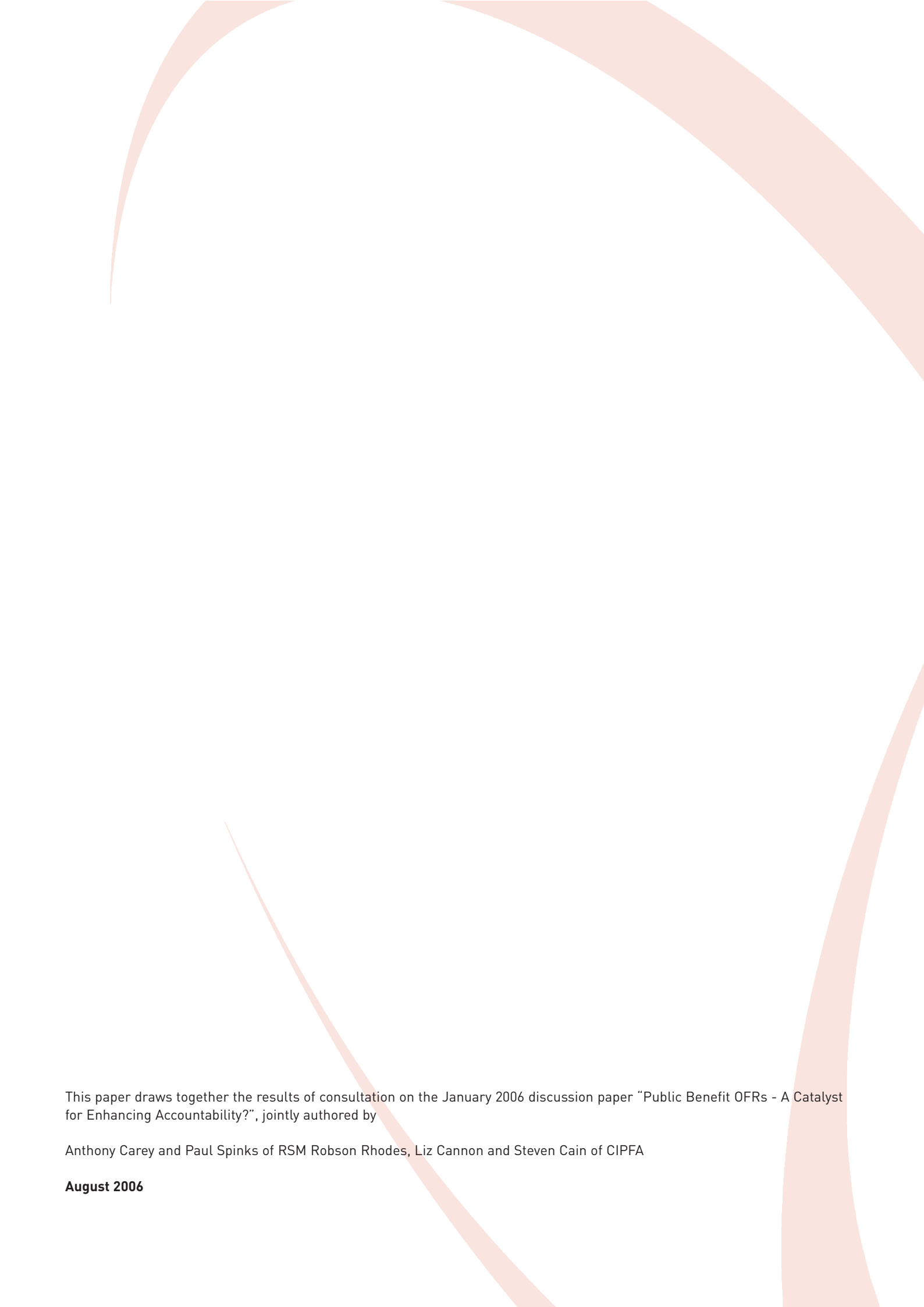


Public Benefit OFRs

A catalyst for enhancing
accountability?

KEY MESSAGES FROM
CONSULTATION



This paper draws together the results of consultation on the January 2006 discussion paper “Public Benefit OFRs - A Catalyst for Enhancing Accountability?”, jointly authored by

Anthony Carey and Paul Spinks of RSM Robson Rhodes, Liz Cannon and Steven Cain of CIPFA

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In January 2006, CIPFA and RSM Robson Rhodes issued “Public Benefit OFRs – A catalyst for enhancing accountability?”, aiming to provoke discussion and debate on optimising narrative reporting in the public benefit sector. This was circulated to finance practitioners across the various public benefit sectors, and to auditors and consultants in those sectors.

