MINUTES OF THE 124th FRAB MEETING HELD ON THURSDAY 18th JUNE 2015 AT HM TREASURY

Present:	Kathryn Cearns (Chair)	Gawain Evans
	David Aldous	Ruth Elliot
	Anthony Appleton	David Hobbs
	Andrew Baigent	Larry Honeysett
	Andrew Buchanan	Ron Hodges
	Gareth Caller	Joanne McBurney
	Ross Campbell	Maggie McGhee
	Ian Carruthers	Mike Usher
	Veronica Poole	

On the phone: Aileen Wright

Secretariat: Michael Sunderland (FRAB Secretary)

Guests: Sarah Sheen, CIPFA

Apologies: Apologies were received from Sir Edward Leigh, Bob Branson, Derek Yule, Jason Dorsett and Neil Hartley.

AGENDA ITEM

1 Matters arising
2 Whole of government accounts
3 Discount rates
4 Research and development under ESA10
5 IFRS 9 Financial Instruments, transition arrangements
6 IFRS 15 Revenue Recognition, verbal update
7 IASB annual improvement cycle 2012-14 and other narrow scope amendments; application in the FReM
8 Health manuals 2015-16 update
9 Code of Practice on Local Authority Accounting 2016-17: Exposure draft
10 Any other business

Item 1: Matters Arising

1. The minutes of the last FRAB meeting held on 26th March 2015 were agreed.

Item 2: Whole of Government Accounts 2013-14

2. The Treasury presented a paper on the Whole of Government Accounts (WGA) updating the Board on the actions taken to reduce the qualifications on the 2013-14 accounts, the use of the accounts as part of the approach to wider public financial management and future developments.

3. The 2013-14 accounts were qualified on six grounds, the first of which is a result of a historic qualification due to the ONS definition of public bodies for consolidation not fully aligning with the accounting boundary under IFRS. Network Rail and the Royal Bank of Scotland (RBS) were excluded from consolidation. However the Government has announced its intention to sell shares in RBS and ONS has reclassified (under ESA 10) Network Rail to the public sector from September 2014 which will further align the two boundaries..

4. CIPFA are leading on a policy change from 2016-17 for local authorities to amend the accounting policy for highways infrastructure assets so they are measured at current value (depreciated replacement cost). The change should hopefully lead to the removal of a further qualification (see agenda item 9).

5. The introduction of IFRS 15 expected in 2018-19, is predicted to partly address the disagreement over the application of accounting standards for income recognition in relation to 3G and 4G licences. An adjustment recognising performance obligations may reduce the risk of qualification and the materiality of the item.

6. Significant work was undertaken to reduce the level differences in intra -government balances, which were reduced to around £7.3bn. Whilst this was below the original materiality level of £8bn set by the NAO, the qualification remained. The Treasury were advised by the NAO that this reduction must be sustainable in the longer term before the qualification may be considered for removal.

7. In respect of qualifications in underlying accounts, the NAO issued a qualified audit opinion for the Department for Education (DfE). The number of academies is continuing to rise with more than 1,000 additional schools becoming academies in the last 12 months. These factors are placing pressure on the DfE to improve the quality and timeliness of the academies consolidation process and will continue to delay the WGA production.

8. The underlying qualification in respect of the Ministry of Defence recognition of leases in embedded contracts is ongoing but the Treasury is working with the Department to resolve the qualifications.

9. Ron Hodges recognised the progress made on resolving the qualifications on WGA. He raised concern around a risk of a lack of control over academies by the Department for Education (DfE) by having different financial year ends. The Chair concurred and suggested how this could change in the future to help resolve issues.

10. Ross Campbell explained to the Board that a huge amount of work is currently being undertaken by both the Treasury and DfE to agree a new accountability and financial management framework. The solution will address a broad spectrum of issues and DfE is fully engaged and has enlisted external support.

11. The Chair requested a paper on the progress towards resolving the issues around academies.

12. A discussion was held around the potential for the MOD qualification to fall away. Veronica Poole suggested that with the introduction of a new leases standard it may not be necessary to introduce the application of IFRIC 4 in isolation but rather in conjunction with other lease changes.

