

Written evidence submitted by the Chartered Institute of Public Finance and Accountancy (CIPFA) [FRA 021]

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

1. Executive summary

- 1.1 CIPFA is of the view that local authority accounts are an important vehicle to promote accountability and transparency. The purpose of local authority accounts is to provide information about a local authority's financial performance, position and cash flows which is useful to their users for assessing stewardship and for making economic decisions. This information is available both in the main statements, the accompanying notes and narrative report but there is more work that can be done in ensuring that the key messages are communicated to the public.

Revisiting the primary user of the accounts

- 1.2 CIPFA LASAAC in accordance with best practice for public sector financial reporting has identified that the primary users of the accounts are local authority service users and resource providers, and those that represent them as a part of providing democratic accountability. This is not incorrect; however, this is a difficult group to access, their needs are complex, different to the users in the commercial world and therefore difficult to define.
- 1.3 CIPFA would suggest that further research is undertaken into mechanisms for reaching the service users, this might look at council members in their role as representatives as providing a proxy for the service users and resource providers and therefore the primary users of accounts. CIPFA is about to undertake a project with the ICAEW to consider the users of the accounts which will consider this issue.
- 1.4 There are opportunities to increase interest in the accounts by including an effective summary of performance and financial information in the narrative report which accompanies the accounts or via Sir Tony Redmond's recommendation in his review for providing a Standardised Statement of Service Information and Costs.

There is complexity in local authority financial statements, but the focus should be on better reporting of the key messages rather than simplification or streamlining

- 1.5 Although there are complexities in local authority accounts as mature organisations the basic requirements of the main (primary) financial statements are the same as the rest of the public sector and the private sector. The four main statements (for more detail see the Annex) which provide a summary of the financial position, financial performance and cash flows of the local authority reflect the financial impact of the decisions taken it takes.
- 1.6 Information can be located in the accounts, but previous surveys have indicated that there is room for improvement. This may to an extent be because there are lengthy disclosures required by IFRS or the need to explain local government transactions.
- 1.7 Local authorities are often compared to significant private sector entities in terms of their size and complexity and are often more complicated than other public sector entities and so the use of IFRS might be deemed to be an appropriate framework to reflect these responsibilities.
- 1.8 Local authority accounting requirements should also be proportionate to the needs of the user of the accounts. Commentators have indicated that there should be both simplification/streamlining of the accounts. However, CIPFA is of the view that calls for simplification most often seek to align the statutory framework for council-tax/budget setting process. This is not an accrual accounting framework and for proper reporting of resources and their use CIPFA could not recommend this approach.
- 1.9 A discussion is needed of what “streamlining,” or “simplification” is intended to mean. CIPFA is keen to ensure that the focus is on accountability to council taxpayers and service users and council members as their representatives as the primary users of the accounts. It therefore considers that the focus should be on developing better reporting so that the accounts and the statements that accompany them are able to convey their key messages to these primary users.
- 1.10 The audit of local authority accounts needs to be reflective of the needs of users of accounts and CIPFA supports the changes to [the Statement of Recommended Practice, Practice Note 10 Audit of Financial Statements and Regularity of Public Sector bodies in the United Kingdom](#) (Practice Note 10) including its new example.

Some of the complexity in local authority accounts is driven by the need to make statutory adjustments to align financial reporting to council tax setting/budgetary frameworks

- 1.11 Alternative accounting frameworks could be used other than IFRS, however, no framework is without its disadvantages. It would require time and resources to move from the IFRS framework to an alternative. All are accrual accounting frameworks and therefore much of the complexity required by the adjustments to align the council tax

or budget setting framework to standards would be retained whichever alternative were used.

- 1.12 This might lead to questions about whether the statutory adjustments (often known as statutory overrides) should be retained. This is not within the gift of CIPFA or CIPFA LASAAC. CIPFA is of the view that accrual accounting should support most reporting needs. Statutory adjustments record the timing differences between those charges and income required by IFRS and those required by the council tax setting/budgetary processes, they protect council taxpayers against the volatility of accrual accounting and reflect government decisions on the capital/revenue split. Statutory provisions are also used to support transformation and councils that are in extreme financial difficulty.
- 1.13 It is likely that the removal of statutory adjustments/overrides would give rise to substantial affordability issues for local government bodies council tax setting processes. CIPFA is of the view though that they should be limited to where circumstances or transactions in local government are different from other entities and make the requirements of IFRS unsuitable or there is a need to avoid perverse outcomes that impact on local government finances.
- 1.14 CIPFA considers that more work can be done on improving the reporting of the statutory adjustments. Its Better Reporting Group will support CIPFA LASAAC in its strategic workplan by seeking better ways of presenting and explaining these adjustments.

Strong system leadership for local audit is important but its focus needs improvement

- 1.15 CIPFA has been supportive of the FRC in its preparations for system leadership within local audit. CIPFA is of the view that a strong system leader will need to take decisions across the local audit system and be able to bring various parts of the system together and affect stepped change. This will include those parts of the system which are not directly within the remit of DLUHC, such as NHS bodies and the Whole of Government Accounts. While the FRC will be able to influence and convene the various stakeholders within the system it is not clear what direct powers it will have to take decisions and make the interventions that will be needed to affect change.

