

Accelerating your financial close arrangements

EY Think Piece

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Accounting, auditing and governance

Accelerating your financial close arrangements for the new 2017/18 deadline, commencing the pathway to success

In our November 2014 briefing, we told you about the Government's consultation on the Local Audit Regulations associated with the Local Audit and Accountability Act. This consultation has now concluded, and on the 17 February 2015 the Accounts and Audit Regulations 2015 were laid before Parliament, having been made (signed by the Minister) under the Local Audit and Accountability Act 2014 on 12 February 2015. www.legislation.gov.uk/ukxi/2015/234/contents/made

A key area of the regulations is that from the 2017/18 financial year, the timetable for the preparation and approval of accounts will be brought forward to a draft accounts deadline of **31 May** and an audit deadline of **31 July**. These changes provide challenges for both the preparers and the auditors of the financial statements. The impact of the changes to the deadlines and their impact is shown in the table below.

	Current deadline	2017/18 deadline	Reduction in time
Preparation of draft financial statements, signed by s151 officer	30 June	31 May	30 days
Approval and publication of financial statements with audit opinion	30 September	31 July	62 days
Available audit time	92 days	61 days	31 days

The Government believes that this change will reduce the burden of the closure process, enabling finance staff to give more time to in-year financial management.

This is the first of a series of briefings we will produce during the transition to the new financial reporting timetable. This briefing draws on our experience of working with clients who have successfully closed their accounts early and had their audit opinions issued by the end of July. It also draws on discussions we have had with our clients at our recent Public Sector Accountants workshops and will highlight early areas of consideration that you can begin to think about. We will set out areas for consideration in how we can work together with you to meet the revised deadline for 2017/18 or sooner, as we think a trial run and review of the process in 2016/17, would pave the way for a successful outcome once the regulations are introduced formally a year later.

The second briefing, which will follow in early summer, will provide a more detailed analysis of how 'fit for purpose' your financial reporting function is, and how you balance the speed of financial reporting, against the quality of financial reporting.





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The economic downturn, the impact of austerity on public sector funding levels, the increased demand for regulatory compliance, greater transparency over the use of public funds, and now a faster reporting timetable is making the task of delivering on-time, high quality financial and non-financial information ever more challenging, for practitioners and auditors.

The good news is that with some planning, communication and joint working, those deadlines are highly attainable – sixteen principal local government bodies received an unqualified audit opinion by 31 July 2014 and published their audited accounts promptly – as reported in the Audit Commission's report – 'Auditing the Accounts 2013/14: Local Government Bodies.' The Audit Commission notes that **'the timely presentation of audited accounts with an unqualified audit opinion is fundamental to good governance. It indicates that bodies have sound financial management arrangements and is the main way that they account for their use of taxpayer's money.'** Therefore, making the year-end closedown routine part of that overall financial management of the Council is crucial to achieving the deadline, not having it as a bolt on exercise for Month 13 with a specific set of autonomous deadlines.

The omens are good, as the majority of Councils are on the right trajectory having met the current reporting deadlines consistently for the last few years, the challenge now is upping the speed of that trajectory to achieve the faster deadlines.

Early considerations for the preparers of the accounts and their auditors

As with any 'project' the key to success is in the planning, together with timely engagement and collaboration between the preparers of the financial statements and the auditors of those statements.

We appreciate that each client starts from a slightly different base position. Therefore, there is no one size fits all solution. However, there are areas where consideration can be given now:

► **Revisit the current project timetable.** Our clients who have been able to close early, place this success on the robustness of their project timetable and their understanding and management of bottlenecks and requirements for information from outside the finance team.

Understanding how your current project timetable, where the bottlenecks are, and the critical path of the tasks required to meet the new deadlines will shape the areas of financial reporting that need the most attention. The earlier this is done, the greater scope there is to smooth the process and develop the capacity to deliver the key tasks.

Working with your auditor, you can discuss and agree timings of the audit and build this into the overall plan, rather than run it as separate closedown and audit work-streams.



