HM TREASURY

FRAB 138 (04)

21st November 2019

Financial Reporting Advisory Board Paper

Update on the pilot thematic review of IFRS 9 and IFRS 15

Issue:	This paper details the progress in the pilot thematic review of IFRS 9 and IFRS 15, including an overview of the report and conclusions drawn.
Impact on guidance:	The responses to the post implementation review questionnaires demonstrate no need for there to be changes made to the FReM as a result of this review. However, lessons learnt will be taken forward and incorporated as further guidance is issued at a later date in respect of the implementation of new financial standards
IAS/IFRS adaptation or interpretations?	N/A
Impact on WGA?	N/A
IPSAS compliant?	N/A
Impact on budgetary regime?	N/A
Alignment with National Accounts (ESA10)?	N/A
Impact on Estimates?	N/A
Recommendation:	The Board is asked to note this paper, and the attached annexes. The Board is asked to provide feedback on this paper including whether the Board is in agreement with the basis of the conclusions and the proposed next steps.
Timing:	The final report is expected to be published on gov.uk in December 2019. Changes suggested by this review as a result of the lessons learnt, are in progress and will continue through the implementation plan for IFRS 16 and IFRS 17 where possible.

DETAIL

Background

1. The Treasury provided the Board with an overview of the actions and next steps arising from the Government Financial Reporting Review at the June 2019 meeting. The Treasury provided further detail on the next steps arising, at the request of the Board, in an out of meeting paper in August 2019. This included a summary of the pilot thematic review of IFRS 9 and IFRS 15, including a commitment to provide further detail on this review to the Board at the September 2019 FRAB meeting.

2. A further paper was provided to the Board in the September 2019 meeting, which gave an update as to how the post implementation review had progressed up to that date.

3. This paper aims to provide the Board with a summary of the actions that have been undertaken as part of the review. It will also provide the Board with the basis of conclusions from the feedback from the two questionnaires and the outcome of the desktop review, which will feed into some proposed next steps. The Board is requested to provide any comments on these conclusions and proposed next steps.

4. There are two annexes to this document:

    - Annex A contains the questions and anonymised responses for the preparers' questionnaire

    - Annex B contains the questions and anonymised responses for the users' questionnaire

Purpose of the review

5. As part of the Government Financial Reporting review, the Treasury committed to undertake regular thematic reviews of government financial reporting. The thematic reviews are intended to support the Treasury's statutory role as a standard setter for central government and act as an opportunity to deep dive into particular areas of reporting with the aim of improving the quality and usefulness of annual reports and accounts (ARAs).

6. IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* were implemented in the public sector from 01 April 2018. This followed a four-year implementation plan by the Treasury, which included valuable input and scrutiny by the Board.

7. The introduction of IFRS 9 and IFRS 15 has been a major reporting challenge for the whole of the public sector. The Treasury is keen to support the continuous improvement of financial reporting and learn from the implementation of these standards. Therefore, this topic was chosen as one of the pilot thematic reviews.

Scope and methodology

8. As set out to the Board previously, this review focuses on the way the standards were implemented in central government, including, the implementation process led by the

Treasury, the guidance provided and the usefulness of information to users disclosed in the ARAs.

9. The Treasury had two surveys open for this review, one for preparers and one for users. Both surveys are now closed. The preparers' questionnaire was live for seven weeks throughout July and August. The users' questionnaire was live for eight weeks across August and September. All respondents to either the preparer or user questionnaire, were invited to a workshop in October to discuss the initial findings from the thematic review and give any further feedback from this.

10. The Treasury also undertook a desktop review of the 2018-19 ARAs, which included looking at a sample of 30 different annual reports and accounts. The sample included 17 ministerial departments, 5 non-ministerial departments, 1 independent body, 1devolved administration, 2 non-departmental public bodies, 1 trading fund, and 2 executive agencies. The focus of the desktop review centred on the usefulness of disclosures to users of the accounts, keeping in mind that not all users of central government ARAs will have expert knowledge of the two new financial standards that have been implemented in the 2018-19 financial year.

11.

Overview of findings

12. The summary findings from both preparers and users suggest that the timing and content of guidance provided by the Treasury during the implementation process met their needs. However, areas of potential improvements were identified. The review also found that there are some very good examples of clear, succinct and easy to read disclosures in the annual reports and accounts (ARAs) which would significantly add to users' understanding in respect to IFRS 9 and IFRS 15. Examples of good practice will be shared as part of the bank of best practice.