To further stimulate discussion, a round table event was held on 31 March 2006, to which representatives of all public benefit sectors were invited, and presentations were made by speakers from the Financial Reporting Council, HM Treasury, and the CIPFA/ LASAAC Joint Committee on local government accounting

This paper sets out the key messages from the consultation, highlighting the main points made in written responses and at the Round Table discussion event.

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1 RESPONSES TO CONSULTATION

1.1 Commentators

A large number of comments were received as follows

Commentator	Organisation	Main sector interest
Andrew T Scott	British Trust for Ornithology	Charity
Barbara Bampton	The Mother's Union	Charity
—	Charity Commission	Charity / wider
—	British Universities Finance Director Group (BUFDG)	Further and Higher Education
Martin Smith	Runshaw College	Further and Higher Education
Nick Gibbins	Hampshire CC	Local authorities
Tim Day	Consultant	Local authorities
—	Society of County Treasurers	Local authorities
Mary Hawkins	Warwick DC	Local authorities
Michael Price	Humberside Fire Authority	Local authorities / Fire
Ronald Potts	South Tyneside	Local authorities / Housing
—	Police Authority Treasurer's Society	Local authorities / Police
Thomas Whiffen	Hampshire CC	Local authorities / Schools
—	Northern Ireland Local Government Association	Local authority/ N Ireland
—	Local Authorities Scotland Accounts Advisory Committee (LASAAC)	Local authority / Scotland
—	Audit Commission	Pan sector / England
—	National Audit Office	Pan sector / England and UK
—	Wales Audit Office	Pan sector / Wales
—	The Institute of Chartered Accounts of Scotland (ICAS)*	Pan sector / Scotland
Russell Frith	Audit Scotland	Pan sector / Scotland
Michael Heekin	Glasgow HA	RSL sector
Mike Wiffen	Barnet Homes	RSL sector

* The ICAS response also included a report of their consultation "Accounting for Public Service – towards a new reporting framework" (December 2003).

1.2 General Responses

- 1.2.1 Many responses, both written and at the Round Table event, suggested that the rationale for narrative reporting in the private sector is not directly comparable with the public benefit sector. While the private sector OFR improves reporting to a wide range of stakeholders, this is in part a side-effect of reporting which mainly serves the interests of the funders and financial supporters of the company. By contrast, in the public sector there is an intrinsic interest in public accountability as part of the democratic process, and in the wider public benefit sector there is seen to be a need to engage directly with donors, beneficiaries and other stakeholders.
- 1.2.2 As a result of this longstanding interest in accountability, those public benefit entities which do not already produce OFRs (and some of those which do) are already required to make additional reports to regulators, which contain information of a similar nature to that which might be included in a public benefit OFR.
- 1.2.3 Several commentators suggested that the key problems for public benefit financial reporting were providing a clear message in the face of information overload, and engaging the interest of appropriate stakeholders.
- 1.2.4 More detailed discussion follows, but the two key messages from the consultation and discussions are set out below.

There is substantial support for the principle of improved narrative reporting for public benefit entities.

However, the way forward needs to be determined in the light of existing requirements so that an undue reporting burden is avoided. In some sectors the Public Benefit OFR may provide an opportunity to streamline reporting rather than add to it.

Users of OFRs should generally be drawn more widely than funders and financial supporters.

Consideration should be given to other stakeholders such as service users. However, in some sectors a narrower view of key users may be appropriate.

- 1.2.5 Other overall important messages from the consultation are that
- Sector specific guidance is desirable, and considered essential by some
 - Entity specific KPIs should be allowed and encouraged
 - Politics and 'spin' need to be carefully handled
 - The OFR model is not the only way to improve financial reporting

1.3 Responses to specific questions

1) Support for the principle of an OFR

Should public benefit entities generally be required to publish an OFR broadly in line with the requirements of RS1? If you agree, will this lead to a significant improvement in reporting by public benefit entities? Do you believe the recent decision not to introduce a statutory OFR for quoted companies will have an impact on support for the OFR in the public sector? Should charities be called on to include an OFR in their annual reports or are the relevant provisions in the 2005 Charities SORP adequate?

Almost all respondents strongly agreed with the principle that financial reporting should be improved, and that something along the lines of an Operating and Financial Review would be beneficial.

