



FINANCIAL
REPORTING
FACULTY

BY ALL ACCOUNTS

PUBLIC SECTOR SUPPLEMENT

JULY 2010

FINANCIAL REPORTING AND THE PUBLIC SECTOR

We speak to Ken Beeton of HM Treasury

PLUS...

Embedding IFRS

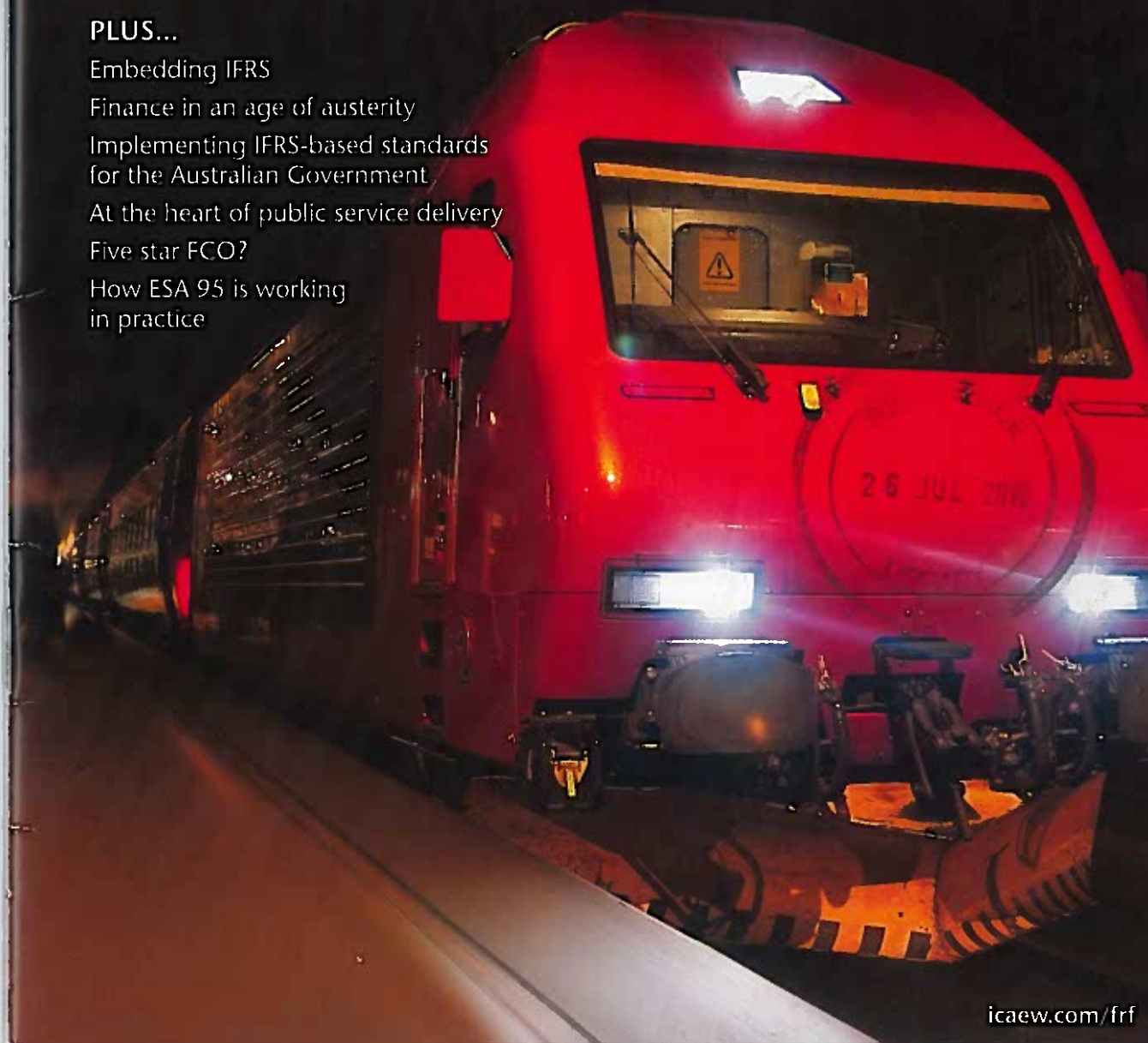
Finance in an age of austerity

Implementing IFRS-based standards
for the Australian Government

At the heart of public service delivery

Five star FCO?

How ESA 95 is working
in practice



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FROM MICHAEL IZZA, ICAEW CEO

I am delighted that the Financial Reporting Faculty is publishing, for the first time, a public sector supplement to *By All Accounts*. In these times of significant change and uncertainty in the UK public sector, it is more important than ever that ICAEW is at the heart of debates around the transparency, accountability, good financial management and good governance needed to support a more effective delivery of public services and value for taxpayers' money. So I warmly welcome the support of the National Audit Office and other government

departments for the efforts of the faculty to play its part in that process over the coming months and years.

With a new government in place and continued economic concerns, there are immense challenges ahead for the public sector. For HM Treasury, that includes the preparation of the first Whole of Government Accounts. I look forward to seeing the overall picture of the UK's finances in spring 2011 and to the major improvement in transparency that entails. A 'revolution at the heart of government' indeed.

Michael Izza



FROM KATHRYN CEARN'S, CHAIR OF THE FACULTY'S FINANCIAL REPORTING COMMITTEE

It's a great pleasure to welcome you to the first public sector supplement to the Financial Reporting Faculty's journal, *By All Accounts*. In this special issue, we reflect on some of the key messages around implementation of IFRS within the public sector – project management, embedding and financial management and governance – highlighted at the annual public sector conferences held jointly with CIPFA earlier this year, *IFRS and beyond*. The events were well attended and proved to be very successful in identifying a number of key messages for professionals working in central and local government and the NHS. The faculty is already planning its joint conference with CIPFA for 2011 and would be interested in your views on content.

