

2 August 2011

**GOVERNMENT FINANCIAL REPORTING  
MANUAL (FReM) EXPOSURE DRAFT No:**

**(11)03**

EXPOSURE DRAFT OF PROPOSED

**AMENDMENTS TO THE FReM**

**Interpretation of IFRS 8 for the public sector  
context**

Comments to be received by 27 September 2011



**HM TREASURY**

## **ASSURANCE AND FINANCIAL REPORTING POLICY TEAM HM TREASURY**

This exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) is published by HM Treasury for comment only. The proposals may be modified in the light of comments received in this consultation process before being presented to the Financial Reporting Advisory Board for its approval. Final proposals approved by the Financial Reporting Advisory Board will be published as amendments to the FReM from the proposed effective date.

Comments on this exposure draft should be submitted in writing so as to be received by **27 September 2011**. Respondents are asked to send their comments electronically to [FReM.consultation@hmtreasury.gsi.gov.uk](mailto:FReM.consultation@hmtreasury.gsi.gov.uk).

All responses will be published on the FReM website unless the respondent requests confidentiality.



**HM TREASURY**

# CONTENTS

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## **PROPOSED AMENDMENTS TO THE GOVERNMENT FINANCIAL REPORTING MANUAL (FReM)**

Introduction and Invitation to Comment	4
Background	5
Summary and proposals	6
General questions	8
Proposed amendments to Chapter 5, <i>Form and content of annual report and accounts</i>	9

# **Proposed amendments to the FReM**

## **Introduction**

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Assurance and Financial Reporting Policy, HM Treasury, has published this exposure draft of proposed amendments to the Government Financial Reporting Manual (FReM) as part of its ongoing work in ensuring that the Manual reflects the latest developments in government financial reporting.

## **Structure of exposure draft**

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The exposure draft includes a section for each FReM chapter for which an amendment is proposed. Each section includes:

- (a) An explanation of why the amendment is proposed;
- (b) When necessary any specific additional questions unique to that proposed amendment;
- (c) The paragraphs of the FReM chapter that are affected by the proposed amendment;
- (d) The proposed effective date of each proposed amendment.

## **Invitation to comment**

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HM Treasury invites comments on the proposed amendments. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

- (a) Answer the question as stated;
- (b) Indicate the specific paragraph or paragraphs to which they relate;
- (c) Contain a clear rationale; and
- (d) Describe any alternative HM Treasury should consider.

HM Treasury will consider all comments received in writing by 27 September 2011. In considering the comments, HM Treasury will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

<b>Amend the FReM interpretation of IFRS 8, <i>Operating Segments</i></b>	
Why the amendment is proposed	<p>Changes to the performance regime and annual reporting for departments have removed the requirement to report against Public Spending Agreements (PSAs) and Departmental Strategic Objectives (DSOs).</p> <p>The FReM interpretation of IFRS 8 states that a department's operating and reportable segments will be its agreed DSOs.</p> <p>As DSOs are no longer applicable for departments, the FReM interpretation of IFRS 8 is no longer valid, and should be amended for adoption by departments in the financial statements from 1 April 2011.</p>
Paragraphs affected by the amendment	<p>5.2.10</p> <p>5.4.25 – 5.4.28 (Option 1)</p> <p>5.4.26 – 5.4.28 (Option 2)</p>
Proposed date	1 April 2011

