HM TREASURY

FRAB (134) 03
22nd NOVEMBER 2018

Financial Reporting Advisory Board Paper

Government Financial Reporting Manual (FReM) and Illustrative Statements for 2019-20 and in year amendments for 2018-19

Issue:	HM Treasury requests that the FRAB agrees to the publication of the 2019-20 FReM and Illustrative Statements, and an update to the 2018-19 FReM and Illustrative Statements. This paper also summarises the major and minor amendments to IFRS applicable for 2018-19 and 2019-20.
Impact on guidance:	The FReM and Illustrative Statements are updated for application from 2018-19. Amendments are made for minor corrections and to improve clarity. Under the assumption that the FRAB agrees with the recommendations in FRAB 134 (02), the 2019-20 FReM has been updated to reflect the introduction of IFRS 16 in the public sector for those entities who meet specific criteria and early adopt from 1 April 2019. The general application date for IFRS 16 in the public sector will be 1 April 2020.
IAS/IFRS adaptation or interpretations for the public-sector context?	Yes – the 2019-20 FReM introduces new interpretations and adaptations for the public-sector context for IFRS 16 (again only applicable for those entities early adopting IFRS 16 from 1 April 2019).
Impact on WGA?	Yes – WGA will be expected to incorporate the changes made in accounting standards within the Whole of Government Accounts. Assuming the FRAB agrees with the recommendations in FRAB 134(02), the 2019-20 WGA will be prepared on an IAS 17 basis.
IPSAS compliant?	No. IPSASB has not concluded its work on revenue, financial instruments or leases which will propose changes to the relevant IPSAS.
Impact on Estimates/budgetary regime?	No Estimates or budgetary regime impacts are anticipated.
Alignment with National Accounts	Prior to IFRS 16, the ONS accepted IAS 17 as a suitable proxy for national accounts requirements. IFRS 16 recognises more leases on balance sheet than required by national accounts. HM Treasury are working closely with ONS to manage this misalignment.
Recommendation:	That FRAB notes the proposed amendments to the FReM and illustrative statements for 2019-20 and 2018-19, and agrees their publication.
Timing:	The updated Manuals will be published in December 2018.

DETAIL

Background

1. The Memorandum of Understanding between the Relevant Authorities for developing financial reporting guidance for the public sector requires that the version of the FReM for financial year 2019-20 is available to users by 1 January 2019. This paper requests that the Board notes the proposed amendments to the FReM for 2019-20 and agrees to their publication.

2. In-year changes are proposed for the 2018-19 FReM and illustrative statements for minor corrections and to improve clarity. This paper requests that the Board notes the proposed amendments to the FReM for 2018-19 and agrees to their publication.

3. This paper also summarises the major and minor amendments to IFRS applicable for reporting periods starting from 1 January 2018 or 1 January 2019.

Amendments to the 2018-19 FReM and illustrative statements

4. Minor changes and corrections are proposed to the 2018-19 FReM for clarity, to acknowledge the new version of the International Accounting Standards Board's (IASB's) *Conceptual Framework*, and to address General Data Protection Regulation (GDPR) implications. The proposed amendments to the FReM and illustrative statements are summarised at Annex B.

5. The revised *Conceptual Framework* applies for financial reporting periods starting on or after 1 January 2020, and entities may choose early adoption. However, the Standards interpret the principles in the *Framework* for practical purposes, and existing Standards take precedence over the revised *Framework*.

6. The introduction of GDPR changes the fundamental assumptions for disclosures relating to named individuals in the Remuneration and staff report. The presumption is still that the information will be given, but entities must now inform individuals in advance and tell them that they can object under Article 21 of GDPR. Entities are strongly advised to take legal advice if individuals do not agree to disclosure, as they may be challenged under the Freedom of Information act if they do not publish.

9. The final version of the 2018-19 FReM and Illustrative Statements are included at Annex E.

Amendments to the 2019-20 FReM and Illustrative Statements

10. Amendments have been made to the 2019-20 FReM primarily to summarise the adaptations and interpretations for IFRS 16 for entities which meet specific, limited criteria and early adopt IFRS 16 from 1 April 2019. The proposed amendments are summarised in Annex C. The Illustrative Statements have not been updated for the introduction of IFRS 16 in the public sector, as most entities will adopt IFRS 16 from 1 April 2020 and so references to IAS 17 should not be changed for these entities in 2019-20. HM Treasury will work separately with those entities early adopting IFRS 16 if they would like any further information on how the Illustrative Statements will change following the adoption of IFRS 16.