With the new UK government in place, many of us are pondering on the serious challenges that lie ahead for the public sector, especially in this current economic environment. Ken Beeton, Director, Financial Management & Reporting at HM Treasury, has set out for us his views on some of these challenges, especially in

relation to the publication of the Whole of Government Accounts (WGA) in 2011. For example, how will the credit rating agencies assess the UK's credit status once the WGA are published? In my new role as chair of the government's Financial Reporting Advisory Board, one issue I will no doubt come across is how well the UK WGA are understood by the public and how useful they are to stakeholders generally.

Finally, having launched just over a year ago, the Financial Reporting Faculty has gone from strength to strength, with a steady increase in members in both the private and public sectors. It is now working closely with partner organisations to increase its profile in public sector financial reporting, to both influence the policy debate and to provide professionals working in the public sector with useful, relevant and practical information.

Kathryn Cearn's

Kathryn Cearn's is Consultant Accountant at Herbert Smith LLP and a member of the faculty board



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A REVOLUTION AT THE HEART OF GOVERNMENT?

In an exclusive interview for the Financial Reporting Faculty the day after the UK General Election, Ken Beeton, Director, Financial Management & Reporting at HM Treasury and a member of the faculty, speaks to veteran financial journalist Robert Bruce.



The public sector in the UK is in the throes of a move to IFRS reporting, a tremendous challenge by any measure. This is part of the drive at the centre of government to improve its financial reporting and transparency. As the Treasury's Director of Financial Management & Reporting, Ken's responsibilities also include the move to what is known as Whole of Government Accounts (WGA). Next year will see the first publication of full accruals-based accounts covering the whole public sector for the 2009-10 financial year. The accounts of some 1,500 bodies across central government, local government, the health service and public corporation will be consolidated and then audited by the National Audit Office. This is a mammoth undertaking and one that will help change the value that accounting information provides to decision makers in government. At its heart is the desire to develop a stronger financial management culture.

Work is also in hand to improve the transparency of reporting. In Ken Beeton's words: 'Of course, the Government knows how much it spends, but the challenge is to understand more about the costs of what it delivers and how these can be managed differently to make money go much further. As we move forward, the focus of financial reporting needs to be on what is being delivered, demonstrating value for money through better financial management.'

Robert Bruce: Let's start with IFRS. The developing IASB/FASB framework has a strong private sector focus. Are IFRS therefore the right standards for the UK public sector?

Ken Beeton: The main reason that we use IFRS is to measure the public sector share of the economy on a consistent basis with the private sector. It is also helpful in ensuring that areas of activity where the public and private sectors are operating together, such as for PFI, are treated consistently in public and private sector accounts. Having said that, I understand the point you are making and we are keeping an eye on developments in the IASB's conceptual framework. The independent

Financial Reporting Advisory Board plays a very important part in advising government on the application of financial reporting standards and, in addition to IFRS, includes International Public Sector Accounting Standards in its hierarchy of standards. So we are well placed because if an answer to an issue isn't available from IFRS, we look next to IPSAS.

How well placed are government finance teams to deliver IFRS-based financial and budget reporting?

We have implemented IFRS in central government from 1 April 2009. We'll find out very shortly just how well this has gone because departments are currently preparing their first IFRS-based resource accounts. However, early signs are encouraging. I am very grateful to the National Audit Office which collaborated appropriately with us on a trigger point strategy to help departments and arm's-length bodies evidence their progress in stages. For example, all 2008-09 comparatives

'WGA will bring a financial accounting perspective to how government finances are reported.'

were restated on an IFRS basis and reviewed by the NAO. There are now very few problems with those numbers and, although there will inevitably be some new issues in 2009-10, we think we are well placed for a successful implementation.

That may be true, but the IASB has a very large work programme, including proposals for fundamental changes to core areas such as leases and liabilities, some of which will be conceptually challenging. How will HM Treasury work with NDPBs and departments to help them introduce such new and complex standards?

We will continue to take advice from the Financial Reporting Advisory Board in developing financial



reporting guidance for central government. Across government, we already have a strong financial reporting capability, which has been demonstrated in the relatively smooth transition to IFRS in 2009–10. I am very confident that we have the capability to digest the IASB's and other work programmes.

Why is the annual report and IFRS accounts thought also to be the right vehicle for the proposed sustainability report? Is there not a danger of it being overlooked because of the volume of other information?

The annual report and accounts is the key accountability document for central government departments and is included in the governance framework. Through the Alignment Project, we are looking at how we can reduce the volume of information in this document and focus on the areas of greatest importance. There is a risk that sustainability information could be overlooked if it is not in the prime accountability document, and it will of course be subject to independent audit arrangements. So this is the right place to report on performance against sustainability targets.

Moving on to the Alignment Project then, there has been debate during the election campaign about efficiency savings and the project is supposed to streamline government financial reporting. What is the level of efficiency saving

envisaged and how will this be tracked to ensure it is realised?

The Alignment Project is about better financial reporting and the main benefit will come in much improved financial scrutiny by Parliament and others. Currently, departments keep three sets of books: budget numbers, which are based on the national economic accounts supported by statistical standards, but also including some elements of IFRS; estimates, which are the basis upon which parliament authorises spending; and resource accounts, which are based on IFRS. These frameworks have many different rules and the boundaries are drawn differently.

The Alignment Project will move us to a single framework from 1 April 2011. It will provide a clear line of sight through budgets, parliamentary authority and accounting for spending, with one version of the truth, as in the private sector. This will be much simpler and more efficient for departments in the way that they manage their business. For example, lining up the Treasury's and Parliament's controls over spending will reduce burdens. It will also enable departments to focus on delivery against a single set of limits, rather than on several. It will move the emphasis away from compliance to adding value across departmental families and will get rid of some perverse and unhelpful incentives. So this is a very important project that will have lasting benefits in terms of improving transparency and accountability and in promoting greater effectiveness and value for money.

