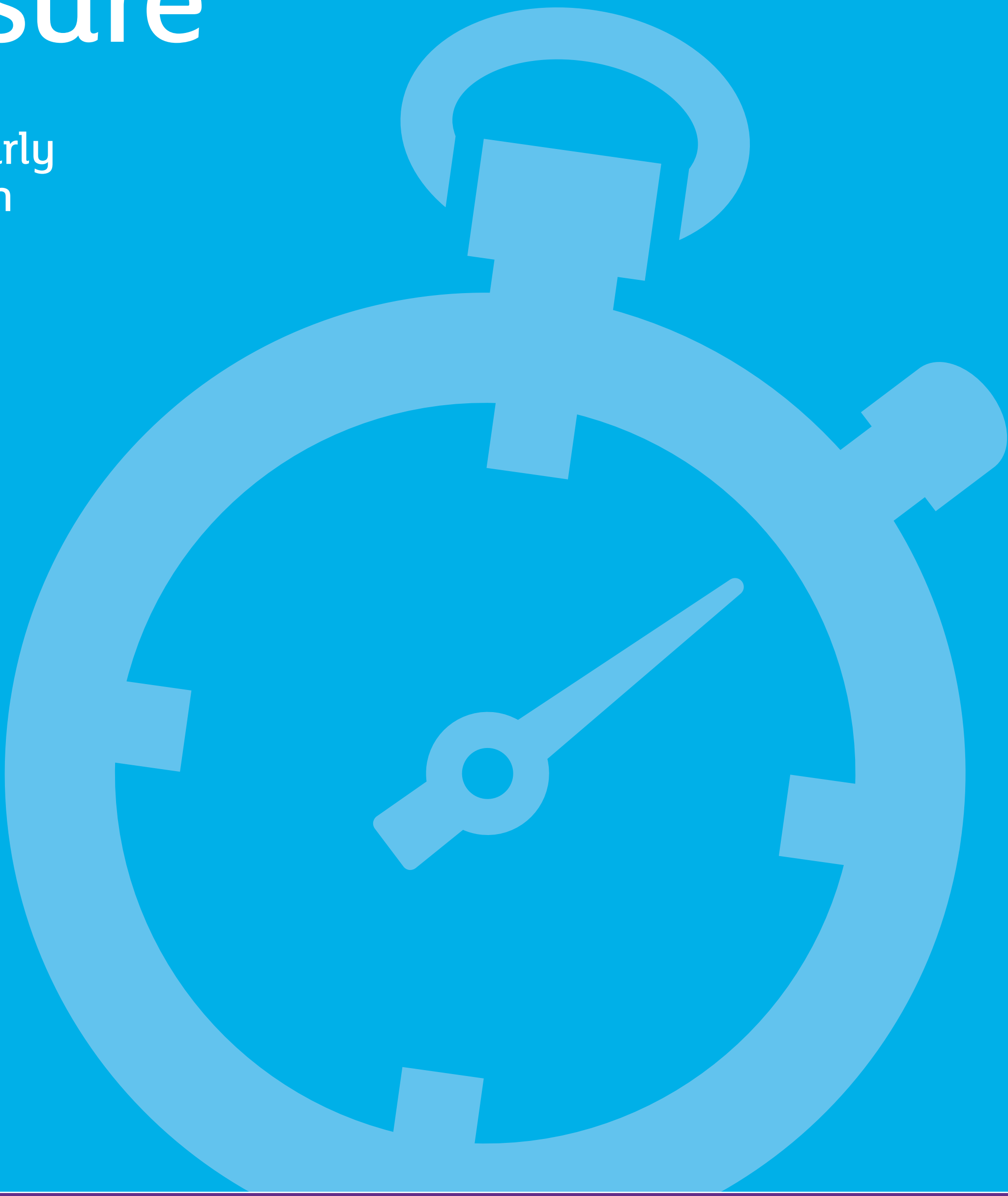
CIPFA The Chartered Institute of Public Finance & Accountancy

easing the pressure

The incentive for early accounts closedown



In association with: EY Building a better working world

INSIGHTS
for public financial management

Contents

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance.

