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CIPFA

By email to: simplification@cipfa.org

19 September 2014

CIPFA CONSULTATION – SIMPLIFYING AND STREAMLINING THE PRESENTATION OF LOCAL AUTHORITY FINANCIAL STATEMENTS – RESPONSE FROM ICAS

Introduction

1. ICAS welcomes this opportunity to comment on CIPFA'S consultation paper. We are a leading professional body for chartered accountants with over 20,000 members working across the UK and internationally. Our members work across the private and not for profit sectors. Our Public Sector Committee is a broad based committee of ICAS members with representation from across the public services. ICAS's Charter requires its Committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first.

Key messages

2. We have sought to draw out broad themes for streamlining the accounts rather than answer each question in the consultation paper. Our views were communicated to LASAAC¹ in May 2013 and the key messages are summarised below. An extract of our submission to LASAAC with further detailed explanations is provided in Annex 1.
3. Local authority accounts are an important and necessary document to demonstrate accountability and stewardship of public funds to tax payers and other stakeholders. Their complexity and specialism creates a barrier to wider understanding and reduces the ability to hold local authorities to account. We strongly support efforts to simplify the accounts, improve transparency and strengthen accountability.

Simplification of accounts

The statutory framework

4. We believe that more fundamental change is needed which includes the statutory framework and its effect on the purpose and structure of local authority accounts. Although quick wins such as removing immaterial disclosures and extraneous detail can help, it risks being cosmetic improvement unless the legislative requirements which create the need for specialism and complexity (such as the Movement in Reserves Statement) are not addressed. This statement has too much prominence and the statutory adjustments create significant inconsistency with other sectors. A legislative review is likely to be a longer term improvement, in the meantime, as a temporary quick win, it would help if the statutory reserves position becomes a note to the accounts or is explained within the Strategic Report
5. The legislative framework which underpins the purpose and format of local authority accounts was established many years ago. Local authorities have changed considerably not only in terms of the services they provide and how they are provided but also the increasing expectation for accountability and transparency. A strategic review of the regulation affecting local authority accounts would also need to identify where there are over and under disclosures so that regulation is better focused to address today's risks and fit to meet users growing needs for transparency, communication and accountability. A statutory review needs to be added to government work programmes to update the framework and trigger meaningful improvements.

¹ ICAS response to LASAAC – published on our website [Simplification of Local Government Accounts Survey 29 May 2013](#)

User needs

6. We also suggest that a decision is made to respond to user needs by identifying the middle majority (assuming a bell curve) and for those more specialist details in the accounts, to increase the use of web links and drill downs to allow those who need more detail to access it. This would help de-clutter the accounts and maintain a higher level focus. The new management commentary could be a vehicle for this. More visually friendly communication methods such as graphs would also help in a management commentary.

A high level management commentary

7. A dual approach is needed to shift the balance in the accounts to provide less technical detail supported by greater narrative analysis. We strongly believe that the introduction of a good practice based management commentary is a critical development to support understanding and transparency of local authority accounts and enhance accountability. It is also a key tool to help drive a holistic approach towards simplification of the accounts i.e. through bolstering the explanatory front half of the accounts to promote wider understanding of the key issues and progressing initiatives to simplify the technical second half of accounts.
8. We note the recent consultation by the DCLG with a proposal to introduce a narrative statement and the recent publication of the [Local Authority Accounts \(Scotland\) Regulations 2014](#) (section 8(2)a). The latter introduces a requirement for a management commentary where good practice is defined in the accompanying guidance, [Local Government Finance Circular 7/2014](#) (paragraph 25), as the model used in the Government financial reporting manual (FReM) which is based on the Strategic Report².
9. This new Strategic Report focuses commentary on the strategy, business model and risks. Given the increasing use of group structures by some local authorities to deliver services, it is important that there is some explanation of the business model used and why it has been selected for example, does it offer efficiencies or deliver services more effectively, what are the risks/ financial exposure to parent local authorities and how does the parent maintain control and ensure their overall responsibility and quality standards are met?
10. Our strong preference would be for consistency across all UK local authorities to align with the approach taken in the FReM and most recently by the Scottish Government. Although the Code encourages application of the FReM when preparing the Explanatory Foreword, it is not mandated. To ensure that good practice is applied consistently, it needs to be clearly articulated in the Code that the Explanatory Foreword is replaced by a Management Commentary based on the FReM model which mirrors the Strategic Report. Such an alignment would also mean that local authorities are better positioned to keep pace with evolving good practice.