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- ▶ **An early in-year financial hard close.** A hard close provides the auditor with the opportunity to perform early substantive procedures, especially on the revenue side of the primary statements, and to 'bank' audit assurance early in the process, thereby saving time in the tighter latter period.

Typically auditors speak of a Month 9 hard close as being optimal in other sectors such as the NHS. But with Local Government responsibilities for setting Council Tax, authorities need to be mindful of their budget setting process and timetable. It may be that a Month 8 or Month 10 hard close would be better. What would work for your auditor? What are the barriers to doing an in-year hard close? Does your finance team have the capacity to do this?

Is it possible to bring forward the process of setting the budget, to allow a Month 8-10 hard close to happen, without reducing capacity for other key finance responsibilities? There are examples of Councils having completed the budget review and setting process by late October – subject to Member discussions and agreement before the end of November. This may be an enabler to performing a part-year hard close.

- ▶ **Format of your accounts.** Do you have any superfluous notes? How much detail do you provide? This is the quality aspect of financial reporting. Now is the time to streamline the content of your statements, and remove any notes that are not required (on the basis of materiality), and review accounting policies in light of those note changes.

In December 2013, CIPFA issued 'Financial Statements: A Good Practice Guide for Local Authorities' which included a chapter around materiality and clutter. This report highlighted two types of clutter identified by the Financial Reporting Council in their report 'Cutting Clutter':

- ▶ Immaterial disclosure that inhibit the ability to identify and understand relevant information
- ▶ Explanatory foreword information that remains unchanged from year to year

Remember as the preparer of the statements, you must determine your own materiality level for inclusion of items in the accounts and this level may be different to that of your auditor.

It is, as is a common theme here, appropriate to discuss what the auditor would consider materiality to be, so you can take an informed view. In addition, discuss any amendments to your accounts template with them prior to rationalising it, so they can begin to build an expectation of the year end position.

- ▶ **Review your approach to estimates.** Estimating is a valid way of closing down certain aspects of your accounts early e.g., year-end accruals, holiday pay accruals, IAS 19 Pension liabilities and deductions. Your auditor will be interested in the robustness of the methodology for estimation, and the impact of estimation uncertainty. For example, you may wish to review your approach to accruals and set a revised upper limit, under



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which you would not accrue. In the next two years, you could monitor post year-end payments and demonstrate that the totality of expenditure below the accrual limit is not material, thereby demonstrating that your approach is valid and not unreasonable.

- ▶ **Review your year-end journal process.** Do your year-end journals actually have to be done at the year end? For example depreciation, this charge is usually put through at the year end. But is there anything stopping it being a Month 1 transaction? The overall asset base upon which the charge is based, is known in April and can be adjusted for any prior year audit amendments early. It will only change if there are significant additions, disposals, revaluations or impairments to that asset base. But even these changes may not lead to a material change in the depreciation charge, given the way in which the annual depreciation charge is derived. A year-end reconciliation of the basis of the charge to any asset base adjustments in the year will justify the charge to the auditor, or require a simple amendment within the financial statements.
- ▶ **Third Party information.** The project timetable, above, should include the receipt of information from third parties. Ensuring that the third parties are on timetable and aware of the revised deadlines is key. Third party information includes the Actuary of the LG Pension fund, valuation information on the asset base, information from wholly owned companies for Group consolidation and Business Rate appeal information from the Valuation Office.

- ▶ **Manage Members' expectations.** A 31 July audit deadline will mean rescheduling your Audit Committee (or equivalent body who perform the duties of 'those charged with governance') before the deadline.

It may also be appropriate to move away from showing members the draft accounts in May (June as it currently is). The 2009 Account and Audit regulations did not require Member 'approval' of the draft accounts as was previously the case, but many Councils still take a full draft set of accounts to an Audit Committee.

