MINUTES OF THE 116th FRAB MEETING HELD ON THURSDAY 4 APRIL 2013 AT HM Treasury

Present: Kathryn Cearns (Chairman)

David Aldous	Sue Higgins
Andrew Buchanan	Ian Carruthers
Robert Davidson	Gawain Evans
Kathryn Gillatt	Fiona Hamill
David Hobbs	Larry Honeysett
Edward Leigh	Maggie McGhee
Janet Perry (by phone)	Karen Sanderson
Mike Usher	Aileen Wright
Ron Hodges	

Secretariat: Philip Trotter (Secretary)
Dennis Lu

Guests: Sarah Sheen
Paul Mason

1. Apologies were received from Bob Branson, Roger Marshall, Janet Dougharty and Veronica Poole. Guests at the meeting included Paul Mason and Sarah Sheen from CIPFA.

Item 1: Matters Arising

2. There was one matter arising from FRAB 115, where Andrew Buchanan had asked whether Parliament felt accountability for the use and stewardship of public assets would be best served by an IFRS 13 exit value approach to fair value or whether service potential could be used. Larry Honeysett reported that there was no Parliament corporate view on this matter but that if asked for advice he would be wary of taking into account service potential for non-specialist buildings. For these assets a market value approach would best serve accountability needs.

Item 2: Update on discount rates (FRAB (116)02)

3. Following a Board request at FRAB 115, the Treasury presented a paper providing a more detailed analysis of current market movements and the impact that this could have on the discount rates set by the Treasury.

4. Having explained the methodologies that are currently used to set discount rates in the areas of general provisions and post-employment benefits, the Treasury provided an analysis of recent market movements and events that could potentially have an impact on the rates set.

5. The Chairman noted that there were two main issues for the Board to consider. These were (i) that there have been changes from the November rate to the year-end rate which could have a significant impact on balances and (ii) the timing of the change in the long-term provision rate. The Chairman reminded the Board that in previous meetings it had agreed to a policy where rates were set in advance, and that it would look at the November to March difference in rates to see if there was significant change.

6. Kathryn Gillatt noted that the difference in rates and the impact on balances looked significant and as such movement to March rates should be explored. Andrew Buchanan concurred asking whether it was necessary to move from the November rate to the March rate and questioning whether it was appropriate for the long-term rate for general provisions not to be updated.

7. Maggie McGhee agreed that the Treasury analysis showed that there was a significant difference and that this could potentially be a true and fair issue. Mike Usher noted that if there was no change to the rates disclosure by way of note would be important.

8. Karen Sanderson reminded the Board that it had agreed the methodology and that this needed to be maintained as stability was important. While accepting the point on true and fair, this only impacted on a small number of entities. Enhanced disclosure was, however, a valid response. Janet Perry also noted that changes this late in the year could have an impact on NHS bodies which could find they suddenly face significant deficits.

9. Ron Hodges noted that whilst the position was not ideal, the methodologies had been accepted by the Board. Ultimately true and fair is for the auditor to decide, although some organisations may face issues and the Government and Board may face criticism.

10. The Chairman noted that whilst we are in a low interest rate environment there is still volatility and it is difficult to explain discount rate changes to users of the accounts. As such disclosure needs to be solid, and if possible there needs to be a mechanism to show the impact of not updating the rates in the disclosures. Andrew Buchanan reiterated his concerns at requiring entities to use a rate that gives rise to a significant misstatement.

11. The Secretary explained the history of why the Treasury first proposed and the Board accepted the use of a November rate. As entities needed to gain Parliamentary Supply cover for impacts arising from discount rate changes, and the last opportunity to do this was at the Supplementary Estimate, requiring a change to year end rates would lead to a large number of qualifications. As this would not be the result of any financial mismanagement by entities but solely due to the manner in which the supply system operates, this was not felt to be in the interest of good finance management.

12. The Chairman indicated that a reminder of the history was useful and that while this situation was not ideal it was reasonable. Given the level of interest, the Board agreed it was useful to keep returning to the topic. The Chairman

then requested that the Treasury provide an indication as to when the long-term rate for general provisions would be updated.