**Background**

1. IFRS 8 requires entities to identify operating segments by considering the different components of activity that are reported to the Chief Operating Decision Maker (in practice, often the Accounting Officer / Chief Executive or Executive Management Board). Entities should be able to identify these clearly.
2. The FReM interprets IFRS 8 for the public sector context. The current interpretation states that a department's operating and reportable segments will be its agreed strategic objectives, as established per the requirements of Comprehensive Spending Review (CSR) 07. This interpretation also requires departments to prepare a primary financial statement - the Statement of Net Operating Cost by Departmental Strategic Objectives - requiring 100% of expenditure to be analysed by operating segment.
3. All other reporting entities who apply the FReM directly apply IFRS 8 in full.
4. The FReM also interprets the requirements of Chapter 5 Part 15, S417(6) of the Companies Act 2006. The interpretation states that the Statement of Net Operating Cost by Departmental Strategic Objectives satisfies the requirement to disclose performance against key performance indicators as part of the annual report.
5. In November 2010 the Prime Minister launched Business Plans for each department, setting out the priorities and milestones for the next four years. The

milestones and performance indicators included in the Business Plans supersede the performance regime of strategic objectives established as part of CSR 07. Consequently, departments will no longer report against PSAs/DSOs within their annual reports.

6. Where departments do not have a Business Plan, it is expected that these departments will establish their own key performance indicators to report against as part of their annual report.

## Summary

7. As departments no longer report performance against DSOs, the current FReM interpretation of IFRS 8 cannot be applied. Additionally the FReM interpretation for reporting against key performance indicators in the annual report is no longer applicable.

8. The FReM requires amendment to remove the current interpretation, and a new approach is necessary to give direction to departments on:

- identification of operating segments;
- measurement and disclosure requirements for operating segments; and
- reporting performance against key performance indicators as part of the annual report.

9. HM Treasury has considered the different options for application of IFRS 8 by departments, and following consultation with the Chief Secretary to the Treasury, HM Treasury presents two options for consideration in the exposure draft.

10. Your views are sought on the two options presented and the proposals to amend the FReM arising from each option.

## Proposals

11. The two options are;

- application of IFRS 8 without interpretation or adaptation (**Option 1**);

- application of IFRS 8, interpreted to require disclosure of segment information in a primary financial statement and requiring 100% of expenditure to be covered (**Option 2**);

12. The key differences between Option 1 and the previous interpretation are:

- a department would be responsible for identifying its operating segments in accordance with the principles of IFRS 8;
- information is presented in a note to the financial statements, rather than in a primary financial statement;
- a department is required to disclose operating segments covering a minimum of 75% of expenditure, rather than 100%;
- information is not necessarily drawn from the same source as other primary statements (e.g. from management accounts rather than the nominal ledger).

13. There is no difference between Option 1 and IFRS 8.

14. The key differences between Option 2 and the previous interpretation are;
  - a department would be responsible for identifying its operating segments in accordance with the principles of IFRS 8;
  - information is not necessarily drawn from the same source as other primary statements (e.g. from management accounts rather than the nominal ledger).
  
15. the key differences between Option 2 and IFRS 8 are;
  - information is presented in a primary financial statement, rather than in a note to the financial statements; and
  - a department is required to disclose operating segments covering 100% of expenditure, rather than 75%.
  
16. HM Treasury has notified Parliament of the intention to consult on these two options, as Option 1 requires the removal of a primary financial statement. Parliament has indicated that it would be content with the removal of the Statement of Net Operating Cost by Departmental Strategic Objectives as a primary financial statement if Option 1 is applied.
  
17. HM Treasury's preference is for Option 1. The conditions underpinning the previous interpretation of IFRS 8 no longer exist, and HM Treasury's view is that the current conditions do not justify an interpretation.
  
18. HM Treasury also proposes that the FReM is amended to require all reporting entities to report performance against key performance indicators, without reference to a specific performance regime.
  
19. HM Treasury would expect to issue appropriate supplementary guidance on the application of the preferred option by departments to ensure alignment between segment information and performance reporting in the annual report and accounts. Further guidance would also be issued to clarify the requirements for reporting entities to report performance against key performance indicators in the annual report and accounts.

## **General questions**

### **Question 1**

Which option (either Option 1 or Option 2) do you prefer for the application of IFRS 8 by departments? Why? If you do not prefer either option, what alternative do you propose?

### **Question 2**

Do you agree that there should be no explicit reference to a performance regime in the FReM? If not, why not, and what alternative do you propose?

