

## **MINUTES OF THE 75<sup>th</sup> FRAB MEETING HELD ON WEDNESDAY 28<sup>th</sup> SEPTEMBER AT HM TREASURY**

**Present:** Elwyn Eilledge (Chair)  
Miranda Carter  
Russell Frith  
Robin Lynch  
Nigel Reader  
Anne Rylatt  
David Thomson  
Steve Warren  
Ken Wild

Gillian Fawcett  
David Heald  
Alastair Matthews  
Michael Romberg  
Martin Sinclair  
John Thornton  
John Williams

**Secretariat:** David Watkins (Secretary)  
Sarah Solomon  
Chris Ruston

**Guest:** Heather Foster

1. The Chairman welcomed everyone to the meeting. Apologies were received from Mike Ashley, Martin Evans (who was substituted for by Steve Warren), Alyson Stafford (substituted for by John Williams), Jeff Tomlinson (substituted for by Anne Rylatt), and Trevor Woolley (substituted for by John Thornton). Gillian Fawcett from the Scrutiny Unit stood in for a parliamentary observer.
2. The Chairman welcomed Alastair Matthews to his first meeting, as the new member representing trading funds, and John Williams who was substituting for Alyson Stafford for the first time. Heather Foster had been invited to attend as she had expressed an interest, while still a Board member, in the discussion on Financial Instruments.

### ***Item 1: Minutes of the Last Meeting: Paper FRAB (75) 1 and Matters Arising***

3. The minutes of the last meeting were agreed, subject to the following amendments:
  - a. The second line of paragraph 25 will be amended from “on a” to “and”.
  - b. The ninth line of paragraph 47 should read “recorded” (not “recoded”)
  - c. The date of the November meeting is Monday 28 November (not 24 November).

4. It was hoped that a new parliamentary observer could be appointed in time for November's meeting.
5. The Chairman's original letter and the Cabinet Office response regarding progress towards getting legislation to put the salary and pension disclosures on to a statutory basis have been published on the FRAB website. ([www.frab.gov.uk](http://www.frab.gov.uk).)
6. Following the discussion at the last meeting on the EC Gas Emission Allowance Trading Directive, Nigel Reader reported back statistics from the Emissions Trading Register. As at the end of July, just over 1000 organisations had registered, of which 135 were government institutions. (These were mainly NHS Trust hospitals and defence organisations.) The carbon emission amounts of the government institutions registered under the scheme made up 1.5% of the total. Ken Wild reported that certificates had started to trade actively over the last few weeks. The subject was on the agenda for November FRAB meeting and guidance from the Treasury may well need to be issued. The IASB will be undertaking work on grants and further work on Emissions Rights may flow from that rather than being considered separately.
7. Nigel Reader also undertook to provide examples of incorporating sustainability into the OFR. He said that the position on good practice was evolving and that he would liaise with the Secretary to provide relevant links for the FReM website.
8. The Exposure Draft for the Statement of Principles for Financial Reporting was published in August and is now publicly available – free of charge – on the ASB website. Consultation papers on the areas agreed at the last meeting have been circulated through the RABIG network for comment. The responses to the consultation will be used to draft a response from the FRAB. Martin Sinclair asked that the draft be circulated to FRAB members in good time (preferably at least two weeks before the November meeting) for them to consider any comments. The draft will be agreed at the meeting in November and the final version submitted shortly after that.
9. The IFRIC update for August was circulated with papers for the meeting. This includes an update on Service Concession arrangements. A journalist had approached the Secretariat regarding Service Concessions and had been directed to the Board's response on the FRAB website. Ken Wild gave an update on the IASB position. It looks likely that they will issue an interpretation at the end of this year or the start of next year. At the moment the scope needs clarification in relation to the public sector. The most contentious issue that needs to be resolved is the dividing line between intangible assets and financial instruments.
10. The Treasury published a new Code Of Good Practice For Corporate Governance In Government Departments in August. This has been

circulated to Board members (any members who had not received it should notify the Secretary who will send a link to the relevant DAO letter to them). The Treasury is revising the Statement on Internal Control in the light of the Code and will return to the Board in due course.

