

Report

To: CIPFA LASAAC

From: Steven Cain, CIPFA Secretariat

Date: 10 June 2021

Subject: CIPFA LASAAC Strategic Plan – Project 1 Materiality

Purpose

The purpose of this report is to ask CIPFA LASAAC to consider and approve the Project Plan for Project 1 Materiality as a part of its Updated Strategic Plan, and provide other direction

Report

1. Introduction

- 1.1 CIPFA LASAAC agreed its updated strategic plan at its 3 March 2021 meeting. This included Project 1 Materiality.
- 1.2 The attached project plan gives an overview of the project. It includes:
 - Objectives of the Project
 - Introduction and background
 - Project approach
 - Project Milestones, and
 - Staff and Resources
- 1.3 This project has strong links with Project 2 on Improving the Presentation of Local Authority Accounts (formerly Streamlining). Some changes to this project may be necessary as a result of this reframing.

2. Anticipated Options for the ED/ITC

- 2.1 To achieve the objectives of the project we would aim to develop for this year's ITC
- proposals which might help local authorities decide what information and how to present in the financial statements, having regard to the various users of the accounts and their information needs. Alternatively, questions which may help the development of such proposals for subsequent consultation
 - Analysis and proposals which address issues around measurement which were raised in the Redmond review
 - Consideration of the amount and complexity of disclosures in local authority accounts, and proposals which support the consideration of materiality to reduce less important disclosures which retaining or enhancing more important ones.

3. Note of Progress

- 3.1 Because the project includes consultation on proposals in this year's ITC, some work has been carried out in advance of full CIPFA LASAAC consideration of the plan.
- 3.2 It was noted by the Chair at the meeting on 3 March 2021 that this project revisits the well explored topic of users of local authority accounts, who are known to be diverse and with differing needs. Work on the project so far has sought where possible to incorporate the Chair's suggestion of 'thought experiments' which consider contrasting users and user needs.
- 3.3 The Secretariat and three volunteer members group have discussed possible proposals in line with the above. The work has not yet produced a full set of 'consultation ready' material for the ED/ITC. Papers reflecting the group discussion are attached, and these include questions on which the Board may wish to provide its view to inform further work. These are also attached as an annex to this paper.

Recommendations

CIPFA LASAAC is invited to consider and approve the attached project plan, and provide feedback on the work to date

Questions for CIPFA LASAAC (property, plant and equipment)

The working group agree that there is a materiality issue, and it may be worth considering this having regard to reasoning around precise valuation being less relevant for assets being used to deliver a service. This reasoning is framed around consideration of the information needs of users interested in service provision, to the extent that it does not conflict with other user needs.

Does CIPFA LASAAC agree with the logic set out in this section of the paper around the approach to current value and materiality – does it capture a key feature of public sector reporting, or does it reflect a degree of wishful thinking?

If so, how would this be best progressed in the Invitation to Comment?

If it is possible to pursue this, it would have ramifications for all government sectors.

In practice, obtaining agreement from the auditor, regulator and standard setter community (including FRAB and other UK public sectors) would be as important as obtaining support from preparers.

Obtaining an understanding of the FRC comments on this issue in the Redmond review report would be helpful.

Questions for CIPFA LASAAC (pensions assets and liabilities)

The working group agree that there is a materiality issue, and it would be beneficial for the case for less revaluation of pension assets and liabilities to be explored.

Questions for CIPFA LASAAC

Does CIPFA LASAAC agree with the logic set out in this section of the paper?

Do CIPFA LASAAC consider that the case for less revaluation of pension assets and liabilities should be explored?

If so, how would this be best progressed in the Invitation to Comment?

If it is possible to pursue this, it could have ramifications for all government sectors.

In practice, obtaining agreement from the auditor, regulator and standard setter community (including FRAB and other UK public sectors) would be as important as obtaining support from preparers.

Obtaining an understanding of the FRC comments on this issue in the Redmond review report would be helpful.

Questions for CIPFA LASAAC (IFRS Practice Statement 2 and related CIPFA guidance)

The working group agreed that the excerpted material from the publication *Streamlining the Accounts* was useful.

However, working group members were less clear whether providing such an extract in the Code would be beneficial, given that this material is already available. It might instead be better to promote that document in the Code, with brief signposting to the relevant sections.

Does CIPFA LASAAC agree that the material in this part of the paper is useful?
Would it be helpful to include material based on this in the Code, despite its non-mandatory status, perhaps as an Appendix?

Questions for CIPFA LASAAC (Can particular types of disclosure be expected to be less material?)

Should we explore this topic with Councils which have recently carried out streamlining projects
Should we seek to apply the 'less prescriptive language' approach in the development of the 23/24 Code, signalling this in the 22/23 ITC

CIPFA LASAAC Project 1 – Materiality

Objective of the Project

This project mainly supports CIPFA LASAAC strategic theme A: Ensuring that the annual accounts clearly articulate the key messages regarding financial performance and position. Achievement of the project may also involve CIPFA LASAAC strategic theme B. Engaging with stakeholders to raise awareness and understanding.

The main objective of the project is to help preparers to put the right emphasis on items in the financial statements, placing greater emphasis on more important matters and lesser emphasis on less important matters.

