CIPFA The Chartered Institute of Public Finance & Accountancy

LASAAC

Local authority accounting

a differential approach

CIPFA/LASAAC discussion paper

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

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

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

We want to ask if there are opportunities to further improve financial reporting for local authorities by ensuring the requirements:

- are appropriate for the varying nature and size of different local authorities
- result in financial reporting that is relevant to users.

This discussion paper sets out concerns about the current complexity of financial reporting requirements for local government. It introduces the concept of differential reporting, which could allow entities to apply specified reporting requirements and accounting practices depending on their circumstances, and describes how this approach has been adopted in other sectors and jurisdictions.

Request for comments and feedback

The ideas put forward in this paper are intended to provide the starting point for debate. Therefore, when you have read this paper, we would like to know what you think.

To help frame your views, we have raised a number of questions which are set out below:

1. Do you think changes are needed to the Code to better reflect the variety of entities which apply it? If so, please explain what is needed and why.
2. What are your views on adopting a differential reporting framework or regime for local government? If you would not favour this do you have any alternative suggestions for how more appropriate provisions for smaller authorities could be made?
3. How could a differential reporting framework for UK local government be implemented? (ie How many tiers of reporting should there be? What criteria should determine each tier? What should be reported to meet user's needs?)
4. How could a differential reporting framework be best implemented in order to maintain public sector consistency of financial reporting requirements, particularly for Whole Government Accounts purposes?
5. Section 6 outlines some other challenges and considerations to changes in this area. Do you agree with this assessment, or have any additional factors which you consider to be relevant?

We hope that when responding you might reply to all of our questions, but we are pleased to accept responses that address only some of them as well as any other comments you wish to make. All contributions matter to this discussion and CIPFA/LASAAC seeks views from all interested parties.

We would appreciate your response to the questions by **4 November 2019.**

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Foreword

Getting the right answers often means asking some difficult questions. What was once bold and innovative can, over time and if unchanged, become stale and stagnant. Improvement requires continuous challenge.

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

The length and complexity of accounts produced in accordance with the Code can make them impenetrable to many. Experienced accountants from outside local government often comment on how hard it is to decode a local authority's accounts. Accounts that are concise and easy to access and understand offer more utility to the citizen and other key stakeholders.

Producing IFRS-based, Code-compliant accounts is also a time-consuming annual task, placing considerable strain on what are now leaner finance teams. This issue is particularly acute for smaller authorities, for whom complying with the Code can place a burden on the limited resources that they have available. Whilst streamlining reforms can help, these are fixes that do little to address structural issues with the Code and the underlying accounting and statutory framework.

We question whether there are opportunities to further improve the financial reporting requirements for local authorities by ensuring the requirements:

- are appropriate for the varying nature and size of different local authorities
- result in financial reporting that is relevant to their users.

We explore how the concept of scalability could be introduced to the current requirements through a differential reporting framework. We look at possible options which could better ensure that the benefits of complying with the Code meet or exceed the costs to preparers.

This is not expected to be an easy or straight-forward conversation. All sizes and types of authorities levy taxes or control public resources and, as such, need to be publicly accountable to the populations they serve. But we also need to think whether we should redefine the scope of the information we're asking some authorities to generate. If authorities are to report less, we need a framework that ensures what is being reported is what users want. Whilst readers may demand brevity, ensuring what they receive is the right information presents its own challenges.

International models provide useful comparators. New Zealand, for example, has accepted differing levels of accountability across its public sector by introducing four tiers of accounting standards. Closer to home, UK companies and charities also apply differential reporting frameworks. These provide useful case studies for the evolution of the Code.

This will not be a quick fix. The process is likely to be protracted, involve significant stakeholder engagement and require legislative change. But we should accept the challenge, and be willing to ask the difficult questions in order to ensure financial reporting remains relevant and fit for purpose.

Lynn Pamment
Chair, CIPFA/LASAAC

Executive summary

Local government in the UK is a diverse group of some 583 entities. Some 188 UK local government bodies, 32% of the total, were responsible for taxpayer supported expenditure of under £15.6m each in 2017/18. At the other end of the spectrum 263 authorities, 45% of the total, were responsible for expenditure of over £120m each.

This discussion paper initiates consideration of whether a single financial reporting framework is appropriate and necessary for all authorities, or whether differential reporting requirements should be explored. The following provides an overview of the key issues addressed:

Current Issues	■ Concerns have been expressed that local government annual accounts are too long and complex for users needs. ■ Additionally, concern exists that the burden and cost involved in preparing the accounts is not commensurate with the benefits provided to users.
Key Assessment Considerations	■ In reviewing the arrangements CIPFA/LASAAC considers that the following should be the key considerations: – Relevance of the information for users of the financial reports for that entity. – Cost of providing the information justified by the benefits to users.
Existing Arrangements	■ The Code requirements apply to all authorities regardless of size or type. ■ This excludes parish, town and community councils.
UK Company Financial Reporting	■ Differential regimes apply dependent on the size and complexity of the organisation. ■ The criteria applied focus on a combination of different measures (turnover, balance sheet, employee numbers), or rely on fuller disclosures in other reports. ■ Each regime generally adheres to a common set of recognition and measurement approaches. ■ Key differences between the requirements relate to the number of primary statements, the extent of disclosures and ability to choose some accounting treatments.
UK Central Government	■ Central government does not operate a differential reporting approach. ■ Local government differential reporting would be a significant change for wider public sector financial information arrangements, particularly in relation to Whole of Government Accounts (WGA).
UK Charity Sector	■ The charity sector is required, dependent on size criteria, to either prepare cash based accounts or apply the Charities SORP (FRS 102). ■ The SORP board is understood to be contemplating a review of the arrangements with the potential for differential reporting tiers to be implemented within the SORP.
New Zealand Public Sector	■ A four tier approach is applied, based on a combination of: – whether there is responsibility to debt holders (eg lenders), shareholders and/or the entity is holding assets in a fiduciary capacity; combined with – scale, based on expenditure. ■ Reflections on implementation indicate positive changes, but that behavioural changes are important to ensure that user needs are met.

UK Local Government: Potential approaches and considerations	■ The focus should be on users' needs and the cost/benefit balance of the requirements. ■ There are a number of different 'scale' measurement criteria which could be applied, either singly or in combination. ■ Establishing if user needs differ significantly between different sizes, groups or types of authorities is a key consideration. ■ A number of other factors to consider arise, including WGA threshold identification, group accounts, and classification volatility. ■ Potentially, an approach based on authority class could be explored. This could be different for each administration. ■ The role of the accounts in the budget and tax setting process should be specifically considered. ■ Any specification changes would require government support, potentially involving statutory amendments. ■ Public sector consistency is a major consideration and requires further stakeholder engagement. ■ Complexity of transactions is also a factor in assessing users' needs. ■ Change would be a cost and future work will need to consider this aspect carefully.

Introduction

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

Encouraging authorities to prepare accounts that clearly communicate this information requires a reporting framework which supports this aim. Excessive and complex requirements can make the reporting process overly cumbersome and result in disproportionate compliance costs. Such requirements can also result in disproportionate complex financial statements that are difficult for their intended users to understand. At a time when resources continue to be constrained within local government, it is essential that statutory accounts meet the information needs of users, but do not unnecessarily burden preparers.

It is acknowledged that there are practical tools available to assist authorities to prepare their accounts promptly. These largely aim to 'streamline' and 'simplify' authorities' reporting processes and financial statements within the existing framework. Whilst these initiatives provide practical measures and have offered incremental improvements to the current reporting framework, this paper aims to explore more substantive and structural changes as part of the longer-term development of the Code.

The paper sets out concerns about the current complexity of financial reporting requirements for local government. More specifically, it focuses on the requirements of smaller authorities by starting with the view that the current code is too complex for this stakeholder group. It introduces the concept of differential reporting, and describes how this approach has been adopted in other sectors and jurisdictions. It presents a number of ideas for what a differential reporting framework for local government might look like, and highlights some of the challenges of change in this area.

The aim of the paper is to stimulate discussion amongst stakeholders by reviewing alternatives for improving the current reporting framework. The paper has been developed under the oversight of CIPFA/LASAAC and with assistance from CIPFA's Local Authority Accounting Panel. This paper intends to facilitate a broad discussion amongst the range of preparers and users of local authority accounts. These discussions will assist in gathering a consensus for potential changes to the format and structure of the Code, and inform future consultation. Other areas of review for alternative engagement include narrative reporting requirements, the extent of disclosures required, and the Code's structure and format.

It is acknowledged that the scope of this paper is limited, in only addressing one potential change aimed at achieving CIPFA/LASAAC's vision for local government financial reporting. However, it is part of an ongoing programme of work designed to advance the discussion about the future of the Code. The work plan aims to support the achievement of the vision through a number of connected events, publications, consultation and research activities. These will provide opportunities to gather feedback from stakeholders on the key themes emerging from the vision, including their views on the annual accounts and those aspects which should influence the Code's development. Further details of this programme are given in CIPFA/LASAAC's *Vision Statement* and *Strategic Implementation Plan* (April 2019).