Turning now to WGA, these are due to be published in the spring of 2011. What is the purpose of Whole of Government Accounts for the UK?

The reason we are developing Whole of Government Accounts is to improve transparency and accountability in how government spends money, and to ensure that public sector reporting at this level is consistent and comparable. WGA will bring a financial accounting perspective to how government finances are reported and, unlike the national economic accounts, will be audited and include all provisions and liabilities. It is a consolidation of the whole of the public sector. WGA will provide a helicopter view of all existing funding flows across government, giving an opportunity to identify how these can be improved and streamlined.

Will it show the true state of the UK's finances? And debt?

The short answer is yes. The National Audit Office will report on whether the accounts provide a true and fair view. With the 'Clear Line of Sight' alignment reforms, WGA will provide complementary information to the national economic accounts and will therefore provide additional information for fiscal decision making.

It is quite widely assumed that the first set of published WGA will be qualified. Does this undermine the exercise? What will you and HM Treasury do to eliminate the problems?

WGA are a consolidation covering around 1,500 public sector bodies, including central government departments and arm's-length bodies, devolved and local government and the NHS. There is no holding company, as such. Historically, different accounting policies have been used across the public sector and one of the benefits of WGA is to bring consistency. However, this will not be achieved fully from day one. For example, central government moved to an IFRS-based framework for 2009-10 but this will not be achieved fully for local government until 2010-11.

In the early years, therefore, there will inevitably be some qualification of WGA by the NAO, but this should be transitional as we improve and align processes and frameworks. Rather than undermining the exercise, as you suggest, this improvement and alignment process reinforces the need for WGA and for the consistent and transparent reporting that these consolidated accounts will bring.

Will the information be accessible and understandable? How are the public and in particular the credit rating agencies likely to interpret the information, especially if the first set of published WGA is qualified?

Broadly, we are planning for WGA to be presented in a similar form to private sector accounts. In appearance, they will be less technical than, for example, departmental resource accounts and much more user-friendly to a wider audience. We shall make sure that the reasons for qualification in the early years are well defined and explain them to ensure there is full understanding. It will take us a couple of years to iron out all the major inconsistencies in financial reporting across government but it is important that we do.

More generally, how do you see the overall financial management capability of central government? What needs to be done?

A lot has been done already. All departments now have qualified finance directors, with an incredibly strong senior cadre. We have nearly 5,000 qualified and 5,000 part-qualified accountants in central government. We are working on a number of initiatives to improve capability further, aimed at establishing a culture where strong financial management and transparency are embraced. There are some big challenges, including improving governance, simplifying and improving the quality and timeliness of

'As a member of the faculty, this journal supplement is a very important step forward.'

reporting, understanding better the costs of what government delivers and developing finance skills in policy and delivery areas. There are some excellent examples of this happening, for example, the Foreign and Commonwealth Office's Five Star financial improvement programme recently received a very favourable hearing at the Public Accounts Committee. This programme includes increased board-level engagement in financial management and embedding finance capabilities in overseas operations.

There is still much more to do. For example, we need to create and embed a culture that always has a strong appetite for good financial management. This starts at the top with departmental boards, where we have found

that the influence from effective non executive members can help improve the financial culture in departments.

What are the barriers to finance directors having a full role at the top of government departments?

There is a perception issue about the value of the finance function. From an historic perspective, finance has often been far too divorced from policy and not seen as sufficiently credible in policy decisions. 'Organograms' often show finance at the side of an organisation rather than at the centre. What we are working towards is fully confident finance directors, who bring strong challenge to the organisation to improve its financial and business performance. With the prospect of tighter departmental budgets and the need to prioritise and make some difficult choices, it should be easier for finance directors to get more traction.

What changes would you like to see in terms of governance for main departments?

We have been looking at ways to improve departmental governance. What this boils down to is leadership and accountability. Departmental boards are advisory. This makes it more difficult for boards to demonstrate collective leadership and for non-executive members, who are appointed by the accounting officer, to provide independent challenge. Also, there is not always sufficient clarity about how departments work with their arm's-length bodies. We are looking at ways to strengthen the role of departmental boards and the leadership that they can provide. And there are always opportunities for greater coherence and efficiency in how the centre of government, the Treasury and the Cabinet Office, together work with other departments.

Could departments make more effective use of non-executives?

This is one of the areas that we are currently reviewing. There are lots of ideas and we are examining how these might work in central government. For example, some departmental boards and arm's-length bodies already have non-executive chairs and we can learn from that experience. Non-executive board members might also have specific areas of responsibility and we need to look at how they are appointed and the points of escalation. We already have some excellent people performing these roles. We need to support them so that they can provide real independent challenge.

Given the threat of spending cuts, what is HM Treasury going to do to try to ensure that finance teams are not reduced to unacceptable levels and that their professional and technical development continues?

Finance functions are not protected from the ongoing need to deliver with improved efficiency. They should lead by example. We have developed some benchmarks to help show where improvements and efficiencies are possible. That said, if we want to deliver cost reductions, we need a strong finance profession to bring together the information and challenge that will help Ministers make the tough choices that fiscal consolidation will require. We shall continue to develop the capacity and capability of the Government Finance Profession, ensuring that finance is the right size and works in the right way to deliver what is needed.

There seems to be a strong belief across government that shared services can deliver significant savings. Is this borne out by HM Treasury evidence?

There has been some good progress on shared services in central government and momentum is building – for example, the Department for Work and Pensions now provides shared services to the Cabinet Office and the Department for Education. Plans are well advanced to take this further, involving several other departments. The National Offender Management Service and the Home Office are sharing services, and many departments have consolidated their operations. These arrangements are delivering sustainable efficiency savings. However, a greater level of sharing is clearly possible – for example, across a range of support and administrative activities, which will help us to deliver more for less. We also need to make sure that we share across government our learning from innovations so that future projects can build on this experience.

