

# Spectrum

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Policy & technical perspectives for CIPFA members and students

CIPFA

The autumn 2005 issue of Spectrum covers a wide range of topics – audit committees in local government, payment by results, e-government, Children’s Trusts, technical updates on accounting and auditing standards, and central/local government relationships.

Future editions of Spectrum will be published on the CIPFA website at [www.cipfa.org.uk/pt/spectrum.cfm](http://www.cipfa.org.uk/pt/spectrum.cfm) where recent issues of Spectrum can also be found.

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## Audit committees: practical guidance for local authorities

*Patrick Clackett*

This new guidance from CIPFA encourages local authorities to put in place an audit committee where they do not have one, and helps those with established audit committees to make them more effective.

The topic of audit committees is not new. They have been in place in many parts of the public sector for some time, operating in different ways in different organisations. Audit committees are ever more widely recognised across the public and private sectors and internationally as a core component of effective governance. Yet local government shows a mixed pattern of adoption and practice. Less than half of local authorities have a formally constituted audit committee. Rising public and media expectations about transparent governance arrangements have raised the bar. In England, Comprehensive Performance Assessment (CPA) sets a challenge for local authorities to ensure their audit committees work effectively. CIPFA would be failing in its responsibilities to local government and to members if it failed to offer guidance at this important time.

CIPFA has listened to a wide spectrum of opinion on this topic and accepts that in local government there is a diversity of views about the added value which audit committees bring to the governance arrangements within authorities. Prescriptive ‘one size fits all’ statements would therefore be inappropriate and unhelpful. What is important is that the functions of audit committees are discharged effectively and are recognised for their significance in relation to overall governance. In this context the Institute is clear that practical guidance, rather than prescription, is the right way forward.

So the guidance is deliberately flexible in a number of areas including the membership and timing of meetings. It also recognises that audit committees may exist under a number of different names. Nevertheless, there are some

**Contents:**  
Front Page  
Introduction

Audit committees:  
practical guidance  
for local authorities  
*By Patrick Clackett*

**Page 3**  
Payment by results  
- German lessons?  
*By Colin Dunn and  
Suzanne Tracey*

**Page 5**  
The real benefits,  
beneficiaries  
and value of  
e-government  
*By Paul Foley*

**Page 7**  
Children’s Trusts -  
new opportunities  
*By Paul Cook*

**Page 9**  
Financial reporting  
developments in  
2005  
*By Steven Cain*

**Page 11**  
Auditing  
developments  
in 2005  
*By Steven Cain*

**Page 13**  
National  
challenges,  
local solutions  
*By Sir Sandy  
Bruce-Lockhart*

AT THE HEART OF  
PUBLIC SERVICES



► core principles on which flexibility is less appropriate. For example, it makes sense for the chair of the committee to be independent of other functions and for the remit of the committee to cover the governance of the whole authority.

Good corporate governance requires independent, effective assurance about the adequacy of financial management and reporting. Effective audit committees help raise the profile of internal control, risk management and financial reporting issues, within an organisations as well as providing a forum for the discussion of issues raised by internal and external auditors.

CIPFA believes that these functions are best delivered by an audit committee separate from executive and scrutiny functions, and chaired independently from both these functions. The committee must also have a clear right of access to full council, other council groups and committees.

The case for separating audit committees from the executive is clear and self evident. But CIPFA recognises that some local authorities have already set up audit committees as part of scrutiny structures. The role of scrutiny is to review policy and challenge whether the executive has made the right decisions to deliver policy goals. This is different from the role of the audit committee which exists to provide independent assurance that there are adequate controls in place to mitigate key risks and to provide assurance that the authority, including the scrutiny function, is operating effectively. That said, an audit committee's judgments may well be informed by the results of scrutiny activity within the authority. Both audit committees and the scrutiny function deal with complex matters, sometimes requiring specialist knowledge and advice. CIPFA believes that they are likely to be more effective if they are required to focus on their own defined areas of business rather than a broader remit.

Status and independence are important, but being effective also means having well informed people able to confirm to the council that the right processes are in place to give confidence that the local authority's financial stewardship and overall governance arrangements can be relied upon. CIPFA's guidance, therefore, provides valuable advice on the skills required by members, their selection and training, and how committees should be supported.

This guidance explores the main purposes of an audit committee and concludes that these include giving independent assurance to members and the public, scrutinising financial management and reporting, and providing challenge across the council.

In addition to internal and external audit the functions overseen by the committee should include a number of control strategies such as risk management, the authority's governance and assurance statements, and anti-fraud and anti-corruption arrangements.

The importance of the relationship with an authority's Chief Finance Officer (CFO) is stressed in the guidance. CIPFA believes that the roles are mutually supportive. An effective audit committee is an additional source of assurance to the CFO that systems of internal control are working effectively, and that internal audit is operating in accordance with the Code of Practice. In turn, the audit committee relies on the CFO to provide advice and guidance. Some CFOs are concerned that the opportunity for external and internal auditors to meet privately with the audit committee might undermine their position. The guidance says that there should be the opportunity for such meetings as a practical outworking of auditor independence just as CFOs should also have confidential access to members in appropriate circumstances. However, CIPFA expects such meetings to be the exception rather than the rule.