11. The FReM and Illustrative Statements for 2019-20 are included at Annex E.

Amendments to IFRS

Minor amendments

12.The IASB has issued eleven amendments to IFRS made up of narrow scope amendments, changes through the annual improvement cycle 2015-2017 and updated references to reflect the revised *Conceptual Framework* and changes to the definition of materiality. There is also one new Interpretation. Annex A provides a summary of the amendments. Only one of these changes, the application of the revised *Conceptual Framework*, has the potential to cause public sector reporting issues. However, this is in exceptional circumstances where existing reporting standards cannot be applied and a bespoke accounting treatment must be developed from the principles in the *Framework*. As these situations are difficult to predict in advance, we do not propose any public sector specific amendment should be prepared to address them, and instead anticipate dealing with them on a case by case basis should any arise.

13. Two of the amendments have already been adopted by the European Union, and adoption of the rest is anticipated in 2018 or 2019, in advance of the finalisation of the 19-20 FReM. HM Treasury is therefore proposing to introduce all amendments in the 2019-20 FReM, with early application permitted in 2018-19 for those entities that wish to include the requirements. The changes in these amendments are not considered to be material across the public sector and therefore should not affect the preparation of group accounts if some entities decide to early adopt.

14. Does the Board agree with the proposed approach to adopt all amendments in the 2019-20 FReM, with early application permitted in 2018-19 (subject to EU adoption)?

Major amendments

15. IFRS 15 – An additional IFRS 15 amendment has been added for 2018-19 to recognise that the reasons given for holding received revenue as a liability may not always apply in the public sector. The following text has been added to Table 6.2.

> 2. Where by statute or Treasury consent, an entity is permitted to retain the revenue from taxation, fines and penalties, this revenue shall be treated as arising from a contract and accounted for under IFRS 15 (15a). However, the requirement under IFRS 15 (15a) for the entity to recognise revenue only when "all, or substantially all, of the consideration promised… has been received" may not always apply.
>
> The nature of revenue from taxation, fines and penalties means the two reasons given for holding received revenue as a liability as set out in paragraph IFRS 15 (16) may not be relevant.
>
> Therefore, where entities receive revenue through taxation, fines and penalties which is wholly non-refundable and leads to no obligations, entities are not required to wait until all, or substantially all, of the promised revenue has been received but instead can recognise the revenue.

16. IFRS 16 – As set out in paper FRAB 134 (02), the following text is proposed for addition to the 2019-20 FReM to support the early adoption of IFRS 16 in the public sector when specific, limited criteria have been met.

IFRS 16 Leases	
Interpretationss	1. The option to apply the election in IFRS 16 (5) has been withdrawn. All entities must apply the recognition and measurement exemption for short-term leases in accordance with IFRS 16 (6-8).. 2. Where lessees cannot readily determine the interest rate implicit in the lease, they are instead required to use the HM Treasury discount rates promulgated in PES papers as their incremental borrowing rate. However, if an entity can demonstrate that another discount rate would more accurately represent their incremental borrowing rate (for example, if they undertake external borrowing independently of the Exchequer), they shall use that discount rate as their incremental borrowing rate. 3. The option to use the revaluation model for subsequent measurement of right-of-use assets has been withdrawn. All entities using this Manual shall apply the cost model to determine the subsequent measurement of the right-of-use asset (IFRS 16 (30-33)) or if applicable, the fair value model for right-of-use assets classified as investment properties under IAS 40 Investment Properties (IFRS 16 (34)). 4. The option to reassess whether a contract is, or contains, a lease at the date of initial application has been withdrawn. All entities shall use the practical expedient detailed in IFRS 16 (C3).[1] 5. Upon transition, the accounting policy choice to apply IFRS 16 retrospectively to each prior period presented in accordance with IAS 8 has been withdrawn. All entities applying this Manual shall recognise the cumulative effects of initially applying IFRS 16 recognised at the date of initial application as an adjustment to the opening balances of taxpayers' equity (or other component of equity, as appropriate) per IFRS 16(C5(b)). This should include the elimination of any revaluation reserve associated with existing finance leases. 6. Upon transition, entities shall measure the right-of-use asset under leases previously classified as operating leases per IFRS 16((C8 (b)(ii))); an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application. 7. Upon transition, all entities applying this Manual shall apply the following options for leases previously classified as operating leases: No adjustments for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a)) No adjustment for leases for which the lease term ends within 12 months of the date of initial application (with a requirement to include the cost