### **Question 3**

Do you agree with HM Treasury's proposal to amend the FReM for your preferred option as described in the exposure draft? If not, why not, and what alternative do you propose?

### **Question 4**

Do you agree with the proposed effective date, detailed in the exposure draft? If not, why not, and what alternative do you propose?

## **FReM chapters addressed**

The following table shows the topics addressed by these proposed amendments.

<b>FReM Chapter</b>	<b>Subject of amendments</b>
Chapter 5, Form and Content of Annual Report and Accounts	<p>To amend the interpretation of IFRS 8 for departments in light of changes to the annual reporting landscape arising from the abolition of Public Spending Agreements and Departmental Strategic Objectives.</p> <p>[Amendment proposed for each of the options for interpretation of IFRS 8 presented in this exposure draft]</p> <p>To amend the interpretation of the annual reporting requirements of Chapter 5 of Part 15 of The Companies Act 2006 for the identification of the key performance indicators that departments will report against to analyse performance within the annual report.</p>

# **Proposed amendment to Government Financial Reporting Manual Chapter 5, *Form and Content of Annual Report and Accounts***

## **Introduction**

An amendment to Chapter 5, *Form and content of Annual Report and Accounts* is proposed.

## **Why the amendments are proposed**

The amendments proposed in this Exposure Draft seek to amend the FReM to remove reference to PSA's and DSO's, and to update the interpretation of IFRS 8 for identification, measurement and disclosure of operating segments by departments.

## **Proposed amendments**

A different FReM amendment is proposed for each of the two options identified for application of IFRS 8 by departments. The narrative at the start of each box states the option that the proposed amendment relates to.

For both options (Option 1 and Option 2), paragraph 5.2.10 is amended (new text is underlined and deleted text is struck through)

5.2.10 S417(6)) Departments should disclose performance against their agreed key performance indicators. Other reporting entities should report performance against those key performance indicators agreed with the Minister and normally promulgated by means of a Parliamentary question. In disclosing information relating to the achievement of financial key performance indicators based on a return on capital employed, reporting entities should use the definitions of "return" and "capital employed" as agreed in their Treasury Minute or other document rather than those given in the Reporting Statement (IG example 1).

If **Option 1** is applied, paragraphs 5.4.25 to 5.4.28 are amended (new text is underlined and deleted text is struck through).

## **IFRS 8 Operating Segments**

### ***Applicability***

5.4.25 IFRS 8 applies in full to all reporting entities covered by the requirements of this manual.

### ***Objectives of IFRS 8***

5.4.26 The objective of IFRS 8 is to require an entity to disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates.

### ***Interpretation of IFRS 8 for the public sector context***

5.4.27 The Scottish Government will follow IFRS 8 except that, as noted in 5.1.6, its accounts will follow the format as agreed between Scottish Ministers and the Audit Committee of the Scottish Parliament.

If **Option 2** is applied, paragraphs 5.4.27 and 5.4.28 are amended (new text is underlined and deleted text is struck through).

***Interpretation of IFRS 8 for the public sector context***

5.4.27 Departments financed through Westminster or the Northern Ireland Assembly Estimates process and the Scottish Government should apply IFRS 8 as interpreted below. All other reporting entities should apply IFRS 8 in full.

- a) departments will report 100% of identified operating segments;
- b) departments will prepare, as a primary financial statement, a Statement of Net Operating Cost by Operating Segments;
- c) departments will report for each operating segment: gross expenditure, income and net expenditure on a full allocation basis;
- d) departments will report any further segmental information required by IFRS 8 that is regularly reviewed by senior management (see 5.2.6d);

5.4.28 The Scottish Government will follow this interpretation except that, as noted in 5.1.6, its accounts will follow the format as agreed between Scottish Ministers and the Audit Committee of the Scottish Parliament.

The effective date for the proposed amendment is 1 April 2011.