



Financial Reporting Advisory Board Paper

Government Financial Reporting Manual (FReM) and illustrative statements for 2014-15 and in-year amendments for 2013-14

Issue:	HM Treasury requests that the FRAB agrees to the publication of the 2014-15 FReM and illustrative statements and an update to the 2013-14 FReM and illustrative statements.
Impact on guidance:	The FReM and illustrative statements have been updated for application from 2014-15. An update to the 2013-14 FReM is proposed to align with a change to Managing Public Money and corrections to the 2012-13 illustrative statements are proposed.
IAS/IFRS adaptation?	Yes, minor change to text of existing IAS 36 adaptation.
Impact on WGA?	No
IPSAS compliant?	No, maintains existing difference on recognition of certain impairments in the SoCNE
Interpretation for the public sector context?	No
Impact on budgetary regime?	No
Alignment with National Accounts	No, maintains existing difference on recognition of certain impairments in the SoCNE
Impact on Estimates?	No
Recommendation:	That the FRAB notes the proposed amendments to the FReM and illustrative statements for 2013-14 and 2014-15, and agrees their publication.
Timing:	2013-14 and 2014-15

DETAIL

Background

1. The Memorandum of Understanding between the Relevant Authorities for developing financial reporting guidance for the public sector requires that the version of the FReM for financial year 2014-15 is available to users by 1 January 2014.
2. HM Treasury originally prepared two versions of the draft manual for 2014-15 in order to explore the option of changing the existing format. Both were presented to the FRAB at the October 2013 meeting. Since then HM Treasury has consulted with preparers through the Resource Accounts Special Interests Group (RASIG) and with the Finance Leadership Group (FLG).
3. HM Treasury is proposing to implement the new format, based on feedback from the Board, RASIG and FLG.
4. At the previous meeting, HM Treasury agreed to provide the Board with further information relating to a change in the wording of an existing adaptation relating to impairments. This paper provides further information on HM Treasury's proposal, including improvements to Consolidated Budgeting Guidance, and requests the Board's agreement to the updated text.
5. This paper requests that the Board notes the proposed amendments to the FReM and illustrative statements for 2014-15 and to agree to their publication.
6. In addition, in-year changes are proposed for the 2013-14 FReM and illustrative statements. This paper requests that the Board notes the proposed amendments to the FReM and illustrative statements for 2013-14 and to agree to their publication.

Amendments to the 2013-14 FReM

7. Minor changes are proposed to the 2013-14 FReM to reflect the following developments:
 - HM Treasury migrated to the gov.uk website and the consequently references for where supporting guidance can be found online have changed; and
 - Amendments to the Companies Act 2006 came into effect for periods ending on or after 1 October 2013.
8. The proposed amendments to the FReM are summarised at Annex A and extracts of the FReM showing the main changes are included at Annex F.

Amendments to the 2013-14 illustrative statements

9. Managing Public Money was updated in July 2013 and the changes included an increase in the threshold for reporting losses and special payments from £250,000 to £300,000. HM Treasury proposes to reflect this change in the 2013-14 illustrative statements.
10. The December 2012 FRAB agreed the following changes to the illustrative financial statements:
 - Amendments related to the presentation of the Statement of Parliamentary Supply to improve clarity and accountability;

- Changes to some notes to improve further clarity on virement and to improve user understanding;
- Removal of some detail to notes as analysis no longer required;
- Clarification of IAS 10 reporting requirement;
- Amendments to the presentation of 'Other Comprehensive Income'; and
- Additional disclosure of funded defined benefit pension obligations.

11. However, these changes weren't fully reflected in the Magenta Pension Scheme illustrative statements and we have identified other errors in the illustrative statements. We believe that these are errors that departments would need to correct even if the illustrative statements weren't updated and that these updates will make it easier for preparers and the NAO to agree on the format of financial statements. The proposed corrections are summarised at Annex A.

12. The corrections detailed in Annex A represent the minimum in-year changes to the illustrative statements. HM Treasury also proposes minor changes to improve the guidance and reporting layout. These changes do not introduce any new reporting requirements. We believe that these changes will make the illustrative statements easier for preparers to use and therefore propose to make the changes in-year. The changes are shown in track changes and reflected in the covering pages of the illustrative statements at Annex G.

Amendments to the 2014-15 FReM

13. HM Treasury has reviewed the form and content of the FReM with the aim of reducing duplication, inconsistencies and ambiguity, and to make the document easier for preparers to use. This has included reviewing all existing interpretations and adaptations to check whether they continue to be relevant and to check that they are internally consistent within the FReM.

14. Since the October 2013 FRAB meeting, HM Treasury has consulted with preparers through RASIG and the FLG. The overall response has been positive and the majority view amongst preparers is that the document is more useful to preparers. In particular, the new chapter 6 is seen as being a useful reference point for all adaptations and interpretations.