Finally, what do you think the Financial Reporting Faculty can contribute to the public sector?

I chaired the *IFRS and beyond* events held in London and Leeds earlier this year, organised jointly with CIPFA. The commitment of the faculty to support professionals in the public sector, given the many financial reporting challenges that we all face, is very welcome. As a member of the faculty, this journal supplement is a very important step forward.

EMBEDDING IFRS

Faculty members Christina Earls, Review Manager at the Department for Work and Pensions, and Elizabeth Dobson, Specialist Group Accountant at the Department for Transport, explain the dangers of regarding IFRS as just a technical accounting issue.



Central Government has now completed the first financial year (to 31 March 2010) for which the outturn will be assessed against IFRS numbers. Consequently, now is the best time to move IFRS reporting from the implementation stage to 'business as usual' activity, changing the focus from the immediate to the longer term.



Although perhaps still preoccupied with making sure we have done everything correctly, we are presented with a great opportunity to consider what process improvements we can begin incorporating into regular activity. Too many practitioners and senior stakeholders still regard IFRS as purely a technical accounting issue, one which can be dealt with through greater overtime, or by external advisors, with detailed calculations undertaken largely off-system. This mindset needs to change. This can be best achieved by firmly embedding, without delay, a new way of working and thinking.

Reflecting on lessons learned in implementing the new IFRS way of working provides the starting point for identifying necessary process improvements. There are recurrent problems that auditors will always highlight, such as insufficient evidence to back up the accounting numbers. So ensuring that a good audit trail is factored into plans is essential. But the many other potential pitfalls identified include a lack of executive sponsorship, failing to agree major accounting policies (eg, for PFI), ambiguity over internal responsibilities (such as which activities shared services operational units should undertake), insufficient resource, lack of planning in determining the timetable, underestimating the complexities, and allowing other 'business as usual' distractions to take precedence.

To embed new ways of working following the transition to IFRS reporting, it is necessary to examine people issues, systems and processes, as well as ensuring that all technical accounting issues have been resolved.

PEOPLE

If external advisers were used during the transition to IFRS, it is vital to ensure a complete transfer of

knowledge; this is also desirable for succession planning to future-proof ongoing activity. Those same staff who were involved in implementing IFRS will not always be there, and skills transfer needs to also occur internally, and not just within the finance fraternity either. Training should focus on key areas, and bring together IT and procurement colleagues with finance to ensure that the strategic and business risk implications of decisions are understood, for consideration with senior stakeholders.

SYSTEMS

If transition required a substantial amount of manual intervention, it may be advisable to question how the systems can be upgraded to take the strain. For example, accrual calculations for annual leave or coping with newly capitalised finance lease assets, always recognising the need for adequate audit trails.

PROCESSES

It is vital to ensure that processes have been revised to ensure that contracts (especially new ones) are reviewed for embedded derivatives, leases and intangible assets. It is also important to review the close-down timetable to take account of all additional activity and the extra time needed in relation to particular accounting areas.

ACCOUNTING

Assurance is required that everyone is familiar with the implications of IFRS requirements for financial instruments, including embedded derivatives – new terminology for many, alongside many others emerging from the new accounting framework. It is also necessary to ensure that a full and systematic review of contracts is undertaken early on to ensure that everyone understands why leases have been classified as operating or finance leases. Guidance on revised capitalisation policies, covering all potential spend, needs to be cascaded to all businesses so they appreciate the implications for the accounts and what additional data is required.

Other key lessons learned from the transition to IFRS include valuing the involvement of the external auditors and retaining support at a senior level within the organisation. Auditors can provide useful guidance on robustness and effectiveness of processes and systems for embedding purposes. Ongoing senior sponsorship remains essential, to ensure that the delivery of high quality and timely accounting to support decision support activity continues to be seen as a high priority.

Finally, it is essential to continue to improve understanding of IFRS principles and key requirements amongst other key areas of the business, for example:

- HR – holiday pay accruals;
- IT – systems changes;
- Procurement – contracts; and
- Others engaged in investment projects – capitalisation and assets.

These are still early days for IFRS reporting in the public sector. But the opportunity to embed the change in accounting regime and its significant business implications into 'business as usual', to maximise the benefit of the improved transparency in public sector financial reporting, is surely too good to miss.

FINANCE IN AN AGE OF AUSTERITY

Mark Williams, Associate Partner in Public Sector Advisory at Deloitte, discusses the challenges faced by finance professionals in the UK public sector.



This article follows the theme of the Deloitte contribution to the 2010 *IFRS and beyond* conferences hosted by the faculty jointly with CIPFA, in March 2010. It uses the example of complex accounting for partnerships and joint financing arrangements to highlight the unique challenges faced by senior finance professionals in the UK public sector. In an age of austerity, these challenges will increase, and finance professionals will become central to the decision-making process taking place in public bodies under the new Conservative/Liberal Democrat administration.

The regime for public sector accounting involves complexity that is, arguably, more testing than that of the private sector, and this adds strength to the argument that finance professionals need a greater level of visibility in public sector organisations. Expenditure budgets are normally fixed and outturns need to be achieved within tight tolerances (below budget, as well as over), particularly in the current economic climate. Under this budgetary regime there are a number of different types of spending. For example, capital and revenue expenditure are recorded separately,

and there are limited opportunities to flex budgets, either in-year or between years. Budgetary affordability is, for the most part, determined by financial accounting, and since 1 April 2009, IFRS has provided the framework.

This budgetary regime means that the way affordability of programmes and projects, such as partnerships and joint financing arrangements, is considered in the public sector differs from the private sector. In the public sector, in addition to cash funding requirements and the total costs and the associated benefits (quantitative and qualitative), financial accounting can also be a key factor in achieving project approval.

