

# **BACK TO BASICS**

A 'FIRST PRINCIPLES' REVIEW OF  
LOCAL AUTHORITY ACCOUNTS

**May 2008**

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Contact: Paul Mason  
Policy and Technical Directorate  
CIPFA  
3 Robert Street  
London  
WC2N 6RL  
Fax: 020 7543 5695  
E-mail: [basics@cipfa.org](mailto:basics@cipfa.org)

(For ease of handling, e-mailed responses, in Word document form, are preferred.)

## EXECUTIVE SUMMARY

The current format of local authority financial statements is sometimes criticised for being too lengthy, difficult to understand, or not focussing on the needs of the general public. There are a number of reasons for the current complexity of local authority accounts, including:

- the mix of financial and regulatory reporting;
- The need to report on the way in which activities have been funded through council tax, rates and rents, as well as their full cost in accounting terms;
- Pressure from the UK Accounting Standards Board to increase alignment with UK Generally Accepted Accounting Practice; and
- Pressure from HM Treasury for consistency for Whole of Government Accounts data collection.

This consultation raises a number of questions regarding the format of the local authority financial statements following the move to an IFRS-based Code of Practice on Local Authority Accounting planned for 2010/11. These questions and the related discussions are grouped into a series of key themes, which are summarised below.

Section 3 considers who are the users of local authority financial statements, and concludes that the most important groups of users are Council Tax and Non-Domestic Rate payers (Domestic and Non-Domestic Rate payers in Northern Ireland); and members, both as representatives of the Council Tax and Non-Domestic Rate payers and as part of the management of the authority. These users are primarily concerned with the authority's performance against Council Tax.

Section 4 considers the key information to be emphasised in the statement of accounts, and how these should determine the order of the financial performance statements under IFRS. The section concludes that the first statement should be the Statement of Changes in Equity. This is a new statement under IFRS, and will enable the primary emphasis of the financial statements to be placed on the authority's financial performance for the year in terms of Council Tax and HRA income. The aim is to avoid the surplus or deficit on the Income and Expenditure Account being seen as the primary measure of an authority's performance. The section goes on to recommend that the Income and Expenditure Account should be presented next, followed by the Balance Sheet and Cash Flow Statement

Section 5 considers the regulatory statements (such as the Collection Fund, Pension Fund and HRA) and notes to the accounts, and recommends the possible removal from the financial statements of a number of these items (subject to legislative amendments being made by CLG and the devolved administrations).

Subsequent sections consider and request practitioner views on:

- whether simplified reporting arrangements would be more appropriate for some authorities, with the conclusion that this would be appropriate for all parish and community councils;
- advantages and disadvantages of authorities producing consolidated accounts only, particularly in the context of their potential role in the Prudential regime.
- options regarding the level of detail that should appear on the face of the financial statements;
- the requirements under IFRS for providing service information, and whether this is best produced on an internal management reporting or BVACOP basis.

## **1. INTRODUCTION**

- 1.1. The move to an IFRS-based Code of Practice on Local Authority Accounting will require a thorough review of local authority financial statements to ensure they comply with the requirements of the relevant standards. As with the current SORP, the new IFRS-based Code (and hence the new financial statements) will apply to all local authorities (except local councils), including Joint Boards, National Park Authorities, Police Authorities and Fire and Rescue Authorities.
- 1.2. The format of IFRS-based accounts is more flexible than under UK GAAP, providing the opportunity to start with a clean slate, think radically and design the accounts that will best meet the needs of users whilst complying with the relevant international standards. CIPFA is therefore undertaking a 'first principles' review of local authority financial statements, with a view to producing statements of accounts that are 'fit for purpose' in the 21st century.
- 1.3. This does not mean that everything is open for discussion and some changes discussed here would require changes to Accounts and Audit regulations. Whilst being less prescriptive about formats, the various IFRS do set out minimum reporting requirements which will need to be complied with. When the private sector moved to IFRS, statements of accounts increased in size due to the increased disclosure requirements of IFRS. Addressing this risk is a key objective of this review.
- 1.4. CIPFA is also undertaking a parallel exercise to consider how best to provide financial information to users outside of the statement of accounts. This review ('Telling the Whole Story') proposes a framework for reporting stakeholder information. The intention is that the two reviews should compliment each other, with the statement of accounts providing information tailored to users within the requirements of the final accounts process, and broader performance information (such as comparisons with budgets and performance) being provided elsewhere.

### **The Consultation Process**

- 1.5. The consultation paper highlights the significant decisions that will need to be made as part of the 'first principles' review of local authority accounts. Comments on any issues raised by the consultation will be welcome, but especially on the questions raised within the consultation document.
- 1.6. In order to assess comments properly CIPFA/LASAAC would prefer respondents to support comments with clear reasons and, where applicable, preferred alternatives. Questions on each issue raised in this consultation are included throughout the document. In addition, all the consultation questions are listed in a separate document to help respondents to formulate their responses more conveniently.
- 1.7. Responses to this consultation will be regarded as on the public record unless confidentiality is specifically requested.

1.8. Responses are required by 31 July 2008 and may be sent to:

Paul Mason  
Policy and Technical Directorate  
CIPFA  
3 Robert Street  
London  
WC2N 6RL  
Fax: 020 7543 5695  
E-mail: [basics@cipfa.org](mailto:basics@cipfa.org)

(For ease of handling, e-mailed responses, in Word document form, are preferred. A Word file containing the questions is available for download. We would be grateful if this file could be used to submit your responses as this will enable the analysis to be carried out more easily.)