EY is a global leader in assurance, tax, transaction and advisory services.

The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organisation, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP
The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

\ summary

Local government is used to accounting in a complex system of rules for reporting, monitoring, governance and scrutiny. Finance teams may spend months looking back, consolidating and finalising the accounts that summarise what the organisation has been doing in the last year. With pressure on the sector to save money many are looking to find ways to enable them to spend more time looking to the future, and giving priority to planning.

In a perfect world the value to be derived from public financial reporting can finally be properly exploited. The future for the finance department however would be different. As it would be for finance professionals who have already been told that they are 95% at risk of being automated by technology.[1] The finance department will, by repositioning the source of the assurance of information, release resources to be a true driver of business decisions. In short it, would finally realise their latent value to the business rather than maintain what for many is simply a technical process.

The publication *Regular as Clockwork*[2] gave an evaluation of the core accounting tasks in local government. Its clear message was that local authorities should not be complacent in prioritising the production of their financial statements, providing reasons why prompt production should be the norm rather than the exception.

These reasons included that the authority should take seriously its responsibility to account properly for the use of public funds; that it provides evidence of its operation of sound financial systems and procedures and that it demonstrates its commitment to full and public disclosure of financial information.

Nearly 30 years later it is difficult to challenge these basic reasons. Since then codification of financial reporting has continued and included the adoption of international financial reporting standards.

These days the debate is essentially around two things:

- the extent to which financial statements should simply be a discrete ‘end in itself’ rather than an expression of modern progressive public financial management
- how finance departments, under the constant strain that austerity measures bring, cope with the challenge of the demand for instant information and the use of more innovative means of financial management and accounts closedown.

1 Oxford University September 2015, as cited by the BBC ‘Probability of automation within 20 years’

2 *Regular as Clockwork,* Audit Commission and CIPFA, 1993 [out of print]

In a simplistic practical sense, prompt production does ease the problem of managing competing demands for scarce staff resources and historically it lessens the impact of old year work on the programming and performance of new year work. Prompt closure also means that key financial decisions can be taken earlier on the basis of known facts about the organisation's financial position.

Since *Regular as Clockwork* local government has continued to carry out more financial accounting work during the year, streamline reporting and bring forward their closedown timetables under more ambitious publication dates.

The common characteristic in the undoubted improvement tends to be more progressive statutory deadlines. However, a number of milestones have emerged which has made it imperative that all authorities review their arrangements for producing financial statements. For many, it meant substantial and urgent improvements in their performance.

These influences should not be underestimated. The introduction of the *Prudential Code for Capital Finance in Local Government* placed a greater premium on reliable and timely interim and final performance information and on the role of balance sheets.[3] The development of Whole of Government Accounts also meant that a new and demanding user of prompt financial statements would be HM Treasury. Together with the adoption of International Financial Reporting Standards these influences galvanised the drive towards local government financial statements ultimately being able to reflect a true and fair view – essentially the gold standard in financial reporting.

It is noteworthy that most practical developments in accounts closedown have revolved around the pace or speed of disclosure. Indeed any commentator could be forgiven for assuming that speed was the single crucial factor in this important process. While the local authorities of the past could focus upon speed in itself, for local authorities of the present and future, speed is a mere essential which, in the world of digital media, is the accepted norm. This means that any focus on improving prompt disclosure will merely get us to where we should have been, not to where we want to be.

In this document we examine the future. What will the future finance department need to do to adhere to the now expected speed of prompt financial reporting and to deliver good practice in terms of quality and efficiency? We examine how capacity can be added by considering how the finance department of the future might source its professional expertise.

