The Chartered Institute of Public Finance & Accountancy

how to tell the story

Local Authority Financial Statements
(Second Edition)

\ introduction

Local authorities have more than met the challenge of moving to IFRS. However, the recent consultation on *simplifying and streamlining the presentation of local authority financial statements* has indicated that they consider that the main messages of local authority financial statements might be obscured by the detail. The respondents indicated that the story of local authority performance measured in terms of General Fund or HRA Balances might also be difficult to present.

But there are also opportunities to simplify presentation and make the messages clearer in a number of areas:

- Comparisons with budgets
- General Fund and HRA performance
- Reserves position; and
- Cash flows.

This briefing note is intended to help CFOs and other senior staff present the financial statements to members and other key stakeholders by explaining how the formats can be used to convey key information in these areas.

comparisons with budgets

For members, probably the most important issue will be whether the authority has a surplus or deficit on General Fund or HRA balances against its budget for the year.

This was confirmed by the responses to the CIPFA/LASAAC *consultation on simplifying and streamlining the presentation of local authority financial statements.*

Because the financial statements follow accounting standards rather than local government legislation, this hasn't been easy to identify in the past. However, the Movement in Reserves Statement shown below provides users of the financial statements with more information to make that analysis (for example, by comparison with their budget reports).

In the Movement in Reserves Statement, the Surplus or Deficit on Provision of Services and Other Comprehensive Income and Expenditure are taken from the Comprehensive Income and Expenditure Statement (see example below). The Movement in Reserves Statement shows:

- how the authority has generated and expended resources in the year
- how the resourcing position is adjusted under statutory rules to show the funds available to be spent at year end; and
- the extent to which available funds have been earmarked for specific purposes.

Movement in Reserves Statement during 20X0/X1	**£'000**
Balance at 31 March 20X0 carried forward	**19,698**
Surplus or (deficit) on the provision of services	(2,783)
Other Comprehensive Income and Expenditure	–
Total Comprehensive Income and Expenditure	**(2,783)**
Adjustments between accounting basis & funding basis under regulations (Note 7)	2,635
Net Increase or Decrease before Transfers to Earmarked Reserves	**(148)**
Transfers to/from Earmarked Reserves (Note 8)	459
Increase or Decrease in 20X0/X1	**311**
Balance at 31 March 20X1 carried forward	**20,009**

General Fund share of the surplus or deficit. The HRA is in a separate column

Statutory adjustments such as the replacement of depreciation with MRP or pension liabilities with contributions etc.

Deficit for the year

Adjusted by transfers from earmarked reserves

Giving an increase in the General Fund balance over the year

How do these last three highlighted figures compare to the budget?

Members will have previously approved the transfers to or from earmarked reserves shown in the Movement in Reserves Statement (MiRS). The increase or decrease on the General Fund balance which is shown in this Statement would also normally be reported to members as part of the outturn report, although it might have been described as the surplus or deficit for the year. For housing authorities, there is a separate column in the Movement in Reserves Statement showing the equivalent HRA figures; other columns show earmarked reserves etc.

A loss shown in the CIES – especially if it's regularly a loss – is an indication that the costs of providing this year's services have not been covered by income and will need to be funded by taxpayers in future years.[1]

An overall increase in usable reserves despite a loss being shown in the CIES will arise where statutory provisions allow a different charge to revenue from the authority expenditure incurred (eg replacement of depreciation by Minimum Revenue Provision (MRP)). The adjustment to usable reserves is balanced by a movement in unusable reserves.

Unusable reserves such as the Capital Adjustment Account and the Pensions Reserve will need to be funded in the future, even if it is over a long period, so increases in these balances show an increasing burden on future taxpayers.

