Since 2007, the Audit Commission has issued a series of briefings on implementing International Financial Reporting Standards (IFRS) in local government.

The series of briefings is mainly for those who prepare IFRS-based accounts in local government. The series also includes general briefings on the results of surveys of auditors in November 2009 and July 2010. These surveys asked questions about the progress being made by local government in preparing, for the first time, IFRS-based accounts for 2010/11.

You can find these briefings on the IFRS page of the Commission’s website.

This latest briefing focuses on a long-running debate that the implementation of IFRS has revived: how to make local government accounts easier to understand.
Summary

Local authority accounts are difficult to understand. Even professional local government accountants can find the statutory accounts hard to explain.

There are several claims made about why local government accounts are so complex. Some people suggest that CIPFA and the standard setters are to blame for following private sector accounting standards. They say the solution lies in bespoke accounting standards, not tied to private sector practice, but perhaps aligned with other parts of the public sector.

However, it is the regulatory framework that causes much of the complexity, leading to large adjustments to accounts that are difficult to explain or understand. In 2010/11, these adjustments were significant – for example, the reversal of charges for depreciation and impairments alone amounted to £19 billion across local government as a whole.

While the statutory accounts give comprehensive information on each local authority's financial position and performance, reflecting the range of activities which they cover, they are a poor way of communicating information to lay readers. Elected members and local people need accessible and clear information on financial performance, without needing to be accountants.

The statutory accounts of local authorities are long, covering several primary statements and many pages of notes. At an average of 113 pages, with some up to 250 pages in length, these documents are very long and much of this is explanatory material to support the financial statements. While this supports transparency, readers can be daunted by this and find it difficult to pick out the information they want. This problem is not unique to local government or the UK, and actions are being taken across the profession to try to reduce unnecessary complexity and the length of accounts.
The briefing concludes by identifying possible steps to make local authority accounts more accessible and easier to understand, and the implications of doing so. The Commission believes that the debate on improving the accessibility and clarity of local government accounts is an important one and we will continue to work with CIPFA, practitioners, auditors and other stakeholders to bring about improvements. We think the steps that could be taken fall into three main areas, and would welcome views on these.

- Elected members and local people would benefit from having access to well-presented extracts from the accounts which would provide the key information on each local authority’s financial position and performance.
- The profession and the Commission could do more to encourage auditors and preparers of accounts to reduce clutter in the statutory accounts.
- Each local authority could do more to ensure their accounts are shorter and more accessible. Those preparing accounts need to look critically at the previous year’s accounts. They should identify how these accounts could be sharper and more focused before starting work on the next set.

The Commission will continue to work with CIPFA, practitioners, auditors and other stakeholders to help bring about the necessary improvements. We also invite readers of this briefing to let us know their views. Details on how to do so are set out at the end.
Introduction

The transition to IFRS has renewed calls to simplify local authority accounts. This is not a new concern. Many practitioners have been commenting on this for several years. Many argue that IFRS has simply made things worse by increasing the length and complexity of accounts still further.

This briefing summarises the problem and suggests ways in which information about the financial position and performance of local authorities can be made more accessible and understandable to a wider range of people. It supplements the Commission’s Auditing the Accounts report for 2011 which summarises the findings of auditors following their audits of the first accounts of local government bodies prepared under IFRS.
What’s the problem?

**Elected members and local people need reliable information about local authorities’ financial performance but the statutory accounts are difficult for non-accountants to understand.**

Audited statutory accounts are the main means by which local authorities report, to taxpayers and the local community, on how they have used public money. Although many authorities supplement their statutory accounts by issuing at least some financial information in annual reports, or similar reports, on websites or in other publications, they are not required, by law, to do so. Recent initiatives to improve transparency have also made data about individual items of expenditure available, but publishing raw data by itself, without explanatory information, is of only limited value.