Project Introduction and Background

An understanding of materiality is crucial to effective presentation of financial statements, particularly the recognition that materiality is often as much about what should be left out of published accounts as what should be included. Information is material *if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting authority* so this necessarily requires consideration of who the users are and the type of decisions they might make.

Materiality is also a key issue raised by the Redmond Review in relation to the measurement of property, plant and equipment and the measurement of pensions liabilities.

This project will therefore focus on helping local authorities decide:

- who are the users of their accounts?
- what financial information do they need?
- how is this best presented?

This project will also consider

- issues around the measurement of property, plant and equipment
- issues around the measurement of pensions assets and liabilities
- the amount and complexity of disclosures in in local authority accounts

Project Approach

A small working group will review the matters set out above, having regard to:

- Positions informing the Redmond Review
- Guidance relevant to materiality
- Other developing thinking on materiality

and will develop options on which to initially consult in the 2022/23 ITC.

Based on responses to the consultation, proposals will be developed to be tested through a dry run or pilot. Probably in conjunction with CIPFA LASAAC Project 2 Improving the Presentation of Local Authority Accounts (formerly Streamlining).

Project Milestones and Resources

| Project Milestones | Dates |
|---|----------------|
| CIPFA LASAAC agree project brief and discuss issues arising | June 2021 |
| Review issues arising | June 2021 |
| Develop consultation material for inclusion in the 22/23 Code ITC/ED | June-July 2021 |
| Review comments on consultation paper | November 2021 |
| Develop material for inclusion in the 23/24 Code ITC/ED | March 2022 |
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Staff and Resources

Volunteers:

| | |
|-----------------|---------------------------------------|
| Gillian Woolman | <i>Audit Scotland</i> |
| Lucy Hume | <i>North Norfolk District Council</i> |
| Colin Hastings | <i>East Ayrshire Council</i> |

Staff:

| | |
|-------------|--------------------------------|
| Steven Cain | <i>CIPFA Technical Manager</i> |
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CIPFA LASAAC Strategic Plan Project 1: Materiality Working Group Briefings and Discussions

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Initial Project Discussion

Gillian Woolman and Steven Cain shared preliminary views on the project on 11 May 2021, also noting the interest in this project from PSAA who are considering matters around audit materiality in the light of the observations of the Redmond review.

Key decisions on the way forward after that discussion were that

- While audit materiality is a relevant matter, this work should initially focus on preparer materiality, which is a matter within the scope of CIPFA LASAAC.
- It is thus not appropriate to engage with PSAA at this stage, although this might become relevant later.
- Issues around measurement of property, plant and equipment to be reviewed.
- Issues around measurement of pensions assets and liabilities to be reviewed.
- IFRS Practice Statement 2 *Making Materiality Judgements* to be reviewed, together with related material developed for the local government context in the CIPFA publication *Streamlining the Accounts*.
- Information on the application of streamlining Fife Council annual report and accounts to be reviewed, to determine if elements of this practical approach which relate to materiality can be developed into something
- Consideration to be given to whether particular types of disclosure could be expected to be less material under defined circumstances or in typical local authority contexts

Subsequent Discussion

In the light of the above, papers were prepared setting out key features of the above, and discussion in a call on 28 May 2021, and in follow up with Gillian Woolman on 2 June 2021.

Some amendments to the papers have been made on the basis of feedback from working group members, and notes of the reactions of the working group have been added.

Issues around measurement of property, plant and equipment

Is there a materiality issue to be addressed?

The Redmond Review report *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting* observed that

Many local authorities have raised concerns that auditors spend a significant amount of time focusing on fixed asset and pension valuations, whereas a fuller understanding of the business would lead to more of a focus on major areas of expenditure, together with the level of usable non-ringfenced revenue reserves.

The report went on to set out the justification provided by local authorities

The reason for this argument is that most changes to fixed asset and pension values are 'reversed out' of the accounts by a range of statutory adjustments. As a result, in those circumstances, these valuations have no immediate impact on the cost of delivering services or on the financial resilience of a local authority.

On the face of it this is a discussion about materiality, but from the perspective of a user of the accounts who is only concerned about the statutory position. CIPFA LASAAC will be familiar with this line of reasoning, which has surfaced in recent consultations, but is not the only view held by local authority preparers. This view does not provide a convincing basis for deeming fixed asset or pension values less material.

More convincing arguments have been given in auditor responses to Code consultations, suggesting, for example, that while these assets are of considerable importance to the delivery of services, precise valuation is much less important than for private sector company assets. The gist of these arguments is that information on current value grounded in replacement cost would be much more relevant to entities which routinely traded or replaced their asset base, whereas local authorities mostly retain assets long term for service provision, and replacement based valuation is not relevant.

Based on the above it seems that there is a materiality issue.

Is there scope for the Code to assist in addressing this issue?

Additionally, the Redmond review states the view of the FRC on this issue, which is as follows:

FRC is of the view that the perception that it focuses mainly on asset valuations understates the scope of their quality reviews. It also believes that if a focus on asset and pension valuations is inappropriate, this is the responsibility of the partnership between CIPFA (England, Northern Ireland and Wales) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) known as CIPFA/LASAAC to resolve, through modifications to the Accounting Code.