11. Robin Lynch reported back on the International Advisory Expert Group on National Accounts that he attended in July and which he had mentioned in his presentation at the last meeting. At the meeting the group had discussed tax credits and a clear majority were in agreement with the ONS preferred approach, ie that payable tax credits were a benefit that should be recorded on a gross basis rather than net.

***Item 2: Grants and grants-in-aid: update on work since FRAB 73 (FRAB (75)2)***

12. The Secretary presented this paper on behalf of the Treasury which was an update on discussions to change the basis on which grant in aid is accounted for in the accounts of NDPBs, ie from income to financing. The subject was last discussed at the May FRAB meeting (FRAB 73). A meeting took place in May between the Treasury and the DTI (as sponsors of the Research Councils who have been the most vocal in their opposition to the proposal that grant in aid should be treated as financing). At that meeting the Research Councils were invited to present a paper to the Treasury with more detail on justifying accounting for grants and grants-in-aid as an exchange transaction. They have now produced a paper which was attached to FRAB (75)2. The paper relies on a wider definition of benefits exchanged in return for revenue, (for instance intangible benefits such as the increase in the fund of human knowledge) than suggested by the Exposure Draft on the Statement of Principles for Public Benefit Entities in relation to the treatment of capital contributions and capital grants. The Treasury's proposals are still that grants in aid should be treated as financing rather than income.
13. Nigel Reader felt the position hadn't changed. While he acknowledged the financing argument, he still felt that where grants and grants in aid were given in return for a service (eg for undertaking new flood defences), they should be treated as income and not as contributions from controlling parties. He considered that the argument in favour of services such as these being considered as a benefit was more compelling than for the one put forward in the Research Council paper.
14. David Heald asked why the Research Councils were so keen for grants and grants in aid to be treated as income. Ken Wild explained how he saw the choice. An organisation doing a worthwhile thing will be funded in one of three ways:
  - a. Somebody will pay them to do it – ie income/funding (for instance if someone wants a house built);

- b. Somebody will collect money to do it (eg a charity)
  - c. A parent company will fund a subsidiary through equity – ie financing.
15. An NDPB would choose the funding option, as that would mean they were not a subsidiary of the government.
16. John Thornton felt that the same arguments that apply to departments should also apply to NDPBs, since they are one step down from government supply and they are consolidated under Resource Budgeting.
17. Michael Romberg pointed out that NDPBs are bodies spending taxpayers' money and as such it would be unhelpful to show as "free".
18. Russell Frith explained that the bulk of funding for local authorities was equivalent to Grants in Aid. Money coming from the same source can be shown in two different places. Being accounted for differently might make the accounts less transparent. Steve Warren noted that funding to primary care trusts by the Department of Health is accounted for as financing, but that the purchase of services by NHS Trusts is accounted for as income by the Trusts.
19. Ken Wild felt that a lot of the problems described were due to boundary issues and the question of exchange transactions versus income. This led him to believe that grants and grants in aid should be shown separately in the accounts.
20. The Secretary felt that the Exposure Draft on the Statement of Principles would support the Treasury position but he saw that it was difficult to persuade NDPBs because of the difficulty in convincing them that departments do have the level of control that makes them controlling parties.
21. David Thomson supported the Treasury view. Grant in aid is a cash based concept (and always will be so, because it is tied into supply). For that reason it should be counted as financing.
22. The subject will be addressed again in November. Nigel Reader conceded that unless there is a stronger case put forward by the NDPB's, the subject should be resolved then in accordance with the views of the majority of FRAB.