Those entrusted with the stewardship of public money must be able to explain how they have looked after public money and what they have done with it. Statutory accounts are comprehensive and prepared in a consistent way. But if they are difficult to understand, they do not achieve their main purpose, which is communicating information about the financial position and performance of the authority.

The published accounts should reflect the economic reality of an authority’s financial transactions and their impact on its financial performance and position. Local authorities are large organisations: even the smallest local district council’s annual gross revenue expenditure is well above the limit for a small or medium-sized enterprise in the private sector. Local authorities have multiple functions, provide a wide range of services, and operate in a complicated legal framework. They enter into complex financial transactions, including financial instruments, leases and various forms of partnerships.

The underlying economic reality of these transactions is inherently complex, so it is inevitable that the accounts themselves will also be as complex as those of similarly large and diverse organisations, whether in the public or the private sector.
At an average of 113 pages, statutory accounts are very long and much of this is explanatory material to support the financial statements. Readers may be daunted by this and find it difficult to pick out the information they want.

Although page length is influenced by the way in which information is presented, even allowing for differences in formats, local government accounts are large documents. On average, accounts are 113 pages long, and have grown in recent years.

The length of 2010/11 accounts varied slightly by type of council (Table 1) but several sets of accounts were much longer than the average, covering up to 237 and 250 pages in the cases of single tier and county councils. Single tier and county councils’ 2010/11 accounts were 139 and 151 pages on average. This compares with 90 pages for single tier and county councils’ 2007/08 accounts.

### Table 1: Length of statutory accounts

Local authorities’ 2010/11 accounts vary in length and some are very long documents.

<table>
<thead>
<tr>
<th>Type of council</th>
<th>Minimum length</th>
<th>Maximum length</th>
<th>Average</th>
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<tbody>
<tr>
<td>All types(^i)</td>
<td>39</td>
<td>250</td>
<td>113</td>
</tr>
<tr>
<td>Single tier councils</td>
<td>72</td>
<td>237</td>
<td>139</td>
</tr>
<tr>
<td>District councils</td>
<td>60</td>
<td>180</td>
<td>104</td>
</tr>
<tr>
<td>County councils</td>
<td>88</td>
<td>250</td>
<td>151</td>
</tr>
</tbody>
</table>

*Source: Audit Commission*

The statutory accounts include several primary statements and various detailed disclosures in supporting notes. Some also include group accounts, where appropriate, and others include relevant supplementary statements, such as the Housing Revenue Account.

The sections providing the main accounting statements represent a small part of the total document compared with the rest which is explanatory or contextual information. The largest section covers the notes to the core statements, as Figure 1 illustrates. These averaged 64 pages in 2010/11, compared with an average of 36 pages for the notes to core statements in 2007/08 single tier and county council accounts.

\(^i\) The shortest set of accounts, at 39 pages, was for a passenger transport executive.
To avoid large year-on-year changes in council tax or fees and charges for council services, the statutory accounting framework for local authorities requires large movements in non-cash figures that are difficult to explain or understand.

Much of the complexity of local authority accounts comes from the need to reconcile accounts produced in accordance with generally accepted accounting practice (GAAP), with the control framework imposed by government.

The need to reconcile the GAAP based accounts with the statutory control framework, to smooth the impact of expenditure on council tax, requires a series of adjustments. These ‘reverse out’ various charges or credits to the comprehensive income and expenditure account. Double entry accounting then requires the creation of various unusual balances.
It is understandable, from a policy perspective, to smooth financing requirements over several years to avoid large fluctuations in council tax demands and to spread the burden of certain ‘one-off’ payments on taxpayers. But these adjustments to the accounts and balances are difficult to explain.

The largest adjustment reverses out the full effects of depreciation and impairments of assets. This adjustment is made to avoid potentially large one-off impacts on council tax requirements in any one year. In 2010/11, this adjustment alone amounted to £19 billion across local government as a whole. There are others in respect of capital financing costs; pension costs; surpluses or deficits on sale of fixed assets; government grants; accrual of holiday pay; and amortisation of intangible assets. In some cases the Department for Communities and Local Government sanctions specific departures from proper accounting. For example it allows local authorities to capitalise certain items of expenditure that would normally be accounted for as current expenditure, such as redundancy costs.

