CIPFA The Chartered Institute of Public Finance & Accountancy

report

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Subject	Research on Differential Reporting Requirements

Purpose

To review the approaches of other sectors and jurisdictions to inform CIPFA/ LASAAC's future work on streamlining and accessible financial reporting

1 Background

1.1 Previous discussions by CIPFA/LASAAC have raised the issue of financial reporting complexity and current reporting not meeting users' needs. This is at odds with CIPFA/LASAAC's vision for 'clear reporting' and which enable users to '*access the information they want to help them to understand the finances of an authority and to take practical and informed decisions*'[1].

1.2 One of the perceived issues of the existing framework is that it largely requires the same level of accountability regardless of the size or economic significance of the authority. This uniform approach contrasts to the differential reporting arrangements in other sectors and jurisdictions, for example UK Company Reporting.

1.3 This paper presents the requirements of the current framework and an overview of its constituents. It then offers a summary of the reporting frameworks in a number of other sectors and jurisdictions as a point of comparison. The accompanying appendices provide an overview of these frameworks.

1.4 The paper aims to provide a context from which the Board can begin the conversation about how to best improve the current framework.

1.5 It aims to inform:

- the content of the 20/21 Code consultation and/or stakeholder survey;
- the longer term Code development; and
- the basis of CIPFA/LASAAC discussions regarding scope for changes in
  - Code requirements; and
  - Stakeholder behaviour (i.e. non-specification changes)

[1] CIPFA/LASAAC's Vision for Local Authority Financial Reporting - February 2019

2 Current application and alternatives of the Code

2.1 The Code applies to local authorities throughout the UK. Appendix A provides an overview of those bodies within local government which are not required to follow the Code and the financial reporting framework they follow.

2.2 CIPFA/LASAAC will be aware of the 'lighter touch' framework being used by those bodies in local government not required to apply the code (e.g. smaller authorities, and parish and community councils).

Discussion/analysis

2.3 In England, approximately 760 of authorities currently meet the definition of a 'smaller authority' and are not required to apply the Code[2]. This is in addition to the some 9,000 parish councils who are not required to comply with the Code[3]. This represents a significant body of entities that are preparing statutory accounts under an alternative financial reporting framework.

2.4 The guidance on the Statement for Accounts for small authorities in England is contained within six pages[4]. The single page Statement is contained in the Annual Governance and Accountability Return completed by the authority. It provides a summary of the authority's income and expenditure (or receipts and payments), its assets and other balances.

2.5 Currently the interaction between the requirements of the Code and the alternative frameworks which are used by those not applying the Code is ill-defined. The guidance produced for smaller authorities in England is not benchmarked against the requirements of the Code. However, it may provide a useful starting point in simplifying the existing framework[5]. For example, the guidance recommends smaller authorities follow UK GAAP (FRS 102). Therefore, the preparers and auditors of smaller authorities may be able to inform any work on local authority financial statements modelled on different financial reporting framework.

3 Distribution of current constituents

3.1 Appendix B shows the distribution of local authorities in England by expenditure.

3.2 The analysis shows the spread of total spending between different classes of local authorities. There is little consistency between an authority's total expenditure and its class. For example, the largest Metropolitan District spent over 12 times more than the smallest Metropolitan District in 2017/18, with total expenditure ranging from £139m to £1,768m.

Discussion/analysis

3.3 Those entities applying the Code are a disparate conglomeration. They vary considerably in size and population which is reflected in their spending.

[2] SAAA - Smaller Authorities' Audit Appointments – 2017/18
[3] Department for Communities and Local Government, 2015
[4] *A Practitioners' Guide to Proper Practices to be applied in the preparation of statutory annual accounts and governance statements*, March 2018 - Pages 16 to 21
[5] *A Practitioners' Guide to Proper Practices to be applied in the preparation of statutory annual accounts and governance statements*, March 2018 - Page 23

3.4 However, all are responsible for providing a range of public services and funded directly by taxation. Therefore, there are similarities between the types of activities and transactions local authorities undertake and are accounting for. The extent to which these similarities justify a single accounting framework is open to discussion. Having the same financial reporting requirements and accounting standards for all authorities has clear benefits, but also has implications for practitioners and standards setters.

4 Aspect of other sectors and jurisdictions

UK Company Reporting

4.1 Appendix C provides an overview and an assessment of the reporting framework for UK companies in relation to local government.

4.2 The current framework for UK companies sees financial reporting requirements getting progressively more complex and comprehensive the further up the suite of standards you go. For the smallest companies, the 'micro-entities regime' offers a simplified approach. Companies classed as 'micro-entities' may prepare accounts which have a reduced number of primary statements and disclosure requirements compared with UK GAAP (FRS 102)[6]. The 'micro-entities regime' was developed largely in response to the implementation of the new EU Accounting Directive and supported by changes to UK legislation.