[1] This presumes that entities have been applying the guidance in IAS 17 and IFRIC 4 appropriately in the past. Any known misapplication of the definition of a lease guidance should be corrected as a prior period error in accordance with IAS 8 unless an entity has explicit approval from the relevant authority to do otherwise.

	associated with those leases in the short-term lease expense disclosure). (C10 (c)) Use hindsight in determining the lease term if the contract contains options to extend or terminate the lease. (C10 (e))

Adaptations	1. IFRS 16, as adapted and interpreted by this Manual, will be effective from 1 April 2020, with one exception. Early adoption from 1 April 2019 is available for entities where the following criteria are met:
	
	• the entity has at least one subsidiary that, under the Companies Act, is required to follow IFRS as adopted by the EU, and the total assets of the subsidiary comprise at least 10% of the total assets at the group level;
	• the subsidiary, or subsidiaries, described above have operating leases commitments that comprise at least 10% of the operating lease commitments at the group level; and
	• approval to early adopt has been received from HM Treasury.
	
	2. The definition of a contract is expanded to include intra-UK government agreements where non-performance may not be enforceable by law.
	
	3. All lessees shall account for peppercorn leases using the following criteria:
	
	• Recognise a right-of-use asset and initially measure it at current value in existing use or fair value, depending on whether the right-of-use asset will be held for its service potential and as set out in paragraphs 7.1.4 7.1.6. However, if the right-of-use asset meets the definition of a heritage asset, it should be initially measured in accordance with paragraphs 7.1.34-7.1.39.
	• Recognise a lease liability measured in accordance with IFRS 16.
	• Recognise any difference between the carrying amount of the right-of-use asset and the lease liability as income as required by IAS 20 as interpreted in this Manual.
	• Subsequently measure the right-of-use asset following the principles of IFRS 16 as adapted and interpreted in this Manual. The initial measurement of the right-of-use asset shall serve as its deemed cost for subsequent measurement purposes.
	• Peppercorn leases are defined as leases for which the consideration paid is nominal (that is, significantly below market value). Upon transition, any peppercorn leases that were classified as operating leases under IAS 17 shall be recognised as follows:
	    • The right-of-use asset shall be measured at current value in existing use or fair value, depending on whether the right-of-use asset will be held for its service potential and as set out in paragraphs 7.1.4 7.1.6. However, if the right-of-use asset meets the definition of a heritage asset, it should be initially measured in accordance with paragraphs 7.1.34-7.1.39.
	    • The lease liability shall be measured at the present value of lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.
	    • The difference between the carrying amount of the right-of-use asset and lease liability shall be included as part of the

	adjustment to the opening balances of taxpayers' equity (or other component of equity, as appropriate) per IFRS 16 (C5(b)).

Recommendation

17. The Board is requested to consider the proposed amendments to both the 2018-19 FReM and 2019-20 FReM and to agree their publication.

HM Treasury
22nd November 2018

Annex A – Analysis of Amendments to IFRS

Amendment	IASB Effective date: periods beginning on or after	FReM introduction effective date (subject to EU adoption)	Summary of changes	Public sector specific reporting issue
IFRIC 23 – Uncertainty over Income Tax Treatments (Interpretation)	1 January 2019	1 April 2019 2019-20 FReM EU adoption – October 2018	IFRIC 23 clarifies the accounting treatment when there is uncertainty about income tax treatments under IAS 12. The entity should determine whether tax treatments are best considered together or individually, and should consider whether it is probable that the relevant tax authority would accept each treatment. Where it is probable, the entity should account on that basis; where it is not probably, the entity should refer instead to the most likely outcome. Decisions should be based on which approach provides better predictions of the resolution of the uncertainty, and when making judgements the entity should assume that the tax authority will examine the accounts with full knowledge of all relevant information. The application of the amendment is <u>prospective</u> though <u>retrospective</u> application is permitted without the use of hindsight.	None noted.
Amendments to references to the *Conceptual Framework* in the Standards.	1 January 2020	1 April 2020 2019-20 FReM EU adoption – 2019	Amendments to IFRS 2, IFRS 3, IFRS 6, IFRS 14, IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22, and SIC-32 to update those pronouncements with regard to references to and quotes from the framework or to indicate where they refer to a different version of the *Conceptual Framework*. The FReM has been updated to acknowledge the new *Conceptual Framework* and to note that early adoption of the new version is permitted. The updated *Conceptual Framework* may cause issues where an entity has an accounting treatment that sidesteps the Standards and refers instead to the	Only in unusual circumstances; not sufficient to require public sector specific amendments.