13. Anthony Appleton raised the impact of the introduction of IFRS15 on income from 3G and 4G licences and that at this point in time there is no clear indication of recognising revenue at a point in time or over time. The Chair agreed that a decision by the IASB on this point would be welcome.

14. The Treasury highlighted that whilst National Accounts remain the primary source for measuring fiscal performance, WGA can provide useful trend analysis over the last 5 years. WGA is being encouraged as a source of data to identify issues and trends. The Treasury also highlighted how WGA has been welcomed and used by external stakeholders including academics and professional institutes.

15. The Chair asked if the WGA production timetable will continue to improve and Treasury confirmed that this was the intention but this is still very dependent on DfE accurately consolidating academies within their financial statements.

16. Maggie McGhee raised a question around the sustainability of resources needed within the WGA team at the Treasury to continue to reduce the eliminations balances within inter group transactions.

17. Ian Carruthers spoke of the longer term aspiration that WGA should be used in a more integrated way for decision making purposes. This would require WGA to be produced in advance of the Autumn Statement, ideally together with the annual OBR Fiscal Sustainability Report in order to influence fiscal policy.

18. Ross Campbell confirmed that a report would be made to FRAB on how faster production could be driven forward and how the number of constraints against doing so can be overcome to improve the sequence of events.

19. Andrew Baigent congratulated the WGA team for the success of improving the production process and confirmed that it helps the Department of Health to have an active engagement between departments, such as the Ministry of Justice for clinical negligence claims. A question remains around how much the technical architecture of production has been examined and if it could be updated particularly in the context of the Financial Management Review for example, real time information and more automated collection of data rather than departments filing periodic returns.

20. Ron Hodges asked if Durham University had contacted the Treasury regarding a study for the Association of Certified Chartered Accountants on the use of WGA and examples from it. Ross Campbell confirmed that contact had been made and information shared which was presented by ACCA at the OECD forum.

21. Ian Carruthers felt it was easy to forget that the introduction of WGA had catalysed both a convergence of accounting across the public sector and the construction of a single data warehouse in the Treasury for budget in-year and outturn information. As a result there has been a significant improvement in the quality of data for example, in public sector pensions. The Chair agreed and that the improvement has forced a base line in accruals accounting in a specified time period. Mike Usher noted that whilst the paper referenced the continued need to work with local authorities and government departments, it was also important that the WGA team should maintain close liaison with the devolved administrations

who, as relevant authorities, had the ability to determine for themselves whether to mirror the faster closing timetables that were being rolled out in England.

22. Gawain Evans told the Board that CIPFA are looking into the possibility of preparing a balance sheet for the individual devolved administrations and asked if the Treasury or the Board were aware of any drive in interest for this.

23. The Chair said that the Board was not aware of any plans but it would be worthwhile for the Board to consider devolution issues and that the Secretariat should prepare a paper for the Board at an appropriate time.

24. Ian Carruthers advised that a paper discussing the issues involved in developing a Whole of Government of Wales balance sheet may be published in 2016 based on the approach used for the CIPFA paper on Scotland's finances published in 2014 ('Scotland's Future in the Balance').

25. Aileen Wright confirmed that CIPFA and Scotland have completed work over the last year or more on the existing powers and potential changes to Scotland including the possibility of WGA for Scotland but so far the proposal has limited support. More work is planned on these considerations. David Hobbs confirmed that discussions were continuing around the question of the production of state level accounts and Eurostat is fairly relaxed on the issue but if greater powers are given to the devolved administrations, then the expectation would crystallise.

26. The Chair reiterated the Board's recognition of the success of WGA and the improvement to both the timetable of production and number of qualifications.