SECTION 1:

The current financial reporting framework for local government

Requirements

The *Code of Practice on Local Authority in the United Kingdom* ('the Code') applies to local authorities throughout the UK. It sets out the principles and practices of accounting required to give a 'true and fair' view of the financial position and performance of a local authority, and specifies the content of their financial statements.

Consistent with the rest of the UK public sector, the Code requires local authorities to apply EU-adopted IFRS as adapted or interpreted for the public sector. In addition, as local authorities are funded directly by taxation, they are required to comply with statutory provisions that determine how much of the authority's expenditure needs to be met from taxation each year. The provisions covering these accounting adjustments are included in various local government and finance acts, which can differ between the four jurisdictions covered by the Code. These 'statutory adjustments' make financial reporting in local authorities unique from the rest of the UK public sector.

The Code currently allows and encourages flexibility in application to recognize the differing nature and needs of entities and the readers of their annual accounts by stating:

"This Code only requires local authority financial statements to disclose information which is material. CIPFA/LASAAC is of the view that local authorities should only include disclosures that are material to the presentation of a 'true and fair' view of the financial position, financial performance and cash flows of the authority and to the understanding of users of the financial statements."[1]

"A local authority need not provide a specific disclosure required by the Code if the information resulting from that disclosure is not material. This is the case even if the section of the Code or IFRS contains a list of specific requirements or describes them as minimum requirements."[2]

This is specifically reinforced in various aspects throughout the Code, for example in relation to accounting policy disclosures[3] and the presentation of disclosure notes.[4]

Constituents

Local authorities applying the Code are a disparate conglomeration of entities. They vary considerably in size and population. Their responsibilities and the services that they provide also vary between jurisdictions and different classes of local authorities.

This diversity is reflected in their spending, as illustrated in Appendix A, which provides the distribution of UK local authorities by expenditure. Unsurprisingly the distribution of authorities is not uniform. As shown in Appendix B, nearly half of authorities have expenditure of less than £40m. In short, there is a significant number of small authorities.

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1 The Code (2019/20) paragraph 1.7.1. The definition of materiality is in 2.1.2.14

2 The Code (2019/20) paragraph 3.4.2.27

3 See the Code (2019/20) 3.4.2.87 which states "An authority shall disclose its significant accounting policies comprising:.." and 3.4.2.89 "In deciding whether a particular accounting policy should be disclosed as a significant accounting policy in its financial statements, a local authority considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position."

4 See the Code (2019/20) paragraph 2.1.2.14 which includes "An authority can comply with the Code, while not complying with specific disclosure and accounting requirements in the Code, if the information is not material to the 'true and fair' view of the financial position, financial performance and cash flows of the authority and to the understanding of users."

However, all local authorities are responsible for providing a range of public services and are funded directly and collectively by taxation. Therefore, there are similarities between the type of activities and transactions local authorities undertake and account for.

The issue and potential solution

The extent to which the current accounting framework, and the application of that framework, appropriately addresses the variability of local authorities is open to discussion. Having the same financial reporting requirements and accounting standards for all authorities has clear benefits, but also has implications for those preparing and auditing these statements. These implications are often more pronounced amongst smaller authorities, where the cost of preparing 'code-compliant' financial statements can be proportionally greater, and the likely number of users fewer. **A differential reporting framework that makes appropriate provision for the different nature of authorities, but reflects the accountability of local government for public resources, is one potential solution.**

What is differential reporting?

A differential reporting framework requires entities to apply specified financial reporting requirements and accounting practices depending on their circumstances. Entities apply different accounting standards based on their size, industry, structure, nature or other differentiating feature. This approach contrasts with a uniform reporting framework, where the same requirements and accounting standards are prescribed for all entities.

The two main methods of achieving differentiation in a reporting framework are:

- Specifying that the same principles of recognition and measurement are to be applied by all entities, but allowing reduced disclosures to be made by smaller entities.
- Specifying different recognition, measurement and disclosure requirements (ie different recognition and measurement principles dependent on the size or type of entity, as well as different disclosure requirements).

A differential reporting framework can have the effect of simplifying or reducing the reporting burden for certain entities. It can be a potential solution where the number and complexity of accounting standards are viewed as increasing the cost of producing financial statements, to the point they outweigh the benefits of doing so.

A differential approach may be implemented to better balance the benefits of financial reporting with the associated cost of compliance. This 'cost-benefit' principle is reflected in a regime whereby the reporting requirements are reduced for different groups of entities in a manner commensurate with the reduction in benefit accruing to users from the information.

The two main drivers of a differential reporting framework are therefore considered as:

- relevance of the information for users of the financial reports for that entity
- cost of providing the information justified by the benefits to users.

SECTION 2:

Current alternatives to the Code

Who does not apply the Code?

Across each UK territory there are specific types of local authorities which do not apply the Code. Most notably in England, approximately 760 authorities currently meet the definition of a 'smaller authority' and are not required to apply the Code. This is in addition to around 9,000 English parish councils and 735 Welsh community councils that do not apply the Code. This represents a significant body of entities that are preparing statutory accounts under alternative reporting frameworks.

Why are they different?

Across the UK, the legislative arrangements for smaller authorities' financial reporting, generally reflects the relevant government administration's policy approach and different controls for smaller local bodies. Exclusion from the Code requirements normally recognises the relatively more limited scope and nature of those smaller authorities' resources, transactions and legal powers (eg borrowing[5]).

However, similarities exist between the financial activities of some smaller authorities and larger councils. Parish and community councils have the power to raise tax locally through precepting arrangements, and whilst their duties are limited, those services which they are responsible for may be similar to those undertaken by larger authorities.

This is explored in 'Parish and town councils: recent issues'[6] which compares the role of parish councils in England with other councils, and with smaller bodies (eg community councils) in Wales, Scotland and Northern Ireland.

For one measure of scale the council tax statistics for town and parish councils in England provide an indication of revenue size of the different English parish councils. The 2019/20 statistics indicate that the total council tax precepted was an average per precepting authority of £62,591 (an average precept per band D of £67.18). This does not include other funding sources, but generally, smaller authorities are not anticipated to receive significant direct government general funding. Grant applications relating to specific initiatives may arise.

An additional consideration for discussion that may arise is the extent of public assets which smaller authorities are responsible for, as well as the size of the workforce employed.

This could suggest that all governments' legislative frameworks and policies, different regulatory controls and the more restricted scale of taxation funding contribute to the basis for different financial reporting regimes for smaller authorities.

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5 For example while they may be able to borrow, governments may specify the controls regarding these powers. The Debt Management Office/PWLB website states "English town and parish councils need a borrowing approval from the Ministry of Housing, Communities and Local Government (MHCLG) in order to apply to the PWLB. Welsh town or community councils need an approval from the Welsh government." **www.dmo.gov.uk/responsibilities/local-authority-lending-pwlb/about-pwlb/**

6 Parish and Town Councils see Parish and town councils: recent issues – Briefing Paper (House of Commons Library, February 2019) . Section 1.4 Parish councils compared to larger authorities, Section 1.5 Notes on smaller authorities in Wales, Scotland and Ireland, Section 2 – Precepting powers.

What do they apply?

The practices for accounting by smaller authorities in England are set out in guidance issued by the Joint Panel on Accountability and Governance (JPAG) on an annual basis. The guidance covers the preparation of the Statement of Annual Accounts, which are prepared in accordance with the format specified in the Annual Governance and Accountability Return completed by smaller authorities. The Statement provides a summary of the authority's income and expenditure (or receipts and payments), its assets and other balances.

The basis of accounting followed by smaller authorities in England preparing the Statement is determined by their gross income or expenditure, and uses a threshold of £200,000. The accruals basis is required where a smaller authority has exceeded the threshold for a period of three years.

In contrast to the majority of authorities applying the Code, smaller authorities typically have no specialised accounting staff. For example, in parish and community councils the preparation of the accounts are usually the responsibility of the council clerk.

Discussion

The population of entities that represent UK local government can be categorised on the basis of whether they are required to apply the Code or not. The reporting requirements of those entities not required to apply the Code differ, however, there is a clear emphasis on demonstrating and evidencing governance and controls, with reduced requirements concerning disclosure of financial transaction information.

It may be suggested that those reduced requirements reflect a 'risk based' approach to financial reporting, recognising the smaller scale and the different regulatory controls in place for those bodies.

This 'division' provides a starting point for future discussion about differential reporting. The Code and these alternatives frameworks could be considered as two extremes of a spectrum.

