CIPFA/LASAAC's commentary on the SDCT discussion paper *Streamlining accounts and the audit process*

Introduction

CIPFA/LASAAC reviewed the report *Streamlining accounts and the audit process* from the Society of District Council Treasurers (SDCT) at its meeting on 6 November 2024. The board wishes to convey its unreserved appreciation for the thorough analysis and invaluable insights presented. The diligent efforts and insightful contributions of the SDCT in the preparation of this report are highly valued.

The report contained seven asks that the SDCT felt would significantly improve the accounts and associated audit process. While the board is unable to directly address these seven requests, it can consider initiating discussions with other organisations regarding each of them.

Although the report was written from the viewpoint of district council treasurers, some members of the board felt that the seven asks contained within the report could be usefully applied to all local authorities.

Comments on the specific asks

Ask number 1

> That separate materiality levels are applied to the balance sheets of local authorities commensurate with total assets values. That this is supported by clarity within the system that this approach will not be challenged by regulators.

Paragraph 10 of International Standard on Auditing (ISA) 320 *Materiality in Planning and Performing an Audit* allows auditors to apply a different materiality level to particular classes of transactions, account balances or disclosures. However, this is only when misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users.

Practice note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom issued by the Financial Reporting Council (FRC) provides further guidance relevant to the public sector context in relation to ISA 320. Paragraph 1-85 states that where a public sector entity has custody of public assets, assets may be an appropriate benchmark.

However, in practice, gross expenditure is used as a benchmark for setting materiality. This is to reflect the entity's role to provide services to the public, even if the entity has significant non-current assets.

CIPFA/LASAAC feels there would be merit in a wider conversation as to what is most relevant to users of the accounts. The Better Reporting Group is also pursuing a project on materiality, which may help this discussion.

Ask number 2

> Where suitably qualified expert external valuations are obtained by local authorities, these can be relied on by auditors subject to normal review of the information supplied by local authorities to that valuer.

The circumstances described in the report arise because of material set out in ISA (UK) 500 *Audit Evidence* in relation to evidence provided by management experts and the way this is interpreted by auditors and regulators.

The FRC aims to regulate proportionately and according to principles, balancing the burden on businesses with the need for high-quality audit and assurance work. This is crucial for maintaining investor and stakeholder confidence.

However, the development of International Standards on Auditing (ISAs) on which ISAs (UK) are based has in some cases been driven by corporate risks highlighted by high-profile failures. These risks often differ significantly from those faced by local authorities. For example, local authorities typically hold operational assets to provide services, prioritising location and service potential over cost, resulting in longer holding periods than in commercial companies. This lower risk profile for certain local authority assets might justify a more targeted approach to audit effort while maintaining appropriate scrutiny of higher-risk areas like investment properties.

CIPFA/LASAAC agrees with SDCT's sentiments and could relay concerns to both the FRC and National Audit Office (NAO) to see if public sector guidance can be developed. If the board decides to implement mandatory five-yearly valuations and indexation in the 2025/26 Code, as proposed in ask number 6, then this could also be helpful.

Ask number 3

> CIPFA and regulators provide guidance on how to reduce the length of accounts through reliance on information published elsewhere and the government reviews the statutory disclosures within accounts.

CIPFA/LASAAC acknowledges that currently many material disclosures require the duplication of information from external sources within financial statements. Given the increasing reliance on electronic publication of accounts, one solution could be to explicitly permit linking to relevant documents. This would streamline the reporting process and reduce the overall length of financial statements.

Ask number 4

> Government legislates to separate out the pension fund accounts and requires local authorities to account on a defined contribution basis.

CIPFA/LASAAC notes that this request is not within its gift. It would require a policy decision by government.

Although CIPFA/LASAAC might provide advice to government on this matter, the board notes that the LGPS is a defined benefit scheme, and the most objective way to account for this is by using defined benefit accounting. Having said this, CIPFA/LASAAC has some concerns that the resulting reporting may be disproportionate, having regard to the needs of the various users of financial statements. While it is important that the viability of pension funds is accurately reported upon, the primary user of this information is perhaps government, who may be more interested in reporting at a pension fund level rather than individual local authority level. A project on pensions reporting is going to be undertaken by the Better Reporting Group.

However, CIPFA/LASAAC will also need to be mindful of the views of the Financial Reporting Advisory Board (FRAB), who have indicated that any changes to the accounting for public sector pension schemes would need to take a holistic view across the whole of the sector, not just within local government. The Better Reporting Group would be well placed to undertake this review and collaborate with the NHS, central government and other interested parties.

Ask number 5

> Government legislates to separate out the collection fund from individual authority accounts and requires that individual authorities account for tax income on a legislative basis.

This request is also not within the gift of CIPFA/LASAAC. It would require a policy decision by government.

CIPFA/LASAAC acknowledges that it is logistically challenging for precepting authorities in two-tier areas to collect the information required from billing authorities to complete the necessary accounting adjustments to the statement of accounts.

The board will suggest that the Better Reporting Group considers the arguments set out in the report to see if this might provide a useful basis for discussion with government.

Ask number 6

> Mandate full valuation every five years, with prescribed indexes to be used to determine values in between. Impairment to be restricted to circumstances when the asset cannot be used for its intended service purpose.

HM Treasury undertook a thematic review of non-investment assets during 2023. The purpose of the review was to assess the current regime of valuation for non-investment assets across the public sector and to identify and evaluate the case, options and timing for any revisions to the existing approach. The review considered the strengths of and areas for improvement in the current regime and potential developments going forwards.

CIPFA/LASAAC has issued the consultation on the 2025/26 Code of Practice on Local Authority Financial Reporting in the UK. The board is consulting on changing the approach to the measurement of operational property, plant and equipment in line with the HM Treasury thematic review. Part of this consultation is asking if the Code should withdraw the IAS 16 requirement for revaluations to be made with sufficient regularity that ensures the carrying amount does not differ materially from that which would be determined using the current value at the end of the reporting period, instead replacing this with a quinquennial revaluation or a five-year rolling basis, supported by indexation in intervening years.

CIPFA/LASAAC will review and discuss the feedback from the consultation at its meeting in March 2025 before deciding whether to proceed with the introduction of mandatory five-yearly valuations and indexation in the 2025/26 Code.

CIPFA/LASAAC notes the comments made in the report in relation to prescribing indices and the nature of impairment, but in developing the Code, requirements will need to have regard to issues around compliance with International Financial Reporting Standards (IFRS).

Ask number 7

> A review of the EFA is undertaken and consideration given to replacing the EFA with a much simplified Capital Funding Statement.

The EFA aims to bridge the gap between an authority's reported outturn and the Comprehensive Income and Expenditure Statement (CIES). However, as the SDCT point out, it has become overcomplicated and impenetrable to users of the accounts.

The Better Reporting Group are looking at how statutory overrides are presented within local authorities' accounts. CIPFA/LASAAC can ask the Better Reporting Group to specifically review the EFA and whether replacing with a simplified Capital Funding Statement would be beneficial.

Board's overall position

CIPFA/LASAAC felt that the report was very timely as they look to introduce longer-term reforms to support local authority reporting recovery. The board was broadly supportive of all the asks contained within the report, even if they did not have direct control over some of them.