AGENDA ITEM NO. 5

LICENSING & GENERAL PURPOSES COMMITTEE
28 MAY 2015

HEAD OF FINANCIAL SERVICES
REPORT NO. FIN1513

FINANCIAL STATEMENTS – DE-CLUTTERING OF THE ACCOUNTS

1. INTRODUCTION

1.1 The purpose of this report is to obtain Member approval for the approach to be taken in respect of the rationalisation of the number of disclosures in our Financial Statements for 2014/15 onwards.

1.2 The majority of the existing disclosures are requirements laid down in the Accounting Code of Practice (ACOP), however there is scope under the new 'de-cluttering' agenda to rationalise what information is included in the statements.

2. BACKGROUND

2.1 The terms 'de-cluttering' and 'disclosure overload' are used to describe a problem in financial reporting as a result of the growth and complexity of financial disclosures. Although there is no formal definition of the disclosure overload issue it is clear that three common themes have emerged:

- Format/structure
- Tailoring
- Materiality

2.2 Traditionally, in the preparation of financial statements, organisations are focused on ensuring that material information is not omitted. Current International Financial Reporting Standards (IFRS's) do not explicitly prohibit the provision of immaterial information in financial statements. As such this, together with the disclosure checklist approach encouraged by some auditors and regulators, may have contributed to the problem of disclosure overload.

2.3 One way of improving disclosure effectiveness is to review the contents of the existing statements. This may be achieved by reference to the primary purpose of the financial statements, namely:

'to communicate in a transparent manner the financial position and performance of the Council'

2.4 In the Ernst & Young' publication '*Improving Disclosure Effectiveness*' (July 2014), the following key areas for consideration were identified:-

- Removing immaterial or irrelevant financial report disclosures that have built up over time.
- Re-ordering and re-labelling accounting policy and detailed notes so that they better reflect the key financial measures and focus areas of most relevance.
- Re-writing technical wording into plain English, whilst still fully complying with relevant accounting standard and regulatory requirements.

2.5 IFRS sets out the minimum disclosure requirements, which, in practice, tend to be complied with but with no consideration of the relevance of the information for the specific entity. A shift in focus is required from a mere 'compliance mode' to also consider disclosure usefulness.

2.6 Minimising the number of disclosures and concentrating on the more material and relevant ones would assist the Council in improving the effectiveness of communication through the financial statements by reducing the users' uncertainty about its financial position and performance.

2.7 In order to ensure that our methodology was reasonable and would be acceptable to our auditors, a meeting was held with Ernst & Young who were helpful in developing our approach.

3. OPTIONS CONSIDERED

3.1 Presentation of Accounting Policies

One of the ways it may be possible to improve the financial statements is to present each of the significant accounting policies, judgements, estimates and assumptions within the relevant note. By including the policy disclosures along with the specific and quantitative information in the relevant notes, the reader can more easily connect the two, which may allow for a more efficient appreciation of both.

However, some of the accounting policies relate to the financial statements as a whole and will not, therefore, fit into a single note disclosing a particular line item in the financial statements. These accounting policies still need to be disclosed together.

In some cases e.g. Financial Instruments and Heritage Assets there is repetition between the Policy and the Disclosure Note and it may be possible to rationalise some of the notes to avoid this.

3.2 Removal of Duplication

The statements could be improved by reducing the amount of duplication in them. There are some notes that are repeated in notes disclosed elsewhere in the statements, for example cash & cash equivalents also appears under financial instruments.

3.3 Materiality

One approach that may be taken in respect to rationalize the number of disclosures in the Financial Statements is to adopt the concept of materiality in determining if an individual note requires disclosure. Applying the concept of materiality requires judgment, yet there is little guidance available.

IFRS provides the following definition of materiality:

"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 entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report".

If a particular transaction or item is immaterial to the reporting entity, then it is not relevant, in which case, IFRS allows for non-disclosure.

It may therefore be appropriate to determine an appropriate de-minimus level, below which amounts may not require disclosure. This could be achieved by applying an appropriate percentage to total Net Assets/Reserves on the Balance Sheet.

Appendix 1 shows the percentage of total Net Assets/Reserves each Balance Sheet item represents. It identifies that:-

- applying a de-minimus level of 0.5% (£305,600 in 13/14) would negate the need to make disclosures in respect of Inventories, Long Term Debtors and Heritage Assets, and
- applying a de-minimus level of 1.0% (£611,200 in 13/14)) would, in addition to the above, negate the need to make disclosures in respect of Intangible Assets.
- applying a de-minimus level of 2.0% (£1,222,400 in 13/14) would, in addition to the above, also negate the need to make disclosures in respect of Cash and Cash Equivalents.

In order to ensure consistency, the same de-minimus level would be applied to both Income & Expenditure and Balance Sheet items.

The materiality level would only be applied after consideration of the requirements of the Code (ACOP) and the usefulness of the disclosure to the Readers understanding of the Financial Statements.

In some cases, the adjudged materiality threshold may be lower, for example for common transactions and outcomes where materiality judgements are usually particularly sensitive. These include:

- Transactions with related parties
- Sensitive matters, such as fraud and non-compliance with law
- Unusual or non-recurring transactions/balances

3.4 Reducing the Length of Disclosures

In some cases it may be possible to reduce the length of some of the disclosures by grouping similar items together rather than showing them individually, for example the list of grants.

3.5 Ensuring Consistency

The concept of consistency is important in determining which notes should be disclosed. One option could be to produce a simple flowchart which would assist in making decisions as to which notes should be disclosed on a consistent basis. The flowchart in Appendix 2 shows one suggested approach.

4. CONCLUSIONS

4.1 To ensure consistency, we should retain the accounting policies in one section rather than present policies with the relevant note. However, we will review disclosure notes for duplication and remove text where it is repeated.

4.2 Notes that are duplicated elsewhere should be removed.

4.3 It would be appropriate to establish a de-minimus level, below which amounts may not require disclosure. A level of 1% (£611,200 based on the Balance Sheet as at the 31st March 2014) is recommended.

4.4 The length of some of the disclosures could be reduced by grouping similar items together.

4.5 To ensure consistency in determining which notes should be disclosed a simple flowchart approach should be adopted.

5. RECOMMENDATIONS

5.1 Members are requested to agree the proposed methodology for reviewing the content of the Council's Statement of Accounts.

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