1 This does not affect local authority annual statutory budgetary duties.

general fund and HRA performance

The Comprehensive Income and Expenditure Statement (CIES) expands the part of the MiRS that shows how resources have been generated and expended. The key lines that summarise performance are highlighted below:

Comprehensive Income and Expenditure Statement 20X0/X1	Gross Expenditure £000	Gross Income £000	Net Expenditure £000
Central services to the public	4,970	(3,765)	1,205
Cultural environmental regulatory and planning services	13,624	(11,370)	2,254
Children's and education services	63,401	(20,496)	42,905
Highways and transport services	23,988	(7,930)	16,058
Local authority housing (HRA)	25,787	(26,901)	(1,114)
Other housing services	4,250	(3,857)	393
Adult social care	16,872	(5,518)	11,354
Social care legal settlements (material item)[a]	2,204	–	2,204
Corporate and democratic core	447	(65)	382
Non distributed costs	604	–	604
Cost of Services	**155,967**	**(79,902)**	**76,065**
Other operating expenditure (Note 9)	2,218	–	2,218
Financing and investment income and expenditure (Note 10)	11,340	(2,359)	8,981
Taxation and non-specific grant income and expenditure (Note 11)	–	(84,876)	(84,876)
(Surplus) or Deficit on Provision of Services			**2,388**
(Surplus) or deficit on revaluation of Property, Plant and Equipment assets			(36,597)
(Surplus) or deficit on revaluation of available for sale financial assets			(101)
Remeasurements of the net defined benefit liability (asset)			(8,444)
Other Comprehensive Income and Expenditure			**(45,142)**
Total Comprehensive Income and Expenditure			**(42,754)**

Expenditure of continuing operations, analysed by service, this line recociles with the segmental reporting note

Operational costs of providing the services of the authority

Total income and expenditure of the authority for the year

[The CIES above is based on the assumption that all operations are continuing]

The Comprehensive Income and Expenditure Statement is split into two parts.

The first part reflects the full economic cost of providing the service of the authority with the results summarised at the Surplus or Deficit on the Provision of Services line, highlighted in green on the preceding page. It represents the operating costs providing the services of the authority in the year. In the private sector this would be equivalent to the profit or loss of a company.[2]

The second part, other comprehensive income and expenditure shows the gains or losses in the measurement of the assets and liabilities of the authority. These gains or losses arise as a result of changes in market valuations, interest rates or changes in measurement assumptions in relation to pensions assets and liabilities.

Whilst the financial statements under the Code don't provide a direct comparison with the budget, one of the notes to the financial statements – on segmental reporting – can provide a bridge between budgets and the financial statements. Whether it does this in practice depends on the decisions authorities take about what goes in this note.

Segmental Reporting Note

As mentioned above, a comparison with budgets is one of the key items members will be looking for. As the financial statements contain figures members won't be used to seeing, it may be helpful to start explaining the accounts by starting with the Segmental Reporting note.

The note is based on internal management reporting structures and has to include at least 75% of service expenditure. The example below starts off by showing outturn information previously reported to members, and includes a line for support service recharges. However, if your authority reports the costs of support services separately, they could appear as a separate segment.

It is useful to point out here that the CIES presents segmental information in accordance with the service expenditure analysis defined by the *Service Reporting Code of Practice.* The segmental reporting note is not defined by this analysis.

2 Due to the statutory accounting arrangements this line does not represent the movements and therefore performance for the year against general fund or HRA balances.

Note that headings are based on the authority's directorates, not the service classification in the Service Reporting Code of Practice

[Directorate] Income and Expenditure[59] 2010/2011

	Education and Learning £000	Health and Social Care £000	Community and Living £000	Environment Planning and Leisure £000	Total £000
Fees, charges & other service income[60]	(1,481)	(5,012)	(2,452)	(30,417)	(39,362)
Government grants	(19,015)	(506)	(5,238)	(12,955)	(37,714)
Total Income	**(20,496)**	**(5,518)**	**(7,690)**	**(43,372)**	**(77,076)**
Employee expenses	40,252	11,235	8,652	30,565	90,704
Other service expenses	10,369	2,044	9,948	9,894	32,255
Support service recharges	4,326	1,273	2,031	6,232	13,862
Total Expenditure	**54,947**	**14,552**	**20,631**	**46,691**	**136,821**
Net Expenditure	34,451	9,034	12,941	3,319	59,745

Outturn figures previously reported to members

This note is then reconciled to the Comprehensive Income and Expenditure Statement. The example below also doesn't include 100% of the service expenditure – so the missing services appear in the reconciliation. Including all the service expenditure in the note is likely to be more beneficial for members, and simplifies the reconciliation. Other reconciling items are likely to be common year-end adjustments such as for depreciation, pension adjustments etc. provided that these aren't already included in monitoring reports.