2. Introduction

- 2.1 CIPFA welcomes the invitation to provide written evidence to the Levelling-Up Housing and Communities Committee (the Committee's) inquiry into Financial Reporting and Audit in Local Authorities.
- 2.2 CIPFA is of the view that local authority accounts and audit are vital parts of local authority transparency and accountability, but both need to be working effectively to achieve this.
- 2.3 Fundamental to the questions posed by the Committee is the consideration of local authority stakeholders. Understanding the key stakeholders and their needs allows for

an articulation of how these needs might be met from financial accounts and assured by auditors. Corporate reporting is moving to consideration of wider groups of stakeholders, and these may be summarised as: investors, creditors and other lenders, employees and customers. While not all of these are relevant to local authorities this model can be adapted for a local authority context:

Stakeholder group	Local authority equivalent
Investors, lenders and other creditors	Funders (council taxpayers, Parliament via central government bodies, other grant providers), lenders and other creditors
Employees	Local authority employees
Customers	Service users, residents, social housing rent payers

- 2.4 CIPFA LASAAC¹ has a continuous improvement programme which looks at implementing standards and their amendments and consults on an annual basis to maintain the IFRS-based Code framework along with the rest of the public sector. CIPFA and CIPFA LASAAC have undertaken numerous reviews of local authority accounts and their use. These reviews are summarised in table 1 in the Annex to this response.
- 2.5 Several significant changes to the Code have been delayed due to COVID-19 and the substantial delays in the local audit system. CIPFA LASAAC issued two urgent consultations in 2022 to support the local audit system. After an [emergency consultation](#) in January 2022, CIPFA LASAAC decided to defer implementation of IFRS 16 *Leases*. More recently there was an [urgent consultation](#) to provide the short-term solution for infrastructure assets reporting.
- 2.6 CIPFA LASAAC's work on the Code will soon be supported by the CIPFA Better Reporting Group, a new group which will support the work of CIPFA LASAAC but also to seek out best practice. This work will build on work undertaken by CIPFA's publication "[Streamlining the Accounts](#)" to assist local authorities in their own attempts at improving the communication of the key messages of the financial statements.
- 2.7 We are aware that any changes to reporting will need to be considered against the backdrop of the current crisis within the local audit system and the impact on resources within finance and audit teams to implement them.

3. What is the purpose of local authority accounts?

- 3.1 CIPFA is of the view that local authority accounts are an integral part of the accountability framework for local authorities. They provide important information about:

¹ The CIPFA LASAAC (Local Authority (Scotland) Accounts Advisory Committee) Local Authority Accounting Code Board.

- How well local authorities have discharged their responsibilities for the stewardship of their resources (including the assets they hold).
- The extent to which resources are available to support future service delivery and provide support to the local community, including the changes during the financial year in the amount of those resources and future claims (future liabilities such as debt repayment and pensions liabilities) against them.
- The amounts and timings of future cash flows needed to service and repay existing claims on a local authorities' resources.

3.2 Annual accounts also provide an important role in the management, internal control and governance of the local authority. By producing annual accounts, the organisation can gain some additional assurance that its financial controls are effective, that information is reliable for decision making and provides a means through which internal and external stakeholders can hold those running the organisation to account.

What role do they play in local authority democracy and accountability?

3.3 Local authority financial statements are an important part of local authority democracy and accountability. They should provide an accurate record for local authority service users, resource providers and representatives of these users (members and Members of Parliament) who do not have the ability to require local authorities to disclose information that they need. They also represent a key point in the annual business and governance cycle in that they are made available to the public, are subject to formal approval by senior management and those charged with governance within the organisation.

3.4 Under the current arrangements the publication of pre-audited accounts provides the starting point for local electors to exercise their rights of public inspection under the Local Audit and Accountability Act 2014.

4. What is the purpose of local audit?

4.1 Local audit should provide stakeholders with independent assurance that public sector bodies are spending public money well and for its intended purpose. The assurance provided by the auditing of local authority financial statements and their accompanying documents is an essential part of transparent and accountable public service. However local auditors have a larger role to play than providing opinions on financial statements. Auditors also provide assurance around the arrangements these organisations have in place for achieving economy, efficiency, and effectiveness in their use of resources. The current system provides external auditors with statutory powers to bring forward matters of concern that should be brought to the attention of the audited body and the public. Auditors have several other statutory powers and duties:

- Sections 26 and 27 of the Local Audit and Accountability Act 2014 (LAAA 2014) provides local government electors with the right to object to their local authority accounts (and any records that support them) – local auditors can decide on objections received in relation to the accounts.

- Section 28 of the LAAA 2014 allows auditors to apply to a court that an item of account is contrary to law.
- Auditors are required to consider whether to issue and, if appropriate, to issue an advisory notice or to make an application for judicial review.
- Auditors have powers under Schedule 7 of the LAAA 2014 to make reports on any matters that comes to their notice during the audit which should be brought to the public's attention (ie it is in the public interest).
- Auditors have powers under Schedule 7 of the LAAA 2014 to make written recommendations to the audited body under Section 24 and Schedule 7 of the LAAA.