CIPFA is not 're inventing the wheel'; significant practical experience of audit committees exists across the public sector. It makes sense to distil this learning for local authorities and create the opportunity for them to take advantage of it. This is why the guidance includes suggested terms of reference and a self assessment check list drawn from good practice elsewhere.

The guidance also sets out some core principles and features common to all. For example, all local authorities should formally approve a Statement of Purpose, along the following lines;

*The purpose of an audit committee is to provide independent assurance of the adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority's financial and non-financial performance to the extent that it affects the authority's exposure to risk and weakens the control environment, and to oversee the financial reporting process.*

The features of good audit committees include having a strong chair – displaying a depth of skills and interest, unbiased attitudes – treating auditors, the executive and management equally, the ability to challenge the executive when required, and a membership that is balanced, objective, independent of mind, and knowledgeable.

CIPFA recognizes that recruiting to an audit committee is not easy, particularly for small councils. Identifying sufficient members with appropriate skills and experience can be difficult, especially as many such members could already be serving on other committees and thus may not be eligible for membership. For some authorities, co-option may be beneficial. Often, the injection of an external view, for specific discussion, can be seen as bringing a new approach and flavour to committee discussions.

The guidance and this article focuses on CIPFA's preferred independent audit committee model. But some local authorities may choose to adopt different arrangements other than those found in the CIPFA guidance. They should clearly be at liberty to do so. Ultimately authorities should have the freedom to make their own judgements about appropriate governance arrangements and to justify their decisions through the relevant accountability channels. ●

*Audit Committees – Practical Guidance for Local Authorities* and details of a related course on 12 December in central London are available from the CIPFA Shop at [www.cipfa.org.uk](http://www.cipfa.org.uk)

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## Payment by results – German lessons Colin Dunn and Suzanne Tracey

**P**ayment by Results (PbR) brings new financial risks and has not had a smooth take off in England illustrated by radical changes to tariff structure, major shifts in market forces factors and a 12-month delay in application to everything but elective services.

This article looks at how Germany is managing the financial risks of implementing a similar system. However, a little background should help put the feature into focus.

### What is Payments by Results?

The Department of Health (DoH) introduced PbR in 2003 and phased it in across England over the next two years. 2005 is the first year it has been used across the whole of England.

The new system means that health-related decision making is handed down to local level rather than from central government directly. It aims to provide a transparent, rules-based system for paying trusts; pay NHS Trusts and other providers fairly and transparently for services delivered; reward efficiency and quality in providing services; support greater patient choice and more responsive services; and enable Primary Care Trusts (PCTs) to concentrate on quality and quantity rather than price.

Importantly, the system rewards efficiency, supports patient choice and diversity and encourages activity for sustainable waiting time reductions. It ensures a fair and consistent basis for hospital funding because payment is linked to activity and adjusted for casemix.

### So what lessons, if any, can be learned from Germany?

Until 2003, German hospitals negotiated their income budget with the health insurance bodies principally on a per diem basis. These funding arrangements arguably encouraged and sustained an inefficient higher level of in-patient capacity and longer lengths of stay than in the UK. ▶

► Despite differences in their starting points, the new German system of performance oriented payment (POP) of hospitals and the English PbR system have similar objectives and similar approaches. Both are adopting a system of reimbursement of hospital activity – diagnosis-related groups (DRGs) in Germany; health-related groups (HRGs) in England. Both systems incentivise improvements in the utilisation of hospital resources and increase competition through patient choice. Both face consequent financial risks.

A significant difference is that the English system provides incentives for PCTs to transfer work to alternative settings. This, coupled with encouragement for the independent sector to occupy a much larger share of the NHS market, will create powerful pressures to improve quality and efficiency in English hospitals. Few doubt that this is the way to go. The risks of unintended consequences are high however, in particular the potential destabilising effect on hospitals and funding bodies of:

- the transition to HRG/DRG tariffs;
- changes to tariff and tariff structure; and
- changes in activity levels.

### What lessons can be learnt from Germany's experiences to help minimise the financial risk?

As in England, in order to manage transition risk, convergence between existing rates and DRG rates is being phased in. By 2007, well over 90% of German hospital income will be driven by DRGs – a very similar picture to that in England. There are however marked contrasts in other areas.

Germany established InEK – a not for profit body jointly owned by the health insurance bodies and the Association of German Hospitals – to set and develop DRG classifications and tariffs. Tariffs for 824 DRGs with 71 additional fees were established. InEK also incorporated a process where all parties are able to propose new DRGs and other refinements to the system – although those are only possible where changes result in reduced variability in the DRG and do not detrimentally impact on 50% of hospitals.

In Germany, DRG rates vary only between the 16 states; based upon their particular economic factors. Although this sounds similar to the English system of market forces factors (MFFs), the variability (except between the old East and West Germany) is apparently far less than the range of English MFFs. Furthermore the changes in

MFFs announced late in 2004 caused significant percentage income increases/decreases for English hospitals. It is difficult to understand how such wide variations in English MFFs and the impact this has on hospital budgets can be justified. We would suggest that this is an area where more research is warranted.