These adjustments are probably the main reason for the complexity of local government accounts. Representatives from local government have highlighted their concerns about this to the House of Commons Communities and Local Government Select Committee inquiry into the future of local audit and inspection.

For all of these reasons, local government accounts have become too difficult to understand and so are failing to fulfil their basic purpose.
The problem is not simply caused by the standard setters

So why are local government accounts difficult to understand? Some blame the requirement to comply with accounting standards developed for the private sector.

Some argue that GAAP-based accounting standards, developed for the private sector, are not appropriate for local authorities. It is suggested that what is needed are specific accounting standards developed for local government, reflecting the particular financial framework within which authorities operate.

Others suggest there should be specific accounting standards for the public sector, while recognising that there is a need for consistency between the accounts of public bodies – to support Whole of Government Accounts (WGA), for example. This could be achieved without adopting practices derived from the private sector.

But the standards that underpin GAAP represent the accounting profession’s evolving understanding of the best way to represent, in published financial statements, the economic effects of different types of financial transaction. The economic effects of, say, entering into a lease or accounting for a government grant are exactly the same, whether the entity concerned is in the private or in the public sector.

It is argued that the preparation of the accounts under GAAP serves little useful purpose, other than demonstrating compliance with regulatory requirements. Indeed, the Communities and Local Government Select Committee received evidence that suggested that applying GAAP in local government has increased compliance and audit costs.
But for government, regulators and key stakeholders, it is important that local authorities’ statutory accounts are prepared in accordance with recognised standards and can be relied upon as ‘regulatory’ accounts. This helps to ensure that information from the accounts can be consolidated by the Department for Communities and Local Government as part of WGA, and comparability of accounts between different authorities. Comparability is important not only to national stakeholders, but to individual authorities and local stakeholders.

However, without some technical knowledge of how accounts are prepared and presented under GAAP, it is difficult for general readers to know which numbers are important and what the significance of the various statements and disclosures is. This means that a lay audience, which may include elected members of authorities and local people, is not able to understand fully the key messages that are being presented in the accounts.

It is also sometimes suggested that local government accounts would be simpler if they could be more like NHS or central government departments’ accounts. But there is already a high level of alignment across the public sector and the accounting framework for local authorities is essentially the same as that which applies in central government and the NHS. This is because of a deliberate policy of aligning with GAAP across the UK economy, including the public sector. Also, neither NHS bodies of central government departments are tax-raising bodies in their own right, so changes in the ‘bottom line’ of their accounts do not impact directly on the taxpayer, as they would in local government.
Complex and long accounts are not unique to local government

Many of the challenges that local government faces to improve financial reporting are also faced by the private sector, and the problems are not unique to the UK.

Similar concerns have been noted in the private sector. For example, in *Right to the End*, which reported on its review of the published financial statements of listed companies, Deloitte found that annual reports were 34 per cent longer in 2008 than they had been in 2005. The financial statements covered 13 to 175 pages, and 25 per cent to 75 per cent of the annual reports as a whole. Deloitte commented:

‘With the complexity of financial reporting ever on the increase, it is no surprise that the average length of annual reports continues to rise year on year.’

There have been increasing calls to clear out unnecessary detail that can make reports more difficult to understand. For example, in April 2011, the Financial Reporting Council (FRC) published its report *Cutting Clutter - Combating Clutter in Annual Reports*. The FRC commented that:

‘Clutter makes it more difficult for users to assess a company’s progress by obscuring relevant information. Due to the time and effort involved in preparing such disclosures, clutter is also a big issue for preparers.’

