MINUTES OF THE 126th FRAB MEETING HELD ON THURSDAY 17th MARCH 2016 AT HM TREASURY

Present:	Kathryn Cearns (Chair)	David Hobbs
	Anthony Appleton	Ron Hodges
	Andrew Baigent	Larry Honeysett
	Bob Branson	Kate Mathers
	Gareth Caller	Craig Mackinlay MP
	Gawain Evans	Joanne McBurney
		Alison Scott

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

Secretariat: Michael Sunderland (FRAB Secretary)

Apologies: Apologies were received from Vicky Rock, Jason Dorsett, Derek Yule, Ian Carruthers, Neil Hartley, Andrew Buchanan and David Aldous.

AGENDA ITEMS (in order tabled)

1. Matters arising
2. IFRS 16 *Leases*
3. International update - verbal
4. IPSAS update - verbal
5. IFRS 9 *Financial Instruments*
   - 5.1 Business Model
   - 5.2 Progress update
   - 5.3 IFRS 4 *Insurance Contracts* amendment
6. IFRS 15 *Revenue* update
7. Health Manuals
8. 'FREM lite' – verbal update
9. FRAB Report (draft)
10. CIPFA/LASAAC update
11. Any other business

Item 1: Matters Arising

1. The minutes of the last FRAB meeting held on 19th November 2015 were agreed.

2. The Chair also welcomed the new parliamentary observer, Craig Mackinlay MP, who was introduced to the Board.

Item 2: IFRS 16 (Leases)

3. The Treasury presented a paper to the Board on IFRS 16 *Leases* which provided a high level overview of the new Standard. The Board were asked to consider the proposed work plan and give their views on the potential public sector impact.

4. The Chair emphasised the significant effect on public sector entities that the Standard would have, not least in terms of cost, as well as the potential benefits. It was also pointed out that IFRS 16 had not yet been endorsed by the EU. The views of the Board were then sought to canvass initial observations and identify areas where further investigation may be required.

5. Ron Hodges questioned whether all lease arrangements would have to be examined to assess their classification under the new Standard, as they were when IFRS was adopted. Andrew Baigent confirmed that this was the case, and that the Standard's adoption would have a profound effect on the balance sheet, as well on the leasing and financing markets. He also identified the key issues of the Standard as the implications on budgeting and the Statement of Parliamentary Supply (SOPS) and the misalignment between IFRS and budgets.

6. Gawain Evans commented that there had been an adverse reaction to the issue of the new Standard in terms of implementation cost and practical implications. He questioned the extent to which the potential benefits applied in the public sector. Gareth Caller noted that the effect on local government should not be as significant given that there were relatively few operating leases remaining. Larry Honeysett highlighted the need to fully understand the potential misalignment and investigate whether this could be avoided. Bob Branson commented on the low suggested materiality threshold in IFRS 16 of $5,000.

7. Kate Mathers emphasised the scale of the work needed and linked this with ongoing difficulties faced by the MoD in identifying the leases that it holds, and agreed that the misalignment and effect on the balance sheet were key issues. She also highlighted the threshold in the Standard and questioned whether it captured everything that it needed to, and queried what the implications for assets and liabilities were for CIPFA colleagues (e.g. prudential borrowing rules). Alison Scott remarked that there would be an impact in terms of an increase in assets and liabilities in financial frameworks, but the frameworks themselves would not need to change.

8. Craig Mackinlay MP raised the issue of PFI contracts and the extent to which they would be affected by the new Standard. The Chair remarked that PFI contracts were outside the scope of IFRS 16. Andrew Baigent said that there were a number of complicated managed service contracts in Health involving the management of assets and sale and lease back arrangements. He noted that there were likely to be a number of leases embedded in these contracts and that the way that these contracts are worded would determine how they are categorised. David Hobbs highlighted the asymmetry between lessee and lessor accounting under IFRS 16.