## **2. WHAT INFORMATION DO USERS NEED?**

- 2.1. Considering who the users of local authority accounts are is a critical precursor to determining the information they may need. This is considered in detail in Annex A in the context of seven classes of users – funders / financial supporters; employees; lenders; suppliers / trade creditors; customers / beneficiaries; governments / agencies; and the public.
- 2.2. The conclusions in Annex A are as follows:
- The defining class of user is ‘funders and financial supporters’, in effect government, Council Tax and Non-Domestic Rate payers. In Northern Ireland, rates are payable in respect of Domestic and Non-Domestic properties. Where the consultation refers to Council Tax payers and Non Domestic Rate payers, this includes Rate payers in respect of Domestic and Non-Domestic properties in Northern Ireland.
  - Council Members have an important role to play both in representing Council Tax and Non-Domestic Rate payers, and as part of the management of the authority, so their needs from both perspectives will need to be met by the financial statements.
  - Preparing financial statements in a manner that is consistent with government information requirements should help minimise the amount of dual reporting that is required.
  - The second most important group of users is customers and beneficiaries, including HRA tenants.
  - Meeting the information needs of these groups should meet the majority of other information needs.
  - The key concern of funders / financial supporters and customers / beneficiaries is whether the authority is able to continuing providing services going forwards and the impact on customers / beneficiaries and taxpayers of the authority’s spending and taxation decisions. The best indication of this from historic data is the performance against budget, represented by the surplus or deficit on the general fund and HRA. The Balance Sheet and Income and Expenditure Account will provide additional information that will be of use to users.
- 2.3. Annex A also identified comparisons with budgets, non-financial performance data and prospective information as information that may be of interest to users of the accounts. These information needs are not considered in this consultation, but are addressed in the companion consultation paper ‘Telling the Whole Story’.

### **What information do users need?**

**Q1 Do you agree with the conclusions in Annex A on the users of the accounts? Please provide reasons.**

**Q2 Are there any information needs not included in Annex A that should be reflected in the review? If yes, please provide details.**

### 3. WHICH IS THE KEY FINANCIAL PERFORMANCE STATEMENT?

- 3.1. *IAS 1 Presentation of Financial Statements* requires all of the main financial statements to be presented with equal prominence. Despite this, the order in which the statements are presented may be taken by some users (especially council tax payers who are not used to reading financial statements) to reflect the relative importance of the statements.
- 3.2. This suggests that the statement of accounts should present the information that will be most relevant to these users before presenting other information that is less relevant to those users.
- 3.3. When considering the order in which information is to be presented, the first step is identifying the information that is most relevant to council tax payers and tenants. A number of comments have been received suggesting that the statement of accounts should emphasise a small number of key figures that reflect the financial performance of the authority and provide important messages to council tax payers and tenants.
- 3.4. It is anticipated that the key figures will include the surplus or deficit on the general fund and HRA, total value of fixed assets, and the level of borrowing. Information regarding the level or change in debtors may also be a key figure.

#### Key Figures in the Statement of Accounts

**Q3 What are the key figures that should be emphasised within the statement of accounts? Please list up to ten items, and please provide reasons why these figures should be emphasised.**

- 3.5. The remainder of this section outlines the information contained in the different statements, relates this to the needs of council tax payers and tenants, and suggests an order for the main financial statements in the local authority statements of accounts.

#### Statement of Changes in Equity

- 3.6. This is a new statement under IFRS, and could replace the Statement of Total Recognised Gains and Losses (STRGL), the Statement of Movement on General Fund Balances, and the Statement of Movement on HRA Balances. The title 'Statement of Changes in Equity' is the title used in *IAS 1*. However, *IAS 1* does not require this title to be used, and another title, more meaningful in a local authority context, could be used. One option, more descriptive of the purpose of the statement, would be 'Outturn and Reserve Movements'. With appropriate sub totals, a new combined statement could show the surplus or deficit on the general fund and HRA for the year. The surplus or deficits on these accounts reflects the performance against budget, and reflects the key decisions made by members with regard to levels of taxation and spending. For this reason, the surplus or deficit on the general fund and the HRA is critical information for members, council tax payers and tenants.

#### Income and Expenditure Account (IFRS - Statement of Comprehensive Income)

- 3.7. Under IFRS, the Income and Expenditure Account would include essentially the same information that is included in the current Income and Expenditure Account format. As such, the statement will reflect the use of resources by an authority

(irrespective of whether legislation permits this to be charged to the General Fund or HRA). The statement provides the best information on the actual expenditure incurred by the authority in providing services, regardless of whether this had to be funded through council tax, rents or other forms of charges in the last year, or will be a call on these in future years. This information should also be of interest to council tax payers and tenants as it reflects the resources used to provide services measured in accordance with generally accepted accounting practices.

- 3.8. A major criticism of the current Income and Expenditure Account is that the surplus or deficit on the account does not reflect the performance of the authority, and does not allow comparison with budgets as these are normally prepared on a different basis to the Income and Expenditure Account. An explanation of the differences between the Income and Expenditure Account and the budget or outturn may be of use to users.
- 3.9. The prominence given to the surplus or deficit can be confusing to anyone not used to the local authority statement of accounts. Whilst the surplus or deficit will still appear in the IFRS-based Income and Expenditure Account, its impact could be reduced by presenting the Income and Expenditure Account immediately following the Statement of Changes in Equity. This would have the effect of emphasising the surplus or deficit on the General Fund and HRA as the key financial performance measures, with the surplus or deficit on the Income and Expenditure Account being shown as one element that contributed to the overall fund surpluses or deficits.

#### **Balance Sheet (IFRS - Statement of Financial Position)**

- 3.10. Under IFRS, the Balance Sheet should include essentially the same information that is already required by the current Balance Sheet format. As such, the statement will reflect the resources available to the authority to provide future services, as well as an authority's liabilities that will have the first call on those resources. It will therefore maintain its position as an increasingly important financial management tool showing the resources an authority has available to provide future services. For this reason balance sheet information is also potentially useful to council tax payers.
- 3.11. However, the current format of the statement can be confusing to non-experts, including even non-local authority accountants, due to the presence of statutory reserves and similar balances. For example, the Capital Adjustment Account, which holds the cumulative differences between the UK GAAP / IFRS treatment of various items and the treatment for Council Tax setting and dwellings rents setting purposes would not appear other than in local authority accounts, and could be misinterpreted. The intention is therefore to use the opportunity of moving to IFRS to improve the focus and clarity of balance sheet presentation.