SECTION 3:

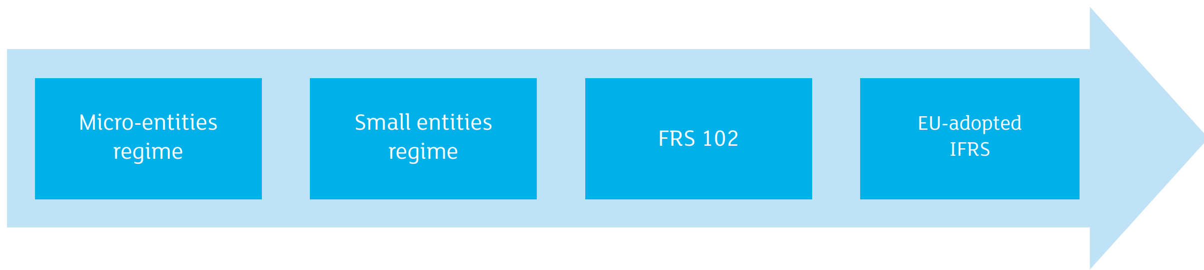
Differential approaches – UK company financial reporting

The current financial reporting framework for UK companies is made up of different regimes that are applicable to entities subject to meeting relevant criteria. Whilst listed companies are required to apply EU-endorsed IFRS, non-listed entities have a choice between three core regimes. It is estimated that around four million entities apply one of these three regimes.

The framework sees the financial reporting requirements getting progressively more complex and comprehensive the further up the suite of standards you go. The increase in complexity aims to correlate to the increasing size and complexity of the entities that are more likely to apply a given standard:[7]

7 *Overview of the financial reporting framework,* Financial Reporting Council, July 2015. Note that legislation may in some cases specify the reporting requirements to apply to an entity

Diagram 1: Complexity in reporting requirements



The factors that contribute towards some of the key differences between each regime and their complexity include:

- number of primary statements
- condensed format of statements
- number of disclosures
- simplified accounting treatments
- requirement for fair value and revaluation accounting
- number of accounting policy choices/mandatory treatment.

The criteria for the micro-entities regime are based on legislation.[8] Generally a company qualifies if it does not exceed two or more of the following criteria:

- Turnover: £632,000
- Balance sheet total: £312,000
- Number of employees: 10

The micro-entities regime allows a simplified accounting treatment for financial instruments and does not permit entities to fair value or revalue any assets or liabilities. As accounting standards require substantial disclosures in the notes to the accounts for both of these areas, this approach contributes to a simpler set of accounting standards and less weighty financial statements.

The criteria for the small entities regime are also based on legislation.[9] Normally a company qualifies if it does not exceed two or more of the following criteria:

- Turnover: £10.2m
- Balance sheet total: £5.1m
- Number of employees: 50

The small entities regime requires the same recognition and measurement requirements as FRS 102, with the key difference being the number of disclosure requirements. This achieves consistency, but also simplification by having significantly reduced disclosures for those entities applying the small entities regime. This consistency also means that preparers and users have to be familiar with only one set of recognition and measurement requirements. This means the comparability of information between both regimes is enhanced and a company's movement between regimes is easier and less costly. It also simplifies the preparation of consolidated financial statements where a group comprises of different entities preparing individual financial statements under different regimes.

8 The Companies Act 2006 section 384A, and 384B

9 The Companies Act 2006 sections 382-384

The reduced disclosure framework (FRS 101) is targeted to allow reduced disclosures where financial reporting by a parent company provides a complete picture and fuller disclosures of the transactions of the group as a whole. The framework only applies where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and the entity concerned is included in the consolidation.[10]

Discussion

The current reporting regime for UK companies is an example of a differential reporting framework. The framework aims to enable users of accounts to receive financial statements that are proportionate to the size and complexity of the entity and users' information needs. Its development took over ten years and, similar to the Code, it had to ensure consistency between the relevant legal and regulatory frameworks. The process involved a fundamental overhaul of the previous financial reporting standards and required extensive consultation with practitioners, investors, and other key stakeholder groups on the future of corporate reporting.

The criteria for applying the different regimes are driven by the need to ensure that accountability requirements are assessed across different measures, so that an entity with a small turnover but large assets, is no less accountable than an entity with large turnover but small assets. Notably the criteria also includes the number of employees as a factor affecting the level of accountability required.

Furthermore, reduced disclosures for some entities, generally subsidiaries, are only permitted where fuller disclosures are provided at the parent level in group statements.

Crucially, the framework achieves a cohesive approach by applying unifying principles, particularly regarding recognition and measurement, to the reporting practices of a large and disparate group of entities. Simplification is created by restricting options and reducing disclosures for smaller sized entities. Individual standards include limited guidance on any sector specific transactions or the implementation of specific reporting requirements. This enables succinct standards that cover those transactions common to entities within the scope of each financial reporting regime.

Differences between the concept of accountability in the private and public sectors and legal underpinning of local government accounts make direct comparisons between the length and scope of the Code with the reporting regime for UK companies difficult. However, the development and structure of the current standards provide a useful benchmark for future discussions about the shape of a differential reporting framework and what could be achieved in the context of UK local government.

SECTION 4:

Differential approaches in other UK financial reporting frameworks

Those sectors that are more directly comparable with local government offer limited examples of differential approaches to financial reporting.

UK public sector

Within other parts of the public sector, no differential reporting frameworks exist. There is one set of reporting requirements and accounting standards which are followed by all entities regardless of their size or significance.

10 As required under FRS 100 Application of Financial Reporting Requirements (FRC) – Appendix I (Glossary)

Discussion

The absence of a differential approach reflects a number of factors, including the function and funding of those bodies within the other parts of the UK public sector. For example, a local authority is commonly responsible for a fragmented collection of services. This contrasts with central government departments, which typically have a single function within a particular area of interest. Presenting the key messages about the financial performance of an entity which has a specific function is arguably far easier than an organisation with a diverse range of functions linked only by their geographical area. As a result, it would be expected that the demand for a simpler framework for smaller entities within central government would be less pronounced compared to local government.

Exploring a differential approach to reporting in local government represents a departure from the existing approach to financial reporting in the UK public sector. Doing so would therefore require a significant change in order to address circumstances unique to the local government sector.

UK charity sector

Similar to local government, the current reporting framework for UK charities broadly consists of two regimes. The Charities Statement of Recommended Practice ('the Charities SORP') applies to charities required to prepare 'true and fair' accounts. It extends and supplements the requirements of FRS 102 by providing additional sector-specific requirements. Those charities not required to apply the Charities SORP may prepare accounts on a cash-basis.

Whilst the reporting framework for charities is developed under the same financial reporting framework for UK companies, primarily due to legislation there is no version of the Charities SORP based on either the micro-entities or small entities regimes. Therefore, all charities required to apply the Charities SORP effectively comply with FRS 102, despite the vast majority of UK charities that also meet the size criteria for either the micro-entities or small entities regimes.

This has led to a perceived mismatch between the requirements of smaller charities. Charities which meet the eligibility criteria to prepare 'true and fair' accounts must prepare fully accrued accounts in accordance with full FRS 102. This contrasts with charities eligible to prepare simple cash-based receipts and payments accounts.

Discussion

The UK charity sector is predominantly made up of smaller organisations which have no specialised accounting staff and rely on volunteers to prepare and examine their financial statements. Recent research identified concerns about the implications of applying the Charities SORP by these organisations. These included the burden created for those preparing accounts and the increased costs of compliance.

Therefore, having a reporting regime that fails to provide a suitable framework for smaller entities is of significant concern to the SORP-making body, responsible for developing and maintaining the Charities SORP. As a result, it is being considered as part of their current discussions on the future development of the SORP. One area being explored is the introduction of different 'tiers' of reporting. This would introduce different thresholds with the aim of reducing disclosures in the notes to the accounts.

Similar to the public sector, different accountability considerations apply to charities when compared with the private sector. Any future changes will have to strike a balance between lessening the regulatory burden and providing the information to meet the public's expectations of accountability. Informing this balance could involve going 'back to basics' in order to consider what charities accounts should look like if they are to meet these expectations.

Similar to local government, there is an appetite for financial reporting which is clearer and simpler for both the user and preparer in the charity sector. Like CIPFA/LASAAC, the SORP-making body is currently at the very start of the process of considering the changes needed to enable this vision. Differential reporting represents one of several options available.

SECTION 5:

Differential approaches for local government in other countries

Although the role, status and services provided by local government in other countries differ, considering their reporting frameworks provide a valuable point of comparison. Of most relevance is New Zealand, which introduced a multi-standards, multi-tiered approach to accounting standards in 2012.

The New Zealand Accounting Standards Framework has three key elements:

Multi-standards approach	Different suites of accounting standards for two distinct sectors: **for-profit entities** and **public benefit entities** (PBEs)* *PBEs are entities whose primary objective is to provide goods or services for community or social benefit, including most public sector entities and not-for-profit entities. Some public sector entities are 'for-profit' entities.
Tiered approach	**Different accounting requirements for each tier** that are appropriate for the entities concerned, based on the **nature and size** of the reporting entity.
Basis for developing each suite of accounting standards	For for-profit entities, accounting standards are NZ equivalents to International Financial Reporting Standards (NZ IFRS). For PBEs, accounting standards are based primarily on International Public Sector Accounting Standards (IPSAS) for Tier 1 and Tier 2.

