ANNEX 2

EXPOSURE DRAFT – PROPOSED CHANGES TO THE 2021/22 CODE

OPTIONS CONSIDERED BY CIPFA/LASAAC THAT MIGHT EASE ACCOUNTS PREPARER AND ASSURANCE RESOURCE PRESSURES

The main options considered by CIPFA/LASAAC were as follows:

0. Making no changes to the Code
1. Changes to valuation approach (encompassing materiality considerations)
2. Suspending the requirement for group financial statements
3. Decoupling pension fund reporting from administering authority financial statements
4. Delaying the implementation of IFRS 16 (voluntary or mandatory)
5. Reducing disclosure requirements for pension fund assets in authority financial statements
6. Suspending or abating local government input to WGA
7. Non-publication of 2021/22 financial statements

More detail consideration of the advantages and disadvantages of each is provided for each option.

Option 0: Making no changes to the Code
Nature of approach This approach is included for completeness and recognising that it may be difficult to develop acceptable modifications to the Code.
Benefits of the approach Making no changes allows the Board to operate within its normal remit. The Board is not obligated to change the Code, and under normal circumstances would not contemplate making changes without extended analysis, a much longer consultation period and a clear conviction that the changes are in line with applicable standards, subject only to reasonable interpretations and adaptations that reflect the public sector environment. There are no unintended consequences particularly on the quality of financial statements or on transparency or accountability. There will be no requirement for an exit strategy from short-term pragmatic interventions.
Disadvantages/risks The key disadvantage of the ‘no changes’ approach is that it will do nothing to help resolve the current delays to audited financial statements. While the Board would prefer that reporting follows the 2021/22 Code as currently approved by CIPFA/LASAAC and agreed by FRAB, it is likely that the timeliness issues will get substantially worse. Delays in audit completion will have knock-on effects on both the accounts preparation process and subsequent audit. While the Code itself will represent a high standard for financial reporting, much of the benefit will be lost if financial statements are not prepared, published and audited, and this will also have knock-on effects for Whole of Government Accounts. These will damage the credibility of public sector financial reporting, and weaken the governance arrangements that are built around financial reporting.
Effect on IFRS compliance and auditor considerations Not applicable from the Code’s perspective, but there may be a considerable delay in production of IFRS-compliant audited financial statements.
Implications for WGA Not applicable.
Issues around mandatory requirements vs. voluntary adoption Not applicable.

Option 1: Changes to valuation approach (encompassing materiality considerations)
Nature of approach(es) a) DLUHC suggests that the Code might provide direction on materiality in relation to certain assets, setting out an expectation that uncertainty in relation to eg property, plant and equipment (PPE) valuation, while needing to be evaluated, should be expected to be less material. b) DLUHC suggests that revaluation of PPE should be 'paused' for two years, with an option to extend for a year. c) DLUHC suggests that PPE asset revaluation be carried out using indices determined by appropriate valuation experts. (Note that this would not be immediately relevant if b) above is activated.) In line with previous CIPFA/LASAAC discussions of materiality, this would apply only to operational PPE, for which category of assets the Code already applies a different public sector specific measurement basis of 'current value'. They would not apply to non-operational assets such as investment property or assets held for sale. The rationale for considering application to these assets is that the current value measurement basis is used because these assets are held for their service potential, and additionally that they are generally held on a long-term basis without view to resale. For this reason short-term fluctuations in the carrying value should not significantly affect decision making by any users of the financial statements. There is therefore a case for considering whether materiality should apply in a different way to these assets. CIPFA/LASAAC is however mindful that to be useful there would need to be a corresponding effect on audit work, whether through a consequential effect on the application of auditor materiality, or some other effect on testing of the measurement of these assets.
Benefits of these approaches If option a) (materiality) is achievable so that the Code directs preparers to use a larger materiality (having regard to the limited effect on user decisions and additionally that this effect on preparer materiality had a corresponding effect on auditor testing and evaluation), then this would reduce the workload for both preparers and auditors. Several CIPFA/LASAAC members consider that this would be the single most constructive approach, as long as it can actually be achieved Option b) (pausing revaluation) would reduce preparer effort and valuation costs. It would be expected to reduce auditor effort if the 'paused' treatment was taken to be the baseline being audited against, rather than introducing additional divergence from an IAS 16 measure based on 100% valuation. Option c) (indexation) could reduce the costs of measurement, particularly if a class of assets (or sub-class) is subject to increases in value due to supply costs. It might also reduce the level of auditor work required. If an indexation approach were adopted, appropriate indices should be applied by valuation experts in accordance with professional judgements. If a more simplified approach was used with less input from valuation experts or with a relatively wide application this might be problematic from an audit perspective.
Disadvantages/risks of Option 1a) Option 1a) (materiality) carries a risk that it might not be possible to justify a Code direction on materiality purely by reference to public sector specific considerations, or local authority specific considerations that are not problematic for WGA consolidation purposes. CIPFA/LASAAC considered analysis on this topic in June 2021 and rejected the proposals. That rejection was partly because of the interaction with auditor materiality, which is out of scope of the Code, but also reflected on the difficulty of determining all relevant user perspectives on this matter. Developing a legitimate and effective approach that works for preparers and auditors might not be possible, or