Amendment	IASB Effective date: periods beginning on or after	FReM introduction effective date (subject to EU adoption)	Summary of changes	Public sector specific reporting issue
			principles in the Framework. We have identified one relevant situation in the public sector, due to a highly unusual liability. While this should be vanishingly rare, there is a possibility that others may exist. Situations unusual enough to require bespoke accounting treatments should be approached on a case by case basis.	
IFRS 3 *Business Combinations* – remeasurement of previously held interest. (Annual Improvements 2015-17 Cycle)	1 January 2019	1 April 2019 2019-20 FReM EU adoption – Q4 2018	Amendments clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business.	None noted.
IFRS 3 *Business Combinations* – amendments to clarify the definition of a business	Business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on	1 April 2020 2019-20 FReM EU adoption – 2019	Amendments to Appendix A *Defined Terms*, which clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs; and narrow the definitions of a business and of outputs by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs. They also provide guidance and illustrative examples to assess whether a substantive process has been acquired, remove the assessment of whether market participants are capable of replacing any missing inputs or processes,	None noted.

Amendment	IASB Effective date: periods beginning on or after	FReM introduction effective date (subject to EU adoption)	Summary of changes	Public sector specific reporting issue
	or after 1 January 2020		and add an optional concentration test to permit a simplified assessment of whether an acquired set of assets and activities is not a business. Early application is permitted.	
IFRS 9 *Financial Instruments* – amendments relating to prepayment features with negative compensation and modifications of financial liabilities	1 January 2019	1 April 2019 201920 FReM EU adoption – March 2018	Under the current IFRS 9 requirements, the SPPI condition is not met if the lender has to make a settlement payment in the event of termination by the borrower (also referred to as early repayment gain). *Prepayment Features with Negative Compensation* amends the existing requirements in IFRS 9 regarding termination rights in order to allow measurement at amortised cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments. The final amendments also contain (in the Basis for Conclusions) a clarification regarding the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability. The application of the amendment is retrospective.	None noted.
IFRS 11 *Joint Arrangements* – remeasurement of previously held interest. (Annual Improvements 2015-17 Cycle)	1 January 2019	1 April 2019 2019-20 FReM EU adoption – Q4 2018	Amendments clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.	None noted.

Amendment	IASB Effective date: periods beginning on or after	FReM introduction effective date (subject to EU adoption)	Summary of changes	Public sector specific reporting issue
IAS 1 *Presentation of financial statements* – amendments regarding the definition of material	1 January 2020	1 April 2020 2019-20 FReM EU adoption – 2019	The amendments clarify the definition of material and bring the Standards in line with the Conceptual Framework. The new definition reads: "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity." Three points to note are the introduction of 'obscuring', the change from 'could' to 'could reasonably be expected', and the change from 'the users' to 'the primary users'. The amendments also elaborate on five ways that information can be 'obscured': vague or unclear language; scattering information in different places in the financial statements; inappropriate aggregation; inappropriate disaggregation; and material information hidden by immaterial information so that it is unclear what is material.	None noted.
IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* – amendments regarding the definition of material	1 January 2020	1 April 2020 2019-20 FReM EU adoption – 2019	The definition of material in IAS 8 has been replaced with a reference to the new definition in IAS 1.	None noted.
IAS 12 *Income Taxes* - income tax	1 January 2019	1 April 2019	Amendments clarify that the requirements in the former paragraph 52B (to recognise the income tax consequences of dividends where the transactions	None noted.

Amendment	IASB Effective date: periods beginning on or after	FReM introduction effective date (subject to EU adoption)	Summary of changes	Public sector specific reporting issue
consequences of dividends (Annual Improvements 2015–2017 Cycle)		2019-20 FReM EU adoption – Q4 2018	or events that generated distributable profits are recognised) apply to all income tax consequences of dividends by moving the paragraph away from paragraph 52A that only deals with situations where there are different tax rates for distributed and undistributed profits	
IAS 19 *Employee Benefits* - amendments regarding plan amendments, curtailments or settlements	1 January 2019	1 April 2019 2019-20 FReM EU adoption – Q4 2018	If a planned amendment, curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement. In addition, amendments have been included to clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling. Early application is permitted but must be disclosed.	None noted.
IAS 23 *Borrowing Costs* - borrowing costs eligible for capitalisation (Annual Improvements 2015–2017 Cycle)	1 January 2019	1 April 2019 2019-20 FReM EU adoption – Q4 2018	Amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.	None noted.
IAS 28 *Investments in Associates and Joint Ventures* – amendments	1 January 2019	1 April 2019 2019-20 FReM	Paragraph 14A has been added to clarify that an entity applies IFRS 9 including its impairment requirements, to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.	None noted.

