



## REVISIONS TO THE GOVERNMENT FINANCIAL REPORTING MANUAL 2020 TO 2021

Issued 25 October 2019

ICAEW welcomes the opportunity to comment on the consultations on revisions to the *Government financial reporting manual 2020 to 2021* (the “FReM”) published by HM Treasury in September 2019, a copy of which is available from this [link](#).

ICAEW supports HM Treasury’s initiative to widen the scope of the financial reporting manual and believes that the update will provide greater clarity for preparers. However, the FReM would benefit from stressing the importance of narrative reporting by linking it to the underlying legislation from which the requirements are derived in order not to give the impression it is not as important as other elements of the annual report.

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For more information, please contact: [frf@icaew.com](mailto:frf@icaew.com)

## KEY POINTS

### SUPPORT FOR THE REVISIONS TO THE 2020-21 FREM

1. We support HM Treasury's initiative to widen the scope of the financial reporting manual and believe that the update will provide greater clarity for preparers of annual reports and financial statements.

### AREAS FOR IMPROVEMENTS

2. The FREM seems to focus more on public spending rather than financial management of the balance sheet which is of equal importance.
3. We believe the FREM would benefit from a more in-depth discussion of materiality, emphasising the importance of good narrative reporting and further strengthening the discussion on linkages across annual reports.
4. The FREM could also be more explicit in addressing the need for preparers to balance the narrative discussion on the one hand based on their statutory accounts and on the other based on budgeting metrics DEL and AME. Both will be required but the balance must be right.
5. We believe the Statement of Parliamentary Supply would be more understandable if described as the Statement of Parliamentary Funding.

## ANSWERS TO QUESTIONS

### Question 1

***Does the revised four part structure make the FREM more useable? Please include any suggestions for improvements or any general comments on the structure.***

6. The new structure offers more clarity and a more holistic approach to wider corporate reporting rather than the narrower focus on financial reporting of the previous FREM.
7. The links to the relevant chapters on the content page are very helpful, but (and this is a very minor point to make) it would make navigating the document easier if there were also links from the chapter headings back to the contents page.

### Question 2

***Does the revised introduction give the right level of information to help understand the nature and purpose of the FREM? Please include any suggestions for improvements or any general comments on the introduction.***

8. Chapter 1 clearly explains the nature and purpose of having an accounting manual. However, it would benefit by clarifying that the UK bases its accounting framework on IFRS and that one major role of the FREM is to highlight the adaptations and/or interpretations from IFRS that have been made for public sector financial reports.
9. We believe paragraph 1.1.1 should be expanded to discuss the management of financial resources and not just public spending. The introductory chapter could describe wider Public Finance Management (PFM) that encompasses balance sheet management. Adopting accruals accounting and IFRS goes beyond government spending and should be suitably reflected.
10. We also recommend that paragraph 2.4.1 *Purposes of government financial reporting* is expanded to cover the management of the balance sheet.
11. We think it would be helpful if the FREM emphasised the Companies Act 'origins' of reports in the front end of the annual report, and that in general, preparers should seek to follow the requirements set out by the Companies Act even where it does not technically apply.

**Question 3**

**Does chapter 2 effectively set out the principles and purposes of government financial reporting? Please include any suggestions for improvements or any general comments on the chapter.**

