the calculation.

As an illustration, for financial year 20XX/XY, the authority identifies a need to recognise additional ECL of £X million. The expected accounting entries would be:

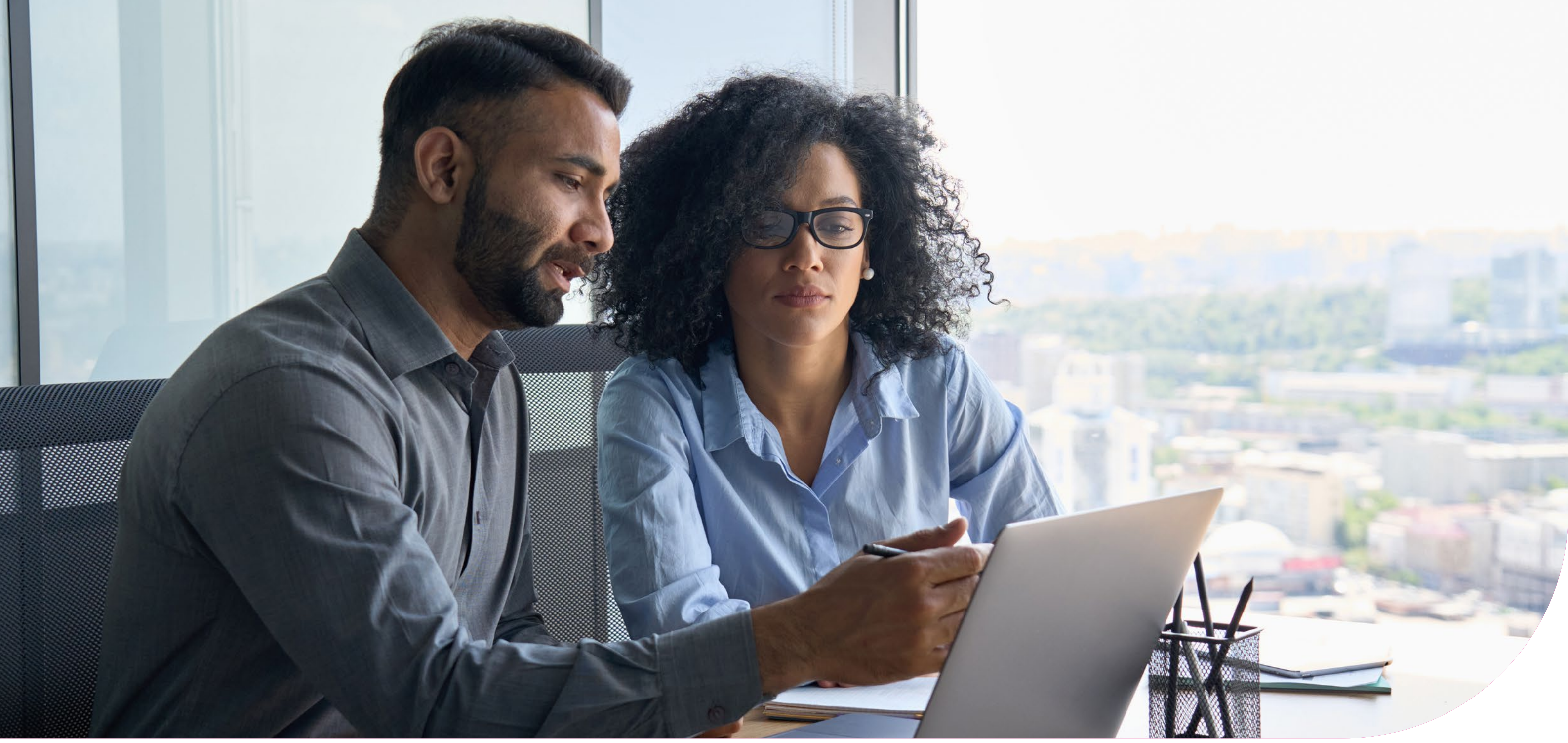
- Dr SDPS £X million (this would also Dr General Fund or HRA)
- Cr Debtors £X million

If the loan meets the definition of capital under statute, then the ECL wouldn't be a proper charge to General Fund or the HRA and the expected accounting entries for the statutory adjustments would be:

- Dr Capital Adjustment Account £X million
- Cr General Fund or HRA £X million

If the loan is capital under statute then the authority may also need to recognise MRP in line with the relevant regulations and statutory guidance.

