

MINUTES OF THE 128th FRAB MEETING HELD ON THURSDAY 24 NOVEMBER 2016 AT HM TREASURY

Present: Ian Mackintosh (Chair) Russell Frith
Andrew Buchannan Larry Honeysett
Veronica Poole Gareth Caller
David Hobbs Vicky Rock
Bob Branson Andrew Baigent
Ruth Elliot Joanne McBurney
David Aldous Ian Webber
Ron Hodges Kate Mathers
Craig Mackinlay MP Gawain Evans
Alison Scott

On the phone: Aileen Wright, Sarah Sheen (CIPFA)

Secretariat: Ian Bulmer (FRAB Secretary)

Guests: Tanya De Jager (HMT) for item (8)

Apologies: Neil Hartley, Joseph Maclachlan

AGENDA ITEMS (in order tabled)

1. FReM 2016-17 and 2017-18
2. IFRS 9 consultation feedback
3. Discount rates
4. IFRS 15 consultation feedback
5. IFRS 16 update
6. Infrastructure Assets in local government
7. Update on CIPFA/LASAAC code
8. WGA strategy for 2015-16
9. Simplifying and streamlining
10. Health manual
11. Any other business

Item 1: FReM 2016-17 and 2017-18

1. Treasury introduced a paper providing the Board with the revised Financial Reporting Manual (FReM) 2016-17 and illustrative statements. The draft FReM and illustrative statements for 2017-18 were also presented for consideration by the Board.
2. Only minor changes were proposed to the 2016-17 FReM to correct errors and inconsistencies. No additional changes were proposed for the draft 2017-18 FReM. The Treasury noted the 2017-18 FReM will need to be updated once CIPFA/LASAAC have considered the impact of the delay to implementation of DRC on highways network assets (see item 6). The Board were asked to consider the proposed amendments to both the 2016-17 and 2017-18 FReM and illustrative statements and agree their publication.
3. Andrew Baigent asked whether the accountability report was capturing everything it should and whether fees and charges should be audited as part of the financial statements. The NAO agreed to work with HMT to confirm the sections in the accountability report that were subject to audit.
4. The Board endorsed both versions of the FReM, and the Chair asked that any final comments should be passed to the Treasury in the next few days.

Item 2: IFRS 9 consultation feedback

5. The Treasury introduced a paper summarising the consultation feedback on the Exposure Draft. There were 23 responses to the ED and the Board's views were sought on a number of areas. The new impairment model is seen as the greatest challenge from a number of respondents. Specifically the need to include forward looking data alongside consistency concerns as each department will exercise their own judgement in determining loss allowances and the credit worthiness of counter parties. The simplified approach to impairment was positively received by the majority of respondents and the Treasury

propose to mandate this across government. Additionally, Treasury are planning to mandate the use of IFRS 9 for hedge accounting, implement retrospective application with no restatement and maintain the existing interpretations in the FReM. Treasury identified three further areas that required further work that will be reported to the Board in March 2017, (1) analysis of loss allowances on liabilities held within the public sector, (2) the impact of financial guarantee contracts and (3) development of application guidance.

6. The Board were asked for their views on these and the other issues raised in the paper.
7. There was a discussion on the comment in paragraph 9 on student loans which stated they were set up 'deliberately blind to the credit worthiness of the loan recipient' and whether this meant student loans shouldn't be subject to an impairment review. Treasury confirmed the methodology used by the department already assesses the likelihood of impairment as part of the valuation approach. Ruth Elliot mentioned that we should do what the standard requires even on loans that are policy driven. Ron Hodges stated the standard doesn't require each individual loan to be assessed, but rather a portfolio approach can be used so that recoverability can be looked at as a whole. Therefore, there is no reason why IFRS 9 shouldn't apply. The Chair concluded the discussion agreeing it would be difficult to make an assessment line by line for student loans, but the requirements of the standard should still apply.
8. The Chair then asked the Board to consider how the impairment approach applies to intra-government balances and invited views on the options put forward by the Treasury. Andrew Buchannan stated he would normally recommend full application of the standard, but recognised that it focussed on a consolidated set of financial statements rather than the sub-consolidating entities. Agreeing a boundary within the public sector where no stage 1 allowances should be recognised seemed a practical solution, but more analysis was needed.
9. Gareth Caller suggested option 3, citing government departments and central funds are not separate legal entities therefore there was no risk of default within this group. Ron Hodges supported this approach, as the implication of impairing inter-government balances was that government would not provide support for these entities should they risk default. The NAO were broadly supportive of option 3 as impairments to balances within central government would be rare and highlighted it could lead to a complex analysis and unnecessary work.
10. Andrew Baigent asked whether option 4 should be considered, as within the health sector it was highly unlikely that there would be any impairment of balances within the group. Veronica Poole supported this approach but agreed that it would be difficult to extend the boundary further due to the increasing risk once those entities in option 5 are included. The NAO expressed concerns on extending the boundary and requested further consideration of how academies fit into the options.
11. Ian Webber stated that public corporations were in essence a government liability and therefore there remained a question of whether there was any credit risk. Treasury agreed the boundary should be analysed to determine what we mean by 'the Crown', especially related to risks on entities outside the 'central government' boundary as the government credit rating may not extend beyond this.