5. Users of local authority accounts

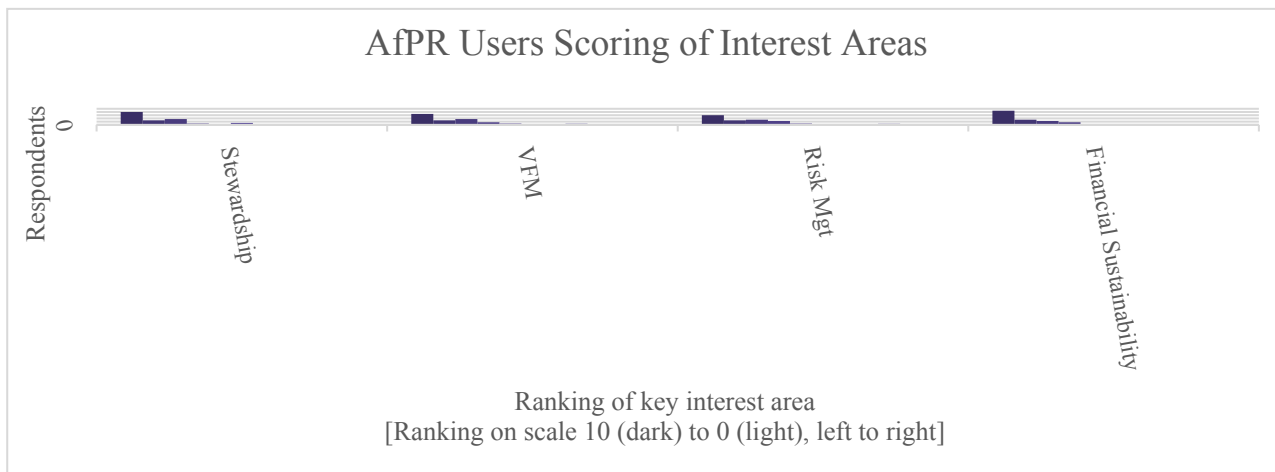
Who currently uses local authority accounts?

- 5.1 The Code establishes service users and resource providers who cannot require local authorities to disclose the information they need as primary users of the accounts. This would include council members and Members of Parliament when acting in their capacity as representatives of service users and resources providers.
- 5.2 In practice it is difficult to answer this question from an unambiguous evidence base. There is significant anecdotal evidence from local government stakeholders that users of local government accounts are few. CIPFA is of the view that even though numbers may be few there are a wide range of users with interest in local authority accounts. In addition to service users, resource providers and their representatives, there is evidence that users of the accounts are also:
- the local and national press – local authority accounts were a feature of national press investigation into an authority's borrowing and investment activities
 - academia
 - various interest and representative groups
 - analysts with local government interests
 - financial analysts for example those producing credit scores for local authority accounts where they are seeking to issue local government bonds
 - local authority partners, resource providers and contractors, where additional information can be sought via the accounts.

What do they use the accounts for?

- 5.3 Although CIPFA does not have any direct current evidence of this, in 2019 it undertook a survey of stakeholders which indicated that users interested in accountability for public resources (AfPR) were focused on:
- stewardship
 - value for money
 - risk management, and
 - financial sustainability.

(See extract of survey results below.)



Who should be using local authority accounts?

- 5.4 CIPFA LASAAC as a public services standard setter followed the model of standard setters in terms of defining the users of the accounts and following a consultative process with this sector. This principle emanated from the IPSASB Conceptual Framework for General Purpose Financial Reporting (IPSASB Conceptual Framework). But this principle, that financial reporting exists for those that do not have the ability to require local authorities to disclose the information they need, also applies in the IFRS Conceptual Framework for Financial Reporting as updated in March 2018.
- 5.5 CIPFA LASAAC established the primary users in paragraph 5.1 following its Telling the Story Review, but CIPFA would note that it is difficult to properly understand and test what the service users might want in terms of useful information in the accounts or how they might prefer this to be presented. Defining a representative set of needs from service users as a group is inherently challenging.
- 5.6 It should be noted that those stakeholders who are using local authority accounts are often doing so from a different position than those in the commercial world. Many users of corporate accounts are making decisions about whether to conduct business with the entity. Public sector stakeholders do not all have this level of discretion; council taxpayers cannot legally refuse to pay council tax and service users have limited choice about how the services they receive are delivered, for example a resident cannot choose another local authority to determine the outcome of a planning application. Local authorities also offer a large variety of services not all of which are used directly by all residents. This means the defining the needs of service users is inherently complex. In this context the needs of stakeholders are more likely to be focused on the accountability of the local authority than in a corporate setting.
- 5.7 The Code, like the rest of the public sector, is based on IFRS. IFRS anticipates that financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. They expect that at times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena. CIPFA would note that although some local authority users may do this,

this may not be the approach of the lay user and therefore there may be a lack of understanding of the more complex transactions.

- 5.8 The Government's Financial Reporting Manual identifies Parliament as the primary user of the annual report and accounts and the Public Administration and Constitutional Affairs Committee report [Accounting for democracy: Making sure Parliament, the people and ministers know how and why public money is spent](#) prioritised Parliament's control of spending, though it included promotion of the public's understanding of the value for money provided by public spending.
- 5.9 It will be helpful to undertake further research to find the best ways of reaching the service users and resource providers and consider whether elected members as their representatives provide a more practicable basis for considering the needs of users of the accounts. CIPFA would welcome the Committee's views and will seek to explore this with local government key stakeholders.
- 5.10 Service users, resource providers and their representatives should be able to use the accounts for the purposes outlined in paragraph 3.1.

If these groups of users aren't the same, why not?

- 5.11 These user groups are the same, but it is likely that more attention is given to the accounts by users with specific interests such as users providing credit ratings, specific interest groups or the press.

What information do citizens need to hold their local authorities to account?

- 5.12 To promote accountability and democracy service users and their representatives will need to know that the accounts and the accompanying narrative report clearly presents:
- whether the resources of the local authority are used to secure value for money for taxpayers and service users and whether their use is in their best interest
 - current levels of council taxes and other resource raising activities of a local authority are sufficient to maintain the quality of services provided
 - the range and the number of services provided are appropriate including the resources used to provide them.

Is this information available in the local authority accounts as they stand?

- 5.13 Yes, the Code is established to ensure that the information on a local authority's financial performance, position and cash flows presents a true and fair view of the authority in accordance with the requirements of the Accounts and Audit Regulations 2015 and will include the presentation of the items listed in paragraph 5.12.