The FRC defines ‘clutter’ in annual reports and accounts as:
- immaterial disclosures that inhibit the ability to identify and understand relevant information; and
- explanatory information that remains unchanged from year to year.
To deal with the problem the FRC argues there is a need to:

- remove barriers to reducing clutter by encouraging debate about what is material in relation to disclosures, tackling long-standing explanatory material in reports, and engaging with stakeholders on information requests;
- address behaviours that can prevent removing clutter – such as relying too much on illustrative accounts that, by their nature, cover all potential disclosures regardless of whether they are relevant to individual organisations; and
- provide better guidance on good practice in making relevant disclosures that are not just simple templates, but which illustrate more effectively what can be done to achieve clearer reporting.

The UK is not alone in seeing clutter in annual reports and accounts as a problem. Similar comments have been made internationally. For example, the International Accounting Standards Board recently commissioned research on how to reduce the volume of disclosure requirements in IFRS from the New Zealand Institute of Chartered Accountants and the Institute of Chartered Accountants of Scotland. The joint report, *Losing the Excess Baggage - Reducing Disclosures in Financial Statements to What’s Important*, was published in July 2011. Like the FRC, the authors call for a more rigorous and thoughtful approach to considering what is material when deciding on disclosures to make in accounts. Their analysis of financial statements suggested that a 30 per cent reduction in the length of accounts might be possible, improving communication by focusing on what is important.
So what can be done to make local government accounts more understandable and accessible?

Professional bodies, auditors and local authorities can work together to reduce clutter in the statutory accounts. Better summarised information could also be made more easily available to support the needs of a wider range of users including elected representatives and the public.

CIPFA has published a briefing, *How to Tell the Story*, which helps directors of finance and other finance professionals to explain to their authorities the most important parts of financial statements. CIPFA’s briefing explains how the statutory accounts can be used effectively to convey information in:

- comparisons with budgets;
- General Fund and Housing Revenue Account performance;
- the reserves position;
- and cash flows.

Good directors of finance are already able to summarise and explain the significance of key numbers in the accounts, and do so in covering reports and presentations to those charged with governance. But there is an urgent need to find ways of making local government accounts more accessible and easier to understand. The story they tell about the financial position and financial performance of an authority must be communicated more effectively to a more generalist interested audience, including councillors and local people.

There may be some measures that can be taken relatively quickly to make local government accounts more understandable but others would take longer to implement. Table 2 identifies short to medium-term and longer-term steps that could be considered, and the implications of doing so.
Table 2: **Making local government accounts more accessible and easier to understand**

<table>
<thead>
<tr>
<th>Short to medium term – possible steps</th>
<th>What this would mean in practice</th>
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<tbody>
<tr>
<td>1. Promote initiatives to reduce clutter in local government financial reporting.</td>
<td>The FRC initiative on reducing clutter is challenging preparers of accounts and auditors to meet the requirements of accounting standards more succinctly and effectively.</td>
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<td></td>
<td>Our survey of auditors shows that there is scope to reduce the length of local government accounts by adopting a similar improvement programme. For 2010/11 there was a wide range of page lengths, with an average of 113 pages, but with some covering over 200 pages. The notes to the core statements alone cover an average of 64 pages.</td>
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<td></td>
<td>How this would need to be taken forward</td>
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<td>CIPFA and practitioners would need to adapt and apply an improvement programme similar to that being promoted by the FRC and others to reduce clutter. They could, for example, challenge the need for disclosures that are not material. The best way to do this might be to start with last year’s accounts to simplify these ahead of the coming year’s accounts preparation process.</td>
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<td></td>
<td>Template accounts, in particular, need to be used with care to avoid including unnecessary or irrelevant detail.</td>
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<td></td>
<td>The Commission will issue guidance to appointed auditors. This will refer to the FRC’s initiative to reduce clutter and remind auditors that they have a significant contribution to play in challenging unnecessary disclosures or detail in the accounts.</td>
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2 Give local authorities the option of issuing summary financial statements.