Arguably the biggest risk of PbR for English hospitals is a move to hospitals being reimbursed only for the level of actual work undertaken against a background of policies that shift activity out of hospitals. However, income under the German system is less volatile than under UK PbR. Each year there is an agreed level of DRG activity between hospitals and their main insurers. If exceeded, only 35% of the full additional DRG income is payable within the first year. Conversely, if the agreed DRG activity level is not reached, the hospital is required to pay back 60% of the under-achievement. In other words, under or over-achievement is adjusted marginally rather than at full cost and performance levels are taken into account in negotiating the agreed level of activity for the following year.

In addition to smoothing the financial impact of activity changes on hospitals, such an arrangement also protects the funding body from sudden increases in activity. This might also allow time for suspicions of inappropriate coding behaviour to be investigated.

Practical lessons can also be learned from German hospitals currently responding to increased efficiency pressures brought about by the new systems.

Maria Hilf hospital in Mönchengladbach, for example, has implemented a detailed patient level costing system in order to manage effectively under a DRG type reimbursement system. For each patient, the system holds a detailed costed 'bill' of services utilised eg 2 days ITU; 3 days general ward; endoscopy x 2; X-Ray x 3; drugs etc. In Germany, detailed billing is not required, either under the old system, or under DRGs. But the hospital became convinced of the need to invest in such a system because it facilitates comparison of income with expenditure at both a departmental and DRG level, thereby driving efficiency.

One of the most notable differences between the new German system and PbR is the level and sophistication of national costing information available to hospitals. In Germany, InEK provides a standard breakdown of each DRG price. This means that a hospital can compare its actual DRG costs with its DRG income on an on-going basis during the year and it can do this at departmental level – it does not have to wait until it does its annual

# The real benefits, beneficiaries and value of e-government Paul Foley

costing return. (In England, it is notable that the annual costing returns are not used to facilitate departmental cost comparisons).

At Maria Hilf hospital, this information is used to drive hard efficiencies from the system:

- Management meet every month with each department, with all clinicians in attendance.
- Reports drill down to specialty, department, DRG and even if required individual patient, analyse actual performance against standard DRG profile and reasons for variance identified. Clinicians have quickly come to own these results and the system proves powerful in terms of clinical information as well as cost performance.
- Significant savings in bed days were demonstrated by the system over the last two years; allowing more activity and income to be attracted into the hospital.
- Each department is held responsible for its own performance using the system. Clinical ownership is aided by coding by doctors rather than dedicated clinical coders.

English hospital trusts will arguably need to improve both their information systems and clinician ownership of information. Two suggested improvements to greatly aid this are:

- HRG costing software providers developing products and functionality to help manage costs rather than merely meeting DoH requirements;
- Using the DoH's system for collating HRG costings to feed back information on the national average ingredients of those costs rather than just total costs for each HRG. Initially an overall departmental unit cost comparison could be developed, but ultimately a breakdown of each HRG price into say, theatre costs, inpatient stay x bed rates, drug costs etc would be extremely powerful in identifying and driving out inefficiencies. ●

The above is a condensed version – a full copy of this report is available from [www.cipfa.org.uk/panels/health](http://www.cipfa.org.uk/panels/health)

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Information and communication technologies (ICTs) have underpinned reforms in many areas and e-government\* is widely perceived to be fundamental to reform, modernization and improvement in government. However, the business case for ICT projects, and the real costs of the benefits attained by e-government services, have rarely been evaluated and a number of publications have called for improvements in this area (for example House of Commons Committee of Public Accounts, 2004; OECD, 2003). Policy-makers, policy advisers and practitioners need to be better informed about the costs, benefits, risks and outcomes associated with e-government.

## Why Evaluate?

During the dotcom boom, e-government enjoyed a healthy level of political and financial support; for example the Prime Minister said in a speech to the International eSummit in London in 2002 that more than '£6 billion will be invested in ICT over the coming years'. Many initial results have achieved a high profile and support has been easy to find. However, the next stage of e-government activity is likely to involve the development of lower-profile services and benefits are likely to be less apparent to policy-makers and users.

Monitoring and evaluation needs to be better incorporated in e-government planning. Without robustly calculated costs and benefits, e-government implementers will find it increasingly difficult to obtain political and public support. Government agencies and departments priorities will differ, but sound evaluation (after investing in ICT) and business case (prior to investment) studies of the impact of e-government will enable policy-makers to compare benefits alongside other demands for public funds. Better evaluation will also highlight where efficiency gains or expenditure savings have been made. This will enable resources to be reallocated and it will be possible to share elements of good practice. ►

### ► Current Studies

Benchmarking studies of e-government are undertaken regularly by IBM, the Economist Intelligence Unit, Accenture and others. However, these are frequently little more than simplistic 'bean-counting' exercises that measure the number of services provided online. These studies tend to focus on the visible interface with users and neglect more complex back-office changes, which could be significant in improving service quality or efficiency. In addition, they ignore the costs of online service provision. A cost-effective strategy would concentrate on introducing services where the greatest benefits and/or savings (or revenues) can be made. It may not be cost effective to provide some services online, or it may only be sensible to do so when sufficient users are forecast to use the e-government service.

