

## IFRS Code of Practice on Local Authority Accounting

### First Principles Review of Format of Accounts

#### Discussion Paper – Users of the Accounts

#### 1 INTRODUCTION

- 1.1 In their document “Statement of Principles - Interpretation for Public Benefit Entities” (June 2007), the ASB states:

“The objective of financial statements is to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity's management and for making economic decisions.”

- 1.2 It follows that any discussion about the format of the accounts must begin by defining the users for whom the accounts should provide useful information.
- 1.3 This paper considers the classes of user identified in the IASB “Framework for the Preparation and Presentation of Financial Statements” and the ASB Interpretation referred to above, and discusses their information needs in the context of local authority accounting.

#### 2 IDENTIFICATION OF USERS

- 2.1 In its “Preface to International Financial Reporting Standards”, the IASB states:

“IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities.”

- 2.2 It follows that the users identified in the IASB Framework above will be appropriate users of the accounts of profit-oriented entities, and may need interpreted for the local authority context. The ASB Interpretation is designed to interpret its Statement of Principles (which is consistent with the IASB Framework) for public benefit entities, and therefore is useful in determining the users of local authority accounts.
- 2.3 The Interpretation concludes that all users of the accounts will use financial statements to inform economic decisions, either directly or indirectly.
- 2.4 Because the Interpretation is generic rather than specific to local authorities, it provides a starting point for considering the relevant users rather than a definitive list of users and their needs.

#### 3 CLASSES OF USERS

- 3.1 The following paragraphs discuss the classes of users and their information needs identified in the IASB Framework, taking into account the ASB Interpretation and the local authority context.

#### 3.2 Investors / Funders and Financial Supporters

The IASB Framework defines investors as the providers of risk capital, who need information to make decisions as to whether to buy, hold or sell. The Framework states that financial statements that meet the needs of investors will also meet most of the needs of other users.

The ASB Interpretation recognises that public benefit entities rarely have such investors, and defines as an alternative class of user “funders and financial supporters”. These are the users who provide the resources for the public benefit entity. The definition includes two distinct sub groups, those who make a conscious decision to provide resources (financial supporters) and those who do not, such as tax payers (funders). Neither funders nor financial supporters will see a direct return on the resources they provide, although they may receive benefits indirectly. In this sense, the provision of resources by funders and financial supporters is a non-exchange transaction.

Funders and financial supporters are referred to in the Interpretation as the defining class of user for the financial statements of public benefit entities.

Funders and financial supporters use financial statements to inform economic decisions. This may include decisions about the level of resources to be provided to an entity (including whether to commence or cease providing resources). Whilst taxpayers cannot directly make economic decisions, they may have the right to vote, which could indirectly impact on the level of resources available to an entity.

In the local authority context, the main funders are Council Tax payers, and the main financial supporters are government departments. As the Interpretation recognises, these users will be primarily interested in a local authority's stewardship of the resources provided by funders and financial supporters. They will also have an interest in ensuring that the authority is acting in a prudent manner, so that services can be maintained from year to year.

Government departments may have more specific information needs than Council Tax payers. However, departments have the ability to require returns (specific purpose financial statements) from authorities and as such are less dependent on the published accounts for their information. Indeed, whilst the information provided to departments is often the same as that included in the accounts, the departments do not request (or receive) the published Statement of Accounts.

The information needs of funders and financial supporters will therefore best be met by considering the needs of Council Tax payers, whilst ensuring that the accounts operate on a basis consistent with the information needs of departments to avoid any dual reporting requirements.

Both the Interpretation and the Framework recognise that users may need to supplement the information in financial statements with other information (e.g. performance information, such as Comprehensive Performance Assessment scores). Financial Statements should therefore concentrate on providing the financial information that will be of use to Council Tax payers.

Council Tax payers are likely to be most interested in whether an authority has under or over spent against its budget (or increased or decreased the level of its General Fund) as this is likely to provide an indication of whether an authority is likely to need to increase Council Tax or reduce services in future to recover a fall in General Fund balances. They will also be interested in how scarce resources are allocated to competing priorities.

Information about assets, liabilities, reserve balances etc. will also provide useful information regarding an authority's ability to provide services, and the cost of providing those services, in the medium to longer term.

In local authorities, Council Tax payers interests are often (but not always) represented by members. This should be borne in mind when considering the financial statements, although the fact that members are in a position to request

additional information, or specific purpose financial statements, should also be taken into account.

### 3.3 Employees

The Framework states that employees will be interested in the stability and profitability of their employer, as this will determine the likelihood of job security and additional employment. In local authorities, employees will be interested in the stability and ability of the authority to continue to provide services, as this is what will determine job security and additional employment. The public sector ethos present in local authorities means that employees will also be interested in the ability of the authority to continue to provide services because of the impact on beneficiaries. These needs will be met by providing similar information to that required by funders and financial supporters – i.e. concentrating on the ability of the authority to continue to provide the existing level of services in the future.