4.3 In addition, the regime allows a simplified accounting treatment for financial instruments and does not permit entities to fair value or revalue any assets or liabilities. Both are areas where IFRS requires substantial disclosures in the notes to the accounts, as reflected in the Code. By not requiring these entities to value assets at fair value and adopt a simplified approach to the treatment of financial instruments, it is inferred that financial statement users of these accounts may not require this information.

UK Charity Reporting

4.4 Appendix D provides an overview of the reporting framework for UK charities and associated issues.

4.5 The perceived mismatch in the current regime means charities with incoming resources of more than £250,000 have the same reporting requirements as the very largest charities. This is largely a result of the existing legal framework and how UK GAAP has been interpreted in the context of charity reporting.

4.6 The body responsible for developing the Charities SORP (the SORP-making body) are currently considering the changes needed to allow a more proportionate approach to reporting. However, any new framework must ensure charities remain transparent and accountable about how they are using their resources.

4.7 Like CIPFA/LASAAC, the SORP-making body are at the start of this process. However, early indicators of their thinking suggest changes to legislation will be required to provide a more suitable framework for small charities.

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[6] A company qualifies as a micro entity if it does not exceed two or more of the following criteria: Turnover £632,000; Balance sheet total £312,000; and No. of employees 10

Financial reporting requirements for Local Government in other countries

4.8 Appendix E offers a review of comparable requirements in a number of other countries. Those countries selected for comparison are relatively similar to the UK in terms of regulatory rigour and/or are jurisdictions that are often compared with UK in terms of financial reporting issues. However, it is observed that the role, status and services provided by local government in each country will differ.

Consistency to enable consolidated financial statements

4.9 Local government entities are not consolidated into the consolidated financial statement provided at a whole of government level in those countries included in the analysis in Appendix E. Therefore, the inclusion of local government in the Whole of Government Accounts is unique to the UK.

4.10 Notwithstanding the role of the WGA in the ongoing management of UK public finances, the requirement for sufficiently consistent set of accounting policies and conventions across the UK public sector as a whole may affect the development of a simpler regime for local government.

Multi-standards, multi-tiered framework

4.11 Public sector entities in New Zealand apply different accounting requirements dependent on their level of spending. The country's accounting framework for public benefit entities is structured around four tiers, using total expenditure as a differentiator. Each tier imposes different financial reporting requirements. These range from ranging from cash accounting ('Tier 4') to IPSAS-based standards ('Tier 1'). The model achieves a simpler regime for Tier 2 through reduced disclosure requirements; however, entities are generally subject to the same recognition and measurement requirements as Tier 1 entities.

4.12 The framework results in only those public sector entities with a prescribed level of economic significance or public interest to external users preparing financial reports which require full recognition, measurement and disclosure. It is observed that this model has only been achieved by accepting differing levels of accountability across the public sector.

5 Potential challenges and considerations for change

5.1 The discussion and analysis presented in sections 2 to 4 and the accompanying appendixes raise a number of potential challenges and other factors relevant to improving the current financial reporting framework for local government.

Information gap: What do users need?

5.2 CIPFA/LASAAC places users' needs at the centre of their vision for local government reporting. The Board's previous discussions have recognised the wide range of users of local authority financial statements, and the even wider range of stakeholders who are interested in them. Information on what users want is essential to developing a framework for financial reporting that meets the needs of these users.

5.3 However, there is currently limited research in this area. 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.

5.4 Whilst the resources associated with obtaining this information are acknowledged, it is considered necessary in order to inform future change. Further outreach would be needed to develop a clear picture of the external users of financial reports and their specific areas of focus.

Funded locally: accountable to the local electorate

5.5 Local authorities are different from other public sector organisations in that they raise funding through local taxation and are consequently directly accountable to their local electorate.

5.6 This is reflected in authorities' financial statements, which provide information on what income and expenditure is to be funded from both locally and centrally provided taxpayer funds. Reporting the statutory adjustments needed to show how much of the authority's expenditure needs to be met from taxation is therefore an important part of their accountability framework.

5.7 As authorities typically have the power to raise tax locally, sometimes through precepting arrangements, there is a perception that all have the same level of public accountability. Therefore taking a differential approach to reporting across local government may be perceived as a decline in accountability.

Consensus on policy changes

5.8 Whilst the existence of 'quick wins' within the existing Code is acknowledged, it is questioned whether amending or changing current requirements would bring the change needed to deliver CIPFA/LASAAC's vision and address the complexity which exists in the overarching framework.