IFRS

11. We welcome the achievement of local authorities to successfully adopt IFRS. However, the application of full (i.e. EU endorsed) IFRS has contributed to the increasing length and complexity of accounts. Since the decision to adopt EU endorsed IFRS, recent developments include the introduction of IFRS with a reduced disclosure framework (FRS 101) and new UK GAAP (FRS 102), which is substantially based on IFRS for SMEs. This is a less complex and more succinct version compared to full IFRS, which has been tailored to the UK environment.
12. Full IFRS is aimed primarily at listed companies who have to satisfy investors' needs for detailed information. In contrast, potential users of public sector accounts include a wide range of financially and non-financially literate stakeholders. To support continuous improvement, current financial reporting developments need to be considered and a question raised, if it is balanced and reasonable for local authorities (and the wider public sector) to apply full IFRS as opposed to the new UK GAAP. We suggest that the CIPFA LASAAC Code Board should initiate discussion and investigate further how a reduced financial reporting disclosure framework could help to streamline the accounts. We suggest that consideration should be given to allowing a greater number of bodies to prepare accounts in accordance with FRS 102.

² Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2014

Terminology

13. ICAS supports alignment between profit and not for profit sectors where possible. There are various historic and specialist terms used for local authorities which create an unnecessary layer of complexity and reduce transparency for the wider public. To improve transparency we believe that CIPFA LASAAC should set an objective to remove any specific jargon or unnecessary specialist terminology and replace this with more universally known terms, working with Government and local authorities to achieve this, as appropriate.
14. As an example, the role of a Finance Director may be known as a Director of Corporate Services and Resources, the section 151 officer or responsible financial officer. The latter two terms are not known beyond local authorities. An example of how this is being driven is provided in sections 2-5 in the [Scottish Government Finance Circular no.7/2014](#). We would also prefer the term 'statement of accounts' to be replaced with the more universal term 'financial statements' or 'annual accounts' and for this to be consistent across the UK. Greater consistency promotes transparency, wider understanding and stronger accountability.
15. We trust that our comments are helpful and would be happy to discuss any aspect of our response with you.

Yours faithfully,

ALICE TELFER
Assistant Director, Business Policy and Public Sector
ICAS

Relevant extracts from the ICAS submission to LASAAC in May 2013

Our comments on specific elements of local authority financial statements

Explanatory Foreword

There is a lack of meaningful high level narrative in the accounts which pulls out key messages on how the organisation has performed, its key financial messages, strategy, risks, how managed and compliance with duties. This inhibits transparency and is a barrier to better understanding the organisation, its use of resources and holding to account more effectively.

The content, length and quality of the Explanatory Foreword in local authority (LA) accounts are variable. Although it can aid interpretation of the accounting statements, it does not extend to explaining how the organisation has performed against its objectives or demonstrate how well resources have been utilised. It can also contain material such as a glossary of accounts terminology which is extraneous detail and not appropriate in a strategic document.

Statement of Responsibilities

The Statement of Responsibilities focuses solely on responsibilities for financial affairs and the financial statements relating to the Authority and Head of Finance but does not mention the rest of the Management/Council Team, the Chief Executive or Leader. The accounts are signed off by the Head of Finance, but not on behalf of the full Management/Council Team.

Our recommendation for an operating financial review type commentary is likely to introduce a need for a wider statement of responsibilities that recognises the wider team of decision-makers (Executive Team / Council) out with the financial statements.