13. The review also found a variance between ARAs, with some containing significantly less detail, or less well-structured detail and explanation of the standards and impact of implementation on the business. Part of the next steps sets out how the Treasury intends to support continuous improvement in the disclosures for new financial standards in the ARAs going forward.

Responses from the thematic review

Summary of the preparer's responses

14. The Treasury received 53 completed responses to the preparers' questionnaire. 11 additional entities filled out the first compulsory question on name of entity but did not respond to any of the other questions.

15. The overall feedback received from the preparers' questionnaire supported the implementation plan adopted for the introduction of IFRS 9 and IFRS15. The timing and content provided during the implementation process was sufficient, although there were areas identified where improvements could be made.

16. There were 22 questions asked in the preparers' survey, with a mix of question types between those that were multiple choice, with the invitation to provide comment, and those which were comment boxes only. Those questions that were multiple choice received more responses than those questions where respondents were invited to give written answers only. Annex A sets out the number of responses received for each question

Timeliness of implementation process

17. The first section of the questionnaire focused on the timeliness of information provided by the Treasury and the response received here was positive. For this set of questions, bar the question in respect of budgeting for IFRS 9, at least 90% marked the timing of the different parts of the implementation process as acceptable or sufficient. Very few marked that they were not satisfied with the timing.

18. Written feedback provided suggested some areas where the Treasury could improve with respects to the timing of the implementation plan. For example, some respondents suggested the earlier publication of the application guidance would be beneficial to avoid publication occurring during the 2017-18 accounts closure process. It would also allow departments more time to give relevant support to their arm's length bodies.

19. The sufficiency of the timing of the budgeting guidance for IFRS 9 (there was no budgeting guidance for IFRS 15) was found to be low with just over 20% of respondent believing the communication on this to be less than satisfactory. Written feedback suggested that changes to budgeting could have been communicated better to entities and that the delay in publication of this guidance had led to some duplication in work, for example when creating new codes in the central finance system.

20. There was also the opportunity for respondents to self-review their implementation process and give further feedback on the timeliness of the Treasury guidance. Whilst there was nothing significant highlighted in either of these questions, a number of best practice examples could be drawn out from the preparers' own feedback including:

    - Early engagement with the interpretations of the financial reporting standards to understand the implications for the entity
    - Use of the knowledge networks that exist within the government[1]
    - Comprehensive embedding of new financial standards into the underlying operations to make them business as usual
    - Focus on project management
    - Early consultation with auditors to agree the treatment of relevant transactions and disclosures before the year end

21. Further suggestions for the Treasury by way of general comments, included:

    - Ensuring any amendments to the adaptations and interpretations in the FReM are finalised as early as possible to help successful implementation
    - Better clarity could have been provided on disclosure guidance
    - Improved interaction between all central government entities and not just departments

[1] Knowledge Networks are platforms for sharing finance expertise across government and developing more standardised finance processes, built around best practice and the sharing of lessons learned

Sufficiency and content of guidance

22. The next section of the questionnaire requested feedback on the content and sufficiency of the guidance provided by the Treasury. This focused on both alignment between the IFRS 9 and IFRS 15 exposure drafts, the respective application guidance, and the FReM. It also considered whether preparers thought the current interpretations and adaptations were fit for purpose, as well as the sufficiency in the guidance relating to disclosures, and the suite of training on offer.

23. Again, the responses for this set of questions was positive, with at least 60% of respondents selecting the most positive option for each question. Similar responses were received for both IFRS 9 and IFRS 15, other than a small disparity in the sufficiency of guidance relating to disclosures. Around 80% of respondents thought the guidance relating to disclosures was sufficient for IFRS 15, but only 70% of respondents agreed for IFRS 9.

24. Respondents also gave written feedback commenting on the usefulness of the application guidance and agreeing there was no need for any further adaptations or interpretations of IFRS 9 and IFRS 15. However, there were some suggestions for improvements in the guidance, for example, a request for more public sector examples in the guidance or including additional specific budgeting guidance.

25. The question on the suite of training received the lowest score, with only 55% of respondents agreeing the training for IFRS 9 was sufficient, which was slightly higher for IFRS 15 at 60%. The written feedback received on this question suggests that the lower scores related to the access to training rather than the content and delivery of the training itself, which would agree with the high review scores the Treasury received on the sessions run as part of the Government Finance Academy technical update training. The questionnaire feedback also suggested that training should have had greater focus on relevant disclosures as well as financial information. Respondents suggested the Treasury could do more to publicise the training on offer and aim to have a broader reach geographically and with arm's length bodies.

