MINUTES OF THE 130th FRAB MEETING HELD ON THURSDAY 15 JUNE 2017
AT HM TREASURY

Present:	Ian Mackintosh (Chair)	Alison Scott
	Andrew Buchanan	Larry Honeysett
	David Hobbs	Vicky Rock
	Ruth Elliot	Ron Hodges
	David Aldous	Alison Scott
	Gawain Evans	Gareth Caller
	Veronica Poole	Joanne McBurney
	Anthony Appleton	Andrew Baigent
	Joseph Mclachlan	Ian Webber

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

Secretariat: Ian Bulmer (FRAB Secretary)

Apologies: Craig Mackinlay MP, Bob Branson, Russell Frith

AGENDA ITEMS (in order tabled)

1. IFRS 9 update
2. IFRS 16 update
3. IFRS 15 update
4. International update (IPSAS/EPSAS)
5. WGA 2015-16 overview
6. Discount rates
7. CIPFA/LASAAC 2018-19 Code
8. Parliamentary hearings on government accounts
9. FRAB forward agenda
10. Any other business

Matters Arising

1. The Chair welcomed members to the meeting, noting the minutes of the previous meeting had been agreed by Board members. There were no other matters arising.

Item 1: IFRS 9 update

2. The Treasury introduced a paper providing the Board with draft application guidance on IFRS 9 for departments, noting it reflected the Treasury's proposals on adaptations and interpretations of the Standard for the public sector context and which had been agreed at previous meetings. The Board will review the changes to the FReM in November for approval, but was asked to provide any comments on the draft guidance.

3. Andrew Buchanan raised a number of comments on the current draft. The Executive Summary should be clearer on judging whether a significant impairment had taken place. In addition, there should be clarity on whether certain bodies are exempt stage from stage 1 impairments and how do it is subsequently judged what a significant impairment would be.

4. Ron Hodges stated that the existing paragraphs 1.8-1.15 were structured differently to the way IFRS 9 is generally understood and this could lead to the reader misinterpretation for example, when considering the business model under equity and debt. He recommended the Treasury review the narrative flow to so as to align more closely wit the Standard.

5. Andrew Baigent confirmed that the Health Manual would incorporate detailed guidance on how to apply IFRS 9. David Hobbs noted that it might be worth having a tabled item detailing any material differences to the ONS treatment

6. There were no further comments from the Board.

Item 2: IFRS 16 update

7. The Treasury explained the paper summarised the discussions of the technical working group and the initial conclusions drawn on the impact for the public sector of the policy choices available in the Standard, particularly in relation to transition. Interpretations are being considered for three areas (1) mandating all short term leases should be exempt from applying IFRS 16, (2) Clarifying the definition of a contract where there is no enforceability in Crown to Crown agreements and (3) mandating the choice of certain options available on transition.

8. The Treasury noted that further interpretations will be considered following the feedback from the initial impact consultation. This will run over the summer to assess the wider landscape and test the early conclusions in the paper with a wider audience. The consultation will also aim to collate additional information and comments on areas of the standard where no firm conclusions have yet been drawn. For example, on the type and nature of low value assets, valuation of right of use assets, internal rate of borrowing and the applicability of IFRS 16 to intangible assets. The working group will continue to discuss the public sector impact of the Standard and consider any early consultation responses.

9. The Board was asked to note the progress made and to provide any comments on the issues identified.

10. David Hobbs highlighted that ESA 10 and MGDD have clear guidance on leases of all types and currently distinguish between operating and finance leases. He agreed it is important to see how the two systems could be brought closer together to minimise any misalignment. There is some room for interpretation, given in IFRS 16 the value of the asset is the value of the future lease payments whereas in ESA 10, it is the value of the whole asset. David confirmed that the ONS is putting together a working group, and although he recognised the need to seek clarity he did not anticipate the difference being resolved quickly.

11. Andrew Baigent stressed that preparers need to know what records are necessary and whether two sets of records at a transactional level are requred. He noted that not all IT systems have the capacity to run dual records. David Hobbs mentioned that there had been discussions on maintaining dual records and the ONS recognised the difficulties and challenges this would entail for smaller bodies.

12. Andrew Buchanan asked where there were any significant sale and lease back arrangements in the public sector as the Standard does change significantly for this and therefore it is an area the Board should be considering in more detail. The NAO asked whether the Ministry of Defence is doing further work in this area and the Treasury confirmed the MoD is on the working group.