	20X0/20X1 £'000
Net expenditure in the [Directorate] Analysis	**59,745**
Net Expenditure of services and support services not included in the analysis.	**2,015**
Amounts included in the Comprehensive Income and Expenditure Statement not reported to management in the Analysis	**37,055**
Amounts included in the Analysis not included in the Comprehensive Income and Expenditure Statement	**(22,750)**
Cost of services in the Comprehensive Income and Expenditure Statement	**76,065**

Reconciles to the cost of services figure in the CIES on page 5

The cost of services forms part of the Surplus or Deficit on the Provision of Services.

Capital grants are generally credited to taxation and non-specific grant income and expenditure line as they are received. This means that service lines won't include capital grant income; and also that the Surplus or Deficit might be more 'lumpy' because of these changes.

balance sheet

The Balance Sheet in local authorities is very similar to other public sector or private sector balance sheets. The balance sheet presents an authority's financial position, i.e. its net resources at the financial year end. The balance sheet is composed of two main balancing parts i.e. its net assets and its total reserves. The net assets part shows the assets of 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.

Balance Sheet	**Notes**	**31 March 20X1 £000**	
Property, Plant and Equipment	12	648,924	This will typically be the largest asset balance in a local athority balance sheet and includes the authority's property asset portfolio
Heritage Assets	13	3,379	
Investment Property	14	4,020	
Intangible Assets	15	709	
Long-term Investments	16	948	
Long-term Debtors	16	3,798	
Long-term Assets		**661,778**	Long term assets ie those expected to provide benefits to the authority beyond 12 months
Short-term Investments	16	24,060	
Assets Held for Sale	21	1,409	
Inventories	17	1,769	
Short-term Debtors	19	15,351	
Current Assets		**42,589**	Current assets ie those anticipated to be consumed in 12 months – the normal operating cycle for the authority
Bank overdraft		(13,767)	Reconciles to the cash and cash equivalents balance in the cash flow statement
Short-term Borrowing	16	(9,500)	
Short-term Creditors	22	(21,960)	
Current Liabilities		**45,227**	Current liabilities ie those liabilities anticipated to be settled within 12 months
Provisions[d]	23	(4,297)	
Long-term Borrowing	16	(89,733)	
Other Long-term Liabilities	16	(155,327)	
Long-term Liabilities		**249,357**	Long-term liabilities ie these liabilities that are anticipated to be settled beyond 12 months
Net Assets		**409,783**	Total assets less total liabilities

For local authorities balance sheet presentation is split between the usable reserves and unusable reserves. Usable reserves are those which the authority can utilise to support the future service provision. Unusable reserves cannot be used to support services and include gains and losses where amounts can only become available to support services if the assets are sold. These gains and losses are referred to as unrealised.

\ reserves

Reserves – including the General Fund and (where relevant) the Housing Revenue Account – are an indication of the resources available to an authority to deliver services in the future. The key messages that members will be looking for in terms of reserves – especially the General Fund and the HRA – are how the balances have changed over the year, whether the balances are still adequate, and what the balances mean in terms of future budgets and services.

Information on the level of reserves can be found in the balance sheet and related notes, and in the Movement in Reserves Statement (and related notes). This latter statement will be more useful in explaining the changes that have taken place during the year, including contributions to and from earmarked reserves.

	Notes	31 March 20X1 £'000
Usable reserves	**23**	**27,068**
Unusable Reserves	**24**	**382,715**
		409,783

The minimum requirement in presenting resources is to include only two lines – usable reserves (such as General Fund and earmarked reserves) and unusable reserves (such as the Revaluation Reserve and the Capital Adjustment Account).

If there are some reserves you want to show on the balance sheet, that's fine, as long as these totals are shown.

Whilst the Balance Sheet aims to show those reserves over which members have control, don't forget that some of the unusable reserves will become a charge against the revenue account – or usable reserves – over time. And in some cases, such as the Unequal Pay Back Account, this might be within a year or two.