6. Understandability and accessibility of local authority accounts and audit

Do the accounts provide a clear picture of the financial sustainability and resilience of a local authority?

- 6.1 The accounts present the financial position of a local authority including their assets, liabilities and reserves. The accounts and the accompanying narrative report provide an opportunity to report on financial sustainability by presenting an authority's ability to deliver services and other local area/community obligations. This will need to include the resources available to it either from anticipated taxation levels or other sources of funding and their capacity to continue to fund its statutory and other service obligations including the assets used to provide those services.
- 6.2 The information in the accounts, supplemented by the commentary in the narrative report, should provide information on demand pressures and levels of funding including those pressures and resources which an authority is not able to control.

How well do users understand the financial position and performance of a local authority from its accounts?

- 6.3 Although there are complexities in local authority accounts as mature organisations, the basic requirements of the main (primary) financial statements are the same as the rest of the public sector and the private sector. The four main statements which provide a summary of the financial position, financial performance and cash flows of the local authority are the:
- Comprehensive Income and Expenditure Statement
 - Movement in Reserves Statement
 - Balance Sheet
 - Cash Flow Statement.
- An overview of the purpose of each statement is provided in the Annex to this response.
- 6.4 Other statements are required by statutory provision eg the Housing Revenue Account and the collection fund.
- 6.5 The notes to the accounts are provided in accordance with IFRS, as adapted in accordance with public sector circumstances. Section 7 of this submission outlines the need for statutory adjustments to align the reporting requirements for council tax setting to those required by accounting standards. This is an area which does add complexity (but note there are similar reconciliations in central government) and requires additional explanation. This will be subject to review by the CIPFA Better Reporting Group.

Reporting the net cost of services

- 6.6 Until 2015/16 the service expenditure analysis for the reporting of the net cost of services was stipulated by the Service Reporting Code of Practice (SeRCOP). The

service expenditure analysis aligns with the reporting analysis in the Revenue Account/Revenue Outcome statistical analysis of services. Local authorities, however, were concerned that this did not represent the way in which they provided services to service users.

- 6.7 The Telling the Story review sought views in their working groups on whether the top section (the net cost of service) of the Comprehensive Income and Expenditure Statement should be presented on a service basis or a nature of expense analysis and whether this should be presented on the (standardised) SeRCOP service analysis. The working group developing the consultation paper was clear that the provision of services was a primary function of local authorities, and the net cost of services should be presented on a service basis. The consultation response therefore supported a move to a service analysis based on the way in which local authorities provided their services to services users.
- 6.8 This decision, driven by the sector's views, may have had some unintended consequences. It lost the comparative analysis which could be provided by SeRCOP as local authorities were of the view that they did not seek to use such comparisons. It potentially also lost some of the understandability of service information. The SeRCOP analysis provides easily understandable service headings ie Education, Social Services, Housing, etc whereas the structures offered by some local authorities are aggregated to a level which may not provide easily understandable descriptions.
- 6.9 An advantage of the SeRCOP service analysis therefore is that it might allow comparability, consistency with government returns and the ability to consider standardisation of practice like that offered in other parts of the public sector (for example the NHS). CIPFA is of the view that it may be opportune to review the presentation of services in the net cost of service section of the Comprehensive Income and Expenditure Statement to ensure that it is analysed in a way which is understandable for the users of the accounts.

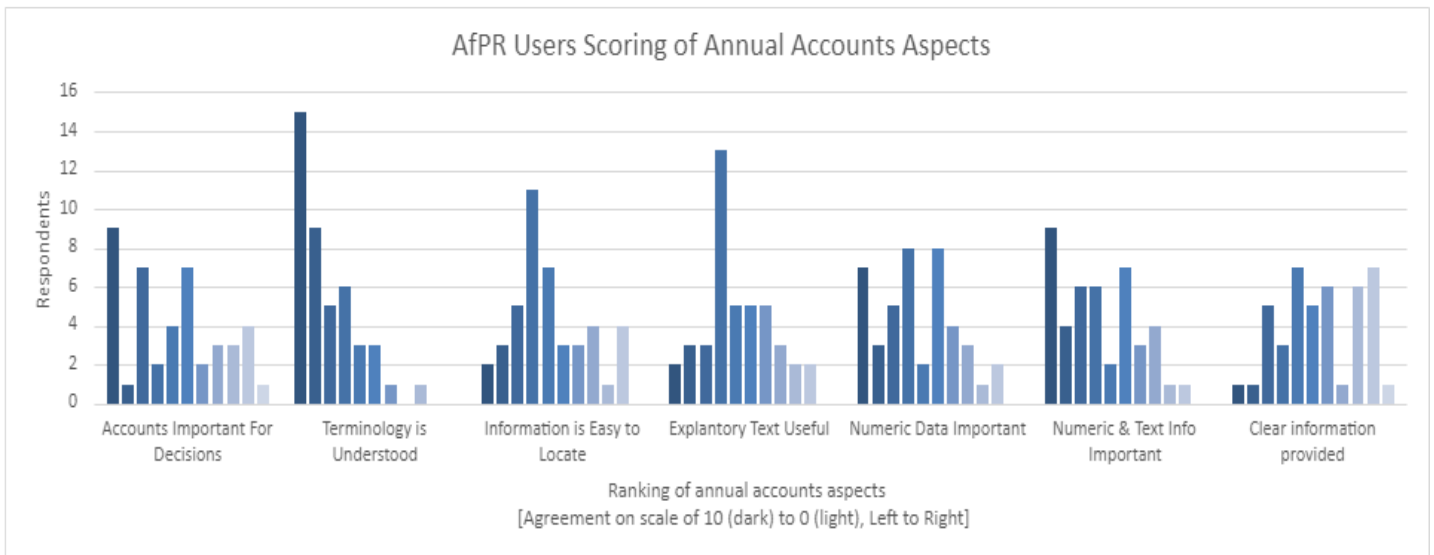
Do the accounts provide a clear picture of the level of reserves within a local authority, and how these might be used?