26. All questions provided the opportunity to offer written feedback. Whilst a number of entities took the opportunity to provide written information, these responses did not highlight any fundamental issues with the guidance documents on offer, although the written feedback received on all the questions, including those points summarised above, will be used to feed into the suggest next steps.

Disclosures and users of accounts

27. The final section was in respect of the disclosures in the ARAs on IFRS 9 and IFRS 15 and whether they are used by those charged with governance within the entity, and how influential the needs of users had been when deciding on what and how to disclose.

28. Over half the respondents admitted that for both IFRS 9 and IFRS 15 the disclosures in the ARAs had not been used for internal decision making or by those charged with governance. However, the written feedback suggested where this was the case, it was because there was more relevant, forward looking information available instead, or because of how recently the ARAs had been published, it was not possible to know yet how this information would be used internally.

29. Around 80% of respondents also marked that the needs of the end user had influenced the disclosures included in ARAs in respect to IFRS 9 and IFRS 15, although only around 30% of these agreed that the needs of the end user fundamentally shaped the information in the ARAs. Written responses suggested that the focus had primarily been on compliance with disclosure requirements of each standard but once this was achieved, the needs of the end user influenced the content or language used to go beyond minimum reporting requirements..

Users response and the desktop review

30. The Treasury directly contacted a number of different users of the ARAs highlighting that a questionnaire was available for comment. Users contacted included those who had given written evidence to the Public Administration and Constitutional Affairs Committee (PACAC) as part of the Accounting for Democracy review into government financial reporting, users who were members of the advisory board for the government financial reporting review, and any users recommended by preparing entities. The questionnaire was also available on gov.uk. The deadline for filling in this questionnaire was also extended to encourage more user feedback. However, the Treasury had multiple users of the ARAs come back and advise that the questionnaire contained detail that was too technical or specific to the public sector for their knowledge bases. As such, disappointingly, only 5 responses to the user questionnaire were received, 3 of which specified they had no knowledge relevant to the questionnaire. The two full responses received had differing views, with one being of the opinion that the disclosures in the ARAs were useful and easy to understand, whereas the other was of the opinion that whilst there was useful information in the disclosures relating to IFRS 9 and IFRS 15, the ARAs could have gone further.

31. The questions that formed the users' questionnaire, and the questions used for the desktop review were very similar. This methodology was followed to allow the responses from the users' questionnaire and the desktop review to be combined into one summary review of the ARAs. As there were only two full user responses, more prominence has been put on the findings of the desktop review.

32. Overall, the findings from the users' questionnaire and the desktop review suggest there are variances between the disclosures in different ARAs, with some entities having clearer and more detailed disclosures whereas others had only a limited reference to the new standards. All ARAs reviewed met the compliance criteria for disclosures relating to the two new standards but some of these failed to ensure disclosures were explained in a way that a lay user would be able to easily understand. This included both situations where not enough information was presented, and others were information cluttered the ARAs making it difficult to understand.

Clarity of explanation around the new standard

33. The first section of the questionnaire focused on how clearly the new standards were implemented and communicated through the ARAs. This focused on the extent to which the new standard had been referenced (in addition to the effective date and the old standards being replaced), what information was provided on the content of the new standards and whether the impact on transition had been explained.

34. The desktop review found that 26 out of the 30 ARAs sampled referenced both IFRS 9 and IFRS 15, 2 of the 30 indicated solely IFRS 9 and another 2 stated solely IFRS 15. Of those

that mentioned a new standard the level of detail varied both within an entity's individual ARAs (so differing level of detail for IFRS 9 versus IFRS 15), and between different entities' ARAs. For example, there were some entities that mentioned other standards that would be impacted by the implementation (IFRS 7 and IAS 32) whereas, others were not clear that those assets, liabilities and transactions in scope of the new standards, would have previously been in scope of a different standard.

35. There was also a variance in the amount of information provided on what the two new financial standards covered. There were examples where the standards were explained succinctly, in easy to understand language. However, there was also evidence of entities providing minimal information or too much information which made it trickier to pull out the key points to note.

36. The explanation as to whether there was a material impact or not on transition was on the whole well explained, and there is a suggestive link between whether the standard had a material impact on transition, and the amount of detail given as to the contents of the new standards. There were also some very good examples of reconciliations explaining the impact of transition on the balance sheet which will be highlighted as part of the final report.

Clarity of specific application to the annual report and accounts

37. Further regard was given to the appropriateness of disclosures and reasons of non-disclosure. It also considered how well the disclosures explained the methodologies chosen for each standard, as well as how well the concepts explained were applied to the ARAs and the basis of significant judgements, assumptions and estimation techniques. This found that whilst there were examples of good explanations within the disclosures, in some instances, explanations were found to be lacking or continued to be generic.