More sophisticated evaluation studies have started to emerge in the past year. These studies move beyond simplistic counting of whether e-government services are available. Instead, they consider the financial costs of providing services and the benefits government and users receive from using e-government services alongside, or instead of, traditional methods of delivery.

The National Office for the Information Economy (NOIE, 2003) in Australia surveyed 38 e-government projects. Twenty-four projects claimed cost reductions (or increased revenues). From an estimated e-government investment of Aus\$108M these 24 projects were expected to achieve cost reductions of Aus\$100M. This represents an agency benefit/cost ratio of 92.6%. This study focused on costs and benefits to government and did not estimate user benefits.

A UK study of 14 e-government projects included user benefits in calculations and found that all except one provided savings. Payback periods for e-government projects varied between four months and 11.5 years, the average was 4.8 years (OECD, 2005).

### Developing Evaluation Methods

These studies and others (IAG, 2003) provide an interesting overview of the magnitude of benefits that can be derived from e-government projects. However, they raise almost as many questions as they answer since many have used different methodologies and results are presented in different ways. Some provide details about costs, others do not. This makes it difficult to be certain that savings exceed development costs and a positive return on investment has occurred.

It is important to emphasise that benefits arising from e-government are usually divided into two groups:

- Benefits for government, which are primarily based around efficiency gains obtained by ICT.
- Benefits for users, for example citizens and businesses.

Two recent government reports highlight the different emphasis that UK government places on these two groups of beneficiaries. Releasing Resources to the Front Line (Gershon, 2004) highlighted the role of ICT and e-government in increasing efficiency in service delivery. Prioritization of e-government services by the Office of the Deputy Prime Minister emphasised outcomes and improvements in services to users (ODPM, 2004). Both studies acknowledged the need to consider all costs, benefits and beneficiaries,

but little consideration was given to methods to evaluate these factors.

### Conclusions

The next stage of e-government activity is likely to involve the development of lower profile services, the joining-up of back-office activities and the integration of e-government programmes across departments and all levels of government. The amount of change and levels of complexity associated with these more advanced developments in e-government will be considerable. High up-front costs may make integrating programmes appear uneconomic.

The author is working with the Organization for Economic Co-operation and Development (OECD) to review best practice in e-government evaluation methods in 30 countries. Cost and benefits checklists and a generic methodology to evaluate economic benefits are being developed to compare costs and savings between different e-government projects (OECD, 2005). This will enable policy-makers, policy advisers and practitioners to better understand the real costs, benefits and beneficiaries of e-government projects. ●

*\* E-government has been defined by the OECD (2003) as 'the use of information and communication technologies (ICT), and particularly the Internet, as a tool to achieve better government'.*

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# Children's Trusts – new opportunities

Paul Cook

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This article looks at the new Children's Trusts, and the new opportunities for pooled budgets that have become available. It begins by looking at the requirement that every Children's Services Authority in England must set up a Children's Trust by 2008.

2003 saw the publication of the Every Child Matters Green Paper. This was part of government's response to the Victoria Climbié inquiry report by Lord Laming. The green paper offered (amongst many other measures):

- A new statutory post of Director of Children's Services
- A statutory Lead Council Member for Children
- The integration of key services for children and young people under the Director of Children's Services as part of Children's Trusts.

The trusts were to 'bring together local authority education and children's social services, some children's health services, Connexions' and might 'include other services such as Youth Offending Teams'. It was proposed that 'Children's Trusts would normally be part of the local authority and will report to local elected members'

With the Children Act 2004, the Every Child Matters proposals were indeed given statutory force. However, there is no statutory force behind the trusts. Nor are they trusts in the normal legal sense.

But the trusts will happen because of the power of the Department for Education and Skills (DfES) in setting the pattern of children's services, and because they are an Inspection given.

Local authorities want them to happen too. That is because the trusts fit the new practice model of integrated working (a child's needs determining how professionals group and what services are provided). Authorities also want the trusts because they need to be in place to meet the new statutory duty of 'promoting cooperation' to improve children's well-being.

Before moving on to the pooling opportunities, it is worth considering three of the multitude of expectations riding on the new trusts. All three will impact on finance managers. The first is improved inter-agency co-operation. ►

► The idea of better inter-agency co-operation in health and social care is hardly new. And there are already plenty of statutory joint planning and consultation requirements in place. True there is now the new dimension of shared information (particularly for protection duties) under the 2004 Act. But if the trusts really do deliver much improved inter-agency co-operation, that will be no mean achievement. The financial and accounting arrangements have a big part to play in this.

The second is initiativeitis. What must be disconcerting for the new Directors of Children's services is the barrage of friendly fire coming their way. Policies for drugs, extended schools, youth opportunity cards, pedagogy, joint area reviews, Commissioners, national service framework, common assessment frameworks – the list grows daily. Organising so many agencies to provide so much good news will put strong management direction (and of course robust financial planning) at a premium.