The exact meaning of this statement is unclear, and should perhaps be resolved by discussion with the FRC.

It may be suggesting that the Code could be modified to support the view of local authorities who suggest that these items are less material because they are reversed out through statutory adjustments. This is a position which CIPFA LASAAC could not support.

On the other hand, it may be seeking clarification of the apparently more reasonable position expressed in terms of the usefulness of precise or particularly up to date valuation information for assets which are not actively traded or frequently replaced before the end of their economic life. This position certainly resonates from the perspective of a user of accounts who is concerned about the capacity of the authority to continue providing services

– the main issue surely to have accurate enough information to determine whether that capacity is increasing, diminishing or remaining broadly stable.

The latter position is perhaps worth exploring, and it is a matter which relates to preparer materiality, even though it has arisen mainly in discussions around audit.

Insofar as it might be possible to pursue this, it would seem natural to confine this approach to assets which are being measured using the Code's concept of *current value* and which are in active use for service provision, so excluding those assets for which current value equates to *fair value* (e.g. surplus assets).

The core position would be that, for these assets, the key requirement to achieve faithful representation is that there is sufficient information to determine whether capacity is increasing, diminishing or remaining broadly stable. Comparison might be drawn with historical cost which is considered to achieve faithful representation, without any revaluation, subject to safeguards around impairment.

This approach would seem to align with decision usefulness for users of the financial statements who are primarily interested in service provision, which might encompass many service recipients and their representatives. It also does not seem antagonistic to users with other perspectives who are, for example, interested in overall economic performance, given that it is restricted to assets where it is not anticipated that economic gains will be achieved through sale. Attending to the needs of these users does however mean that while there might be some scope to be less rigorous about obtaining less up to date valuations, this will be quite restricted – the values cannot be allowed to drift into irrelevance. There is also a requirement for 'current value' to be sufficiently close to what it is understood to be, in order to achieve faithful representation

As discussed later the IASB is currently consulting on its approach to disclosure, both generally and in IFRS 13 *Fair Value Measurement* and IAS 19 *Employee Benefits*. It is seeking comments on Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* by 21 October 2021.

This document is addressing the IASB's approach to standard setting by reference to specific standards. It is possible that it may provide a useful rationale for CIPFA LASAAC when considering its approach to setting Code requirements in relation to public sector specific issues. The ED is specifically addressing disclosure issues, but may contain reasoning which is more widely relevant.

Questions for the working group

Does the group agree that there is a materiality issue?

Does the group agree that this issue should be considered having regard to the arguments around precise valuation being less relevant for assets being used to deliver a service.

Does the group think that CIPFA LASAAC should consider this matter further?

If so, how would this be best progressed in the Invitation to Comment?

Reactions from the working group

Members of the working group strongly agreed that this discussion resonates, and that disproportionate efforts seems to be required in supporting the valuation of PPE in the preparation of accounts for audit.

The view was expressed that while the valuation process needs to be undertaken in good faith, it will only ever give a snapshot at a moment in time, and this might be quite different to a valuation taken at a slightly different time, without having any effect at all on the use of assets for service provision.

The group therefore agreed that there is a materiality issue, and it would be good to develop an approach based on precise valuation being less relevant. However, while framed in terms of preparer materiality, this would only be worth doing if this fed into a changed dynamic with auditors.

Questions for CIPFA LASAAC (property, plant and equipment)

The working group agree that there is a materiality issue, and it may be worth considering this having regard to reasoning around precise valuation being less relevant for assets being used to deliver a service. This reasoning is framed around consideration of the information needs of users interested in service provision, to the extent that it does not conflict with other user needs.

Does CIPFA LASAAC agree with the logic set out in this section of the paper around the approach to current value and materiality – does it capture a key feature of public sector reporting, or does it reflect a degree of wishful thinking?

If so, how would this be best progressed in the Invitation to Comment?

If it is possible to pursue this, it would have ramifications for all government sectors.

In practice, obtaining agreement from the auditor, regulator and standard setter community (including FRAB and other UK public sectors) would be as important as obtaining support from preparers.

Obtaining an understanding of the FRC comments on this issue in the Redmond review report would be helpful.

Issues around measurement of pensions assets and liabilities

Is there a materiality issue to be addressed?

The Redmond Review report *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting* observed that

Many local authorities have raised concerns that auditors spend a significant amount of time focusing on fixed asset and pension valuations, whereas a fuller understanding of the business would lead to more of a focus on major areas of expenditure, together with the level of usable non-ringfenced revenue reserves.

The report went on to set out the justification provided by local authorities

The reason for this argument is that most changes to fixed asset and pension values are 'reversed out' of the accounts by a range of statutory adjustments. As a result, in those circumstances, these valuations have no immediate impact on the cost of delivering services or on the financial resilience of a local authority.

On the face of it this is a discussion about materiality, but from the perspective of a user of the accounts who is only concerned about the statutory position. CIPFA LASAAC will be familiar with this line of reasoning, which has surfaced in recent consultations, but is not the only view held by local authority preparers. This view does not provide a convincing basis for deeming fixed asset or pension values less material.

The above discussion surfaced in a consultation on audit and reporting in England, and I understand that the issues may be less severe in Scotland and Wales, where full reporting on employee assets and liabilities has been de-coupled from authority accounts, and detailed reporting is only carried out in the pension fund accounts of the providing authority. However, practitioners from Scotland confirm that this issue is still relevant given the requirement to report on the net liability.

