CIPFA The Chartered Institute of Public Finance & Accountancy

Report

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Subject	Simplification and Streamlining Project- Review of the Financial Statements

The purpose of this report is to consider a review of local authority financial statements

1 Introduction

1.1 This report summarises a review of 20 sets of financial statements selected from English, Scottish and Welsh local authorities (2 Scottish and 2 Welsh authorities). As the review had to take place in early September the review focussed on the 2012/13 financial statements. The review sample was largely from similar sized (in resource terms) authorities but there are some outliers so that the review might be able to assess whether this makes any difference to the presentation of the financial statements.

1.2 As the simplification and streamlining review project has prioritised the performance statements and narrative reporting the review of the 2012/13 statements has considered:

- the Movement in Reserves Statement and (explicitly) related notes,
- the Comprehensive Income and Expenditure Statement and (explicitly) related notes,
- the Explanatory Foreword, and
- the length of the financial statements[1] for a three year period from 2011/12 to the 2013/14 financial statements (these figures have been taken from the PDF page count and therefore this does sometimes include some blank pages and front and back covers).

[1] The length of the financial statements should be treated with some caution as many of the financial statements include the reports which accompany the statements eg many include the annual governance statement, whilst some include the pension fund accounts as relevant and the Scottish local authorities include the Remuneration Report. All the publications included the Explanatory Foreword or equivalent statement.

1.3 Appendix 1 to this report provides a summary of the review undertaken. The Review is split over three tables: the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement and the Explanatory Foreword. The final spreadsheet also includes an analysis of the length of the financial statements.

1.4 This report highlights in bold issues that can either be considered by the Simplification and Streamlining Review or might be issues that CIPFA/LASAAC can take immediate action on in the 2015/16 Draft Code.

Length of the Financial Statements

1.5 There does not seem to be a substantial change in the length of the financial statements between 2011/12 and 2012/13 financial years at an average of 151 pages. Interestingly following the audited 2013/14 financial statements the average number increased to 157 pages (this had increased from the unaudited statements). The table below provides more information on the length of the financial statements with the longest in 2012/13 being 222 pages whilst the shortest was 106. The longest in 2013/14 is now 243 pages with the shortest being 105. The sample appears consistent with the information provided by the Audit Commission in their 2012 report *Let's be Clear* where average financial statement length in 2010/11 is the same as was reported for County Councils ie 151 pages, though the average for all types of Council was 113 with single tier authorities at 139 pages.

Table 1
Length[2] of local authority financial statements in the sample

	2011/12	2012/13	2013/14
Average Length	151	151	157
Longest	228	222	243
Shortest	116	108	105

1.6 One authority appeared to have considered their approach to the complexity of the financial statements, where some of the more detailed financial information was held at the back of the statements. Other authorities split their statements into core and supplementary statements.

2 Movement in Reserves Statement

Statement Presentation

2.1 The Movement in Reserves Statement (MiRS) shows:

- how the authority has generated and expended resources in the year;
- how the resourcing position is adjusted under statutory rules to show the funds available to be spent at year end; and
- the extent to which available funds have been earmarked for specific purpose.

[2] See footnote 1.

2.2 The Code's requirements for presentation of the MiRS are set out in paragraph 3.4.2.39 (included in Appendix 2 for ease of reference). The Code of Practice on Local Authority Accounting in the United Kingdom Guidance Notes for Practitioners 2013/14 Accounts (Guidance Notes) example financial statements include two presentations:

- one which meets the minimum requirements of the Code and
- an alternative presentation which includes additional rows or lines ie alternative ways of configuring the MiRS to present additional detail as is necessary to explain the performance demonstrated by the line items to their users.

It is important to note that the Guidance Notes provides example formats only and authorities can chose to present information in any appropriate format which meets the minimum requirements of the Code and the needs of the users of their financial statements.

2.3 Sixteen out of the twenty local authorities sampled largely followed the minimum requirements format of the Movement in Reserves Statement as presented in the Guidance Notes example financial statements. An example of an effective presentation of this format is included for information in Appendix 3. The Secretariat considers that this is a good way of presenting the three key elements of the MiRS per paragraph 2.1. The MiRS therefore presents a summary of CIES performance, reconciliation to the funding basis and transfers between earmarked or statutory reserves (Scotland). This is particularly effective when the Statement is presented with clear shading and an appropriate font. **CIPFA/LASAAC's views are sought on the effectiveness of the presentation of the MiRS presented in Appendix 3**.