5.9 Any significant amendments to this framework could require potential policy changes across each jurisdiction. There would be time and effort required to achieve this, as well as clear support from all stakeholders involved in this process.

Financial reporting which reflects the nature of the authorities

5.10 In contrast to most other public sector bodies, local authorities are multi-purpose entities responsible for a wide variety of different services. Whilst the types of services may be similar, authorities' method of delivery will differ and may involve entering into non-standard transactions. It may be noted that the size (eg revenue expenditure) of an authority is not necessarily an indicator of how complex its financial transactions and arrangements are.

5.11 Consequently, the Code allows for flexibility in presentation to ensure that the financial statements reflect the individual circumstances and transactions of each authority. Therefore, where an authority is undertaking a range of different activities and entering into complex financial transactions, this will contribute towards the length and complexity of the notes to their accounts.

Process of change

5.12 The process of transitioning to new requirements can be resource intensive. Therefore adopting a new framework will require a significant investment of time and cost, notwithstanding the potential savings it will bring over the longer-term. Given that a differential framework is likely to be for the 'smaller' end of the population, the impact of this change on resources is likely to be proportionately higher when compared to larger local authorities. Therefore a phased programme of change and transitional relief may be required.

CIPFA/LASAAC is invited to consider the approaches of other sectors and jurisdictions presented in the paper, and provide its views on the extent to which these could inform the development of the Code.

Appendix A: Summary of bodies not required to prepare accounts using the Code – UK Local Government (*Based on requirements for 2018/19*)

Specific application of the Code of Practice on Local Authority Accounting is different in each UK territory.

England

The Code does not apply to:

Smaller authorities

- Smaller authorities that have not chosen to prepare their accounts for the purpose of a full audit (i.e. a 'Category 2 authority')
- Smaller authorities are defined under the 2014 Act as those local authorities where for three years (or one or two years if the body has existed for less than three years) the higher of gross income or expenditure does not exceed £6.5 million

Parish Councils

- Any parish councils, even those required to prepare a Statement of Accounts.

The Joint Panel on Accountability and Governance (JPAG) are responsible for issuing proper practices in relation to the accounts of smaller authorities. These are set out in '*A Practitioners' Guide to Proper Practices to be applied in the preparation of statutory annual accounts and governance statements*'.

Wales

The Code does not apply to Community Councils

Community Councils must prepare annual accounts following proper practices as set out in the One Voice Wales /SLCC publication '*Governance and accountability for local councils in Wales – A Practitioners' Guide*'.