- 6.10 Local authority balance sheets include two main types of reserves, usable and unusable reserves. Usable reserves are those reserves which can be used to immediately support services (but some of those reserves may be 'earmarked' for specific purposes).
- 6.11 Unusable reserves arise primarily out of the interaction of legislation and proper accounting practice. They either store revaluation gains or act as adjustment accounts to reconcile accounting requirements driven by reporting standards to statutory requirements. Unusable reserves are not resource backed and cannot be used for any other purpose. [CIPFA Bulletin 13 Local Authority Reserves and Balances](#) provides more information on the unusable reserves and their purpose.
- 6.12 Unusable reserves which are adjustment accounts most often reflect the timing differences for those transactions which are required to be recognised by accounting

standards and those to be recognised in accordance with statutory provisions for council tax/budget setting purposes.

How easy do users find it to locate key information they are looking for in accounts?

- 6.13 Information should be easy to find. CIPFA would anticipate that the information in the main financial statements outlined in table 2 in the Annex is easy to locate. The CIPFA LASAAC's survey in 2019 contained some useful feedback on the location of information which supports this comment. The third graph in the extract of the survey results below indicates that users find the information easy to locate though the graph indicates that there is room for improvement. This may to an extent be because there are lengthy disclosures required by IFRS or the need to explain local government transactions.



Electors have a statutory right to inspect and object to pre-audited accounts. How widespread is this, and how does the current format of local authority accounts affect it?

- 6.14 CIPFA understands that the statutory rights to inspect and object to local authority accounts are used relatively frequently. However, it does not have access to any information how widespread its use is. CIPFA is not clear that this is affected by the format of local authority accounts.

How well do users understand published audit findings and reports?

- 6.15 CIPFA cannot directly comment on how well users understand published audit findings. However, it has undertaken research in [Examination of ISA 260 Reports for the 2019/20 financial year](#) (with early information on 2020/21 reports). Although not

an objective of the report, not all the reports had easily identifiable information on the quality of financial information or significant financial control issues.

Are some outputs more understandable and accessible than others?

- 6.16 CIPFA is not clear on whether this relates to published audit findings or the local authority accounts but please see response in paragraph 6.15.

7. Making local authority accounts meet the needs of users

Are local accounting requirements proportionate?

- 7.1 This is a difficult question, and the answer could vary depending on the size and complexity of an authority. Local authorities are often compared to significant private sector entities in terms of their size and complexity and are often more complicated than other public sector entities and so the use of IFRS might be deemed to be an appropriate framework to reflect these responsibilities.
- 7.2 The financial statements of such complex organisations must accurately represent their transactions to ensure accountability and transparency. It is notable that the rest of the public sector use IFRS and it would seem inappropriate that local authorities use a framework that might provide less accountability than the rest of the public sector including, for example, NHS bodies operating under the same audit framework.
- 7.3 Notwithstanding the comments above, some of the requirements for financial reporting, for example financial instruments, may be onerous for the smallest of local authorities. In its 2019 research CIPFA LASAAC did consult on differential reporting. However, the results of that consultation were not clear (including arguments for the need for the same accountability applying to small authorities) but this could be pursued.
- 7.4 It is also important to consider how auditing standards are applied in the local authority context. CIPFA maintains its view that public sector audit should align its requirements with International Auditing and Assurance Standards Board (IAASB) International Standards on Auditing (ISAs). CIPFA recognises that these standards have been developed primarily for the private sector, but the requirements are not unduly difficult to apply to audits of public sector entities.
- 7.5 What would be of interest to the users of local authority accounts is, however, quite different from issues that would concern private sector's users. The focus in local government bodies is on how much is spent on services, and the financial sustainability of the council. The ISAs provide an appropriate framework for these considerations and while they require interpretation and guidance, this is provided through [the Statement of Recommended Practice, Practice Note 10 Audit of Financial Statements and Regularity of Public Sector bodies in the United Kingdom](#) (Practice Note 10) and supplementary material in Audit Guidance Notes.
- 7.6 Both the Redmond Review and CIPFA's own survey undertaken in December 2020 indicated that there are areas of disproportionate audit focus particularly asset valuations and measurements of pension assets and liabilities. CIPFA thinks that

local audit should be focused on the things that matter and welcomed the fact that the most recent FRC [Major Local Audits Audit Quality Inspection](#) report, issued in October 2022, included a focus on local government specific issues including expenditure on services, the appropriateness of capital expenditure, investment property valuation and the minimum revenue provision in local government.

- 7.7 CIPFA supports the Practice Note 10 approach to materiality, particularly its most recent changes. It agrees that the auditor needs to exercise their professional judgement in developing their approach to materiality and this should be tailored to the circumstances applicable to the audited entity and the financial information needs of users of its financial statements. This will be particularly important for entities such as local authorities that have significant property, plant and equipment and pension assets and liability.