Item 3: Discount rates

27. The Treasury presented a paper on discount rates and confirmed that it had decided to maintain its existing policies on discount rates, including the policy agreed by the Board in 2011 for provisions. The long term rate for provisions will be updated in 2015-16 using the methodology previously agreed. The Treasury also highlighted that the financial instrument discount rate is being reviewed and GAD have been commissioned to undertake some work in this regard. The adaptation to IAS 39 itself (which gives rise to the use of the rate) will be reviewed as part of planning for the introduction of IFRS 9 into the public sector.

28. Ruth Elliot asked a question about the discount rate used for student loans and the Treasury confirmed this was the financial instrument rate that is currently being reviewed.

29. Andrew Buchanan suggested it may be appropriate to update the long term rate more periodically to improve explanations around significant changes. The Chair replied that although long term rates are expected to remain fairly stable, if changes are expected to short and medium term rates, it would be appropriate to consider long term rates more often.

Item 4: Research and development under ESA 10

30. The Treasury presented a paper to the Board on the changes to the treatment of research and development costs under ESA 10 which came into effect for Member States in September 2014. Previously research and development (R&D) costs were treated as current expenditure but going forward will be treated as capital expenditure.

31. The paper clarified there are no plans to change financial reporting requirements under the FReM. There will however, be a change to budgets and Estimates and therefore the normal process with be followed for such misalignments, including as necessary a meeting of the Alignment Review Committee (ARC).

32. Ian Carruthers asked for an estimation of the impact of this change and Ross Campbell responded that it was in the order of ten billion and principally affects the DoH, Ministry of Defence and Department for Business, Innovation and Skills.

33. Larry Honeysett raised a concern about creating misalignments between budgets, Estimates and financial reporting. Whilst it will be considered at ARC he expressed some uneasiness about the prospect of introducing a misalignment when significant work has been done over the last 5-6 years on eliminating them.

34. The Board discussed the nature of misalignment and the Treasury confirmed they were currently undertaking a data gathering exercise to determine the scale of the impact. Andrew Baigent estimated the value to be £1.078bn for the Department of Health and although significant by value, the adjustment will be relatively simple.

35. The Board felt it was useful to understand the differences under National Accounts and IFRS but Ron Hodges was concerned that the restructuring of the NHS could result in the use of broad definitions and a danger exists that current expenditure will be classified as R&D. Gawain Evans indicated the devolved authorities will need guidance relating to the completion of grant templates to comply with definitions.

David Hobbs shared the background to the change that was brought about by a concern in Europe that not all relevant costs were being capitalised. A task force considered these issues which resulted in a change to definitions but a satisfactory agreement was yet to be reached on the principles of application.

36. The Board agreed and discussed the conceptual principles behind classification of R&D costs and the economic benefits which may arise at social, national and entity levels for related costs. The Chair asked for a paper to be presented at a future meeting explaining the misalignment and expected impact on the public sector for discussion by the Board.

Item 5: IFRS 9 Financial Instruments: Transition arrangements

37. The Treasury presented a paper to the Board summarising the options and requirements for transition arrangements for the introduction of the IFRS 9. The paper also included a summary of concerns raised by some central government entities canvassed for views on the impact of the Standard's introduction. The considerations when assessing the transition and relevant tranches of work were highlighted to the Board particularly around the three phased approach of classification and measurement of financial instruments, impairment methodology and hedge accounting. The Board were invited to offer opinion on the transition options including the appropriateness of setting a blanket approach and to provide comment to help shape future discussion at the Technical Working Group meetings being formed as part of the implementation work plan.

38. The Chair set the context of the debate on IFRS 9 endorsements and the interplay between the Standard and insurance contracts. Further discussion was had by the Board on the balance of flexibility required by entities with the transition.

39. Veronica Poole raised the importance of being pragmatic suggesting a blanket approach for entities for the classification and measurement of financial instruments but that greater flexibility is probably more appropriate for hedging. The Board discussed the implications of both approaches in more depth including the effect on WGA and what approach the private sector are planning to adopt. Wider considerations were also raised by Andrew Baigent relating to the usefulness and costs of implementation adjustments and restatements. The Board reached an initial consensus that a consistent approach along the lines suggested but that more thought is needed before a view was finalised.