PARTNERSHIP AND JOINT FINANCING ARRANGEMENTS

Over recent years, with the aim of delivering public services more efficiently in a climate of declining departmental budgets, we have seen a greater number of – and more complex – partnership and joint financing arrangements.

In the case of partnerships, new entities and arrangements have been formed between both



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public sector bodies and between public and private sector in order to deliver back office functions, infrastructure and front line services. Joint financing arrangements include established private finance initiative approaches, as well as more innovative public private partnerships and outsourcing models.

CHANGE IN ACCOUNTING STANDARDS AND BUDGETING

In addition to increased complexity and a climate of economic uncertainty, we have seen the rules applied in the public sector change.

Until recently, the accounting for these types of arrangements, including determining who should record any underlying assets and/or liabilities, has depended on an assessment of risk and reward. Under IFRS we have seen a shift to considering control. For example, under IFRS the guidance that applies to 'service concessions arrangements' is IFRIC 12, and this asks 'who has control?' The outcome of applying IFRIC 12 is that the majority of PFI, PPP and outsourcing arrangements now have to be recorded on the UK public sector's balance sheet for financial accounting. However, it is worth noting that the treatment in budgets of PFI and PPP contracts is one of the few exceptions where the budgetary and financial accounting treatments have been 'de-coupled', such that an on-balance sheet conclusion for financial accounting does not automatically lead to a call on capital budgets.

LIMITING FINANCE'S INVOLVEMENT

The following short case study highlights what can happen if the finance function of a public sector organisation is not central to the project appraisal process.

Deloitte became involved prior to the 'financial close' of a partnership funding vehicle arrangement. The business case involved external (non-governmental) funding in the form of loans being passed through an 'arm's-length' body onto third parties. However, after being asked to assess the IFRS accounting treatment, it became clear that our client retained control such that it was not an 'arm's-length' body and the funds flow would need to be included in our client's budget.

It was fortunate for the client's objectives that this was identified before any contracts had been signed, meaning that it was possible to renegotiate the terms so that the 'arm's-length' body was no longer deemed to be controlled by our client. Had this not been identified until after legally binding contracts had been entered into, our client would have faced un-manageable pressures on its budgets.

CONCLUSION

Given the fiscal backdrop, it is important that UK public sector bodies explore new ways of delivering and financing their services. However, the additional complexity of partnership and joint financing arrangements, combined with the move to IFRS and reduced budgetary flexibility, means that an increased focus from senior finance professionals will be required. This also means that non-finance teams need to be familiar with the key affordability considerations, so they know when to involve finance colleagues in the project appraisal process.

As illustrated above, the risk of not involving finance colleagues, of not understanding the accounting implications, is potentially the failure of a major project – perhaps a risk too far in an age of austerity!

IMPLEMENTING IFRS-BASED STANDARDS FOR THE AUSTRALIAN GOVERNMENT

Peter Gibson and Brett Kaufmann of the Australian Government Department of Finance and Deregulation reflect on the experience of the Australian public sector in implementing IFRS.

The purpose of this article is to describe the experience of the Australian Government in first implementing the Australian equivalents of International Financial Reporting Standards (AEIFRS), for its fiscal 2006 year. We hope that this account of the Australian experience resonates with faculty members in the UK public sector who have recently completed their first year of IFRS accounts and provides some lessons and insights for other members still dealing with the challenges of IFRS transition in the public sector.

BACKGROUND – THE AUSTRALIAN GOVERNMENT CONTEXT

There are a number of distinctive factors that influenced the Australian experience, as follows:

- the implication of Australia's federal system is that each level of government prepares separate financial statements. The Australian (national) Government does not consolidate the numbers of provincial or local governments;
- the predominant management paradigm has been decentralisation, and to support financial accountability at this level each Australian Government agency is responsible for preparing their own financial statements, having them audited, and making them publicly available in their annual reports;
- the Australian Government produces a consolidated whole of government financial report,¹ where many of the accounting issues are resolved and audit-cleared at the agency level – a 'bottom up' approach; and
- by 2006 Australian Governments had over a decade of experience with a comprehensive suite of accrual accounting standards that were already closely aligned with private sector standards and AEIFRS in many respects.

THE DECISION AND ITS APPLICATION

In 2002 the government decided to adopt AEIFRS accounting standards from 1 July 2005, for both its own public sector and the private sector. As in the UK, standards issued specifically for the public sector by the International Public Sector

Accounting Standards Board (IPSASB) were not adopted since, at that time, they did not constitute a comprehensive suite of standards and were not supported by a conceptual framework. Australian standard-setting has also been characterised by sector neutrality,² the concept that a single set of accounting standards can be applied to all sectors of the economy, with differences only justified in rare circumstances.

Through until 2004, the Australian Accounting Standards Board (the Australian standard setter) worked to finalise the standards that would apply at that time. In order to accommodate not-for-profit entity differences, the AASB introduced a series of additional paragraphs not present in the original IFRS standards known as 'Aus paragraphs', and retained several accounting standards that dealt specifically with government accounting issues not addressed by AEIFRS, such as non-exchange revenue, accounting for administrative restructures, and reporting on 'administered items'³ at agency level. This approach preserved the sector neutral approach in a single suite of standards, but still allowed for-profit private sector entities to assert compliance with IFRS.