2.4 It appears from previous commentaries included in responses to the simplification and streamlining consultation in 2013/14 that for local authority users perhaps what is less apparent are the movements in general fund and HRA balances, the "traditional" performance measures that local authorities use.

2.5 The remaining authorities have deemed it necessary to add either extra rows or extra columns to the presentation. Two authorities used extra columns to present more information on unusable reserves. One appears to include all the major unusable reserves. This is useful to the knowledgeable user as it presents all the movements in one statement. The presentation of this statement may seem a little daunting as this means that there is a lot of information in this statement. However, the authority has mitigated this by means of an effective use of boxes and shading which highlights the key messages of the statement. The second authority splits the reserves between statutory revenue reserves and capital balances.

2.6 One authority provided:

- a further analysis on Comprehensive Income and Expenditure,
- a more detailed analysis of difference between the adjustments between accounting basis and funding basis, including:
  - reversal of items debited or credited to the CIES,
  - insertion of items not debited to the CIES, and

– other adjustments,

- all the major unusable reserves.

This authority's MiRS therefore provided a substantial amount of useful information for the knowledgeable user of the financial statements. However, this does mean that there is a risk that the key messages from the statement might be obscured by the amount of detail included.

2.7 One authority presented the MiRS over three pages first presenting the usable reserves (including the group usable reserves) and then presenting the total of these reserves on the second page accompanied with the authority (single entity) unusable reserves with the group unusable reserves on the following page. This is then followed by the preceding year's information. This presentation does have benefits of presenting the Group information with the authority (single entity) information but without totals for the usable reserves on the relevant page this does make the statement more difficult to read quickly.

MiRS Earmarked Reserves

2.8 Most presentations of earmarked reserves follow the format provided in the Guidance Notes. A small number of authorities identified schools balances separately. A recent review of the local authority reserves and balances LAAP Bulletin considered that the status of earmarked reserves is no different between Scottish and Northern Irish and English and Welsh Reserves. There are likely to be arguments for reviewing the requirements for the presentation of these reserves in the Code. **CIPFA/LASAAC's views are sought on whether or not specific reference to these reserves is therefore required on the face of the MiRS**.

Prominence of Current Year Information

2.9 Although a number of authorities presented effective MiRS Statements and provided an effective flow of financial information by providing the comparator information first. This does raise the issue of this potentially leading to comparator information being presented with equal prominence to the current financial year. **This therefore might lead to a conclusion that it is difficult to present the requirements of the MiRS effectively and it an issue that the Secretariat recommends should be considered by the Simplification and Streamlining Review Group**.

Explaining the MiRS – The Disclosures

2.10 Paragraph 3.4.2.40 of the Code extracted in Appendix 2 requires exemplification of the line items:

c) other comprehensive income and expenditure (this is provided by the CIES and notes other relevant notes eg remeasurements of the pensions liability)
e) adjustments between the Group Accounts and the authority accounts
g) adjustments between accounting basis and funding basis under regulations
i) transfers to or from earmarked reserves (England and Wales) or other statutory reserves (Scotland)

2.11 This paragraph then requires further analysis of lines g) and i) and for line g) sets out 18 items which might need to be included in the analysis eg depreciation, impairment, movements in investment property fair value. This disclosure is very detailed for most authorities. The Guidance Notes *Example Financial Statements* provides a detailed exemplification of the possible items that might be included in this note – which does cover a number of pages. However, the Guidance Notes indicate that the detail provided is for demonstration purposes. Many of the authorities in the sample follow general approach in the Guidance Notes example format and compensate for the length of this note on occasion by using a smaller font. A small number of authorities have chosen alternative formats. One authority presented the note in a landscape table which presented the:

- reversal of items debited or credited to the CIES,
- insertion of items not debited or credited to the CIES, and
- other adjustments and presents these over the major reserves headings.

Other authorities have included a more narrative description for this note.