In a company annual report and accounts the Board of Directors has collective responsibility for the accounts³ which is evidenced by requiring the signature of one of the Directors who signs on behalf of the Board. The Directors' responsibility statement comes after the Directors' report. This reflects the unitary board structure which is seen as UK corporate governance good practice as it strengthens the opportunity for challenge and proper scrutiny.

The gap in wider responsibilities out with the financial statements suggests a lack of clarity or even a gap in top responsibility. It is also inconsistent with the principle of the unitary board. The arrangements in place for local authorities are due to the legislative framework which has not kept pace with corporate governance good practice.

The accounts are a key communication document (especially as there is no requirement to produce an annual report) so if the statement of responsibilities is not comprehensive in the accounts, it is not clear where else this would fit.

Annual Governance Statement/ Statement of Internal Control

There is inconsistent application of good practice. Some LAs use an Annual Governance Statement whereas others use a Statement of Internal Control. There is also inconsistency in where this is located in the accounts with some placing this statement upfront with the other statements and others including it at the end of the accounts after the notes. These disparities reduce transparency over important matters of governance; they are confusing and unhelpful to the reader.

Independent auditors' report

The auditors' report is presented in different locations in different LA accounts. We believe that the independent auditors' report should be consistently presented before the financial statements (as it is for central government and generally in the private sector). We do not believe it is appropriate for the report which gives readers an opinion on the accounts to be placed at the back of the accounts. This appears to present less priority to the matter and reduces transparency over whether the accounts are true and fair.

³ The Companies Act 2006 (s394) it is the responsibility of the directors of every company to prepare accounts and a directors' report (s 415).

Statutory framework and specialist nature of accounts

Confusion arises due to the particular need for local authorities' accounts to meet legislative requirements which sit out with the scope of normal financial statements⁴. The result is a set of accounts which are intended for external users and stakeholders that try to meet the varied needs of funding, management accounting and end up creating a more complex and confusing document for the public audience – tax payers and other stakeholders. This inconsistency needs resolved.

The Movement in Reserves Statement is an additional statement peculiar to local authorities which creates an additional layer of complexity and confusion for readers unused to LA accounts.

Local authority accounts mix the separate themes of funding and financial reporting in the Movement in Reserves Statement. Statutory interventions (SI) are required to square the difference between the LA legislation for calculating funding in the accounts (council tax and housing rents and the information in the accounts it is based on) and compliance with accounting practice. This link does not reflect current accounting practice and the SI is like a sticking plaster to ensure both requirements are met.

Although the Movement in Reserves Statement is important in the current legislative framework, consideration needs to be given to amending the legislation to separate the elements of funding and financial reporting. This would allow LAs to prepare accounts which better reflect GAAP rather than need to formulate various statutory interventions to square the difference between legislative requirements and funding calculations.

These legislative and technical peculiarities in LA accounts exacerbate the specialist nature of the accounts and reduce the ability of stakeholders to understand and hold the Authority to account. If the legislative framework is modified it would remove the root cause for a complex Movement in Reserves Statement.

Remuneration report

Demonstrating pay restraint with public funds is a strand of effective governance. ICAS support the inclusion of a remuneration report in local authority accounts.

Comprehensive I&E statement

This is a primary statement of revenue received and expenditure and likely to be one of the most important sources of information for readers. It is significantly complicated by its presentation style and the need to align with the council tax calculation. This specialist anomaly means specialist knowledge is required to fully understand what is going on which creates a barrier to understanding and importantly, this reduces accountability.

The presentation of this statement is significantly different from conventional accounts. It does not follow the traditional income less expenditure format and inverts +/- signs so a negative which would normally represent expenditure is actually income. This creates confusion.

The purpose of this statement needs to be streamlined to focus on accounting practice so it is more comparative with other sectors and therefore more easily understood by a wider range of stakeholders. Our preference is for it to do one job well (i.e. present GAAP-based I&E for a mixed audience of external users) rather than more than one at the expense of clarity.