In contrast to the position for property, plant and equipment, it is not possible to set out arguments based on a notion that the value of the assets in exchanges is not relevant – the whole reason for holding assets is to exchange them over time to fund the liability.

I understand that arguments have been made in the past, perhaps in responses to CIPFA LASAAC consultations and in other contexts, suggesting that it would be possible to value pension assets and liabilities less often, and with less need to update between full actuarial assessments. This was probably grounded in the perception that in contrast to some private sector company arrangements, the governance arrangements are particularly strong, and there is an underlying safeguard because these are public sector schemes.

Potential approaches reflecting this might be that

- a) Financial reporting could be based directly on the triennial actuarial reports, with no significant updating between formal triennial actuarial exercises; or
- b) Financial reporting could follow IAS 19 with a strong injunction that actuarial exercises would be carried out triennially except where there is good reason to believe that catastrophic and irrecoverable deterioration of the net position has occurred.

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Returning to the contrast with property, plant and equipment, perhaps a rationale might be developed which recognises that

- the value of the assets in exchanges is highly relevant,

- the value of the liability is highly relevant; but
- pension schemes are, in general managed over the long term, and the portion of assets which need to be realised through exchanges in a specific period is much less than the total value of the fund

None of the above arguments would be convincing without periodic correction through the formal actuarial valuation.

As discussed later the IASB is currently consulting on its approach to disclosure, both generally and in IFRS 13 and IAS 19. It is seeking comments on Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* by 21 October 2021.

This document is addressing the IASB's approach to standard setting by reference to specific standards. It is possible that it may provide a useful rationale for CIPFA LASAAC when considering its approach to setting Code requirements in relation to public sector specific issues. The ED is specifically addressing disclosure issues, but may contain reasoning which is more widely relevant.

Questions for the working group

Does the group consider that there is a materiality issue around measurement of pension assets and liabilities, and if so, can it be usefully addressed by the Code?

Do group members consider that the case for less revaluation should be explored?

Is the fact that additional reporting is carried out at a scheme level relevant to materiality in individual local authority financial statements?

Does the group think that CIPFA LASAAC should consider this matter further?

Reactions from the working group

Members of the working group strongly agreed that this discussion resonates, and that disproportionate efforts seem to be required in supporting pension fund information in the preparation of accounts for audit.

The group recognised that there is a difference to PPE, in that the value of pension fund assets in exchanges is very relevant.

The group therefore agreed that there is a materiality issue, and it would be good to develop an approach based on precise valuation being less relevant. However, while framed in terms of preparer materiality, this would only be worth doing if this fed into a changed dynamic with auditors.

Questions for CIPFA LASAAC (pensions assets and liabilities)

The working group agree that there is a materiality issue, and it would be beneficial for the case for less revaluation of pension assets and liabilities to be explored.

Does CIPFA LASAAC agree with the logic set out in this section of the paper?

Do CIPFA LASAAC consider that the case for less revaluation of pension assets and liabilities should be explored?

If so, how would this be best progressed in the Invitation to Comment?

If it is possible to pursue this, it could have ramifications for all government sectors.

In practice, obtaining agreement from the auditor, regulator and standard setter community (including FRAB and other UK public sectors) would be as important as obtaining support from preparers.

Obtaining an understanding of the FRC comments on this issue in the Redmond review report would be helpful.

Review of IFRS Practice Statement 2 and related CIPFA guidance

In line with the discussion between Gillian Woolman and Steven Cain on 11 May 2021, the primary IASB guidance on materiality has been reviewed for usefulness, together with material in the CIPFA publication *Streamlining the Accounts* which references this.

IFRS Practice Statement 2, *Making Materiality Judgements* is the key non-mandatory pronouncement by the IASB.

The Practice Statement document is very good and generally quite clear, but is strongly framed in its private sector context and this makes it harder to read across to public sector circumstances. It reflects the view that existing and potential investors, lenders and other creditors as users of financial statements. This would not be a problem if later sections referred to 'users': as the material would then be readily understandable in terms of other concepts of user, such as that for local authority accounts. However, the drafting is deliberately quite concrete in a way that is helpful for private sector users, but requires additional effort from a public sector reader.

I reviewed the Practice Statement to consider how it might usefully be reframed in a way suitable for public sector readers, having regard to work that had already been carried out for the December 2018 publication *Streamlining the Accounts*. Sections 2 to 6 of this document set out a number of approaches to making financial statements more readable which are:

- Applying materiality to improve the focus of the accounts
- Streamlining accounting policies
- Streamlining presentation and layout
- Streamlining the closure process
- Working papers and audit trail

The first of these is based on IFRS Practice Statement 2, working with the Code definition of users of accounts, and expressing the key content of the statement in user neutral or authority specific terms.

The section on Streamlining accounting policies also has some consideration of materiality.

Having reviewed these documents, I consider that the first part of 'Applying materiality to improve the focus of the accounts' is very similar to what I was hoping to produce.

