

report

Paper CL 07 06-16B

Committee	CIPFA/LASAAC
Venue	CIPFA Scotland, Edinburgh
Date	7 June 2016
Author	Sarah Sheen, CIPFA, Technical Manager, Local Government Financial Reporting
Subject	Development of 2017/18 Code of Practice on Local Authority Accounting – Going Concern Reporting

To consider the reporting requirements in the Code on going concern

1 Introduction

- 1.1 A respondent to the consultation on the 2016/17 Code raised the issue of going concern reporting. The respondent suggested that the Code, whilst not changing the underlying assumption, clarifies disclosure requirements in relation to going concern. The respondent noted that IAS 1 *Presentation of Financial Statements* requires management to make an assessment of an entity's ability to continue as a going concern and to disclose any material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The respondent considered that authorities should disclose that the accounts have been prepared on going concern basis and where there are any uncertainties a description of these.
- 1.2 Paragraph 3.4.2.23 of the Code stipulates that a local authority's financial statements should be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence for the foreseeable future. Paragraph 3.4.2.82 a) requires that the notes present information about the basis of preparation of the financial statements and the specific accounting policies use.
- 1.3 Local authorities are only created or discontinued by a statutory prescription and therefore the Code stipulates that the financial statements are prepared on a going concern basis. Local authorities in Great Britain have to adhere to a balanced budget requirement ie:
- England, sections 31A, 42A of the Local Government Finance Act 1992, as amended
 - Wales, sections 32 and 43 and Scotland, 93 of the Local Government Finance Act 1992, and

- section 85 of the Greater London Authority Act 1999.

Section 28 the Local Government Act 2003 requires that local authorities take action for the deterioration of the financial position of the authority.

- 1.4 It is therefore unlawful for an authority in Great Britain not to budget for a positive general fund balance.
- 1.5 The going concern assumption under the Code is therefore drawn up to assume that a local authority's services will continue to operate for the foreseeable future. This assumption is made because local authorities carry out functions essential to the local community and are themselves revenue-raising bodies (with limits on their revenue-raising powers arising only at the discretion of central government). If an authority were in financial difficulty, the prospects are thus that alternative arrangements might be made by central government either for the continuation of the services it provides or for assistance with the recovery of a deficit over more than one financial year. The Code is clear that transfers of services under combinations of public sector bodies (such as local government reorganisation) do not negate the presumption of going concern.
- 1.6 For information the Government's Financial Reporting Manual (FReM) interprets going concern for the public sector context:
- *for non-trading entities, the anticipated continuation of the provision of a service in the future, as evidenced by inclusion of financial provision for that service in published documents, is normally sufficient evidence of going concern.*
- (FReM table 6.2)

In addition paragraph 2.23 states

"In presenting information in their financial statements, preparers should also have regard to the:

- *underlying assumption (financial statements shall be prepared on a going concern basis);"*

- 1.7 For local authorities the statutory framework means that there can be no material uncertainties related to events or conditions that may cast significant doubt upon their ability to continue as a going concern. It might be the case that there are substantial resource issues facing the local authority and/or that there may be liquidity risks for the authority and these would need to be reported the financial statements under the Code's adoption of IFRS 7 *Financial Instruments; Disclosure* (see section 7.4.3 of the Code) and as necessary in its Narrative Report ie when demonstrating the financial performance and financial position of the authority (see paragraph 3.1.1.4 of the 2016/17 Code) (and for English authorities paragraph 3.1.5.3). However, it would be misleading to report going concern issues as the authority will not be dissolved without statutory prescription.
- 1.8 IAS 1 *Presentation of Financial Statements* states that:

"An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so." (IAS 1 paragraph 25)

Even in the event of severe resource issues facing a local authority, local authority's management will not be able to take the actions necessary to liquidate

the assets and other resources it holds as the statutory services it provides would need to be continued to be provided to the local population and the assets would remain in the public domain. This is supported by the second assumption in the Code on going concern ie that a "machinery of government" or other public sector change does not negate the assumption of going concern. An authority would also therefore be precluded again by statutory prescription from taking the steps to liquidate its statutory functions. There have been few examples of substantial failure of local authorities in resource terms. Where this has been the case the authority has been supported by the relevant government interventions.

- 1.9 The Secretariat would argue therefore that there are no further requirements under IAS 1 for reporting going concern and suggests that this is reinforced in the Code (Ref ED2, paragraph 3.4.2.23). The Secretariat does not consider this is an interpretation of IAS 1 as this is a factual result of the statutory environment in which a local authority operates.
- 1.10 The Code can emphasise the need to report the resource issues facing the authority effectively ie in the Narrative Report and stress the need for effective liquidity risk reporting. However, the Secretariat suggests that the latter may be best offered in application guidance.

Recommendation

CIPFA/LASAAC is asked to consider the recommendation of the Secretariat relating to going concern reporting in the Code.