The development of the New Zealand Accounting Standards Framework was underpinned by two key objectives:

1. To meet user needs – by recognising the different users and user-needs in the for-profit and PBE sectors.
2. To balance the costs and benefits of reporting – by providing appropriate accounting requirements based on the nature and size of the entity.

With differential reporting regimes in mind, the second objective of balancing the cost and benefit of reporting is of particular interest. The New Zealand External Reporting Board (XRB) operationalised this objective by adopting a multi-tiered approach. That is, there are different accounting requirements for each tier that are appropriate for the entities within that tier, based on the nature and size of the reporting entity.[11]

The multi-tiered approach for public sector PBEs consists of four tiers, using total expenditure as a differentiator, as shown in Table A and summarised below.

11 Although note that government direction or legislation can specify the requirements or tier that should apply to an entity or type of entities

Table A: Summary of reporting requirements of public sector PBEs in New Zealand
(Source: External Reporting Board, New Zealand Accounting Standards Framework – December 2015)

Tiers	Entity attributes	Reporting requirements and standards
Tier 1	■ Has **public accountability** (as defined*), or ■ Has total expenses (including grants) > $30m (UK > £15.6m).	PBE Standards (Based on IPSAS)
Tier 2	■ Has **no public accountability** (as defined*) ■ Has total expenses (including grants) ≤ $30m but >$2m (UK ≤ £15.6m but > £1.04m). And elects to be in Tier 2 rather than Tier 1.	PBE Standards Reduced Disclosure Regime
Tier 3	■ Has **no public accountability** (as defined*) ■ Has expenses ≤ $2m (UK ≤ £1.04m). And elects to be in Tier 3 rather than Tiers 1 or 2.	PBE Simple Format Reporting Standard – Accrual (Public Sector)
Tier 4	■ Has no **public accountability** (as defined*) ■ Has total operating payments of less than $125,000 (UK £65,000) in each of the previous two reporting periods. ■ Is permitted by an enactment to comply with a 'non-GAAP Standard' or cash accounting. And elects to be in Tier 4 rather than Tiers 1, 2 or 3.	PBE Simple Format Reporting Standard – Cash (Public Sector)

(1 NZD = 0.52 GBP – Average exchange rate for April 2019)

* *The External Reporting Board has adopted its definition of* **public accountability** *from the IASB, which is applicable to both the public sector and the for-profit sector. In accordance with the IASB definition an entity has* ***public accountability*** *if:*

a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance providers, securities brokers/dealers, mutual funds and investment banks.

Additionally, certain entities also have been deemed to have public accountability under the New Zealand framework.

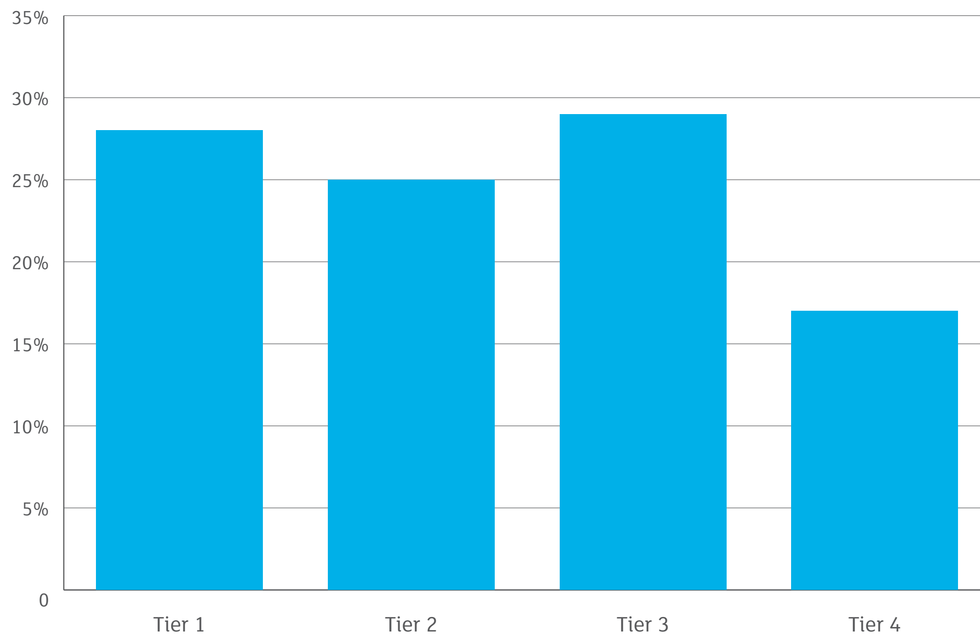
The ability to tax or levy the public does not result in an entity having public accountability as defined by the New Zealand framework. Therefore, not all public sector entities in New Zealand that have powers to tax or levy the public report under Tier 1.

There are some 3,140[12] public sector PBEs. It is worth noting that all public sector schools (some 2,390[13]) regardless of size are required to report under Tier 2. Consequently 82% of all public sector PBEs report under Tier 2. Excluding schools the profile of reporting for the remaining 750 entities is shown in Diagram 5.

12 Information from Office of the Auditor-General of New Zealand.

13 Information from Office of the Auditor-General of New Zealand.

Diagram 2: New Zealand public sector PBEs (excluding schools)



Data source: Office of the Auditor-General, New Zealand

- The **Tier 1** and **Tier 2** requirements consist of 38 individual standards derived largely from International Public Sector Accounting Standards (IPSAS).
- **Tier 2** PBE Standards consist of the same recognition and measurement requirements as Tier 1 but with reduced disclosure requirements.
- The **Tier 3** requirements is based on a simple format reporting approach using accrual accounting. This reflects the small size and reduced level of complexity within many entities in this tier, as well as the needs of the users of the financial statements of these entities. There is a single standard specifying simple format reporting (accrual) requirements Tier 3 entities.
- The **Tier 4** requirements also uses a simple format reporting approach, but uses cash accounting and is simpler than the Tier 3 standard as Tier 4 entities are very small. There is a single standard specifying simple format reporting (cash) requirements Tier 4 entities mainly including entity information, statement of service performance, receipts and payments, and statement of resource and commitments along with certain other information such as related party disclosure and events after the reporting date.
- The **Tier 3** and **Tier 4** standards are accompanied by optional templates and guidance notes.

Approach to non-financial information

In New Zealand, the primary users of financial reports prepared in accordance with public sector PBE accounting requirements are resource providers (for example, taxpayers, ratepayers and lenders), and service recipients and their representatives.

Users of the financial reports of public sector PBEs rely on those reports for information that is useful for accountability and decision making. Financial statements provide some, but not all, of the information users require. Therefore, the XRB considers that information about the entities service performance is also an important part of public sector PBEs' financial reports.

Service performance information is defined as information about what the entity has done during the reporting period in working towards its broader aims and objectives, together with supporting contextual information.

The XRB issued a PBE Standard on service performance Reporting (PBE FRS 48 *Service Performance Reporting*) in November 2017. The standard applies to Tier 1 and Tier 2 public sector PBEs required by legislation to provide information in respect of service performance in accordance with generally accepted accounting practice (GAAP). The standard does not prescribe the format of service information and takes a high-level principles-based approach. Entities are encouraged to develop a format that best meets the information needs of their users. The standards provide flexibility to include graphs, tables and infographics, as well as narrative and descriptive information.

For smaller entities, the Tier 3 and Tier 4 accounting requirements stipulate the preparation of a performance report which includes non-financial information about the entity's structure and objectives and also the preparation of a statement of service performance for public sector public benefit entities required by law to produce such a statement.

Consideration of public accountability with the power to raise tax

During the development of the framework, the XRB specifically considered how it could appropriately reflect the public accountability of public sector PBEs. This included how best to reflect the accountability that exists between PBE's funded directly by revenue collected from taxpayers and ratepayers. In New Zealand this includes local authorities who have 'coercive levying powers'.

The XRB's original proposal was for all 'coercive leviers' to be in Tier 1 and prepare financial reports which require full recognition, measurement and disclosures. However following consultation, this proposal was reconsidered. This was done on the basis of the 'cost-benefit' mismatch created by requiring smaller local authorities to be included within Tier 1. Therefore, all PBE's apply the framework in the same way, regardless of if they have 'coercive levying powers' or not.

It is observed that whilst a local authority may fall into any of the four tiers, there are additional regulatory and legislative reporting requirements which apply to their annual reports. Similar to the UK, this includes detailed information about income from local taxation, as well as budget versus actual spend analysis and a selection of performance and fiscal prudence benchmarks that are prescribed by central government.