As indicated on the preceding page not all reserves can be used to deliver services, and the Code reflects this by reporting reserves in two groups – 'usable' and 'unusable' reserves. Usable reserves such as the General Fund and earmarked reserves are those where members will be involved in deciding on the levels maintained, and their use. Unusable reserves such as the Revaluation Reserve and the Capital Adjustment Account aren't subject to such member influence.

cash flows

The final statement required by the Code is the *Cash Flow Statement.* 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, ie operating, investing and financing. The cash flow statement shows the resulting movement in cash flows, ie its cash and cash equivalents. Cash and cash equivalents include short-term investments that are readily convertible and which are subject to only insignificant risk of changes in value.

	20X0/X1 £000
Net (surplus) or deficit on the provision of services	2,388
Adjustments to net surplus or deficit on the provision of services for non-cash movements	(24,067)
Adjustments for items included in the net surplus or deficit on the provision of services that are investing and financing activities	11,523
Net cash flows from Operating Activities (Note 26)	(10,156)
Investing Activities (Note 27)	(24,585)
Financing Activities (Note 28)	35,140
Net increase or decrease in cash and cash equivalents	399
Cash and cash equivalents at the beginning of the reporting period	(14,166)
Cash and cash equivalents at the end of the reporting period (Note 19)	**(13,767)**

Surplus or Deficit taken from the Comprehensive Income and Expenditure Statement

3 groups of transactions:
- Operating
- Investing
- Financing

Cash and cash equivalents figure in the Balance Sheet

The Code sets out the minimum requirements for the financial statements of the authority, but authorities are free to include more detail if they think it will help them to explain the accounts to members and other stakeholders.

\ reminders and questions raised on the IFRS-based Code

IFRS – what is it?

International Financial Reporting Standards (IFRSs) are a suite of accounting standards used across the world. IFRS is the international equivalent of the Financial Reporting Standards (FRSs) used until now in the UK.

IFRS is intended for the private sector – why are we using it?

IFRS has been developed for the private sector, but the impact of the vast majority of transactions is the same whatever sector you are in. Where there are specific public sector reasons to diverge from IFRS, CIPFA/LASAAC (and the rest of the public sector) is permitted to refer to other Generally Accepted Accounting Practices (GAAP) including IPSAS and UK GAAP.

IPSAS?

International Public Sector Accounting Standards - these are accounting standards developed specifically for the public sector by the International Public Sector Accounting Standards Board (IPSASB). The 'rules of the road' followed by the IPSASB when developing IFRS-based standards mean that the requirements of IPSAS will be the same as those under IFRS, except where there is a pressing public sector reason to adopt a different treatment. This makes them and other GAAP the natural first port of call for CIPFA/LASAAC when IFRS isn't appropriate, although other GAAP is used in the Code for example for heritage assets. There are also some IPSASs that deal with exclusively public sector issues, and for which there is no IFRS equivalent – such as taxation.

So why use IFRS rather than IPSAS?

When the Treasury took the decision to follow IFRS, IPSASs were not as up to date as IFRS and were still under development in key areas. That's now changed and governments around the world are increasingly adopting IPSAS directly.

The Pension deficit is meaningless – why do we have to show it?

The deficit doesn't have to be funded from this year's budget, but it's still a true cost – it represents the amount that will need to be found from future budgets to pay for pension entitlements already incurred in delivering services. So it's a real call on future funding. Not showing this would hide the liability that the authority has incurred.

This also applies to other reserves. Like the Pension Reserve, the Capital Adjustment Account, the Unequal Pay Back Pay Account and similar reserves all do one thing: they hold expenditure that the authority has incurred but not yet financed. Think of them as being a bit like a credit card balance – these amounts will have to be funded in future, either from taxation or from usable reserves.

Concerns have been expressed that all these reserves make the Balance Sheet incomprehensible. But all that needs to be shown on the Balance Sheet itself are 'Usable Reserves' and 'Unusable Reserves' – the details can all go in a note. This will help to declutter the Balance Sheet.

The financial statements do not clearly demonstrate traditional measures of local authority performance, ie General Fund and HRA Balances!

The IFRS-based Code sets out that local authority financial statements are intended to be used for assessing the stewardship of local authority resources and for making economic decisions. Thus the information is intended for two purposes. The statements present information on the real economic cost of providing services in the year. However, this publication also sets out that the statements show the movement in General Fund and HRA Balances. CIPFA and CIPFA/LASAAC are, however, reviewing options for making this clearer.