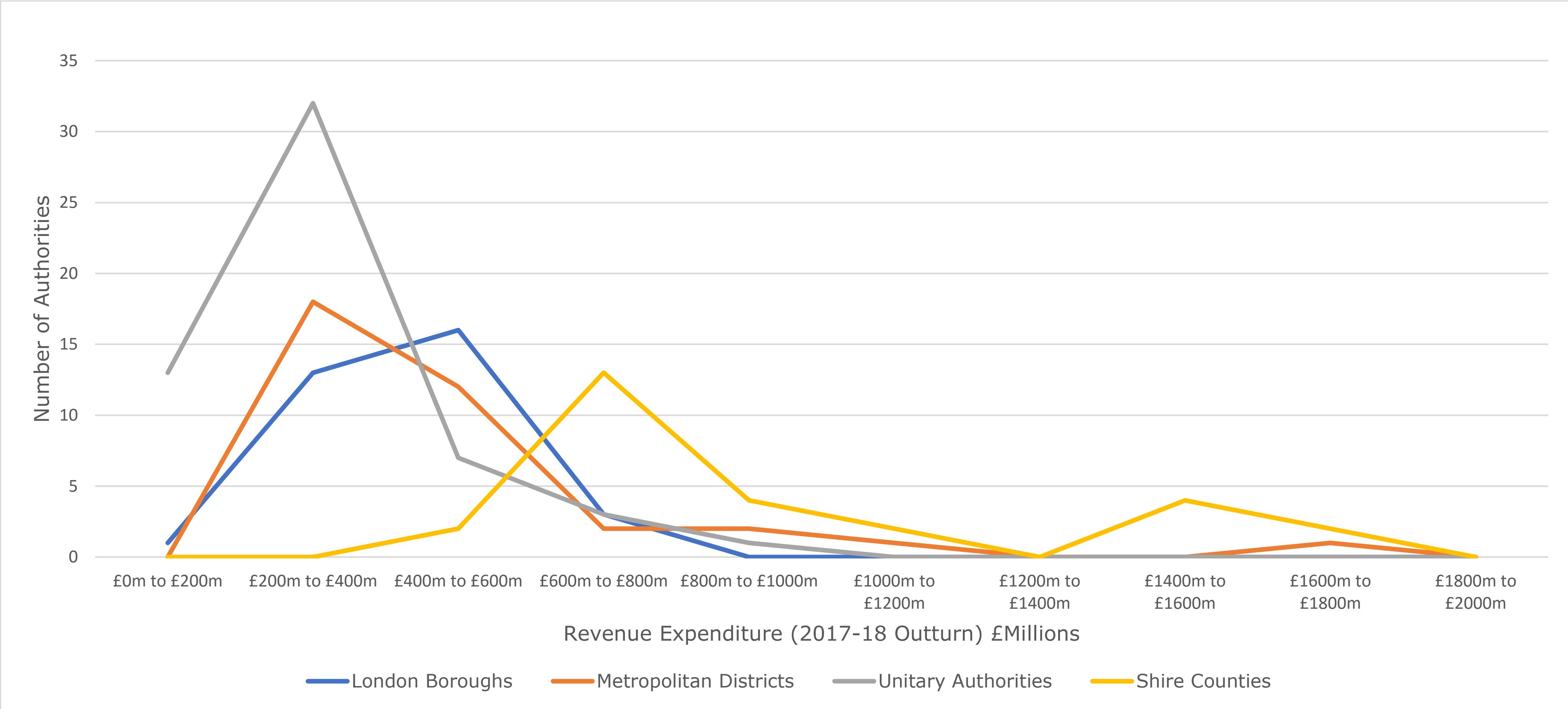
Scotland

There are no specific identified exemptions for compliance with the Code for Local Authorities in Scotland. Registered charities administered by authorities may be included in authority group accounts, but prepare their own accounts using the financial reporting framework for charities and not those of local government.

Northern Ireland

There are no specific identified exemptions for compliance with the Code for District Councils in Northern Ireland

Appendix B: Distribution of Local authorities in England by Revenue Expenditure (2017/18)



Based on data compiled from the Ministry of Housing, Communities and Local Government Revenue Outturn (RO) returns submitted by local authorities in England for 2017/18, accessible at: www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing#2017-to-2018

Excludes the following classes of authorities:

- Shire Districts, all 201 of which had revenue expenditure of < £40m; and
- Other Authorities.

Appendix C: Overview of the UK Company financial reporting framework
(Source: FRC, Overview of the financial reporting framework - July 2015)

The following is a summary and does not aim to provide a comprehensive overview. Further detail of each framework can be found within the relevant accounting standard, as issued by the Financial Reporting Council (FRC).

EU-endorsed IFRS

IFRS adopted in the EU is required only for the group accounts of listed companies (including AIM-listed companies)

UK and Ireland GAAP

The UK and Ireland GAAP reporting framework is made up of five regimes, three of which are available within FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

These are set out in Appendix C.1.

Smaller entities have a choice between three core UK GAAP regimes subject to meeting relevant criteria:

- the micro-entities regime (FRS 105);
- the small entities regime (Section 1A *Small Entities* of FRS 102); and
- FRS 102.

An overview of each of these regimes is given below:

The micro-entities regime (FRS 105)

Micro-entities are the smallest of entities (with turnover of up to £632,000) and a subset of small entities. The accounting standard for micro-entities, FRS 105, has been developed around the legal framework and simplified the requirements of FRS 102 for this group of entities.

The micro-entities regime requires limited disclosures and constrains the accounting policies that can be applied:

- The only primary statements required are a **balance sheet** and **profit and loss account**. The information presented in these statements is condensed (for example 'fixed assets' is not disaggregated into tangible fixed assets, intangible assets, investment properties etc).
- No assets can be measured at fair value or a revalued amount.
- Micro-entities' accounts are <u>only</u> required to disclose the following:
  - the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet;

  - an indication of the nature and form of any valuable security which has been provided;
  - the amounts of advances and credits granted to its directors with indications of interest rates, main conditions and any amounts repaid or written off or waived; and
  - any commitments entered into on their behalf by way of guarantees of any kind, with an indication of the total for each category.
- However, micro-entities may voluntarily choose to disclose more information.

The small entities regime (Section 1A Small Entities of FRS 102)

Similar to FRS 105, Section 1A Small Entities of FRS 102 has been developed around the legal framework from the requirements of FRS 102.

The requirements of the small entities regime are more comprehensive than the micro-entities regime and the recognition and measurement requirements of Section 1A are the same as those set out in the rest of FRS 102.

In relation to recognition and measurement, key differences between the small entities regime and the micro-entities regime include the use of fair value and revaluation accounting and the additional accounting requirements in respect of derivatives, deferred tax and equity-settled share-based payments.

