MINUTES OF THE 127th FRAB MEETING HELD ON THURSDAY 23 June MARCH 2016
AT HM TREASURY

Present:	Katheryn Cearns (Chair)	Russell Frith (observer)
	Andrew Buchannan	Larry Honeysett
	Veronica Poole	Gareth Caller
	David Hobbs	Vicky Rock
	Bob Branson	Andrew Baigent
	Ruth Elliot	Joanne McBurney
	David Aldous	

On the phone: Anthony Appleton, Gawain Evans, Aileen Wright, Sarah Sheen (CIPFA)

Secretariat: Michael Sunderland (FRAB Secretary)

Apologies: Ron Hodges, Jason Dorsett, Derek Yule, Ian Carruthers, Neil Hartley

AGENDA ITEMS (in order tabled)

1. Whole of Government Accounts
2. IFRS 15 Exposure Draft
3. IFRS 9 Exposure Draft
4. IFRS 16 Leases Update
5. CIPFA/LASSAC update
6. Any other business

Item 1: Whole of Government Accounts

Treasury introduced the paper highlighting key trends from the 2014-15 Whole of Government Accounts and a progress update on 2015-16. Publication of the 2014-15 WGA was expected at the end of March but delays in major components (e.g. Department for Education) resulted in publication at the end of May. Two qualifications were removed on 3G/4G income and the valuation of schools assets. The qualification on un-eliminated balances is expected to be removed for 2015-16; the error has been less than £8 billion for two years running. The qualification on highways network assets is also expected to be removed following the change in accounting in the CIPFA/LASSAC Code of Practice.

There has been a significant reduction in the 'front half'as the Treasury starts to apply the principles of simplifying and streamlining for WGA. The focus for 2015-16 will be on reviewing disclosures. The Treasury is looking to improve the communications strategy to expand the audience and usage of the WGA data. The WGA team will also be operating an account manager approach to provide more tailored advice and support to departments and to head off recurring issues.

The WGA team are currently in the testing phase of the 2015-16 Data Collection Tool (DCT) and as such there is likely to be delay in the 2015-16 timetable. Treasury are discussing with the National Audit Office whether this will have any implications on the audit time table. The expectation is still to publish WGA 2015-16 at the end of March 2017.

The Chair asked how much information is needed from central government departments before Treasury can start the consolidation process. In the private sector, consolidation is often based on draft data which is updated as needed. The Treasury explained that they did not wait for all departments to start the consolidation process. However departments prioritise the production of their own statutory accounts over completing the DCT which prevents the timetable from being accelerated.

The Chair also asked how the 3G/4G qualification was removed. Treasury explained that in light of the change in classification in ESA 10 and an assessment of the likely future treatment under IFRS 15, the decision was made to change the treatment now, still applying IAS 18, thus removing the qualification.

Kate Mathers recognised progress is being made to improve WGA and the NAO were very supportive on the direction of travel and efforts made to raise the prominence of the accounts. There is a PAC hearing in July on the government's balance sheet which would be another opportunity to raise the profile of the accounts. Kate Mather said she had seen increased interest in government accounts from parliamentarians.

Vicky Rock raised the question of how the account could be better used, including the dataset behind it which has been collated over several years. The IFRS 16 paper shows some usages but she called for any reflections on where the Treasury could go further. Andrew Baigent said it would be worth reflecting on the practical uses of WGA. Within Health, there has been an increased interest from Ministers in the clinical negligence provisions resulting in more focus on the value for money aspects and looking more long term at how the provision can be reduced. The Treasury stated that the OBR will be producing a fiscal risks report and may look at the Whole of Government Accounts. The Board should be aware that the OBR is looking to consult publically on the potential scope of the fiscal risks report.

David Hobbs asked whether there were any plans to audit the reconciliation between IFRS and the National Accounts. The Chair stated that as the reconciliation was in the front half, it was not subject to an audit opinion but was reviewed for consistency with the financial statements. In the private sector there was more emphasis on the front end reporting of non-statutory information and reconciling it back to the statutory information. Veronica Poole added there was well established practices in the private sector of disclosing reconciliations in the notes to the financial statements. For example in the oil and gas sector where they disclose underlying performance measures. This provides users an indication of what management considers when looking at performance as well as the benefit of a full audit. Kate Mathers will discuss this point with the NAO WGA team.

The Chair thanked the WGA team and summarised that there was a lot of good work being undertaken. The Board would be interested in the feedback from the PAC hearing.