Criteria underpinning thresholds

The XRB also considered which size criteria should be used to differentiate between the tiers in order to reflect the relative costs and benefits of reporting in the public sector. The use of expenses as the criteria to define entity size was considered the most appropriate proxy for cost and benefit, rather than either revenue, asset value or employee numbers. In the context of a public sector PBE, their level of spending was viewed as reflective of their underlying activity, given that financial performance is typically driven by expenses.

Discussion

New Zealand's multi-standard, multi-tiered financial reporting framework caters for the size variability of public sector entities. This is achieved by taking an approach whereby accounting requirements are able to be better tailored to the nature and size of the entity – allowing the costs and benefits of financial reporting to be better balanced.

The framework takes a differential approach for Tier 2 PBEs (total expenses ≤ £15.6m but > £1.04m) by adopting a reduced disclosure regime. Under this regime the same recognition and measurement requirements of Tier 1 PBE Standards are retained. The advantages of this approach include:

- The comparability of financial information between Tier 1 and Tier 2 is enhanced.
- The preparation of consolidated financial statements where a group comprises entities in Tier 1 and Tier 2 is simplified.
- The movement of entities between Tier 1 and Tier 2 is easier and less costly.

In broad terms, the recognition and measurement requirements for Tier 3 are also consistent with Tier 1 and Tier 2 PBE Standards, but several simplifications are made to reflect the 'simple' nature of the entities in this tier. Tier 3 focuses on providing requirements for transactions that are commonly undertaken by entities in this tier but allows entities the option to 'opt-up' to Tier 2 for specific types of more complex transactions.

The XRB undertook numerous consultations as part of its project to develop and implement its current framework, which resulted in changes to the accounting standards for the public and private sectors. From the discussion of the initial concept of the framework to its issue, the process took over three years.

Although New Zealand is only one specific example, their framework provides a useful case study for the development of the Code. A similar cost-benefit approach may well be a suitable basis for a differential reporting framework for local government.

Reflections on New Zealand's experience

In 2016, New Zealand's Controller and Auditor-General published 'Improving Financial Reporting in the Public Sector' which looked at the experience to that date and some of the challenges arising. The following extracts highlight some key points.

"I am pleased to report positive changes to accounting standards during the last six to seven years, which I expect to lead to improvements in financial reporting."

"The tiered structure is likely to help smaller entities achieve a better balance between the costs and benefits of general purpose financial reporting."

"These changes better position the public sector to report more meaningfully in the future."

The paper indicates however that changing the framework is only part of the process, and that continual focus on user needs is required:

"We would like to see public entities take more advantage of the flexibility available within the new PBE accounting standards to prepare general purpose financial reports that are more useful. There is scope to reduce the complexity of reporting by focusing on the information that is material to users."

"Sometimes, an entity should provide detailed information on particular issues, regardless of whether the issues are complex or unexpected."

"We expect such estimates and judgements to be made. However, the inherent uncertainties associated with these matters must be effectively communicated to users through general purpose financial reports so users can appreciate the potential variability in reported amounts."

SECTION 6:

Challenges and considerations for change

The overview and analysis of approaches to differential reporting in other sectors and jurisdictions raises a number of factors relevant to changing the current financial reporting for UK local government.

Users needs

CIPFA/LASAAC places users' needs at the centre of their vision for local government reporting. Their vision aims for users of UK local authority accounts to be able to access the information they want to help them understand the finances of the authority and take practical and informed decisions. Information about what users want is therefore essential to developing a framework for financial reporting that meets the needs of these users.

Previous discussions on this topic have recognised the wide range of potential users of local authority financial statements and the even wider range of stakeholders interested in them. This complements the concept of public bodies being publicly accountable for the use of public money. However, it contrasts with the perception that financial statements are rarely drawn on by those within government and are largely inaccessible to the general public.

Despite this focus on users' needs, there is currently limited research on who these users are and what information they want. The call for change from practitioners has not been matched by discussions with users on what information they want and how this should be provided. To inform further debate on the possible implementation of differential reporting, establishing whether user needs differ significantly between different groups or types of authority is a key consideration.

To address this gap CIPFA/LASAAC is undertaking further outreach to develop a clearer picture of the external users of financial reports and their specific areas of focus. An initial step in this direction was the launch of a stakeholder survey on local government annual accounts. Additional discussion and engagement with users, and other stakeholders, is anticipated to ensure that local government annual accounts are clearly focused on their needs.

Criteria for classification

The criteria used in each of the differential frameworks described in this paper differs. In New Zealand, total expenditure is used to establish the tiers in its reporting framework for its public sector, whilst the requirements for smaller authorities in England employs a threshold based on gross income or expenditure. For UK companies, the thresholds are defined in legislation and based on three criteria: turnover, balance sheet total and number of employees. In all cases, the measurements used are considered to reflect the nature and profile of the population which they segment.

Determining the appropriate criteria for local government is an important starting point in the development of a differential reporting framework. Making this judgement will involve considering how best to reflect the 'cost-benefit' principle. This usually employs entity size as a proxy. Doing so for local authorities would mean assuming:

- the smaller the authority, the smaller the likely number of users and therefore fewer benefits are likely to accrue from additional information being reported
- the smaller the authority, the greater the cost of preparing financial statements that comply with all the requirements of the Code.

Single measurement criteria

There are a range of approaches to defining the size of a local authority. Classifying entities based on expenditure offers a simple option, however, a single measurement can compound the 'cliff-edge' created by any threshold. A single measurement creates the potential that significant financial information, for example in relation to assets and liabilities, which is important for user needs is not considered in determining the disclosures required.

An example may be an authority which has a significant and complex asset base, essential for public service provision, where information on the risks to, and maintenance of, those assets would be important for readers. Another example would be the risks and potential returns arising from commercial ventures or investments. Adhering to a single measurement may require much more reliance on the appropriate application of professional judgement at an authority level to ensure user needs are met.

A further consideration is the treatment of non-agency funding transfers between authorities which may be significant in some administrations. A point of principle may require to be established as to whether these should be excluded from the measure, to avoid double counting, or included to reflect the responsibility of both parties for the proper use of those public resources.

Combined measurement criteria

Employing a number of different measurements, such as specifying expenditure and gross asset criteria, can soften the threshold's 'tipping point' and address some of the issues noted with a single measurement criteria. In particular use of combined criteria can ensure that different aspects which may be considered to affect accountability are recognised, minimising the risk that reporting on public resources does not achieve the transparency and clarity required by users of the accounts.

A combined measurement criteria approach may provide some complexity in application, and lead to an increased frequency of reclassification occurring if an entity's circumstances change.

Potential measurements

The following tables illustrate measurements that could be used either as 'single' criteria or in combination, under the headings income, expenditure and balance sheet.

Income measures

Measure	Description
Taxation Income and Funding	Provides an indication of scale of **public accountability** based on the **taxpayer resources provided to the authority**, determined by total resources (ie government grants, council tax and business rates). Consideration as to how to treat exchange transaction charges for statutory services, most notably housing rents, would be required as, although not taxation, the basis of provision and servicecharge is statutory.
Gross Income	Provides an indication of scale in terms of the **total resources generated or provided in the year which are under democratic control** to allow an authority to support services. Definition would be important in terms of whether investment income should be treated as 'net' income or as 'gross', especially for those authorities with significant reliance on investment income for supporting service delivery. Group accounts activities may also require specific consideration.

Expenditure measures

Taxpayer Supported Expenditure	Provides an indication of scale in terms of the total taxpayer resources used in providing public services. This would include expenditure supported by council tax and government grants, etc. In principle this would focus attention on the transparency of taxpayer support or subsidy for services, and tend to not focus on the total resources used to provide public services. As for income however the treatment of some exchange transactions, such as the provision of housing for rental income, would require consideration.
Gross Expenditure	Provides an indication of scale in terms of the total resources used in the year under democratic control to provide services. This would provide a clear focus on the cost of providing services, regardless of whether they are supported by the taxpayer or through fees and charges, etc. As for income definition would be important in terms of whether financing costs and other items should be treated as 'net' spend or as 'gross', especially for those authorities with significant investment expenditure and income. Group accounts activities may also require specific consideration.

Balance sheet measures

Gross Assets	This would provide an indication of **the public resources which an entity has stewardship of and responsibility for** in supporting the provision of public services. It would however neglect to recognise the extent of public interest in the legal and constructive obligations which an entity has that will affect the availability of these resources in the future. Group accounts assets may also require specific consideration.
Gross Liabilities	This would provide an indication of the **legal and constructive obligations which will need to be settled by the use of public resources** which an entity has incurred through the provision of public services. It would however neglect to recognise the existing public resources held by an entity which may be used to settle those liabilities. Group accounts liabilities may also require specific consideration.
Net Assets (Assets – Liabilities)	This provides a **limited indication of the importance of the balance sheet to understanding the public resources position of an entity**, since it would not draw a distinction between authorities which have large asset values offset by significant liabilities and those which have minimal balance sheets (eg just small debtors and creditors).
Assets + Liabilities (Absolute Figures)	By converting the liabilities figure to a positive figure, and aggregating with the gross assets, this would **provide indication of how important the balance sheet is in providing an understanding of the public resources position** of the entity. For example, it indicates the **size** of the authorities determined by the 'balance sheet total'. Treatment of group assets and liabilities would need to be considered.