The third is delivering largely within existing resources. Cutting out local education authority (LEA) bureaucracy is an Eldorado that has been sought far longer even than improved inter-agency co-operation. The trusts arrive just as a new dedicated schools grant (DSG) comes into force. There is scope to use DSG (the centrally retained element of the Schools Budget) to support trust activities. But retained DSG will no doubt be under siege. Schools generally want to spend their own money. Yet at the same time, Children's Directors are taking over the notoriously hard to control children's social services budget. It will therefore be most interesting to see how the new trusts match that wide range of aspirations to the budget they have available.

The Children Act 2004 includes a new power to set up a 'pooled fund'. This seems to be a flexible power as there is no fierce schedule of accounting requirements. Perhaps this is because there has been learning from previous pooling initiatives (these being Section 28 of the NHS Act 1977, and Section 31 of the Health Act 1999).

What are the lessons that trusts can take forward from those previous attempts to square teetotal entity accounting with the heady Chateau Neuf du Pape of integrated service provision?

The plusses seem to be that:

- Partners find it easier to control their financial commitment to the service
- Generally avoids disputes about who pays for what
- Generally avoids complex administration or even disputes about which agency bears the cost of

particular clients (or in more complex cases, how one client's cost is shared between agencies).

- Resources may be used to deliver a shared agenda, rather than service priorities being determined by individual partners' resource position

Some of the minuses could be:

- Authorities set up extensive agreements to govern and define such arrangements. Superficially these appear to offer strong control of the arrangements. In practice, too extensive an agreement is pointless because there is not the management capacity to perform all the contractual requirements (e.g. formal notice to partners of service changes, routine reporting requirements)
- The rapid change agenda soon renders contractual provisions obsolete, and again there is not the management capacity frequently to review and renegotiate the agreement
- Valuable financial management resources may become diverted into disputes over relatively small values
- The agreements do not cope well with partners having to make expenditure reductions at different rates.
- Technical issues with auditors about FRS 15 requirements for a joint arrangement that is not an entity (JANE)

Finance managers can now take a strong role in making pooled funds a source of strength for the fledgling trusts. This entails:

- Good involvement in service planning so that Trust strategies and plans are backed by robust medium term financial plans
- Ensure that finance, performance and activity are three perspectives on the same service vision – not three disparate and contradictory views.
- Providing flexible financial management and accounting systems that can cope with truly integrated working outside the safety of traditional budget hierarchies.
- Ensuring financial reporting requirements for JANEs do not become a diversion at year-end

CIPFA's Education Panel is shortly to produce guidance on the financial management of trusts and there will be a number of courses in CIPFA's programme on the theme. Let us know what you think. ●

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Standard setting in the private sector in 2004 was dominated by the international convergence agenda, and this continues to be the main theme in 2005. Listed companies are now required to use EU-adopted International Financial Reporting Standards (IFRS) to prepare group financial statements in place of national standards. All but one of the 36 international standards apply without amendment for use in the EU. The exception is IAS 39 'Financial Instruments: Recognition and Measurement', where the European Commission adopted an amended version, with 'carve-outs' affecting hedge accounting requirements and the so-called 'fair value' option. The Accounting Standards Board (ASB) issued guidance in December 2004 to help UK companies understand the amended fair value option.

In March 2005 the ASB published a draft policy statement 'Accounting Standard-setting in a Changing Environment: The Role of the Accounting Standards Board'. This suggests that in future the ASB'S most significant role will be contributing with the International Accounting Standards Board (IASB) and others to the development of high quality global accounting standards.

The ASB also published two updates to its technical plan, giving more detail on phased convergence between UK Generally Accepted Accounting Practice (GAAP) and IFRS, and setting out plans for new standards coming into effect for 2006, 2007 and 2008.

## Public Sector

In the central government context, HM Treasury announced during 2004 that they would follow the convergence path for UK GAAP rather than adopting international standards. Major factors in this decision were

- A desire to avoid too many changes in accounting policies as new or improved IFRS are issued following the 'period of calm'
- The lack of a single IFRS that corresponds to FRS 5 Reporting the Substance of Transactions and in particular its Private Finance Initiative Application Note.

Central government accounting continues to follow UK GAAP adapted for the requirements of parliament in Westminster and the devolved jurisdictions. The Financial Reporting Advisory Board noted in its 2004-05

report that government will be delaying adoption of FRS 25 and FRS 26 relating to financial instruments, because of the complexity of first time adoption in a government context.

From 2005-06 guidance will be published in the Government Financial Reporting Manual (FreM) which replaces the Resource Accounting Manual (RAM). The new manual is briefer than the RAM, referring to other more detailed guidance as appropriate. This allows it to bring together guidance for departments, NDPBs and trading funds, while also being applicable to financial statements prepared by NHS bodies and bodies within the devolved administrations.

In the local government sector, the 2005 update to the Local Authority SORP was published in July 2005. Consultation will soon begin for the 2006 update and international convergence issues will be on the agenda.

Other developments in the public benefit area include a revised Statement Of Recommended Practice (SORP) for Registered Social Landlords.