3 *The Prudential Code for Capital Finance in Local Authorities,* CIPFA, 2011, www.cipfa.org

\ introduction

Austerity measures and changes in funding streams have led to organisations rethinking how and why they do things. The public sector faces increasing demand for transparency in the use of public funds and pressure to maintain levels of good financial management and effective planning are higher than ever.

The drive to submit audited accounts early is not new. In 1993, CIPFA, the Audit Commission and the Accounts Commission jointly published *Regular as Clockwork* which emphasised that "prompt, accurate and high quality public reporting is one of the main indicators of the proper stewardship of public funds". It urged authorities not to be complacent in prioritising the production of financial statements, providing a number of reasons why prompt production should be the norm rather than the exception.

Legislation and regulations set the dates for closure across the UK, with increasing pressure for the public sector to keep pace with a private sector able to complete in almost record time. The latest set of regulations, the Accounts and Audit regulations 2015, has ushered in a major area of change for local authorities. They require authorities in England and Wales to approve and publish their accounts by 31 July, bringing the current turnaround forward by a month.

Authorities are used to working within complex rules of reporting, monitoring, governance and scrutiny. Many have yet to start the critical process of planning and preparing to achieve the new deadlines being demanded of them.

All this in the shadow of the current funding climate which is putting increasing pressure on public sector organisations to continue delivering results within reduced resources. Finding a way to deliver signed off accounts early could save staff from endless hours reviewing previous spend and freeing them up to plan ahead.

what does good look like?

Local government financial reporting (like the public sector generally) has always sat uneasily against the perceived success of private companies in financial reporting. The experience of the private sector is revealing in that the (historic) targets for improvement in local government performance can be considered generous by comparison.

There are of course different incentives in the commercial world to prepare financial information for shareholders at the earliest opportunity. Companies and auditors expect to work at maximum efficiency to ensure that the financial statements are produced.

By the same token, large companies are substantially bigger than local authorities, with complex group structures spreading over national boundaries. Yet even the largest companies in the FTSE 100 achieve impressive results for completion of the accounts and audit process.

The private sector does it and it does it well and it would not be unreasonable to take that as a learning point and to understand more. But what are the benefits of the prompt closure of accounts? CIPFA has previously summarised these as being:

- the relevance of reliable financial information for users is greater the earlier it is available
- good governance requires assurance that weaknesses, errors or omissions in financial systems have been identified and corrected at the earliest opportunity
- improvements in financial procedures and systems necessary for earlier closure can have a much wider benefit for the administration of the authority
- the production of financial statements with an unqualified audit report provides everyone with assurance of good financial governance
- early compilation of the financial statements allows members and officers to concentrate on current year financial matters and future plans (with confidence that assumptions about brought forward resources are secure)
- early and effective publication of the statement of accounts can be promoted as a key indicator of good financial management by authorities that wish to improve their accounts production performance.

But while local authorities can look to the same benefits, the wider environment has changed. In an era of reduced resources and shrinking finance departments, the increasing demand for accountability (or stewardship) brings a tension with the ability to continue to provide that assurance.

The change in social trends such as availability of data under Freedom of Information requests and the corporate as well as personal use of social media means that there is an expectation that information will be available almost instantaneously.

> In an era of reduced resources and shrinking finance departments, the increasing demand for accountability (or stewardship) brings a tension with the ability to continue to provide that assurance.

Paradoxically, that demand is less likely to be met by the traditional finance department delivering what is a traditional service. The cost of reporting and providing assurance on stewardship is one that has largely been hidden or has been absorbed within the wider corporate costs of the local authority. Accounts closedown can cost as much as £500,000.

Those costs are based on the traditional method of delivery and the time is almost certainly right for local authorities to seek new more innovative and less expensive models of assurance and accountability.

However, doing it quickly is not necessarily the same as doing it right. The answer to what good looks like lies in a more in-depth assessment rather than simply following the private sector, good as it is.

Views have developed over time to recognise that achievement of speed in accounts preparation is a greater sum of the parts than simply preparing the accounts quicker. An understanding of other sectors assists us further in understanding the specific regulatory requirements and also in building a picture of what good actually looks like.