2.12 Most of the local authority disclosures for line g) of paragraph 3.4.2.40 provide a large amount of financial detail that at least some users might find difficult to understand. This disclosure is very much a technical disclosure to explain one of the most important lines in the preparation of local authority financial statements. It could probably be presented more succinctly. Many of the items will either be immaterial or disclosed elsewhere in the notes (eg in the property, plant and equipment or pensions note). As this is disclosure is not driven by IFRS it is worthwhile considering what the purpose of the note is and what it might mean to users of local authority financial statements.

2.13 CIPFA/LASAAC and the review group may wish to consider whether the note for the line g) is intended to:

- explain the material adjustments in line g)
- act as a reconciliation of the line and/or
- provide a link between the MiRS and the other reserves notes.

It is likely to be the case that it is intended to meet the needs of all three purposes but it is possible that these requirements could be more clearly stated in the Code. It is suggested that the review group may wish to consider the purpose of this disclosure note alongside its review of the MiRS. **However, CL 06 11 14 seeks CIPFA/LASAAC's views on whether additional commentary can be included in the 2015/16 Draft Code to encourage and support authorities in their attempts to reduce the volume of this disclosure.**

2.14 A further disclosure which is often presented with considerable amount of detail is the transfers between earmarked reserves note (statutory reserves, Scotland). This disclosure is required by paragraph 3.4.2.42 of the Code. Within the sample it is often presented by the inclusion of a substantial number of reserves (with examples of over 30 and over 50 reserves presented in this note) and on occasion these reserves do not appear to the Secretariat to be material from a quantitative perspective. The requirements of paragraph 3.4.2.42 are subject to the general provisions of the Code on materiality. Again the **CL 06 11 14 seeks CIPFA/LASAAC's views on whether the Code can support local authorities in their approaches on materiality**.

Statutory Reversals

2.15 All of the authorities included adjustments for the main adjustment reserves ie the Capital Adjustment Account, Pensions Reserve, the Capital Receipts Reserve (CRR)(with the exception of Scottish authorities for the CRR as this does not apply) and the Accumulated Absences Account. The Financial Instruments Adjustments Account was used by all but one authority. The other adjustment accounts appear to be used as is relevant to the authority.

3 Comprehensive Income and Expenditure Statement

3.1 The Comprehensive and Expenditure Statement (CIES) expands the part of the MiRS that shows how resources have been generated and expended. The Comprehensive Income Expenditure Statement is split into two parts. The first part reflects the full economic cost of providing the service of the authority with the results summarised at the Surplus or Deficit on the Provision of Services line. It represents the operating costs of providing the services of the authority in the year. The second part, other comprehensive income and expenditure, shows the gains or losses in the measurement of the assets and liabilities of the authority.

3.2 The majority of the authorities from the sample reviewed appear to follow the minimum reporting requirements of the Code as presented in the Guidance Notes. An example of a typical statement is provided in Appendix 4. Here the analysis follows the Code’s adoption and interpretation of IAS 1 *Presentation of Financial Statements.* It also includes the segmental analysis in the first section based on service expenditure analysis headings in the *Service Reporting Code of Practice.*

3.3 Five authorities add additional lines, most of these following the alternative format exemplifying other operating expenditure, financing and investment income and expenditure and taxation and non-specific grant income lines. Some authorities add additional lines for material items. There are other cases of additional lines being added but it is not clear why these authorities have chosen to do this.

3.4 The CIES provided by local authorities following the minimum requirements of the Code appears to be as effective as other statements in the public or private sector in the ability to demonstrate performance under the requirements of IFRS. The authorities following the minimum requirements of the Code appear to provide a clear analysis of income and expenditure under accounting requirements using the one statement approach allowed for under IAS 1 as adapted by the Code.

3.5 Those that have provided additional analysis for certain lines on the face of the Statement also provide an effective analysis of performance under IFRS. It is recognised that there is more information within this Statement. It might be the case that this is what is appropriate for the needs of the users of those local authority statements.

3.6 **The segmental analysis on the face of the CIES does not present an authority’s income and expenditure in accordance with the individual organisational structure and this is why this issue has been raised in the Simplification and Streamlining consultation in July this year**.

Explaining the CIES - Disclosures

3.7 The notes in respect of the CIES in the sample are primarily:

- Other operating expenditure
- Financing and investment income and expenditure

- Taxation and non-specific grant income and expenditure.