The application by the Australian Government was approached as a significant project by the responsible agency, the Department of Finance and Administration⁴ (Finance). The significant points of the project plan were:

- communicating with agencies about the changes, including establishment of a working group of CFOs from significant agencies to identify and consider accounting and reporting changes;
- providing extensive training to staff, including agency staff, in co-operation with the professional accounting body, CPA Australia;
- finance providing advice to agencies from its Accounting Policy Branch;
- regular meetings with staff of the Australian National Audit Office (ANAO) to discuss areas of uncertainty and interpretation, and preparation of position papers to document interpretations and as a basis of resolving more difficult issues with the ANAO;



- exchange of information between various Australian government jurisdictions, principally through HoTARAC (the Heads of Treasuries' Accounting and Reporting Advisory Committee). HoTARAC, representing public sector preparers, co-ordinated consolidated public sector comments to the AASB on each draft standard;
- early identification and quantification of known differences that would arise from the application of AEIFRS; and
- all agencies were requested to recast their 2005 fiscal year financial statements using the new standards, and to have these recast statements subject to audit review. This was seen as particularly important as it meant that agencies would have experience with AEIFRS, including computing comparatives, prior to preparation of their fiscal 2006 financial statements.

PROCESS OUTCOMES

As with all large projects, not everything in the process ran smoothly. Apart from accounting policy issues, several things that stand out were a lack of sufficient progress in resolving issues with the ANAO, and incomplete identification of all the differences between the old and new standards (resulting in some last minute changes); and not all agencies were capable of recasting their 2005 numbers at the time, resulting in more concentrated (and stressful!) effort in 2006.

Nevertheless, the outcome was satisfactory – the introduction of AEIFRS did not result in any delay in completing agency financial statements on average, and there were no audit qualifications issued on AEIFRS matters.⁵

TECHNICAL ACCOUNTING ISSUES

It would be fair to say that AEIFRS was not a perfect fit for the Australian Government, despite the

introduction of 'Aus paragraphs' in the standards. To overcome this, the approach adopted during implementation was essentially a practical one.

Following the first year of implementation, HoTARAC and ACAG (the Australasian Council of Auditors-General) submitted a range of issues to the AASB under the title 'Gaps in GAAP', with a request for resolution. The AASB declined to resolve some issues and for others resolution is still continuing. Space does not permit detail on these issues (we may come back to them in a later article), but they broadly fell into a number of categories:

- transitional issues not adequately covered by AASB1, *First Time Adoption*;
- issues where the private-sector focus of AEIFRS did not deal adequately with public sector specific issues. Many of these issues have been considered or are being considered by IPSASB in developing their suite of standards; and
- issues also faced by the private sector, but where the magnitude or nature when applied by the public sector gave results that were counter-intuitive.

CONCLUSION

Many aspects of the Australian experience are likely to find parallels in the UK. While the Australian Government had a relatively 'minimalist' task in implementing AEIFRS, it nevertheless required a high standard of planning and project management. As occurred in the private sector, unexpected results and issues arose, with these ultimately dealt with in a practical way through a great deal of communication with agencies and the ANAO, to achieve outcomes that were unqualified and largely on time. A range of technical issues arose which were referred to standard setters for further consideration, and some of these are still ongoing in 2010.

ENDNOTES

- 1 The consolidated entity is based on the concept of control, almost identical to the concept in IAS27/AASB127.
- 2 Later reviewed and re-named transaction neutrality.
- 3 Administered items are transactions and balances that are not controlled by the government agency but are managed by it on behalf of the government as a whole. They are mostly comprised of government programme expenditures, collection of government revenue including taxes, and associated balance sheet items.
- 4 Now the Department of Finance and Deregulation.
- 5 There were financial statement audit qualifications, but these qualifications were not related to AEIFRS.



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AT THE HEART OF PUBLIC SERVICE DELIVERY

Nick Jackson, Head of Finance Professionalism at HM Treasury, and Sumita Shah, Technical Manager with the Audit and Assurance Faculty, discuss the importance of financial management in the public sector.



Strong financial management, integrated with performance management, is essential if government is to succeed in its policy-making, planning and delivery of key objectives. The finance function needs to move to the heart of this policy, delivery and decision-making role because its role isn't just to account for money after it has been spent; it needs to be closely involved right from the start of projects, before funds are committed.



With this in mind, at the recent CIPFA/ICAEW IFRS conference, there was discussion about the challenges for improving financial management within government, with the Foreign and Commonwealth Office providing highlights of its transformation.

HM Treasury, working with the Government Finance Profession, advocates a top-down, cross-team approach, identifying overarching

departments. Encouraging and influencing their peers and staff to behave consistently in accordance with good financial management and governance principles is a must.

INTEGRATION

Mechanisms need to be in place to facilitate, integrate and enable the implementation of effective governance and financial management throughout the organisation. It is important to embed the finance function into all aspects of decision making, perhaps by linking achievement of finance targets to performance management.

Integration will provide a better basis for priorities to be set and will improve the visibility of costs against delivery of outputs and outcomes. It will also help to link inputs and activities to outputs and outcomes, and provides an evidence base for key decisions.

COMMUNICATION AND ENGAGEMENT

It is difficult to overstate the importance of two-way communication and engagement between leaders and staff at all levels, with clear lines for decision making and accountability. Departments need to have an understanding, not only of their own role and activities, but also of the roles of others and how they can be supported effectively. Communicating the right information to the right people will enable the right decisions to be made.

It is also important to communicate and engage with relevant stakeholders. Providing clear and consistent messages will help to improve understanding of the financial management agenda. Departments should be open to challenge by stakeholders and indeed should respond to it. They need to fully understand the purpose of the service they are providing, know who the recipients are, why they need it and be open and responsive to stakeholder expectations.

ACCOUNTING STANDARDS AND QUALITY

Financial reporting standards need to be applied appropriately in the context of the public sector to

'It is difficult to overstate the importance of two-way communication and engagement between leaders and staff at all levels.'

priorities to ensure that there is connectivity and that the focus is on the things that matter most. In the remainder of this article we summarise some of the key aspects of their approach: leadership and culture; integration; communication and engagement; standards and quality; and last but not least, professional qualifications and development.