Item 2 and 3: IFRS 9 and IFRS 15 Exposure Drafts

The Treasury introduced both Exposure Drafts. These Exposure Drafts were circulated for early comments out of meeting. Thanks was given to Ron Hodges and Department for Health for providing comments. The Exposure Drafts will be put out for consultation from 1 August to 30 September.

The proposals are to retain the existing IAS 39 interpretations when IFRS 9 is introduced and the existing treatment for revenue from taxes, duties, fines and penalties. No other adaptations or interpretations are proposed for either standard. The application of materiality is emphasised across both Exposure Drafts and will be an important judgment entities will have to make when applying the new standards and keeping in tune with the simplifying and streamlining agenda. To support implementation the Treasury plans to issue application guidance using examples from across government to assist with first time implementation and disclosures.

IFRS 15 Exposure Draft

Andrew Baigent was supportive of the approach taken by the Treasury but had some concerns on the disclosure requirements, in particular what WGA may look for, as this may have material impacts on the way in which information is collated from the Heath sector.

Andrew Buchanan highlighted that preparers should not underestimate the implementation issues and challenges associated with IFRS 15. Even if the accounting did not have a significant impact, bodies found there was an increase in the amount of work required to produce the disclosures.

The Chair indicated it would be good to signpost in the Exposure Draft that work would be undertaken to provide examples of what disclosures would look like, not only for individual entities but also for the Whole of Government Accounts.

Vicky Rock stated it would be beneficial to provide some clarity in the overview on why the Standard was introduced by the IASB to provide some context to preparers that this was not a change merely imposed by relevant authorities. The Chair added that the five step process will be useful for new revenue items and whilst the change would be challenging, the implementation would be easier once the methodology was institutionalised.

Gawain Evans had no concerns on the Exposure Draft but was concerned on getting the application guidance soon to minimise issues raised later with auditors. Kate Mathers stressed that early engagement with auditors was encouraged.

The Chair highlighted that the IPSASB were looking at expanding the principles of IFRS 15 to non-exchange transactions i.e. through applying a modified IFRS 15 approach as IPSAS 23 was being revisited. A mirror image for non-exchange expenses was being considered as well. The projects were likely to take a long time and as such the Treasury should continue with its proposed approach rather than wait for IPSASB to complete their projects.

Anthony Appleton clarified that EFRAG provided advice rather than formal endorsement which is the job of the Commission. The ARC meeting was scheduled the following week so the Exposure Draft could be updated to reflect the latest position in the endorsement process before it is published.

Anthony also raised concerns of a potential inconsistency where CIPFA/LASAAC appeared to treat council tax as outside of scope of the Standard whereas Treasury were treating fees and levies as within scope. The Treasury Exposure Draft provided an example that legislation could be considered equivalent to a contract.

CIPFA explained that local authority taxes (ie council tax and non-domestic rates) were required by statutory prescription and were not a contractual arrangement, there was no agreement with a customer and no exchange of goods or services . Treasury explained that for departments, they act as an agent rather than a principal for taxes, and thus the revenue can reasonably be outside the scope of IFRS 15. In terms of levies it was considered that entities will need to undertake an assessment whether it is within the scope of IFRS 15 rather than automatically assume a classification. Anthony Appleton agreed and asked if para 4.7 could be expanded to distinguish general taxation from other sources of revenue to provide the other side of the equation.

David Hobbs requested that the ONS classifications should be kept in mind on determining definitions. The Treasury explained that the nature of IFRS as a micro level was a granular approach. On contract by contract level was required but the Treasury didn't see this as causing issues for the macro level ESA10 framework; the two are expected to remain broadly aligned. Bob Branson supported individual application as the Environment Agency has multiple revenue sources, including taxes that it can retain. It was appropriate that each one is assessed to determine the correct classification.

IFRS 9 Exposure Draft

Similar to IFRS 15, the Chair stated the Exposure Draft would need to be updated for the upcoming ARC vote and add explanation on what had driven the change between IAS 39 and IFRS 9 referencing the financial crisis and the impairment methodology.

Andrew Buchanan asked for further emphasis that the change from an incurred loss model to an expected loss model would be a fundamental change in mind-set (para 4.13). Andrew raised concerns that para 4.15 could be read to suggest that the assessment on expected losses could be made solely on historical default rates. He explained that whilst historic data was a potential useful starting point, it needed to be overlaid with prospective data in order to meet the new criteria.