9. Anthony Appleton stated that the disentangling of leases and service elements in contracts was a major issue. He suggested that the $5,000 threshold in the Standard was not intended to refer to materiality but existed as a practical expedient. Bob Branson pointed out that the $5,000 threshold was more stringent that the level at which entities recognise fixed assets as capital. The Chair queried how small leases operate in practice and whether contracts were split into components, and suggested a two-stage approach to assessing materiality. Firstly, all leases of assets of less than $5,000 would be excluded from the scope of IFRS 16. Secondly, the notion of materiality would be considered in the normal way for those leases that remained.

10. Ron Hodges stated that there needs to be a link between IFRS 16 and accounting for PPE in terms of when to capitalise non-current assets and the minimum monetary level for capitalisation. He also suggested that early adoption of the Standard was not a realistic proposition for the public sector and the Board generally agreed. The Chair agreed also, but noted that there would be advantages for some businesses with adopting IFRS 16 early and linking with the adoption of IFRS 15.

11. The Chair then suggested that it would be helpful to consider producing guidance for entities on materiality. Kate Mathers agreed and also suggested that entities should discuss the issue with their auditors. Andrew Baigent explained that materiality was a particularly complex issue for those consolidating a large number of accounts into a group.

12. The Chair summarised by saying that although the draft timetable produced in the paper was useful, exploratory work needs to be completed on the impact of the Standard before any decisions could be made. She suggested that this work should assess the overall impact on public sector financial statements using WGA data, plus more focussed granular work with individual departments. The Chair also stated that the effect on budgets, Estimates and SOPS was a key driver and required further analysis. Finally, it was suggested that there needed to be a picture of exactly where the real problems lie for entities and the links to IFRS 15. It was felt that the Board needed to be provided with further information in order to take a neutral and balanced view of whether IFRS 16 should be adopted, and what the regime would look like if the Standard wasn't adopted. The Treasury agreed to bring a paper taking on these points to the next meeting of the Board.

Items 3&4: International and IPSAS Update - verbal

13. The Treasury provided the Board with an update on developments in international accounting. This began by clarifying that whilst the UK public sector applies EU-adopted IFRS, IPSAS is used as a potential reference point for considering adaptations and for areas not directly addressed by IFRS. IPSAS are also a unique reference point for the development of EPSAS.

14. Feedback was provided from the Inaugural International Public Sector Standard Setters Forum, convened by the IPSAS Board and the Government Accounting Standards Board (GASB) in Connecticut (USA) in March 2016. The aims of the forum were to gather public sector standard setters together to build relationships and share objectives, and to provide an update on the issues that IPSASB had been considering. Among these issues was the new revenue standard and the overall approach of differentiating between exchange and non-exchange revenue. The IPSASB were also looking at non-exchange expenses such as grants, and doing this through the same lens as the performance obligation approach in IFRS 15.

15. Another area that the IPSASB was focussing on was social benefits, in particular social assistance and social security. This is a large and complex project, the scope of which has been set to align with the system for Government Finance Statistics (based on the System of National Accounts). The IPSASB were also considering the accounting for heritage assets. There was also discussion of other areas not formally on IPSASB's work plan but of interest to other partners. For example, Swiss interest in an 'IPSAS lite' for smaller organisations, French consideration of the consolidation boundary, work on the presentation of financial performance information in New Zealand and a project examining tax expenditures in the USA.

16. The Treasury then moved on to update the Board on the ongoing work by Eurostat to develop European Public Sector Accounting Standards (EPSAS). A large number of EU Member States currently undertake cash accounting and the work to harmonise public sector accounting standards across Europe is based on the premise that in order to get good fiscal data, there needs to be good micro-level accounting data. The new staged approach to EPSAS supported by Eurostat is to encourage voluntary adoption of accrual accounting in Member States (improving fiscal transparency) while developing

harmonised standards (in the form of EPSAS) over the medium term to improve comparability.