LEADERSHIP AND CULTURE

Leadership and culture derive from a clear tone from the top, exemplified by the behaviours of senior management.

Senior officials need to demonstrate and provide strong leadership and commitment to improving financial management within and across



ensure that there is consistency and transparency. HM Treasury will provide guidance on definitions and application of requirements, but departments should then cascade that guidance down to all

‘It is highly desirable for staff responsible for finance within government departments to have a relevant professional qualification.’

levels within the organisation. High quality systems and processes are needed to generate timely, high quality and relevant financial information for key decision makers to drive the performance of the organisation as a whole.

PROFESSIONAL QUALIFICATIONS AND DEVELOPMENT

It is highly desirable for staff responsible for finance within government departments to have a relevant professional qualification.

This is now recognised within government, and the number of qualified professionals is increasing. However, skills and competences need to be enhanced still further. To ensure that the right decisions are made to improve efficiency and

effectiveness within the organisation, departments need to have the necessary skill-sets, competences, capabilities and commitment in place. They also need to recognise the need for professional development, and to identify and retain the right staff through managing their resources, succession planning and creation of appropriate opportunities for staff.

There are significant challenges involved in embedding and maintaining strong financial management throughout an organisation, but operating any other way is not an option. We believe that close and consistent attention by departments to the factors outlined above will ensure that steady progress is made towards that goal.

FIVE STAR FCO?

Keith Luck, Director General Finance at the UK Foreign and Commonwealth Office, explains the journey of the department from financial management straggler to 4★ and counting.



'We do not often say this in this Committee: it is a good report ...and you have made considerable progress.'

Committee of Public Accounts Chairman Edward Leigh to FCO Permanent Under Secretary Sir Peter Ricketts, October 2009.

This quote from the hearing of the Committee of Public Accounts (PAC) on financial management in the Foreign and Commonwealth Office (FCO) will have turned a few finance directors' heads in Whitehall. The fearsome PAC praising a department traditionally a straggler in financial management? Edward Leigh's comment was based on a substantial National Audit Office (NAO) report, so this wasn't just the FCO talking a good game. What lay behind this transformation?

The FCO knew from several internal and external reviews that it was far from top of the class in managing its finances systematically and maturely. Its business was strategic policy, with some service delivery. With global dispersal and frequent moves among its UK staff, there had been little internal pressure to sharpen up its financial management.

The top leadership recognised the need to improve resource management performance but needed an understandable framework to make it meaningful for the wider FCO.

Soon after my appointment as Director General Finance, I launched the '5★ Finance Programme'. This provided an intuitive framework for the FCO. The aims were to function more effectively and become recognised as a Whitehall leader in the field. The structure of milestones ranging from 1★ (poor) to 5★ (excellent) was based on NAO's December 2003 report on managing resources to deliver better public services.

The programme started in September 2007, with an initial self-assessment of 2.5★. A small programme team took forward the work. It led a handful of projects itself, with almost all the work done outside the team in the finance community. The early days concentrated on IT systems and processes, aiming to raise worldwide process compliance, simplify routines and speed up the

adoption of audit recommendations. The FCO also strengthened the units that link the overseas network with central finance and introduced six new professional finance training schemes.

In autumn 2008 the programme reached an intermediate milestone of 3.5★, which the NAO endorsed as a reasonable summary of progress. An internal review in early 2009 concluded that after securing a sizeable number of technical gains, the next step was to mainstream those improvements. Transforming financial management was about step changes in quality beyond the boundaries of the core finance community. The business had to be engaged, and the finance side was now in a position to push this forward.

The FCO focused the next 4★ stage on improving the quality of management information available to senior managers in the UK – 'Firm Finance Facts'. It reached 4★ by November 2009.

The current 4.5★ phase – 'Far Flung Finance', due to end in July 2010 – is about pushing out into the wider FCO and the overseas network.

'5★ is not itself about making efficiency savings but about enabling better financial management.'

Crucially, it adopts an ambitious maturity-based approach, driving the transformation throughout the organisation. The NAO – observers on the Programme Board – will assess the FCO on the maturity of its financial management after this phase. They are working with FCO on the assessment methodology to be used later in 2010.

How did the FCO get this far? I believe that the main lessons of this innovative programme have been:

- The FCO put time and energy into making the sometimes hackneyed concept of 'senior management buy-in' real. The FCO Board undertook significant financial training and Peter Ricketts, Permanent Under Secretary, and Non-



Executive Director Alistair Johnston, of KPMG, have led 5★ from the front.

- The FCO understood that the programme was far wider and deeper than a few technical fixes or new IT applications. The programme has been about creating a step change in the quality of financial management rather than just focusing on structures and processes, leading to greater organisational maturity.
- Being more than business as usual, a small, dedicated change programme team was created, blending the business and finance sides. The approach embraced systems (how we manage the finances) processes (what exactly we do) and practices (how well we do it).
- The worldwide network has been engaged in the 5★ brand and programme, through a focused communications effort and a popular series of short self-help guides that help overseas posts to diagnose their financial competence and to work on simple ways to improve their performance towards 5★.
- 5★ is not itself about making efficiency savings but about enabling better financial management so that the FCO is better placed to make required efficiencies.

The Whitehall finance directors look forward to the next phase of this endeavour.

As part of its overall activity around public sector transparency and accountability of public expenditure, ICAEW has launched its *Public Sector Finances – Views from the Inside* research. This document highlights policy messages to key decision makers ahead of the UK Emergency Budget.