Group accounts

These are inconsistently presented with some LAs showing this statement upfront as part of the primary statements and others showing this at the back after notes and other statements. Given their significance in terms of finance and governance as well as being a statement in themselves, we believe it is more appropriate to show group accounts figures as part of the primary statements and this approach should be consistent across the sector.

Ideally the figures for group and parent entity should be shown together on one page not just for simplicity but also so that comparisons can be drawn. An example is the increasing use of arms-length

⁴ For example: Section 93 of the Local Government Finance Act 1992 which requires councils to set council tax that will cover expenses.

organisations to deliver services which is reducing entity level size and services but correspondingly increasing the group. The split presentation and inconsistency in location across LA accounts reduces the ability to make this comparison and appreciate the scale of service transfer. This reduces the ability to hold the Authority to account.

Structure of accounts and removal of unrelated material

The structure of LA accounts does not follow conventional accounts. There is a mix of primary statements, followed by notes and then more statements which are specialist to an LA (HRA Account, Council Tax Account etc.). A more logical flow would be to have all statements upfront followed by notes.

The pension fund accounts have been separated from the main LA accounts, this has helped to focus content and reduce the volume of information in one place. There are other additional accounts which are not related to the main council's activities such as Common Good and Charitable Trust Funds which may also be better placed for external users out with the main LA accounts but signposted as appropriate.

Achieving an optimal balance between explanatory narrative and technical disclosures – options for discussion and review

We have suggested a need to expand the explanatory narrative (front half of the accounts). As a consequence, options need to be considered to reduce the length and complexity of the technical detail in the second half of the accounts to avoid contributing to even longer financial statements.

A shift in the balance is needed whereby less detailed financial statements are balanced by a more meaningful narrative which focuses on key messages to demonstrate stewardship. This would make the accounts less detailed, less complex and more accessible to a wider group of users.

Statutory requirements

Various other statements in the accounts reflect legislative requirements, some of which were set many years ago. These include the HRA, council tax income account and non-domestic rate account. The way which services are provided has changed since these requirements were first set. For example arms-length organisations which provide certain services have increased, so group accounts are more significant than they might have been 20 years ago and council house sales with the subsequent increase in housing associations have changed housing activity levels in local authorities since the [Housing \(Scotland\) Act 1987](#) (which details the income and expenditure which should be charged to the HRA) was enacted.

Legislative requirements are a significant driver of the form of local authority accounts and contribute to their complexity. We suggest that a review of whether the balance of information requirements fits the current landscape of how services are provided, the priorities for disclosure, significance, risks etc. would be an important contribution to identify actions for simplifying accounts. Such a review could highlight parts of the accounts that may be under/ over disclosed or areas that have a higher/ lower profile than befits the risk and impact. In our view, examples of under/ insufficient disclosure include narrative reporting and group accounts; an example of lower profile than befits the impact is the audit report at the end of the accounts. Consideration should also be given to whether additional statements such as the HRA, council tax income account and non-domestic rate account are best represented by a statement in the accounts or if a more succinct note would suffice.

IFRS

We welcome the achievement of local authorities to successfully adopt IFRS. However, the application of full (i.e. EU endorsed) IFRS has contributed to the increasing length and complexity of accounts. The volume of information an authority can produce makes it more difficult for stakeholders to hold the authority to account. The combination of IFRS and the specialised complexities and additional statements in local authority accounts has made the need for simplification more urgent.

Since the time of the decision to adopt full IFRS, recent developments include the introduction of IFRS for SMEs and new UK GAAP including FRS 102, which is substantially based on IFRS for SMEs. This is

a less complex and more succinct version compared to full IFRS. The European Commission has not yet decided to adopt IFRS for SMEs, there is still on-going discussion on one aspect – the presentation of unpaid subscribed share capital (not relevant to the public sector), although it may be resolved during the current IASB consultation process.