17. The emerging working model incorporates formal Working Groups with representation from all Member States. Specific proposals for consideration are being developed through small 'cells' of technical experts from some Member States and observers. For example, Alison Scott from CIPFA is participating as an observer in the cell considering first time implementation issues. Further cells focus on the Principles of EPSAS standards and one cover the Principles of EPSAS governance. HM Treasury is involved in the latter. These cells are still at their early stages and the substance of EPSAS is still being considered. A number of the cells will report on progress to the Working Group in July 2016.

18. The Chair asked whether any EU Member States were in the process of moving to accrual accounting. The Treasury commented that both Cyprus and Malta are in the process of doing this, but that a number of countries appear to have been planning to transition from cash to accrual accounting for a number of years with little progress made. There is sometime an issue with countries' capacity to implement such changes as well as a question of how useful accrual accounting is if budgets remain on a cash basis. The upcoming OECD Public Sector Accruals Symposium will look at where countries are in terms of accrual accounting. Ron Hodges remarked that moving to full accrual accounting was very expensive and questioned how motivated large countries in the EU were to do this.

Item 5: IFRS 9 Financial Instruments

5.1 Business Model

19. The Treasury presented a paper discussing and interpreting the business model assessment in IFRS 9 and its applicability in the public sector context. At the last meeting of the Board, it was noted that central government entities often hold financial instruments primarily for policy reasons rather than with a business model objective in mind.

20. Anthony Appleton observed that it is correct to state that there is a difference between the business model in IFRS 9 and policy, but that there may be things other than a change in public policy than impact on the management of the underlying financial asset. He also raised the risk of confusion between the level at which management is done and the level of aggregation of financial assets, and suggested that there should be a focus on assessing whether assets are managed individually or as part of a portfolio. It was felt that entities needed to be careful not to mix up the level of management with the level of aggregation.

21. The Chair agreed that there needed to be care taken in applying the application model, but that it shouldn't be difficult to transfer the business model approach to the policy approach. She also suggested that there may be a need to issue application guidance on the business model assessment to give clarification to entities. Kate Mathers agreed with

this approach and felt that the business model approach works without adaptation or interpretation for the public sector.

22. The Treasury raised the question of whether a change in government policy immediately changed the accounting policy, and whether the accounting should change if a policy is not finalised or formally announced. Gareth Caller pointed out that changes in government policy may not have an immediate effect on entities, particularly those that are subsidiaries in a complex group.

23. Craig Mackinlay MP queried the accounting for significant events that occur after the balance sheet date that are a result of policy changes, and gave the example of the Student Loan Book. The Treasury responded by suggesting that the standard dealing with post-balance sheet events would most likely apply.

24. Ron Hodges referred to paragraph 24 of the paper and remarked that the assessment of whether policy changes actually impacted on the business model of an asset was both challenging and vitally important. He observed that policy is often not clear and that it doesn't seem appropriate to base the accounting treatment on the perception of what government policy might be..

25. Andrew Baigent commented that the paper does give flexibility to use the policy trigger, but that it does not restrict the use to solely policy and is not exclusive. The Chair suggested that this approach was potentially tricky to apply and therefore some additional guidance may be required (for example using public sector versions of the existing examples in IFRS 9) but that at this time there was no case for an adaptation of the Standard.

5.2 Progress update

26. The Treasury presented a paper which provided the Board with a progress update on the introduction of IFRS 9 including feedback from the IFRS 9 technical working group. The paper also considered hedge accounting and the simplified approach to impairment, as raised by the Board at its previous meeting.

27. The Treasury remarked that the very early views of the WGA team was that a common approach is always optimal for them but that materiality and fully understanding movements in opening balances would be key considerations. The Treasury also asked the Board whether having separate arrangements for "intra-Crown" balances would be desirable, particularly for certain classes of assets such as government gilts and securities.

28. The Chair raised the issue of calculating impairment allowances on intra-government balances and asked the Board whether they agreed that the requirements of the Standard should be applied without interpretation or adaptation.

