CIPFA The Chartered Institute of Public Finance & Accountancy

LASAAC

Local authority annual accounts

a strategic approach

CIPFA/LASAAC discussion paper

Over the last decade CIPFA/LASAAC has been proud to lead work on developing the Code of Practice for Local Authorities in the United Kingdom (the Code) based on International Financial Reporting Standards. Local authorities have made a success of adopting the Code and embedding it into their processes and procedures. But the context that financial reporting reflects is not static: it changes and evolves.

CIPFA/LASAAC's renewed vision for local government financial reporting aims to deliver accounts that clearly report authorities' financial performance and position. Currently:

- the length and complexity of accounts produced in accordance with the Code can make them impenetrable to many
- producing IFRS-based, code-compliant accounts is a time-consuming annual task, placing considerable strain on what are now leaner finance teams.

We wish to engage in a discussion about the future of local government financial reporting. This paper seeks to start a conversation on potential options. Most importantly it seeks to identify what considerations need to be addressed in determining the future for local government annual accounts.

Request for feedback

This paper provides each section as a 'stand alone' item, with suggested feedback questions, to enable and support delegation to individuals within an organisation where this is desired.

CIPFA/LASAAC would appreciate your comments on this paper, whether related to the suggested questions or any additional matters, by **4 November 2019.**

Please respond:

By post: The Secretary
CIPFA/LASAAC Local Authority Accounting Code Board
Policy and Technical Directorate
CIPFA
77 Mansell Street
London
E1 8AN

By email: cipfalasaac@cipfa.org

Contents

Foreword

The status quo is not an option.

The changing landscape and environment for UK local government, and in particular the post 2008 austerity requirements, mean that authorities are having to change how they achieve their objectives.

This is a reality that we are not in control of. We can however determine how we react to that reality.

For CIPFA/LASAAC the key area of attention is clearly on local government annual accounts. For authorities challenge arises in terms of the competing priorities for staff time required for the annual accounts, monitoring processes, budget planning, and long term transformation projects. External auditors are also facing pressures with a drive to demonstrate that the audit process is achieving value for money while also satisfying the expectations of regulators and governments.

In doing so however we cannot afford to underestimate or understate how important the annual accounts process is, most especially in an era of austerity. The annual accounts are literally a statement of how well we are looking after and maintaining public resources.

The professional discipline and culture needed to provide transparency, clarity and assurance regarding the management of those scarce public resources is critical. If there is no need for accountability, there is no need for an accountancy profession. We should not be shy about noting that the reverse also applies. Without a proper and professional financial reporting framework for local government, accountability for public resources will not be secured.

The primary challenge facing us is therefore one of balance.

How can we maximise the benefits of the annual accounts and audit process within the existing resource constraints?

CIPFA/LASAAC believes that the key to this is clarity, with the focus being squarely placed on the needs of the primary users of local government accounts.

This discussion paper starts to explore what that means in practice. The end shape and destination may only become clear as this discussion evolves. Since change is inevitable and unavoidable, we hope that you will take this opportunity to help shape that change and the future of local government annual accounts.

To return to our starting point: the status quo is not an option.

Lynn Pamment
Chair,[1] CIPFA/LASAAC

Disclaimer

CIPFA/LASAAC and CIPFA do not accept responsibility for the use of external websites (eg via hyperlinks). External website content hyperlinked, and any summary text in this e-mail, do not represent endorsement of any views or data presented.

1 Lynn Pamment is stepping down as Chair of CIPFA/LASAAC. Conrad Hall will be assuming the Chair.

Executive summary

Local government financial reporting needs to support the needs of the users of local government annual accounts. CIPFA/LASAAC's *vision statement* sets this as the key ambition and target for local government accounts. This should be undertaken with an awareness of the cost-benefit balance involved in the reporting process.

This discussion paper is intended to secure stakeholder dialogue and participation in achieving this objective. It seeks to explore the current position, particularly those areas where existing stakeholder comments indicate concerns that the desired objective is not being met. Some of the key considerations involved are outlined, and potential questions to promote and inform discussion between stakeholder groups are put forward.

The following provides an overview of the key issues for consideration and discussion:

Local Government Financial Reporting Framework	■ Governments have the authority for setting the financial reporting framework for local government ■ Governments currently support CIPFA/LASAAC's role in developing the Code of Practice on Local Authority Accounting ■ CIPFA/LASAAC works within a wider public sector framework, including reference to the Financial Reporting Advisory Board (FRAB) ■ FRAB will normally be concerned to ensure that local government financial reporting appropriately supports a wider view of public sector finances, particularly through Whole of Government Accounts (WGA)
Code Format and Structure	■ The structure and format of the Code needs to appropriately support all professional experts in supporting the achievement of clarity and focus in the annual accounts. ■ A fundamental review of the Code structure and format is proposed, with due consideration of practices and specifications in other standard setting environments ■ Initial feedback from preliminary discussions with a small number of stakeholders has been gathered ■ Wider professional stakeholder feedback is requested
Primary Users and Statutory Adjustments	■ Specification of the primary users of the annual accounts and their needs may assist with ensuring that clarity and focus is supported in the annual accounts ■ For local government this may potentially be stated to relate to a user's interest in an authority's accountability for public resources ■ Potentially a section or summary in the accounts providing specific information supporting this purpose would improve clarity and focus ■ The balance between Code adaptations or interpretations, to determine the impact on usable reserve balances, and reliance on statutory adjustments could be discussed subject to governments' views ■ The role of Narrative Reporting or the Management Commentary should be subject to specific consideration.
Primary Statements	■ The Comprehensive Income and Expenditure Statement (CIES), and particularly the Surplus or Deficit on Provision of Services (SDPS), could potentially be adapted to more clearly present the impact on taxpayer funds (usable reserves) for the year ■ The presentation and layout of the Balance Sheet, Movement In Reserves Statement and the Cash Flow Statement may also be considered in terms of primary user needs.

Capital	■ The information needs of different primary users relating to statutory charges for capital, historical cost and current value should be explicitly discussed. ■ Current value information can be considered to be relevant for longer term financial management, particularly for informing asset management planning ■ A key issue arising however is the degree of accuracy required for current value data in the annual accounts, given the requirements of the primary users are not considered to be those which would apply in the private sector ■ Potentially specification could seek to support an appropriate degree of estimation for annual accounts purposes which better reflects the costs and benefits arising from current value information provision ■ Implications for Whole of Government Accounts (WGA) and group accounts would require identification ■ The alignment of depreciation charges and statutory charges for capital assets could be sought. The replacement of depreciation by statutory charges, or the cessation of statutory charges and reliance on depreciation, would require governments' support and may be a complex undertaking.
Pensions	■ The need of different primary users for information on pension liabilities should be discussed. ■ Discussion could be initiated regarding whether reliance could be placed for WGA purposes on data in individual pension fund (eg LGPS) accounts. ■ The requirements of regulatory bodies, such as The Pensions Regulator, and the WGA implications would require further discussion. ■ The statutory adjustments framework may not normally apply for group entities. ■ In the event that measurement of pension liabilities reflects funding valuations, consideration of any mechanism to reflect annual changes in liabilities between formal funding valuations will be required.
Financial Instruments	■ The information needs of different primary users regarding financial instruments should be assessed. ■ A particular focus is likely to be required in relation to complex instruments and those involving more significant risks ■ Potentially specification to support more proportionate requirements for 'basic' instruments might be considered ■ This however would place more emphasis and reliance on appropriate professional judgement at an entity level, and on each entity's governance arrangements for financial instruments. ■ Safeguards to ensure that complex instruments and significant risks are properly presented would be required. ■ The potential to disapply 'fair value' requirements for some instruments could be discussed, however this would require clarity and unambiguous specification as to which instruments it may be relevant for.