The private sector

The FTSE 100 companies achieve impressive results for completion of the accounts and audit process. Previous research identified that the average performance from accounts closedown to finalisation of audit opinion was 58 days. In some cases that was concluded within one month of the year end.

The essential factor behind the speed with which these companies produce their accounts is the intense market demand for their audited results. This in turn leads to a high internal profile for the closure process, which is not restricted to the finance department. The consequences of failure to meet deadlines are considered to be serious in terms of reputation.

The techniques that contribute to the success of private sector management at turning target deadlines into reality were found to include the following:

- thorough planning and timetabling of stages of the process, with stringent deadlines
- clear communication with everyone involved of what is needed and by when
- strict formats for the information to be submitted for consolidation into the final accounts

- management of holidays and time off of key staff
- viewing as a serious matter any failure by staff to deliver to deadlines
- robust financial management through the year – information is reported and followed up internally on a regular basis, meaning that the majority of issues have been resolved by the year-end quarterly closure and consolidation, accompanied by external reporting of interim results, eg balance sheets prepared quarterly for internal purposes and half-yearly for external publication
- closure of accounts payable and accounts receivable systems a couple of weeks prior to the year-end
- accruals made for all items outstanding after this date – regular monitoring means that staff are aware of what they need to accrue for.

Central government

The benefits of early closure for central government bodies have long been recognised. One government body identified the following keys to its success:

- Commitment at a high level – the audit committee and management are committed to the accounts closure process and competitive targets have been set. League tables are used to drive improvement, and training on roles and responsibilities is provided.
- Effective partnership with auditors – there are regular meetings to agree timetables and identify and resolve issues at an early date.
- In-year monitoring – the year-end is only a special sort of period end. Management accounts are produced nine days after each period end and great importance attached to meeting these deadlines.

As with NHS and private sector bodies, financial position is well monitored throughout the year, meaning that less work is needed at the year-end. Reconciliations and other regular control procedures are regarded as vital elements of ongoing financial management.

> "Research identified that the average performance from accounts closedown to finalisation of audit opinion in the private sector was 58 days."

The National Health Service

NHS bodies have historically worked to tighter closure deadlines than local authorities. The deadline for the submission of draft financial statements is in April for health bodies in England, Scotland and Wales.

Parliamentary reporting requirements place an urgency upon health bodies which results in summarised accounts for NHS health bodies in total. These are then laid before Parliament and published. The existence of these deadlines is a key factor in ensuring that accounts are prepared at a comparatively early date. Accounts are submitted to the audit committee and then approved by the board, so interest comes from the highest level.

Additionally there are a number of identifiable key features of the NHS closure process that aid efficiency:

- *Manual for Accounts* – health bodies are required by direction of the Secretary of State to meet the accounting requirements of a group accounting manual issued by the Department of Health each year. The Scottish Government Health and Social Care Directorate issues a separate, equivalent annual *Manual for Accounts.* In Northern Ireland the Department of Health, Social Services and Public Safety issues an Accounts Direction which includes relevant accounting and disclosure requirements and which must be followed. The manual is consulted on prior to release, updated throughout the closedown period with amendments, updates or further explanations provided in published frequently asked questions in response to ambiguities identified by practitioners. Bodies have little discretion as to how they make their disclosures, and must use the prescribed format. Each line of the statement of accounts is then supported by explanatory material, which gives guidance on what should be included. More complex areas of accounting are expanded on with examples in additional annexes.
- Staff training – training on the *Manual for Accounts* (particularly changes to it) is specifically provided.
- Management accounts – Health bodies have a statutory duty to break even each year. If a trust or NHS foundation trust records a deficit this is taken very seriously; NHS Improvement will get involved and a recovery plan will be drawn up and the trust will be monitored to ensure that it returns to a sustainable financial position. The consequences of failure are severe and the importance attached to avoiding such situations is correspondingly high. These consequences can include removal and replacement of individual board members/whole boards of finance teams and replacement board members imposed.
- Because of this, health bodies generally make use of detailed management accounts throughout the year. In order to have an accurate picture of their financial position, these are prepared on an accruals basis. It is common for health bodies to close down at period ends, raising journals for accruals, which are then reversed out in the following period.
- The obligation to break even obviously makes it vital that health bodies know exactly what their financial position is throughout the year and have a good. understanding of whether they are likely to overspend, in order to take remedial action at an appropriate point where necessary. However, the preparation of comprehensive management accounts and year-end projections, based on accruals, rather than cash accounting, is not only an aid to early closure, but also a major element of effective financial governance. Few local authorities currently apply such practices, but the incentive to do so is increasing, and there is little doubt of the potential benefits.