#### **Cash Flow Statement (IFRS – Statement of Cash Flows)**

- 3.12. The Cash Flow Statement would include similar information to that included in the current Cash Flow Statement format (although the focus under IFRS is on cash and cash equivalents rather than just cash). This statement is widely used in the private sector as it is useful in forming an opinion on an entity's ability to generate cash and service debt and other liabilities. As local authorities derive most of their income through various forms of taxation, the statement is perhaps less critical to users of local authority accounts.

## **Order of Statements**

- 3.13. Subject to the key figures identified through the consultation process, the analysis above suggests that the information that will be of most interest to council tax payers and tenants is the surplus or deficit on the General Fund and statutory HRA. The proposal is that this information should be contained in the Statement of Changes in Equity and should therefore be presented as the first statement in the Statement of Accounts.
- 3.14. The Income and Expenditure Account and the Balance Sheet both contain information that would be useful to council tax payers and tenants. However, as information from the Income and Expenditure Account forms part of the Statement in Changes of Equity (the surplus or deficit on the Income and Expenditure Account for the year), it would seem sensible to present this statement directly after the Statement of Changes in Equity.
- 3.15. The Balance Sheet would then be presented as the next statement as it contains information useful to council tax payers and tenants, followed by the Cash Flow Statement which appears to be the least useful in a local authority context.
- 3.16. The suggested order of the statements is therefore:
- Statement of Changes in Equity
  - Income and Expenditure Account
  - Balance Sheet
  - Cash Flow Statement

These would be followed by the notes to the accounts.

### **Which is the key statement?**

- Q4 What is your preferred title for the Statement of Changes in Equity? Please provide reasons.**
- Q5 Do you agree with the suggested order of the statements? If not, what is your preferred order? Please provide reasons.**
- Q6 Should local authorities prepare an explanation of the differences between the Income and Expenditure Account and the budget or outturn, and if so what is the most appropriate approach? Please provide reasons.**

#### **4. REGULATORY STATEMENTS AND NOTES TO THE ACCOUNTS**

4.1. A number of statements and notes within the local authority statements of accounts are required by regulation or statute. These apply to all bodies covered by the SORP, including joint boards. These vary between the different jurisdictions. As part of the first principles review, the following questions need to be addressed:

- Is the information in the statement and/or note(s) still required?
- If so, would the information be better provided in another manner?
- If the information would not be better provided in another manner, should the information be inside or outside the main statement of accounts?

4.2. The following paragraphs consider the various regulatory statements and notes in turn.

##### **Housing Revenue Account**

4.3. For many authorities, their members, and members of the public, the Housing Revenue Account (HRA) is a key service within the council, and its financial performance is of particular interest to the users of the accounts. The current format of the accounts only includes the surplus or deficit on the HRA within the Statement of Movement on HRA Balances. Within the IFRS-based statement of accounts, it would be possible to include the surplus or deficit on the HRA within the Statement of Changes in Equity which we have proposed should be the first of the core financial performance statements.

4.4. Authorities are required by statute to maintain a Housing Revenue Account. This adds to the size of the accounts for housing authorities because a separate prime statement and notes are required. An alternative approach would be to provide the information currently shown within the HRA statement as part of the service information required by IFRS. This would then allow the removal of the separate HRA statement from the accounts, whilst still providing the same information to users. This treatment may need CLG / devolved administrations to amend the relevant regulations.

4.5. A further point when considering the need for a separate HRA statement is the need for central government to ensure information is available to support grant allocations and policy requirements. However, central government obtains the information for such purposes through returns such as the Housing Subsidy return rather than through the statement of accounts. As such, there is no requirement to maintain the separate HRA statement in the financial statements to meet central government needs. Alternatively, under a simplified regime, it might be possible to provide sufficient information in the financial statements to remove the need for separate returns, providing issues relating to timing and the level of detail required could be agreed with CLG / devolved administrations.

##### **Housing Revenue Account**

**Q7** Should the surplus or deficit on the HRA be included within the Statement of Changes in Equity (one of the core financial performance statements)? Please provide reasons.

**Q8** Should information on the HRA be included as part of the service information or as a separate statement? Please provide reasons.

**Q9 Do you support exploring with CLG / devolved administrations the possibility of removing the requirement for separate returns on the HRA? Please provide reasons.**

#### **Collection Fund / Council Tax Income / NDR Income / Rates Income**

- 4.6. In England, a Collection Fund account is required to be published in a billing authority's accounts. This covers Council Tax and NDR. In Scotland, separate accounts are produced for Council Tax and NDR. In Wales, Council Tax is shown gross in the Income and Expenditure account, whereas only the distribution from the NDR Pool is shown in the Income and Expenditure account. In Northern Ireland, rates in respect of domestic and non-domestic properties are collected by an agency; the amount receivable from the agency is shown in the Income and Expenditure accounts. These different approaches reflect the different regulatory approaches in the different jurisdictions.
- 4.7. These approaches could be reviewed with a view to simplifying the accounts by removing the separate statements. Any changes would require regulatory amendments to be made, and these would need to be agreed with CLG / devolved administrations.
- 4.8. As with the HRA, central government obtains information on council tax and non domestic rates through various returns, and does not rely on the financial statements. As such there is no requirement to include these separate statements to meet central government needs. Alternatively, it might be possible to provide sufficient information in the financial statements to remove the need for separate returns.
- 4.9. In principle, accounting for NDR has fewer complexities than for Council Tax. Because NDR is paid into the Pool, with amounts then being distributed to authorities, NDR collection is effectively on an agency basis. The need for a separate account could therefore be removed, with just the distributed amount shown in the Income and Expenditure Account (as in Wales and as is the case for all rates in Northern Ireland). Disclosures regarding the NDR collected and received could be made in the notes to the accounts.
- 4.10. Accounting for Council Tax is less straightforward due to the impact of precepts. Two possible approaches are suggested:
- Account for Council Tax and precepts gross in the Income and Expenditure Account (as in Wales).
  - Account for Council Tax on an agency basis, with disclosures in the notes. On this basis, billing authorities would only include their share of the Collection Fund / Council Tax account in their accounts. Precepting authorities would include their share of debtors / creditors in their accounts.
- 4.11. Having decided which approach to adopt, consideration will also need to be given to how surpluses / deficits on the Collection Fund / Council Tax account were to be presented in the accounts, including issues of timing.