Group accounts

Particular consideration is required for group accounts, especially in the current era whereby it is more common for authorities to operate, either to provide services or for commercial purposes to generate income, through group entities. An argument can be made that a sole focus on only the 'single entity' scale is insufficient to truly reflect accountability for public resources where these support, either directly or through guarantees, activities outside the single entity. Users interested in public accountability may be interested in the extent to which public resources are used for such purposes, and the risks and returns arising from this use.

Specifying the threshold for the measurement

Once the principle of which measurement(s) are appropriate was established, the actual thresholds would have to be set. Again, selecting an appropriate threshold would involve considering how best to reflect the 'cost-benefit' principle. This would require analysing a profile of the population and identifying where there are natural groupings. Where identified, the degree of uniformity between these groups would have to be analysed. Where a segment is established, the extent to which they have similar characteristics which justify a separate reporting framework would have to be justified.

Annual changes in classification and threshold reviews

Even using a combination of measurements may not address all potential issues, since any 'set point' criteria may mean that an authority could change classification (ie financial reporting requirements) from one year to the next dependent on whether it ceases or increases its expenditure/income, or its balance sheet position changes. Linked to this may be the question of how frequently the thresholds should be reviewed, whether annually, every three years, five years or longer.

Implications for public sector information (including Whole of Government Accounts and National Accounts)

A further consideration that arises is the impact of differential reporting on wider public sector financial information and statistics. A particular consideration relates to Whole of Government Accounts (WGA), where consistency of overall measurement principles (where material to WGA) will be important. In particular a measurement and threshold specification which would materially affect the aggregation of data for WGA purposes could be anticipated to lead to additional information being requested from some authorities. At present the WGA guidance[14] indicates that for local government, audit of WGA data is required if any of the following items are above £500m:

- Total assets excluding property, plant and equipment
- Total liabilities less pension liabilities
- Total income
- Total expenditure

In this respect using a measurement-based approach may pose particular challenges and complexity in identifying those authorities which would be required to provide additional data and audit arrangements. Clear discussion and agreement on WGA requirements would therefore be required. Similar considerations may also arise regarding other public sector information, such as that used for National Accounts.

Other classification approaches

Potentially alternative approaches could be taken to applying the 'cost-benefit' principle. Instead of size, the authority's deemed level of public accountability or scale of activities could be used. While this could potentially be achieved through specific or alternative means, perhaps the most transparent and less complex approach would be to relate this to the different types of authority which exist.

14 Whole of Government Accounts: Local Government Guidance 2018/19 WGA (HM Treasury) paragraph 2.4

This discussion paper provides a starting point for consideration, however more detailed work to ensure appropriate application of the 'cost-benefit' principle would be required. As indicated above the uniformity of authorities of one type and the WGA implications would require assessment. Most importantly of course, an understanding of the different user needs regarding information on authorities of the same type would be needed.

The structural arrangements differ for each part of the UK. To illustrate, to some extent, the differing nature of UK local government bodies Appendix A provides an indication, based solely on (net) taxpayer funded expenditure, of the scale of authorities in each class for each territory. Appendix B provides the same information in table format. This analysis is not presented as support for the application of a single criteria approach. It is an initial exploration of whether a measurement based approach could be considered for UK local government, either based on a combination of criteria or a single measure.

Based on the information in the appendices the following overview is intended to support discussion.

<table>
<tr>
<td>England</td>
<td>
England has a wide variety of different authority classifications, and differing tiers of authority dependent on geographical area. This may require specific consideration when assessing user needs, as service responsibilities for one locality may vest in a number of authorities.
It is suggested that the following are aspects of note:
Shire districts are, by class, clearly relatively smaller based on a single measure of taxpayer funded expenditure (ranging up to some £32m) than the other classes in general (see diagram below table). The degree of uniformity between shire districts could be assumed as being based on the services they are responsible for, noted below:

housing
leisure and recreation
environmental health
waste
planning
local taxation collection.

'Other authorities' vary significantly in scale, with some at the scale of shire districts and others at the scale of unitary authorities. Of the 'other authorities':

smaller entities include national parks and waste authorities
fire and rescue authorities typically fall between £20m – £80m
police and crime commissioners fall between £97m – £604m
the Greater London Authority is a significant outlier at some £5,893m.

Other classes generally relate to spend of over £120m.
</td>
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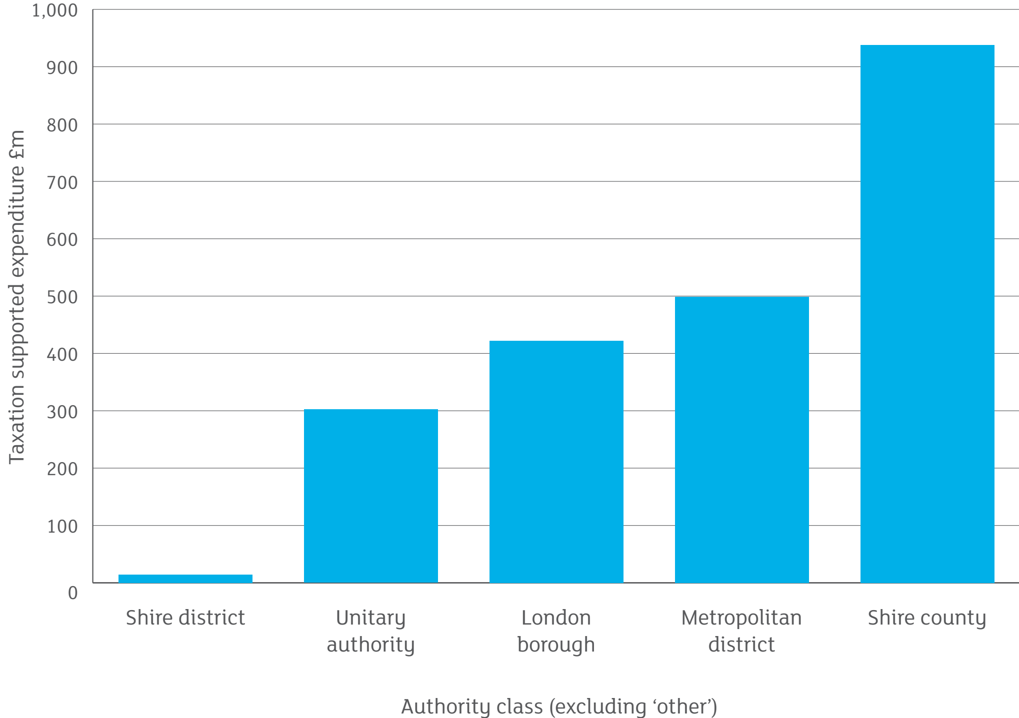
</table>

Wales	Wales generally has a less complex local government structure. The unitary authorities appear to be reasonably consistently grouped in terms of scale. Other Welsh authorities includes: ■ Fire authorities which appear to have low scale figures. This however is due to funding received from councils (total £297.6m) being deducted in the statistics before arriving at ‘gross revenue expenditure’. This avoids double counting and includes this spend as cost within councils. For scale assessment purposes however it may arguably understate the responsibility for public resources that fire authorities have. ■ National parks which also show relatively low scale expenditure for similar reasons to the fire authorities, although the scale of the impact (funding transfer total £6.4m) is significantly less. ■ Police, with entities ranging from £111m – £296m.
Scotland	Scotland has a relatively uniform structure for authorities, however this uniformity includes some significant differences in scale within each class: ■ Scottish councils range from £91m to £1,614m. ■ Scottish integration joint boards (IJBs) range from £47m to £1,156m. ■ Other Scottish bodies includes regional transport partnerships (max entity scale £40m); valuation joint boards (max entity scale £7.2m); and other smaller bodies. It should be noted that for the purpose of this analysis, funding transfers between councils and IJBs are not eliminated from spending (ie both IJB spend and council spend will effectively include the figures as expenditure). This reflects the separate responsibility that each body has for their management of the resources.
Northern Ireland	Northern Ireland has a uniform structure with key points to note being: ■ Two smaller bodies (arc 21 and a waste management body) of up to £7m are included. ■ Like Scotland the uniformity of councils includes some differences in scale, ranging from £41.4m to £175.7m.

For English authorities the average scale of authority per class is illustrated below (for source data see Appendix B).

Diagram 3: Average scale of English authorities measured solely by taxpayer funded expenditure.



Local accountability and budgetary process

Within the public sector the production and publication of statutory accounts are key to the delivery of accountability to taxpayers and other stakeholders by showing how public money is used. In addition to this general public accountability, local authorities raise funding through local taxation and are consequently directly accountable to their local electorate.