- Agreement of inter-NHS balances – all inter-NHS debtors and creditors and inter-group revenue and expenditure must be agreed between health bodies by mid-March. This follows agreement exercises for inter-NHS debtors and creditors at month six and at month nine which are designed to identify areas of difference at an early stage and to allow good time for resolution. Deadlines for notifying other health bodies of amounts owing and certifying these returns are set out at the front of the *Manual for Accounts*. These values are significant in terms of the overall balances.

Prompt production of the accounts is achievable provided that there is an awareness of the importance of the financial statements, a will to perform, effective planning, and a dedication from senior personnel to make the necessary resources available and to enforce critical deadlines. But the main and emerging characteristic is that a linkage to the financial year as a whole enables prompt production of year-end financial statements. This means that interim closedown, monthly or periodic accruals is an investment to enable prompt production to be one of the expressions of good public financial management.

“Prompt production of the accounts is achievable.”

the journey to prompt accounts closure

The brief look at the practice of other sectors enables us to review prompt closure as not simply an end in itself but that it is in fact part of a wider move to good practice financial reporting within a modern finance department. CIPFA's financial management reviews of more than 400 public bodies has enabled a wide assessment of the overriding messages and characteristics of the 'typical' public body.

Background to the reviews and the FM Model[4] methodology

Good financial management needs to work across the whole organisation and thus non-financial managers need to be as informed as the CFO and the CEO. However, the leadership team and the CFO should be prime drivers for making sure the financial goals are achived.

The critical success factor identified in every case of prompt production of accounts was the need for commitment at the highest levels of the authority. The best performing authorities have a drive for early closure that starts with senior management willing to stake their reputation and professional credibility, as well as civic and personal pride, on achieving an early and satisfactory result.

This commitment can be generated in reaction to both internal and external influences, but if the authority does not have it then it will be impossible to make plans with the necessary degree of assurance or to rely on the co-operation of everyone.

There are several different ways in which authority-wide commitment can be secured, some involving the use of carrots, others requiring a stick:

- Ensuring that members are fully briefed on their responsibility for the publication of the statement of accounts and appreciate the importance of their role.
- Working to generate a readership so that demand for prompt publication is maximised and job satisfaction is raised.
- Ensuring that the statement of accounts is on the agenda of the executive and the management team as a recurring item.
- Agreeing deliverables, setting target dates and monitoring achievement with chief officers.
- Being seen to react positively to the contributions of others and give them feedback.
- Securing reputational gains for the authority through the statement of accounts.

4 *CIPFA Financial Management Model,* CIPFA, www.cipfa.org/FMmodel

Engaging the readership

The incentive to produce the statement of accounts promptly will increase with the demand that exists for use of the information whilst it is at its freshest. Knowing that readers might be making good use of the accounts will also increase the job satisfaction of being involved in the production process.

Authorities have traditionally found it difficult to engage a readership for the statement of accounts, with a desire for information being satisfied more often by budget reports, simplified annual reports, best value plans/performance reports or other specific documents (eg reports to tenants).