Accounting framework

- 7.8 CIPFA acknowledges the frequent calls for simplification and streamlining. We are concerned that a move to aligning the accounting framework to that which is required to be charged to a revenue account under council tax/budget setting requirements would result in a move away from an accrual accounting framework. CIPFA strongly believes that accounting on a resource or accruals basis provides proper accountability and a better basis for decision making.
- 7.9 CIPFA is not aware of other sectors moving from accruals to a cash basis of reporting. Any model other than an accrual model would see local authorities not accounting properly for the resources they hold, not accurately reflecting their stewardship role, and not promoting intergenerational equity for council taxpayers and service users. Any suggestion that local authorities should move to cash accounting should be seen as a regressive move which would put the sector at odds with corporate reporting trends in the UK and globally.
- 7.10 There are other frameworks for accrual accounting which could be used which are sometimes cited as being more appropriate and might be deemed more proportionate. In addition to IFRS local authorities could apply:
- **International Public Sector Accounting Standards** – IPSAS standards are developed in a manner which minimises unnecessary differences from IFRS on matters where public and private sectors engage in comparable activity. This is set out in the IPSASB document *Process for Reviewing and Modifying IASB Documents* (2008) referred to as the ‘rules of the road’.
 - **FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland** – FRS 102 is designed to apply to general purpose financial statements and financial reporting of entities including those that are not constituted as companies and those that are not profit-oriented. It is also designed for those companies not using full IFRS.
- 7.11 Table 3 in the Annex presents the main advantages and disadvantages of using each framework.

- 7.12 None of the accounting frameworks offer a solution without disadvantages. The current system of IFRS offers global accounting standards comparable with best practice in both the private and public sectors. In both cases the alternative frameworks would require some form of statutory adjustments to align accounting to council tax setting frameworks. Both would also be different to the rest of the public sector (in different ways) and would require consolidation adjustments for Whole of Government Accounts.

Are the bespoke reporting requirements for local government accounts (as opposed to central government accounts or non-government accounts) beneficial?

- 7.13 CIPFA would not characterise the different reporting arrangements as bespoke but would describe them as arrangements which reflect the specific reporting needs for local government statutory arrangements for reporting income and expenditure which must be charged to council tax for budget setting purposes.

The use of statutory adjustments

- 7.14 This leads to the question of whether the system of statutory adjustments should be maintained. As noted above some of the complexity of local authority accounts arises from their use and application. From an accounting profession's perspective accrual accounting should meet the reporting needs of most organisations. However, adjustments from those amounts required under council tax/budget setting requirement to what should be charged under accounting standards is a part of the financial performance of local authorities. CIPFA would note that a similar reconciliation process is a feature of other public sector accounts most notably for central government in the statement of parliamentary supply.
- 7.15 The current system of statutory adjustments (sometimes referred to as statutory overrides) is intended to bring together the financial performance determined by the council tax setting process with accounting standards as both are relevant. This system:
- protects council taxpayers from the volatility and timings of accrual accounting for capital finance transactions, accounting for pensions and financial instruments
 - reflects the government reporting needs for the capital and revenue split
 - supports government policy for financing transformation
 - is used as a mechanism by government to provide support to local authorities in significant financial difficulty.
- 7.16 It is likely that the removal of statutory adjustments/overrides would give rise to substantial affordability issues for local government bodies council tax setting processes. This would prove incredibly challenging in the current environment of significant challenges for public sector finances.
- 7.17 CIPFA is of the view that the statutory adjustments have their place in the framework for financial reporting for local authorities. However, they should be limited to where circumstances or transactions in local government are different from other entities

and make the requirements of IFRS unsuitable or there is a need to avoid perverse outcomes that impact on local government finances.

Do local authority finance teams have sufficient expertise and capacity?

- 7.18 Local government has seen its core spending power decrease in real terms in the period 2015/16 to 2022/23 but constrained resources have been an issue for over a decade.
- 7.19 Local government has struggled to recruit and retain people throughout this period, with this being true in its finance community as well as its service areas. The increased work that auditors are doing in several areas and the delays in the audit of the accounts has a corresponding impact on local authority accounts preparers who must field the questions from auditors and provide the evidence to support their responses, this is often very iterative in nature.

Could changes be made to local authority accounts that would both simplify their production and improve understandability for users? How could local authority annual report and accounts be more accessible?

- 7.20 Commentators have referred to a need for simplification and/or streamlining of local authority accounts – see earlier commentaries in paragraphs 7.8 and 7.9 CIPFA does not consider that accounting professionals across the public sector can support such a non-accrual framework and could not support it as a professional accounting institute.
- 7.21 A discussion is needed of what “streamlining” or “simplification” is intended to mean. CIPFA is keen to ensure that the focus is on accountability to service users and resource providers and council members as their representatives as the primary users of the accounts. It therefore considers that the focus should be on developing better reporting so that the accounts and the statements that accompany them are able to convey their key messages to their primary users.
- 7.22 CIPFA LASAAC’s strategic work plan will continue to prioritise the needs of users and will, for example, include new work on the narrative report which will focus on performance and summary financial information. This would be able to be a precursor or a replacement for the standardised statement of information and costs as recommended by Sir Tony Redmond in his [Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting](#). The standardised statement or a focus on performance and summary information in the statement of accounts would both improve the understanding of performance reported in the accounts therefore increasing interest and the access to the information reported therein. CIPFA is supportive of this recommendation in the Redmond Review and DLUHC’s decision not to proceed with the statement while the current delays in local audit persist.

What is the role of the new local audit system leader in improving local authority accounts?