13. The Chair asked the Treasury if the Standard would be implemented on time and the Treasury confirmed the project timetable was on track although is challenging.

Item 3: IFRS 15 Update

14. The Treasury provided a brief update on IFRS 15, noting the Board had previously agreed interpretations to allow legislation or regulation to be considered akin to a contract, in those instances where revenue is not recognised as a tax. Where entities are permitted to keep tax revenue the performance obligations step will not apply.

15. The Treasury explained that work on the application guidance has been slightly slower than anticipated, but this will be finalised during the summer and issued later in the year, and before IFRS 15 comes into effect on 1 April 2018. The guidance will cover the interpretations agreed and provide public sector examples to assist with implementation, particularly around the disclosure requirements, which are significantly more extensive. The guidance will be clear that disclosures are required only where material.

16. There were no further comments from the Board.

Item 4: International Update

17. The Treasury provided a short verbal update on IPSAS/EPSAS.

18. Eurostat has been working with Member States and other stakeholders in developing more concrete proposals for the EPSAS framework. Eurostat has used small 'cells' of selected technical experts to develop proposals in specific areas such as first time implementation, principles underlying EPSAS governance and principles related to EPSAS. At the most recent working group in April, the work of the cells was presented with the principles largely aligning to the principles identified in the IPSAS Conceptual Framework.

19. PWC will be working on the next set of issue papers, which include intangible assets, disclosures and the approach member states take to harmonising chart of accounts. Further work is also required to consider what the governance structure will look like now the principles have been developed.

20. The discussions at the EPSAS working group aligns with the current IPSASB work programme which features heritage assets (consultation paper currently out for comments), social benefits (exposure draft deferred for approval until September) and infrastructure assets (to start in September).

21. IPSASB are also considering IPSAS changes required for the new IFRS through their exchange versus non-exchange revenue and expenses (consultation approval has been deferred to the June meeting), leases (project currently underway with an exposure draft in September, noting IPSAS moving away from the lessor model in IFRS 16), and financial instruments (Exposure draft on the agenda to be approved in June but the public sector specific financial instruments project to be delayed until further work on the public sector measurement project is undertaken).

22. The Board noted the updates.

Item 5: WGA Update

23. The Treasury provided an overview of the 2015-16 Whole of Government Accounts, noting that publication had been delayed due to Purdah but publication is anticipated in July. The Treasury explained how the assets and liabilities in the latest set of accounts had changed from the previous year, explaining the discount rate changes had significantly increased the value of provisions.

24. The Board suggested that the Treasury do more to explain the significant movements in pensions and provisions, highlighting what the underlying drivers are and how this had affected the liabilities. The Treasury confirmed that the latest report had split out the operating costs from the financing cost of long-term liabilities and the narrative expanded to explain what the various discount rates were and how they had changed.

25. The Board asked whether the notes to the 2015-16 accounts could indicate what the likely movements might be for 2016-17 to help inform readers. The Treasury confirmed that this had been done for pensions.

Item 6: Discount Rates

26. The Treasury introduced the paper, noting the Board had agreed to a review of the discounting methodology and explaining the approach in this paper had been to go back to the basics of the requirement in accounting standards, review the methodology and assess whether it still meets the requirements. The Board was asked for views on the questions and conclusions set out in the paper, which would be used to inform a consultation with departments.

27. The Chair started the session by asking whether the interpretation in other areas of policy, such as what is considered a risk free rate helped inform some of the judgements in this paper. He explained that the IASB's overarching principle was that it would not necessarily have one discount rate methodology, but there are no plans to test this further.

28. The Chair questioned why unfunded pension schemes were different from funded schemes and whether inflation was built into the cashflows. Veronica Poole confirmed that the private sector uses high quality corporate bonds and in absolute terms the rates were low. For provisions, the private sector would generally adjust the cashflows. The Standard allows for this or to adjust the rate but most companies would not adjust the rate.

29. Andrew Buchanan confirmed that it was unusual for those in the private sector to use cashflows excluding inflation. In the few occasions where this is the case, there must be certainty of using a rate that excludes inflation and that it had excluded inflation from the cashflows. Andrew Baigent confirmed that the health sector used real rather than nominal rates. Anthony Appleton noted that it results in the same answer if the flows include rate of inflation and the discount rate uses the equivalent rate. The Treasury confirmed that real and nominal rates were provided to departments.