**Item 3: Charging for the cost of capital in financial statements (FRAB (75)3)**

23. The Treasury presented this paper which considered the rationale behind the cost of capital charge and debated its inclusion in financial statements. Capital charging is viewed as the basis for estimating the cost of capital within government, ie the opportunity cost of the Government financing investments made by departments. Under the

Exposure Draft on the Statement of Principles for Financial Reporting – Proposed Interpretation for Public Benefit Entities, the capital charge meets the definition of a notional transaction rather than an economic event. The main arguments for including capital charges in financial statements are: to provide transparency of full costs; to aid the recovery of full costs; for resource accounts to remain consistent with resource budgeting and to be consistent with National Accounts (although National Accounts don't currently include a cost of capital charge, it is possible that in the future the System for National Accounts is likely to move to include a measure of capital services – cost of production, similar in principle to a cost of capital charge). The main argument for excluding the cost of capital charge in financial statements is that it would not be GAAP compliant. The paper concluded that, on balance, the arguments for the continued inclusion of the cost of capital charge in financial statements outweighed the arguments against inclusion. The Treasury had received support from the Department of Health. It welcomed the Board's views on the conclusion reached.

24. Some Board members were concerned at the suggestion of a departure from GAAP:
  - a. David Heald felt that there should be hard charging. Departures from GAAP should be minimised. He was surprised that the paper didn't refer to the Green Book which includes information on opportunity cost of capital.
  - b. Ken Wild was concerned that this approach meant that the accounting treatment itself altered a transaction and could mean more costs incurred. The emphasis should be on what is required in GAAP and showing what actually happens. He had sympathy with the reasons for including a capital charge, ie as a reminder that money was tied up in a particular asset. However he suggested that alternative ways of presenting the information should be considered, for instance by including information in a box in the operating cost statement.
25. Robin Lynch felt that there is a lot of pressure to do analysis and comparisons on why some people are doing better than others. Management accounts need to remain unchanged but there needs to be supplementary accounts. The debate on capital assets (and in particular heritage assets) remains unfinished. Ken Wild felt that a distinction needed to be drawn in these cases.
26. Others felt that a departure from GAAP was justified:
  - a. John Thornton pointed out that capital charging preceded Resource Accounts and was used in management accounts and budgeting. He was concerned at the prospect that it would no longer feature in published accounts particularly as this could cause a divergence between budgeting and accounts. He

therefore preferred that they remained as part of the accounts rather than something that is shown with the accounts. John Williams was also concerned about maintaining the link between budgeting and accounts.

- b. Michael Romberg supported the idea of departments treating capital charging as real and appreciating benefits that can be gained. He could understand why hard charging may be an attractive option, however it would have an additional cost attached. He suggested that the operating cost statement could include the cost of capital, and could also be shown without. However, he was happy with the current position.
27. The Secretary pointed out that NDPBs charge for cost of capital and then reverse it. The Treasury could explore what NDPBs do and carry it through to the Resource Accounts.
28. Ken Wild agreed/accepted that it was best to maintain the status quo, however suggested that the presentation could be improved and make the accounts GAAP compliant.
29. John Thornton was concerned at the impact that this would have in the accounts (eg the knock effect on the notes and other information).
30. Steve Warren explained how this was handled in local authorities. The cost of capital charge is shown above the line and reversed out. However they have a different budgeting context from voted supply.
31. David Heald suggested that the Treasury should produce a paper establishing the base for capital charge. (He suggested that paragraphs 20 and 21 of FRAB 75(3) already touched on this). The paper should highlight things that produce odd results (such as pensions) and also suggest alternative presentations.
32. Anne Rylatt questioned whether the Board should agree a divergence from something that is intended for Public Benefit Entities. Ken Wild felt that in the move towards international accounting standards the Board must be prepared to forfeit some practices in order not to pull too far away from GAAP and lose the consequent benefits, for instance having public sector accounts that can easily be compared to those from other sectors. David Heald agreed that it would be particularly unfortunate if we deviate from something aimed at Public Benefit Entities. He felt it should be possible to make accounts GAAP compliant while still bringing particular information to the attention of the reader.
33. The Chairman summed up. The Board's aim was for the accounts covered by their remit to be as GAAP compliant as possible. However, the Board accepted that cost of capital was a useful thing to include. The Treasury should explore this further.

34. It was timely to be considering what the cost of capital is and does but we should hold fire on how we account for it until the interpretation has been issued. This will allow the Treasury to consider how we can remain GAAP compliant.
35. A response to the Statement of Principle is required by 30 November but the final Statement is unlikely to be issued until spring next year. It was agreed that the Secretary would circulate a draft response two weeks before the November meeting when the subject would be discussed again.
36. The subject will be discussed again in November meeting.