12. Chapter 2 could be improved by including a principle on reporting linkages – essentially relationships or interdependencies between, or the causes and effects of, facts and circumstances disclosed in the annual report. The Financial Reporting Council's (FRC) *Guidance on the Strategic Report* paragraphs 6.17 to 6.24 goes into more detail on this. (This guidance could usefully be added to Annex 5 *Links to relevant guidance and resources*.)
13. The concept of materiality in the context of narrative reporting is important, in particular in ensuring that annual reports are as concise as possible and focus on the most important matters to Parliament and to other users. Chapter 2 could helpfully include more detailed guidance on how judgements can be made about users and identifiable needs (figure 1 on page 7) and in determining whether information should be published or not.
14. Paragraph 2.5.1 states that 'each of the four purposes of government financial reporting reflects the needs of a different group of users'. However, only Parliament (including Select Committees) is specifically mentioned as a user. It would be helpful to identify other users, including government departments with oversight responsibilities, HM Treasury (given its responsibility for overseeing the overall public finances), and the general public. Other stakeholders include the Board, management teams and employees of the organisation concerned, for whom the annual report often provides a reference work that sets out objectives, strategy, and financial resources all in one place. Identifying different categories of user groups is important as the purpose of producing financial statements is to provide useful information for accountability and decision making proposes to the users of those financial statements. More work and consideration should go into this section as it currently seems incomplete.
15. Paragraph 2.3.4 focuses on the fundamental qualitative characteristics from IASB's Conceptual Framework, but does not mention the enhancing qualitative characteristics; preparers should be considering these other characteristics: comparability, verifiability, timeliness and understandability.
16. Paragraph 2.4.1 lists out four principal purposes of government financial reporting but, in our view, the purpose of government financial reporting goes beyond government spending and into the wider use of publicly owned assets as well as the management of liabilities and financial commitments. We believe the FReM should amend 'parliamentary control of government spending' to 'parliamentary control of government spending, the use of public financial resources and the management of liabilities and financial commitments'.
17. The basic concept of section 2.6 – choosing what to publish and where to publish - is helpful but does not provide much detail. We believe that the guidance should make a reference to *Simplifying and streamlining statutory annual report and accounts*. It should also be listed in Annex 5.
18. The third question in Figure 1 says that if the information is not accurate or reliable enough to be useful without being misleading, then such information is not to be published. We are concerned that this might be misinterpreted to exclude information that is relevant to an understanding of the financial performance or position of the public body concerned. Where relevant, the annual report should acknowledge this and identify steps that are being taken to improve data collection/processing and disclosure a timeframe when reliable data will be made available.

**Question 4**

***Do you think the addition of chapter 3 regarding best practice in narrative reporting is useful? Please include any suggestions for improvements or any general comments on the chapter.***

19. One significant omission is the particular challenge faced by public bodies in discussing their financial performance, as presented in the financial statements, while at the same time analysing their financial performance in terms of DEL and AME, per the statement of parliamentary supply. In practice, annual reports often get the balance wrong – either presenting a financial picture based on DEL and AME that does not match the numbers reported in the financial statements, or alternatively presenting a picture based on the financial statements that does not effectively reflect the use of DEL and AME to manage expenditure. We believe that there should be a clear requirement to provide both perspectives on financial performance, albeit as concisely as possible. We would be happy to discuss further how this could be effectively achieved.
20. Having a chapter regarding best practice is useful, but the best practice listed is quite generic and high level. There are a number of different annual financial reporting awards for government entities which celebrate the best practice. The FReM could list a few of these and highlight one or two practical examples of what made them stand out without too much difficulty. We notice that Annex 5 contains a link to *Building Public Trust Awards*, but this could be a more prominent feature in the body of the FReM.
21. One criticism of narrative reporting in practice is that it does not always link the front end to the back end of the annual report. This could be emphasised in section 3.3. The FRC's *Guidance on the Strategic Report* contains some good content on this.

**Question 5**

***Is the new chapter 4 regarding the annual reports and accounts effective in bringing together different sections of the FReM in a useful way? Please include any suggestions for improvements or any general comments on the chapter.***

22. We find chapter 4 a helpful consolidation of the information that was previously scattered throughout the FReM. It also includes useful background information.

**Question 6**

***Is the drafting of mandatory requirements and comply or explain requirements in respect of performance reporting in chapter 5 clear? Please include any suggestions for improvements or any general comments on the chapter.***

23. As the FReM makes clear, the key user of the annual reports is Parliament and given that many MPs are not overly familiar with financial statements, the importance of the performance report should not be underestimated. In many cases it may be the only section that gets read.
24. The quality of management commentary/performance reporting varies with some entities viewing these requirements with less importance as they are often seen as non-mandatory. It would be really helpful for the FReM to make it crystal clear which sections are mandatory and which ones are not, and to spell out the authoritative legislation under which certain elements of the annual report are mandatory. The FReM makes a number of references to the Companies Act and it is not clear how the Companies Act links to the public sector.
25. Chapter 5 contains a significant amount of information in bullet point format. It might be helpful to include some of this in diagrammatic form to provide an overview of the key requirements and whether these are based on company law or public sector specific requirements. For example, paragraph 5.4.3 could form part of this pictorial representation at the beginning of the chapter. This would also help to make key sections of this chapter more visible.