- 7.23 CIPFA has been supportive of the FRC in its preparations for system leadership within local audit. CIPFA is of the view that a strong system leader will need to take decisions across the local audit system and be able to bring various parts of the system together and affect stepped change. This will include those parts of the system which are not directly within the remit of DLUHC, such as NHS bodies and the Whole of Government Accounts. While the FRC will be able to influence and convene the various stakeholders within the system it is not clear what direct powers it will have to take decisions and make the interventions that will be needed to affect change.
- 7.24 CIPFA notes that one of the FRC's responsibilities for companies is to ensure that the provision of financial information including directors' reports is consistent with Companies Act 2006 requirements. It does not have this responsibility for local audit/government.
- 7.25 CIPFA is of the view that a similar function should be specified under the Local Audit and Accountability Act 2014. It is vital though that this work should be carried out by a body which has:
- the experience and close understanding of the operating, financial reporting requirements and regulatory structure which impacts on these (eg capital finance system) for local government but also
 - an understanding of how best to undertake this function.
- CIPFA would suggest that further consideration should therefore be given to how this should be taken forward, it might be via a combination of expertise.
- 7.26 CIPFA is uniquely placed to support this in its:
- role as technical secretariat to CIPFA LASAAC
 - understanding of capital and local government finance, for example, as standard setter for its professional codes ie for the CIPFA Prudential Code for Capital Finance, and the CIPFA Treasury Management and Financial Management codes
 - provision of extensive guidance on local government policy
 - production of its statement on *Role of the Chief Financial Officer in Local Government*, and
 - co-production of CIPFA/SOLACE publication *Delivering Good Governance in Local Government*.

8. Addressing findings in audits and sharing best practice

To what extent can local authority audits identify issues prior to the most significant difficulties being known?

Is there a sufficient advance warning mechanism when issues are identified to ensure action is taken?

- 8.1 If an issue is identified by the audit, then the problem has already occurred as the accounts are a financial record of what has happened. It cannot be an early warning system. The accounts should, however, be able to identify patterns of:
- expenditure on local authority services or other corporate objectives which support the community
 - falling/increasing levels of income
 - the value of the assets used by the authority, and how well they can support services
 - increasing/decreasing levels of debt and the impact of that debt on the resources of the authority
 - adherence to the capital finance regime including the affordability of decisions taken
 - increasing/decreasing levels of pension commitments and their impact on future resources
 - the effects of treasury management policies including an authority's risk strategies for its investments.
- (Note this is not an exhaustive list.)
- 8.2 As noted earlier in this submission local authority auditors have requirements which go beyond those in the corporate sector and are required to report on the body's arrangements for value for money. This work can identify significant weaknesses in respect of governance, financial sustainability and efficient use of resources. Again, reporting on these arrangements is retrospective.
- 8.3 Auditors in the public sector also have statutory powers which they should consider exercising as part of their role. Some of these are retrospective in nature and can be useful in terms of an impartial and transparent view about "what went wrong" but may not be as effective in identifying current issues. There are ways in which auditors can use to highlight concerns either prior to or as actions are taken by local authorities. These include the use of soft influence such as expressing concerns to management or those charged with governance and statutory powers such as issuing an advisory notice.
- 8.4 CIPFA is encouraged that some auditors are using the powers available to them to highlight issues of concern within local authorities but note that many of these reports are not timely in nature and therefore have less impact than might be desirable. Anecdotal evidence from our work with the sector suggests that auditors are more focused on the accounting implications of actions by local authorities than a consideration of what risks these might pose to the proper use of public funds. A shift in emphasis and culture is required for the value that local audit can provide in this space to be realised.

To what extent is there a framework for auditors in local government to work together and to share best practice? Should such a framework be formalised?

- 8.5 The NAO supports both the Local Auditors Advisory Group and the Local Audit Technical Network Group where technical and issues of interpretation of the Code of Audit Practice and auditing standards are discussed. This could be formalised under the new structure when the Auditing Reporting and Governance Authority has been established.

To what extent has a recent absence of multi-year funding settlements hindered budgeting and forecasting?

- 8.6 CIPFA's Financial Management Code states that while the statutory local authority budget setting process continues to be on an annual basis, a longer-term perspective is essential if local authorities are to demonstrate their financial sustainability. The absence of a multi-year funding settlement makes it increasingly difficult to budget or forecast with any degree of certainty. The impact of this increase in risk and uncertainty can best be illustrated through an analysis of reserves. Our research showed that the last time total reserves fell (in 2016/17) it followed the introduction of four-year financial settlements for local authorities.

Annex to CIPFA's response

Section 2:

Table 1: Summary of CIPFA and CIPFA LASAAC's work on the review of accounts and their use

Review and timing	Covering
Simplifying and streamlining the presentation of local authority financial statements , 2013	This consultation followed the approach in the HM Treasury consultation on the same topic. It commented that there is a need for more transparent, relevant information to help external challenge and sought views on meeting the needs of users while balancing the resources for local authority accounts preparers.
Simplification and Streamlining of the Presentation of Local Authority Financial Statements , 2014	This consultation focused on the reporting of local authority performance and therefore on the Comprehensive Income and Expenditure Statement, the Movement in Reserves Statement and the segmental reporting requirements. It also considered the use of statutory adjustments.
Telling the story: improving the presentation of local authority financial statements , 2015 (Telling the Story Review)	This consultation led to major changes to the 2016/17 Code including: <ul style="list-style-type: none"> • changes to two of the main statements (including the move away from a standard service analysis), and • the introduction of the Expenditure and Funding Analysis. CIPFA also issued Understanding Local Authority Financial Statements to assist local authority members and other users.
CIPFA LASAAC future strategy for the development of the Code of Practice , 2019	This document considered the: <ul style="list-style-type: none"> • users of the accounts • main financial statements • accounting for capital, pensions, financial instruments and the interests in other entities.
The potential for differential reporting requirements , 2019	This paper considered potential alternatives for differential reporting including that used in the UK and other countries.