***Item 4: Public Dividend Capital(PDC): accounting for PDC under FRS 25 and FRS 26 (FRAB 75(4))***

37. The Treasury presented this paper which was an update to the FRAB's previous consideration of PDC and the discussions in February on the implementation of FRS 21 and 25. The Treasury has considered the potential impact of these standards on PDC. It has consulted its legal advisers and parties who would be particularly affected. Together they came to the conclusion that PDC is an oddity – a statutory concept, not a contract and thus does not come under the scope of FRSs 21 and 25. The Treasury recommended that the current accounting treatment of PDC and dividends should continue and that there should be extra disclosure for capital employed as appropriate.
38. While some felt that this was an unnecessary departure from GAAP, Ken Wild felt that it may not be a departure and could see the Treasury's underlying argument. FRS 21 depends on the entity giving an expectation of dividend or dividend and interest.
39. Alastair Matthews and Heather Foster gave their viewpoint on the nature of the dividends paid by Trading Funds, ie the expectation of a return and what happens if a dividend is not being paid and whether the dividend constituted a liability. Their replies indicated that their dividends are treated like any other liability.
40. Michael Romberg explained the basis of PDC. It was used to put money into bodies where there was an expectation of some return. The return would be variable although there was no return of the principal. Trading Funds are set up by individual statute and this determines whether or not there is an obligation to pay a dividend.
41. The Treasury noted that PDC followed a different model to the private sector. It was a statutory concept. The PDC stays at the same rate, but the capital return changes, ie it remains as financing and is more akin to reserve. Therefore there isn't a straight read across to anything in the private sector. The approach taken by the Treasury took into account the needs of the users. Trading Funds are employed to bring a return and are served best through this approach.

42. Ken Wild concluded that a trading fund has PDC and a “dividend” has to be paid but the dividend is not necessarily connected to the PDC. The obligation to pay a return arises from trading over a period and the link with the initial PDC is lost.
43. The Chairman summed up. The Board was convinced by the arguments which were encapsulated in paragraph 11 of the paper which they brought to the Board. David Heald was keen that there should be more research, particularly to see if there was any equivalent in other countries, such as Australia or New Zealand. In response to the suggestion that we should move away from the term “dividend”, the Treasury would consult further to explore the terminology referring to PDC, particularly in relation to the current work on Government Accounting.
44. The subject will be discussed again in November meeting.

**Item 5: *Financial instruments: update on work on other work on FRS 25 and FRS 26 since FRAB 71 – ORAL UPDATE***

45. At the FRAB meeting in February the Treasury undertook to report back on the progress made since its meeting in February (FRAB 71) and to update the Board on the plans to implement FRS 25 and 26. At the time, the standards were still evolving and the Treasury wanted a more stable platform on which to implement them. In July the ASB issued a statement of its tentative plans for the implementation of changes to the financial instrument standards. However it has not yet issued the amendments to FRS 26 or the new standard to replace the disclosure requirements of FRS 25 - a standard to implement IFRS7. This will be more user friendly across government but slightly longer. This should happen shortly, after which RABIG consultation will take place. Other areas of measurement will be covered by FRS 26 – again consultation will take place. The Treasury has been consulting individual departments regarding the ED on specific issues arising from changes to FRS12, as well as carrying out basic consultation across government. The Treasury has also been liaising with CIPFA regarding local authority standards in relation to WGA. The indications so far are that there isn't anything to preclude implementation in 2006/07 but this is being kept under review. The Treasury will return to the Board in February with more information on the timing and any adaptations that are necessary. The amendment to FRS 12 via FRED 39 will be discussed at the meeting in November.

**Item 6: *FRED 37 Intangible Assets and FRED 38 Impairment of Assets (FRAB 75(6))***

46. The Treasury presented this paper which looked at the implications of implementing FRED 37 and 38 which set out proposals for replacing and amending several standards as part of the IASB convergence agenda. The Treasury has consulted on implementation and the issues that may arise as a result.