30. Ron Hodges commented that one of the options discussed at the previous Board meeting were whether there should be a minimum band; if nominal discount rates are below 0%

then should the rate be capped at 0% and asked why this was not an option in the paper. The Treasury explained that the review was about assessing whether the current methodology was correct, not driven by the fact there were currently negative rates.

31. The Board thought it would be helpful to look at the discount rates for pensions and provisions, but agreed that the review should be targeted at provisions.

32. The Board discussed the issue of exit prices, highlighting that even in the private sector it is difficult to pay a third party to take the liabilities off an entity's books and that it is not a common practice. The Standard requires the notion of an exit price and the goal is to estimate that amount. This requirement does not change for the public sector. Anthony Appleton explained there were plenty of non-financial liability provisions that cannot be exited, this is a hypothetical exit price and does not necessarily mean there is a real one. The Standard requires a consideration of the risk relating to the cash outflows and then assumes a risk free rate, where a portfolio of investments would be considered. There is no problem in how the public sector is applying the Standard. He thought the private sector would not use investment returns to value liabilities.

33. Andrew Buchanan commented on the question of risk free rate versus risk rate. Looking at this particular obligation, what is needed to issue in long term government bonds so that the liability is fulfilled. Insurers have risk premium, which accounts for the fact that the claims may be more or less than anticipated. He felt there was no rationale to say that an exit price is not relevant for government.

34. David Hobbs highlighted that over time the term risk free rate is being taken as the same as the government bonds rate, but the issue was how to explain it to the lay reader of accounts.

35. Veronica Poole stated that the purpose of this exercise is to identify the risk free rate. This being government gilts and the yield at issuance not the coupon. The maturity becomes relevant when looking at coupons. If using risk free and adjustment to cash flows, then it should not result in any disparity with the requirements of IAS 37. Ron Hodges mentioned the measurement objective in IAS 37 and that it may be inappropriate in the public and private sector as the objective is to simulate an equivalent market for these liabilities. He understood that the Treasury is faced with a problem to discount these liabilities on a risk free basis, but stated there was no such thing as a risk free investment, just a close approximation. Ian Webber agreed and stated gilts are low risk assets, highlighting a number of European bodies investing in government gilts and how these are valued as relatively risk free.

36. Veronica Poole mentioned that in the private sector, the question had moved more towards estimates of uncertainty and how this is communicated, reiterating that IAS 1 requires sensitivity analysis. The probability of the rate changing gives better indication and regulators are asking for this to be disclosed. She wondered whether the issue could be resolved by better communication and enhanced disclosures.

37. Joseph Mclachlan stated that only one or two local authorities have large provisions at the moment so this is not a significant issue in local government, although he expected more local authorities to face legal cases so the level of provisions may change.

38. Andrew Buchanan mentioned that large companies work across many jurisdictions therefore comparisons with private sector discount rates may not necessarily be helpful. These companies' provisions may have nothing to go with UK government rates. He also highlighted that companies reflect risk adjustments to cashflows and there is not a single methodology that could be used. The options are: pure risk free adjusted cashflows; vice versa: and something in between. Because of this variety, the regulators focus more on the sensitivities and disclosures.

39. The Chair summarised the discussion and the Treasury stated that the next step is to undertake a consultation with departments, determine how the existing methodology is applied in practice and seek views on alternative options. The Treasury agreed to provide an update at the next Board meeting in November.

Item 7: CIPFA/LASAAC 2018-19 Code

40. Alison Scott summarised the updates to the Code and explained the areas they intend to include in their consultation with local authorities. She stated the consultation focused on areas that had not been previously considered, but was smaller than usual because consultation on IFRS 9 and IFRS 15 had been undergone in the previous year. The sector recognised that the disclosure requirements for IFRS 15 were extensive but local authorities were being strongly encouraged to use materiality appropriately. Alison also mentioned that CIPFA would be consulting separately on post implementation feedback on IAS 19 and the group accounting standards.

Item 8: Parliamentary hearings

41. Larry Honeysett updated the Board on the two recent parliamentary hearings on the Estimates process and utility of annual reports and accounts and management accounts.