12. Russell Frith asked how the devolved administrations fit into the options presented by Treasury and stated that local government should be included. Craig Mackinlay MP agreed that option 3 was the starting point but asked whether the recoverability of local government grants meant that option 5 was more appropriate.
13. Vicky Rock commented that other bodies such as local government may have a low credit risk, but this is not the same as their being part of the crown. She queried whether there were bodies within a departmental consolidation group that did not share the credit rating of their parent. Andrew Baigent agreed that option four would work within the health sector. Gareth Caller mentioned there are examples of local authorities challenging liabilities with central government so it was important to choose an option that sent the right message on managing these balances.
14. The Chair summarised the discussion stating that the Board were content to go as far as option 3 and there were pros and cons to extending to options 4 or 5. It was suggested that more more analysis was needed from the Treasury in time for the next meeting in order to make a final decision.
15. The Board then considered the Treasury proposal to adopt the simplified impairment model for long term receivables. Alison Scott stated there were potentially significant budgeting issues with this approach in local government, considering the up front impact of applying the impairment methodology. The Board recognised this but agreed that the budgeting should not routinely determine the financial reporting arrangements. They concluded that adopting the simplified approach for central government was appropriate.
16. The Board discussed the Treasury options for applying a consistent methodology for determining 'credit risk' on liabilities measured at fair value within the public sector. There was a general consensus that the approach should be consistent with the options already discussed on the intra government impairment methodology. Craig Mackinlay MP proposed that option four (including all central government and central funds) was appropriate, but Treasury should consider extending the boundary to include local government, given the need to have consistency for the Whole of Government Accounts.
17. The Board discussed the government approach to valuing financial investments as departments can spend a lot of time on this activity. Andrew Baigent stated a number of accounting standards don't work as the boundary can change quite quickly and some of the newer standards risk increasing the complexity. Veronica Poole stated that the private sector also has bodies that consolidate financial investments at fair value and there is a possible exemption for investment entities that may apply in the public sector. Vicky Rock noted that a particular problem for the public sector was that some bodies which would otherwise be consolidated as subsidiaries were treated as investments as a result of the adaptations to consolidation standards. The Board were supportive of Treasury and the NAO looking at how to fair value investments in a way that was sensible in the public sector context.
18. The Board supported the transition approach of retrospective application with no restatement, the effective date and maintaining the existing interpretations and adaptations

in the FReM as per IAS 39. The NAO raised a conceptual question on how to measure Public Dividend Capital, but after a brief discussion the Board agreed the current methodology was the correct approach.

Item 3: Discount rates

19. Treasury introduced the paper setting out the discount rates to be applied for 2016-17 and asked for the Board's views on delaying the long term discount rate update and conducting a full review of the discount rate policy. This was driven by the current negative rates and observations that discussions on liabilities can be disproportionately focussed on trying to conceptually understand the meaning of negative rates.
20. The Chair stated it was confusing how the methodology led to a negative rate, as the purpose of valuing the liability is to determine how much you would need to pay someone to take the liability off your hands. If there is no active market then you would make an estimate and discount appropriately. Andrew Buchannan stated that if you use a discount rate that includes inflation then it is possible to have a negative rate, but agreed it was confusing. He explained it might be better to include inflation in the cashflow forecasts and then discount using a positive rate.
21. There was a brief discussion on whether to update the long term rate for each spending review cycle or an update annually in line with the short term rate methodology. The Treasury stated that Parliament were one of the main users of financial accounts therefore stability in the long term rate ensures confidence in the numbers presented. Annual updates could lead to significant fluctuations each year making comparisons and understanding the underlying position difficult.
22. Andrew Baigant explained that last time the long term rate changed it resulted in a £25bn increase for Health provisions. This makes it a difficult message to explain that this is not an additional cost but is a result of timing due to discount rate changes.
23. The NAO supported the methodology review but highlighted the need to ensure it remained consistent with the accounting standards. Treasury confirmed the aim of the review was to have the mechanism in place for 2017-18.
24. The Chair summarised the discussion and the Board agreed to delay the long term rate update and to the review of the discounting methodology.