Similar to FRS 105, the only primary statements required are a **balance sheet** and **profit and loss account**.

FRS 102

The requirements of FRS 102 were developed from the IFRS for SMEs. However, the scope of FRS 102 is wider than the scope of the IFRS for SMEs. When comparing FRS 102 with the IFRS for SMEs, the main differences come from:

- Modifications for public benefit entities (PBE);
- Modifications to align with the old UK GAAP; and
- Simplified language in the financial instruments sections

Assessment of UK Company financial reporting framework

Increasing size and complexity

The existing framework sees financial reporting requirements getting progressively more complex and comprehensive the further up the suite of standards you go. The increase in complexity correlates to the increasing size and complexity of the entities that are most likely to apply a given standard.

Options for small companies and entities that are part of a group

There is choice of regimes for those companies at the 'smaller' end of the scale, as well as reduced disclosure requirements where an entities that are part of a group. These choices are dependent on meeting eligibility criteria, which includes:

- The type of financial statements (i.e. individual or group) being prepared;
- Size threshold; and
- Entity type.

The key differences between the three regimes available to smaller companies include:

- Number of primary statements
- Condensed formats of statements
- The number of disclosures
- Simplified accounting treatment
- Requirement for fair value and revaluation accounting
- The number of accounting policy choices/mandatory treatments

Abridged accounts

Recent changes in regulation introduced the option for small companies to prepare 'abridged' statutory financial statements. These statement allow small companies to show fewer line items on the face of their balance sheet and profit and loss account. However these statements are still required to give a true and fair view.

Relevance to UK local government reporting

Change in legislation

As with the Code, the development of UK accounting standards has to ensure consistency between the relevant legal frameworks and the financial reporting framework.

It is observed that the development of the 'micro-entities' regime was a response to the EU Accounting Directive. Legislation means that micro-entity accounts are automatically presumed to give a true and fair view if the financial statement are prepare in accordance with the legal requirements of the micro-entities regime. This differs to small companies, where directors are required to consider what additional information may be needed in order for the accounts to give a true and fair view.

This change in legislation created a new category of entities which are eligible to prepare very simplified accounts. This approach significantly reduced the number of disclosures and length of accounts for the small companies. However, this has also seen a potential loss of information for account users. In practice, many credit rating agencies and finance providers now request additional financial information from those companies preparing micro-entities accounts.

Public accountability

Accountability is often considered to be more complex and salient in the public sector compared to the private sector given there is a need to be accountable for the use of public money. To provide such accountability, public sector financial statements include information on non-exchange revenue and expenditure.

To this extent, directly comparing the length, bases and scope of the financial reporting frameworks for UK Companies with the current framework for local authorities is questionable.

It is observed that UK charities currently follow UK and Irish GAAP through the application FRS 102. As with the public sector, different accountability considerations apply to charities when compared with the private sector. There is a substantial expectation that charities will provide additional accountability for the benefit of funders. This is acknowledged in the current reporting framework which:

- Specifically exempts charities from applying FRS 101 *Reduced Disclosure Framework* and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*; and
- Requires additional accountability information through application of a Statement of Recommended Practice (SORP).

On this basis, an overview and assessment of the reporting framework for UK charities is considered a more relevant point of comparison and is provided in Appendix D.

Appendix C.1: UK and Ireland GAAP (*Source: FRC, Overview of the financial reporting framework - July 2015*)

Framework	**Micro-entities regime**	**Small entities regime**	**FRS 102**	**Reduced disclosure framework**	**Reduced disclosures For subsidiaries and ultimate parents**
Related accounting standard(s)	FRS 105	Section 1A *Small Entities* of FRS 102	FRS 102	FRS 101	Paragraphs 1.8 to 1.13 of FRS 102
Source of eligibility criteria	Sections 384A to 384B of the Companies Act 2006.	Sections 382 to 384 of the Companies Act 2006.	Companies Act 2006	Definition of a qualifying entity as set out in the glossary to FRS 101.	Definition of a qualifying entity as set out in the glossary to FRS 102.
Eligible entities	• Companies only (Note: Whilst the legislation and consequently FRS 105 uses the term micro-entities regime, it is only currently available in law to companies.)	• Companies • Limited liability partnerships • Any other type of entity that would have met the criteria of the small companies regime had it been a company incorporated under companies law (for examples charities)	Entities required to follow UK GAAP. This excludes: • Entities required to apply EU-adopted IFRS • Companies that choose to apply the micro or small entities regimes	A member of a group: • where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and • that is included in the consolidation	A member of a group: • Where the parent prepares publicly available consolidated financial statements which are intended to give a true and fair view; and • that is included in the consolidation
Size thresholds	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £632,000 • Balance sheet total £312,000 • No. of employees 10	A company qualifies if it does not exceed two or more of the following criteria: • Turnover £10.2m • Balance sheet total £5.1m • No. of employees 50	-	None	None
Ineligible entities	• Any companies excluded from the small companies regime • Financial institutions including credit and insurance institutions • Charities • Small parent companies that choose to prepare group accounts • Companies that are not parent companies but their accounts are included in group accounts	• Public companies • Financial institutions including insurance companies and banking companies	• Entities required to apply EU-adopted IFRS	Charities	None