42. Larry Honeysett explained that the Procedure Committee had held an inquiry looking at the authorisation of government spending through the Supply Estimates. The Committee concluded the current arrangements are not very effective because of the number of allocated parliamentary days for debate on the process, do not focus on the Estimates themselves. The Committee also recommended improvements to the format of the documentation to improve ease of use and understanding for both parliamentarians and other users.

43. In their report, the Public Administration and Constitutional Affairs Committee (PACAC) agreed accruals accounting gave confidence in the financial reporting currently prepared by central government entities. The Committee is also supportive of the steps taken to simplify and streamline the accounts. The Report recommends making resource accounts more useful by including further analysis of expenditure, improving performance information and ensuring the performance report is fair and balanced. The Committee requested that underlying data is made available in other formats such as Excel to allow ease of analysis. In addition, it recommended that the linkage of information between Spending Reviews and

ministerial announcements to the information reported in the accounts is improved. The Committee felt FRAB itself should be open to wider membership, such as representatives from users of the accounts, although recognised there may be some practical difficulties in doing so. Nevertheless, government should still consider how to gain broader user views. Larry explained that he expected government to respond to the reports in due course and for the NAO and ONS to follow up their recommendations.

44. Ron Hodges noted that the Committee had raised similar issues to those prevalent in the private sector, including the need to strike a balance between reducing detail and providing clarity as well as responding to increasing demands for information in the accounts. He suggested that to increase confidence all areas of the annual report and accounts should be formally audited. Joseph Mclachlan agreed and stated the accounts have to be written for an informed reader and could become unwieldy if further analysis on unit costs and performance data is added. Whilst such information is relevant, the annual report and accounts is not necessarily the right place for it.

45. Andrew Buchanan mentioned there is currently much work underway looking at the future of corporate reporting and it is a high priority on the IASB agenda, suggesting it was worth looking at this existing work. Veronica Poole highlighted the FRC work on strategic reporting and reflected on Integrated Reporting, suggesting this could help steer how the performance report element of public sector annual report and accounts should be structured.

46. David Hobbs stated that it was for the entities themselves to consider how best to present and promote the material in their accounts and it may be outside the remit of the FRAB to make recommendations.

47. Anthony Appleton stated that financial regulators had started to expand their role to look more into financial reporting, especially given the IASB developments. He explained that one report will never meet everyone's needs, but the accounts should be the lynchpin that other reports can be linked to. He suggested entities should think more expansively about their corporate reporting.

Item 9: Forward Agenda

48. The Chair introduced the forward agenda and asked for any further suggestions.

49. Andrew Buchanan suggested reviewing the Interpretation Committee agenda. Anthony Appleton raised a question around the content of the FReM post Brexit and how the role of the Board would evolve. The Chair stated the Board needed more time to review its mandate. Treasury agreed to provide regular updates on the simplifying and streamlining project where it impacted on resource accounts.

Item 10: Any Other Business

50. Veronica Poole raised the issue of how to account for the new Apprenticeship Levy and explained that Deloitte had issued some initial guidance. The Levy was introduced in April 2017 and requires all employers with a pay bill of £3m or more to pay a levy based on a percentage of the pay bill. The government provides an additional 10% top up to the Levy. The Levy may then be used by the entity to pay for apprenticeship costs by agreed training

providers. The Deloitte guidance proposes the Levy amounts to a prepayment of training costs with the 10% top up akin to a government grant. Veronica explained that this treatment, generally agreed with the accountancy firms and applied in the private sector, does not quite reflect the same proposed treatment being discussed to apply in the public sector.

51. The Treasury explained that their expert advice from the Classification Team has considered the levy to be a tax. As a result, the accounting treatment must treat it as such with the top up amount providing access to a government grant. The Department for Education as policy lead, are examining proposed accounting treatments by both the private and public sectors, namely as either a prepayment or tax but both with access to future grant income. The Department will be consulting with other government departments over the summer. FRAB representatives fro the Devolved Authorities highlighted that in Scotland, Wales and Northern Ireland the levy is treated as a tax and that they have no access to the apprenticeship scheme as it applies in England.

52. Finally, Andrew Baigent stated that the revised Health manual was ready to be published, but had been delayed due to the election.

53. The Chair closed the meeting and thanked Board members for their contributions and discussion.

Date of next meeting: 16th November 2017