15. Preparers made a range of further suggestions, including some cases where the document should be closer to the original. HM Treasury proposes to implement changes where there is a general consensus amongst preparers or where it is evident that a further change is needed. These are summarised at Annex B.

16. Some of the changes to the 2014-15 FReM reflect the amendments already presented to the Board at the October 2013 meeting. These are summarised at Annex C.

17. At the October 2013 FRAB meeting, HM Treasury proposed a clarification to the circumstances in which the FReM's IAS 36 adaptation would apply. The Board requested further details about the basis of the original decision which are provided below.

18. At the October 2009 meeting the FRAB agreed to adapt IAS 36 such that those impairments caused by a clear consumption of economic benefit would be taken to the SCNE. The adaptation was agreed on the following grounds:

- To promote parliamentary accountability; and

- To reflect the fact that the revaluation of assets is mandatory in the public sector. Taking fundamental impairments to the income statement would provide a disincentive to the private sector revaluing their assets which is not relevant for the public sector. Therefore a different treatment for the public sector to promote parliamentary accountability was considered acceptable.

The relevant extracts of papers and minutes from previous FRAB meetings are included at Annex D.

19. HM Treasury believes that given that one of the reasons for the adaptation is parliamentary accountability, and given the principles underpinning Clear Line of Sight, that the treatment of impairment losses should be the same in budgets, Estimates and accounts. Despite there being no change to Consolidated Budgeting Guidance (CBG) since the adaptation was agreed, there is a subtle difference between budgeting and accounts which we do not believe was the FRAB's intention.

20. CBG requires entities to recognise an impairment loss if a fall in the value of an asset is as a result of 'consumption of economic benefit (e.g. physical damage) or a deterioration in the quality of service provided by the asset'.

21. We have discussed existing budgeting guidance with the preparers of CBG. They have agreed to change their description of a fall in value as a result of 'a deterioration in the quality of service provided by the asset' to 'consumption of service potential' in order to align with terminology used by RICS. They do not propose to make any other changes of substance to CBG. An extract of the draft 2014-15 CBG is included at Annex E.

22. The current text in the FReM is internally inconsistent as the table below shows:

Paragraph	Text
8.2.3	The objective of IAS 36 Impairment of Assets is to ensure that assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the recognition of an impairment loss. In other words, <u>an impairment reflects a permanent diminution in the value of an asset as a result of a clear consumption of economic benefits or service potential.</u> Downward revaluations resulting from changes in market value do not necessarily result in an impairment.
8.2.4	References in IAS 36 to the recognition of an impairment loss of a revalued asset being treated as a revaluation decrease to the extent that that impairment does not exceed the amount in the revaluation surplus for the same asset, are adapted such that <u>only those impairment losses that do not result from a loss of economic value or service potential should be taken to the revaluation reserve.</u> Impairment losses that arise from a clear consumption of economic benefit should be taken to the Statement of Comprehensive Net Expenditure.
8.2.19	Downward revaluations result in an impairment only where an asset is <u>revalued below its historical cost carrying amount.</u> In these cases, the accounting treatment is as for any other impairment. <u>All other downward movements (for example, as a result of market fluctuations) should be accounted for through the revaluation reserve</u> to the extent that there is a credit in that reserve that relates to the revalued asset or portfolio of assets.

23. HM Treasury proposes the following changes to the 2014-15 FReM:

- In equivalent of paragraph 8.2.4, refer to consumption of economic benefits or service potential;
- Delete the equivalent of paragraph 8.2.19;
- Align impairment DEL/AME categories and explanations with Consolidated Budgeting Guidance.

24. In relation to the Ministry of Defence, there may still have been a disagreement between the Accounting Officer and the NAO over the Germany accounting treatment. HM Treasury believes that there was an underlying issue with the valuation used and that this may be resolved as part of wider work on valuing non-owned assets.

25. The final version of the 2014-15 FReM is included at Annex H.

Amendments to the 2014-15 illustrative statements

26. The main changes to the 2014-15 illustrative statements are:

- To move profit on asset disposal from expenditure to income;
- To add additional disclosures for investments in public sector bodies which are accounted for as associates, reflecting changes to group accounting standards as adapted by the FReM; and
- To add guidance on special severance payment disclosures.

27. The changes are shown in track changes and reflected in the covering pages of the illustrative statements at Annex I.

Summary and recommendation

28. The Board is requested to consider the proposed amendments to the FReM and the illustrative statements for 2013-14 and 2014-15, and to agree their publication.