29. The Chair suggested that guidance may be useful for gilts and other large balances in order to better enable uniformity in approach. The Chair commented that as long as Accounting Officers were comfortable and that evidence-based application guidance is

published then a standardised approach to certain government assets is acceptable to the Board and the preferred option rather than adaptation of the Standard. Craig Mackinlay MP queried the accounting arrangements for undated government gilts that were paid back at the government's discretion. The Treasury suggested that they would be accounted for under IAS 39 (which covers the recognition and measurement of financial instruments).

30. Bob Branson pointed out that on the income side, if an entity adopted a prudent policy of setting up a provision for non-payment then this would create a mismatch in accounting treatment with the entity receiving the debt. The Chair remarked that this mismatch would always exist and noted that this situation is not unique to the public sector.

5.3 IFRS 4 Insurance Contracts amendment

31. The Treasury presented a paper discussing the IASB's proposed amendments to the existing standard, IFRS 4 *Insurance Contracts* due to the issues arising from applying IFRS 9 in advance of the new insurance contracts standard (yet to be finalised), given that they have different effective dates. Both new standards are relevant to entities that issue insurance contracts.

32. Anthony Appleton, referring to para 21 of the paper, questioned whether the option to account for financial guarantee contracts (FGCs) as either insurance contracts or financial instruments still existed in IFRS 9. He went on to ask what the situation would be if the Board advised that one of the options could not be taken i.e. whether it would be considered an adaptation or interpretation of the Standard. The Chair and other Board members confirmed that this would be considered as an interpretation of the Standard rather than an adaptation.

33. The Chair remarked that if necessary, it would not be an issue to give a view that aspects of the Standard (IFRS 4) are not appropriate for the public sector, and that by following due process and issuing an Exposure Draft for IFRS 9, issues on insurance contracts in the public sector should be uncovered. The Treasury noted that entities such as UK Export Finance did have insurance contracts and account for them using IFRS 4.

34. The Chair commented that changes in IFRS 4 were brought in as a result of mismatched effective dates with IFRS 9, and highlighted that costs could be incurred under IFRS 9 and then again when the new insurance contracts standard is issued. The Chair felt that this point needed further exploration in order to determine the extent to which a problem existed, and that the Relevant Authorities should to liaise with bodies affected.

35. Anthony Appleton suggested that pragmatic and practical principles should be applied until the new insurance contracts standard is effective. Ron Hodges emphasised that the effect of adapting the existing IFRS 4 would be to improve the consistency of accounting policies across the public sector, referencing paragraph 27 of the paper. The Chair confirmed this view and added that if there was an attempt to overlay the two standards then this would likely create inconsistency.

Item 6: IFRS 15 Revenue update

36. The Treasury presented the Board with a paper providing a progress update on IFRS 15 *Revenue from Contracts with Customers*, including IASB clarifications, the technical working group's consideration of the matters previously raised by the Board and initial views on WGA implications. The Board were asked to note the progress made to date and give their views on the issues raised.

37. The Chair noted that the Standard (in general) was controversial and that there was still considerable work to be completed before it is implemented. She also noted that the work of the IPSASB on a revenue project would not keep pace with the planned timetable for IFRS 15. Craig Mackinlay MP raised the issue of deferred tax and how this had been considered in terms of National Accounts. The Treasury commented that National Accounts is on an accruals basis, although in practice tax receipts ten to be accounted for on a cash basis, as permitted under the guidance. Craig Mackinlay MP then questioned whether it was correct to not account for future government tax income as an asset.

38. The Treasury responded by confirming that the question of whether to recognise a future tax asset was a significant and pertinent one for public sector accounting. The Chair agreed that this was a good question and but that the new standard did not change the overall approach to accounting for taxation. David Hobbs commented that accounting for future tax income may not be understood by the average user of the accounts and stressed the difference between National Accounts and IFRS, and that future years' taxation income would be taken into account in OBR forecasts.

39. The Chair confirmed that progress against the IFRS 15 timetable was good and that work was proceeding as expected, and stressed the importance of issuing guidance and information to entities as soon as possible.

Item 7: Health Manuals

40. Andrew Baigent presented the Board with a paper seeking approval for the merged 2016-17 Health Group Accounting Manual, which had been circulated to FRAB members prior to the meeting. He suggested that Board members could also raise specific points, if they had any, out of meeting (copying the Board secretariat and the Chair).

