

Financial Reporting Advisory Board Paper

Secretariat paper

Adaptations of UK GAAP in the Government Financial Reporting Manual

Issue:	To note that the Government Financial Reporting Manual retains the adaptations of UK GAAP previously contained in the Resource Accounting Manual, and to note that the adaptations are under review.
Impact on guidance:	Not at present,
UK GAAP adaptation?	N/A
IAS/IFRS compliant?	N/A
IPSAS compliant?	N/A
Impact on budgetary regime?	N/A
Recommendation:	That the Board notes the paper.
Timing:	N/A

DETAIL

Introduction

1. This paper notes that the Government Financial Reporting Manual (FReM) retains the adaptations of UK GAAP previously contained in the Resource Accounting Manual (RAM) (and, to a lesser extent, in the NDPB Annual Reports and Accounts Guidance and Trading Funds Accounts Guidance). The paper concludes that the process to review these adaptations to determine whether they remain relevant has started, or is planned.

2. The following chapters of the FReM contain adaptations of UK GAAP: chapter 2 (accounting principles); chapter 3 (statement of parliamentary supply); chapter 5 (balance sheet: tangible and intangible fixed assets); chapter 7 (annual report and accounts); and chapter 8 (retirement benefits). With minor exceptions, the adaptations derive from the RAM; those in chapter 7 relating to the presentation of the operating cost statement, balance sheet, cash flow statement and notes are more

explicitly related to the requirements of companies legislation and relevant accounting standards than the equivalent RAM requirements. The adaptations fall into two categories: the presentation of information in resource accounts and accounting for tangible and intangible fixed assets; these categories are discussed in more detail in paragraphs 4 to 11 below.

3. The requirement to include a cost of capital charge and a notional audit fee where an actual fee is not charged is, it could be argued, an adaptation of GAAP. Including a cost of capital charge in financial statements is currently being reviewed and is not considered further here. The notional audit fee will be discussed as part of the consideration of the Accounting Standards Board's *Interpretation for Public Benefit Entities of the Statement of Principles for Financial Reporting*.

Work on reviewing the presentation of information in resource accounts

4. The adaptations in chapter 2 relate to the resource accounting boundary (paragraphs 2.4.8 to 2.4.10) and are not considered further here. Issues surrounding the resource accounting boundary (FRS 2, FRS 5, FRS 9 and UITF Abstract 31) are being examined separately as part of the work on amendments to FRS 2 *Subsidiary undertakings*, linked to a review of the classification tests developed by HM Treasury and the Office for National Statistics. It is not clear at this stage how, in the longer term, all the adaptations will be removed, although it is likely that, in the shorter term, some of the adaptations (for example, in relation to non-departmental public bodies) might be removed.

5. The Statement of Parliamentary Supply (chapter 3) is an adaptation of UK GAAP in that it is a primary financial statement developed specifically for departmental resource accounts to report outturn against Estimate for the purposes of parliamentary accountability. The format of resource accounts generally (chapter 7) is being considered as part of a project to ensure that the presentation of information in resource accounts meets the needs of users. The formats of the primary statements and the information in the notes are unlikely ever to look exactly the same as a pro-forma set of company accounts, and adaptations are, therefore, likely to remain. This project also links in with work on aligning budgets, Estimates and accounts. The adaptations in the FReM are not considered further here.

Adaptations in accounting for tangible and intangible fixed assets

6. Specific adaptations in respect of accounting for roads, for heritage assets, for donated assets and for asset transfers will be examined in the context of other developments: convergence with international accounting standards in respect of roads; developments articulated by the Accounting Standards Board's Committee on Accounting for Public-benefit Entities (CAPE – formerly the Public Sector and Not-for-Profit Committee) in a forthcoming Discussion Paper; and the Exposure Draft *Interpretation for Public Benefit Entities of the Statement of Principles for Financial Reporting* in relation to donated and transferred assets.

7. The general adaptations of the accounting treatment of tangible and intangible fixed assets are set out below.

FRS 15 *Tangible fixed assets*

Interim valuations by a qualified valuer of land and buildings in the third year of every five year valuation cycle are not required. (*One of the interpretations requires the annual valuation of land and buildings by using appropriate indices. Another requires non-land and buildings assets to be valued by use of indices where it is not possible or not cost effective to obtain a professional valuation.*)

Interim valuations by a qualified valuer of tangible fixed assets other than land and buildings are not required.

FRS 15 *Tangible fixed assets (cont)*

Gains on revaluation of fixed assets should be credited to the relevant reserve. This will be the donated asset reserve in respect of donated assets or to a government grant reserve in respect of assets financed by government grant. Losses on revaluation (other than impairment losses reflecting losses of economic benefits) should be debited to the relevant reserve to the extent that gains have been recorded previously, and otherwise to the operating cost statement, unless it can be demonstrated that the recoverable amount is greater than the revalued amount in which case the impairment can be taken to the statement of recognised gains and losses.

One of the interpretations disallows the capitalisation of any finance costs that are directly attributable to the construction of tangible fixed assets.