HM Treasury
13 December 2013

Financial Reporting Manual (FReM) – Amendment Record Sheet 2013-14

Factual corrections to the 2013-14 FReM:

Paragraph	Standard	Adaptation or interpretation	Change	Reason for change
1.1.4, 5.1.1, 5.2.26	N/A	N/A	References to the Manual's dedicated website changed to gov.uk	Change to website where guidance is available
6.2.59	N/A	N/A	Delete	Guidance referenced is not available and relates to previous accounting standards
5.1.2, 5.1.7, 5.2.2, 5.2.5 to 5.2.20, 5.2.23, 5.2.24, 5.2.27, 5.5.6, 10.3.6	N/A	N/A	Update references to Companies Act 2006	Changes to the Companies Act 2006 were presented at the October 2013 FRAB. As these take effect in 2013-14 we are proposing to update the FReM in-year.

Factual corrections to the 2013-14 illustrative statements:

Illustrative statement	Note reference	Change	Reason for change
Magenta Pension Scheme	SoPS	Re-ordering of Notes to create a Parliamentary Accountability section distinct from IFRS-based reporting requirements, including an accounting policies note for the SoPS	To implement changes agreed at the December 2012 FRAB
Department Yellow, NDPB Green	1.ab Pensions	<p>[The departmental group] also operates [name of the scheme(s)] funded defined benefit schemes. A summary of the performance of the schemes is provided in these financial statements, with further information available [link to ALB financial statements]. In accordance with IAS 19, the Scheme Managers/trustees are required to undertake a sensitivity analysis for each significant actuarial assumption as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date.</p> <p><i>This analysis, including Entities should disclose details of the methods and assumptions used in preparing the sensitivity analyses, the limitations of these methods, and the reasons for any changes in methods and assumptions used in preparing the sensitivity</i></p>	Illustrative accounting policy ends mid-sentence. Text has been updated to provide departments with guidance on what information they should disclose.

Illustrative statement	Note reference	Change	Reason for change
		<p><i>analyses. To provide an indication of the effect of the defined benefit plan on the entity's future cash flows, entities should disclose a description of any funding arrangements and funding policy that affect future contributions, the expected contributions to the plan for the next annual reporting period, and information about the maturity profile of the defined benefit obligation. Where relevant, an entity should disclose a description of any asset-liability matching strategies used by the entity, including the use of annuities and other techniques.</i></p>	
<p>Department Yellow, Agency Pink, NDPB Green</p>	<p>2.1 Reconciliation between Operating Segments and SoCNE/SoFP</p>	<p>Rename first row of reconciliation to <i>Total net expenditure reported for operating segments</i> and add a corresponding reconciliation between Operating Segments and the SoFP.</p>	<p>Existing reconciliation reconciles between the SoCNE and the SoCNE instead of between operating segments and the SoCNE. There is no illustrative reconciliation to the SoFP despite this being referenced in the title.</p>
<p>Department Yellow</p>	<p>3 Staff numbers and related costs</p>	<p>Add a column for <i>Charged to Capital budgets</i> in the second part of the table, alongside existing columns for <i>Charged to Administration budgets</i> and <i>Charged to Programme budgets</i></p>	<p>Additional category required so that the totals in the first and second parts of the table will be the same.</p>
<p>Department Yellow, Agency Pink, NDPB Green</p>	<p>19 Losses and special payments</p>	<p>Change reporting thresholds from £250,000 to £300,000</p>	<p>Consistency with Managing Public Money.</p>

Financial Reporting Manual (FReM) – Amendment Record Sheet 2014-15

Changes to the FReM as a result of consultation with preparers:

Paragraph	Change and reason for change
1.2.1	Additional reference to materiality added, saying: for the avoidance of doubt, preparers are reminded that they do not need to develop accounting policies, or provide disclosures, in relation to accounting standards that do not apply to their circumstances or are immaterial.
1.3.1, 1.3.2, 1.3.5	Improve guidance on budgetary controls through adding a reference to Consolidated Budgeting Guidance, including a new annex on the main differences between budgets and accounts, and advising preparers to contact the relevant authorities to discuss the budgeting and Estimates implications of prior period adjustments.
3.3.1	Improve guidance on Supply through reinstating the previous definition and adding a reference to the Supply Estimates Guidance Manual and the Supply Estimates Guidance Manual in Northern Ireland.
4.1.3	Reinforce the point that there is legislation behind the list of ALBs which have to be consolidated by saying: In accordance with the principles set out in Managing Public Money, executive non-departmental and similar public bodies classified to central government by the ONS will normally be controlled for accountability purposes by only one department and the designation order will require that they are consolidated by the department.
5.4.26, Table 6.2, 7.1.11 to 7.1.19 (new), 7.1.26 to 7.1.60	Previous guidance on networked assets, heritage assets, and accounting for PPP arrangements moved from a proposed new annex and reinstated in the main body. Cross-references from chapters 5 and 6 amended. No changes have been made to the underlying guidance.
8.2.1 to 8.2.20	Previous guidance on Consolidated Fund revenue reinstated. No changes have been made to the underlying guidance.

