

# Contents

<b>PART 1: PRINCIPLES</b> .....	<b>5</b>
<b>CHAPTER ONE: TELLING YOUR STORY: THE PRINCIPLES OF EFFECTIVE COMMUNICATION</b> .....	<b>7</b>
FOCUSED .....	8
OPEN AND HONEST .....	10
CLEAR AND UNDERSTANDABLE .....	10
INTERESTING AND ENGAGING.....	10
<b>CHAPTER TWO: OBJECTIVE AND USERS OF FINANCIAL STATEMENTS</b> .....	<b>15</b>
<b>CHAPTER THREE: INFORMATION NEEDS</b> .....	<b>21</b>
IFRS 13 FAIR VALUE MEASUREMENT .....	22
DIFFERING INFORMATION NEEDS.....	24
<b>CHAPTER FOUR: MATERIALITY AND CLUTTER</b> .....	<b>33</b>
IMMATERIAL DISCLOSURES .....	33
EXPLANATORY INFORMATION THAT REMAINS UNCHANGED FROM YEAR TO YEAR .....	43
<b>CHAPTER FIVE: EXPLAINING THE IMPACT OF LEGISLATION</b> .....	<b>47</b>
DIFFERENCE BETWEEN ACCOUNTING AND LEGISLATION.....	48
EXPLAINING THE DIFFERENCES TO USERS.....	51
ANNEX A: WORKED EXAMPLE – SALE OF AN ASSET .....	56
ANNEX B: ALTERNATIVE PRESENTATION OF THE MOVEMENT IN RESERVES STATEMENT .....	60
<b>CHAPTER SIX: A NEW APPROACH</b> .....	<b>67</b>
<b>CHAPTER SEVEN: THE IMPORTANCE OF PLANNING</b> .....	<b>75</b>
<b>PART 2: GOOD PRACTICE</b> .....	<b>79</b>
<b>CHAPTER EIGHT: THE PRESENTATION OF FINANCIAL STATEMENTS</b> .....	<b>81</b>
TELLING YOUR STORY .....	81
OBJECTIVES, USERS AND INFORMATION NEEDS .....	82
MATERIALITY .....	83
PRESENTATION OPTIONS PERMITTED BY THE ACCOUNTING CODE .....	83
GROUP ACCOUNTS .....	84
<b>CHAPTER NINE: THE MOVEMENT IN RESERVES STATEMENT</b> .....	<b>89</b>
WHICH RESERVES? .....	89
WHICH ADJUSTMENTS? .....	90
EXAMPLES .....	91
<b>CHAPTER TEN: THE COMPREHENSIVE INCOME AND EXPENDITURE STATEMENT</b> .....	<b>101</b>
<b>CHAPTER ELEVEN: THE BALANCE SHEET</b> .....	<b>107</b>

<b>CHAPTER TWELVE: THE CASH FLOW STATEMENT</b> .....	<b>115</b>
INDIRECT METHOD .....	116
DIRECT METHOD .....	117
INVESTING AND FINANCING ACTIVITIES .....	118
PRESENTATION .....	119
ANNEX A: ANALYSIS OF ADJUSTMENTS TO THE SURPLUS OR DEFICIT ON THE PROVISION OF SERVICES IN THE OPERATING ACTIVITIES SECTION OF A CASH FLOW STATEMENT PREPARED UNDER THE INDIRECT METHOD .....	120
ANNEX B: ANALYSIS OF THE ITEMS THAT MAKE UP THE OPERATING ACTIVITIES LINE IN A CASH FLOW STATEMENT PREPARED UNDER THE DIRECT METHOD .....	121
ANNEX C: USEFULNESS OF THE ADDITIONAL INFORMATION PROVIDED BY THE DIRECT METHOD .....	123
ANNEX D: EXAMPLES OF CASH FLOW STATEMENTS AND NOTES.....	124
<b>CHAPTER THIRTEEN: APPLYING THE NEW APPROACH</b> .....	<b>129</b>
EXPLANATORY FOREWORD.....	130
ACCOUNTING POLICIES.....	131
CRITICAL JUDGEMENTS AND ESTIMATION UNCERTAINTY .....	133
OTHER NOTES.....	134
ANNEX A: ANALYSIS OF THE APPLICABILITY TO LOCAL GOVERNMENT FINANCIAL STATEMENTS OF THE KEY MESSAGES IN CUTTING CLUTTER'S DISCLOSURE AID 2.....	137
ANNEX B: EXAMPLES .....	138
<b>CHAPTER FOURTEEN: INTERESTING AND ENGAGING? SOME GOOD PRACTICE EXAMPLES</b> .....	<b>159</b>
MAKE A GOOD FIRST IMPRESSION .....	160
RETAINING ENGAGEMENT .....	161
USE OF COLOUR .....	164
GLOSSARY OF TERMS .....	166
PERSONALISE THE FINANCIAL STATEMENTS .....	166
WEB PUBLICATION.....	166
ANNEX A: FURTHER EXAMPLES OF GOOD DESIGN.....	167
ANNEX B: WEB PUBLICATION TECHNIQUES IN PRACTICE .....	171
<b>CONCLUSION</b> .....	<b>175</b>