might require an extended discussion with auditors and audit regulators that is not achievable in the timescale.

Government has no locus in the determination of auditing standards, which are the responsibility of the heads of the audit agencies, and in practice follow ISAs (UK) subject to additional material set out in Practice Note 10: *Audit of financial statements of public sector bodies in the United Kingdom*. DLUHC and some auditor members of the Board reinforced the point that specific materiality levels applied to parts of the accounts can only be **less than but not more than** overall materiality. One CIPFA/LASAAC member noted that some years ago discussions had been undertaken with a view to starting with a higher materiality (which would, in practice apply to lower risk assets) and then reduced to a lower more stringent level for other areas (so that matters that directly impact on performance would be adequately covered).

On balance CIPFA/LASAAC secretariat see little prospect of making significant progress in this area solely through an accounts-based solution. However, board members were very keen to explore the possibility of auditors using something analogous to previous approaches using two different levels of materiality for assets and for expenditure. This would need to be progressed through auditing standards and related guidance rather than the Code. CIPFA is pursuing this with sector stakeholders, to see whether an approach can be developed that complies with ISAs (UK) and Practice Note 10.

Disadvantages/Risks of Options 1b) and 1c)

Option 1b) (pausing revaluation) has the effect of reducing the evidence obtained that PPE figures in financial statements are materially in line with the idealised measurement that would be obtained if all PPE were subject to valuation in year. It would be difficult to represent this as being an IFRS-compliant application of the valuation approach, even for a single accounting period, without argumentation to indicate that the effect is not expected to be material.

Pausing revaluation could also be effected through an accounting policy change to the cost basis, and taking current asset valuations as deemed cost. This would be out of line with general UK public sector use of the valuation approach, although CIPFA/LASAAC will be aware that the approach to asset valuation will be subject to a thematic review by HM Treasury. Moving to the (deemed) cost basis would also be unusual in that changes to accounting policies are normally made on the basis of improving the information provided, rather than to reflect preparer or auditor resource issues.

Some members of CIPFA/LASAAC have indicated that either approach to pausing revaluation would be problematic for auditors, and either not reduce audit effort, or require signposting in the auditor's report. It is not clear whether signposting would be as an emphasis of matter or a modification of the audit opinion.

Alternatively, pausing revaluation could be required through statutory direction by DLUHC. This would raise no issues around IFRS compliance but the nature of the change to the measurement basis would need to be adequately explained and properly justified to alleviate the risk that auditors might have concerns that the resulting reporting did not represent a true and fair view. CIPFA/LASAAC would therefore be concerned that the approach should be considered sufficiently rigorous and might support this through discussion of materiality.