13. The Treasury noted that in accordance with the agreed methodology the long-term rate would be expected to be set ahead of the next Spending Round in 2015-16.

Item 3: Verbal update on Consolidation Standards/ Accounting for Schools (FRAB (116)03)

14. The Treasury provided a verbal update of work that has been undertaken on consolidation standards and accounting for schools, first recapping the structure of the groups that are undertaking work in this area and then providing an update on the technical issues being addressed.

15. The Treasury reported that there is a technical working group that is looking at consolidation standards and their impact for financial reporting in the public sector as a whole. This group will feed into and provide the technical foundations for the cross-government schools working group that will look specifically at the accounting for schools issue. Separately there is a CIPFA/LASAAC working party that is looking to develop accounting advice for the Code.

16. The technical working group met at the beginning of March and will be meeting again at the end of April. The outputs of this group will inform HMT and other Relevant Authorities in their consultations on the application of the consolidation standards over the summer. The group aims to provide papers to the FRAB in October. The cross government group will meet in early May taking a principles based approach.

17. The technical working group is drawing on experiences from the private sector in looking at the public sector view of the implications. It is expected that the outcome under IFRS 10 will be similar as under IAS 27, although there were some fringe cases where there may be differences. In particular the group was examining the definition of variable returns and the standard's applications to non-financial returns. The group was also examining control criteria with respect to grant funding and wider regulatory arrangements, which were deemed to be different to control under IFRS 10. Early indications were that there would need to be additional guidance on controls and consolidation for public sector organisations, particularly with respect to joint arrangements.

18. Sarah Sheen then updated the Board on the progress of the CIPFA/LASAAC group, which met on 14 March. The group examined consultation responses and the response provided by the Department for Education. For 2013/14 it was agreed not to make any changes to the Code, but a technical alert has been produced setting out in overview the current deliberations of the CIPFA/LASAAC Working Party and issued on the CIPFA website.

19. The Chairman invited the Board to put forward any questions on the progress of the groups. David Aldous noted that consolidation presented a number of current and important issues for public sector bodies and so the work of the groups is needed, and it was encouraging that a distinction was being made between regulation and control. He indicated that IPSAS 6 provided useful information here.

20. The Chairman indicated that if the boundary had been drawn in a different way, this issue would have been raised earlier. It was, however, useful to now spend time on this to get things right as the principles expounded will be helpful even if the boundary rules are not changed. She thanked the Treasury and looked forward to future updates to the Board on this issue.

Item 4: IFRS 13 Fair value – Application in central government Measurement (FRAB (116)04)

21. The Treasury presented a paper that analysed the application of IFRS 13 to central government assets. The Treasury requested the Board's views on the conceptual issues raised by the paper as this would assist in further developing the proposals.

22. Ian Carruthers noted that the Treasury paper was helpful in setting out how a direct application of IFRS 13 would work and especially in highlighting the WGA data and the relative importance of the various asset categories. He indicated that CIPFA/LASAAC discussed IFRS 13 at its most recent meeting, and it had requested CIPFA provide an overview of the history of how it had got to the current asset valuation position and a detailed examination of the impact of changing valuation methodologies for certain types of asset. A draft CIPFA/LASAAC paper was provided to the Board showing the particular importance of restrictions on the usage and disposal of assets. Ian Carruthers therefore asked for the Board's views on restrictions and how these are dealt with in the private sector.

23. The Chairman noted that the papers helped to move the debate forwards. One issue highlighted by the papers is that there is a multiplicity of valuation approaches, which may not be helpful for users of accounts. It would be useful to have a more principled view as to which methodology is appropriate in what circumstances.

24. Ron Hodges said that he felt there is a major conceptual difference between an IFRS approach based on exit values and current approaches in the public sector that use entry values. He noted that it was inevitable that IFRS would take an exit values approach as they have been developed to meet the needs of capital markets. He was not convinced that exit values will always be most appropriate for the public sector. Level 3 inputs seem potentially dangerous, and there is a need to minimise these if at all possible. There is a role for Depreciated Replacement Cost (DRC) in the public sector, even if starting from entry value, as it is especially useful for specialised assets. He noted that market values do have a role to play for non-specialised assets. He agreed

with Ian Carruther's view that restrictions were important as not all assets are easy to sell for highest and best (and hence most valuable) use.