The survey interviewed 131 members across the public sector on views about the potential opportunities and barriers for efficiency savings in their organisation. The key points of the ICAEW research are:

- 82% of respondents think further savings can be made within their organisation in the next year without affecting the current level of service they provide.
- 1 in 3 think these savings could be in excess of 5% of their discretionary budget.
- 'Improved use of IT and technology' and 'reducing spend on staff headcount' provide the biggest opportunities for savings.
- 84% fear that 'political interference from government' will hinder the organisation from being effective in making financial savings over the next two years. 74% fear that the 'overall culture of their organisation' will hinder them.
- Only 20% thought that publishing more information about public expenditure and performance would have a positive impact on their organisation.

The research indicates the opportunity to reduce public expenditure in a strategic manner that best delivers value for taxpayers' money, and emphasises that the expertise of public sector finance professionals will be critical in order to achieve this.

To read the research go to icaew.com/publicpolicy

HOW ESA 95 IS WORKING IN PRACTICE

Chris Hughes and Peter Dymoke, Senior Managers at PwC, look at some of the challenges involved in accounting for PFI in the UK public sector.



The familiar landscape of PFI has changed in the last 12 months. Not only will private finance initiative projects come on to the balance sheet (now the Statement of Financial Position) under IFRS principles, but the budgeting and accounting treatments could also diverge. As a result, provided they meet a set of given criteria, PFI projects could be excluded from the UK Government's calculation of Public Sector Net Borrowing (PSNB).



HM Treasury requires that PFI and similar projects (service concessions) should be budgeted for according to their treatment in the National Accounts. This treatment follows the European System of Accounts 95 (ESA 95), the European Community rules that dictate how member states should prepare their national accounts to ensure consistency of preparation across the EC.

In most cases, service concessions are recorded under ESA 95 according to the criteria set out in the Manual for Government Deficit and Debt, or the ESA 95 Supplement. Where a project falls within the category of 'services purchased by government on the basis of dedicated assets', the Supplement provides additional guidance on how to determine whether the Government has the risks and benefits of ownership of the assets underlying a project and therefore should account for those assets in its PSNB.

Essentially, if the operator takes the majority of construction risk along with the majority of either availability or demand risk, and if the risk transferred to the operator is significant, the assets will be excluded from the PSNB under ESA 95, and as a result will not score against capital budgets under the 2009/10 Consolidated Budgeting Guidance.

The determinants of accounting treatment under IFRIC 12 and ESA 95 (and specifically the ESA 95 Supplement) therefore differ. Treatment of assets within a contract is determined by the concept of 'control' in IFRIC 12 and on the 'balance of risk and reward' of ownership under ESA 95. Therefore, a project could be budgeted for differently to how it is accounted for under the two sets of standards.

It is also possible for arrangements that are within the scope of IFRIC 12 to be without the scope of the ESA 95 Supplement, which can cause confusion, to say the least. For example, the ESA 95 Supplement does not consider assets such as toll bridges funded by payments from users. Nor does it consider projects where existing assets are refurbished and at a cost less than the existing asset value, for example adding a lane to an existing motorway.

COMPARISON OF EXPERIENCE OF APPLYING IFRIC 12 IN LOCAL AUTHORITIES AND THE NHS

As a result of recent amendments to the applicable Statement of Recommended Practice, local authorities currently apply IFRIC 12 principles in their 2009/10 accounts, bringing service concessions, including PFI schemes, onto their balance sheets prior to the formal introduction of IFRS in 2010/11. The NHS, like central government, has already had to submit audited restated 2008/09 accounts prepared under IFRS. Full IFRS requirements apply for 2009/10.

Practical application of IFRIC 12 principles has proved difficult in both sectors. In the NHS, some schemes that fell to be accounted for under

'The determinants of accounting treatment under IFRIC 12 and ESA 95 differ.'

IFRIC 12, but were not badged as PFIs, were not identified promptly. For example, schemes where Primary Care Trusts held legal charges over properties, from which they also controlled the services provided through certain commissioning arrangements, turned out to be, in many cases, on-balance sheet service concessions.

A similar issue is occurring in many local authorities, where the identification and analysis of schemes that could fall to be accounted for as service concessions is still ongoing. Local authorities are considering schemes that involve

the provision of vehicles to provide a service such as waste collection and home to school transport schemes, and contractual arrangements that involve nomination rights – for example social housing.

Local authority PFI schemes are also subject to different and often more complex payment structures, increasing further the challenges of

'Practical application of IFRIC 12 principles has proved difficult in both sectors.'

practical application. There are many more types of scheme to consider, such as waste, street lighting, housing, leisure, information technology and building schools for the future. While the principles in the Local Government SORP Guidance Notes are relevant for all of the different types of scheme, local authorities are finding that accounting issues, such as the treatment of third party income in leisure schemes and the existence of foundation schools, do not have easy answers.

ESA 95 is particularly relevant to new local authority PFI schemes. The Department for Communities and Local Government requires that all PPP and PFI business cases submitted as part of an application for government grant support (PFI credits) include an assessment of how the project may be classified in the National Accounts. Schemes will normally only receive PFI credits if they fall to be accounted for as off PSNB under ESA 95.

As we face up to the new political and economic realities in the UK, PFI schemes in general, and the relationship between IFRIC 12 and ESA 95 in particular, are likely to remain topics at the heart of the debate about UK public sector financial reporting.

This is the first public sector supplement published by the Financial Reporting Faculty. We would welcome your thoughts on whether you found this supplement interesting and useful. Your ideas on future content and features would also be welcome. Please contact the faculty at lrfac@icaew.com with your comments.

The 32 page main edition of the faculty journal *By All Accounts* published at the same time as this public sector supplement explores many of the current challenges facing financial reporting professionals. The articles are written by experts in the field covering both IFRS and UK GAAP and include:

- The calm before the storm? IFRS beyond 2010;
- From IAS 39 to IFRS 9: more than just a name change;
- IFRS for SMEs: an update; and
- Directors' accounting disclosures revisited.

It also contains an exclusive interview with Sir David Tweedie, chair of the IASB.

The journal is available to members on request from lrfac@icaew.com

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