However, the vast majority of responses indicated that any new reporting requirement could only be progressed if the whole package of existing reporting is reviewed and streamlined. Some respondents suggested that any guidance would need to be voluntary rather than mandatory, and that there are other approaches to improving reporting, such as Best Value plans and summarised financial statements. Several local authority respondents suggested that reporting would be best served by incorporating OFR style disclosures in an Annual Report or other document.

Only one respondent was of the view that Public Benefit OFRs would not be beneficial, suggesting that the disclosures currently adopted in the Charity sector would be a better model for the Further and Higher Education Sector.
(A number of responses pointed out that some sectors and bodies already produce OFRs, reducing the scope for 'improvement').

Most respondents declined to comment on the withdrawal of the statutory requirement for an OFR in the private sector. Some saw private sector regulation as largely irrelevant to the determination of good practice in the public benefit sector, while others suggested that the government turnaround reflected difficulties inherent in imposing mandatory reporting requirements.

Charity respondents urged against mandating an OFR for charities so soon after the 2005 SORP revision. Other commentators including the Charity Commission suggested that in the longer term there is scope for developing charity reporting along OFR lines, as long as this is developed in consultation with charity preparers.

2) Size thresholds

In sectors where an OFR will be required to be prepared, should there be a size threshold exempting smaller entities? Should this just apply to public benefit entities such as housing associations and smaller educational institutions or should it also be available within the public sector itself, eg smaller health trusts and local authorities?

There was general agreement that smaller entities should not be exposed to disproportionate reporting burdens, although some commentators suggested that the existing guidance already provides for reduced disclosure. Some responses suggested that additional guidance on reduced disclosure would be helpful.

A variety of approaches to full exemption were proposed, including the general suggestion that compliance should be voluntary. The most supported approach was to adopt size thresholds, but proposals also included exemption by regulators on a case by case basis, and exemption based on a cost-benefit assessment.

The predominant theme of the responses was that this was a question that should be considered separately for different sectors.

3) Sector-specific guidance

Is additional sector-specific guidance needed in respect of local authorities and educational institutions to enable them to apply the OFR in a manner appropriate to their respective sectors and to ensure comparability in disclosure across the sector? If so, who should develop the guidance? Has sufficient guidance been published for the health and central government sectors and for RSLs?

There was overwhelming support for sector specific guidance for certain sectors. There were a variety of suggestions that guidance might be produced by SORP setters (and by analogy, the government bodies which approve the various versions of the FReM) or regulators.

In most cases there was a strong concern that the consultation should involve and be targeted at stakeholders drawn more widely than normal SORP consultations. There were also suggestions that Health guidance should be revisited in the light of experience in other sectors.

4) Implications for current reporting arrangements

How will the OFR dovetail with the current reporting arrangements in the various sectors (eg departmental reports and autumn performance reports for central government departments)? Are there any other changes that it would be helpful to introduce in particular sectors, for example, in relation to the reporting cycle, that would enhance the overall quality of reporting and enable OFRs to be published whilst minimising any duplication of disclosures?

Few responses focussed on timetabling issues for OFR and other reporting. The main concern, particularly in the local government and education areas is that there is already a significant burden of reporting to regulators.

The majority of responses to this question suggested that

- a review of reporting arrangements is necessary to eliminate duplication; or
- OFR requirements should be progressed through existing reporting initiatives (such as the Improvement Plans produced by Welsh local authorities).

Many of the responses saw the introduction of OFR reporting requirements as an *opportunity* to streamline and thereby improve reporting.

5) General guidance

In addition to any further sector-specific guidance, is there a need for any additional general guidance on OFRs which would cover all public benefit entities? If so, what issues should be addressed? Who should prepare the guidance?

There were mixed views as to whether general guidance would be beneficial, partly reflecting the fact that some respondents considered that it would be best for each sector to have a single set of comprehensive guidance.

Some suggested that generic guidance could be given in line with the proposed interpretation of the Statement of Principles for public benefit entities, and that this might be produced by CIPFA or by the ASB Committee on Accounting for Public Benefit Entities (CAPE). There was also a suggestion that the Environment Agency should produce guidance on environmental issues.

6) Principal users of OFRs

Who should be the defining class of users of OFRs in public benefit entities? If 'funders and financial supporters' how should this be defined in particular sectors? Does any special account need to be taken of service users?