#### **Collection Fund / Council Tax Income / NDR Income**

- Q10** Do you support exploring accounting for NDR on an agency basis with CLG and the devolved administrations in Scotland and Wales? Please provide reasons.
- Q11** Do you agree that the possibility of amending the accounting for Council Tax should be explored with CLG and the Welsh Assembly Government, and considered for Scotland? Please provide reasons. [Note: no changes are proposed for Northern Ireland as only the amount of domestic and non-domestic rates receivable is included in the Income and Expenditure Account, and no separate account dealing with the collection of rates is required]
- Q11a** For Scotland only, please indicate if you believe there are any legislative barriers to amending the accounting that would need to be discussed with the Scottish Government.
- Q12** For England and Wales, if your answer to Q11 is 'Agree', should this be on the basis of including gross amounts in the I&E, or on an agency basis? Please provide reasons. [Note: in Scotland, as there are no precepting bodies the agency basis would not apply]
- Q13** Do you support exploring with CLG / devolved administrations the possibility of removing the requirement for separate returns on the Collection Fund / Council Tax / NDR? Please provide reasons.

#### **Pension Fund Accounts**

- 4.12. From 1 April 2007 the Local Government Pension Scheme (Amendment) (No. 3) Regulations 2007 requires administering authorities in England and Wales to prepare a Pension Fund Annual Report that includes the Pension Fund Accounts. The local authority accounts could therefore be simplified by removing the requirement to include the Pension Fund Accounts in the Statement of Accounts of an administering authority. Consultation with the Scottish Government may be needed to introduce regulations relating to the separate publication of a Pension Fund Annual Report in Scotland. There are also some outstanding issues regarding proper practice and audit approaches that would need to be resolved across the UK prior to this change being made.

#### **Pension Fund Accounts**

- Q14** For England and Wales, do you agree that administering authorities should not be required to include Pension Fund Accounts in the local authority's Statement of Accounts? Please provide reasons.
- Q15** For Scotland, do you agree that the Scottish Government should be consulted about introducing regulations requiring a separate Pension Fund Annual Report, and that the Pension Fund Accounts should then not be required in the administering authority's Statement of Accounts? Please provide reasons.

## Trust and Charity Accounts

- 4.13. The SORP currently requires disclosure of information regarding trust funds where the local authority acts as sole trustee. Further information is required where the authority administers other trust and third party funds.
- 4.14. In Scotland, the Office of the Scottish Charity Regulator (OSCR) is proposing that registered charity trust funds be required to publish separate accounts (this would be a similar requirement to those for pension funds discussed above). Where separate accounts are already prepared, there would be an opportunity to reduce the disclosures in the local authority accounts (provided the revised consolidation requirements of IFRS did not require those charitable trusts to be consolidated into the authority's accounts). Trusts that were not registered charities, or were not otherwise producing separate publicly available accounts to a similar standard, would still need to be included in the local authority accounts. Regulations may need to be amended to permit such reduced disclosures in local authority accounts.

### Trust and Charity Accounts

**Q16 Do you agree that to avoid duplicate reporting where trusts and charities produce separate publicly available accounts, disclosures would not be required in a local authority's accounts (unless there was a requirement to consolidate the trust or charity into the local authority's accounts)? Please provide reasons.**

### Other regulatory disclosures

- 4.15. A number of the notes to the accounts required by the current SORP provide disclosures required by regulation. Where these would not be required by IFRS, there is the scope to simplify the accounts by removing the notes. Any such changes would require amendments to regulations by CLG and devolved administrations. A list of notes for consideration is provided below (based on the 2007 SORP and related Guidance Notes). Despite not being required by IFRS, there may be good reasons (for example, accountability) for retaining some of the notes. The list is therefore shown in two parts, those notes CIPFA/LASACC recommend are removed from the statement of accounts, and those CIPFA/LASAAC recommend are retained in the statement of accounts. The options for each note are: to repeal the regulation if it no longer serves a purpose; amend the regulation so that the underlying purpose is retained but disclosure in the accounts is no longer required; amend the regulation to require amended reporting requirements; or to retain the existing disclosure in the accounts.

## Notes to the accounts

**Q17 For each note shown below, please indicate whether you believe that:**

**(A) the requirement should be repealed;**

**(B) the requirement should be retained without being included in the accounts (if selecting this option, please indicate how / where the information should be provided);**

**(C) the requirement should be retained, but with a different reporting approach (if selecting this option, please indicate what this would be); or**

**(D) the existing requirement should be retained.**

**Please provide reasons.**

## Removal recommended by CIPFA/LASAAC

Notes	Regulation	Preference
Discretionary Expenditure (5)	s137 Local Government Act 1972 (England & Wales); s115 Local Government Act (Northern Ireland) 1972	
Expenditure on publicity (6)	s5(1) Local Government Act 1986; s115(c) Local Government Act (Northern Ireland) 1972	
The building control account (England and Wales only) (7)	Building (Local Authority Charges) Regulations 1998	
Schemes under the Transport Act 2000 or Transport (Scotland) Act 2001 (9)	Schedule 12 of the Transport Act 2000 and Schedule 1 of the Transport (Scotland) Act 2001	
Business Improvement District Schemes (10)	Business Improvement Districts (England) Regulations 2004; Local Government Act 2003; Planning etc (Scotland) Act 2006	
Local Authority (Goods and Services) Act 1970 (11)	Local Authority (Goods and Services) Act 1970 s2(2)	
Collection of local taxes (Wales) (18)	Consequence of section 38 of the Local Government (Wales) Act 1994 ( <b><i>see Council Tax proposals above</i></b> )	
Insurance provisions (Scotland) (35)	s13 Local Government etc (Scotland) Act 1994	