Any change in this area would need to have regard to developing information on the HM Treasury thematic review. Consideration would also need to be given to how local authorities might transition back to a full IAS 16 valuation approach at the end of the 'pause'.

Option 1c) (indexation) has been raised as an issue in the past. If indexation is used in the valuation process appropriate indices should be applied by valuation experts in accordance with professional judgements. This could prima facie be carried out in a way that is fully consistent with the IAS 16 valuation approach. There would be a need to develop protocols on application, and to determine how this would be integrated with existing valuations of assets based on rolling revaluation.

If a more simplified approach used less sensitively applied indices, this is likely to be less clearly compliant with IAS 16 and/or problematic from an audit perspective. Such indexation could be imposed through statutory direction by DLUHC. This would eliminate issues around IFRS compliance. CIPFA/LASAAC would be concerned that any indices used would be the subject of advice from valuation experts and would clearly only be used as a temporary measure.

Audit issues might need statutory support, so that the thing being tested was the accuracy of the specified measurement approach, not its relationship to an IAS 16 valuation. Auditor members of the Board noted that the auditor has to determine both that the information is presented in accordance with the framework and that it achieves a true and fair view.

Effect on IFRS compliance and auditor considerations

As noted above,

- Option a) (materiality) would, if achievable, not seem to raise IFRS compliance issues if it can be done by reference to public sector specific considerations, or local authority specific considerations that are not problematic for WGA consolidation purposes.
- Option b) (pausing) might raise issues around IFRS compliance, which in turn could be problematic for audit. These might be alleviated through statutory direction.
- Option c) (indexation) could probably be consistent with an IAS 16 approach. However, a more radical and simplified approach that reduced the need for professional valuer input at individual local authorities might raise issues around IFRS compliance, which in turn could be problematic for audit. These could perhaps be alleviated through statutory direction.

Option a) raises no issues around returning to normal. In relation to option b) it should be noted that returning to full compliance with IAS 16 valuation approach in a single accounting period (rather than over the revaluation cycle) would probably need additional professional valuations to be carried out and additional audit review. In principle, option c) should require less effort to transition back to normal. These issues would potentially be alleviated if progress can be made on auditor materiality.

Implications for WGA

Adoption of approach b) would potentially create a misalignment with the overall accounting policies for WGA, although in the short term the quantum of difference to financial reporting may well not be material in WGA terms.

Issues around mandatory requirements vs. voluntary adoption

Option a) (materiality) would, if achievable through interpretation, introduce no additional requirements.

If an approach based on option b) (pausing) was developed, then implementation would require changes to procedures. While the revised approach might require fewer resources, some authorities might prefer to keep to existing well-established procedures, while having regard to the possible knock-on effects for their auditors. This might reduce the effectiveness of this approach in easing audit pressures in England.

Option c) (indexation) would require changes to procedures, and in the initial set up phase might require more work than existing approaches. Some authorities might prefer to keep to existing well-established procedures, while having regard to the possible knock-on effects for their auditors. This might reduce the effectiveness of this approach in easing audit pressures in England.

Option 2: Suspending the requirement for group financial statements
Nature of approach It was suggested that consideration be given to suspending the requirement for consolidation of local authority subsidiaries into group financial statements, instead providing additional information on related party transactions in local authority single entity financial statements.
Benefits of the approach This would reduce both preparer effort and auditor effort on the principal financial statements. However, much of the effort is around eliminations within the group, and this would still need to be carried out for WGA purposes.
Disadvantages/risks Having regard to material issues for some local authorities, this change would have an immediate impact on public accountability and transparency. CIPFA/LASAAC determined that this should therefore be considered only under the most difficult of circumstances. In contrast, for some authorities group aspects are not material and group accounts are already not published so this approach would have no beneficial effect Insofar as improvement or guidance would be helpful in this area, matters around this are to be considered and evaluated within the work of the CIPFA Financial Reporting Hub. Developing better guidance on this for 2021/22 might require more technical resources than are easily available. The Board is of the view that it would be risky to pursue this for 2021/22.
Effect on IFRS compliance and auditor considerations While individual entity statements would remain IFRS compliant, non-publication of group financial statements would be problematic where material. It is difficult to see how a public sector specific case could be developed to justify an adaptation or interpretation.
Implications for WGA There would be no direct implications unless there was a move not to provide elimination information to the WGA process.
Issues around mandatory requirements vs. voluntary adoption No special considerations. It should be noted that if local authorities choose to continue with their current reporting, there will be no reduction in audit effort.