# Introduction

Public sector financial reporting needs to improve.

That is the clear message from the G20, the International Monetary Fund (IMF) and Eurostat. A flurry of activity at the end of 2012 and the beginning of 2013 saw all three organisations make statements to this effect.

The sovereign debt crisis has prompted the G20 to consider the causes of the crisis, and what steps can be taken to prevent a recurrence of the factors that led to it. The G20 finance ministers identified a lack of transparency and weaknesses in public sector financial reporting as areas for improvement, as was made clear in a Communiqué issued in February 2013:

*In pursuit of our goal of strengthening the public sector balance sheet, work is needed to better assess risks to public debt sustainability. This includes, inter alia, taking into account country-specific circumstances, looking at transparency and comparability of public sector reporting, and monitoring the impact of financial sector vulnerabilities on public debt.*

**Source: Communiqué issued at the close of the G20 Finance Ministers and Central Bank Governors' Meeting held February 15 and 16 2013 in Moscow.**

This is not to say that weak public sector financial reporting was a cause of the crisis (although in countries with poor public financial management, it may have been a contributing factor); rather that improved reporting is an important tool for policy makers in repairing the damage caused by the crisis. You need to know the scale of the problem before you can fix it, and public sector financial reporting as it currently stands in some countries (but not the UK) does not always give you that.

This call for improvement echoed similar sentiments in an IMF report issued in 2012. Independently of the G20, the IMF reached the conclusion that greater transparency and greater adherence to financial reporting standards was required:

*Fiscal transparency is a critical element of effective fiscal policymaking and the management of fiscal risks. The last decade and a half has seen a concerted effort to develop a set of internationally accepted standards for fiscal transparency and to monitor and promote the implementation of those standards at the national level. This period has also witnessed a steady improvement in the comprehensiveness, quality, and timeliness of public financial reporting in countries across the income scale.*

*Despite these advances, understanding of governments' underlying fiscal position and the risks to that position remains inadequate... These shortcomings in fiscal disclosure are due to a combination of gaps and inconsistencies in fiscal transparency standards, delays and discrepancies in countries' adherence to those standards, and a lack of effective multilateral monitoring of compliance with those standards.*

**Source: Fiscal Transparency, Accountability, and Risk, IMF, 2012.**

The Eurozone has experienced particular problems as a result of the sovereign debt crisis, and this has prompted the European Commission and Eurostat to seek ways of improving the quality of government financial information in the EU. Indeed, the Commission is considering mandating public sector accounting standards across Europe as part of this drive for improved financial information:

*Government activity accounts for a major part of gross domestic product (GDP) in all EU economies, and government assets and liabilities are substantial in all EU countries. It is therefore important that they are effectively managed and that governments are accountable for this management to their citizens, their representatives, investors and other stakeholders.*

*... Reliable government financial accounts are essential for the preparation of national accounts and of course for fiscal planning, coordination and supervision.*

**Source: *Towards Implementing Harmonised Public Sector Accounting Standards in Member States: The Suitability of IPSAS for the Member States, Report from the Commission to the Council and the European Parliament, 2013.***

These calls for improvement were aimed at national governments, many of whom still account on a cash basis. But the UK cannot be complacent. Public sector organisations in the UK may be ahead of many of their continental cousins in producing high quality, audited, accruals-based financial statements. However, is the information they contain being used as intended by the standard setters, to inform decision making and accountability?