47. FRED 38's proposed amendments to FRS 15 on impairments would have the effect of removing the direct support provided by resource accounts in providing information that is currently required for budgetary purposes and is likely to be required for the National Accounts.
48. The Treasury wishes to retain this link and proposed two alternative approaches. The ONS is examining the possibility of using depreciation data from the departmental resource accounts directly in the production of the national accounts. As a result, work is being undertaken to examine which types of impairments should score in the production account and in the public sector finance numbers used to measure performance against the Fiscal Rules. Alternatively an interpretation could be added to the FReM for extra disclosure for impairment losses that brings together those charged to the revaluation reserve where there has been a clear consumption of economic benefits and those charged to the operating cost statement. This would in effect recreate the OCS as per FRS15. However, though this would provide the information to support the National Accounts and budgetary treatment, the links would be weaker and the result more complex to operate.
49. Ken Wild had sympathy with the proposals and accepted that the Government has more impairment losses but felt that the private sector was equally affected but would have to live with the proposals. The Chairman agreed that, although the Treasury proposals provided a better solution, the Board should carefully consider whether there is a need to agree a divergence from GAAP. Divergences should be agreed for two reasons: for a budgetary issue or for an issue that had National Accounts implications. A better argument was required.
50. John Thornton was concerned by the practical implications of not adopting the Treasury's proposals. This would have the effect of giving departments an overhead of running two systems. However, if the budgetary system changed, then it could be GAAP compliant.
51. Michael Romberg explained that the budgeting system was constrained by the need to keep costs down. It was recognised that it doesn't achieve all its objectives. When it is clearer what is required by National Accounts, changes to the Budgeting System can be considered. He questioned producing information that makes the accounts GAAP compliant, but is not used by customers of the accounts.
52. Anne Rylatt explained that in Department of Health, problems arose from the valuation process. Heather Foster said that in the Land Registry if properties dropped in value and there were not sufficient reserves, the loss in value was put through the income and expenditure account.
53. The overall picture was that FRED 38 would lead to problems so long as parallel systems aren't set. At the moment the two systems are

scoring against parliamentary control but entities are also required to validate outturn against control totals. The problems only occur if there is different scoring for the budgetary system - the result being that if the value of an asset falls, one could end up with two different answers.

54. The Treasury would return to the Board. It would undertake a cost benefit analysis to illustrate better the impact of FRED 38. The subject will come back to the Board after the ASB has finished its deliberations.

**Item 7: 2005-06 Manual for Foundation Trusts (FRAB 75(7))**

55. Miranda Carter presented this paper which asked the Board to approve the approach to streamline the Manual for Accounts and Capital Accounting Manual for NHS Foundation Trusts into one document entitled the NHS Foundation Trust FReM. (The Board was content with this name.) The streamlined document would contain less guidance and would encourage readers to refer to the government FReM. The new document would be circulated to the technical issues forum and will be consulted upon at the end of October/early November. At the moment there were no specific issues for the FRAB to consider. The subject will be considered again in November, when Miranda will take away any concerns and the document will be finalised early in 2006.

**Item 8: Adaptations of UK GAAP in the Government Financial Reporting Manual (FRAB 75(8))**

56. The Secretary had revisited all the adaptations of UK GAAP in the FReM to ensure that they are under review or are planned to be reviewed to confirm their continuing relevance. The Secretary confirmed to Robin Lynch that renewals accounting is included in GAAP and is covered by FRS 15. Renewals accounting isn't covered by international standards and any changes to FRS 15 will be considered under the convergence strategy. Robin Lynch noted his view that renewals accounting can be seen as a method of arriving at a depreciation figure.

**Item 9: Forward Work Programme (FRAB 75(9))**

57. The Secretary presented this paper. Since the last meeting, the ASB timetable suggested that more papers would be issued although he said that the plans were subject to constant change.

**Item 10: Date of the Next Meeting**

58. The Board confirmed the timing of the next meetings as:

Monday 28<sup>th</sup> November 2005  
 Tuesday 7<sup>th</sup> February 2006  
 Monday 20<sup>th</sup> March 2006  
 Monday 8<sup>th</sup> May 2006