Appendix D: Overview of the UK financial reporting framework for charities
(Source: FRC, Practice Note 11: The audit of charities in the UK - November 2017)

The following is a summary and does not aim to provide a comprehensive overview. Further detail of each framework can be found within the relevant accounting standard and associated guidance, as issued by the Financial Reporting Council (FRC) and joint Charity SORP-making body

EU-endorsed IFRS

UK company law prohibits charities from preparing financial statements in accordance with EU-endorsed IFRS.

UK and Ireland GAAP

UK charities currently follow UK and Irish GAAP through the application FRS 102.

The Charities SORP (FRS 102) provides guidance for charities on how to apply FRS 102.

Charities SORP (FRS 102)[7]

The Charities SORP applies to all charities in the UK required to prepare 'true and fair' accounts unless a more specialist Statement of Recommended Practice applies (i.e. sector-specific SORPs exist for the housing and education sector).

Therefore, registered charities in Scotland, England and Wales, and Northern Ireland whose income, expenditure or assets exceed certain thresholds are required to follow UK and Irish GAAP, as interpreted by the Charities SORP. These are set out in Appendix D.1.

The SORP extends the treatment and supplements requirements of FRS 102. The Charities SORP adds additional charity-specific requirements aimed at providing a high level of accountability and transparency to donors, funders, financial supporters and other stakeholders

Some of the matters addressed in the SORP are noted below:

- The SORP requires charities to distinguish between unrestricted income funds, restricted income funds and the endowment funds of charities. Further disclosures of restrictions on the use of income and assets are required in the notes to the financial statements.
- The Charities SORP requires charities to produce a Statement of Financial Activities (SoFA). The SoFA includes recognised gains and losses in addition to income and expenditure, providing information which goes beyond that which FRS 102 requires to be included in the statement of comprehensive income.

[7] Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland

- FRS 102 does not specify any requirements for narrative reporting. Therefore the Charities SORP contains additional requirements covering narrative reporting for charities and sets out the content of the 'Trustees' Annual Report'.

Currently the SORP has a simple two tiered approach with more required of larger charities, defined as those with gross income over £500,000. These requirements are largely limited to the disclosure of additional information in the 'Trustees' Annual Report'.

The micro-entities regime (FRS 105)

UK Charities are ineligible to report under the micro-entities regime

The small entities regime (Section 1A Small Entities of FRS 102)

The exemptions offered by Section 1A do not offer much simplification for those charities which meet the definition of a small company, given the legal requirement for financial statements to be prepared to give a 'true and fair' view and how this had been interpreted.

Therefore, for all intents and purposes, Section 1A cannot be applied by UK charities.

Cash-based receipts and payments accounts

Charities whose income, expenditure or assets fall below certain thresholds may prepare cash-based receipts and payments accounts. These are set out in Appendix D.1.

The reporting requirements for cash accounts are determined by regulatory requirements and legislation specific to the charities jurisdiction. These requirements differ between jurisdictions. Consistent with the requirements of the SORP, the following is required by charities preparing cash accounts:

- The application of the principles of fund accounting
- The preparation of a 'Trustees' Annual Report'.

Assessment of UK financial reporting framework for charities

Divide in requirements

There is a perceived mismatch between the requirements for company and non-company charities, whereby non-company charities with incoming resources of less than £250,000 are eligible to prepare cash-based receipts and payments accounts, but company charities must prepare fully accrued accounts in accordance with the SORP. This 'division' is a result of the requirements of company law, whereby very small charitable companies must prepare their accounts to give a true and fair view.

Beyond the requirement to prepare cash-based or accrued accounts, there is limited differential reporting for UK Charities.

Current length of charity accounts

Recent research by the Charities SORP-making body identified concerns around the growing length and level of information included in charity's reports and accounts and the impact of this on various stakeholders[8]. This included the burden for those preparing accounts and the increasing costs of compliance for charities. The length and volume of information has also been cited preventing those interested in the work of a charity from understand its finances and what it has done with its resources.