Group Accounts	■ The role of group accounts presentation for the purposes of different primary users would benefit from discussion. ■ The focus on the authority's (single entity) General Fund in the authority budget setting process may be regarded as affecting the perceived relevance of group accounts. ■ A wider discussion on the nature of group arrangements, and their impact on the financial management of public resources, would help to inform the consideration of financial reporting requirements.

Introduction

CIPFA/LASAAC vision and strategic plan

With interests in streamlining, transparency and assurance being a key focus for stakeholders, CIPFA/LASAAC has determined a *Vision Statement* for the future of local government annual accounts which states:

"UK local authority annual accounts should be widely recognised as an exemplar for clear reporting of the financial performance and position of complex public sector bodies. Users of accounts should be able to access the information they want to help them to understand the finances of an authority and to take practical and informed decisions."

A *Strategic Implementation Plan* (April 2019) has been developed to support this, and this discussion paper is a core element of that plan, to secure stakeholder engagement and feedback. This paper has been partially informed by early initial responses to a stakeholder survey issued by CIPFA/LASAAC. Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey, or wish to provide further considerations responses or comments following the discussion points raised would be helpful and greatly appreciated.

This paper should also be considered in parallel with, the Code 2020/21 Invitation to Comment (closed 27 September) and a discussion paper on differential reporting. Feedback to all of these will also inform a future review on Narrative Reporting in local government annual accounts.

For English local government, this initiative is of course parallel and complementary to the Redmond Review into local authority financial reporting and external audit in England. The review findings are of course expected to comment on the arrangements in place to support the transparency and quality of local authority financial reporting and external audit for English local government. CIPFA/LASAAC are supportive of the review and will consider the impact of the review's findings.

Code Strategy Implementation Discussion

This paper seeks to continue a discussion initiated in CIPFA/LASAAC's stakeholder survey regarding the requirements for local government accounts, particularly in respect of identifying users, focusing on their needs, presenting information and addressing issues relating to specific topics.

This open discussion does not, at this stage seek to identify set proposals, but rather to explore what considerations should be taken into account in developing firmer proposals for consultation purposes. This discussion paper will therefore provide the foundations for implementing practical and achievable changes.

Feedback on the discussion areas, and any other areas of comments that stakeholders may have is warmly welcomed. **Responses are requested by Monday 4 November 2019.**

Structure of Sections

Each section for feedback will seek to explain the financial reporting objective, current concerns being expressed, some of the considerations and potential options that stakeholders may wish to comment on; and some discussion questions to provide a basis for feedback. Any additional comments from stakeholders are more than welcome.

The local government financial reporting framework

CIPFA/LASAAC role

The authority for specifying local government financial reporting requirements rests with:

"… the Secretary of State for Housing, Communities and Local Government, the Welsh Assembly Government, the Scottish Ministers, and the Department for Communities, Northern Ireland.."[2]

To date governments have supported CIPFA/LASAAC's role and responsibility in developing financial reporting requirements for local government through regulation and the expectation of adherence to the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). CIPFA/LASAAC develops the Code under the terms of the Memorandum of Understanding with governments and relevant authorities; and the remit of the Financial Reporting Advisory Board (FRAB).

For CIPFA/LASAAC and its stakeholders the focus of discussion then becomes how to best use the judgement and flexibility that can be applied, within the public sector framework and the expectations of governments, to ensure that the Code's requirements are suitable for local government.

The objectives of public sector accounting requirements

The current requirements are based on IFRS accounting standards.[3] Amendments for public sector and local government application can involve interpretation, where specific IFRS options are required to be applied, or adaptation for more significant departures.

For either of these actions to be considered, a clear case as to why this is required for local government circumstances is expected. Where an adaptation or interpretation is suggested which is specific to local government, and would not apply to the wider public sector, FRAB will seek specific supporting evidence for the difference. A key focus for FRAB and the relevant authorities will normally be the impact on being able to provide financial information on a whole public sector' basis particularly through the Whole of Government Accounts (WGA).

2 Per the Financial Reporting Advisory Board (FRAB) Terms of Reference (May 2019) paragraph 1.3

3 As developed by the IASB. This is specified in the 'Memorandum of Understanding' signed with the constituent bodies of the Financial Reporting Advisory Board (FRAB) which states "Financial reporting guidance for the public sector is based on EU-adopted International Financial Reporting Standards (IFRS), adapted as necessary for the public sector context."

The 2017/18 WGA states[4] "Having a picture of long term liabilities helps inform more effective management of fiscal risks. WGA is independently audited, providing assurance that the figures are prepared in line with International Financial Reporting Standards, as interpreted for the public sector context."

This highlights key objectives for FRAB, and governments', consideration as:

- To ensure that the financial reporting provides a transparent and wider view of public resources, not solely based on in-year taxation, cash flows and borrowing requirements; and
- To ensure that the information is appropriately audited and verified

If the above are not sufficiently achieved through annual accounts requirements potentially local government additional data, may need to be provided by local government for WGA purposes and subject to specific audit arrangements.

A further consideration is the extent to which the accounting requirements support accountability, transparency and governance. Compliance with the accounting standards will normally require an entity to have information and evidence regarding its assets, rights and obligations; to make estimates of future cash flows; and to provide transparency regarding these. It may be considered to be important that the requirements for local government appropriately support these, with a recognition of the resource implications that arise in doing so.

Code format and structure

Objective

To support clarity for the primary users, it is critical that the Code itself is effective for those who are involved, in any role, in the preparation and assurance of local government annual accounts

CIPFA/LASAAC's strategic plan for achievement of its vision statement proposes a fundamental review to ensure that the Code's requirements are clearly provided to, and understood by, its readers.

Current concerns

Initial limited stakeholder discussions, including a focus group, has provided the following feedback:

- Practitioners indicated they will normally and primarily refer to guidance notes rather than the Code.
- If uncertainty arises the Code may be referenced, however this may often require further direct reference to the underlying standard or relevant legislation
- Extensive Code detail in respect of IFRS application may be less relevant where guidance is available. Alternatively however it was also noted that the Code detail of IFRS requirements was helpful in providing a clear overview of requirements rather than requiring continual recourse to IFRS standards
- The focus group clearly expressed the view that more focus could be placed on the adaptation and interpretation in the development of the Code (eg especially in relation to disclosures)
- The existing consultation process was noted as being insufficient in itself to ensure engagement with stakeholders, especially in highlighting key issues and potential impacts in any proposals
- It was suggested that the Code could clarify the respective roles and responsibilities of preparers and auditors

4 See page 4 of the 21017/18 Whole of Government Accounts

Considerations

Review of practices

As part of considering changes to the Code format and structure, a review of practices in other accounting standard setting arrangements is planned, including:

- The central government Financial Reporting Manual (FReM, HM Treasury)
- The FRC Financial Reporting Framework (UK GAAP – FRS 101, FRS 102, etc)
- Existing UK SORPs such as:
  - Further and Higher Education SORP (Universities UK/ BUFDG)
  - Charities SORP (Charities SORP Committee)
  - Financial Reports of Pension Schemes – SORP (PRAG)
  - Accounting by Limited Liability Partnerships – SORP (CCAB)
  - Housing SORP (Social Housing Providers) – (Housing SMB)

Professional expert feedback

Suggested discussion questions:

Feedback has already been requested through CIPFA/LASAAC's stakeholder survey. Where stakeholders did not provide comments in the survey or wish to provide further considerations, responses to all or some of the following questions would be helpful and greatly appreciated.