Amendment	IASB Effective date: periods beginning on or after	FReM introduction effective date (subject to EU adoption)	Summary of changes	Public sector specific reporting issue
regarding long-term investments in associates and joint ventures		EU adoption – Q4 2018	Paragraph 41 has been deleted because the Board felt that it merely reiterated requirements in IFRS 9 and had created confusion about the accounting for long-term interests. An illustrative example accompanies these amendments. Early application is permitted. Application is retrospective without hindsight; however there are transition requirements similar to those in IFRS 9 for those applying the changes after they have applied IFRS 9, as well as relief from restating prior periods for entities electing (in accordance with IFRS 4) to apply the temporary exemption from IFRS 9.	

Annex B: In-year amendments to the 2018-19 Government Financial Reporting Manual (FReM)

Amendments have been made to the 2017-18 FReM and illustrative statements to correct minor errors and provide clarifications to improve disclosure requirements and the introduction of the Non-Financial Reporting Regulations.

Paragraph	Change	Reason for change
Throughout	Minor grammatical errors	
2.2.6-8	Added text to discuss the role of the Conceptual Framework in setting out the principles behind the Standards, to highlight the introduction of the new Conceptual Framework, and to note that departments can choose to early adopt it.	In rare circumstances accounting treatment may require an explicit reference back to the principles in the Conceptual Framework; updating the reference ensures that departments refer to the correct version of the Framework.
3.2.4	Reference added to the new *Financial Controls Summary*.	A note to draw attention to guidance on controls that will be available by the publication date of the 18-19 FReM.
3.2.12	Reference added to the new *Contingent liability approval framework* published by HM Treasury.	A note to draw attention to further guidance on contingent liabilities.
5.3.17 - 5.3.18	Remuneration and staff report – guidance on disclosing information about individuals updated to reflect the requirements of General Data Protection Regulations (GDPR).	GDPR requires a different set of assumptions around disclosing information about individuals.
5.3.28 (f)	Remuneration and staff report – Additional requirement for disclosures related to Trade Union facility time reporting.	To reflect the disclosure requirement introduced by Statutory Instrument 328: The Trade Union (Facility Time Publication Requirements) Regulations 2017. Links to HMT FAQs and Cabinet Office further guidance have also been added.
5.4.22	Added text to emphasise that IFRS 8 applies in full to all public sector bodies.	To clarify the wording around applying IFRS 8 in the public sector.
Table 6.2	IFRS 9 Adaptations – minor update to coordinate with the expansion to the	To improve consistency across adaptations of IFRS.

	definition of a contract applied for IFRS 15.	
Table 6.2	IFRS 15 Adaptions – amended to allow recognition of revenue before all (or substantially all) of the consideration is received, when revenue is from taxation, fines and penalties and therefore not refundable.	To recognise where the reasons given in IFRS 15 for holding revenue received as a liability may not be relevant.
Model Statements of Accounting Officers' Responsibilities	Model Statements of Responsibilities updated to reflect the language of the UK Corporate Governance Code, both in reference to the financial statements and in reference to the responsibilities of the auditor.	To bring the language in line with the UK Corporate Governance Code.
Annex 4	List of links to relevant guidance updated to remove dead links, replacing where possible.	To update hyperlinks.

Annex C: Amendments to the 2019-20 Government Financial Reporting Manual (FReM)

Amendments have been made to the 2018-19 FReM and illustrative statements for the introduction of IFRS 9 and IFRS 15 in the public sector,

Paragraph	Change	Reason for change
Table 6.1	Insertion of IFRS 16.	Introduction of IFRS 16 in the public sector for those where early adoption has been agreed.
Table 6.2	Adaptations and Interpretations added for IFRS 16 Leases.	Introduction of IFRS 16 in the public sector for those where early adoption has been agreed.

Please see separate documents for the following annexes:

Annex D – 20118-19 FReM and Illustrative Statements in track changes

Annex E – 2019-20 FReM and Illustrative Statements in track changes