41. Kate Mather welcomed the combined Manual and queried the extent to which other guidance referred to in the Manual would need to be seen by the Board. The Chair also welcomed the production of the new combined Manual and suggested that thought would need to be given to the extent to which any proposed guidance is procedural or operational and therefore whether further Board approval needed to be sought.

42. Anthony Appleton raised the issue of whether an entity was a going concern when its functions were due to be transferred to another entity. Andrew Baigent agreed that this was an interesting area but that the accounting approach would depend on individual

circumstances including the statutory basis of the entity and what was contained within the Memorandum of Understanding.

43. The Chair agreed that this was a complex area, and that it applied to the private sector as well as the wider public sector. She highlighted the uncertainty that existed where an entity was in the process of being rescued but this rescue had not been finalised, and questioned whether the entity would be considered as a going concern. Kate Mathers said that these points should be fed into the consultation that is taking place over the summer.

Item 8: 'FREM lite' – verbal update

44. The Treasury provided an update on the current thinking around the potential development of a 'FReM lite'. This was linked to the *Simplifying and Streamlining Accounts* project and if developed would aim to make reporting less onerous for smaller bodies.

45. This possibility was raised with the government finance community in a series of workshops at the Government Finance and Internal Audit Event that took place in Birmingham in January 2016. Surprisingly the feedback was not very supportive of the proposal. Participants felt that new arrangements would not save much time and effort as they would still need to provide information to their parent for the purposes of group accounts. The general consensus was that there was sufficient freedom within the existing reporting regime and stressed the importance of working with auditors, especially around the question of materiality. They also highlighted the value of stability in reporting requirements.

46. The Treasury asked the Board for their views on whether the next stage of the project should be pursued, given the strength of views and the likely quantity of work involved. Craig Mackinlay MP queried the size of entity that would be affected. The Treasury replied that there were various options that were yet to be fully explored, including aligning with the thresholds used in the private sector. Bob Branson thought that a distinction needed to be made for those entities that still needed to be consolidated into group accounts, and the question of potentially removing entities from the consolidation should be considered.

47. Gawain Evans commented that the 'FReM lite' would be beneficial to very small bodies who could be over-audited in some cases. Bob Branson remarked that there were a number of smaller entities within DEFRA that would benefit from less onerous reporting. Andrew Baigent remarked that the new reporting requirements were unlikely to reduce workloads in the DoH and questioned how the 'FReM lite' would fit in with Parliamentary accountability. He noted that if a body was to be consolidated then accounts should be prepared on a similar basis, and highlighted the legal requirements of Companies Act disclosures that affected some entities.

48. Kate Mathers agreed that there did not appear to be much appetite for change and echoed Andrew Baigent's point about the risk of diminution of accountability to Parliament and the need to avoid this. Gareth Caller pointed out the link between the accounts production process and the broader approach to financial management. Larry

Honeysett questioned which bodies the 'FReM lite' would apply to, given that there are often public sector entities that are small in size but have a large political interest in them. Ruth Elliott remarked that there would need to be an assessment of materiality but that this may be challenging.

49. The Chair agreed that the issue of identifying which entities would potentially fall under the 'FReM lite' guidance was less straightforward than in the private sector due to issues around Parliamentary accountability. She suggested that the Treasury could draw up a matrix of issues including those arising from accountability, legal form, consolidation and Accounting Officer responsibilities, and that this should form the basis of exploratory work.

50. Ruth Elliott pointed out issues around the constantly changing landscape and that BIS had a significant number of smaller bodies consolidated into their accounts. Bob Branson suggested that DEFRA and BIS could be looked at initially given the number of ALBs contained within each department. Ron Hodges emphasised the importance of the narrative in annual reports and accounts and remarked that the actual reporting should be based on the financial management process.