Code format and structure

- How usable and helpful is the current Code format and structure? If it is not, why is this? What format or structural issues in the Code make it less usable?
- Does the language and phrasing in the Code help in appropriately and clearly conveying the financial reporting requirements?
- Is the detailed text provided in the Code for IFRS standards (where expected to be generally applicable in local government) of assistance?
- Are cross references to other standards (for example IPSASs), and the Code requirements arising, clearly communicated?
- Are adaptations and interpretations of standards affecting application for UK local government clearly identified?
- Are the current book or pdf format options provided helpful to preparers and auditors? Are there improvements or alternative publication formats that would be helpful?
- Do preparers and auditors commonly agree on an understanding of what the Code specifications are, or do instances of ambiguity in the Code frequently arise?
- Are the requirements for disclosures appropriately and clearly specified in the Code?
- Is the Code structure appropriate and is the coverage (eg amount and detail) of each chapter or appendix helpful?

SECTION 1:

Primary users and statutory adjustments

Objectives

The objective of the annual accounts is to provide information that is "useful to a wide range of users for assessing the stewardship of the authority's management and for making economic decisions."[5] Primary users are identified as service recipients and their representatives and resource providers and their representatives. This includes elected members.[6]

A distinguishing and unique feature of local government is the statutory framework which directly affects the financial management of local government bodies. Where statutory requirements amend what is chargeable to the general fund or taxpayer funding, local government annual accounts currently seek to identify and explain this.[7]

Current concerns

At present the ability of the annual accounts to provide appropriately focused information for readers such as local residents, the electorate and those responsible for governance has been questioned.

Considerations

CIPFA/LASAAC suggests that critical improvements are required in respect of:

- Identifying the primary users of the accounts; and
- Clearly presenting information regarding statutory adjustments and taxpayer funding

Primary users

CIPFA/LASAAC is of the view that what differentiates local government accounts from other sectors is the need to demonstrate accountability for the care and use of public resources within the legal framework.

Arguably however the focus on primary users, as identified above, is currently not fully maintained or achieved in local government accounts. In particular it is not always clear to what extent information provision, especially materiality assessment, appropriately considers the needs of primary users.

Consideration could therefore be given, in the Code, to more explicitly identifying primary users as those, including councillors, who have an interest in local government's accountability for public resources. This would clearly recognise and support the stewardship role of councillors in administering public resources, on behalf of current and future taxpayers and service users.

5 The Code of Practice on Local Authority Accounting in the UK 2019/20 (the Code) paragraph 2.1.2.1. See also the Code Section 1.8 regarding the purpose of the accounts.

6 See The Code of Practice on Local Authority Accounting in the UK 2019/20 (the Code) paragraph 2.1.2.6

7 The Code paragraph 1.2.6 which indicates the Code "sets out the transactions required to adjust the accounting requirements under IFRS as adopted by this Code to arrive at the amounts chargeable to the general fund. This includes the presentation of those statutory requirements. The impact of the statutory reporting requirements is presented in the movement in reserves statement."

The Code requirements could then more frequently and explicitly refer to, and structure the provision of information for, such primary users. The Code could also include a specific requirement to assess relevance and faithful representation,[8] including materiality, based on the needs of such primary users.

This approach however needs to be balanced with acknowledgement that other user groups exist. Lenders, credit rating agencies, unions, researchers and others may also have information requirements. A specific example may include Local Government Pension Scheme fund accounts where scheme members will be concerned with the management of their funds.

Potentially the Code could require the provision of additional information for other significant user groups, with the condition that this should not obscure the information for the primary users.[9] A requirement to disclose the judgements made regarding the relevant user groups, and their needs, may be appropriate.

A clearer focus on the specific needs of users of public sector accounts is also supported in central government reporting reviews and proposals.[10,11] In particular the purposes of central government financial reporting have been proposed as[12], in summary:

- Elected representatives' control of, and government accountability for, spending.
- Stakeholders understanding and consideration of the value for money offered by public spending.
- Provision of a credible and accurate record which can be relied upon.
- Provision to Ministers and employed managers with the information that they require to run Departments and agencies efficiently and effectively.

Statutory adjustments and taxpayer funding

The management of taxation funding by local government entities may be considered to be a key focus for primary users. Locally, most residents will presumably be interested in accountability for council tax and the level of charge set. Other stakeholders, such as governments, will be interested in authorities' use of government grants, and the application of the statutory framework which applies to local government financial management.

This suggests that primary users could have a need for clear information concerning the receipt and application of taxation funding. While the current reporting requirements seek to achieve this, identification of improvements is sought.

This may potentially be part of a more comprehensive discussion on the role, applicability and appropriateness of the statutory framework. This could include consideration of whether Code adaptations and interpretations are appropriate alternatives to statutory adjustments in some instances.

In relation to the existing or any future statutory framework, for primary users a specific section of the financial statements, anticipated to be subject to audit, could be developed relating to taxpayer funding.[13]

---

8 These are the 'fundamental qualitative characteristics' of financial information as expressed in the IASB's *Conceptual Framework for Financial Reporting* (paragraphs 2.4-2.22).

9 This would be consistent with the IASB's *Conceptual Framework for Financial Reporting* para 1.8 which includes "Individual primary users have different, and possibly conflicting, information needs and desires." and "…focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users."

10 Accounting for Democracy (House of Commons, PACAC, 2017). See paragraphs 17 "….Annual Reports and Accounts must be clearly presented so that non-accountants can read and make use of them." and 24 "We believe Accounts would be better used if they were prepared more often with the ultimate readers in mind, for example commentators on public policy, peers and MPs and their researchers."

11 The Government Financial Reporting Review (HM Treasury, 2019) See paragraph 3.6 "The International Financial Reporting Standards framework states that the needs of the primary user of a report always takes precedent. Parliament is the primary user of government financial reporting……" "….those preparing reports should seek to meet all the user needs that they are aware of, but if there is a conflict the needs of Parliament must come first."

12 The Government Financial Reporting Review (HM Treasury, 2019) See paragraph 3.

13 In principle some comparison could be drawn with the central government FReM 2019/20 Section 3.2 requirement for a Statement of Parliamentary Supply. The form of that statement is not directly applicable for local government, but the principle of providing a clear statement of the accountability for public resources may be regarded as similar.

This could support easier navigation for accounts users; a focus on accountability for public resources; commonality of data used for narrative reporting purposes; and enable such sections or statements to be presented (with minimal additional work) as separate publications (eg on-line webpage, leaflet etc) for primary users.

The form and content of any such section could be informed by more detailed debate and also feedback from the stakeholder survey being conducted. An important consideration will be the applicability of the audit process to any information included. Views on possible content are sought, with possible examples including:

- taxpayer funds used to provide services in the reporting year
- sources of taxpayer funds which supported services provided in the reporting year
- commitments of future taxpayer funding streams arising from statutory adjustments
- the stewardship of taxpayer funds under the statutory adjustment framework
- financial risks related to the commitment of future taxpayer funding arising from statutory mitigation arrangements.

The interaction of any such section or statement with the narrative report or management commentary is clearly of critical importance. CIPFA/LASAAC plans to review this as a later piece of work. Early consideration could however be given to the balance between the narrative report/management commentary and a specific statement or section on taxpayer resources.