It is acknowledged that the 'bulk' of charity accounts are associated with the notes to the accounts. These will differ between charities, however, many are specific to 'fund accounting' disclosures and the FRS 102 requirement for comparative information.

Future consideration in the development of the SORP

The above issues have been discussed in the context of the future development of the SORP by the SORP-making body. In 2018, working groups were formed of members of the current SORP Committee to make recommendations for changes in the following areas:

- Tiers of reporting – *looking at different thresholds for certain disclosures*
- Small charities – *looking at simplifying the reporting requirements for this group of charities*

Whilst the group's findings and recommendations have yet to be fully considered by the SORP-making body, both groups identified that potential changes to legislation and regulation would be required in order to reduce the perceived reporting burden and develop a more appropriate accounting framework for small charities.

Relevance to UK local government reporting

Appetite for change

There are similarities between the issues being considered in the development of the reporting framework for charities and local authorities. In both sectors there is an appetite for change in order make financial reporting clearer and simpler, both for the user and preparer.

However, there are features of the charity sector which make the issue more pronounced.

- The vast majority of charities applying the Charities SORP (FRS 102) meet the eligibility criteria of the micro-entities regime and small entities regime, but are required to prepare accounts under full FRS 102.
- Those smaller charities which fall within the scope of FRS 102 will often have no specialised accounting staff and rely on volunteers to prepare and examine their financial statements. These individuals are typically unfamiliar with accounting concepts and the different elements of a set of financial statements.

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[8] Research Exercise on the Charities SORP (FRS 102), The Charities SORP-making body/CIPFA, 2016

- The SORP provides a standard framework for organisations that undertake a large and diverse range of activities, largely irrespective of size.

Time needed for legislative change

Early indications of the work being undertaken by the SORP-making body have focused on the existing legal framework. The current framework is complex due to the interaction between charity law and company law. However, these difficulties would need to be addressed and would require legislative change.

In addition, any changes would have to strike the right balance between lessening the regulatory burden and the need for transparency in charity reporting. Informing this balance could involve going 'back to basics', and considering what charity accounts should look like if they are to enable users to understand how the charity has spent their money.

It is acknowledged that change in this area is unlikely to be immediate. The existing SORP was developed using a 'think small first' approach. However despite this, the SORP arguably still fails to provide a suitable framework for the significant number of small charities preparing accruals accounts. Therefore, any new framework will take a significant amount of time and effort to achieve.

Appendix D.1: UK Charities - Summary of Accounting Requirements (*Source: FRC, Practice Note 11: The audit of charities in the UK - November 2017)*

<table>
<tr><th>Charitable company</th><th>Friendly or registered society</th><th colspan="3">Non-company charity, excluding a friendly or registered society</th></tr>
<tr><td>UK-wide</td><td>UK-wide</td><td>England & Wales *</td><td>Scotland</td><td>Norther Ireland</td></tr>
<tr><td colspan="2" rowspan="2">Accruals basis:
‘true and fair’ view required</td><td>Gross income no more than £250,000, option to prepare receipts and payments accounts</td><td>Gross income less than £250,000, option to prepare receipts and payments accounts</td><td>Gross income no more than £250,000, option to prepare receipts and payments accounts</td></tr>
<tr><td colspan="3">Accruals basis; ‘true and fair’ view required where gross income is £250,001 (or £250,000) or more</td></tr>
</table>

* In England and Wales, registered charities with a gross income of £25,000 or less, and excepted charities which are not registered, are not required to submit a trustees’ annual report and accounts to the Charity Commission for England and Wales, unless requested to do so.

All registered charities must prepare a trustees’ annual report, even if they are not requested to submit it to the Charity Commission for England and Wales.

Appendix E: Overview of selected financial reporting requirements for Local Government in other countries
(Source: AASB, Research Report No.6, Financial Reporting Requirements Applicable to Public Sector Entities - May 2018)

The following observations are based on the financial reporting requirements of other countries.

It is observed that the scope of the international comparison is limited; however those countries selected for comparison are relatively comparable in terms of regulatory rigour or are jurisdictions that are often compared with the UK in terms of financial reporting issues.

Levels of consolidation

Local government entities are not consolidated into WGA or equivalent financial statements in the following countries:

- Australia
- Canada
- New Zealand
- South Africa
- The United States

In the UK, the WGA is a uniquely comprehensive product, as the only set of consolidated public sector accounts that consolidates information from all government bodies, including local government.

Assessment and relevance to UK local government reporting

The WGA forms a key part of the mechanisms for understanding the UK government's financial performance, financial position and cash flows. The preparation of the WGA is done on an accruals basis and in accordance with the 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 which use a different accounting framework are required to prepare information for WGA purposes which is compliant with IFRS.