38. For example, the language that referred to the application of the business model for IFRS 9 and the performance obligations for IFRS 15 continued to be generic or referenced the financial standard itself for the conclusions, rather than being tailored to the entity's specific circumstances. References to the impairment policies (including the expected credit loss) for IFRS 9 were missed in some instances where the entity had determined there was no material impact as no loans or equity assets were held, even though there were still a significant balance of trade receivables.

39. Finally, each ARA was reviewed to consider the quality of disclosures in the ARAs with respect to the specific nature of the impact of each standard on the business. Assessing this demonstrated that whilst there were specific areas an entity had lacked detail in with respect to the disclosures, for both IFRS 9 and IFRS 15, the disclosures were generally good and it was possible to understand the impact on the ARAs. This finding was also reflected in the responses to the users' questionnaire, where users agreed they could partially or fully understand the impact of both new standards on the ARAs.

Findings and conclusions

40. The feedback from the preparers' questionnaire gave positive responses for both the timing and content of the Treasury implementation process and associated guidance. There is also no evidence from the questionnaire responses or the desktop review to suggest any amendments to the existing adaptations or interpretations are needed for either IFRS 9 or

IFRS 15. This suggests that the implementation process led by the Treasury was effective for implementation of IFRS 9 and IFRS 15 in central government. Entities individual implementation plans were not looked at as part of this review.

41. Feedback from the review suggested that preparers would have benefited from earlier publication of the application guidance to allow greater opportunity to review it before the year end preparation process. It would also enable parent departments to have more time to support arm's length bodies and share guidance. The application guidance for each standard was published in December 2017, with implementation in the public sector from 1 April 2018. However, the standards were originally published in 2014 and available to entities to use as part of individual implementation plans. There was an expectation that entities would commence implementation of these new standards in advance of the application guidance publication.

42. It was found that key features of the implementation timeline was not fully understood by all respondents. Respondents also suggested that it would be useful for a parent department to have a 12 month forward look timeline, and better plan communication with their arm's length bodies. The implementation timetable was presented and discussed at both the 2017 and 2018 Government Finance Function Conferences.

43. Feedback from the survey also suggested that access to more guidance and examples relating to disclosures would have been beneficial to preparers of ARAs, especially in the first year of implementation. This is supported from the findings of the desktop review, and the feedback from the user survey, which demonstrated there is a disparity between how well different entities explained the new standards in their accounts. Entities are encouraged to "tell their story" and as such, the Treasury avoids setting out boiler plate language wherever possible. However, the availability of recommended additional consistent narrative may have mitigated the risk of variability.

44. Written feedback also specified that entities were using external guidance for the implementation of the new standards, as well as Treasury guidance. There was recognition of the important role the NAO had played in working with entities to ensure compliance when introducing these new standards. External guidance and the role of the NAO should play a fundamental role in the implementation of new standards by reviewing significant judgements and estimations.

45. Requests were also given for budgeting guidance to be provided as well as application guidance where relevant. In this instance in respect of IFRS 9.

46. Access to training led by the Centre was noted as an issue. Whilst some entities found it was sufficient, a few respondents noted that they were unaware of training on offer, or it was not accessible. Where training was accessed, the quality of it was not in the main questioned. However, the desktop review suggests that a greater prominence of the importance of sufficient and easy to understand disclosures when new standards are implemented would be advantageous.

47. As part of the self-review questions, entities also acknowledged areas of improvement within their own entities, as well as suggesting some areas of best practice they had identified during the implementation of these standards. Suggestions included early engagement with the financial standards and embedding them into business as usual, early engagement with the auditors, and use of knowledge networks.

In conclusion, the finding of this thematic review have been largely positive and has identified some areas where improvements can be made. It was disappointing that the Treasury had difficulties with the engagement of users in this thematic review. The creation of the new users / preparers group should mean in the future, there is more engagement in thematic reviews.

Next steps

For this review

48. The Treasury has committed to publishing a report on the findings of this thematic review. This will include both a summary of the responses from the questionnaires and the outcome of the desktop review. Key findings and proposed next steps as set out in this paper will also be included.

49. For each section of the report that relates to the desktop review, there will be a summary of the findings, supplemented with some best practice examples that have been identified during the review. Entities will be encouraged to follow these examples when thinking about how to structure disclosures for newly implemented standards.