Only two responses considered that "funders and financial supporters" provided a sufficient defining class of users for public benefit OFR reporting. Nine responses took the contrasting view that it would be appropriate to explicitly consider a wider stakeholder group, in many instances including the needs of service users, or beneficiaries.

7) KPIs and external assessments

What are the KPIs that you think should be disclosed in OFRs in particular sectors? Are there any additional assurance measures that should be applied to KPIs? Should entity-specific KPIs be allowed as well? Should guidance be provided on how external inspection reports should be discussed in OFRs?

The main focus of responses was to refer to already existing KPIs or measures developed for particular sectors.

There was also strong support for the use of entity specific measures, especially for entities which perform very specific functions.

Most commentators considered that there was a need to obtain assurance for KPIs and that auditors would be best placed to provide such assurances. One response suggested that quality control regimes such as ISO 9000 could provide sufficient assurance without the need for audit.

8) Other issues

Are there any issues relating to the publication of OFRs by public benefit entities that have not been covered in this discussion paper? Do you have any further comments on the matters raised in this paper?

While there was substantial agreement that the discussion paper had addressed most of the key issues, a number of responses raised further issues, or provided further comment on matters not addressed in the specific questions for comment, as follows:

- (a) Consideration should be given to the substantial differences in the operation of government in the devolved administrations, where even apparently similar initiatives such as Best Value (or Improvement Plans in Wales) operate differently and with different levels of success and credibility.
- (b) In particular, a prescriptive approach to reporting of outcomes would not sit well in Scotland, where legislation sets out a statutory requirement to report, coupled with a presumption of flexibility as to the form of reporting.
- (c) Narrative reporting must include safeguards against political manipulation and 'spin'. Commentators suggested that safeguards could be built in through the assurance process, and by limiting the scope of 'forward looking' pronouncements. One response suggested that local government OFRs should separately report the views of political appointees, and those of management.
- (d) Some responses also discussed the need to develop guidance on the scope for legitimate non-disclosures (for example, where this might adversely affect the competitiveness of income generating activities).
- (e) Some responses expressed residual concerns that ASB guidance, drafted primarily for a private sector audience, would need considerable adaptation to be useful for public benefit entities.
- (f) One response suggested that "Operating and Financial Review" was not a helpful title for public benefit narrative reports.
- (g) One response emphasised the need for any further development to be carried out with due regard for other external initiatives, trialling proposals before requiring more general application.

1.4 Round Table Discussion

1.4.1 To provide additional and more immediate discussion of the points raised in the CIPFA / RSM Robson Rhodes discussion paper, a Round Table discussion event was held on 31 March 2006. Presentations were given by Ian Mackintosh, (Chairman, Accounting Standards Board), David Watkins (HM Treasury) and Nick Bennett (Chairman, CIPFA/ LASAAC joint committee). Attendees included practitioners, auditors and regulators involved in central and local government, police, education, social housing and charity sectors.

1.4.2 The ASB presentation

- explained that the focus on company 'members' reflected legal concerns and was narrower than originally proposed
- expressed support for the CIPFA initiative
- noted that the Accounting Standards Board would be interested in helping with further developments

1.4.3 The HM Treasury presentation noted that

- central government and health sectors already produce OFRs
- from 2005-06 an OFR (renamed Management Commentary for central government departments) would be produced in line with the ASB Reporting Statement
- planned government initiatives will link the OFR to Spring Departmental Reports, which may improve the 'forward look'
- from 2006-07, a comparison of budget and outturn will be included
- guidance on sustainability reporting has been produced and is available online from the FReM website

1.4.4 The CIPFA/LASAAC presentation

- welcomed developments in narrative reporting
- stressed that flexibility was important, and that a variety of approaches could be taken to improving the usefulness of financial reporting to stakeholders
- reinforced the point that a variety of approaches were being undertaken in Scotland, and that this flexibility was embedded in relevant Scottish legislation

1.4.5 Most of the points made in written responses to the consultation were reinforced at the Round Table. Particular stress was given to the need to work within the context of existing initiatives to avoid an overload on accounts preparers. There was also a more thorough discussion of differences in the operation of government across the devolved administrations.

Political bias and spin

1.4.6 In discussions relating to the avoidance of political bias and 'spin', it was agreed that while no approach would be entirely proof against bias, a workable framework could probably be achieved through the efforts of accounts preparers and auditors, together with a recognition that the readers of financial reports already have an awareness of the risk of bias. A related discussion emphasised the need for any guidance to promote selective reporting of key issues, to reduce the risk that 'bad news' be concealed within overlong documents that were difficult to read.