Andrew asked why there was a difference in the approach to hedge accounting where Treasury had kept the options open whereas CIPFA/LASAAC restricted it to just applying IFRS 9. Alison Scott explained the use of hedge accounting was very limited and therefore made sense to direct preparers to the new Standard. Andrew Buchanan raised concern that it might not be beneficial for WGA to have hedge accounting under both IFRS 9 and IAS 39 in use. The Chair asked whether there would be any material difference. The Treasury said it expects the WGA team to be a respondent to the Exposure Draft and will be able to highlight any concerns with the use of both IAS 39 and IFRS 9 by entities.

Veronica Poole added that it was unlikely that private sector entities with significant hedging would move towards the IFRS 9 approach as it would be costly to change systems which are considered well established under IAS 39. Andrew Buchannan agreed that where there was an established hedging strategy in place, there was no incentive to change. He raised the question on whether more of the public sector would be eligible to hedge under IFRS 9. The Treasury stated that under Managing Public Money hedging as a strategy was not actively encouraged as government had the ability to absorb the risk itself.

The Treasury asked whether there was any insights into the IASB macro hedging project and whether it could be changing. Andrew Buchanan stated that the IASB work on macro hedging was unlikely to progress quickly. The Chair asked who in government was using macro hedging. Vicky Rock said she was not aware of any that undertook macro hedging.

For the Exposure Draft it was decided that pros and cons for hedging under IAS 39 and IFRS 9 should be included. Questions should be asked to identify who in government undertakes macro hedging and whether entities had any concerns if Treasury mandated the use of IFRS 9.

Veronica Poole highlighted there were significant balances of receivables in the Whole of Government Accounts and recommended that the Treasury mandate the short cut method in IFRS 9 to reduce implementation issues. Veronica went on to say that it was easier to explain taking the impairment in one go rather than having to undergo constant assessment. Also where some departments only have receivables, it would make sense to use the short cut method. It was decided that a question would be raised to identify whether any entities had any issues with Treasury mandating the short cut method to see if it can help streamline implementation.

The Chair also asked for a paragraph to be added in both Exposure Drafts to show that relevant authorities were looking at the implementation issues in the private sector and considering any corresponding impacts in the public sector before the standards come into force.

The Treasury proposed to issue both Exposure Drafts for publication on 1 August. The Chair asked for the revised Exposure Drafts to be circulated to the board a week before publication for any final comments.

Item 4: IFRS 16 Leases

The Treasury introduced the paper on IFRS 16 providing an analysis of the existing leases disclosed in the 2014-15 Whole of Government Accounts and initial consideration of transition. Future obligations on finance leases amount to £24 billion including interest – the majority sat with the Ministry of Defence. Future obligations on operating leases amount to £19.2 billion. The paper also provides a brief discussion on the misalignment between accounts, budgets and estimates if IFRS 16 were to be adopted.

Analysis of WGA has identified key players for whom the Standard is likely to have an impact but what it masks are intra-government lease type arrangements which will have been eliminated but still accounted for in the individual accounts. Further work is needed to explore the departmental and sector landscapes.

The Chair asked, with regard to intra government leasing arrangements, what would be the impact of the new property model. Andrew Baigent explained that the timetable of transferring the properties would be staggered over the coming years so there would not be one big impact. Existing leases coming to an end and those nearing break clauses are being considered on a case by case basis. He also mentioned that the unit would be holding central government assets and the NHS assets were not affected.

Larry Honeysett asked whether there was any way of avoiding the misalignment between accounts and budgets. David Hobbs explained that this was unlikely; whilst ESA10 was more aligned with IAS 17, the framework was unlikely to change in time for IFRS 16 introduction. The Chair indicated the analogy with PFI highlighted in the paper was most relevant here. The Chair indicated that IFRS 16 would be interesting from an endorsement perspective. Veronica Poole confirmed that and effects analysis was to be commissioned shortly.

Andrew Baigent emphasized that running two systems was very expensive and difficult. The way in which the public sector engages with the lease market is based on the budgetary classification so there is a fundamental value for money question as well as an accounting question. Andrew had already started to see a change in the lease market and would be very worried about any real cost for the NHS and other organisations arising from a misaligned framework.

The Chair stated that the Board would want to know whether the issues on intra-government leases and the costs Andrew Baigent highlighted was specifically a public sector issue or a general market issue. Questions were raised by members on how one might reliably measure the wider economic costs of moving towards IFRS 16.