Other changes to the FReM:

Paragraph	Change and reason for change
5.2.25	Clarify existing remuneration report guidance on compensation payments by saying that the cost to be used must include any top-up to compensation provided by the employer to buy out the actuarial reduction on an individual's pension. This is already reflected in EPN guidance issued by the Cabinet Office and is not a new requirement.
3.2.13	Clarify that disclosures required by Managing Public Money or Managing Public Money Northern Ireland are required by all entities covered by that guidance and not only departments. Clarify that disclosures are only required where the amounts are over the limit prescribed in Managing Public Money or Managing Public Money Northern Ireland. Introduce more detailed disclosure requirements for special severance payments (i.e. non-contractual severance payments) as requested by the Public Accounts Committee. This will be consistent with the 2014-15 version of Managing Public Money.
Table 6.2, IAS 36	Change reference to 'loss of economic value or service potential' to consumption of economic value or service potential'

<p>7.3.1 to 7.3.3</p>	<p>Add the following text:</p> <p>7.3.1 Where the carrying amount of an asset exceeds its recoverable amount departments will recognise an impairment loss. Departments need to establish whether any of the impairment loss is as a result of:</p> <ul style="list-style-type: none"> • Consumption of economic benefit or service potential, or; • A change in market price. <p>7.3.2 A fall in value relating to a consumption of economic benefit or service potential is always taken to the SoCNE. A fall in value relating to changes in market price should first be offset against a revaluation reserve for the asset in question if there is one, and once that element of the reserve is exhausted the fall in value should be taken to the SoCNE.</p> <p>7.3.3 Examples of impairments resulting from a consumption of economic benefit or service potential include losses as a result of loss or damage, abandonment of projects, gold-plating and use of the asset for a lower specification purpose.</p>
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Annex C

Financial Reporting Manual (FReM) – Amendment Record Sheet 2014-15 from October meeting

Paragraph	Standard	FRAB (Paper)	Title	Reason for change
6.2.2 (new), 6.2.3 (new), 14.2.20	IFRS 13	FRAB (118) 04	IFRS 13 Fair value measurement – response to exposure draft	HM Treasury proposes to adopt IFRS 13 without adaptation from 1 April 2015. The changes proposed provide information to allow users to prepare for IFRS 13 adoption.
5.1.7, 5.2.2, 5.2.5 to 5.2.19, 5.2.22, 5.2.23, 5.2.25, 14.3.1	Companies Act 2006	FRAB (118) 07	Changes to the reporting requirements of the Companies Act 2006 and associated regulations	The Department of Business, Innovation and Skills (BIS) has implemented new legislation that affects aspects of the reporting requirements within the Companies Act 2006. The changes proposed apply to reporting entities covered by the FReM.
4.2.1 to 4.2.9, 4.2.15 (renumbered), 14.2.1, 14.2.4, 14.2.10 (renumbered)	IFRS 10, IFRS 11, IFRS 12, IAS 27, IAS 28	FRAB (118) 03	IFRS – Group Accounting Standards	<p>The IASB issued IFRS 10, Consolidated Financial Statements, IFRS 11, Joint Arrangements and IFRS 12, Disclosure of Interests in Other Entities in 2011. These standards, along with amendments made to IAS 27, Separate Financial Statements and IAS 28, Investments in Associates and Joint Ventures constitute the Group Accounting Standards, which remove inconsistencies within IFRS. These standards were EU-adopted for annual periods beginning on or after 1 January 2014.</p> <p>Following public consultation, the Treasury is now in a position to recommend the application of the Group Accounting Standards to the FReM with adaptation to maintain the departmental and WGA accounting boundaries.</p>

FReM review of adaptations and interpretations from October meeting

Paragraph	Standard	Adaptation or interpretation	Change	Reason for change
5.4.11, 11.2.9	IAS 1	Profit on disposal of an asset can be accounted for as negative expenditure to the extent that the profit represents a final adjustment for depreciation. Where this is not the case, profits should be accounted for as income.	Delete interpretation	<p>Alignment of treatment of profit on disposal of an asset with Consolidated Budgeting Guidance.</p> <p>The existing FReM text is not consistent with changes made to Consolidated Budgeting Guidance relating to the retention of income under Clear Line of Sight. Consolidated Budgeting Guidance limits the level of</p>