Item 9: FRAB Report (draft)

51. The Treasury presented the initial draft annual FRAB Report for 2015-16. This had been produced on the same basis as the previous year and would need to be updated further to incorporate the work of this meeting. The Board were asked to provide comments and whether they wished to revise the format and content of the report in order to make it more accessible to the lay reader.

52. The Chair suggested changing the Executive Summary of the report to make it more readable for a non-accountant, but that the detail of the Board's work during the year should remain at the back of the report, to form the public record. Gawain Evans agreed that a more straightforward introduction would be helpful, and other Board members supported this approach.

53. Ron Hodges commented that the section on membership should contain the names of all members who served the Board for any part of the previous year. He also supported keeping separate Chairman's Foreword and Executive Summary sections as he felt that the Chair was able to provide a useful perspective having led the Board over the course of the previous year.

54. Andrew Baigent suggested that the report should place more emphasis on the independent nature of the Board, and also do more to explain the work of the Board on discount rates over the course of the year given the impact that the update to the long term discount rate has had on entities. The Chair agreed and remarked that the report needed to give a useful overview of discount rates and explain what they were, how they were used and how they had changed in the year. The Board then suggested a number of minor alterations to the wording of the report which were noted by the Treasury.

55. The Board agreed that the updated report should be circulated outside of the meeting and that finalisation of the report should be delegated to a small sub-committee,

including the Chair. The Chair suggested that the report should be published and laid before the June 2016 FRAB meeting, to a similar timeline to the previous year.

Item 10: CIPFA/LASAAC update

56. Alison Scott provided the Board with an update on the work being carried out by CIPFA/LASAAC Local Authority Code Board following their recent meeting. The focus of the meeting had been the draft 2017/18 Code of Practice on Local Authority Accounting. Recent work streams have included reviews of going concern reporting and narrative reporting as well as considering narrow scope amendments and accounting policy reviews. It was reported that the combined authorities were consulting on IFRS 9 and IFRS 15 as part of the consultation on the 2017/18 code, ahead of the effective date of 2018/19. More detail was needed on the practical implications of IFRS 9 as well as potentially extending the definition of hedging. Currently it was felt that IFRS 15 could be introduced without adaptation, but there would need to be guidance on NNDR and Council Tax.

57. The Chair asked whether there were any accounting implications for Lender Option Borrower Option loans (LOBOS). Alison Scott commented that there were some disclosure complications resulting from IFRS that were being considered, but that there was no impact on the bottom line.

58. Craig Mackinlay MP questioned the amount of cost and effort involved in valuing heritage assets given their somewhat abstract nature. Sarah Sheen explained that cost/benefit analysis appraisals were carried out and that the relevant accounting standards followed UK GAAP. In addition, it was noted that there had been a relaxation of the validation methodology which should have reduced costs for entities. The Chair queried what the approach to heritage assets was in local authorities. Alison Scott remarked that heritage assets were often a benefit to local authorities and for assets such as museum pieces, accurate valuation was important in order to assist decisions on whether to continue to hold them.

Item 11: Any other business

59. The Chair raised the issue of the inquiry into government accounts by the Public Administration and Constitutional Affairs Committee. It was noted that the inquiry would look at both management and financial reporting and the Treasury and CIPFA are likely to submit written evidence. The Treasury agreed to keep the Board informed of any developments.

60. Bob Branson informed the Board that he had been invited to a meeting at the Cabinet Office on the Government Property Model, whereby departments would pay market rents for freehold property that they own in order to assist with rationalising the central government estate. The Treasury confirmed that the relevant accounting standards had been considered by those developing the model.

61. The Chair informed the Board that her term was due to end in early June 2016, before the current date for the June 2016 meeting. Board members confirmed they were content

for her to remain in the Chair for the meeting as required (the new Chair acting as observer). The applications process for the new Chair would close imminently and the intention is to have some handover. The new Chair would take over at the November 2016 meeting. The date of the next meeting coincided with the EU referendum and therefore Board members were asked to inform the Board secretariat of any problems with this date as soon as possible, so that the meeting could be rescheduled if necessary.

Date of next meeting: 23rd June 2016