The section on accounting policies might also be helpful, and it might be possible to further improve it, having regard to recent amendments to IAS 1 in *Disclosure of Accounting Policies - Amendments to IAS 1 and IFRS Practice Statement 2* issued February 2021, which changes the focus from 'significant policies' to 'material policy information' and provides explanation of what this entails.

An extract from *Streamlining the Accounts* is attached, setting out the relevant material, together with a diagram from the amended Practice Statement 2.

Questions for the working group

Does the group agree that this material is useful?

Would it be helpful to include material based on this in the Code, despite its non-mandatory status, perhaps as an Appendix.

Reactions from the working group

Members of the working group agreed that this material is useful, and emphasised their support for the publication *Streamlining the Accounts* developed by CIPFA with LAAP.

Some members of the group were not sure that much would be gained by adding this to the Code, given that it already exists in the *Streamlining* publication. It might instead be better to promote that document in the Code, with brief signposting to the relevant sections.

Questions for CIPFA LASAAC (IFRS Practice Statement 2 and related CIPFA guidance)

The working group agreed that the excerpted material from the publication *Streamlining the Accounts* was useful.

However, working group members were less clear whether providing such an extract in the Code would be beneficial, given that this material is already available. It might instead be better to promote that document in the Code, with brief signposting to the relevant sections.

Does CIPFA LASAAC agree that the material in this part of the paper is useful?

Would it be helpful to include material based on this in the Code, despite its non-mandatory status, perhaps as an Appendix?

Review of Fife Council streamlining

In line with the discussion between Gillian Woolman and Steven Cain on 11 May 2021, I have reviewed a note provided to Gillian by the Fife team, setting out the process they carried out to produce shorter, clearer financial statements.

My brief analysis of that note is attached.

I would be clear that this looks to be good work, especially given that it was done before the issue of the CIPFA document *Streamlining the Accounts*. I would also note that the 2018-19 and 2019-20 accounts also appear to be short and clear.

On the face of it, most of the explanation provided reflects other aspects of good practice than consideration of materiality. Those aspects which explicitly relate to materiality probably reflect the considerations which are now set out in Section 2 of *Streamlining the Accounts*.

This does not mean that materiality was not a factor in the streamlining process. The process of removing material will generally reflect a view that certain matters are less material and should be omitted, or expressed in less detail..

It may also be worth keeping Fife Council in mind if we are trying to develop public sector specific examples to support application of IFRS Practice Statement 2. Especially as we might be able to look at the 2016-17 financial statements to get a 'before and after' comparison. This sort of material might not be as clearly appropriate for the Code, but if not, might be incorporated into other work on e.g. streamlining.

Questions for the working group

Does the working group agree with this assessment?

Does the working group think that it would be worth discussing this project with members of the Fife team to establish the extent to which these judgments reflected on materiality, to consider whether any systematic issues were noted which might be usefully captured in guidance?

The group generally agreed with this assessment. However, it is not clear that it would be useful to engage with the Fife team given the period of time which has elapsed since the main streamlining exercise was undertaken.

Can particular types of disclosure be expected to be less material?

Disclosures which are required by standards will normally be potentially material for the entities or circumstances for which the standard is designed. Additionally, where standards or disclosures are clearly inapplicable or irrelevant to an entity, it will normally be straightforward to make no disclosure.

However, there can be types of disclosure which are technically applicable to all entities including local authorities, but where disclosures frequently convey no material information for local authorities (and sometimes for most entities). There can also be standards which potentially require extensive disclosures, and there is a risk that preparers populate the disclosures without consideration of whether the disclosure really provides relevant and material information.

Identifying local authority examples

Prima facie it would be worth engaging with local authorities which have recently carried out 'streamlining' projects, to see if and how their exercises identified unnecessary disclosures on materiality grounds in a systematic way. Particularly where these reflect consideration of the users of the financial statements, and the interests of particular types of user in the type of information provided by the various disclosures.

More general work being undertaken by the IASB

The IASB acknowledges the risks above, and is seeking to improve matters through its Disclosure Project

A key example of the first type is in relation to disclosure of accounting policies. The IASB hopes to ameliorate this through its recent amendment to IAS 1 and IFRS Practice Statement 2, by replacing the focus on 'significant accounting policies' with 'material policy information'

The IASB is also developing an approach to standard setting which might alleviate the second problem by using less 'prescriptive' language for its requirements, with a view to being clearer that the requirements only apply when material,

The IASB is currently consulting on its approach to disclosure, both generally and in IFRS 13 and IAS 19. It is seeking comments on Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* by 21 October 2021.

This document sets out proposals on standard setting, albeit framed as a pilot on specific standards.

The core idea set out in the paper is that standards will be written with disclosure objectives. IASB has discussed this before, and the purpose of this pilot is to see how it works in practice. The 'prescriptive language' which mandates application will only be used for the achievement of the objectives. That will allow a more descriptive approach to disclosures which might be expected under certain circumstances, and of course, subject to materiality.

The expectation is that this won't change the intended nature of standards, but will allow them to be applied more intelligently.

The consultation on the Exposure Draft will not be completed until later in the year, and it could be some time before amendments are made to IFRS 13 and IAS 19, and longer for other standards.

It may be possible to apply what appear to be sensible ideas in the ED in advance of formal IASB process, and in particular seek to reduce the use of 'prescriptive' language in the Code. To the extent that IASB have provided disclosure objectives they could be used.