Local authority accounts also confirm their outturn for the year, which informs how much of their future spending will be funded from locally and centrally provided taxpayer funds. Therefore, the accounts play a role in the budgetary process as well as part of the accountability framework.

However, the extent to which these roles require uniform accounting standards and reporting requirements, irrespective of size, could be challenged. The need for consistent requirements amongst authorities that raise tax locally has been justified on an understanding that these entities have the same level of public accountability. Departing from this approach could be perceived as a decline in accountability and lessening the role of the statutory accounts in the overall financial management of these authorities.

Consensus on policy change

The statutory and regulatory framework that underpins the financial reporting framework for local government is complex and varies between each jurisdiction and class of authority. Therefore, bringing forward any fundamental change to the shape of the reporting framework will require changes to the legislation and regulation in each jurisdiction.

Assimilating these will not be straight forward. The process will also involve a significant amount of time and effort in order for a consensus to be reached, as well as support from those stakeholders in each jurisdiction involved.

It is observed that the appetite for change is expected to vary between each jurisdiction and class of authority. For example, changes which result in authorities in the same jurisdiction applying different accounting standards is likely to impact on the comparability of their financial statements.

Consistency to enable consolidated financial statements

The WGA are the consolidated financial statements for the whole of the UK public sector and include local government. They are a key mechanism for understanding the financial performance and position of the public sector and play an important role in the ongoing management of UK public finances. An examination of the public sector reporting practice of other countries identifies the inclusion of local government in the WGA as unique to the UK.

The preparation of the WGA is done in accordance with the Government Financial Reporting Manual (FReM), which uses IFRS adapted as appropriate for the public sector. Therefore, bodies included in the WGA are required to prepare information on this basis. Those bodies that use a different accounting framework are required to prepare information for WGA purposes which is compliant with IFRS.

It is feasible for a body to apply an accounting framework that does not comply with the FReM or IFRS. However, where it does so, bodies must provide information on any such differences as part of the WGA process. If a reporting regime was developed for local authorities that departed from full IFRS, any time and cost saving realised would have to be balanced against the consistent accounting conventions needed for WGA. As such, the benefits to the preparer of a simpler accounting framework could be lost in finding the figures necessary for the WGA. Therefore, development of a simpler regime for local government could be affected by the overriding requirements for a sufficiently consistent set of accounting policies and conventions across the UK public sector as a whole.

Financial reporting which reflects the nature of the authorities

Local authorities are multi-purpose entities and responsible for a wide variety of different services. Whilst the types of services may be similar, authorities' method of delivery and funding arrangements will differ. It is therefore inevitable that authorities will enter into non-standard and complex transactions, irrespective of their size.

The Code currently allows for flexibility in presentation to ensure that authorities' financial statements reflect their individual circumstances and the variety of transactions they are undertaking. This rationale potentially challenges the need for a differential approach that attempts to reduce the reporting required of entities based on their size.

For example, where an authority undertakes a range of different activities and enters into complex financial transactions, this will contribute towards the length and complexity of the notes to their accounts. Equally, an authority undertaking simple transactions will make simpler disclosures and produce shorter and more straight-forward accounts. However, a regime based on size may result in 'small but complex' authorities applying simpler accounting standards. This could result in such authorities applying reporting requirements that do not match the risk of the transactions being undertaken, or acknowledge the relevance of information about these transactions for users of the accounts.

Process of change

Transitioning to new reporting requirements is a resource intensive process. Changes to accounting standards can demand a significant amount of time from preparers and auditors, as well as users of accounts. Therefore adopting a new framework would require the investment of time and cost, notwithstanding the potential savings and stability it will bring over the longer-term.

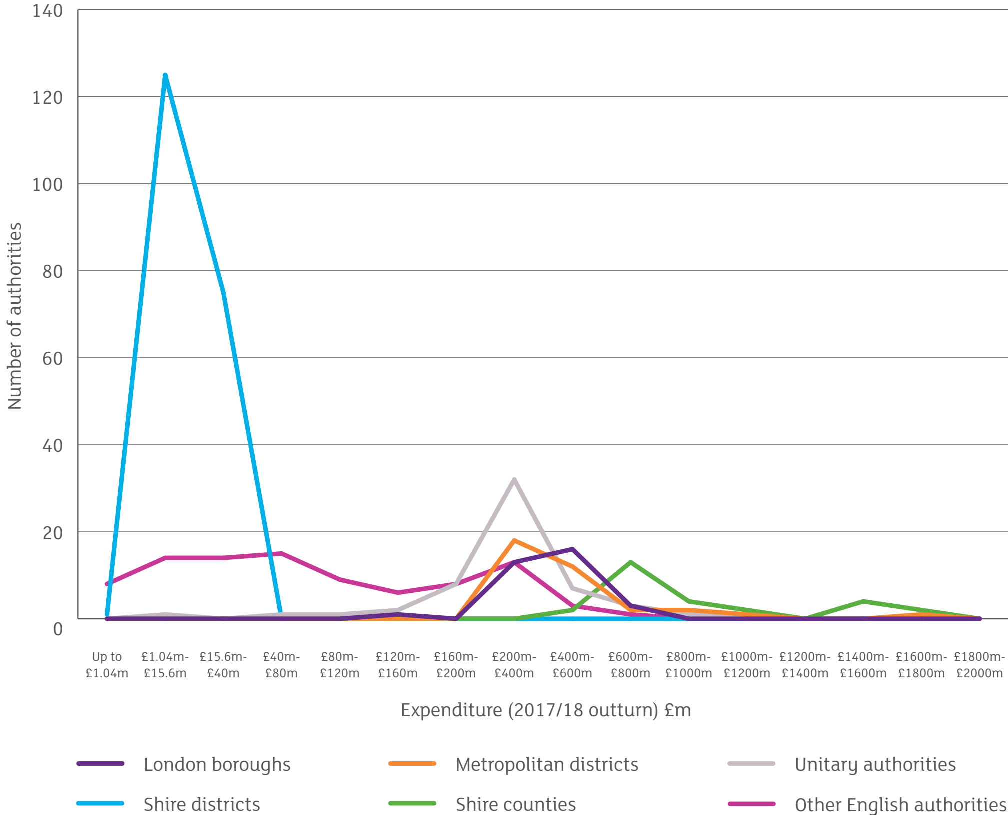
A differential framework that aims to simplify or reduce reporting based on size is likely to result in greater changes for authorities at the 'smaller' end of the population. Therefore, the impact on smaller authorities' workloads to ensure readiness for adoption would be expected to be more acute when compared to larger authorities. Any changes would have to be accompanied by a programme of consultative activities specific to this stakeholder group, and would require an appropriate period of transition.

APPENDIX A:

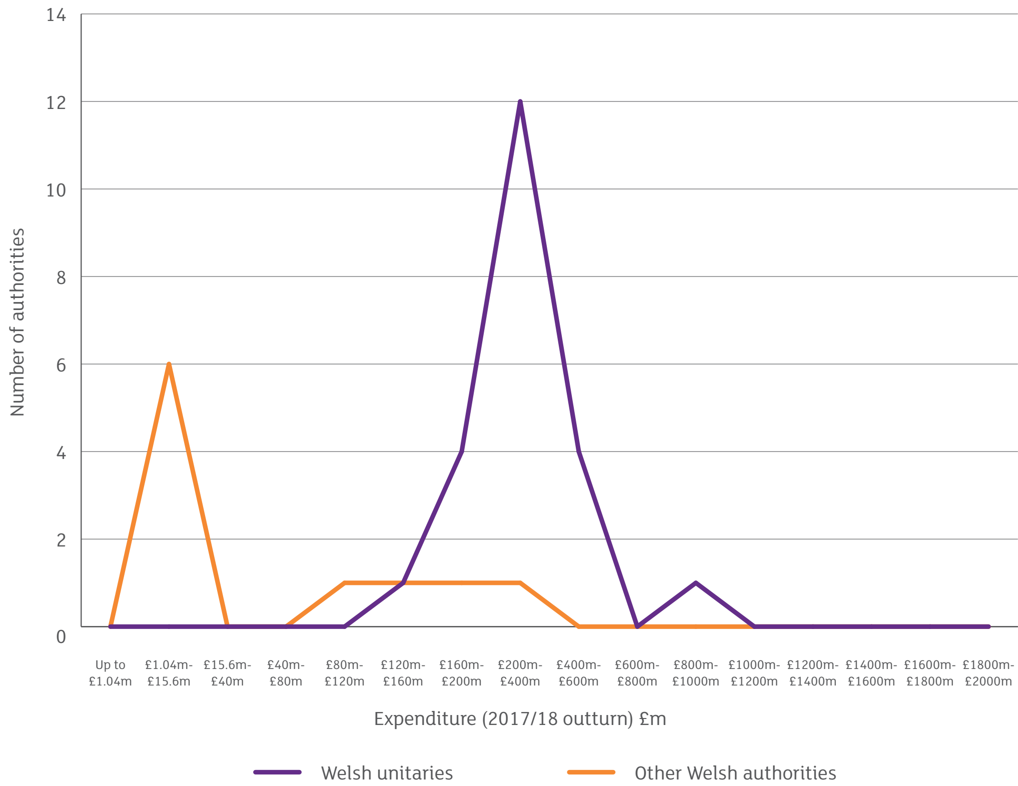
Graphs: Distribution of local authorities by taxpayer funded expenditure (2017/18)

For information sources and measurement bases, please see Appendix B.