Additionally the presentation of other statements could be amended to more specifically reflect the taxpayer funding provided and applied during the year. This is considered in a later section.

Suggested discussion questions:

Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey or wish to provide further views, responses or comments following the discussion points raised would be helpful and greatly appreciated.

Primary users

- Do you agree with the principle that local government annual accounts should principally focus on accountability for public resources?
- Do you agree with the potential for more explicitly specifying primary users in the Code of Practice to support more focused reporting?
- Do you agree with the potential requirement for other users' needs to be considered, with the provision that this should not decrease the clarity of the accounts for primary users?

Statutory adjustments and taxpayer funding

- Do you consider that those users interested in public accountability for taxpayer resources would benefit from a specific section or summary in the annual accounts for key items, particularly regarding taxpayer funding?
- If so, what would you suggest is included in such a section or summary?
- Would the provision of such information be onerous or fail to achieve a suitable cost/ benefit balance?
- Should more reliance be placed on Code adaptations and interpretations, rather than statutory adjustments?

Role of the narrative report/management commentary

- If a specific section or summary is included on accountability for taxpayer resources, how would this affect the narrative report/management commentary?
- Could a clear distinction or specification be achieved which provides clarity to users regarding the respective role and content of the narrative report/management commentary as opposed to a section on accountability for public resources?

SECTION 2:

The primary statements

Objectives

The objective of the annual accounts is to provide information on income, expenditure, assets, liabilities, reserves and cash flows.[14] The primary statements form the main means of doing so, with the level of detail open to some discretion on the part of authorities. The primary financial statements are:

- comprehensive income and expenditure statement
- movement in reserves statement
- balance sheet
- cash flow statement

Disclosure notes provide further details supporting the primary statements.

Current concerns

CIPFA/LASAAC wishes to ensure that the presentation and layout of the primary statements are appropriate for the primary users.

Aspects relating to the recognition and measurement of items, such as capital and pensions obligations, follow in later sections.

Considerations

Comprehensive Income and Expenditure Statement (CIES)

Arguably the presentation of the CIES has been a significant challenge for users of the accounts, since the figures in the CIES are based on accounting standards rather than on what is actually chargeable against taxation funding under the legislative frameworks.

The Expenditure and Funding Analysis was developed to address this and provide a link between the accounting and taxation funding position. Some, but not all, stakeholders have queried the success of this approach for primary users.

If the key point of principle is that the CIES should reflect, in a clearly recognisable way, the expenditure supported by taxation then the adaptation of normal accounting presentation requirements may arguably be open to consideration.

One potential approach would be to split the Surplus or Deficit on Provision of Services (SDPS) section between Statutory Cost, to clearly show the expenditure charged to taxpayer funds, and the adjustments made to reach an accounting standards based indication of expenditure incurred. Possible examples of presentation are illustrated in Appendix A.

In the event that this possibility is explored in more detail, specific consideration of the appropriate presentation of group activities will be required, with a key focus on the needs of primary users in this respect.

14 The Code of Practice on Local Authority Accounting in the UK 2019/20 (the Code) paragraph 2.1.2.1.

A further potential question for the CIES is whether a 'segment' or service analysis is required. In particular if a segment analysis is provided in a separate section related to taxpayer funds, arguably there may be little additional benefit in presenting a segment analysis in the CIES. This could allow an analysis based on type, rather than purpose, of expenditure (eg by employee costs, property costs etc). Such an approach would generally be consistent with the Whole of Government Accounts.[15]

Balance Sheet, Movement in Reserves Statement (MiRS) and Cash Flow Statement

Balance Sheet

As noted earlier it is considered that the annual accounts should support accountability for public resources. While the previous section focused on taxation funding in this respect, public resources also encompasses assets such as buildings, land, transport infrastructure, legal rights and investments. Notably public resources would also include authority controlled assets used for commercial purposes, as well as any increase in assets generated from those services. It is therefore considered important that the financial statements appropriately present information on these, and obligations which will affect them, for the primary users.

Movement in Reserves Statement (MiRS)

The Movement in Reserves Statement provides a reconciliation of how reserve balances have changed in the period. The potential implementation of a specific section on taxpayer funding may affect the relevance and usefulness of the MiRS for primary users.

In particular fully understanding the MiRS generally requires that readers are aware of, and understand, the basis of local government reserves. For example the restrictions on the use of a Capital Receipts Reserve (or Capital Fund) is clearly a major consideration in understanding the movements in the year, and what they mean for an authority.

Cash Flow Statement

For all organisations cash flow is an important consideration. The factors which affect cash flow, including their volatility and uncertainty, can differ. Generally for local government, especially for those with revenues which predominantly rely on tax raising powers and/or receipt of government grants, cash flow management may not normally constitute a major risk.

The degree of risk may be a relevant consideration affecting the need of primary users for this information. Some users however, such as lenders, may have a stronger and clearer requirement for cash flow information.

Comments on the extent to which balance sheet, movement in reserves and cash flow statement presentation requirements support the needs of users in relation to accountability for public resources is welcome.

15 See the Whole of Government Accounts 2017-18 page 95

Suggested discussion questions:

Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey or wish to provide further views, responses or comments following the discussion points raised would be helpful and greatly appreciated.

Comprehensive income and expenditure statement (CIES)

- Does the CIES layout and presentation currently meet the needs of primary users?
- Does the current provision of the Expenditure and Funding Analysis, to complement the CIES, appropriately address the needs of the primary users?
- If not what suggestions or options should be explored to better meet those needs?
- If segment or service expenditure information is provided elsewhere, would a CIES analysis by type of expenditure, not purpose, be preferred?

Balance sheet, movement in reserves statement (MiRS) and cash flow statement

- What improvements to the Balance Sheet, MiRS and Cash Flow Statement layout and presentation could be made to assist the primary users?

SECTION 3:

Capital

Objectives

The objective of the accounting standards requirements for property, plant and equipment in particular is to reflect an authority's investment in assets used for service provision or administration.[16] In relation to providing information on the maintenance and consumption of capital assets the IFRS framework[17] identifies two concepts for this purpose:

- financial capital maintenance: concerned with the recognition of what an asset cost to procure, and the manner in which the 'historical cost' of an asset is consumed or used.

or

- physical capital maintenance: concerned with the operating capability of the entity and the manner in which the 'current cost' of an asset has changed during the year. For example by measuring the use or consumption of the asset in 'current cost' terms rather than in terms of what was originally paid for the asset.

16 IFRS 16 Property, Plant and Equipment paragraphs 1 indicates the objective is "so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment." The definition of property plant and equipment is given in paragraph 6.

17 In this respect see the IASB's *Conceptual Framework for Financial Reporting.* This is discussed in paragraphs 8.1-8.10. Paragraph 8.2 states "a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used."

The choice of which concept applies for a particular asset group determines their balance sheet measurement basis, and the calculation of depreciation for the year.

For the private sector historical cost depreciation is often, but not always, used as the primary concept applied.

Current concerns

Stakeholder comments have been noted that the information on capital assets, and the format it is provided in, for local government do not currently provide clarity for primary users.

The mixture of 'historical cost' and 'current cost' measurement of capital assets on the balance sheet, and for depreciation purposes, has been noted as challenging to explain to users of the accounts, such as members. In particular it can be difficult to assess the relative capital budget needs for different assets, when the consumption of assets is measured differently. For example depreciation of roads is based on historical cost while schools' depreciation is normally based on 'current value'. This fails to provide a clear comparison of the consumption, and by implication the need for maintenance, of different asset groups.