Note that the authority may also need to consider impairment of the investment in the subsidiary, which is held at cost in the single entity accounts. However, this would need to be assessed based on the requirements of Chapter 4.7 of the Code, which is based on IAS 36 - Impairment of assets, rather than under the ECL model.



Challenge questions

- Has the authority reviewed agreements to identify those where the amortised cost wouldn't be the same as principal and accrued interest?
- Has the authority identified any financial instruments requiring a fair valuation, and whether expert input is required?
- Has the authority appropriately applied IFRS 9 requirements to calculate ECL, including for intragroup loans to subsidiaries?

Financial instrument disclosures

The Code contains extensive disclosure requirements for financial instruments, which should also cover PFI and lease balances in addition to those financial instruments accounted for under Chapter 7 of the Code. The disclosures in the accounts are important to help users understand the impact of financial instruments on the entity.

The overall aim of the disclosures is to highlight to the reader of the accounts:

- the significance of financial instruments for the authority's financial position and performance
- the nature and extent of risks arising from financial instruments to which the authority is exposed during the period and at the end of reporting period and
- how the authority manages those risks.

There are also a number of different disclosures that are required relating to fair value, both for those financial instruments carried at fair value and for those not carried at fair value.

If disclosures are incomplete or contain poor-quality information that's generic and hasn't been tailored appropriately to the authority's specific circumstances, then the reader of the accounts can't fully understand the impact of financial instruments on the authority, or the risks related to those financial instruments and how those risks are managed. Equally, the inclusion of irrelevant or immaterial information can add clutter and distract from key messages. Materiality should be considered to ensure that appropriate focus is given to those areas that have the greatest impact or the highest risk.

The extent of fair value disclosures required is driven by the level within the fair value hierarchy into which each fair valuation falls. For level 1 valuations (quoted prices for identical assets / liabilities in active markets at the measurement date), the requirements are more limited as there's very limited subjectivity in the valuation. For level 2 (observable inputs) and in particular level 3 (unobservable inputs) valuations the disclosure requirements are more extensive. This reflects the higher risk of subjectivity in these valuations, so the disclosures should help the reader of the accounts to understand the valuation techniques applied and give the reader an indication of the level of potential risk of variation between the recorded value and the value that may be realised. More limited disclosures are required to compare carrying value to fair value for those financial instruments not carried at fair value (for example this may include borrowings debtors and creditors along with any other financial instruments not carried at fair value). These disclosures highlight to a reader any differences between fair value and amortised cost, as fair value is a market-based measurement.

Challenge questions

- Do the disclosures in the accounts make it clear to the user of the accounts what type of financial instruments the authority has, the terms of those instruments, the risks identified and how the risks are managed?
- Are the disclosures tailored to reflect the instruments the authority holds?
- Are there any material and/or complex arrangements that should be separately disclosed?
- Has materiality been considered and a 'stand back' review been undertaken to ensure that all material disclosures are included, and aren't obscured by the unnecessary inclusion of immaterial or irrelevant information?

Local authority statutory accounting

In addition to the Code's requirements based on proper accounting practice, there are various statutory accounting requirements which are relevant to financial instruments. The exact requirements vary between different United Kingdom jurisdictions, depending on the relevant statute (or in some cases statutory guidance) relevant to that jurisdiction. The Code summarises these requirements, with the full detail set out in the relevant legislation and / or statutory guidance. Further details of the legislative basis for each statutory accounting requirement can be found in an appendix to the Code. In each case, any accounting via the CIES must follow proper accounting practice as set out in the Code; any statutory adjustments are then made via the MIRS.

Premiums and discounts incurred on the early repayment of loan debt

In England, Wales and Scotland, regulations/statutory guidance permit (or for discounts, require) that premiums / discounts incurred on the early repayment of debt since 1 April 2007 which are required under the 2007 SORP to be taken immediately to SDPS may be amortised to the General Fund over various periods specified in the regulations/statutory guidance. The amounts charged to SDPS should reflect the Code (and IFRS 9) requirements, with the impact of applying the regulations accounted for via the MIRS. This therefore spreads the impact on the general fund over a longer period.