40. The Chair suggested that a straw man proposal would help stakeholders consider the practical implications as part of the consultation exercise. A question was asked about the membership of the technical working group and whether members had the right skills and experience to contribute and formulate the straw man proposal. Representatives from CIPFA, local authorities and the devolved administrations should be part of the group as technical expertise that can draw on the experience in the private sector. The Chair asked for regular updates at future Board meetings on the progress and issues arising from the work.

Item 6: IFRS 15 Revenue from contracts with customers: Verbal update

41. The Treasury provided a verbal update on the implementation work for IFRS 15, included some reflections on the transition arrangements. The update included details of the proposed delay of application by the IASB by one year to 1 January 2018. Despite a possible

delay, work on the implementation arrangements is continuing according to the original timetable and sits alongside the work stream for IFRS 9.

42. The Board heard that departments had been contacted in April requesting both early views of the potential impact of the Standard and for contributors to the technical working group. Responses had been slow and it was not understood if this was as a result of a lack of awareness by departments of the implications.

43. An outline of the key impacts of transition was given including a summary of the options available, that being either full retrospective adoption (with optional practical expedients) or the cumulative effect model. Whichever option is adopted, there may be a significant effect on the recognition of revenue and costs. The Board was advised that a wider consultation exercise on the implications of the Standard and any proposed adaptations and transition arrangements will be undertaken in late summer/early autumn 2015 and a technical paper to the Board will follow in November.

44. The Board discussed the transitional issues and that in line with previous discussions on IFRS 9, a consistent approach is recommended particularly with WGA in mind. Andrew Baigent explained that he expected this Standard to have relevance for the internal market within the NHS but at a group level less so. He also noted the significant lead time needed around reviewing the contractual arrangements in place and consideration to changes to contract terms but this would be undertaken as part of scoping the annual revision cycle within the Department of Health. It was agreed by the Board that the delay in introducing the Standard would offer essential time to isolate issues and affected areas of the public sector to identify how entities will be affected.

45. Veronica Poole indicated that there is an opportunity to review and update contract terms with a view of achieving the economic outcome wanted. She also suggested that licensing is a key element changing within the new standard and it will be included in the exposure draft along with other potential amendments.

46. The Chair added that it would be helpful to highlight the amount of work necessary to consider the operational impact and contractual terms as part of the consultation exercise and requested that the Treasury report back to the Board regularly on progress and issues arising.

Item 7: IASB Annual improvement cycle 2012-14 and other narrow scope amendments; application in the FReM

47. The Treasury present a paper outlining the narrow scope amendments issued by the IASB as part of their annual improvements process for 2012-2014. Each amendment has been considered by the Treasury and a view formed on whether there are any public sector specific financial reporting impacts that may require further work to be performed and the relevant

effective dates of the amendments. It was noted that no immediate further action is required as a result of the amendments considered and no amendments to the FReM are proposed. Only one of the amendments has been adopted by the EU.

48. Anthony Appleton queried why the amendment to IAS36, with an effective date of 1 January 2014, was only coming into the FReM for 2015-16. The Treasury clarified that this was due to IFRS 13 only applying in the FReM from 2015-16, with the IAS 36 amendment being linked to the implications of introducing IFRS 13. The Chair thanked the Treasury for bringing these items to the attention of the Board and confirmed that no further action was necessary.

Item 8: Health manuals 2015-16 update

49. Andrew Baigent presented a paper to the Board noting progress in respect of the 2015-16 Department of Health Group Manual for Accounts and integral Better Care Fund guidance. A request was put to the Board to form a sub group to review the guidance and to confirm agreement that it may be published ahead of the next Board meeting in November. He advised that the guidance will be ready for review before the summer.

50. The Chair confirmed that the Board were content to delegate this matter to a sub group with Chair sign off and both Andrew Buchanan and Victoria Poole volunteered to join the sub group. Any significant issues would be referred to other Board members if they arise. It was noted that the Board were broadly happy with the guidance when last presented and that it had now been further aligned.