Paragraph	Standard	Adaptation or interpretation	Change	Reason for change
				<p>profit on disposal scoring in resource DEL to a maximum of £20 million, or 5 percent above the net book value of the disposal, whichever is the lower.</p> <p>No interpretation is needed for the accounting for profits on disposal. Departments will follow Consolidated Budgeting Guidance to determine whether the profit can subsequently be spent.</p>
7.2.4	IAS 38	An entity adopting the requirements of the FReM for the first time can only use retrospective capitalisation for an internally generated asset where it holds reliable original cost information.	Delete interpretation	<p>The current text does not interpret the standard but instead provides general guidance which would apply to any entity adopting IAS 38 for the first time.</p> <p>As there are increasingly few bodies applying the FReM for the first time it doesn't seem necessary to provide this extra guidance.</p>
9.2.7e	IAS 39	Liabilities under financial guarantee contracts that are not accounted for as insurance contracts should be measured initially at their fair value and, as appropriate, amortised subsequently to the SoCNE or its equivalent. Subsequent changes in probabilities should not be reflected in the carrying value except where the result is that IAS 37 would require recognition of a liability because it is more probable than not that a transfer of resources will occur.	Delete interpretation	The current text does not interpret the standard but instead provides general guidance which would apply to any entity with financial guarantee contracts that are not accounted for as insurance contracts.
1.7.4b	IFRS 1	Reporting entities cannot elect to use the 'corridor' approach in IAS 19 <i>Employee Benefits</i> .	Delete interpretation	Interpretation no longer necessary following amendments to IAS 19 <i>Employee Benefits</i> which removes the option of the 'corridor' approach from 2013-14.

FReM clarifications, tidy up and corrections from October meeting

Paragraph	Reason for Change
1.1.4, 1.2.3, 2.1.6, 5.1.1, 5.2.9, 5.2.20e, 6.2.3, 6.2.7b	References to the Manual's dedicated website changed to gov.uk
1.4, 1.4.1, 4.2.2, 5.1.2, 5.2.1, 5.2.4, 5.2.8, 5.2.10 (new), 5.2.18 (new), 5.4.8, 5.4.10, 5.4.13, 5.4.17, 5.4.28, 6.2.71(b), 11.2.7, 11.2.17 (renumbered), 11.5.1	References to non-departmental public bodies or NDPBs updated to arms length bodies or ALBs to cover all bodies within a departmental group
1.7.4, 2.1.4	Clarifying that there are no adaptations to the valuation of inventories within the Manual
3.2.6	Allowing flexibility to allow explanations of variances to be given with the Statement of Parliamentary supply rather than specifying that they must be on the face of the note, which may be impractical
5.1.2, 5.2.4	Specifying which chapters of the Companies Act 2006 apply to entities using the FReM
5.1.8	Departments will be carrying out mid-year reporting to Parliament from 2013-14. The FReM has been updated to note that this mid-year reporting is outside the scope of IAS 24 <i>Interim financial information</i> . Entities choosing to produce interim financial information will continue to apply the standard in full.
5.2.12	Reference corrected from OCS to SCNE
5.2.18	Reference corrected from Part 4 and Schedule 8 of the Companies Act to Part 4 of Schedule 8
5.2.23 (renumbered)	Include reference to remuneration report guidance for Westminster departments circulated annually by the Cabinet Office
5.4.48	Correcting cross-reference
5.5.6 (new)	<p>A new provision (s.479A) was inserted into the Companies Act 2006 (by SI 2012/2301) which allows exemption from audit for subsidiary companies, provided that the parent company provides a guarantee for the subsidiary's liabilities, and the subsidiary is included in the consolidated accounts of the parent. This new provision applies to accounts for financial years ending on or after 1st October 2012.</p> <p>The FReM has been updated to note the exemption available and to require entities wishing to apply the exemption to seek approval from the relevant authority.</p> <p>HM Treasury's view on the use of the exemption by government owned companies is that the potential loss of accountability should be considered against materiality and that decisions should therefore be made on a case by case basis.</p>
6.2.8, 6.2.9, 6.2.20, 6.2.32, 6.2.33 (all renumbered)	Standardising references to fair value and reporting date
7.2.6	Correcting cross-reference
9.2.7d	Clarifying that the real discount rate that preparers should apply is the financial instrument discount rate (currently 2.2%) as HM Treasury publishes several real discount rates
10.2.16	Correcting cross-reference
3.2.5, 11.2.8 to 11.2.10, 11.2.13 (renumbered), 11.2.14 (renumbered)	Updating language to remove references to 'appropriations in aid' and 'request for resources' in order to align with Consolidated Budgeting Guidance on recording of income in the Statement of Parliamentary Supply
11.3.7	Correcting cross-reference
12.1.1	Including Royal Mail Statutory Pension Scheme to the list of public sector pension schemes
14.2.5	Correcting duplicated text

Previous FRAB discussions of IAS 36

Extract of FRAB paper 02 of the 94th FRAB meeting held on 20 November 2008 at HM Treasury

21. Impairments are recognised where the recoverable amount of a fixed asset falls below its carrying amount. Impairments score in the resource budget alongside the depreciation charge, and are separately identified. Impairments are also required to be identified by type of asset and reason as, from 2007-08, some charges are scored to DEL and some to AME.

22. The budgeting treatment is dependent on the cause of the impairment, which is split into six categories, across DEL and AME, and provides support for departments' management decisions. Essentially, this ensures that DEL is at risk for impairments that arise from a clear consumption of economic benefit or other factors when these should be within the control of the department, for example loss or damage resulting from normal business operations, or "gold plating". Where the department has no control over the event that caused the impairment (eg a catastrophe or general price movements), DEL is not impacted and the charge is scored to AME.