## Drafts and Discussion Papers

To date the ASB has not issued any new Financial Reporting Standards (FRS) during 2005. Six exposure drafts have been issued, all reflecting convergence with international standards. These include an amendment to FRS 26 (IAS 39): 'Financial Instruments: Measurement', and FRED 35 'Corresponding Amounts' which deals with restatements of comparative figures. More controversially, in July the ASB released four Financial Reporting Exposure Drafts (FREDs) with implications for acquisition and merger accounting, in a 'Business Combinations' bundle, as follows:

- FRED 36 'Business Combinations (IFRS 3) and Amendments to FRS 2 Accounting for Subsidiary Undertakings (parts of IAS 27 Consolidated and Separate Financial Statements)'
- FRED 37 'Intangible Assets (IAS 38)'
- FRED 38 'Impairment of Assets (IAS 36)'
- FRED 39 'Amendments to FRS 12 Provisions, contingent liabilities and contingent assets and ►

### ► Amendments to FRS 17 Retirement benefits’.

The ASB notes that the proposals in FREDs 36-39 raise a number of issues, some of which may not be improvements to existing standards. These include:

- full recognition of goodwill, even if less than 100% of a business is acquired;
- goodwill to be measured at cost less impairment, and amortisation is not permitted;
- liabilities to be recognised even where it is probable that no outflow will be required to settle the obligation. The measurement of the liability to be adjusted by the probability of an outflow.

From a public sector perspective, perhaps the most significant ASB release of 2005 is the exposure draft ‘Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities’. The draft takes forward a discussion paper published in 2003, together with comments made by CIPFA and other public sector interests. The interpretation is intended to operate alongside the ASB’s 1999 paper ‘Statement of Principles for Financial Reporting’, expanding on common underlying principles to clarify how they apply to public benefit entities. The consultation runs until 30 November 2005, and earlier this month the ASB and CIPFA held a joint round table event so that representatives from key public benefit areas could discuss the proposals.

Also relevant to the public sector are current developments in heritage assets accounting. The ASB aims to issue a UK Discussion Paper in the Autumn of 2005. The ASB and CIPFA will be holding another round table event so that practitioners from heritage bodies can discuss the proposals.

Also very relevant to the public sector perspective are international developments in accounting for ‘service concessions’ which correspond to an arrangement frequently used in Private Finance Initiative (PFI) projects. On 3 March 2005, the International Financial Reporting Interpretations Committee (IFRIC) released three draft interpretations:

- D12 Service Concession Arrangements - Determining the Accounting Model
- D13 Service Concession Arrangements - the Financial Asset Model
- D14 Service Concession Arrangements - the Intangible Asset Model

These take a different approach to that adopted in Application Note F to FRS 5, looking only at the operator perspective, and determining the accounting treatment based on considerations of control, rather than using a risk and rewards approach. The effect of this is to challenge the treatment of some infrastructure assets shown on operator balance sheets, and by implication, challenging the off-balance sheet treatment adopted by the public sector. Responses to IFRIC from CIPFA, the Financial Reporting Advisory Board and other public sector standards setters include concerns that

- The scope of the guidance is unduly limited and does not cover the ‘grantor’ position, which may result in inconsistent accounting
- The control based approach is more complex than suggested by the draft interpretations, and is inconsistent with the risks and rewards approach used both in national standards and in international standards such as IAS 17 ‘Leases’.

### Reporting Standards and the Operating and Financial Review

Last but not least, during May 2005, the ASB issued the first of a new sort of standard, under recently granted legal powers. Reporting Standard (RS) 1 ‘The Operating and Financial Review’ applies to quoted companies in Great Britain and other entities that purport to prepare “Operating and Financial Reviews”. RS 1 sets out a framework of the main elements that should be disclosed in an OFR, leaving it to directors to consider how best to structure their review, in the light of the particular circumstances of the entity. The standard is accompanied by Implementation Guidance, setting out illustrations and suggestions of specific content and related KPIs that might be included.

CIPFA is working to stimulate thought development on the public sector application of RS 1. Matters to be considered include the extent to which the standard can be applied to the public sector, the definition of class of user in the public sector context, and the appropriate content for a public sector OFR in the light of other required reports. The first output will be a discussion paper produced jointly by CIPFA and RSM Robson Rhodes, to be published in two parts. The first part, dealing with overarching principles, will be published in the new year. ●

*Steven Cain, Technical Manager, CIPFA*

## Application of ISAs and other international standards in 2005

In parallel to developments in accounting, the Auditing Practices Board (APB) adopted International Standards on Auditing (ISAs) from 15 December 2004. This was not exactly convergence, as the APB explained that many of the existing Statements of Auditing Standards (SAS) had more exacting requirements than their ISA counterparts.

The Board therefore supplemented the international standards with 'ISA plus' material to bring the combined guidance up to UK standards. The APB consulted on 31 exposure drafts, and issued in December 2004 a complete suite of International Standards on Auditing (UK & Ireland), together with International Standard on Quality Control (UK & Ireland) 1.

UK standards have been developed in line with ISA requirements for some years, and so most of the ISAs (UK & Ireland) merely restate existing requirements. However, international standards include additional requirements in the areas of quality control (ISQC 1), assessment of risk (ISAs 315 and 330), fraud (ISA 240) and related documentation.