CIPFA LASAAC might in some cases be able to develop more specific objectives for the local authority context.

Questions for the working group

Not provided because this paper was not fully developed at the time of discussion.

Questions for CIPFA LASAAC (Can particular types of disclosure be expected to be less material?)

Should we explore with this topic with Councils which have recently carried out streamlining projects

Should we seek to apply the 'less prescriptive language' approach in the development of the 23/24 Code, signalling this in the 22/23 ITC

SECTION 1: PURPOSE AND SCOPE OF THIS GUIDANCE

Key Aspects of the Approach to Streamlining the Financial Statements

This publication considers three aspects of streamlining the presentation of local authority financial statements

- Using materiality to avoid key messages of the financial statements being obscured by excessive detail – see section two
- Reviewing an authority's accounting policies so that only information which is important to readers of local authority financial statements is included - see section three, and
- Considering the presentation and layout of the financial statements and using streamlining techniques to help accounts preparers focus on the key messages of the financial statements, and techniques to help users navigate through the statements – see section four.

Responding to the Needs of Users of Financial Statements

One of the most important aspects of streamlining the financial statements is deciding who the primary users are and what information they need to be provided with. In the commercial world, companies can assume that they are presenting financial statements to investors, lenders and other creditors and focus on demonstrating how profits have been made and prospects for continued profitability. For local authority financial statements the users of the financial statements are more varied.

Section 2.1 of the Code explains that the primary users of local authority financial statements are service recipients (including local residents, workers and employers) and resource providers (including council tax payers). They also include elected representatives insofar as they act on behalf of service recipients and resource providers who cannot require local authorities to disclose the information they need. The characteristics and interests of these individuals will be different at each authority. Therefore the first steps in effective accounts preparation should be to:

- consider who the financial statements are being prepared for, based on the authority's own experience to date, and what decisions they might take

based on the information presented

- set aims and objectives for how this information will meet their needs
- use these aims and objectives to determine how to present the key messages of the financial statements to those users.

EXTRACT FROM SECTION 2 OF *STREAMLINING THE ACCOUNTS* (DECEMBER 2018)
– THIS MIGHT BE USABLE WITH FEW AMENDMENTS. FOR EXAMPLE BY TIDYING UP OR
REFRAMING REFERENCES TO THE CODE

SECTION 2 APPLYING MATERIALITY TO IMPROVE THE FOCUS OF THE ACCOUNTS

Introduction – What is Materiality?

An understanding of materiality is crucial to effective streamlining of the financial statements, particularly the recognition that materiality is often as much about what should be left out of the published accounts as it is about what should be included.

Paragraph 2.1.2.11 of the Code defines information as material

“...if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting authority ...”

This means that any consideration of materiality has to be based on a clear view of who the users of the financial statements are, the sort of decisions that they might take and the information they would need to support these decisions (see section one for more details on who local authority primary users are). Particularly for local government, relevant decisions can have political as well as economic dimensions and have a significant impact on local services and communities.

Materiality and Disclosures

Importantly, thought must be given to the information that readers will not need or, particularly, that would detract from the key messages of the accounts if it were included. Paragraph 3.4.2.27 of the Code says:

“A local authority need not provide a specific disclosure required by the Code if the information resulting from that disclosure is not material. This is the case even if the section of the Code or IFRS contains a list of specific requirements or describes them as minimum requirements. An authority shall also consider whether to provide additional disclosures when compliance with the specific requirements in another section of the Code or IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the authority’s financial position and financial performance.”