Option 3: Decoupling pension fund reporting from administering authority financial statements
Nature of approach Removal from the Code of the regulatory requirement in England for the inclusion of pension fund accounts in the administering authority accounts.
Benefits of the approach This would reduce both preparer effort and auditor effort on the principal financial statements of administering authorities but might not significantly affect the overall quantum of work. Insofar as it affected the sequencing, this would probably benefit the pension fund financial statements rather than the principal financial statements. It would probably allow auditors to complete the audits of the pension fund financial statements more quickly, as these are currently delayed if the audit of the principal financial statements has not been completed. This matter has also been discussed as part of Streamlining the Accounts, where there would be some benefits.
Disadvantages/risks This is not in the gift of CIPFA/LASAAC. It is possible that primary legislation would be required. Arrangements in England would then align with those in Wales and Scotland. There would arguably be some reduction in transparency/accountability, but not unacceptably so, and in some ways it might make the accounts package more readable.
Effect on IFRS compliance and auditor considerations No effect.
Implications for WGA There would be no direct implications.
Issues around mandatory requirements vs. voluntary adoption If the requirement were removed, then it would seem natural for the Code to allow but not require administering local authorities to exclude these items. It should be noted that if administering authorities choose to continue with their current reporting, there will be no change in audit effort or publication.

Option 4: Delaying the implementation of IFRS 16 (voluntary or mandatory)
Nature of approach Further deferral of the implementation of IFRS 16. The proposal would be to not implement a new burden and thereby make resource pressures worse
Benefits of the approach Unlike other options this would affect the 2022/23 Code but could free up resources for 2021/22 as well as 2022/23. Deferring IFRS 16 implementation would probably reduce preparer effort on the principal financial statements, especially in local authorities that are not currently well prepared for transition. It would also probably reduce auditor effort verifying the transition. Some CIPFA/LASAAC members see this as a more significant matter than preparer issues which at their authority are considered fully in hand. CIPFA surveys of 109 attendees of the local authority accounting conference suggest that 38% were ‘confident/quite confident’ about IFRS 16 implementation. 53% were uncertain or not confident; 8% indicated that they did not know.
Disadvantages/risks For authorities that are well prepared, deferring IFRS 16 might create some additional work if procedures needed to be rolled back to IAS 17. There are also credibility/reputational issues for the sector and for CIPFA/LASAAC if IFRS 16 is deferred for another year.
Effect on IFRS compliance and auditor considerations Mandatory deferral for England would affect IFRS compliance in the same way as other deferrals that allow early adoption. While undesirable, it is within approaches used by CIPFA/LASAAC. Consideration would need to be given to the period of deferral.
Implications for WGA There would be direct implications for WGA as this would result in the local government sector accounting policies being out of line with group policies. The short-term effect on the WGA balance sheet would be difficult to assess. The effect on WGA would be reduced (possibly to acceptable levels) if deferral was not applied to larger authorities as noted in the next section. A suggestion from one CIPFA/LASAAC member was that financial statements should be prepared and audited on an IAS 17 basis, but that WGA adjustments should be prepared on an IFRS 16 basis, which would not be subject to audit. Other board members noted that, while this would reduce immediate pressures, the overall quantum of work to get to a fully audited position would be increased.
Issues around mandatory requirements vs. voluntary adoption No special considerations, but a voluntary adoption approach would allow accounts preparers who are well progressed to avoid losing the benefit of work already done. It should be noted that for local authorities that choose to continue with their planned implementation, there will be no reduction in audit effort. Another approach would be to mandate implementation of IFRS 16 for larger authorities, which:

a) have larger finance teams so might be expected to be better prepared

b) may have larger audit teams that are better equipped to do this work

c) will be more significant from the perspective of WGA.