## Retention within the accounts recommended by CIPFA/LASAAC

Notes	Regulation	Preference
Health Act 1999 pooled funds and similar arrangements (12)	<b><i>Note not mandatory under regulations</i></b>	
Members' allowances (14)	Disclosure required, but not mandatory to be in Statement of Accounts	
Officers' emoluments (15)	Accounts and Audit Regulations 2003 (England) and Accounts and Audit (Wales) Regulations 2005 (Wales); not a statutory requirement in Scotland and Northern Ireland	
Reserves and balances held by schools under delegated schemes (42)	May be possible to cover this in the <i>Statement of Changes in Equity</i>	
Dedicated Schools Grant (England)	Accounts and Audit Regulations 2003	

## **5. SAME INFORMATION FOR ALL AUTHORITIES?**

- 5.1. Over recent years the SORP requirements have become more complex as new accounting standards such as those dealing with financial instruments have been incorporated. This has led some stakeholders to question how relevant the SORP is to smaller authorities and their accounts users, and whether simplified or reduced reporting requirements would better meet their needs.
- 5.2. A key aim of the accounts is to demonstrate public accountability, both to central government and to the public. It can be argued that as long as sufficient information to achieve this aim is included in the statement of accounts, further information is not required. The alternative view is that the additional information is required to provide a full picture of local government finances, especially where the same services may be provided by different classes of authority.
- 5.3. If simplified or reduced reporting requirements are considered appropriate, the question as to which authorities these requirements should apply will need to be addressed. Currently the SORP applies to parish and community councils with a turnover in excess of £1 million. All other authorities (including joint boards) are covered by the SORP.
- 5.4. In the private sector, simplified or reduced reporting requirements are provided through the Financial Reporting Standard for Smaller Entities (FRSSE). The FRSSE applies to small entities (a small company is defined in the Companies Act 2006 as a company meeting at least two of the following criteria: turnover of not more than £6.5 million; balance sheet assets of not more than £3.36 million; and number of employees not more than 50). Applying similar levels to local authorities would exclude parish and community councils from the requirements of the new IFRS Code of Practice. All other authorities (including joint boards) would still be required to comply with the full requirements of the Code.

### **Same information for all authorities?**

**Q18 Do you agree that reduced or simplified reporting requirements would be appropriate for small authorities? Please provide reasons.**

**Q19 Do you agree that the appropriate cut off point for simplified or reduced reporting requirements should be in line with those applying to the FRSSE? Please provide reasons.**

## **6. SINGLE ENTITY OR CONSOLIDATED ACCOUNTS?**

- 6.1. Under IFRS, entities are required to produce consolidated financial statements. Separate financial statements (single entity financial statements) are not required, although entities may elect to produce them. In theory, local authority accounts could therefore be simplified by producing consolidated accounts only, rather than two sets as at present.
- 6.2. Where a local authority group includes one company that provides services primarily to the authority, the consolidated accounts may be a better representation of the resources available to provide services to the local population than the single entity accounts. By contrast, where a local authority group includes one or more companies that have a significant volume of work outside the local authority area, the consolidated accounts will not represent the resources available to provide services to the local population as accurately as the single entity accounts. However, the consolidated accounts will give a better representation of the business risks and opportunities (whether financial or reputational) to which the authority is exposed.
- 6.3. Prudential indicators and the Prudential Code are currently based on the single entity accounts. Were authorities to produce consolidated financial statements only, then either the prudential indicators and Prudential Code would need to be amended as part of the planned review to focus on the group, or authorities would need to maintain sufficient single entity information to enable the indicators to be calculated and the Code to be followed.
- 6.4. This need not be an either/or decision. It would be possible to follow the approach used by private sector groups under the Companies Act, where consolidated financial statements are supplemented by more limited information on a single entity basis for the group holding company itself.

### **Single entity or consolidated accounts?**

- Q20** Should local authorities only produce consolidated financial statements? Please provide reasons.
- Q21** If your answer to Q20 is Yes, should the prudential indicators and Prudential Code be amended to refer to the consolidated position? Please provide reasons.
- Q22** If your answer to Q20 is No, should an additional full set of authority only accounts be produced, or a more limited set of financial information? If the latter, which statements and notes should be provided for the single entity disclosure? Please provide reasons.

## **7. LEVEL OF INFORMATION ON THE FACE OF THE FINANCIAL STATEMENTS**

- 7.1. As mentioned earlier, IFRS is less prescriptive than UK GAAP in determining the layout of the financial statements. The minimum information required to be included in each statement is specified, but the layout of the statements and which additional disclosures required by IFRS are included in the statements and which are included in the notes are left to the discretion of the entity. To ensure comparability between local authorities, these decisions should be addressed by the new IFRS-based Code of Practice on Local Authority Accounting.
- 7.2. The flexibility within IFRS allows a minimum amount of information to be presented in the financial statements, with the bulk of the detailed disclosures in the notes; or full disclosure on the face of the statements, resulting in shorter notes; or a compromise between these two extremes. Annex B lists the minimum requirements and gives examples of disclosures that could appear either within the main financial statements or the notes.
- 7.3. To be useful, the financial statements need to be understandable. Reducing the level of detail within the main statements, and providing this detail in the notes, may make the accounts more understandable for some users. However, the result may be that the main statements become less useful for other users, as the information they need is provided elsewhere. Comments on the appropriate level of detail to be included in the financial statements are sought.