In addition to auditing standards, during 2004 the APB also issued five Ethical Standards for auditors, which apply from 15 December 2004. These are based on the International Federation of Accountants 'Code of Ethics for Professional Accountants'.

### FRC paper on True and Fair View

On 9 August 2005, the Financial Reporting Council (FRC) issued a paper 'The Implications of New Accounting and Auditing Standards for the 'True and Fair View' and Auditors' Responsibilities'. The paper responds to suggestions that UK adoption of international standards will erode the importance of the concept of the 'true and fair view' in financial reporting and auditing. It concludes that although there will be changes to the format and content of company accounts and audit reports:

- the concept of the 'true and fair view' remains a cornerstone of financial reporting and auditing in the UK
- there has been no substantive change in the objectives of an audit and the nature of auditors' responsibilities; and
- the need for professional judgement remains central to the work of preparers of accounts and auditors in the UK.

The FRC paper invites views on this analysis, and also invites comment on how financial reporting and auditing frameworks in the UK should evolve in the future.

### Conforming amendments

As a direct consequence of adopting ISAs, many existing APB publications became out of date overnight, and all of the APB's Practice Notes require redrafting to reflect additional ISA requirements relating to risk and fraud.

Most significantly from a public sector perspective, the APB has just completed exposure of Practice Note 10 (Public Sector Bodies). The draft was prepared in consultation with the National Audit Office, the Audit Commission and other key public sector auditors. The Board has also completed consultation on Practice Note 14 (Registered Social Landlords) which was also due for revision to reflect changes in legislation and other requirements.

In addition, four APB Bulletins have been issued as temporary updates to practice notes for audits of Charities, Investment Businesses, Occupational Pension Schemes, and Banks and Building Societies.

### Consultations on new ISAs

The International Auditing and Assurance Standards Board (IAASB) is continuing to develop and improve ISAs. In line with earlier IAASB consultations, on 13 April 2005 the APB issued two proposed revised standards for UK application

- ISA (UK and Ireland) 260 'The Auditor's Communication With Those Charged With Governance'
- ISA (UK and Ireland) 600 'The Audit of Group Financial Statements' ►

▶ and two proposed new standards which separately present matters covered in the current draft of ISA (UK and Ireland) 700 'The Auditor's Report on Financial Statements'

- ISA (UK and Ireland) 705 'Modifications to the Opinion in the Independent Auditor's Report'
- ISA (UK and Ireland) 706 'Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report'

The CIPFA response to this consultation is available on the CIPFA website.

Also in line with IAASB consultations, on 20 July 2005 the APB released three exposure drafts as follows:

- ISA (UK and Ireland) 700 'The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements'
- ISA (UK and Ireland) 701 'The Independent Auditor's Report on Other Historical Financial Information'
- ISA 800 'The Independent Auditor's Report on Summary Audited Financial Statements'

The APB comment period on the exposure drafts closed on 3 October 2005. The exposure of ISA 800 was slightly controversial because of difficulties which may arise from differing legal frameworks for summarised financial statements. The 'Invitation To Comment' asked respondents whether they considered this to be an area which should be regulated by ISAs.

#### **Statements on Investment Circular Reporting (SIRs)**

During 2004 and 2005 the APB has been updating and developing guidance for accountants engaged in investment reporting, in preparation for the EU Prospectus Directive which came into force from 1 July 2005. The Board has published two SIRs and has exposed drafts of two more standards. ●

# National challenges, local solutions

Sir Sandy Bruce-Lockhart

**T**wo clear messages emerged from the 2005 General Election: first, local people are increasingly voting on local issues, but second, there is a growing disillusionment with and distrust for politicians of whatever party. Wide regional and local voting patterns and the growth of both single issue campaigns and minority parties demonstrate the hunger for more choice and power at the local level. But overall turnout highlights a broader frustration and a cynicism both with politicians and a political process over which the public feel they can exert little influence. Democracy now needs to be strengthened, and this can be rebuilt most effectively from the bottom up, through more vibrant, confident and more autonomous local government.

Encouragingly, the major political parties have already begun to move. 'Localism' will feature strongly in the Conservative policy debates, while the Government has appointed an additional Cabinet-ranking Minister, a move which must also be welcomed. But how, in practice, can the political commitments be delivered?

An immediate answer can be found in the LGA Manifesto, launched in September 2004. It calls for a bold and radical decentralization to improve public services, devolve power to local people, strengthen local democracy and make better use of the public's money. At its heart is a sweeping decentralization, together with real change in the way in which local and central government work together, enabling priorities to be set locally and re-engaging people with local democracy.

The LGA manifesto argues for decentralization both to local councils and through local councils; and that we in turn empower the local residents, local organizations and communities that we represent. It is not enough for local councils simply to gain additional powers, we must ourselves devolve to increase local responsiveness and confidence in the political system.

But the Government must go further. Many national standards must also be removed. There is a genuine dichotomy between any government's desire to have national standards and the need for local choice and local diversity. However, we need clarity about which services require national standards so that the remainder can be freed from central control.