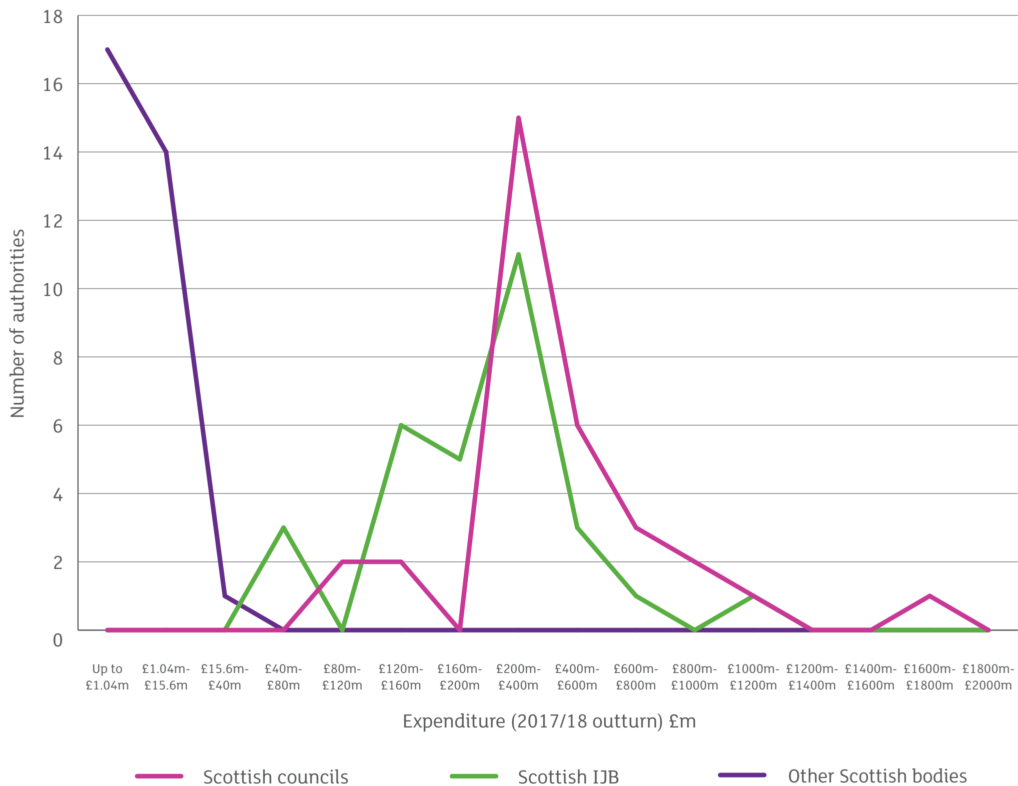
Graph 1: Distribution of local authorities in England (excluding town and parish councils)



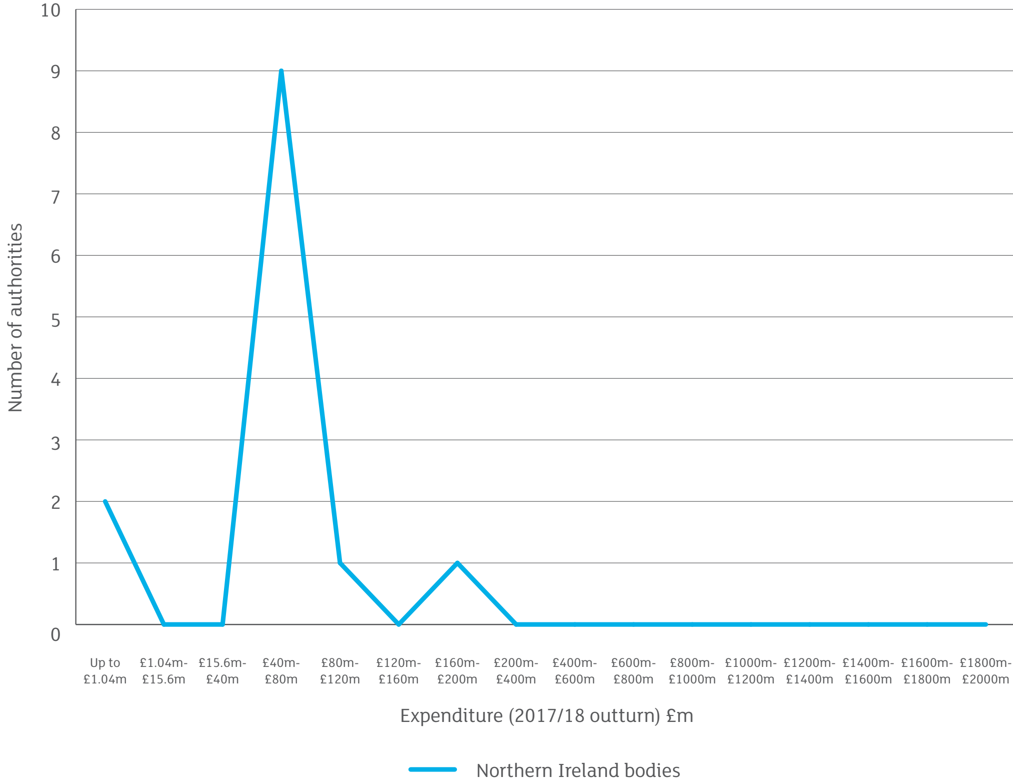
Graph 2: Distribution of local authorities in Wales (excluding town and community councils)



Graph 3: Distribution of local authorities in Scotland (excluding community councils)



Graph 4: Distribution of local authorities in Northern Ireland



APPENDIX B:

Table: Distribution of UK local authorities by taxpayer funded expenditure (2017/18)

	Up to £1.04m	£1.04m £15.6m	£15.6m – £40m	£40m – £80m	£80m – £120m	Over £120m	Total
London boroughs	–	–	–	–	–	33	**33**
Metropolitan districts	–	–	–	–	–	36	**36**
Unitary authorities	–	1	–	1	1	53	**56**
Shire counties	–	–	–	–	–	27	**27**
Shire districts	1	125	75	–	–	–	**201**
Other English authorities	8	14	14	15	9	31	**91**
Welsh unitaries	–	–	–	–	–	22	**22**
Other Welsh authorities	–	6	–	–	1	3	**10**
Scottish councils	–	–	–	–	2	30	**32**
Scottish IJBs	–	–	–	3	–	27	**30**
Other Scottish bodies	17	14	1	–	–	–	**32**
Northern Ireland bodies	2	–	–	9	1	1	**13**
Total UK Local Authorities [Note 2]	**28**	**160**	**90**	**28**	**14**	**263**	**583**

Percentage of total [Note 2]	5%	27%	15%	5%	2%	45%	100%

Note 1: The measurement for expenditure reflects the net expenditure which relies on taxpayer funding. More details are provided in the sources section below.

Note 2: Due to the different information sources for each area and/or type of organisation, the information at a UK level should be regarded only as indicative of expenditure profiles based on readily available data. Measurement is regarded as consistent for each row.

Note 3: The analysis excludes English town and parish councils, Welsh town and community councils and Scottish community councils. It therefore reflects those authorities currently applying the code of practice on local authority accounting.

Sources

England: Revenue outturn summary (RS) 2017-2018 – revised. Measure: Revenue Expenditure (line 800)

Wales: Welsh Government: Revenue Outturn (RO), 2017/18, (see Revenue outturn expenditure summary, by authority). Measure: Gross revenue expenditure (column CW on detailed excel export)

Scotland (Councils): Audit Scotland database (submitted accounts 2017/18, single entity). Measure: Net cost of services, plus other operating income/ expenditure and financing and investment income/expenditure.

Scotland (IJBs): Integration Joint Board annual accounts 2017/18 (single entity). Measure: Net cost of services, plus other operating income/ expenditure and financing and investment income/expenditure.

Scotland (Other): Dependent on body: LFR 2017/18 A10 (accounts based data, F16, F22, F48) or annual accounts (single entity). Measure: Net cost of services, plus other operating income/expenditure and financing and investment income/expenditure.

Northern Ireland: Local government annual accounts 2017/18 (single entity). Measure: Net cost of services, plus other operating income/expenditure and financing and investment income/expenditure.

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