KPIs

- 1.4.7 In discussions of RSL and Further and Higher Education sectors, there was a view that existing reporting was of variable utility, and that narrative disclosures and KPIs provide an opportunity to improve readability and comparability. However, it was noted that these sectors were already required to produce OFRs. Additional guidance on standardised KPIs might assist comparability, although there were some suggestions that the different objectives pursued by different educational institutions would make it difficult to develop outcome measures that were applicable across the sector. It was suggested that a range of standard KPIs be produced, from which relevant measures could be chosen, but there was some disagreement as to whether such an approach would be workable.

Users of public benefit OFRs

- 1.4.8 Perhaps the area in which discussions added most to the points raised in written responses was in the discussion of the users/readers of public benefit OFRs. All were clear that it was desirable to engage citizens in the affairs of government, as part of the democratic process. However, achieving such engagement was seen to be becoming more and more difficult. In central government the view was taken that MPs act to some extent as proxies for voters and citizens in the examination of resource accounts. However, this was not seen as a model with a workable parallel in local government, and the degree of interest in local authority financial statements was considered to be low. A particular problem was seen to be the multiplicity of services provided by local government, so that financial statements are more difficult to understand, and it is correspondingly more difficult to produce simple and understandable explanatory narrative. Recent initiatives to increase engagement with local government have mainly focussed on less detailed and more service specific reporting, particularly in Scotland which has pioneered the use of summary financial statements in local government.
- 1.4.9 In contrast, while engagement with wider stakeholders such as tenants and students was considered desirable in the RSL and Further and Higher Education areas, it was not considered so critical that this be done as part of financial reporting. A workable approach might therefore be to focus on the needs of regulators, who are normally funders or financial supporters.
- 1.4.10 In the charity sector, there is a longstanding tradition of wider accountability. Charities which support disadvantaged groups and individuals are keen to make their reports accessible to charity beneficiaries, and many charities consider that they have a duty to seek wider engagement with their local community or, in some cases, with society generally. Current charity reporting requirements have evolved with this inclusiveness in mind, and any improvements resulting from OFR disclosures would be expected to preserve this approach.

2 SUMMARY AND WAY FORWARD

- 2.1.1 CIPFA and RSM Robson Rhodes were very pleased to be the recipients of the substantial and well considered responses generated by this consultation, together with a thoughtful and wide ranging discussion at the 31 March 2006 Round Table event.
- 2.1.2 In some respects, the response to the consultation was very clear. There was strong support for improved reporting to supplement that provided by financial statements, and the OFR provides a very useful model in that respect. Also, the appropriate audience for such reporting is generally considered to be a wider stakeholder group than 'funders and financial supporters', a finding which is consistent with earlier CIPFA comments on the ASB exposure draft 'Statement of Principles for Financial Reporting: Proposed Interpretation for Public Benefit Entities'.
- 2.1.3 However, in other respects, the responses to consultation were less straightforward. It was clear that the OFR model was not considered the only viable approach to improving reporting. For example, in the Scottish jurisdiction, a prescriptive approach to narrative reporting might not be well received, and could conflict with the intent of established legislation. The consultation also reinforced the point that the backdrop of existing reporting requirements is a key consideration for those public benefit sectors which do not currently produce OFRs: there was substantial support for using the OFR as a tool to streamline the reporting burden, rather than adding to it.
- 2.1.4 CIPFA and RSM Robson Rhodes remain convinced that the OFR model is a useful one. We believe that this will become increasingly clear as OFRs and management commentaries are produced, either on a mandatory or a voluntary basis. We therefore propose, over the next few months, to undertake an exercise to monitor developments in this area, and to seek out good practice in public benefit narrative reporting. We will also compare the best examples with existing regulatory disclosures, and consider whether public benefit OFRs might provide an opportunity to *streamline* and thereby improve accountability.

The Chartered Institute of
Public Finance and Accountancy
Registered with the Charity
Commissioners of England and Wales No. 231060

Registered office:
3 Robert Street
London WC2N 6RL
Tel: 020 7543 5600
Fax: 020 7543 5700

www.cipfa.org.uk



RSM Robson Rhodes LLP

Registered office:
186 City Road
London EC1V 2NU
Tel: 020 7251 1644
Fax: 020 7250 0801

www.rsmi.co.uk

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