At present for capital assets the financial statements provide a variety of information relating to:

- *Historical cost.* As noted historical cost information generally reflects how much it cost the authority to procure the services of an asset.
- *Current value or fair value.* Current value is often measured as 'existing use value' for the public sector. This normally provides an indication of the cost of replacing the remaining service life of the asset if the authority was deprived of the asset, on the basis that service provision will continue. Where used, fair value generally reflects market value.
- *Statutory charges for the funding of assets.* Examples include capital receipts applied, statutory charges for the repayment of debt/MRP, grants applied. The statutory funding information relates to the manner in which taxpayer funds are used to pay for an asset.

Concern has also been raised over the cost-benefit balance of the current arrangements[18], especially in relation to the requirement for some assets to be carried at valuation

Considerations

Primary user needs

A key question that arises is whether primary users need all of the three forms of information noted above. Not all primary users may have the same requirements, for instance the electorate may be directly concerned with the use of taxpayer funds, whereas governments and councillors may also be interested in the current value of assets. These reflect the different concepts of capital maintenance in the IASB's Conceptual Framework for Financial Reporting.[19]

18 In this respect see the IASB's *Conceptual Framework for Financial Reporting* paras 2.39-2.43, especially 2.43 which includes (emphasis added) "That does not mean that assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, **different ways of raising capital (publicly or privately), different users' needs or other factors.**" Pragmatic implementation decisions in IFRS may be taken to include the IFRS 9 *Financial Instruments* use of a '12 month expected credit loss' approach and the IFRS 16 *Leases* differential lessee / lessor requirements. These would both appear to indicate pragmatic implementation considerations rather than a pure 'application of principle' approach.

19 See the IASB's *Conceptual Framework for Financial Reporting* 'concepts of capital maintenance..' paras 8.3-8.10 which differentiate between financial capital maintenance (generally whether the purchasing power of the entity has increased or decreased) and physical capital maintenance (generally whether the physical ability of the entity to provide services or produce goods has increased or decreased). See also 6.23-6.42 which discuss the use of different measurement bases.

Current value

In terms of current value, a key factor is how clearly the information is readily understood by primary users. An example is whether the valuation of HRA dwellings using an Existing Use Value – Social Housing is readily understood. Also does the provision of a 'Total Property, Plant and Equipment' figure provide relevant information given that it includes a mix of approaches, including depreciated historical cost and current value?

A further consideration is the cost of valuation and the maintenance of the detailed accounting information required. This is highlighted during the external audit process as current value figures are often significant balance sheet items, affecting quantitative materiality assessment and tolerance for errors.

It should however be noted that asset management planning is regarded as a core and critical element of public sector governance. It also reflects the proper care (eg maintenance) and risk management (eg insurance) of public resources. Good practice in public sector asset management indicates that information on current or market value, and current condition, is necessary for this process.[20] Current value in the annual accounts therefore supports asset management practices and crucially, ensures that information relating to this is provided for primary users, including those charged with governance, in the audited annual accounts.

This contrasts with the use of depreciated historical cost, where there is relatively less resource input; less detailed accounting information required; generally a lower comparable impact on materiality assessment; and key areas of review will relate to impairment and depreciation arrangements.

The emphasis often given in other sectors to the importance of accuracy in reporting asset values is arguably less applicable to local government bodies (although it may apply for subsidiaries and associates). In particular legislation typically specifies that local authority borrowing cannot be secured upon its assets.[21] Therefore the relevance and role of precise market based valuation of assets for lenders, and other creditors, in local government accounts may be challenged.[22]

A move towards only historical cost could however be anticipated to lead to significant challenges for Whole of Government Accounts purposes, and potentially a dual reporting requirement for local government over and above the information provided in the annual accounts.

From the above a key question is whether the current focus and requirements are appropriate for local government. A move towards historical cost may not meet all primary user needs and could be challenging.

Alternatively a change in focus and direction relating to the application of current value could be sought. In particular the level of accuracy, and costs therefore incurred, could possibly be more appropriately balanced. Adaptations could be explored to potentially involve specification that:

- Current value information is provided to meet primary user needs, not for the purposes of valuing a local authority nor for an assessment of the security available to lenders
- Primary users would be considered to include governments (including Whole of Government Accounts), elected representatives, local residents and service recipients.

---

20 See 'Public Sector property asset management Guidelines 2nd Edition' (RICS, 2012). In particular Section 3.2 (page 21) includes "The 'ground level' starting point is an understanding of the make-up of the present portfolio of property assets, their suitability for purpose, condition, cost of restoration to full repair, market value, flexibility of use, utilisation levels, user and customer satisfaction and remaining life."

21 For England and Wales see Local Government Act 2003 section 13; for Northern Ireland see Local Government Finance Act (Northern Ireland) 2011 section 24; and for Scotland The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 [SSI 2016/123] section 7.

22 The IASB's *Conceptual Framework for Financial Reporting* para 1.7 states (bold added for emphasis) "General purpose financial reports are not designed to show the value of a reporting entity; **but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity"**

- Relevance and faithful representation, including materiality, judgements should be based on primary user needs, principally to demonstrate the stewardship and care of public assets.
- Presentation and disclosures should support demonstration, in financial reporting terms, of the application of asset management planning by the authority. This may affect the disclosures considered appropriate.

The above would not necessarily apply for some assets such as surplus assets, assets held for sale and investment property where the focus for primary users will normally be on the market value of the asset. Additionally the primary user needs in respect of information on group entity assets would need to be clarified, particularly since group entities may be holding assets for a variety of different reasons, some of which may be crucial to ongoing service delivery.

Depreciation

Following from the discussion above the implications for the CIES of changes in asset measurement bases should also be considered.

The potential to replace the historical cost element of depreciation charges with the statutory repayment of debt has been raised. Potentially, for some primary users, this may provide more relevant and meaningful information regarding how asset charges affect service delivery capacity and decisions; and more support direct and easier accounts preparation.

It may also be observed that historical cost depreciation, in the private sector, generally has the effect of ensuring that income is set aside to cover the consumption of assets, before distributable (usable) reserves are determined. The statutory frameworks do not generally require this at present, except for the English HRA.[23]

Challenges that may however arise include:

- Loss of information on asset consumption, especially for assets carried at historical cost. This also may be particularly relevant for assets funded from capital receipts, capital grants or current revenue.
- For assets which may still be carried at current value, the revaluation reserve would be affected but potentially the overall current value depreciation charge in the CIES would be unchanged.
- A potential impact on asset management planning practices
- A potential requirement to provide WGA depreciation estimates as adjustment data
- Audit process requirements relating to the review of statutory charges
- Comparability of costs of services between authorities may be questioned

An alternative approach could be to seek governments' support to move towards a situation where statutory charges are replaced by, or equivalent to, depreciation charges. This has been undertaken for Housing Revenue Account balances in England.[24]

This would of course require significant stakeholder engagement, governments' support and careful transition arrangements. A particular consideration would also be the impact on council tax, especially when contrasted to the 'ring-fenced' nature of the HRA whereby service users are directly charged for service provision rather than through taxation.

23 See The Item 8 Credit and Item 8 Debit (General) Determination from April 2017 (Item 8 Determination). Note that impairments may be reversed under the statutory requirements.

24

Suggested discussion questions:

Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey or wish to provide further views, responses or comments following the discussion points raised would be helpful and greatly appreciated.