Item 4: IFRS15 Consultation Feedback

25. The Treasury presented the paper highlighting the issues raised through the Exposure Draft consultation and the proposed next steps for implementation. The Treasury received 22 responses for the Exposure Draft. Half of the respondents agreed with the proposed approach for adopting IFRS 15 and raised no further comments or issues for consideration.
26. The remaining responses included comments on the distinction between revenue and tax, the use of legislation as an equivalent for a contract, capitalising assets, fees and charges and consistency with expenditure for intra-group transactions.

27. Bob Branson welcomed the comment to work with the Treasury to consider the impact on the Environment Agency's fees and charges and interaction with the principles in Managing Public Money (MPM).
28. The Board agreed with the next steps to prepare application guidance to assist implementation of the Standard.

Item 5: IFRS16 Leases Update

29. The Treasury introduced the paper which set out the implementation plan for the new standard and highlighted the key issues identified so far. The Board were asked to agree the work plan and comments on how the Treasury should prioritise these issues.
30. There was a brief discussion on materiality in the context of what is meant in the Standard as 'low value items'. Veronica Poole highlighted that materiality and low value items were two different concepts in the new standard and therefore needed separate consideration.
31. Larry Honeysett asked whether there is a parallel ONS workplan and if there is a risk of misalignment with the National Accounts. David Hobbs confirmed there was a distinct misalignment between the two systems as IFRS 16 classifies all leases on balance sheet, but ESA 10 maintained the distinction between finance and operating leases. He stated they did not yet know what the impact would be but that the ONS and Treasury would work together on the issues.
32. Andrew Baigent favoured parallel workplans, but wondered whether there was a risk of creating a separate leasing market in the public sector and how the private sector might respond to that. Andrew Buchanan echoed these concerns but stated this is about determining what is a lease and then accounting for it appropriately.
33. Ron Hodges highlighted the risk of leases being missed. For example, academies are not permitted to enter into finance leases, but how would the Treasury be sure they haven't. Andrew Baigent clarified that academies were not allowed to borrow rather than entering into finance leases. The issue is what does the definition of borrowing mean in this context if there was no distinction between finance and operating leases.
34. There were no further comments and the Board endorsed the Treasury workplan.

Item 6: Infrastructure Assets in Local Government

35. Alison Scott explained the background to the implementation of depreciated replacement cost for highway infrastructure in local government. The original plan was to implement in 2016-17, but a delay in the provision of central rate information means this is no longer feasible and CIPFA are delaying the implementation to 2017-18.
36. David Aldous expressed disappointment at the delay in providing the central rates, acknowledged all the work done locally to prepare for the change in policy and stated we should look to maintain the existing momentum. He stated that it was important to have robust information on the central rates and sufficient assurance that these had been applied appropriately in local authorities.

37. Alison Scott assured the Board that implementation would proceed in 2017-18 and Treasury agreed that it was better to delay and get right due to the impact on WGA.

Item 7: Update on CIPFA/LASAAC code

38. Alison Scott asked for feedback on the 2017-18 Local Government Code of Practice, highlighting some minor changes on narrative reporting requirements and a new appendix on IFRS 9 and 15 which will be updated in the 2018-19 Code. Treasury highlighted the risk of differences in applying the simplified impairment model given the earlier Board decision to mandate this approach in central government.
39. The Board endorsed the Code of Practice and the Chair asked for any further comments to be sent directly to CIPFA.