It may be better to take the accounting policies to an Audit Committee during the year for approval (as required annually) and build a finance reporting culture that will demonstrate to members what the expected outturn position will be, highlighting any key transactions (for example big asset transactions in or out, revaluations, provisions).

If this happens throughout the financial year and Audit Committee cycle, then Members will know what to expect. A final year-end paper with the accounts for approval in July will join the information together and allow Members to have the right information to be able to approve the financial statements. In addition, those accounts would have been subject to audit, and the auditor's report will be available to read alongside the financial statements.



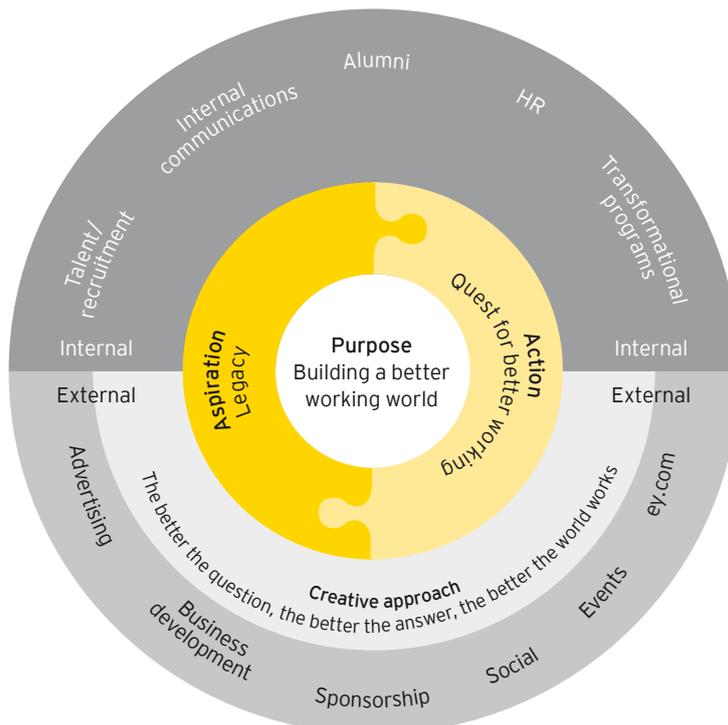
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► **Review the operation of your ledger system.** Whilst everyone uses a ledger system, not everyone derives their financial statements straight from it. There are many instances of off-ledger spreadsheets, and ad-hoc systems being bolted on to create the accounts.

To auditors, this is inefficient and requires additional audit procedures over the off-ledger work. Councils should review their ledger system and its capabilities. Is your chart of accounts correct? Can your current system do more to support the preparation of the accounts? Can you minimise the extent of off-ledger work that is required to prepare the financial statements?

► **How fit for purpose is your current financial reporting system?**

This would allow us to make better use of data analytics – our tool which analyses all data in a certain population (i.e., payroll, ledger, Accounts Payable) rather than sample test that population. Analytics is a powerful tool, giving assurance across the whole population data set, quickly pulling out anomalies for further review. However, the power of analytics is dependent upon the data set going into the tool. This requires us to work with you, so we get the data in the way which is quick and easy for us to use, without manipulation or filtering.





Questions for Audit Committees

Our think piece highlights a number of questions that are pertinent to the preparers of your Council's financial statements. We set out below, some high level questions, which Audit Committees should consider and gain assurance over, in preparation for the earlier financial statement deadlines.

1. How reliable are your internal financial reporting processes and how aligned are they to delivering external facing financial statements, as opposed to delivering internal management reporting requirements?
2. How assured are you about your overall control environment currently and how robust are those arrangements ahead of preparing for the new accelerated reporting deadlines?
3. Have you considered the impact of new financial reporting requirements¹ and complexities which will impact on the same timeline?

¹Examples of new financial reporting requirements for consideration; the extension of the accounting for Infrastructure assets, changes to the CIPFA Code of Practice on Local Authority Accounting; and changes to service delivery models which leads to the requirement for group accounts.

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