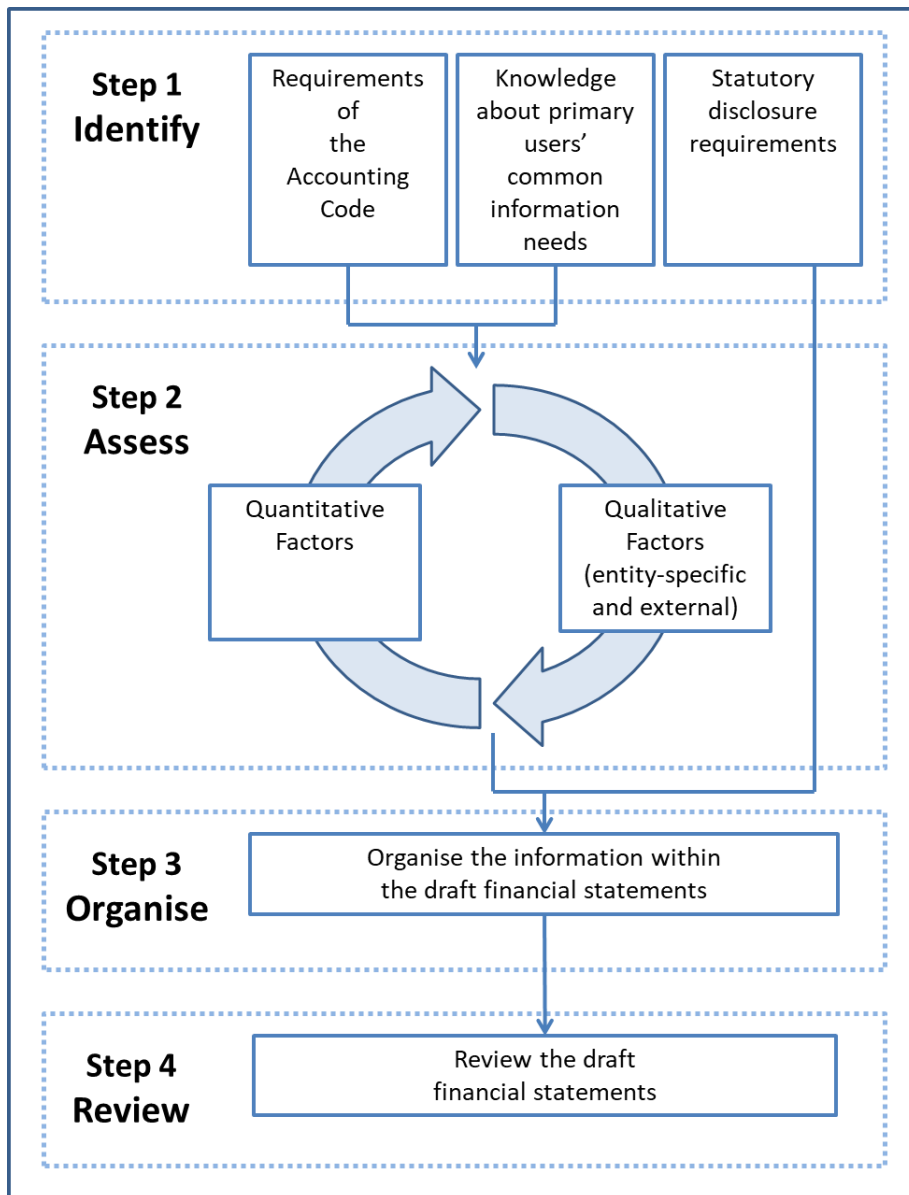
These considerations will be particular to each individual authority.

The considerations could also be particular to each disclosure that the Code requires an authority to make. This is because materiality does not depend solely on the magnitude of an item, but also on the particular context that it might provide for other disclosures in the accounts. For instance, the impairment loss allowance for an authority's deposits with financial institutions might be quantitatively immaterial but its disclosure would demonstrate the extent to which credit risk has been minimised in making the deposits.

However, even though individual cases might require individual judgement, authorities will wish to set up an overall framework to facilitate this work.

The Four Step Approach to Materiality

The International Accounting Standards Board's *Materiality Practice Statement* provides useful guidance on the arrangements that might be put in place. The following diagram summarises the IASB's four step process, adapted for local government circumstances:



The four Steps will involve the following considerations in local government:

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|----------------------------|--|
| <p>Step 1 Identify</p> | <p>The output of this Step is the identification of the potentially material information, through consideration of:</p> <ul style="list-style-type: none"> • the Code’s requirements that are relevant to the authority’s transactions, other events and conditions • any additional information necessary to enable users to understand the impact of the authority’s transactions, other events and conditions on the financial position, financial performance and cash flows. <p>The disclosures that are mandatory under statute should also be identified.</p> |
| <p>Step 2 Assess</p> | <p>The output of this Step is a preliminary set of material information.</p> <p>It is not appropriate to rely on purely numerical guidelines or to apply a uniform quantitative threshold for materiality. Stage 2 therefore involves the interplay of quantitative and qualitative factors to determine whether an item is material:</p> <ul style="list-style-type: none"> • set a quantitative threshold—a specified measure used in assessing size – above which items will be considered material • consider qualitative factors that would justify lowering the thresholds for particular items - the more significant the qualitative factors, the lower the quantitative thresholds might be (even down to zero). <p>The assessment of quantitative factors involves considering the size of the impact of transactions, other events or conditions against measures of the authority’s financial position, financial performance and cash flows. Judgement is needed in identifying the most appropriate measure(s) based on the interests of users, which could include:</p> <ul style="list-style-type: none"> • % of Surplus or Deficit on the Provision of Services • % of Movement on the General Fund Balance • % of Net Assets • % of Gross Income or Gross Expenditure. <p>Calculations based on the first two options are likely to lead to much lower materiality levels more appropriate for authorities with lower levels of General Fund and working balances.</p> |

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| | <p>Qualitative factors can be specific to an authority or external. Authority-specific considerations could include:</p> <ul style="list-style-type: none"> • local political interest in particular transactions, other events or conditions • uncommon or non-standard features of the authority’s business • unexpected variation or unexpected changes in trends. • <p>External considerations relate to the context in which the authority operates. For example, particular interest might currently focus on disclosures that demonstrate the level of an authority’s resilience or its commercialisation.</p> |
| <p>Step 3 Organise</p> | <p>The output of this Step is the draft accounts.</p> <p>The objective in organising the material information is to ensure that:</p> <ul style="list-style-type: none"> • material items that have different natures or functions are not inappropriately aggregated • material information is not obscured by an excessive amount of immaterial information • items of information are appropriately disclosed separately or aggregated with other information in the primary financial statements, or in the notes. <p>Particular tasks could be to:</p> <ul style="list-style-type: none"> • emphasise material matters • tailor information to the authority’s own circumstances • describe transactions, other events and conditions as simply and directly as possible without omitting material information and without unnecessarily increasing the length of the financial statements • highlight relationships between different pieces of information • provide information in the most appropriate format (eg, tables, narrative, etc) • maximise comparability between authorities and across reporting periods |