FRS 11 *Impairment of fixed assets and goodwill*

References in FRS 11 to the statement of total recognised gains and losses should be read to mean the revaluation (or donated asset or government grant) reserve. Where impairment losses are taken to one of the reserves, it should be to the extent only that there is a credit value in the reserve relating to the impaired asset and only until the carrying value becomes equal to the depreciated historical cost. (For this purpose, 'historical cost' means the value at which an asset was taken on to the fixed asset register if no historical cost is otherwise available.)

Downward revaluations in excess of the credit in the revaluation or other reserve or leading to a reduction in value below the depreciated historical cost should be charged to the operating cost statement unless it can be demonstrated that the recoverable amount is greater than the revalued amount in which case the impairment can be taken to the statement of recognised gains and losses. For the recoverable amount to be greater than the revalued amount, entities must demonstrate that:

- I: they are not aware of any factors that have caused a substantial fall in usage or decline in the condition of the asset – that is, that the fall in value has not been caused by a consumption of economic benefits;
- II: for assets valued on an existing use value or other market-based valuation, the reduction is due to a short-term reduction in market prices, which informed opinion believes will be reversed in the medium term; or
- III: for assets valued on a depreciated replacement cost basis, changes in technology in the relevant sector are small, so that any downward movement in prices is likely to be short-term, as there are no noticeable improvements in technology or sustained falls in commodity prices that would cause prices to fall over the medium term.

SSAP 4 *Accounting for government grants*
(One of the interpretations notes that parliamentary Supply does not fall within the meaning of government grants.)

Entities other than non-departmental public bodies that are charities (who should follow the requirements of the Charities SORP) or NDPBs that are companies (who should follow the requirements of the standard (except that grants received as a contribution towards the cost of an asset should be accounted for as deferred income not as a deduction in the cost of the asset) should credit grants received as a contribution towards the cost of a fixed asset to a government grant reserve (not to deferred income), which is then released to the operating cost statement over the useful economic life of the asset in amounts equal to the depreciation charge on the asset and any impairment – that is, the option given in SSAP 4 to deduct the grant from the cost of the asset has been withdrawn.

On disposal of an asset financed by government grant, the profit or loss is taken to the operating cost statement and is offset by a transfer from the government grant reserve of the same proportion of the profit or loss that the amount of the grant bears to the original acquisition cost of the asset. The balance on the government grant reserve in respect of that asset should be transferred to the general fund, representing that same proportion of the proceeds.

SSAP 13 Accounting for research and development

Development expenditure should be capitalised where there is a clearly defined project for which expenditure can be separately identified and which an entity expects to complete with the result that an asset will be brought into use or in the case of entities engaged in profit making activities, where the project is commercially viable.
Internal costs, including the charge for the cost of capital, should not be capitalised if they relate to activities that can only be carried out by in-house staff.

Asset valuations

8. Based on the above extracts from the FReM, the main adaptations centre on asset valuation issues. These are the subject of a separate piece of work that will address concerns about the methodology used in depreciated replacement cost valuations and the way in which impairments are accounted for. The adaptations of FRS 11 and FRS 15 will be considered as part of that work.

Accounting for government grants

9. One of the proposals in the Exposure Draft *Interpretation for Public Benefit Entities of the Statement of Principles for Financial Reporting* is that the accounting treatments allowed under SSAP 4 are now incompatible with the definitions of elements in financial statements. Thus the deferral of income would be discouraged (it is unlikely that the ASB would move quickly to replace SSAP 4 with a UK version of IAS 20 *Accounting for government grants and disclosure of government assistance*, since IAS 20 is under review). Accounting for grants and grants-in-aid is already the subject of a separate piece of work, which will incorporate consultation on the proposals in the Exposure Draft. Any changes in the adaptations will need to be considered in the context of that work.

Accounting for research and development

10. IAS 38 *Intangible assets* is due to be implemented in UK standards for accounting periods beginning on or after 1 January 2007, with earlier adoption encouraged (FRED 37 was published on 28 July 2005). SSAP 13 permits, but does not require, the capitalisation of development costs when the recognition criteria are met. IAS 38 requires capitalisation. Where any development project is likely to lead to a loss, SSAP 13 does not allow the recognition of an asset, since it requires aggregate revenues to be likely to exceed aggregate costs. IAS 38 allows an asset to be recognised, written down to reflect any impairment. The changes to the UK standard likely to be brought in by IAS 38 would remove the first of the adaptations set out above.

11. The question that will need to be asked is whether the prohibition on the capitalisation of internal costs relating to activities that can only be carried out by in-house staff should remain. This will be asked as part of the work on the implementation of IAS 38 unto UK standards.

Conclusion

12. The FReM contains relatively few adaptations of UK GAAP and they fall into two categories: the presentation of information in resource accounts and accounting for tangible and intangible fixed assets. The presentation of information has two centres of focus – the boundary and the format – and work on both of these is underway. Adaptations to the accounting for tangible and intangible

fixed assets relate mainly to valuation issues – and work is planned for this area. Work on the minor areas is being, or will be, handled as part of routine consultation on proposals emanating from the Accounting Standards Board. The process to review whether adaptations remain relevant has, therefore, started, or is planned, in all cases.

David Watkins
Secretary
17 August