The wider challenge is to engage a readership amongst the general public. Provided that the information in the accounts is recent enough to be relevant, details of financial performance and year-end balances could provide a solid basis for consultation about future plans. Again, this is best contemplated through the use of summary financial statements rather than the full statement of accounts, but the former cannot realistically be produced without the latter.

The more progressive authorities have managed not only to get the final accounts on the agenda but also to make a commitment to present interim financial statements on a quarterly or monthly basis. This increases the discipline required amongst the accounts preparers, provides a more sophisticated assessment of the authority's position than comparison of spend against the budget and raises financial awareness amongst senior officers.

No process will work well unless there is a clear target for completion and an adequately resourced framework for achieving it. The essential elements for successful management are:

- having clarity about the roles of those involved in the accounts production process
- securing effective strategic management
- appointing an appropriate officer to supervise the day-to-day management of the accounts production process
- being aware of the minimum statutory requirements for the accounts process and making sure that these are controlled before developing the authority's own enhanced qualitative and quantitative objectives
- devising a closedown plan and making arrangements to monitor progress and secure its achievement
- managing human resources to ensure that all participants are motivated to achieve the target
- ensuring that other resources will be sufficient, especially in relation to information technology
- setting the standards to which work needs to be performed and documented
- identifying the risks that might prevent achievement of the target and preparing a strategy to remove or manage the risk.

designing a new normal

There is no one answer or 'silver bullet' that will be appropriate for all organisations. Individual approaches, whilst having similar elements will have a different emphasis. Closedown is thus one part of the overall financial reporting continuum. The interrelationship between the speed/timing of production, the acceptable quality standard that the organisation wishes to achieve and the efficiency with which this is carried out will differ not least because of the respective cost restraints at different organisations.

The practicalities of a new normal will likely mean a complete re-engineering from the production of the accounts to supporting decision making. The consequences of this will be an optimisation of financial management and reporting processes.

But while the future is easy to describe for the shrinking finance department, the path towards the assurance to be gained is perhaps less easy to see. Yet the evidence that we have examined tells us that there are four critical areas which form the footprint for the new normal:

- Transition to periodic reporting. This is perhaps the process which will become the biggest challenge for local authorities yet the evidence is clear that the successful prompt closers, reposition some of the year-end heavy lifting to elsewhere during the financial year.
- A more automated year end process. This would also hasten the closedown process meaning that key decisions were taken to inform business rather than merely for financial reporting. This means that production of the financial statements will become an extension of the business of the year rather than an end in itself. Again this will represent a significant cultural shift for many finance professionals and indeed many organisations.
- A strategic management approach. The importance of accounts production is owned by the executive team.
- A service relationship with the auditor. The back-up information from accounts production is automatically assembled and presented as a matter of course.

For some local authorities this will be achievable. For many however, perhaps understandably, it will mean a fundamental rethink in terms of resource allocation and even in terms of culture. It could even mean that achieving this new normal is not achievable within current resources. A move to periodic reporting (even though periodic reports are already produced internally and for elected members) would mean moving from 'cash' basis to an accruals basis. It would also mean that the statement of accounts would be clearly (more understandably) linked to financial information reported in-year rather than being a separate exercise.

Realistically, for some local authorities it will now have to begin to think the unthinkable. That is firstly, that valuable internal resources will be ring fenced. Secondly it could mean that external capacity will have to be sought in the form of say a shared service. Increased technology could streamline the process to render much of the post 31 March effort obsolete. We await to see whether our finance leaders will demonstrate true leadership and be ready to take the difficult decisions which could transform their service.

CIPFA The Chartered Institute of Public Finance & Accountancy

EY Building a better working world

Registered office:
77 Mansell Street, London E1 8AN
T: +44 (0)20 7543 5600 F: +44 (0)20 7543 5700
www.cipfa.org

Registered office:
Ernst & Young LLP
1 More London Place, London SE1 2AF
T: + 44 (0)20 7951 2000 F: +44 (0)20 7951 1345

recycle

INVESTORS IN PEOPLE

10/2016