The Chair indicated it was for the new chair to determine the way forward but suggested that a draft timetable presented to the Board highlighting key points where a decision to proceed needs to be undertaken. A programme of issue papers should also be established to understand the impacts of implementation, teasing out the issues such as intra-government leases; application of the $5,000 exemption; transitional arrangements and market impacts.

The Chair concluded that if relevant authorities suggest that IFRS 16 should not be adopted, there must be a very strong case not to do so, supported by a firm evidence base. She also noted that it will be interesting to see how the private sector react to implementing the new Standard.

Bob Branson explained he was on the finance task and finish group for the new property model and indicated his preference for the FRAB to consider the accounting issues. The Chair indicated there were a number of accounting issues that would need to be considered such as property valuations, transfers and rents on freehold properties.

The Treasury stated that the policy was still in development and accounting issues are being worked through. The question would be whether the FReM provided sufficient scope to address these issues or whether there would be any need to change the FReM (or allow a significant exemption). In the case of the latter the Board would need to be presented with the case for such a change. The Chair cautioned on the need to consider the accounting issues before the policy is finalised.

Item 5: CIPFA/LASAAC update

CIPFA/LASAAC met in June where it discussed proposed changes to the 2017/18 Code of Practice on Local Authority Accounting in the United Kingdom (the Code). Key areas of the Code that are changing are: narrative reporting based on International Integrated Reporting Council (IIRC) Framework elements and which were considered to meet the major FReM requirements; tidying up of going concern and accounting policy reporting; proposed reporting requirements for IFRS 9 and IFRS 15 and a request for volunteers to assess the implications of IFRS 16.

Vicky Rock asked for explanations on IFRS 15, as discussed earlier, on the definition of a contract and the applicability to council tax and Non Domestic Rates. This should link the CIPFA/LASAAC and Treasury Exposure Drafts. There was also a need to consider the expected loss model for taxes under IFRS 9 in order to avoid issues at a WGA level.

The Chair asked how much of a challenge implementing the narrative reporting would be and the reaction of local government. Alison Scott explained that she expected iterative improvement as this is a principles based approach.

Anthony Appleton thought the principles of narrative reporting in the annex were good but questioned implications of the cross reference to the IIRC integrated reporting. Was there a risk that preparers would look to undertake more of the IIRC requirements? Alison Scott explained that CIPFA/LASAAC were trying to move towards integrated reporting but were focused on the high level principles in the Code. They were not wedded to having a cross reference.

Anthony Appleton questioned the approach that LOBOs were assumed to be at amortised cost. This has caused problems for the FRC when developing UK GAAP as there was a possibility that some contained embedded derivatives. Within housing associations as an example there were so many variations that the FRC could not mandate an approach. As there was not a caveat to allow for embedded derivatives, there could be a risk that preparers would assume one approach. Sarah Sheen pointed out that paragraph 7.1.1.3 indicated that where an authority considered that the LOBO included an embedded derivative it should be accounted for as such. It was agreed that this commentary should be included explicitly in paragraph 7.2.5.6 of the Exposure Draft.

Item 6: Any other business

The Treasury provided a short update on European Public Sector Accounting Standards (EPSAS). The working group of Member State representatives would meet in July where they will have reports from the various cells (first time implementation, governance and standards etc.) as well as an analysis from EY looking at IPSAS and the choices that could be mandated to enable alignment with government finance statistics. A detailed update would be provided at the November meeting.

The Chair updated on the first meeting of the IPSASB Consultative Advisory Group whose deliberations included consideration of the social benefits and revenue projects. There was still concern about the scope of the social benefits project and there was a risk that healthcare may be included. IPSASB are looking at widening the scope of their revenue project where IFRS 15 principles could be applied to enable a mirroring of transactions for non-exhange expenses. Overall IPSASB were being very ambitious in their timetable for reviewing a number of significant standards by 2019-20.

Andrew Baigent explained he would like to present the Health Manual as an out of committee paper so it can be approved before the November meeting. Andrew Buchanan and Vicky Rock volunteered to review the manual for approval.

Andrew also went on to thank the Chair for her time on the FRAB highlighting anecdotes from her original interview panel. He highlighted that the Chair had been constructive, working outside of the formal meetings and forging strong relationships. She has set the bar very high for the new Chair.

The Chair thanked the Board highlighting how fascinating it was to work on a number of challenging issues within the public sector. She praised the staff and the Board on being very constructive and is confident that the new Chair will be equally as challenging. She wished the Board good luck and will be looking forward to reading the next WGA!

Date of next meeting: 24th November 2016