### **Level of information on the face of the statements**

**Q23 What is the appropriate level of detail to be provided in the financial statements? Please provide reasons.**

**Q24 What considerations should be taken into account when determining whether an item is presented in the financial statements or in the notes to the accounts? Please provide reasons.**

## **8. SERVICE INFORMATION**

- 8.1. International Financial Reporting Standards require service information to be provided as part of the financial statements. IFRS 8 requires segment information to be provided on the basis of internal management reporting, based on local decisions as to what information is provided and to whom. However, this requirement has been adapted elsewhere in the public sector.
- 8.2. The underlying principle of IFRS 8 is that 'An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates'. For the private sector, IFRS 8 complies with the principle by requiring entities to make disclosures based on how they are managed. For local authorities, the legislative and financial framework in which they operate may mean that users would better be able to evaluate the activities of an authority if service information were provided on a consistent basis throughout the sector.
- 8.3. Providing service information on the basis of Best Value Accounting Code of Practice (BVACOP) would be consistent with existing requirements to produce information in line with BVACOP, and would provide comparability across authorities. Information about how private sector companies are managed is useful to users because each company may be providing different goods or services in different areas, and information about how the companies are managed will be useful for investment decisions. Local authorities on the other hand provide a well defined, comparable range of services, and there is not the same need to have information that will be of use to investors. Service information that allows users to compare the performance of different authorities for a particular service is therefore more likely to be of benefit, and would best be provided by service information following BVACOP.
- 8.4. Providing service information on the basis of BVACOP would also avoid the need for additional reconciliations of service information to the authority's Income and Expenditure Account, thus simplifying the accounts, and would also be consistent with the Whole of Government Accounts, national accounts data collection requirements, and other regulatory returns.
- 8.5. Providing service information on the basis of internal management reports would have the advantage that the information would match reporting to members throughout the financial year, and would allow authorities to concentrate on local issues. The disadvantages are that, as information produced in this manner is unlikely to be on the same basis as that used in the Income and Expenditure Account (see explanation below), reconciliations between the service information and the Income and Expenditure Account would need to be provided. Service information produced on the basis of internal management reporting is also unlikely to match other reporting requirements such as the Whole of Government Accounts.
- 8.6. If service information is provided on the basis of internal management reporting, IFRS 8 would require information to be disclosed on the basis of internal reports provided to the 'chief operating decision maker'; this function appears to best match either the Cabinet (or equivalent group of members) or the Chief Executive and directors (or equivalent group of officers) in local authorities.
- 8.7. Reports to members or directors may not include a number of items that appear in the Income and Expenditure Account, for example gains or losses on disposal of fixed assets and pension costs. Items that do not affect the General Fund balance are more likely not to be reported to members or directors as part of the normal

monitoring process. Under IFRS 8, these items would not need to be included in the service information, but would form part of the reconciliation between services' income and expenditure and the authority's income and expenditure. Further reconciling items will be required where service reporting is based on thresholds and not all services are reported.

- 8.8. The SORP currently requires authorities to provide a service analysis on the basis of BVACOP in the financial statements. Under UK GAAP, this is normally within the Income and Expenditure Account, although authorities are able to present a locally determined service analysis within the Income and Expenditure Account, as long as a BVACOP service analysis is provided in the notes. An option to present both a locally determined and a BVACOP based service analysis would be possible under IFRS.

#### **Service information**

**Q25 Which is your preferred option for providing service information?**

**(A) Internal management information as primary approach, reconciled to a BVACOP approach;**

**(B) BVACOP as primary approach, reconciled to an internal management information approach;**

**(C) Continue with current option to use either a BVACOP approach, or an internal management information approach reconciled to a BVACOP approach?**

**Please provide reasons.**

**9. FACTORS NOT COVERED BY THE CONSULTATION**

- 9.1. If you consider there are other factors not covered by this consultation that should be taken into account in considering the presentation and content of the statement of accounts, CIPFA/LASAAC would be pleased to consider these.

## USERS OF LOCAL AUTHORITY ACCOUNTS

### 1. INTRODUCTION

- 1.1 In their document 'Statement of Principles - Interpretation for Public Benefit Entities' (June 2007), the ASB states:

'The objective of financial statements is to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity's management and for making economic decisions.'

- 1.2 It follows that any discussion about the format of the accounts must begin by defining the users for whom the accounts should provide useful information.
- 1.3 This paper considers the classes of user identified in the IASB 'Framework for the Preparation and Presentation of Financial Statements' and the ASB Interpretation referred to above, and discusses their information needs in the context of local authority accounting.
- 1.4 The International Public Sector Accounting Standards Board (IPSASB) is currently undertaking a 'Public Sector Conceptual Framework Project' aimed at developing a conceptual framework for public sector financial reporting. Whilst this project has not yet reached firm preliminary conclusions, issues identified by the project are considered in the rest of this paper.

### 2. IDENTIFICATION OF USERS

- 2.1 In its 'Preface to International Financial Reporting Standards', the IASB states:

'IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities.'

- 2.2 It follows that the users identified in the IASB Framework above will be appropriate users of the accounts of profit-oriented entities, and may need interpreted for the local authority context. The ASB Interpretation is designed to interpret its Statement of Principles (which is consistent with the IASB Framework) for public benefit entities, and therefore is useful in determining the users of local authority accounts. The IPSASB project has also identified a list of users of public sector accounts. This list is generally consistent with the classes of users considered below, and any discrepancies are discussed in the relevant paragraphs.
- 2.3 The Interpretation concludes that all users of the accounts will use financial statements to inform economic decisions, either directly or indirectly.
- 2.4 Because the Interpretation is generic rather than specific to local authorities, it provides a starting point for considering the relevant users rather than a definitive list of users and their needs.

### 3. CLASSES OF USERS

- 3.1 The following paragraphs discuss the classes of users and their information needs identified in the IASB Framework, taking into account the ASB Interpretation and the local authority context.

### 3.2 Investors / Funders and Financial Supporters

The IASB Framework defines investors as the providers of risk capital, who need information to make decisions as to whether to buy, hold or sell. The Framework states that financial statements that meet the needs of investors will also meet most of the needs of other users.