Share and loan capital

The acquisition and disposal of 'share capital' in England and Wales, and 'share and loan capital' in Northern Ireland, are captured by regulations. The implications of this include the need to include any unfinanced acquisitions of such instruments within the capital financing requirement and in the calculation of Minimum Revenue Provision (MRP), and that any movements in the fair value of these instruments wouldn't be a proper charge to the General Fund.

Fair value gains and losses of pooled investment funds

In England and Wales, there is at the time of writing a time-limited statutory override in place which applies to pooled investments and enables authorities to remove the impact of FVTPL movements on such investments from the General Fund. In England, SI 2023/241 initially extended the expiry date of this statutory override to 31 March 2025 for all pooled investment funds, while SI 2025/422 further extended this to 31 March 2029, but only for existing investments held at 1 April 2024. The Welsh Government has indicated that the same extension will be applied in Wales.

Soft loans advanced by an authority

The Code contains specific requirements for accounting for soft loans. In England and Wales, regulations require the amount to be taken to the General Fund to be the contractual interest receivable. Similar provisions apply in Scotland, but only for soft loans on the authority's Balance Sheet as at 31 March 2007.

Investment or debtor financial instrument balances which meet the definition of capital expenditure

Where a financial asset which is an investment or debtor balance meets the definition of capital expenditure under statute, any impairment losses aren't proper charges to the General Fund. However, a prudent MRP may be required in line with the relevant regulations and statutory guidance in place for the financial year in question.

Challenge questions

- Has the authority identified all relevant statutory accounting requirements and applied these appropriately via the MIRS?
- Has the authority considered any requirements to increase its MRP for the year in respect of any ECL identified for loans accounted for as capital?

Checklist

This table provides an at-a-glance checklist for all the challenge questions

Challenge question	Response
Has the authority identified all its arrangements that fall within the IFRS 9 boundary and those which don't?	
Has the authority identified any complex arrangements (including but not limited to financial guarantees and arrangements taking the legal form of a lease)?	
Has the authority understood the rationale for such arrangements, identified and understood any associated risks, and properly considered value for money?	
Has the authority sought appropriate financial and legal advice?	
Are the accounting implications fully understood before entering into the arrangement?	
Does the authority have the required accounting expertise in-house or is external expert support required?	
Have appropriate governance arrangements been followed when making decisions about entering into significant arrangements, including member approval where relevant?	
Where arrangements are novel, complex or involve significant judgements, has the authority sought to engage with their external auditor at an early stage to enable the auditor to raise any queries or challenges about the proposed treatment?	
Has a detailed accounting paper been prepared setting out key points, including rationale for the transaction, relevant Code requirements and any significant judgements?	
Have all financial assets been assessed under the IFRS 9 model to identify the appropriate classification?	
Have financial liabilities been assessed to identify embedded derivatives and whether or not they're closely related to the host?	
Has the authority classified investments in collective investment vehicles (eg, CCLA, money market funds) appropriately?	
Has the authority reviewed agreements to identify those where the amortised cost wouldn't be the same as principal and accrued interest?	
Has the authority identified any financial instruments requiring a fair valuation, and whether expert input is required?	
Has the authority appropriately applied IFRS 9 requirements to calculate ECL, including for intragroup loans to subsidiaries?	
Do the disclosures in the accounts make it clear to the user of the accounts what types of financial instruments the authority has; the terms of those instruments; the risks identified and how risks are managed?	
Are the disclosures tailored to reflect the instruments the authority holds?	
Are there any material and / or complex arrangements that should be separately disclosed?	
Has materiality been considered and a 'stand back' review been undertaken to ensure that all material disclosures are included, and aren't obscured by the unnecessary inclusion of immaterial or irrelevant information?	
Has the authority identified all relevant statutory accounting requirements and applied these appropriately via the MIRS?	
Has the authority considered any requirements to increase its MRP for the year in respect of any ECL identified for loans accounted for as capital?	

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