As part of longer term continuous improvement, it may now be beneficial to initiate discussions to reflect on where the changes are useful and less useful and in particular, to consider current developments in IFRS and question if it is balanced and reasonable for local authorities (and the wider public sector) to apply full IFRS as opposed to the new UK GAAP. Full IFRS is aimed primarily at listed companies who have to satisfy investors' needs for detailed information. In contrast, potential users of public sector accounts include a wide range of financially and non-financially literate stakeholders. The new UK GAAP disclosures are less detailed and therefore less complex.

Suggestions for improving the relevance and usability of local authority accounts

Overview

Local authority accounts are an important and necessary document to demonstrate accountability and stewardship of public funds to external users. The accounts are complex, technical and specialist. This creates a barrier to wider understanding. Greater prioritisation of a user-focused approach to presentation which reflects normal conventional accounts and reduces the need for specialist knowledge is needed.

We suggest that more emphasis is required on providing an explanatory narrative which pulls out the key messages and links the financial and non-financial performance. This should be counter-balanced by actions to reduce the technical complexity and length of the second-half of the accounts. Our view is that a shift in the balance to less technical detail supported by greater narrative analysis would improve understanding and accessibility. Consideration should be given to removing both legislative and technical barriers to user-focused accounts.

There are not only inconsistencies with standard accounting practice but also across local authority accounts which creates an additional and unnecessary layer of confusion. This includes the extent to which good practice is adopted, the positioning of statements in the accounts, content, length and quality of narrative commentary.

More consistent application of good practice and ordering of accounts content are required. In particular all statements and the auditors' report should be upfront in the accounts (not with some at the back), more meaningful narrative analysis, whether a Statement of Internal Control is used or an Annual Governance Statement.

We have set out some suggestions for improvement below.

- i) Clarify the purpose of published accounts as a key communication document to external users of how a local authority has undertaken its stewardship duties and is of public interest.
- ii) Remove legislative barriers which complicate the published accounts to separate the various objectives related to funding and tax-raising, management information and accounting requirements.

Ideally an annual report and accounts would be prepared for each LA. As the former is not a requirement, we suggest that it is all the more important for meaningful narrative to support the accounts. The Explanatory Foreword could be removed and replaced with a directors' style report/ operating financial review as used in other public and private sector annual report and accounts. This could signpost to other more detailed information. The IASB Management Commentary is a good model as is the Strategic Report introduced by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

Presentation and format of the accounts could mirror conventional accounting practice more closely, starting with the I&E and group accounts – parent and group balances should ideally be on the one page to enable comparisons to be drawn. Significant risks and issues arising in subsidiaries (such as going concern problems or qualified audit reports) should be more clearly and consistently communicated in the parent accounts as a matter of public interest.

A shift in the balance of information to demonstrate stewardship so that more meaningful narrative draws out the key messages, supported by less detailed financial statements. Options to progress could include:

(i) A review of how well the balance of information requirements fits the current landscape of how services are provided, the priorities for disclosure, significance, risks etc. to help identify areas of over and under disclosures with actions for simplifying accounts.

(ii) Initiating a debate to consider recent accounting developments, reflect on the cost versus benefit for key users of full IFRS and question whether it is balanced and reasonable to apply full IFRS as opposed to the new UK GAAP. (This could be applied to the wider public sector, not just local authorities).

All statements to the accounts should be positioned upfront in the accounts, not at the back. This should be consistent across all local authorities. An example of inconsistent treatment is the annual governance statement, group accounts and remuneration report.

There is inconsistent application of good practice. Examples include: some LAs use an Annual Governance Statement whereas others use a Statement of Internal Control; the content, length and quality of the Foreword and performance reporting is variable. If LAs are not consistently applying good practice in areas of importance, this needs to be highlighted by auditors to encourage self-improvement otherwise as a last resort, a statutory intervention would be needed.

Detail on topics which do not relate to main council activity should be removed from the main accounts such as Charitable Funds and the Common Good Fund. These can be cross referenced as appropriate.

We support consistency across the UK.