Primary user needs

- What is your assessment of primary user information needs related to capital assets, especially in terms of the relative importance of statutory charges, historical cost and current value?

Current value

- Do any primary users need current value information on assets, and if so what is this information used for?
- Do other users need current value information and if so, what is it used for?
- What would be the practical impact of moving towards a 'historical cost' basis for all 'used in service' assets, particularly regarding the cost-benefit balance of information provision and WGA requirements?
- Would an improved focus on primary users' needs, through adaptation, improve the cost-benefit balance of current value information?

Depreciation

- Is the currently historical cost depreciation information relevant for primary users, and if so what is it used for?
- Could historical cost depreciation be replaced by the statutory funding charges?
- Alternatively, should consideration be given to moving towards a situation where depreciation charges replace statutory charges?

Section 4:
Pensions

Objectives

The objective of the accounting standards requirements for pensions is to ensure that the estimated cost of providing retirement benefits is recognised as they are earned by employees. This means that estimated future funding obligations for pensions are recognised on the balance sheet. It also means an estimate of current service costs, to indicate what the actual cost to an authority may eventually be, is presented in the CIES.[25]

25 This is a summary of IAS 19 *Employee Benefits* paragraph 1, which provides a more technical specification of this relating to the recognition of employee benefit obligations as they are earned, and the use of the services as they are consumed by the entity.

Current concerns

A number of concerns have been noted in relation to the measurement of pension liabilities, particularly defined benefit plans, under the requirements of IAS 19 Employee Benefits. These include:

- The volatility, variability and estimation tolerance of pension liabilities, and therefore also employee remuneration to the balance sheet date, have been raised as areas for concern in relation to the requirements of IAS 19. This has been highlighted during the external audit process, for instance in relation to the impact of pension plan asset valuation changes and, more recently, the rulings related to discrimination arising from changes to public sector pension schemes.
- The difference in assumptions, particularly in the discount rate used, for the estimation of IAS 19 based liabilities compared to those used for the triennial (to be quadrennial) funding valuations has been noted. In particular it has been commented that this means that the estimates presented are not usually directly related to, and do not represent, what the actual cost to an authority will be.
- The cost-benefit balance of providing the estimates annually, given the challenges above, taking into consideration the statutory arrangements which negate the impact on taxpayer funds has been queried. Since pension funding arrangements are managed on a different timescale to the private sector, with adjustments normally made to employer and/or employee contributions in line with the formal funding valuation cycle, the cost-benefit balance may be different to that for the private sector.

Considerations

Primary user needs

For the private sector the estimated cost of pension benefits earned up to the balance sheet date would normally mean income is required in the year, or in the future, to cover the estimated cost of pension remuneration earned by employees. The estimated cost of benefits directly affects distributable reserves but may be volatile from year to year.

The application of IAS 19 *Employee Benefits* in the private sector may be noted to have resulted in specific management of pensions liabilities, often through movement to defined contribution plans.

A key consideration is the information on pension remuneration which primary users, including governments and elected representatives, need. Potentially The Pensions Regulator (TPR) and relevant public sector Scheme Advisory Boards could also be regarded as primary users, in fulfilling their role. Other users, such as employees and unions, are also possible users of pensions information in the annual accounts.

A further consideration is the timeframe which primary users are considered to be interested in. If the focus is solely on the level of taxpayer funds required in the current, and forthcoming year, the main information sought will be employer contribution levels for those years. If however there is interest in the longer term, then in principle, some estimation of the pensions earned and the liability arising would presumably be desired.

Additionally it should be noted that typically the statutory adjustments framework will not apply to group entities, which may mean that their IAS 19 based estimates have a direct impact on the group position and usable reserves.

Bodies presenting estimated liabilities

Central government bodies typically do not present liabilities for 'central' (unfunded) schemes in their accounts, but these are normally provided in separate pension accounts and thereby consolidated in Whole of Government Accounts. Some parties have suggested that a similar approach could be applied for local government, for instance relying on LGPS accounts information to be consolidated into whole of government accounts.

Such an initiative would require suitable disclosures in LGPS fund (or other scheme fund) and employer accounts. For example LGPS fund accounts could include an analysis of the fund pension liability by employer. Employer accounts could provide a disclosure note stating the liability, but not include this in their balance sheets. Equally the full cost of pensions would not appear in the CIES. This would also generally negate the need for a pensions statutory adjustment.

This approach may support an alternative, and still audited, basis for most of the WGA information collation, subject to stakeholder views. Other considerations are the potential impact on forward financial planning, transparency, service cost comparability and behavioural incentives arising.

Measurement basis

The difficulty of estimating the liability is noted as a concern. In particular the volatility arising and lack of direct correlation to the formal funding valuation which will often assume a different level of plan asset return are challenges.

It has been suggested that a potential approach could be to use the funding valuation assumptions for the estimation of employer liabilities in employer accounts. Due care and consideration would be required as to whether, or how, the funding valuation liability should be updated in intervening years.

Potential considerations in support of such an approach could include:

- More relevant and meaningful information regarding how pension contributions affect service delivery
- More direct and easier accounts preparation
- Less volatility in the reported cost of services
- Reduced costs and workload
- Synchronised with the funding review process

The potential challenges however are anticipated to include:

- Loss of information and emphasis on pensions obligations, potentially adversely affecting medium and longer term financial planning
- Difficulty in establishing what adjustments would need to be applied to the pensions liability between valuations eg in the event of significant staff transfers
- The provision of additional WGA adjustment data to align the valuation figures with the IAS 19 basis used for WGA
- Regulator and Scheme Advisory Board requirements

Suggested discussion questions:

Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey or wish to provide further views, responses or comments following the discussion points raised would be helpful and greatly appreciated.

Primary user needs

- What is your assessment of primary user information needs related to pensions information in the annual accounts, particularly in terms of timeframe and potential measurement basis?

Bodies presenting estimated liabilities

- What would be the practical impact of moving towards a position where local authority employer liabilities (eg re LGPS) are only presented in pension fund (eg LGPS fund) accounts?

Measurement basis

- How important is it that local authority pension liabilities are measured on an IAS 19 basis, compared to a funding valuation basis?

SECTION 5:

Financial instruments

Objectives

The objective of the accounting standard requirements for financial instruments is to "present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows."[26]

Current concerns

Standards relating to financial instruments previously existed under UK GAAP and applied to local government under the previous SORP arrangements. Recent revisions to IFRS 9 *Financial Instruments* and other events have refocused debate on applicability to local government. Some items raised include:

- The transparency and treatment of complex financial instruments, especially those with volatile or particularly uncertain cash flows. These may arise from detailed contract clauses.
- The appropriateness of Fair Value treatment, especially Fair Value through Profit or Loss (FVPL), for some instruments. Examples cited include investments in subsidiaries or associates on the basis that, for strategic service delivery investments, it is the cost to public resources which is most relevant not the value of the investment which is unlikely to be realised through market sale. Similar views have been expressed in relation to investments in pooled investment funds, although it is assumed that realisation through sale is normally anticipated when an investment is made.

26 From IFRS 9 *Financial Instruments* paragraph 1

- The cost-benefit balance of applying the Financial Instrument requirements. In relation to disclosures, it has been suggested that there can be extensive resource invested in work which evidences that disclosure is either non-material or otherwise not appropriate for an authority.

Considerations

Financial instruments affect all local government bodies as they are used and relevant for almost all transactions. There can be significant differences between local government bodies in terms of how significant they are for that body, particularly in terms of their uncertainty and risk, length of contract and the commitment of future public resources.