An accounting framework may be developed for bodies included in the WGA which does not comply with the FReM and IFRS. However, where a body departs from these standards, it is required to provide information on any such differences as part of the WGA process. This affects the development of a simpler regime for local government. Any time and cost savings realised by a simpler regime which departs from full IFRS will need to be balanced against the requirement for a sufficiently consistent set of accounting policies and conventions across the UK public sector as a whole.

Appendix D: Overview of selected financial reporting requirements for Local Government in other countries

Differential reporting - New Zealand's multi-standards, multi-tiered framework

The External Reporting Board (XRB) is responsible for accounting standards in New Zealand across all sectors.

New Zealand has four tiers of reporting available to public sector entities, ranging from cash accounting to IPSAS-based standards.

There are essentially two suites of standards – standards applying to for-profit entities (including for-profit public sector entities, such as state-owned enterprises) and standards applying to 'Public Benefit Entities' (PBEs). Hence, each public sector entity first needs to determine whether it meets the definition of a PBE and then apply the appropriate tier of reporting.

Public Sector PBEs are defined '*as reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders*'.

A summary and explanation of the standards that apply to Public Sector PBEs ('PBE Standards') is provided in Appendix E.1.

Local government entities are required to prepare financial statement in accordance with PBE Standards. However, there are additional regulatory and legislative reporting requirements which apply to local authority's financial statements, such as:

- A local authority's statement of comprehensive income must disclose separately the amount of income received or to be received from each of the following sources:
    - Rates
    - Development and financial contributions
    - Subsidies and grants
- A local authority's statement of financial position must specify the sum of the amounts of the authority's investments in council-controlled organisations and other entities listed in legislation.
- The notes to a local authority's financial statements must specify, in relation to each group of activities, the combined depreciation and amortisation expense for assets used directly in providing the group of activities.
- The notes to a local authority's financial statements must specify the amount of income received or to be received from targeted rates for metered water supply.
- Budget versus actual analysis with explanations for significant variances

Central government has also established performance benchmarks for local government's infrastructure services, namely the three waters (treated, waste and storm) roads and flood banks. In addition central government prescribes a number of fiscal prudence benchmarks for local government covering, for example, debt servicing costs, balanced budgets and affordability.

Relevance to UK local government reporting

Rationale for approach

New Zealand's multi-standards, multi-tiered approach to accounting standards makes their financial reporting framework unique. All public sector entities are required to report, but cost-benefit determines what is to be reported.

The XRB use entity size as a general cost-benefit proxy. This is based on a rationale of '*the smaller the entity the smaller the likely number of users, and therefore the fewer the benefits that are likely to accrue from general purpose financial reporting*'[9]. This is considered to balance the cost of preparing/auditing financial statements with the benefit to the users of the financial statements.

Criteria underpinning thresholds

The XRB consider the use of expenses as the criterion to define entity size as the most appropriate proxy for cost and benefit in the PBE context. PBE performance is typically driven by expenditure, rather than revenue. Expenses are also considered more reflective of the underlying activity of PBEs.

Meeting the threshold for Tier 2 allows PBE entities to report under a 'Reduced Disclosure Regime'. These entities are generally subject to the same recognition and measurement requirements as Tier 1 entities applying standards based on IPSAS, but have significantly reduced disclosure requirements.

The $30million (£15.6m) expense threshold for Tier 2 is higher when benchmarked against the threshold for smaller authorities in England (gross income or expenditure does not exceed £6.5 million).

[9] NZ Accounting Standards Framework (2012)

Appendix E.1: 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) > $30 million (> £15.6m)	IPSAS-based PBE Standards
Tier 2	• Has **no public accountability** (as defined *) • Has total expenses (including grants) ≤ $30 million but >$2million (≤ £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 ≤ $2 million (≤ £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 (£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 January 2019)

* The External Reporting Board has adopted its definition of **public accountability** from the IFRS, which is applicable to both the public sector and the for-profit sector.
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.*

It is observed that this leads to the conclusion that not all public sector entities should report under Tier 1.

Further explanation of reporting requirements and standards:

- The **Tier 1** and **Tier 2** PBE standards consist of 38 individual standards derived largely from International Public Sector Accounting Standards (IPSAS).
- **Tier 2** entities are generally subject to the same recognition and measurement requirements as Tier 1 entities but are able to use significantly reduced disclosure requirements.
- The **Tier 3** accounting standard 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** accounting standard 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 & payments, and statement of resource and commitments along with certain other information such as related party disclosure and events after the reporting date.