Option 5: Reducing disclosure requirements for pension fund assets in authority financial statements
Nature of approach It has been suggested that disclosure requirements for pension fund assets in local authority financial statements could be reduced and replaced by a cross-reference to pension fund financial statements, which provide this information.
Benefits of the approach This would reduce both preparer effort and auditor effort on the principal financial statements.
Disadvantages/risks Some loss of accountability and transparency, although some argue that inclusion of these items adds clutter to the financial statements while not improving reader understanding. (Disclosures on fund assets are of course crucial in the pension fund statements.)
Effect on IFRS compliance and auditor considerations This would result in non-compliance with the letter of IFRS, which could not be excused on the basis of the materiality of the amounts involved. However, it would perhaps be possible to develop an interpretation based on a view that these disclosures are duplicated in other financial statements which are publicly available and could be referenced from the local authority financial statements, and are not substantially relevant to the decision making of the local authority, which is mainly informed by the bottom line and overall picture of pension reporting.
Implications for WGA There would be no direct implications.
Issues around mandatory requirements vs. voluntary adoption No special considerations. It should be noted that if authorities choose to continue with their current reporting, there will be no reduction in audit effort.

Option 6: Suspending or abating local government input to WGA
Nature of approach The suggestion was made that consideration be given to suspending local government input to WGA for 2021/22 It was noted that the WGA process is already extremely delayed. Specifying a substantial lengthening of the deadline for local government input would give more time for auditors to get the underlying financial statements audits completed.
Benefits of the approach This would reduce preparer effort and auditor effort, freeing up resources for the principal financial statements.
Disadvantages/risks This is not in the gift of CIPFA/LASAAC. It would also reduce accountability and transparency at the WGA level. While WGA could be prepared based on previous year figures for local government and other estimates reflecting eg grant flows from central government, it would be difficult to obtain assurance that WGA were not materially misstated. Additionally, whether WGA input was suspended for 2021/22 as a permanent omission or as a delay, there would be later resource inefficiencies for both preparers and auditors when recovering the position.
Effect on IFRS compliance and auditor considerations Obviously problematic from a WGA perspective.
Implications for WGA Obviously problematic from a WGA perspective. Any approach based on WGA adjustments would need to be agreed with HM Treasury and the WGA team.
Issues around mandatory requirements vs. voluntary adoption No special considerations. It should be noted that if authorities choose to continue with their current reporting, there will be no reduction in audit effort.

Option 7: Non-publication of 2021/22 financial statements
Nature of approach It has been suggested that consideration be given to suspending local government requirements to publish financial statements for 2021/22 and there should be no requirement to have them audited.
Benefits of the approach This would reduce both preparer effort and auditor effort although it is difficult to perceive of this as being implemented other than as a 'pause', which would have to be caught up with at some future date, and this would require additional work. CIPFA/LASAAC agrees that this would clearly have a massive effect on resource requirements.
Disadvantages/risks This is not in the gift of CIPFA/LASAAC and supporting it may pose reputational risks. CIPFA/LASAAC notes that it would clearly have a significant effect on financial reporting. It would massively reduce accountability and transparency at the authority level and would have corresponding effects on the reputation of the sector. It would also pose significant issues around recovering the position: there would clearly be a need to recover the position at a later stage, but by that time both preparers and auditors might face significant verification issues.
Effect on IFRS compliance and auditor considerations Substantially problematic.
Implications for WGA Obviously problematic from a WGA perspective and likely to lead to significant qualifications.
Issues around mandatory requirements vs. voluntary adoption No special considerations. It should be noted that if authorities choose to continue with their current reporting, there will be no reduction in audit effort.