Item 8: WGA Strategy

40. Tanya De Jager updated the Board on the strategy for delivering the 2015-16 Whole of Government Accounts, highlighting that improvements to timing and quality had been delivered in the 2014-15 accounts although they were published two months later than originally planned. Two qualifications have been removed from the accounts and the focus for 2015-16 is on improving timeliness, simplifying the accounts and implementing a communications strategy to raise the profile and enable better use of the accounts. The Board were asked for their views on the strategy.
41. The NAO stated the eliminations error was below the quantitative materiality threshold but it remained a sensitive issue and they will work closely with the WGA team on continuing progress in this area. The timetable was highlighted as a significant challenge, although the implementation of earlier accounts preparation in local government will help deliver improvements in 2017-18.
42. David Aldous welcomed the improvements, but suggested more use must be made of the accounts as there was still some scepticism of the value of WGA therefore the communications strategy was key to tell users why it was important. Gareth Caller agreed with this and suggested giving departments access to the WGA data to help increase the usefulness of the document. Larry Honeysett extended this request for Parliament.
43. Treasury agreed and stated they were looking at ways to supply the underlying data for analysis and were starting to explore options using the 2014-15 data. The NAO mentioned their own analytical website was available for users to query data, but remained a work in progress.
44. Ron Hodges asked if there were any remaining boundary issues or alignment issues with National Accounts. Treasury stated that Housing Associations were not being consolidated into the 2015-16 accounts and they would review the disclosures relating to RBS, which is the only other material boundary difference.

Item 9: Simplifying and Streamlining

45. Treasury stated that following the introduction of the simplifying and streamlining project in 2015-16 they had now conducted a high level post implementation review with the 17 main departments, account preparers, Parliamentary Scrutiny Unit and the NAO. Feedback from the Public Administration and Constitutional Affairs Committee inquiry into resource accounts will also be taken into account. Feedback had been positive and departments would like to go further and continue to make iterative improvements. Treasury asked the Board for views on the review feedback and to share any good practice from the public and private sector.
46. Gawain Evans stated that the Welsh Government were supportive of simplification and had previously said the accounts were 'impenetrable'. Infographics were welcomed, but their PAC had asked what more they could do and auditors had faced difficulties given the amount of information presented in the revised report.
47. Craig Mackinlay MP agreed with the simplification principles but suggested the performance report should be audited to ensure it matched the financial statements and presented a balanced reflection of the reporting year. The NAO confirmed the report was reviewed as part of their consistency checks but was not formally audited.
48. Larry Honeysett welcomed the initiative to improve the readability of accounts, agreeing that substantive improvements had been made. He highlighted the varying quality of reports across government and the need to improve standards across all departments. It was important that departments were explicit about their strategic objectives and how they are reporting against those in the financial statements, linking the information to the Single Departmental Plans.
49. Craig Mackinlay MP agreed, stating that unless departments have clear performance indicators it is difficult to achieve a balanced report that the public can understand and this could lead to an overly positive report. Treasury agreed but stated that there is now a 'fair, balanced and understandable' statement in the financial reports that Accounting Officers must sign, mirroring the private sector requirement.
50. Ron Hodges welcomed the project and stated it was important to recognise there are multiple citizen users of the accounts. Preparer success was a good starting point, but Treasury needed to test the statements with other representative users to ensure their needs were also being met.
51. Veronica Poole highlighted the linkages with the private sector and stated that Deloitte prepare an annual reports survey which contains good practice examples. She emphasised that the users of accounts were constantly changing and it was important to take account of this. It was important to identify what the objective is and understand how a more efficient and effective business can be delivered.
52. Andrew Baigant mentioned that most of the information they removed from their financial statements had resulted in a separate request from users. While it may be useful for some

users, it is important to determine whether the annual report and accounts is the right place to report it.

53. Veronica Poole noted that WGA had been highly commended at the 'Finance for the Future Awards' and the Board passed on their congratulations.

54. The Chair noted this had been a good discussion of the issues on simplification and the Board fully supported the ongoing work in this area.

Item 10: Health Manual

55. Andrew Baigent introduced the session and explained that the two previous health manuals has been combined into one Group Accounting Manual (GAM) for the first time for 2016-17 and that there were only minor changes for the 2017-18 GAM. The Board agreed that a subgroup consisting of Vicky Rock and Andrew Buchanan would review the detail of the 2017-18 GAM and provide any comments directly to Andrew Baigent.

Item 11: Any Other Business

56. Gawain Evans highlighted the need for Relevant Authorities to continue working together when drafting new guidance.

57. The Chair thanked the Board for their contributions and stated it had been an enjoyable first meeting.

Date of next meeting: 16th March 2017