26. The guidance regarding single departmental plans in paragraph 5.4.4 a) is useful but fails to address the broader point regarding linkages. The paragraph seems to be merely encouraging cross-referencing rather than asking for the interdependencies of the facts and circumstances against which the strategic objectives will be analysed.
27. Paragraph 5.4.4 b) might be better placed in referring to the Companies Act rather than the originating EU law, as this might be misunderstood following Brexit.
28. We support the comply or explain principle in financial reporting as it has proven to generate useful information. However, the FReM needs to be careful with paragraph 5.4.5 to avoid softening the requirements. In particular 5.4.5 c) requires details on the risk profile of the organisation yet states that the information is required on a comply or explain basis unless already summarised in the performance overview or accountability report. We believe that this should be a mandatory requirement with a choice in location (where it is most useful in telling your story as per the principles described in chapters two and three).

### Question 7

***Are the requirements in chapter 6 for reporting risk disclosures, staff turnover and staff engagement scores clear? Please include any suggested improvements plus any general comments on the chapter.***

29. This chapter, unlike the previous, starts by stating that the requirements of the accountability report are based on the Companies Act. We recommend that other relevant chapters should start in similar fashion if the Companies Act is the legislation driving the requirements.

### Question 8

***Is chapter 7 in respect of the format and content of the financial statements clear and useful? Please include any suggested improvements plus any general comments on the chapter.***

30. Paragraph 7.6.10 states that IFRS 8 on Operating Segment applies to all entities within the scope of this Manual. This may need emphasising, as segmental disclosures in practice are often quite limited and less useful than they should be.

### Question 9

***Do the proposed changes to the FReM improve the guidance overall? What parts are most helpful and why? Are any parts unclear or unhelpful or is anything missing from the guidance? Please provide any suggested improvements plus any general comments on the overall draft 2020-21 FReM.***

31. We find the new FReM much improved overall. It provides a clearer and more comprehensive overview of what is required from the viewpoint of preparers.
32. Linkages are important and the FReM should stress the interconnectivity of the entire annual report and drive home the importance of preparing cohesive annual reports that present a full picture rather than a series of disparate individual chapters.
33. In paragraph 5.4.4 b) the FReM could be clearer in indicating what non-financial information is required rather than linking to EU law.

### Question 10

***Will the changes to the FReM require your organisation to collect any new data or information or have any unintentional consequences? Please provide details of any likely instances and state how practical this will be for the organisation.***

34. Not applicable for ICAEW to respond.

### **Question 11**

***What further changes should HM Treasury consider making to the FReM in future reviews? Please provide the reasons for any suggestions.***

35. We would welcome an opportunity to comment on the accounting adaptations from IFRS set out in the FReM in a future consultation. This would merit review as public sector financial reporting continues to develop in the UK and around the world.”

### **Question 12**

***Do you have any comments on the findings on the Statement of Parliamentary Supply reporting as part of the SoPS thematic review and do you think it achieves its objectives as a Parliamentary accountability statement? Please provide any reasons and general comments.***

36. We welcome the improvements to the Statement of Parliamentary Supply and the inclusion of clear requirements to comment on it in the performance commentary.
37. Organisations providing a SoPS should provide a clear link to their Parliamentary Estimates as a footnote to either the Summary table or SOPS note 1.

### **Question 13**

***Do you agree with the new requirements for the Statement of Parliamentary Supply disclosures to be introduced as an in-year change for 2019-20? Please provide any reasons and general comments.***

38. Yes, there is sufficient time for organisations to prepare their 2019-20 annual reports on this basis.

### **Question 14**

***Do you see any value in changing the name of the Statement of Parliamentary Supply? If, so do you have a preference – either one of those outlined above or an alternative name? Please include any reasons and general comments.***

39. We believe that ‘Statement of Parliamentary Funding’ would be clearer to readers.

### **Question 15**

***Do you agree with the new 2020-21 SoPS reporting requirements and do you think these requirements should be on a comply or explain basis? Please provide any supporting comments to your answer.***

40. We believe the requirements are an improvement and should be mandatory, where relevant. We do not understand why there would be any valid explanation for non-compliance.

### **Question 16**

***Do you agree with the recommendations and updates to SoPs guidance, and any broader comments on the outcomes of the SoPS thematic review? Are there any further improvements that could be made? Please provide any reasons and general comments.***

41. Yes, we agree with the recommendations and updates. There are further improvements that could be made, but we believe that these changes should be implemented and the outputs in annual reports reviewed before proposing further changes.