25. Kathryn Gillat noted that the papers showed that there would only be limited change with the full application of IFRS 13. Ian Carruthers indicated that there were some areas where there could be major changes if IFRS 13 were directly applied, in particular the valuation of buildings and dwellings. David Aldous agreed that restrictions are relevant, noting that the draft CIPFA/LASAAC papers approach to social housing appeared, in effect, to be a fair value with restrictions approach.

26. Andrew Buchanan commented that highest and best use was particularly relevant in the public sector context when there are significant restrictions placed on assets as IFRS 13 does say highest and best use where legally permissible. He thought that the use of level 1 inputs was likely to be limited, with a large proportion of asset valuations being level 3. He was not troubled by level 3 valuations. He concluded by noting that whilst the categorisation of assets in the Treasury paper was useful, it would be helpful if this could be expanded upon to look at assets within each of these categories.

27. Gawain Evans' view was that if assets were not specialised then he saw no reason not to adopt IFRS 13 valuation. His worry was that entities would be too eager to use exceptions for non-specialised assets if they were available. He thought that the MoD should be examined in particular, as there could be a big impact if the approach was changed for the specialised assets it held.

28. Karen Sanderson raised the question as to whether it was appropriate to use "the highest and best use" conceptually for public sector assets. This was less about the outcome, but rather whether this was conceptually a sound approach, especially for specialised assets.

29. The Chairman drew the debate to a close. She noted that in her opinion IFRS13 is conceptually sound for the public sector. While it was acceptable to reflect in valuation methodologies the differences related to specialised assets, recognising assets at highest and best use is an important accountability issue. The Chairman suggested that a small working group be formed so that a common position can be reached by the end of May. By that point it will be necessary for the Relevant Authorities to say whether they are applying IFRS13 and if not why not. Sue Higgins volunteered to assist in putting this group together.

Item 5: Verbal update on accounting for PPP arrangements and service concessions (FRAB (116)05)

30. The Treasury provided a verbal update on further work that had been undertaken on accounting proposals for PPP arrangements and service concessions. The Board was reminded that an exposure draft proposing amendments to the FReM had previously been issued following the release of IPSAS 32. The exposure draft proposed changes to the timing of asset recognition and an accounting treatment for those arrangements not involving

(or not solely involving) a unitary payment to the operator from the grantor. While the first amendment was agreed, the accounting treatment for non-unitary payment arrangements was not accepted by the NAO. Their view was that it was conceptually incorrect to raise a liability for a performance obligation, and that this would in any case not match the value of the gain associated with the asset.

31. The Treasury reported that it had subsequently met to further discuss this issue with the NAO, but no significant progress was made. The IASB recently released an exposure draft on accounting for performance obligations, and it was proposed that until a more developed understanding of the IASB position has been reached any further work in this area should be put on hold.

32. The Chairman responded noting that the Accounting Council had agreed with the NAO position and asked why the IPSASB felt able to undertake the approach it had adopted for IPSAS 32.

33. Paul Mason who had been on the taskforce that developed the standard indicated that a consequence of not recognising a liability it to show a full gain immediately and that this windfall gain was inappropriate. The IPSASB taskforce had looked at revenue recognition principles, particularly with respect to licenses and royalties. It came to the conclusion that this is an asset swap involving the transfer of an intangible asset to the operator and a performance obligation needed to be recognised.

34. Karen Sanderson raised the question as to whether this was really an issue as she could not immediately see a real world application. The Chairman agreed and work was deferred until real world examples arose. Ron Hodges indicated that when the IPSAS was being consulted upon there were many comments that this was not a liability as no exchange of cash or other asset was involved. He felt there is a need to recognise something, as an obligation does exist, but what this is remains uncertain.

Item 6: The NHS Manuals for Accounts – update on progress (FRAB (116)06)

35. Janet Perry presented this paper. Despite aims to issue the Manual at the start of each financial year, it has still not been possible to meet this timescale in 2013-14; major changes made to the structure of the NHS and the need to consult on policies around the transition has made meeting the deadline more difficult.. The draft Manual is expected to be available for the Board’s May meeting, with the final Manual being circulated in July.