The signs are not good. The recent report by the Public Accounts Committee on the Whole of Government Accounts raises concerns that would be familiar to readers of the G20, IMF and European Commission documents:

*The Treasury acknowledges the potential of the WGA to help it manage the public finances more effectively. But the Treasury does not have a clear plan to realise that potential or improve the quality and timeliness of the WGA to improve its usefulness...*

*... More needs to be done to make the accounts easier to understand.*

**Source: *HM Treasury: Whole of Government Accounts 2010-11, House of Commons Committee of Public Accounts, 2013.***

Similar criticisms have been made about local authority accounts. The need to produce financial statements that address both an accounting framework and a legislative framework does lead to complexity. This 'dual reporting' approach not only results in additional information being provided – additional notes required by regulations – but also requires some items to be accounted for in ways that do not reflect how the authority manages its budget. Timing differences in recognising expenditure and a service analysis that reflects national accounts (and a need for consistency) rather than how the authority is organised are just two examples.

Consequently, decision makers struggle to understand financial statements, and the valuable information they contain can be overlooked when policies and strategies are being considered.

This situation is not unique to local authorities, or even the public sector. Financial statements in all sectors have dramatically increased in size and complexity over recent years, and have led to calls for standard setters to ‘cut the clutter’ in annual reports and financial statements.

The response of the standard setters to this call has been positive, with the agendas of the various standard-setting bodies across the globe now including projects to review disclosures. Indeed, the International Accounting Standards Board (IASB) asked the Institute of Chartered Accountants of Scotland and the New Zealand Institute of Chartered Accountants to undertake a project to review the levels of disclosure requirements in existing International Financial Reporting Standards (IFRS) and to recommend deletions and changes to disclosure requirements.<sup>1</sup> And in a speech in June 2013 at the IFRS Foundation conference, Hans Hoogervorst, Chairman of the IASB, talked about the steps the IASB was proposing to take to ‘make disclosures less indiscriminate and more meaningful’.

This emphasis on improving the disclosures is not limited to the international arena. At the time this publication was being written, both CIPFA/LASAAC and HM Treasury were consulting on how to simplify the accounts in the UK public sector.

But changes to standards and regulations will take time. All the disclosures currently required under accounting standards are useful to someone. One person’s clutter is another person’s essential information. Balancing these competing needs will be no easy task.

Yet waiting for the standard setters to complete their review is not the only option. There is much that individual organisations can do to review their financial statements and make them fit for purpose. Cutting the clutter is not something that can only be achieved at standards level; each organisation can and should be removing the excess baggage from its own financial statements.

How? By considering what information is material to the readers of the accounts. Too often, organisations play safe by including every disclosure required by standards, just in case an omission is questioned. And too often, auditors question the omission of non-material disclosures, encouraging this behaviour. If financial statements are to reduce in size, everyone involved in the process needs to take materiality seriously.

This does not mean that shorter, leaner financial statements are an end in themselves. They are desirable because, done correctly, this transformation should make them easier to use. Readers should be able to identify the important messages, and to find them more quickly without the clutter of less important information obscuring those messages.

Making use of materiality to reduce the size of financial statements isn’t the only thing that organisations can do to assist readers of the accounts. Improving the presentation of the accounts so that readers can more easily identify key information will also help. The information in the financial statements can be complex, and therefore needs to be presented in as accessible a manner as possible to help readers understand it. Innovations such as graphical or narrative approaches are likely to be needed if we want to improve the accessibility of the accounts.

---

1. The institutes’ recommendations can be found in their report *Losing the Excess Baggage – Reducing disclosures in financial statements to what’s important*, 2011.

None of this can be achieved without some effort, and a willingness to exercise professional judgement in deciding what information to omit or present in a new manner. Yet important information can be hidden in the financial statements; making this accessible could better inform readers of the accounts, and improve decision making.

Financial statements are one part of a wide range of financial information provided by local authorities. Many users will obtain the information they want from other publications, such as budgets and summarised accounts. But the financial statements include information not found elsewhere; information that can be critical for decision making. Too often, it may be ignored because readers find the financial statements difficult to read. Shorter, leaner, more accessible financial statements will help to overcome this problem.

This publication is intended to help local authorities starting down this path by providing examples of good practice. There is no right answer; no template to follow. Instead, each authority will need to determine what is right for its readers. This requires an understanding of who those readers are – or should be – and what they (should) want to know. By providing examples of good practice along with some more innovative ideas, this publication aims to encourage the debate about what will work best for individual local authorities.

**Part 1** of this publication considers general principles, such as identifying the users of the accounts, and how to apply the concept of materiality. **Part 2** discusses good practice in the production of each of the primary statements, the notes to the accounts, and the explanatory foreword, and considers how alternative presentation formats may help make information – especially in the notes – more accessible.

Local authorities produce high-quality financial statements that contain valuable information. The challenge is to make that information accessible, so that it can inform decision making and accountability.