50. The report format will be a summary in the form of a slide pack to enable the report to be easy to read and well structured. For example, the information provided in the final report will be split into different textboxes to make it more eye-catching and increase readability.

In response to conclusions and findings

51. *Earlier publication of the application guidance:* it is important that guidance is published as early as possible and at a time useful to the preparer. The Treasury will commit to publish final application guidance as early as possible, which will be by the autumn of the year preceding implementation, with access to an exposure draft earlier in the implementation plan. This will be circulated and available on OneFinance, the finance function platform. The Treasury also notes the importance of early engagement with preparers and will incorporate advance notice of publication of application guidance into the communication strategy so that this consideration can be incorporated into entities' individual implementation plans.

52. *Communication of a forward plan:* the relationships between a department and its' arm's length bodies is very important, as is ensuring this relationship gets the support it needs from the Treasury. As a lesson learnt, for IFRS 16, the Treasury published an implementation timeline for the 2019-20 and 2020-21 financial years that included some key milestones. Going forward, the Treasury will also look to publish a timetable in 2020 setting out the key anticipated dates for 2020-22 for IFRS 17 (and in any future standards) and will promote this widely to encourage engagement.

53. *More disclosure guidance:* the disclosures are an important part of the ARAs to provide users more context and understanding. However, each entity is individual and therefore setting out boiler plate language for disclosures in the year of implementation is undesirable and risk the disclosures in the ARAs becoming less useful. Therefore, the Treasury will look to issue some practical support on the disclosures for future standards including IFRS 16 through the illustrative statements, along with sharing the best practice examples for IFRS 9 and IFRS 15 that were identified during the desktop review. The revised 20-21 FReM has also made the importance of the user more prominent in the guidance. Entities within the

remit of the FReM will be expected to follow this guidance and will continue to encourage entities to seek feedback from their users wherever possible.

54. *Use of external guidance and the NAO:* Application guidance and the FReM are not intended to replace the standard themselves, or other external guidance, and it is encouraging that entities are using these resources. Agreement of key balances and processes of these new standards with the NAO is essential and the Treasury will continue to encourage early engagement with their audit teams, familiarity of new standards and consideration of relevant guidance as early as possible.

55. *Budgeting guidance:* the Treasury understands that for central government entities, budgeting is a key element of implementing new financial reporting requirements. Budgeting guidance will be issued as early as possible, where relevant. It is acknowledged that the publication of final budgeting guidance for IFRS9 was delayed which caused difficulty for some preparers. The Treasury aims not to have to repeat this delay in changes again and would aim to publish any application guidance before the year of implementation. For IFRS 16 the application guidance for financial reporting was published in April 2019, one year before the start of the financial year for those not early adoption. The budgeting guidance was published in July 2019. 8 months before the start of the financial year for those not early adopting. The Treasury also worked closely with those early adopting to give them sight of the expected guidance. Departments should continue engaging with their respective spending teams early to discuss the impact of new financial standards on the departmental budget. The Treasury also encourages entities to consider potential budgeting issues as early as possible and ahead of the year that a standard comes into effect.

56. *Training on offer:* training is a very important tool to support the increase of capability across the public sector, which in turn leads to better quality ARAs. The feedback received here was very valuable as it demonstrated that even though there is training on offer, it is not as easily accessed as it could be. Suggestions have also been made for additional training content. Therefore, the Treasury will work closely with the Government Finance Academy to seek to expand the reach of the training on offer, via direct and online training to increase accessibility. The Treasury will also look at what additional training content can be included on disclosures for new financial standards going forward. The Treasury will look to promote training opportunities more widely and encourage departments to make relevant staff (both in their core departments and ALBs) aware of relevant training offers and encourage them to engage.

57. *Early engagement:* early engagement by preparers of the ARAs with the implementation process of new financial standards is encouraged by the Treasury and it was good to see that this was identified by preparers as useful. Entities are encouraged to engage early in the implementation process by means of joining working groups, the Resource Account Special Interest Group (RASIG), sharing best practice and common issues and responding promptly to different stages of the implementation plan. Entities are encouraged to use existing resources for enabling this, for example the Technical Accounting Centre of Excellence (TACoE). Early engagement with the audit teams is also strongly encouraged, as is the raising any potential issues as early as possible, with the Treasury where relevant. Entities are encouraged to learn from the best practice examples and suggestions for improved disclosures in this review, for disclosures in future ARAs.

Recommendation

58. The Board is asked to note the findings of this review and are asked to provide any feedback on this paper, including whether the Board is in agreement with the basis of the conclusion and the proposed next steps.

HM Treasury
21st November 2019