Review and timing	Covering
Survey local authority stakeholders, 2019	The summary of the survey feedback is available on the CIPFA website and relevant extracts include respondents to the survey who self-identified to specific user groups. 'Users interested in accountability for public resources (AfPR)' (43 respondents) provided particularly interesting feedback and commented on accounts complexity.
CIPFA LASAAC Strategic Work Plan direction , latest consultation, 2022	Consultation on the topics of CIPFA LASAAC's Strategic (Work) Plan alongside the annual consultation on the Code.

Section 6:

Table 2: Overview of the main financial statements of local authorities and their purpose

Statement	Purpose
Comprehensive Income and Expenditure Statement	<p>The Comprehensive Income and Expenditure Statement shows how resources have been generated and expended in accordance with International Financial Reporting Standards. It shows:</p> <ul style="list-style-type: none"> • gross and net expenditure of services on a resource basis, and • whether the authority's operations resulted in a surplus or deficit.
Movement in Reserves Statement*	<p>The Movement in Reserves Statement shows how:</p> <ul style="list-style-type: none"> • the authority has generated and expended resources in the year; and • the resourcing position is adjusted under statutory rules to show the funds available to be spent at year-end. <p>*Note the Movement in Reserves statement follows the principles of the IFRS equivalent (Statement of Changes in Equity), but a line is included see second bullet above to adjust the resources to the council tax setting position.</p>
Balance Sheet	<p>The Balance Sheet presents an authority's financial position, ie its net resources at the financial year-end.</p> <p>The Balance Sheet is composed of two main balancing parts: its net assets and its total reserves. The net assets' part shows the assets the authority would have control of after settling all its liabilities. The balance of these assets and liabilities is then shown as being attributable to the various reserves of the authority.</p>
Cash Flow Statement	<p>The Cash Flow Statement shows changes in cash flows of the authority during the financial year. It shows net cash flows split into three activities: operating, investing and financing. The Cash Flow Statement shows the resulting movement in the authority's cash and cash</p>

Statement	Purpose
	equivalents.

Section 7:

Table 3: Comparison of accounting frameworks which could be used for local government financial reporting

International Financial Reporting Standards	International Public Sector Accounting Standards	UK Generally Accepted Accounting Practice (FRS 102)
ADVANTAGES		
<ul style="list-style-type: none"> • Global financial reporting standards on an accruals basis allows for proper representation of complex entities' transactions. • Standards are subject to a rigorous development and continuous improvement process. • Government gains the assurance that transactions are recorded in accordance with global financial reporting standards. • Allows for comparison with the rest of the UK public sector and compliance with WGA (with limited exceptions). • Uses best practice for private sector entities globally. 	<ul style="list-style-type: none"> • Global financial reporting standards on an accrual basis allows for proper representation of complex entities' transactions. • Standards are subject to a rigorous development and continuous improvement process. • Allows for comparison with the international public sector organisations using IPSAS. • Might require less adaptation or interpretation for public sector transactions. 	<ul style="list-style-type: none"> • UK GAAP is subject to a rigorous development process on a periodic review basis. • There are simplifications from IFRS and some of the reporting framework might better meet the reporting needs of local government. Note before the move to IFRS the Code which was then a Statement of Recommended Practice used to implement UK GAAP. • This may allow for similar accounting processes to some (but not all) local authority companies as many follow this framework allowing for easier consolidation processes.
DISADVANTAGES		

International Financial Reporting Standards	International Public Sector Accounting Standards	UK Generally Accepted Accounting Practice (FRS 102)
<ul style="list-style-type: none"> • Requires adaptation or interpretation for some public sector transactions. • Requires additional statutory reporting (adjustments) so that the revenue account meets the council tax setting and other statutory requirements. • There are significant disclosure requirements (note this is an issue for all entities and accounting standard setters have programmes in hand to review this). 	<ul style="list-style-type: none"> • The ‘rules of the road’ process ie their consistency with IFRS is likely to mean the same statutory reporting (adjustments) for the local government will be required. This would include the same disclosure requirements as IFRS. • The IPSAS interpretations for public sector context might in some cases be materially different from those made in the UK public sector, although so far, the main differences have been in the speed at which the IPSASB standards respond to changes in IFRS. If the differences are material this would mean that the reporting outcomes will not be the same as the rest of the public sector and that accounting adjustments would be needed for WGA. • There is not an obvious due process framework for reporting under IPSAS (eg developing the Code under the guidance of the government’s Financial Reporting Advisory Board or the FRC’s Policy on Developing Statements of Recommended Practice). • If a move to IPSAS were to be agreed, this would require at least a year, development to meet local government needs and two years for local authorities to prepare for a new accounting framework and so 	<ul style="list-style-type: none"> • No other public sector entities use this basis of reporting and therefore this would not be consistent with the rest of the public sector. • There would need to be consolidation adjustments for WGA. • There is still likely to be the need for public sector interpretations. • As UK GAAP is on an accrual basis there would still need to be forms of statutory adjustments to align with council tax setting requirements. • It is arguable particularly for larger local authorities that a reporting under UK GAAP might not be suitable for local authorities, particularly those with complex transactions. Its suitability would need to be tested. • If a move to UK GAAP were to be agreed this would require two years development to meet local government needs and two years for local authorities to prepare for a new accounting framework and so would probably take four years to achieve change.

International Financial Reporting Standards	International Public Sector Accounting Standards	UK Generally Accepted Accounting Practice (FRS 102)
	would probably take at least three years to achieve change.	

April 2023