Primary user needs

For the private sector the application of IFRS 9 Financial Instruments normally means:

- For amortised cost instruments there is no allowance for an 'interest free' or special 'low interest' period. Interest charges are recognised on the same basis (percentage interest charge) in each accounting period. Interest charges for qualifying floating rate amortised cost instruments will generally reflect the interest rate(s) applicable in the period.
- Expected changes in future cash flows (eg default, non-payment) will normally be annually assessed and the effects recognised in Profit or Loss.
- Modification of amortised cost cash flows (eg contract renegotiation) can require immediate recognition of a gain or loss in Profit or Loss.
- Premiums and discounts on the early repayment of debt are normally charged immediately to Profit or Loss.
- For FVOCI assets the fair value changes are recognised but do not directly affect Profit or Loss.
- For FVPL instruments the fair value changes directly affect Profit or Loss.

It is important to consider whether these are appropriate in terms of the financial reporting needs of the primary users of local government accounts, and to assess the cost-benefit balance involved.

Elected representatives, governments, and other users may be interested in the financial management decisions related to financial instruments, such as borrowing and investment, made by authorities. Clear reporting under the accounting standards may arguably be regarded as promoting good governance and accountability.

It is relevant to note that a factor in the revisions to the IFRS financial instrument standards and their adoption for the UK public sector was to improve financial reporting following the 2008 financial crisis, particularly with a view to provide more transparency regarding risk, the reality of financial instrument current values, and the decisions relating to these that affect public resources.

Complex transactions and risk focus

Where there are no complex transactions, cash flows are relatively clearly stated, there are no significant clauses affecting the variability of the cash flows, and risk analysis indicates no specific issues it may be suggested that extensive information in the accounts is not required.

In this respect it has been noted that FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland (FRC) draws a distinction between, and provides specific requirements in relation to:

- Basic financial Instruments (See Chapter 11 of FRS 102)
- Other Financial Instruments (See Chapter 12 of FRS 102)

This may represent a possible approach for local government, with the objective of reducing the reporting burden for authorities which do not have specifically complex or risk sensitive instruments.

Such an approach would involve reliance on professional judgement in preparing the accounts and during the external audit process. A key interest for primary users may be instances where a financial instrument is complex or has significant risk.

It also places a degree of reliance, subject to assessment, on the governance arrangements in place for the management of financial instruments to identify those with unusual risks or complexity.

Confidence in the arrangements above may be a critical factor in securing stakeholder support for such an approach.

Alternatively, but with similar provisos and reliance on professional judgement, a 'must', 'should' and 'may' approach to some requirements could be adopted to indicate which ones are commonly expected to apply across all authorities.

Measurement basis

The use of 'fair value' for some instruments is an integral part of the IFRS requirements. To adapt the standards to disapply fair value accounting would be a substantial and significant amendment.

In relation to the use of fair value for investments in subsidiaries, which in some cases may be directly concerned with the service delivery, consideration of the IASB's ***Conceptual Framework for Financial Reporting*** may be appropriate in determining whether adaptation could be supported.[27]

A question that arises is whether a historical cost measure for the balance sheet with additional disclosure of fair value, or permitting further specific instruments to be designated as FVOCI, appropriately provides transparency and informs management decisions, or whether fair value is more relevant in doing so.

Additionally differentiating between which investments are held for strategic purposes (physical service delivery), and will never be realised, and those which may be realised for market value at a later date, may be challenging.

Normally where the relevant governments have considered it appropriate to amend the impact on usable reserves, which affects the budget setting process, this has been implemented by each administration. The arrangements can differ between administrations in nature and extent.[28] Some stakeholders may consider that the Code itself could more actively apply adaptations and interpretations, negating the need for specific statutory adjustments.

In the event that this is to be undertaken, early assessment of the impact on usable reserves is essential to be able to implement standards in a manner which is appropriate for local government circumstances. Stakeholder engagement is crucial in doing so.

Where a standard has been implemented to support transparency, especially with specific measurement requirements, and inform financial management decisions this may be specifically considered by stakeholders.

Consideration would also need to be given to the wider public sector reporting framework, and any issues that inconsistency of treatment may have for WGA data collation purposes.

27 See the IASB's *Conceptual Framework for Financial Reporting* 'concepts of capital maintenance..' paras 8.3-8.10 which differentiate between financial capital maintenance (generally whether the purchasing power of the entity has increased or decreased) and physical capital maintenance (generally whether the physical ability of the entity to provide services or produce goods has increased or decreased). See also 6.23-6.42 which discuss the use of different measurement bases.

28 For example see The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2018 SI 2018/1207 (insertion of 30K) which allows for English authorities a time limited adjustment for some instruments, compared to Scotland where, as detailed in LASAAC Guidance on IFRS 9 Financial Instruments – Earmarking of gains not available to fund services which notes that no such adjustment is supported in Scotland.

Suggested discussion questions:

Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey or wish to provide further views, responses or comments following the discussion points raised would be helpful and greatly appreciated.

Primary user needs

- What is your assessment of primary user information needs related to financial instruments?
- What the main factors which affect the cost-benefit balance of providing information on financial instruments?

Complex transactions and risk focus

- If reduced requirements related to common or basic instruments were implemented, what safeguards could be built in to ensure appropriate information on complex instruments or significant risks are presented in the accounts?

Measurement basis

- Should stakeholder support for adaptation of IFRS 9 to disapply fair value or FVPL requirements for some instruments be sought, and if so what criteria (type of instrument or circumstance) would this be appropriate for?

SECTION 6:

Group accounts

Objectives

Financial reporting of group accounts is intended to present combined information on the assets, liabilities, equity, income, expenses and cash flows of an entity and the entities it controls.[29]

The accounting requirements are therefore concerned with reflecting the overall picture for a group arrangement, to represent the reality that risks, cash flows, assets and obligations are inter-related and under common control. The accounting requirements expect that group accounts are necessary for a clear understanding of these, unless materiality considerations indicate otherwise.

Current concerns

The use of group entities to deliver public services, manage public resources or generate revenue streams has increased in more recent years. Questions have been raised regarding whether the financial reporting requirements appropriately address group arrangements. In particular:

- They may be regarded as too complex. The extent to which the primary users find group accounts information relevant or helpful is not clear. More specifically the manner in which primary users interpret group accounts information, for instance the treatment of associates and joint ventures, may be debated.

29 This is based on the IASB's Conceptual Framework for Financial Reporting and IFRS 10 *Consolidated Financial Statements* which defines what a 'group' means.

- Local government annual accounts presentation reflects a statutory framework which is often not applicable to the other entities in group arrangements.
- The cost-benefit balance of providing group accounts may be queried. It has been suggested that in many cases the differences between the single-entity statements and the group statements are marginal in nature. Additionally other entities in a group often prepare their own annual accounts under a different framework (eg FRS 102, Charities SORP etc) and resource input in aligning accounting treatments may be required.
- The extent of disclosures that are appropriate has been questioned. Some variation in practices between authorities has been commented on.

Considerations

Primary user needs

The impact of group transactions on public resources, including assets sold to or managed by such entities; the funding provided to such bodies; guarantees or commitments made in respect of the obligations of such bodies; and the exposure of public resources to risk arising from group arrangements are all important. Primary users may legitimately expect to be provided with information on such aspects.

A pivotal question that arises is whether the existing group accounts requirements are the most appropriate means of achieving this.