The Public Service Board (PSB)/Local Area Agreement (LAA) concept should also be rolled out. There has always been a difficulty for government departments in co-ordinating and joining central government and it is essential that we build on the success of Public Service Agreements and develop the PSB/LAA approach. The LGA is committed to go forward with LAAs, and welcomed the announcement of

the roll-out of a further 40 pilot LAAs in January 2005. Although it is early days, PSBs have proved effective in joining public services together locally in council-led boards—bringing together the heads of the major local services (police, fire, health, benefits) around a single table. Councils are now ready to offer to take on responsibility for the wider governance of their area, and to shift visible accountability from Ministers to local government.

Fundamentally, there must also be a bonfire of quangos and a re-balancing back to accountable and democratic councils. The growing array of unelected, unaccountable quangos, trusts and agencies now spend more than four times that of local government!

In addition, local government inspection can, and should, be reduced. We see local government with a track record of improvement but, while the Audit Commission is taking some steps in the right direction, too many managers across public services are forced to permanently look to Whitehall, its inspectorates and targets. Local public managers should be encouraged instead to look more to the customers, and to tailor their services accordingly. National inspection must be reduced, and be proportionate to risk.

On funding for local government, it is imperative that local people can see a clear relationship between the services they receive and what they pay in local tax. More of the money already collected locally must be retained locally. Council tax increases have been held to 4% this year only because of the extra £1 billion for local government from the Chancellor last autumn. Most of this, however, was one year of 'one-off' ►

funding. LGA research shows that £1.5 billion will be needed to plug next year's 'black hole' in funding. The Ministerial Balance of Funding Review confirmed that no change is not an option, and the LGA has put forward workable proposals for reform. We expect an early conclusion from the Lyons Review and a government commitment to act.

The General Election gave further proof that the majority of issues that most concern the public are the local ones; recent surveys too, show that the public regards councils as twice as relevant to their lives as central government and that the overwhelming majority wish to see councils, not government or agencies, delivering public services. As such, the potential is real for a resurgence of civic pride and civic renewal, which in itself can help renew confidence and trust in politics. The democratic arguments for localism are irrefutable and lie alongside the potential to dramatically improve public services. Freed from the dead hand of Whitehall, public sector managers would be empowered to innovate in local service delivery, focusing wholly on their customers and residents instead of sometimes irrelevant or perverse national targets.

Despite some tentative moves towards localism, the UK is seen to be highly centralist and increasingly out-of-date. The new Government must now demonstrate, with decisive action, its commitment to a radical decentralization which brings freedom and autonomy to local government. With a track record of improving delivery, with the public's renewed interest in local issues and with the need to rebuild democracy, local government has a new legitimacy and a new confidence. Given greater autonomy we can provide better services, greater choice, increased efficiency and better value for money while at the same time helping to re-strengthen democracy and trust. ●

*This article was first published in the August 2005 issue of the PMPA Review.*

*Sir Sandy Bruce-Lockhart  
Chairman, Local  
Government Association  
(LGA).*

# Public Management and Policy Association Annual Conference 2005: 8 December, London 'Devolve, Decentralise, Deconcentrate'

[David Walker](#) of the Guardian will chair the conference, which features localism, democracy and choice as key elements. PMPA Advisory Board Chair, [Sir David Normington](#) will open the event.

Speakers include:

[Professor Robert Hazell](#), Constitution Unit, School of Public Policy,  
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[Anna Randle](#), Head of Policy at the New Local Government Network.

[Sue Slipman](#), Director of the Foundation Trust Network.

[Ben Page](#), MORI Director.

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and regions.

To ensure that you see the full programme and booking form, you can register your interest in the event by sending your details to:

Rikki Ellsmore, Courses unit, CIPFA, 3 Robert Street, London, WC2N 6RL

Tel: 020 7543 5746 Fax: 020 7543 5792 Email: [rikki.ellsmore@cipfa.org](mailto:rikki.ellsmore@cipfa.org)

Fees for the PMPA annual conference 2005, Thursday 8 December 2005, central London are:

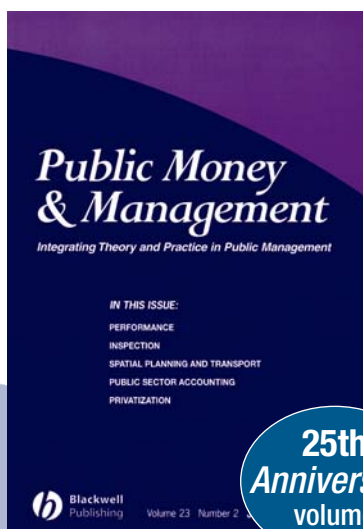
- PMPA Members: £290.00 plus VAT = £340.75
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2005 will be the 25th anniversary of the journal. It is also likely to be an election year. The editors have decided to mark these events with a series of special editions that take stock of our public policy and management.

January 2005: **The State of Public Management.** Editor: Andrew Gray

April 2005: **Transport.** Guest Editor: Francis Terry

June 2005: **Health Policy and Management.** Guest Editor: David Hunter

August 2005: **Criminal Justice.** Guest Editor: Sandra Nutley

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