23. The current treatment in UK GAAP based resource accounts is that where there is a clear consumption of economic benefit, the impairment is taken to the OCS. This will usually result in a treatment that is consistent with the budgeting treatment. However, under IFRS, if there is a remaining revaluation reserve, this is to be utilised first. This will cause a misalignment between the budget and resource accounts treatment. At present, a note in Department Yellow, the illustrative departmental resource accounts, shows the level of impairment caused by a clear consumption of economic benefit.

24. The proposed approach is to score impairments to the resource DEL or resource AME budget as now, depending on whether they arise from a clear consumption of economic benefit that should be managed within DEL, or from factors outside the department's control, which will be scored to AME. This is considered necessary to reflect the underlying economic substance of the change in value and to avoid increasing fiscal risk. To regain the alignment between budgets, Estimates and resource accounts existing under the current FReM, we propose to ask the Board to reconsider an adaptation to the IFRS-based FReM to allow the scoring of all impairments that are caused by a clear consumption of economic benefit to the OCS. However, to ensure that the outcome as reflected in the reserves figures on the balance sheet is consistent with the requirements of IAS 36, the balance on any revaluation reserve to which the impairment would have been charged under IAS 36 will be transferred to the general fund.

Extract of minutes of the 94th FRAB meeting held on 20 November 2008 at HM Treasury

25. In UK GAAP based resource accounts, where there is a clear consumption of economic benefit, the impairment is taken to the OCS. This usually results in a treatment that is consistent with the budgeting treatment. However, under IFRS, if there is a remaining revaluation reserve, this should be utilised first and will cause a misalignment between the budget and resource accounts treatment. The Treasury is proposing an adaptation to IAS 36 in the IFRS based FReM to allow the scoring of all impairments that are caused by a clear consumption of economic benefit to the OCS, and the balance on any revaluation reserve to which the impairment would have been charged under IAS 36 to be transferred to the general fund.

26. The Chairman asked whether this could be solved by changing the budgeting treatment, however the Treasury replied that it would not be possible as it would require knowing in-year how much revaluation reserve would be left.

27. David Heald asked whether the proposals (in particular in relation to the roads network) could mean that there would be very big and unpredictable big hits to the OCS. It was confirmed that this was the case. However Ian Carruthers said that following on from previous discussions about the roads network, it had been concluded that to budget properly, a joined up approach was necessary and the proposals would reinforce the need for good asset and financial management.

28. Ian Mackintosh had concerns about creating a reserve. However, the Treasury and other Board members said that this was necessary in order to make the numbers add up and that there was a difference between reporting what's happened and reporting the balance of reserves in year. David Heald warned that depending on the size of hits, this could have a significant impact.

29. Martin Sinclair commented that while this proposal called for an adaptation and a better accounting solution might be possible, this proposal would give the best solution in terms of parliamentary oversight.

30. Kerry Twyman was concerned that the arguments presented did not meet the Board's criteria for agreeing to an adaptation of IFRS. Martin Sinclair suggested that it should be agreed on the basis that it would give improved parliamentary control.

31. Ken Wild suggested that the adaptation wasn't a departure from GAAP, rather a way of making sure that things are looked at in the right way.

32. The majority of the Board agreed in principle that impairments caused by a clear consumption of economic benefit should be taken to the OCS. Scotland, however, did not currently agree in principle and could not consider signing up to the proposals until the Treasury brought back more detailed papers to support its argument.

33. Summing up, the Chairman confirmed that the majority of the Board had no objections in principle to the proposals put forward and the Treasury agreed to return to the Board with detailed papers on their proposals in due course.

Extract of FRAB paper 06A of the 98th FRAB meeting held on 8th October 2009 at HM Treasury

7. The budgeting treatment of impairments is that they are charged to Departmental Expenditure Limit (DEL) or Annually Managed Expenditure (AME), (depending on the reason for the impairment) if they result from a clear consumption of economic benefit. This is aligned to the treatment of impairments in the National Accounts and is consistent with UK GAAP which requires impairments meeting these criteria to be included in the income and expenditure account.

8. This treatment is not however consistent with IFRS which requires any balance on the revaluation reserve to be used first, and the uncovered residue (if any) of the impairment to be included in the income and expenditure account.

9. The Treasury proposed in FRAB paper 94 (02) in November 2008 an adaptation to the IFRS-based FReM to allow the scoring of all impairments that are caused by a clear consumption of economic benefit to the OCS. This would regain the alignment between budgets, Estimates and resource accounts that existed under the UK GAAP FReM. Whilst there are benefits in regaining such alignment, there are practical obstacles to achieving this by amending the budgetary treatment and the Treasury believes that there are clear public sector reasons to instead adapt the IFRS treatment.