The ASB Interpretation recognises that public benefit entities rarely have such investors, and defines as an alternative class of user 'funders and financial supporters'. These are the users who provide the resources for the public benefit entity. The definition includes two distinct sub groups, those who make a conscious decision to provide resources (financial supporters) and those who do not, such as local tax payers (funders). Neither funders nor financial supporters will see a direct return on the resources they provide, although they may receive benefits indirectly. In this sense, the provision of resources by funders and financial supporters is a non-exchange transaction.

Funders and financial supporters are referred to in the Interpretation as the defining class of user for the financial statements of public benefit entities.

Funders and financial supporters use financial statements to inform economic decisions. This may include decisions about the level of resources to be provided to an entity (including whether to commence or cease providing resources). Whilst taxpayers cannot directly make economic decisions, they may have the right to vote, which could indirectly impact on the level of resources available to an entity.

In the local authority context, the main funders are the local Council Tax payers and, less directly, Non-Domestic Ratepayers, and the main financial supporters are government departments. However government departments could be said to be acting on behalf of taxpayers on national basis, the majority of whom also pay Council Tax, and so have a general interest in the performance of local government everywhere. As the Interpretation recognises, these users will be primarily interested in a local authority's stewardship of the resources provided by funders and financial supporters. They will also have an interest in ensuring that the authority is acting in a prudent manner, so that services can be maintained from year to year.

Government departments may have more specific information needs than Council Tax and Non-Domestic Rate payers. However, departments have the ability to require returns (specific purpose financial statements) from authorities and as such are less dependent on the published accounts for their information. Indeed, whilst the information provided to departments is often the same as that included in the accounts, the departments do not request (or receive) the published Statement of Accounts.

The information needs of funders and financial supporters will therefore best be met by considering the needs of Council Tax and Non-Domestic Rate payers, whilst ensuring that the accounts operate on a basis consistent with the information needs of departments to avoid any dual reporting requirements.

Both the Interpretation and the Framework recognise that users may need to supplement the information in financial statements with other information (e.g. performance information, such as Comprehensive Performance Assessment scores). Financial Statements should therefore concentrate on

providing the financial information that will be of use to Council Tax and Non-Domestic Rate payers.

Council Tax and Non-Domestic Rate payers are likely to be most interested in whether an authority has under or over spent against its budget (or increased or decreased the level of its General Fund) as this is likely to provide an indication of whether an authority is likely to need to increase Council Tax or reduce services in future to recover a fall in General Fund balances. They will also be interested in how scarce resources are allocated to competing priorities.

Information about assets, liabilities, reserve balances etc. will also provide useful information regarding an authority's ability to provide services, and the cost of providing those services, in the medium to longer term.

In local authorities, Council Tax and Non-Domestic Rate payers interests are often (but not always) represented by members. This should be borne in mind when considering the financial statements, although the fact that members are in a position to request additional information, or specific purpose financial statements, should also be taken into account. Members have a dual role, both representing Council Tax and Non-Domestic Rate payers and as part of the management of the local authority.

In the IPSASB project, Funders and Financial Supporters are identified as two different classes of user. Some possible additional information needs are identified; these are:

- comparison with budgets
- non-financial performance data
- prospective information

The separate classification of funders and financial supporters in the IPSASB project does not change the analysis of information needs detailed above.

### 3.3 Employees

The Framework states that employees will be interested in the stability and profitability of their employer, as this will determine the likelihood of job security and additional employment. In local authorities, employees will be interested in the stability and ability of the authority to continue to provide services, as this is what will determine job security and additional employment. The public sector ethos present in local authorities means that employees will also be interested in the ability of the authority to continue to provide services because of the impact on beneficiaries. These needs will be met by providing similar information to that required by funders and financial supporters – i.e. concentrating on the ability of the authority to continue to provide the existing level of services in the future.

The interests of employees will often be represented by unions and other such bodies.

### 3.4 Lenders

Lenders are interested in whether their loans and related interest will be repaid, as is recognised by both the Framework and the Interpretation. As authorities tend to borrow mainly from the Public Works Loan Board, this class of user is of lesser importance for most authorities than would be the case for a commercial enterprise. Local authorities' status as part of general

government may also mean that commercial lenders are less dependent on the published accounts when deciding whether to lend money to a local authority.

Lenders will be interested in the level of resources available to repay loans. As such, the level of assets will be a significant factor. The financial performance of the authority will also be of interest, as this could influence the level of resources that have to be applied to other purposes. In local authorities, statute does not allow loans to be secured against assets; instead they are secured against future tax revenues.

### 3.5 Suppliers and other Trade Creditors

Suppliers and trade creditors are interested in whether amounts due to them are likely to be paid, as recognised by the Framework. The Framework also recognises that unless the suppliers have a long term relationship with the authority, their interest is likely to be over a shorter period than lenders, although in other respects their information needs are likely to be the same. In a similar manner as for lenders, the nature of local authorities may be a more significant factor when deciding whether to provide goods and services than the published accounts.

Suppliers and other Trade Creditors will be interested in the level of resources available to pay the amounts due. Consequently, the level of assets (especially liquid assets such as cash) will be a significant factor.

In the IPSASB project, suppliers and creditors are identified as two different classes of user.

### 3.6 Customers / Beneficiaries

The Framework states that customers have an interest in the continuance of an entity, especially where they have a long term relationship with, or are dependent on the entity. The Interpretation refers to beneficiaries as well as customers, as for public benefit entities services will often be provided without charge, and there may be no choice as to the provider of those services. For both beneficiaries and customers, the main concern will be whether an authority will be able to continue to provide the existing level of services (and in the case of customers or beneficiaries who are required to make a contribution, at what cost). These users will therefore seek information on an authority's financial performance against budget, as this will impact on the level of resources available for services in future.

Information about assets, liabilities, reserve balances etc. will also provide useful information regarding an authority's ability to provide services, and the cost of providing those services, in the medium to longer term. Customers and beneficiaries will also be interested in the allocation of scarce resources to competing priorities, as changes in this area could affect the availability or cost of services in which they have an interest.