| | |
|--------------------------|--|
| | <ul style="list-style-type: none"> • avoid or minimise duplication of information in different parts of the financial statements. |
| <p>Step 4 Review</p> | <p>The main tasks in the Review Step will be to confirm:</p> <ul style="list-style-type: none"> • all relevant relationships between different items of information have been identified • the potential for items of information that are individually immaterial to be material when considered together <ul style="list-style-type: none"> • • communication is effective and understandable, and there is no obscuring of material information <ul style="list-style-type: none"> • • the financial statements provide a fair presentation of the authority's financial performance, financial position, and cash flows. <p>An important element of this step could be consideration of whether the Step 2 assessment was effective. As a result of re-performing Step 2, an authority might revise its decisions about information previously identified as material and remove it from the draft accounts.</p> |

When applying this guidance, authorities may want or need to set different materiality levels for different aspects of the financial statements, or to reflect levels of assessed risk – generally speaking higher risk items should have lower materiality levels.

EXTRACT FROM SECTION 3 OF *STREAMLINING THE ACCOUNTS* (DECEMBER 2018)
– SOME OF THIS RELATES TO MATERIALITY.

IT WOULD IN TIME NEED TO BE REFRAMED (AND WOULD PROBABLY BE IMPROVED) TO REFLECT AMENDMENTS TO IAS 1 AND IFRS PRACTICE STATEMENT 2 MADE IN FEBRUARY 2021 AND EFFECTIVE FROM 1 JANUARY 2023

AN ADDITIONAL EXTRACT FROM THE NEW AMENDMENTS TO IFRS PRACTICE STATEMENT 2 IS ATTACHED FOR INFORMATION

SECTION 3 ACCOUNTING POLICIES AND STREAMLINING

Introduction - What is the Purpose of Accounting Policies in the Financial Statements?

Before considering how to streamline the presentation of local authority accounting policies within the financial statements it is perhaps useful to consider their purpose. Accounting policies for local authorities are the specific principles, conventions, rules and practices applied by a local authority in preparing and presenting its financial statements.

They should:

- set out the basis for accounting ie that the authority complies with the Code and relevant statutory reporting requirements
- highlight any changes in accounting policies or other information compared to previous years (substantive changes which affect core statements and disclosure notes only, not just changes to the way accounting policies have been presented)
- set out how any discretion on accounting policy choices permitted by the Code have been exercised
- identify new accounting policies which have been adopted, for example, on the implementation of a new IFRS into the Code.

Accounting policies should focus on recognition, measurement and presentation in line with the requirements of Section 3.3 (Accounting Policies, Changes in Accounting Estimates and Errors) of the Code as follows:

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| Recognition | The process for recording a transaction in the Balance Sheet or |
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| | |
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| | the Comprehensive Income and Expenditure Statement. |
| Presentation | The process for effectively communicating information on assets, liabilities, income, expenditure and reserves in the financial statements and the disclosures. |
| Measurement | The quantification in monetary terms of the amounts at which assets, liabilities, income, expenditure and reserves are measured. |

Examples of common accounting policies in local authority financial statements are most likely to include:

- depreciation policies and estimated asset lives
- estimation methods used for complex provisions, service contracts, etc
- accounting treatments adopted for the recognition of assets for different types of local authority maintained school
- the valuation basis for material assets not being held at cost
- policies for income recognition
- accounting treatments adopted for reallocation of support services and overheads.

How to Assess which Accounting Policies are Significant

The Code requires that only **significant** accounting policies are disclosed. Paragraph 3.4.2.87 makes clear that authorities should decide for themselves which policies are significant, taking into account

“... whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position ...”.

The Code requirements mean that authorities need to assess significance for their

local circumstances, based on who their primary users are deemed to be and the information that will be of most help to them (see section 1). The Code assists local authority accounts preparers in their assessment by specifying in paragraph 2.1.2.20 that:

“... The financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently...”

The concept of materiality should also be applied to the inclusion of significant accounting policies in local authority financial statements. Accounting policies are not required for transactions and balances which are not material.

These assessments will also advise decisions about whether policies are best presented in a single consolidated note or can more usefully be hosted in the notes about the particular transactions and/or balances that they relate to.

When drafting the significant accounting policies for inclusion in the financial statements local authority accounts preparers should consider the following:

- the relevance of the policy to the local authority
- how the authority has applied the policy
- which choices have been made and why
- how this impact on the authority’s financial statements.

When reviewing or amending accounting policies, accounts preparers should be mindful of the need to keep an adequate audit trail and maintain a record of what has been changed and why.

EXTRACT FROM AMENDMENTS TO IFRS PRACTICE STATEMENT 2 (FEBRUARY 2021)

New paragraphs 88A to 88G of IFRS Practice Statement 2 *Making Materiality Judgements* reference the changed approach to accounting policies in IAS 8, and provides a helpful diagram shown below setting out how to determine whether accounting policy is material

DISCLOSURE OF ACCOUNTING POLICIES

Diagram 2 – determining whether accounting policy information is material