Item 9: Code of Practice on local authority accounting 2016-17, Exposure Draft

51. Sarah Sheen presented a paper to the Board on an update to the Exposure Draft of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) 2016/17. The consultation papers on these changes are expected to be issued from mid-July to 9 October 2015.

52. The proposed substantive changes to the 2015-16 Code outlined in the Exposure Draft include the measurement of the Highways Network Asset (Transport Infrastructure Assets) changing to current value (depreciated replacement cost - DRC) in accordance with the CIPFA Code of Practice on Transport Infrastructure Assets (Transport Code). Sarah Sheen noted that CIPFA/LASAAC is taking a close interest in the level of preparedness of local authorities.

53. Other amendments also included a review of the accounting and reporting of pension funds section of the Code, narrow scope amendments to IFRS, legislative amendments and

augmentation of the Code's provisions on concepts following the issue of the IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities.

54. The Chair made reference to the change in treatment to DRC for the Highways Network Asset and Sarah Sheen reported that some local authorities were doing well with the change but that the position was by no means clear across the board. David Aldous noted the amount of work that CIPFA Secretariat has done with the sector in relation to the accounting model. However, he noted a nervousness about how far local authorities have progressed and CIPFA was planning to undertake the consultation more widely to include engineers and other stakeholders. Audit agencies had agreed that more information is needed to fully understand the issues involved.

55. Ian Carruthers indicated that he is encouraged by the engagement with the audit community but recognised the complexity in terms of approach which leads to a risk of inconsistent treatment. He also noted that the Department for Transport had indicated that funding will be increasing directed to local authorities implementing good asset management and maintenance practices. Identifying a good sense of what's going on is a critical challenge in terms of the size and numbers involved and in relation to the materiality of the local authority balance sheet. The Board agreed that CIPFA/LASAAC were correct in prioritising the issue.

56. The Board discussed the effects of the change in treatment of assets to a DRC model particularly with regard to the derecognition of provisons in the Exposure Draft and compared the approach to that required by the FReM. It was recommended that the drafting of derecognition provisions in the Code would benefit from further clarification. The Chair asked if CIPFA can circulate a worked example of the DRC method and confirmation that the approach was consistent with the treatment in the FReM.

57. Other areas of changes to the Code were discussed by the Board. Anthony Appleton referenced the, "Telling the Story" consultation on the Code which aimed to improve the presentation of local authority financial statements. He queried the introduction of a new funding analysis section of the report and uncertainty around whether the Code is meeting in full the objectives of IFRS 8. Sarah Sheen advised that local authorities' measurement of performance (ie financial management information) did not place as much emphasis on the measures of profit and loss but the data may be interpreted through the funding analysis. She advised that CIPFA/LASAAC had debated this issue at length and had concluded that it was more relevant to include information within the narrative report that would accompany the financial statements. This matter was to be subject to consultation. She reported that CIPFA/LASAAC had expressed a view that if necessary it would propose that the Code would adapt IFRS 8 to achieve this. Andrew Buchanan suggested that this might be achieved without adaptation as the Code could specify that even though the Funding Analysis was included in the Narrative Report it would be deemed to be a part of the financial statements. Sarah Sheen thanked the Board for this suggestion. Ian Carruthers commented that on the introduction of the IFRS-based Code the decision had been taken to specify a standard segmental analysis in the local authority performance statement (the Comprehensive Income and Expenditure Statement) on the grounds of comparability. However, it was more useful to allow local

authorities to reflect how they are being run and views were being expressed that this may not be met by this standardisation. The Board did note however, that this may raise audit issues which have yet to be resolved.

58. The Chair concluded by suggesting that more clarification around adoption in the consultation document would be beneficial.

Item 10: Any other business

59. The Chair raised an issue around devolution and recommended the Board keep this in view to decide what action, if any, was needed in the future.

60. The Chair reminded the Board that the IASB had recently issued an Exposure Draft on their conceptual framework which would be covered at the November meeting and that Ian Carruthers would also report on the outcome of the IPSASB's June meeting.