The analysis provided in Appendix 1 demonstrates that presentation of these notes is both short and clear and largely follows the format in the Examples in the Guidance Notes; the three notes are usually no longer than a page in length for all three notes. There are other notes which are related to information in the CIES and Expenditure Statement (eg information required to be disclosed by statute, the dedicated schools grant and the remuneration disclosures). These are not explicitly linked the Statement.

4 Segmental Reporting

4.1 The segmental reporting requirements were also reviewed. The aim of segmental reporting is to disclose information to enable users of a local authority's financial statements to evaluate the nature and financial effects of the activities in which it engages and the economic environments in which it operates.

4.2 The principle makes it clear that the Code's provisions are primarily about disclosure. They do not contain detailed rules about how segmental information is to be measured, but do require reconciliations from this information to the figures in the Comprehensive Income and Expenditure Statement. The disclosure requirements in summary require that:

- A segmental analysis is provided on a subjective basis which must be reconciled to the net cost of services. This segmental analysis should be prepared in a way that the authority presents its resource decisions to the group or individual has the ultimate responsibility for determining the allocation of resources.

- The segmental disclosures also require an analysis and reconciliation over the subjective analysis prescribed by the Code.

These segmental disclosures are also deemed by the Code to satisfy the IAS 1 requirements to present information regarding the nature of expenses. The Code notes that these disclosures are not intended to be onerous.

4.3 The majority of the authorities in the sample provide a segmental reporting note in a format that is similar to Guidance Notes. They take on average 3 pages and the example at Appendix 5 extracted from the Guidance Notes is very similar to the approach of most authorities. Appendix 5 does not include the comparative year.

4.4 The disclosures have been commented on as a part of a number of the CIPFA/LASAAC consultations (including the 2013/14 simplification and streamlining consultation) where a message from respondents is that even though the disclosures are not intended to be onerous local authorities responding considered that they are. A counter argument to this is that these meet more than one of the substantial reporting requirements of IFRS. However this might be again countered by the possibility that this note is trying to meet the needs of too many requirements and by authorities having to provide two segmental analyses, one under IFRS and one under SeRCOP specifications. This issue was therefore raised in the 2014/15 simplification and streamlining consultation. **CIPFA/LASAAC may wish to consider whether it is necessary to review the segmental reporting requirements and the requirement in IAS 1 to report on the nature of expenses**.

5 Explanatory Foreword

5.1 The purpose of the Explanatory Foreword (EF) is to offer interested parties an easily understandable guide to the most significant matters reported in the accounts. The Code also stipulates that the EF must provide an explanation of the financial position of the authority assists with the interpretation of the financial statements and includes a commentary on the major influences affecting the authority's income and expenditure and cash flow. It also includes a list of recommended topics which is intended to assist the authority in the production of the EF.

5.2 The EFs reviewed in the sample vary in content and style. They also vary in length with an average of 11 pages, a maximum length of 36 pages and a minimum of 3 pages. Many of the EFs also include the traditional analysis of what we spent and where did the money come from. This is reinforced by paragraph 1.5.1 of the Code which comments on the purpose of the financial statements that they should answer these types of questions.

Links to the CIES and MiRS

5.3 Many of the EFs reviewed provide summaries of performance against a general fund/HRA outturn and some provide this analysis in detail. However, substantially fewer authorities then explicitly link this to the summary lines in the performance statements. A small number of authorities in the sample do comment that the CIES and MiRS provide a wider or different view based on accounting standards requirements and explain how the performance against general fund relates to the results in the statements. To do this these authorities explain the main adjustments eg pensions adjustment, the difference between the capital accounting charges required by accounting standards and those required by statutory charges for capital. Other authorities highlight items like significant impairments. For some this leads on into the narrative on the balance sheet and the movements in financial position.

Interpretation of the Financial Statements

5.4 The recommendations in Code for items that are likely to be significant to the understanding of the financial statements appear to assist with the interpretation of the financial statements in the EFs that are subject to the review. The EFs include comments on:

- the pensions liability (including movements on the liability)
- budget against outturn summaries including the adequacy of reserves
- impact of the current economic climate
- capital spend and financing (major acquisitions, including PFI Schemes)
- movements in financial position (eg academy transfers, impairment of assets)
- the effect of changes in accounting policies

A summary of the content of each EF is included in Appendix 1.

Recommendation

CIPFA/LASAAC is invited to consider each of the areas as a part of its debates following the consultation responses.