10. The Board agreed in principle at the November 2008 meeting to the suggested adaptation, although the Scottish Government member expressed concern that the arguments presented did not meet the Board's criteria for agreeing to an adaptation of IFRS and was not convinced that a clear public sector rationale to support the proposed adaptation had been articulated. This paper therefore expands on the Treasury's arguments for an adaptation of IAS 36 Impairment of Assets at paragraphs 11 and 12 below.

11. In the private sector the overall cash return on the use of an asset is an important consideration and, to the extent that impairment can be absorbed by a previous upward revaluation, then it is arguable that the profit and loss account has not suffered a realised loss. In the public sector the more important concept is that of the maintenance of service potential – the fact that there may have been previous, market driven, revaluation gains is not so relevant as these will not in themselves result in an increase in the service potential or utility of an asset against which a real decrease in service potential (due to a subsequent clear consumption of economic benefit) can be offset. As the OCS is the accounting statement designed to show the use of resources (i.e. the consumption of economic benefit) then it would seem appropriate in a public sector context to use it to score impairments due to the consumption of economic benefit. Unlike the for-profit sector the effect of such impairments cannot be 'cushioned' by previous revaluation gains.

12. The Treasury also believes that there are sound financial management and parliamentary oversight reasons to score impairment losses caused by a clear consumption of economic benefits to the OCS regardless of the fact that a reserve may happen to exist. By including such impairments in a primary statement, there will be visibility to Parliament and others of the consumption of economic benefits. This will strengthen the incentive on managers to ensure that public sector assets, (which, in contrast to the private sector, are held for the provision of public services, not income or capital gains), are well managed as they will have to account for their actions or inactions in the OCS regardless of whether there is a revaluation reserve (the value of which may be largely outside of their control). The NAO endorsed this view at the November 2008 Board meeting.

13. Further arguments subsequently put forward by the Scottish Government for retaining the IFRS treatment and amending the budgetary treatment have included the limited ability to plan for impairments and that the scope to charge impairments to the revaluation reserve will allow greater 'headroom' and avoid hits on DEL budgets. However the Treasury believes it would remain difficult to budget for impairment hits when revaluation reserves themselves may be volatile and would also note that, irrespective of the accounting treatment, impairments that are truly unpredictable such as damage through catastrophe or unforeseen obsolescence are scored through AME. To avoid taking a hit against resource budgets, whether DEL or AME, would increase fiscal risk and would reduce the incentives for public sector bodies to seek to manage impairments wherever possible.

14. We therefore request the Board endorse its earlier agreement in principle to an adaptation in the FReM to allow the scoring of all impairments that are caused by a clear consumption of economic benefit to the OCS. However, to ensure that the outcome as reflected in the reserves figures on the balance sheet is consistent with the requirements of IAS 36, the balance on any revaluation reserve (up to the level of the impairment) to which the impairment would have been charged under IAS 36 will be transferred to the general fund. The proposed changes to Chapter 8 of the FReM are set out at annex A.

Extract of minutes of the 98th FRAB meeting held on 8th October 2009 at HM Treasury

39. On the impairment issue the Board had agreed last year in principle to an adaptation of IAS 36, subject to receiving a detailed paper from the Treasury. However, there hadn't been a unanimous agreement by the Board, and there were differing views on the way forward, including arguments around private sector objectives v public sector objectives, and the capacity of the public sector and private sector to deliver.

40. The Treasury explained that the primary use of resource accounts is to provide parliamentary accountability on the consumption of resources. The Treasury believes that there are sound financial management and parliamentary oversight reasons to score impairment losses caused by a clear consumption of economic benefits to the OCS regardless of the fact that a reserve may happen to exist. By including such impairments in a primary statement, there will be visibility to Parliament and others of the consumption of economic benefits due to poor management decision making.

41. David Thomson said that although the Board wanted to keep budgeting and accounting aligned he couldn't see why it was proposed to diverge from IFRS to meet budgetary rules.

42. Ken Wild said that the aim should be to align as much as possible. The impairment disclosure under IAS 36 for revalued assets followed from the fact that fair value was optional under IAS 16. Taking fundamental impairments to the Income Statement would have been a disincentive to the private sector using fair value and the IASB wanted to encourage it without making it compulsory. This did not apply to the public sector where it was compulsory and so the different treatment was probably acceptable. However, there are other standards where value is not as optional - IAS 39 and 41 - and therefore the public sector specific argument could be questioned.

43. Ian Carruthers suggested that the problem lay with the fact that nobody has thought through all the budgeting and accounting issues involved with a full revaluation regime.

44. Kerry Twyman was not convinced that a clear enough argument had been presented for the adaptation. Russell Frith also agreed that he was unconvinced by the arguments in the paper, but was persuaded by Ken Wild's argument and by the parliamentary accountability issue.

45. The Board discussed how impairments should be handled. Ken Wild suggested that the IAS 36 treatment was bad accounting. Ian Mackintosh agreed that there was an accountability issue.