36. The Chairman asked for comments from the Board. David Aldous had no comments on the Manual but wanted further information on the PCT/SHA issues that were noted in the paper. Janet Perry commented that the issue had arisen because application of absorption/merger accounting guidelines would have resulted in new bodies receiving windfall gains or unexpected losses and a change in spending power. Karen Sanderson indicated that the

Department had written to the Treasury requesting that gains and losses be taken through reserves as a result of these unintended consequences.

37. The Chairman asked why these unintended changes in spending power did not apply on every occasion and if this is likely to be a pervasive problem with the guidance. Janet Perry noted that this could have been avoided through the movement of resources, however with the separation of providers and commissioners this is no longer an alternative solution. .

38. The Chairman asked for the draft manual to be circulated early given its size and complexity and also asked the Treasury to report back on the accounting issue raised. The Chairman also noted that it would be helpful for the Department of Health to present to the Board an overview of the new NHS reforms at a future meeting, given the nature of the restructure that has taken place.

Item 7: Verbal update on Improving Relevance and Clarity in Central Government Financial Reporting (FRAB (116)07)

39. Karen Sanderson provided a verbal update on a project that the Treasury has recently initiated on simplifying and streamlining the annual report and accounts of central government entities. She noted as background that this project was informed in part by the reaction to WGA, where numbers that were already in the public domain, were being commented on for the first time. Also no assessment has been made since the introduction of accrual accounting as to whether annual report and accounts are meeting the needs of users.

40. It was explained that the purpose of the project is to simplify and streamline the presentation of annual report and accounts, to better meet the needs of users of the accounts, based on a clear understanding of the purpose of those accounts, and to remove unnecessary burdens from the preparer community. The scope of the project will include all information in departmental annual report and accounts and WGA, with a tight project timescale meaning that the work will be conducted over the summer with a view to introducing improvements progressively from 2014/15, but with the possibility of some benefits being realised in 2013/14.

41. It was noted that the NAO also has an active project in this area, and the Treasury would look to work with the NAO to achieve synergies between the two projects. The Treasury would also be looking for support from the Relevant Authorities and FRAB. Maggie McGhee noted that the NAO project is mainly looking at this issue from an audit perspective, with a particular focus on materiality for individual entities.

42. Board members were unanimously positive about the project. Andrew Buchanan indicated that he would like to see as wide a group of users as possible included, especially MPs and other parliamentary users. He also

indicated that the IASB was about to begin a short-term project to amend IAS 1 focussing on materiality and its proper application. There could therefore be results this year relevant to the streamlining and simplification project.

43. Mike Usher was pleased with the reference to potential users and he hoped the project would start a positive debate about what users wanted to see in the Annual Report and Accounts. Ian Carruthers also expressed his hopes that the project could be used for consultation with the local government community.

44. Sue Higgins indicated that the Finance Leadership Group was active in a similar space and had been looking at how to make accounts more useful to users. Kathryn Gillat requested that the Treasury look at the possibility of using digital communications techniques to improve accessibility, whilst Larry Honeysett also noted that accessibility was key, with Members appreciating intelligible accounts as lay users.

45. Gawain Evans expressed his support for a joint project with the NAO. He indicated that in his experience auditors were the reason for much of the increase in unnecessary disclosure and clutter. David Hobbs was of the view that rather than users of accounts, governments have users of information and there could be a good opportunity here to draw together a number of information sources.

46. The Chairman raised the point that in the private sector Finance Directors (FDs) who meet analysts never get asked questions about the accounts. Analysts use the face time to get an understanding of the big issues and then use the accounts extensively in their modelling once they have this understanding. Accounts are important and it is positive that the Treasury is taking forward this project. The Board looks forward to seeing how the project progresses and is ready to offer its support.

Item 8: Verbal update on FRAB working practices (FRAB (116)08)

47. The Secretary provided an update to the Board on the results of a meeting held by the Relevant Authorities on future FRAB working practices. In order to aid their discussion, the Chairman had drafted a paper that highlighted the relevant issues and risks arising from internal resourcing challenges and the possible responses that the Relevant Authorities could make to them.