<table>
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<th>What this would mean in practice</th>
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<tr>
<td>This would be similar to the private sector where summary financial statements are increasingly the principal means by which companies communicate with the mass of their private shareholders. The full accounts are increasingly the preserve of the specialist analysts.</td>
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<tr>
<td>Summary financial statements, in plainer and more accessible language, could be the main way of communicating key information more effectively to a wider audience.</td>
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<td>Initially authorities could be encouraged to prepare summary financial statements on a voluntary basis. But without changes to the Accounts and Audit Regulations the full council would still need to approve the audited full accounts prior to publication.</td>
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<tr>
<td>In the medium term it would be possible to go further and permit authorities, through an amendment to the Accounts and Audit Regulations, to opt to take only the summarised financial statements to the full council for approval. This would be their main means of discharging local government bodies’ accountability to taxpayers and other stakeholders.</td>
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<tr>
<th>How this would need to be taken forward</th>
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<tr>
<td>There would need to be an agreed set of standards (or ‘proper practices’) governing the form and content of summary financial statements.</td>
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<tr>
<td>The development of proper practices could be overseen by the joint CIPFA and Local Authority (Scotland) Accounts Advisory Committee (CIPFA/LASAAC) local government accounting code board, under the auspices of the Financial Reporting Advisory Board.</td>
</tr>
<tr>
<td>The Accounts and Audit Regulations would need to be amended to give authorities the option of approving and reporting summary financial statements as their main means of discharging local government bodies’ accountability to taxpayers. The full accounts would remain and continue to be subject to audit, but could be approved only by the chief financial (‘section 151’) officer.</td>
</tr>
<tr>
<td>There would need to be a requirement for the auditor to report on the consistency of the summary financial statements with the audited regulatory accounts, just as there already is in other sectors. The authority would also need to state where the audited regulatory accounts can be found.</td>
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</table>
3 Make more effective use of summary financial information in support of more general reporting.

What this would mean in practice

This would build on existing good practice in annual reporting. Many local authorities already prepare annual reports that include some financial information. Effective annual reporting combines explanatory narrative, non-financial information and financial data.

Authorities could tailor their reporting to meet local circumstances making effective use of web-based reporting. This would help to ensure that summary financial information is easily accessible to local people. It would offer sufficient explanatory information to help ‘armchair auditors’ interpret raw data published under transparency requirements.

How this would need to be taken forward

CIPFA’s project on Effective Reporting is identifying examples of good practice. It also aims to provide tools which will help support locally developed arrangements to improve reporting.

More information on this can be found at [cipfa.org.uk/panels/lgpp/index.cfm](http://cipfa.org.uk/panels/lgpp/index.cfm).

4 Progressively move towards arrangements that minimise the need for adjustments between GAAP-based accounts and the control framework.

What this would mean in practice

This could ultimately lead to a framework in which accounts are prepared in accordance with GAAP only. There would be no need to develop guidance on adjustments between GAAP-based accounts and the control framework. But it is too simplistic to make this change in one step. Data from the 2010/11 published accounts suggests that to do so would add several billion pounds to council tax bills in the year of transition.

However, there would be longer-term advantages in a phased approach to moving to GAAP-only reporting. For example, moving to arrangements in which depreciation charges impact on authorities’ reported financial performance, without reversing out the impact, would strengthen accountability for the cost of the capital.

How this would need to be taken forward

There would need to be a planned, long-term approach to eliminating the need for adjustments between the GAAP-based accounts and the control framework.

Source: Audit Commission
How to respond to this briefing

Effective financial reporting is a fundamental part of good governance. But this briefing has summarised several problems with existing practice in the preparation and publication of statutory local government accounts. We would welcome your thoughts and comments on the issues presented in this briefing.

Whether you agree or disagree with the conclusions in this briefing please let us have your views. If you have other suggestions on how to make local government accounts more accessible or easier to understand, or how to reduce the clutter in accounts, please forward your ideas to letsbeclear@audit-commission.gov.uk by 16 March 2012.
If you require a copy of this document in an alternative format or in a language other than English, please call: 0844 798 7070

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

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