46. Andrew Baigent said that although the Board had spoken about whether budgets should drive accounting, it had not considered whether parliamentary accountability should override IFRS. The Board was establishing reasons why it was not comfortable with the proposal but accountability would be a good reason why this might be the right approach.

47. Kerry Twyman said she could not agree in principle to the proposed adaptation, and would need to take back the new arguments presented to determine the Scottish position. Following further extensive discussion the Chair moved that the Board had reached a point of decision on this accounting issue. The majority of the Board agreed the proposed adaptation. Scotland however disagreed with the Board's decision, as it thought the adaptation might result in a distortion of management decision-making and that the adaptation was not justified in the public sector context.

Extract of 2014-15 Consolidated Budgeting Guidance

Revaluations and impairments – tangible fixed assets

IAS 16 provides entities with the option of carrying tangible fixed assets at historical cost or fair value. However, the FReM has withdrawn the option to carry assets at historical cost; therefore all tangible fixed assets must be carried at valuation at the reporting period (see FReM for details of the full accounting and valuation requirements).

The treatment of revaluations in budgets mirrors the treatment in accounts.

Revaluation gains will be taken to the revaluation reserve in accounts so will not score in budgets.

Where the carrying amount of an asset exceeds its recoverable amount departments will recognise an impairment loss. Departments need to establish whether any of the impairment loss is as a result of:

- Consumption of economic benefit or service potential, or;
- A change in market price.

A fall in value relating to a consumption of economic benefit or service potential is always taken to the SoCNE.

The following types of impairment relating to the consumption of economic benefit or service potential score in DEL budgets:

- Loss or Damage resulting from normal business operations –The department has a choice about how it manages assets to reduce the risk of damage, accident and theft.
- Abandonment of projects –Abandonment results from managerial decisions, and can be an indicator that a stronger project approval process and business case evaluation is necessary.
- Gold plating –Gold plating is the unnecessary over specification of assets; this could be prevented through improved control processes. Construction to a necessarily high standard for legitimate reasons (security for example) should not be considered gold plating.

The following types of impairment relating to the consumption of economic benefit or service potential score in AME budgets:

- Loss caused by a catastrophe –This sort of loss is outside the normal experience of a department, so the only trade-offs that should be made are between the capital cost of replacing this asset and doing other capital work. Where a department believes an impairment should score as catastrophic loss it should first contact the relevant authority, as these are rare events.
- Unforeseen obsolescence –As the obsolescence is unforeseeable and there seems little benefit in trade-offs with other current spending. Where the asset has been rendered obsolete by the acquisition of a new technologically advanced asset the investment appraisal of the new asset should have covered the option of continuing to use the old one. Unforeseen obsolescence can also arise as a result of changes to legislation. When a department believes an impairment should score as unforeseen obsolescence it should first contact the relevant authority.
- Other – Scores as AME. This category includes:

- write downs where an asset is to be used for a lower specification purpose than originally intended; and
 - write downs as result of asset being seized without compensation provided (usually by other governments).
- When a department believes an impairment should score in the 'other' category and it is not included on this list they should contact HMT.

A fall in value relating to changes in market price should first be offset against a revaluation reserve for the asset in question if there is one, and once that element of the reserve is exhausted the fall in value should be taken to the SoCNE and would score in AME. This type of impairment includes:

- Write downs of development land to open market value;
- Write downs of specialised properties held at depreciated replacement cost to open market value immediately prior to sale (where a non-specialised asset is to be written down it should be treated as accelerated depreciation or profit/loss on disposal as appropriate); and
- Write downs of newly constructed specialised properties to depreciated replacement cost on the initial professional valuation.

Revaluations and impairments – intangible assets

Where an impairment is applied to tangible fixed assets, the budgeting treatment is dependent on the reason for incurring the impairment. The same budgeting treatment applies to intangible assets, but where a department believes an intangible asset is subject to one of the categories of impairment above it should first contact HMT.

Revaluations and impairments – stocks

The impairment of stocks would be treated differently depending on the budgeting treatment of stocks:

- the normal budgeting treatment of stocks is that stock acquisition does not score in budgets, but use and write-off do score. In this case, all impairment or write-off of stock would score in RDEL whatever the cause;
- exceptionally, the acquisition of some stock scores in capital budgets (see Chapter 6). In that case, stock is generally analogous to tangible fixed assets, and the rules for the DEL/AME treatment of impairments would follow the treatment for tangible fixed assets.

Revaluations and impairments – investments

In Departmental Accounts, upwards revaluations of certain types of financial asset are taken directly to the SoCNE, rather than any revaluation reserve. The budgeting treatment reflects this, and revaluations of these assets also score to resource AME.

The same budgeting treatment applies to impairments to investments as for tangible assets, but where a department believes an investment asset is subject to one of the categories of impairment above it should first contact HMT.