48. The Secretary noted that the Relevant Authorities had a positive discussion around the issues highlighted in the paper, and felt that the move to a reduced number of Board meetings was an opportunity to work together in a more efficient and effective manner. It was agreed that in future individual Relevant Authorities would take the lead on specific accounting and financial reporting issues, acting as responsible lead and ensuring that necessary technical resources were utilised, including if appropriate a technical “panel” comprised

of volunteers from the firms. The Relevant Authorities also committed to meet on a more frequent and regular basis.

49. The Secretary informed the Board that he would be looking to trial a new system to keep Board members informed of the future work programme and the progress being made by the Relevant Authorities. With a move to a reduced number of meetings, the Secretary will update Board members electronically on a monthly basis. Where appropriate the Secretary will also look at whether items can be agreed between meetings.

50. The Chairman thanked the Relevant Authorities for their constructive approach to responding to the issues raised, and looked forward to seeing the results of the improved working practices.

Item 9: Report from the European Commission – Towards implementing harmonised public sector accounting standards in Member States – The suitability of IPSAS for Member States (FRAB (116)09)

51. Karen Sanderson presented a paper on a recent report from the European Commission that examines the potential implementation of harmonised public sector accounting standards in EU Member States, and specifically the suitability of IPSAS as the basis for these standards.

52. Ian Carruthers noted that Eurostat had done a good job with the report and had engaged a wide range of users. He indicated that from an IPSASB perspective it recognised some of the criticisms that were levelled at IPSAS, but felt that others were less warranted. In general though he noted that it was a fair report and agreed with Karen Sanderson's view that political support was crucial. He also indicated that the project was timely given that the G20 and international organisations including the IMF and World Bank had noted the importance of accrual accounting.

53. The Chairman indicated that she recognised the comments made on IPSAS as being the same as made by the Securities Board when the introduction of IFRS was being debated. This was a good sign as critical comments indicated that the Commission are looking at this seriously. She noted that the endorsement process would be important as that introduced for IFRS in the EU was far from optimal.

54. Ron Hodges noted that politics was likely to be a greater barrier than technical issues and that if accrual accounting were seen as just being used to produce a set of annual accounts, and not utilised to develop accrual based budgeting, then it would be of no real benefit. The UK could pass on valuable experience here. Ian Carruthers noted that a recently produced IMF paper looks at these issues and recommends that budgeting be on the same basis of reporting, i.e. accrual based.

55. The Chairman noted that this work could have long-term implications not only for finance reporting in the UK public sector but also for the Board itself. She requested that the Board be updated on the results of the high level conference and other work undertaken by the Commission at the October meeting.

Item 10: FRAB Report 2012-13 (FRAB (116)10)

56. The Secretary presented the draft FRAB Report, requesting final comments and amendments from Members by Tuesday 9 April so that the report could be finalised. The Secretary also requested that the Board agree to the delegation of the final clearance of the report to the Chairman, Andrew Buchanan and Maggie McGhee.

57. The Chairman noted that with respect to IFRS 13 adoption the report would clarify that this was a complex issue and it was worth getting the correct treatment even if this meant a delay in adoption. A number of further drafting issues were raised by Board members which the Secretary noted he would consider.

58. The Board agreed to the request to delegate the final clearance of the report. The Secretary noted that it was hoped that the Report would be published by 29 April 2013.

Item 11: Forward work programme (FRAB (116)11)

59. The Secretary introduced the forward work programme and indicated that it would be revised to take into consideration the discussion on FRAB working practices held by the Relevant Authorities prior to the meeting. A new suggested programme would be circulated to FRAB members out of meeting for comment. It was confirmed that the October meeting would be retained in 2013, with the new three meeting per year work programme being introduced in 2014.

60. Ron Hodges asked whether an item could be included on a future agenda related to accounting for provisions, contingencies and guarantees. This is a topical issue and the Secretary indicated that he would include this on the forward work programme.

Any Other Business

61. No other business was brought forward.

Dates of Next Meeting

62. The next FRAB meeting is due to be held on Thursday 30 May 2013. As a high level conference on EPSAS is due to be held in Brussels on 29 and 30

May that will be attended by a number of Board Members, the Chairman indicated that an attempt would be made to move the date of the next meeting.