The accounts are too long!

Yes, the accounts can be long, but local authorities have a complex story to tell. But notes only need to be produced if they are material – leaving out notes that aren't material or required by legislation is a good start. CIPFA/LASAAC as standard setter is continuously challenging the need to introduce disclosures and reporting requirements for local government.

CIPFA/LASAAC also consulted in the summer of 2013 on simplifying and streamlining the presentation of local authority financial statements. It is reviewing the responses to the consultation and as a second stage of the post implementation review is reviewing the financial statements for relevance to local authority circumstances and to ensure they reflect local authority financial position and performance including those measures important to local authority performance.

CIPFA and CIPFA/LASAAC also anticipate holding roundtables on the financial statements to support the review. In the interim the following article highlights areas local authorities may wish to consider to cut clutter from the financial statements.

clear out the clutter

By Alison Scott
Public Finance – 7 April 2014

We need more clarity and brevity in financial statements if they are to meet the needs of users. But too often public bodies play safe and fail to consider the 'materiality' of the information included.

The public sector is well advanced in producing high-quality, audited, accrual-based financial statements. However, an important question remains – is the information they contain being used as intended by the standard setters, to inform decision making and accountability?

In local government, the need to produce financial statements that address both accounting and legislative frameworks leads to complexity. Some items have to be accounted for in ways that do not reflect how the authority manages its budget. Timing differences in recognising expenditure and a service analysis that reflects national accounts requirements rather than how an authority is organised are just two examples of this. Decision makers often struggle to understand their own financial statements, and the valuable information they contain can be overlooked when policies and strategies are being considered.

Both CIPFA/LASAAC and the Treasury are aware of these problems and are reviewing how to simplify financial accounts across the public sector, but any changes will take time. However, there is much that individual organisations can do to improve their financial statements.

CIPFA published Financial Statements: a good practice guide for local authorities in late 2013. This looks at how the presentation can be improved and clutter cut from the accounts.

Too often, organisations play safe by including every disclosure required by standards, in case an omission is questioned. And too often, auditors question the omission of non-material disclosures, encouraging this behaviour.

If financial statements are to reduce in size, everyone involved needs to take materiality seriously. So how can materiality to the reader of the accounts be used to drive improvements in clarity and brevity?

In considering materiality, a number of key factors can be found in the definition:

- First, an item is not material if omitting or misstating it would not influence the decisions that users might make. As the Accounting Code notes, materiality is an aspect of relevance so omitting credit risk information that showed an authority had a significant proportion of its investments in high-risk institutions could influence the decision of a lender on whether to lend, or at what rate. Conversely, omitting credit risk information where a debt-free authority had all its investments in government-backed investments is less likely to be material, at least from a lender's perspective.
- Second, materiality does not just depend on the magnitude of an item; its nature is also relevant. A small investment in a high-risk institution might not be material when compared with the total value of investments; but it might be material by nature if the authority had already suffered a default by that institution, as users may question the authority's investment strategy, and make different decisions.
- Third, the individual context needs to be considered. An item may not be material by magnitude, and its nature may be unremarkable, but if it is the difference between an authority showing a surplus or a deficit on its General Fund for the year, then it may be. Users may assess stewardship based on whether the authority's net expenditure was within budget; so small items that resulted in the authority overspending its budget might be material for those users.
- Finally, the information that should be disclosed needs to be considered. Even if an item is material, additional information about it may not be. We should not only ask 'Is this item material?' but also 'Is this piece of information material?' The second question may produce a different answer to the first. An item may be material, but the full accompanying information may not. Or information may not relate to a particular item, but be material.

At CIPFA, we are looking at the scope to be more radical in presenting accounts to better meet the needs of primary users. By focusing on materiality, public sector organisations can remove a great deal of clutter from their accounts relatively quickly. While some decisions can only be made in the context of final draft accounts, most of the work on cutting clutter can be done in advance. This should also facilitate the senior level input required. But, the bottom line is, there already is scope to make your 2013/14 accounts[3] shorter and better focused if you want to take up that challenge now.

3 (or future accounts).

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