In particular it may be noted that for some primary users the focus on the single-entity General Fund balance for budget and tax setting purposes may affect the perceived usefulness and relevance of group accounts information.

Provision of specific related party disclosures for group entities

Practitioners have commented that the provision of information on group arrangements as part of the related party transactions disclosures has proved to be more relevant for primary users than seeking to interpret the group accounts.

Potentially a specific disclosure section for group arrangements, as part of the single entity statements, instead of requiring group accounts might be considered. In discussing this an assessment of primary user needs, and perhaps most relevantly an understanding of the extent of expertise which is required to interpret group accounts, will be important.

In this respect however the IASB's *Conceptual Framework for Financial Reporting* states[30]

"Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore possibly misleading."

and

"Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information….."

It also notes[31] that for investors, lenders and creditors "unconsolidated financial statements cannot serve as a substitute for consolidated financial statements" and that "Another way to provide information about some or all assets, liabilities, equity, income and expenses of the parent alone is in consolidated financial statements, in the notes."

30 The IASB's *Conceptual Framework for Financial Reporting* paras 2.35-2.36

31 IASB's *Conceptual Framework for Financial Reporting* paras 3.18 and 3.17 respectively

Additionally the potential requirement to provide further adjustment data for WGA purposes would require consideration.

The reporting entity

An argument may be made that a shift towards a focus on the group usable reserves position for budget and tax setting purposes may provide a clearer focus on the need for financial reporting of the group position. This would emphasise, and support the need for, the provision of group accounts.

Clearly that shift is not a matter for the Code to specify or determine. It is a matter for governments and other stakeholders. It may however be relevant for this paper to initiate discussion in this regard as arguably the current legislative requirements were established before the recent wider reliance on group arrangements for the delivery of public services became a more common practice.

Such a discussion would help to inform the appropriate identification of the reporting entity[32] and the needs of primary users.

Suggested discussion questions:

Where stakeholders did not provide comments in CIPFA/LASAAC's stakeholder survey or wish to provide further views, responses or comments following the discussion points raised would be helpful and greatly appreciated.

Primary user needs

- What is your assessment of primary user information needs related to group accounts and how well annual accounts currently satisfy these?

Provision of specific related party disclosures for group entities

- What would be the practical and behavioural implications of specifying clear disclosures, rather than the preparation of group accounts?
- Would this provide a better cost-benefit balance?

The reporting entity

- Should a wider discussion on the nature of group arrangements, and their impact on the financial management of public resources, be sought?

32 See the IASB's *Conceptual Framework for Financial Reporting* paras 3.10-3.18, which includes the following limited extracts: 3.10 "A reporting entity is not necessarily a legal entity";
3.13. "Determining the appropriate boundary of a reporting entity can be difficult if the reporting entity: (a) is not a legal entity; and (b) does not comprise only legal entities linked by a parent-subsidiary relationship."
3.14 "In such cases, determining the boundary of the reporting entity is driven by the information needs of the primary users of the reporting entity's financial statements."
3.16 "Consolidated financial statements are not designed to provide separate information about the assets, liabilities, equity, income and expenses of any particular subsidiary. A subsidiary's own financial statements are designed to provide that information."
3.17 A statement that single-entity (unconsolidated) statements are useful or necessary in giving information about (a) claims against the parent that don't apply to subsidiaries and (b) legal limits on the ability to use reserves.

APPENDIX A

Comprehensive income and expenditure statement (CIES) illustrations

The following are provided as illustrative examples of presentation approaches for the CIES, in particular to more clearly identify in the statement the taxpayer funding impact of spending.

Illustration 1: Adjustment to reach accounting cost in SDPS

Accounting Line	Description of Line
Cost of Services (showing gross income & gross expenditure, either segment or type of spend)	Statutory cost/ impact on GF/HRA and other usable reserves
Corporate Items (eg interest)	Statutory cost/ impact on GF/HRA and other usable reserves
Change in Taxpayer funds	**Statutory cost/ impact on usable reserves (resources available for services)**
Adjustments to reach Accounting Costs	Adjusting entries
SDPS Total	**Accounting basis**
OCIE	Generally per accounting basis
Overall Total Change in Net Assets	**Accounting basis**

Illustration 2: Adjustment to reach accounting cost in SDPS (capital & revenue split)

The above however would not clearly differentiate between revenue resources and capital resources and therefore a 'multi-layer approach to the statutory cost element may be appropriate, although potentially at a risk of more complexity for primary users to interpret:

Accounting Line	Description of Line
Cost of Services (showing gross income & gross expenditure, either segment or type of spend)	Statutory cost/ impact on GF/HRA and revenue usable reserves
Corporate Items (eg interest)	Statutory cost/ impact on GF/HRA and revenue usable reserves
Statutory Cost (Revenue) of Services (Change in eg GF/HRA, Other statutory funds etc)	**Statutory impact on Revenue Usable Reserves**
Capital statutory cost/Income (eg capital receipts taken to CRR, capital grants taken to CGUA, capital receipts applied to support spend, CGUA applied to support spend)	Statutory cost/ income related to usable capital reserves
Statutory Treatment of Capital Receipts (ie. Change in eg CRR, CGUA)	**Statutory impact on Capital Usable Reserves**

Change in Taxpayers' Usable Funds	Statutory cost/ impact on Taxpayers' Usable Reserves
Adjustments to reach Accounting Costs	Adjusting entries
SDPS Total	**Accounting basis**
OCIE	Generally per accounting basis
Overall total change in net assets	**Accounting basis**

Illustration 3: SDPS equates to change in taxpayer funds

Alternatively an argument may be made that for local authorities what is most relevant to the primary users in assessing financial performance is the charge against taxpayer funds. This is relevant since IFRS standards draw a distinction between what should be presented in profit or loss [SDPS] and OCIE, which generally suggests that historical cost is the relevant or appropriate basis for profit or loss [SDPS] to show the financial performance of a commercial entity for readers.[33]

Potentially therefore a case may be made for adaptation to present charges against taxpayer funds in SDPS, with other adjustments relating to measurement of assets and liabilities being presented in OCIE. This is a more radical alternative, which would involve more challenge relating to WGA alignment. A summary example might be:

Accounting Line	Description of Line
Cost of Services (showing gross income & gross expenditure, either segment or type of spend)	Statutory cost/ impact on GF/HRA
Corporate Items (eg interest)	Statutory cost/ impact on GF/HRA
SDPS – Taxpayer funds	**Statutory cost impact on GF/HRA**
OCIE: Adjustments to Accounting Based Costs	Adjusting entries
OCIE: Accounting based OCIE	Generally per accounting basis
Overall total change in net assets	**Accounting basis**

33 See the IASB's Conceptual Framework for Financial Reporting, particularly: paras 6.43-6.48 (factors to consider when selecting a measurement basis); para 6.49 (relevance of information and measurement bases); paras 6.69-6.71 (some of the limitations of historical cost measurement); para 7.16 (difference in role between profit or loss [SDPS] and OCIE); and para 7.18 (historical cost affecting profit or loss).

The Chartered Institute of Public Finance & Accountancy

Registered office: 77 Mansell Street, London E1 8AN
T: 020 7543 5600 F: 020 7543 5700 www.cipfa.org

CIPFA, registered with the Charity Commissioners of England and Wales No. 231060 and the Office of the Scottish Charity Regulator No.SCO37963.
CIPFA Business Limited, the trading arm of CIPFA that provides a range of services to public sector clients, registered in England and Wales no.2376684.

INVESTORS IN PEOPLE

SEPTEMBER 2019