A particularly important group of customers and beneficiaries within local authorities is council house tenants. They will have similar interests to other customers and beneficiaries, but because of the ring-fenced nature of the HRA, they will be interested in the financial performance of this account in isolation, as well as the overall financial performance of the authority.

In view of their numbers and direct relationships, customers and beneficiaries are likely to be the second most important group of users when considering

the financial statements of local authorities, after funders and financial supporters. The information needs of the two groups are likely to be similar, and there is likely to be a significant overlap between the two groups.

### 3.7 Governments and Agencies

Governments and their agencies are interested in the allocation of resources (by others) and consequently are interested in the activities of all entities. This is recognised by both the Framework and the Interpretation, and is a different role to that of financial supporter, where governments and their agencies are interested in allocating their resources.

Governments are interested in the activities of entities for a variety of reasons, including regulation, taxation and policy reasons, and the information required may form part of national statistics.

Governments and their agencies will generally seek this information from local authorities through special purpose financial statements such as returns, although these will often be consistent with the financial statements.

When considering the financial statements of local authorities, the information needs of this class of user do not need to be designed into the format of the accounts. However, ensuring that the accounts operate on a basis consistent with the information needs of central government and its various agencies (e.g. the Office for National Statistics for national accounts data and HM Treasury for Whole of Government Accounts consolidation returns) should help minimise the need for dual reporting.

In the IPSASB project, 'elected officials and their staff' and 'legislative bodies and regulators' are identified as two different classes of user.

### 3.8 Public

The Framework states that the public have an interest in the financial performance of entities for a variety reasons; one example given being that the entity was a major employer in the area. The Interpretation acknowledges that the interest will vary for public benefit entities; for example the public may be interested in the relative allocation of resources between competing priorities.

For local authorities, the public will generally also be funders, and may be customers / beneficiaries as well. As such, their information needs are likely to be met by meeting the information needs of funders and customers / beneficiaries.

## 4. CONCLUSIONS

4.1 This discussion paper has considered the users of local authority financial statements and their information needs. The key factors to be taken into account when designing the IFRS compliant local authority financial statements are detailed below:

- The defining class of user is funders and financial supporters, in effect government, Council Tax and Non-Domestic Rate payers.
- Preparing financial statements in a manner that is consistent with government information requirements should minimise the amount of dual reporting that is required.

- Council Members have an important role to play both in representing Council Tax and Non-Domestic Rate payers and as part of the management of the authority, so their needs from both perspectives will need to be met by the financial statements.
- The second most important group of users is customers and beneficiaries, including HRA tenants.
- Meeting the information needs of these groups should meet the majority of other information needs.
- The key concern of funders / financial supporters and customers/ beneficiaries is whether the authority is able to continue providing the same level of service going forwards. The best indication of this from historic data is the performance against budget, represented by the surplus or deficit on the general fund and HRA. The Balance Sheet and Income and Expenditure Account will provide additional information that will be of use to users.

**Information that is required to be or may be presented in the financial statements under IFRS**

<b>Required</b>	<b>Optional (Statement or Notes)</b>
<b>Statement of Changes in Equity</b>	
Opening Balance	
Comprehensive Income	
Adjustments to Comply with Statute	Amortisation of Intangible Assets Depreciation and Impairment Government Grants Deferred Amortisation Transfers re Expenditure funded from Capital Resources Adjustments re Soft Loans, Premiums & Discounts Net FRS 17 adjustments Employers contributions re retirement benefits MRP / Loans Fund Charges Major Repairs Reserve RCCO Housing Capital Receipts Pool
Other Transfers	Voluntary revenue provision Transfer to earmarked reserves Transfer from earmarked reserves
Closing Balance	
<b>Statement of Comprehensive Income (Income &amp; Expenditure Account)</b>	
Revenue	Subjective breakdown, e.g. Fees & Charges, Other Service Income, Specific grants etc.
Other Income	E.g. Gain or Loss on Disposal of Fixed Assets
Expenses	Subjective breakdown, either to minimum required (Employee expenses, depreciation and amortisation and other expenses) or by BVACOP subjective grouping (Employee expenses, premises expenses, etc.)
Finance Costs	Interest payable and similar charges Pension interest cost
Profit or Loss of Associates and Joint Venturers	

Profit or Loss of Discontinued Operations	
<i>Surplus or Deficit for year [TOTAL]</i>	
Surplus or deficit on revaluation of fixed assets	
Surplus or deficit on revaluation of available for sale financial assets	
Actuarial gains / losses on pension assets / liabilities	
Other Comprehensive Income	
Share of other Comprehensive Income of joint ventures, etc	
<i>Total Comprehensive Income [TOTAL]</i>	
<b>Statement of Financial Position (Balance Sheet)</b>	
Property, Plant & Equipment	Breakdown, e.g. Council Dwellings, Other Land & Buildings, Plant, Vehicles & Equipment etc.
Investment Property	
Intangible Assets	Breakdown by Class, e.g. Computer Software, Patents, etc.
Non Current Financial Assets	
Non Current Receivables	
<i>Non Current Assets [TOTAL]</i>	
Current Financial Assets	
Current Receivables	
Inventories	
Cash & Cash Equivalents	Breakdown to e.g. Cash, Short term deposits etc.
Assets held for Sale	
<i>Current Assets [TOTAL]</i>	
Current Payables	
Current Financial Liabilities	Short Term Borrowing Overdrafts

Liabilities in disposal groups	
<i>Current Liabilities [TOTAL]</i>	
Non Current Payables	
Non Current Financial Liabilities	Long Term Borrowing Liability in relation to Pensions Other Deferred Liabilities
Provisions	
<i>Non Current Liabilities [TOTAL]</i>	
Reserves	Breakdown to e.g. General Fund, HRA, Earmarked Reserves etc. or breakdown to each reserve

Examples for the Cash Flow statement are not included here as the statement is more prescriptive than others.