The interests of employees will often be represented by unions and other such bodies.

### 3.4 Lenders

Lenders are interested in whether their loans and related interest will be repaid, as is recognised by both the Framework and the Interpretation. As authorities borrow mainly from the Public Works Loan Board, this class of user is of lesser importance for most authorities than would be the case for a commercial enterprise. Local authorities' status as part of general government may also mean that commercial lenders are less dependent on the published accounts when deciding whether to lend money to a local authority.

Lenders will be interested in the level of resources available to repay loans. As such, the level of assets will be a significant factor. The financial performance of the authority will also be of interest, as this could influence the level of resources that have to be applied to other purposes.

### 3.5 Suppliers and other Trade Creditors

Suppliers and trade creditors are interested in whether amounts due to them are likely to be paid, as recognised by the Framework. The Framework also recognises that unless the suppliers have a long term relationship with the authority, their interest is likely to be over a shorter period than lenders, although in other respects their information needs are likely to be the same. In a similar manner as for lenders, the nature of local authorities may be a more significant factor when deciding whether to provide goods and services than the published accounts.

Suppliers and other Trade Creditors will be interested in the level of resources available to pay the amounts due. Consequently, the level of assets (especially liquid assets such as cash) will be a significant factor.

### 3.6 Customers / Beneficiaries

The Framework states that customers have an interest in the continuance of an entity, especially where they have a long term relationship with, or are dependent on the entity. The Interpretation refers to beneficiaries as well as customers, as for public benefit entities services will often be provided without charge, and there may be no choice as to the provider of those services. For both beneficiaries and customers, the main concern will be whether an authority will be able to continue to provide the existing level of services (and in the case of customers or beneficiaries who are required to make a contribution, at what

cost). These users will therefore seek information on an authority's financial performance against budget, as this will impact on the level of resources available for services in future.

Information about assets, liabilities, reserve balances etc. will also provide useful information regarding an authority's ability to provide services, and the cost of providing those services, in the medium to longer term. Customers and beneficiaries will also be interested in the allocation of scarce resources to competing priorities, as changes in this area could affect the availability or cost of services in which they have an interest.

A particularly important group of customers and beneficiaries within local authorities is council house tenants. They will have similar interests to other customers and beneficiaries, but because of the ring-fenced nature of the HRA, they will be interested in the financial performance of this account in isolation, as well as the overall financial performance of the authority.

Customers and beneficiaries are likely to be the second most important group of users when considering the financial statements of local authorities, after funders and financial supporters. The information needs of the two groups is likely to be similar, and there is likely to be a significant overlap between the two groups.

### 3.7 Governments and Agencies

Governments and their agencies are interested in the allocation of resources (by others) and consequently are interested in the activities of all entities. This is recognised by both the Framework and the Interpretation, and is a different role to that of financial supporter, where governments and their agencies are interested in allocating their resources.

Governments are interested in the activities of entities for a variety of reasons, including regulation, taxation and policy reasons, and the information required may form part of national statistics.

Governments and their agencies will generally seek this information from local authorities through special purpose financial statements such as returns, although these will often be consistent with the financial statements.

When considering the financial statements of local authorities, the information needs of this class of user do not need to be designed into the format of the accounts. However, ensuring that the accounts operate on a basis consistent with the information needs of central government and its various agencies (e.g. Whole of Government Accounts) will avoid any dual reporting requirements.

### 3.8 Public

The Framework states that the public have an interest in the financial performance of entities for a variety of reasons; one example given being that the entity was a major employer in the area. The Interpretation acknowledges that the interest will vary for public benefit entities; for example the public may be interested in the relative allocation of resources between competing priorities.

For local authorities, the public will generally also be funders, and may be customers / beneficiaries. As such, their information needs are likely to be met by meeting the information needs of funders and customers / beneficiaries.

## 4 CONCLUSIONS

4.1 This discussion paper has considered the users of local authority financial statements and their information needs. The key factors to be taken into account when designing the IFRS compliant local authority financial statements are detailed below:

- All users of the accounts will use them to make economic decisions, either directly or indirectly.
- The defining class of user is funders and financial supporters, in effect government and Council Tax payers. Government's ability to request information through returns suggests the needs of Council Tax payers and their representatives are paramount.
- The second most important group of users is customers and beneficiaries, including HRA tenants.
- Meeting the information needs of these groups will meet the majority of other information needs.
- The key concern of funders / financial supporters and customers/ beneficiaries is whether the authority is able to continuing providing the same level of service going forwards. The best indication of this from historic data is the performance against budget, represented by the surplus or deficit on the general fund and HRA. The Balance Sheet and Income and Expenditure Account will provide additional information that will be of use to users.
- Preparing financial statements in a manner that is consistent with government information requirements will minimise the amount of dual reporting that is required.