

MINUTES OF THE 78th FRAB MEETING HELD ON TUESDAY 20th MARCH 2006 AT HM TREASURY

Present: Elwyn Eilledge (Chair)
Mike Ashley
Martin Evans
Russell Frith
Robin Lynch
Michael Romberg
Martin Sinclair
John Thornton
Maureen Wellen

Miranda Carter
Gillian Fawcett
David Heald
Alastair Matthews
Anne Rylatt
David Thomson
Kerry Twyman
Ken Wild

Secretariat: David Watkins (Secretary)
Sarah Solomon
Chris Ruston

Speakers: Andrew Lennard, Chairman of the Accounting Standards Board's Committee on Accounting for Public-benefit Entities (Item 2)

1. The Chairman welcomed everyone to the meeting. Apologies were received from, Alyson Stafford (who was substituted for by Kerry Twyman), Jeff Tomlinson (who was substituted for by Anne Rylatt) and Trevor Woolley, (substituted for by John Thornton) and Nigel Reader. Gillian Fawcett from the Scrutiny Unit stood in for a parliamentary observer.
2. The Chairman welcomed Andrew Lennard, Chairman of the Accounting Standards Board's (ASB) Committee on Accounting for Public-benefit Entities who was presenting item 2.

Item 1: Minutes of the Last Meeting: Paper FRAB (78) 1 and Matters Arising

3. The minutes of the last meeting were agreed, subject to the following amendments:
 - A new paragraph 42: "Anne Rylatt and Miranda Carter advised that there could be a timing problem for the Department of Health since it would have to await aggregate information on Foundation Trusts from Monitor to be able to prepare the note."
 - In the newly numbered paragraph 43, the second sentence was amended to read "The NAO supported moves to provide more timely information but were concerned that there may be an additional cost falling on both the auditor and the auditee"

- In the third sentence from the end of newly numbered paragraph 51 “controlled” was amended to “control”
 - In the penultimate sentence of paragraph 51 “an administrative” was inserted before “budgetary issue”.
4. There was no further news from the Chief Whip’s Office regarding a Parliamentary Observer, the search will resume after the budget. (Since the meeting Robert Fieello has been confirmed as the new Parliamentary Observer).
 5. The Chief Secretary has agreed to speak at the reception on the 8 May to mark the tenth anniversary of the Board.

Item 2: Presentation on the ASB’s Discussion Paper on accounting for Heritage Assets (FRAB (78)02)

6. Andrew Lennard gave a presentation on the ASB’s discussion paper on Heritage Assets. The Chairman of the FRAB wrote to the Chairman of the ASB in October 2000 expressing the FRAB’s disquiet and suggesting a review of the accounting treatment of Heritage Assets.
7. A sub-group of the ASB’s Committee on Accounting for Public-benefit Entities (CAPE) started a review in 2003 to develop proposals to improve the quality of financial reporting in this area. There was no immediate obvious answer to this issue and the group recognised that requiring entities to report at current value would not be effective. The group started by considering what Heritage Assets are. Some have utility and service potential, for some there is an inalienable argument that they can’t be sold, for some their status as a heritage asset is central to their purpose, but in all cases they are assets. This was conceptually the best approach. The current treatment (whereby in the majority of cases, collections in existence at 1 April 2001 are off balance sheet, and additions to the collections since that date are capitalised at purchase price or donated equivalent) is not popular. The ASB paper proposes that two approaches have to be allowed:
 - The holder of the Heritage Assets should adopt a capitalisation approach for its total holdings, where it is practicable to obtain valuations which are sufficient to assist in an assessment of the value of Heritage Assets held, or if this is not possible, for individual collections with the total holdings.
 - Where it is clear that a capitalisation approach is not practicable, a non-capitalisation approach should be adopted.
8. In either case, notes to the accounts should provide full information to allow the user of the accounts to understand the entity’s holding and management of Heritage Assets. In order to avoid transactions on a collection affecting reporting, acquisitions and disposals of heritage assets in the current reporting period should be reported separately

outside of the income and expenditure account to distinguish them clearly from the financial performance of the entity.

9. The new proposals don't allow historical cost, notional values, cherry picking of assets or expensing acquisitions. The aim is to achieve a consistent approach.
10. The paper also proposes a requirement for better disclosures about Heritage Assets and suggests that transactions involving non-capitalised Heritage Assets might be presented in a new 'statement of change in recognised net assets', which might be part of the primary financial statements. However, some disclosures may be more appropriate in the OFR rather than the note, for example the five year financial summary of activity.
11. The paper defines Heritage Assets. Andrew highlighted the grey areas that the paper sought to clarify such as writer's houses, historic university buildings and corporate art.
12. This is mainly a UK project but the ASB have been collaborating with IPSASB, (who have issued a consultation paper *Accounting for Heritage Assets under the accrual basis of accounting* that includes the ASB discussion paper), comments on the ASB paper are requested by 31 May. Who takes the issues in the paper forward will depend on what needs to be done.
13. David Thomson liked the paper but had concerns about the practicality of implementing the proposals where large collections already exist.
14. Ken Wild also felt that the paper set the issues out well, concentrating on the big issue, ie the approach to take if a decision is made not to capitalise. He felt that accounting had a stewardship role to perform and that the proposals provided a good starting point for this. He recognised that in many cases it would be difficult to capture the backlog.
15. The Chairman summed up. The Board was happy to receive the paper and it has addressed the concerns that the Board had earlier expressed. The Board will respond formally to the paper following a discussion at the 8 May meeting.

Item 3: Assets Valuation and Capital Charging Group (FRAB(78)03)

16. The Treasury gave an update on the Assets Valuation and Capital Charging Group, which had been established to consider the incentives, or otherwise, that capital charging and impairments bring to asset management – in particular the incentives for disposals.
17. The group has focused on the impact the various regimes have on the ability of public sector bodies to manage their estates, looking

particularly at specialised buildings. Many felt that the interaction between the Royal Institution of Chartered Surveyors (RICS) Depreciated Replacement Cost (DRC) guidance with the accounting and budgeting regimes, in certain circumstances, created barriers to good asset management which lead to public sector bodies finding themselves unable to dispose of unwanted buildings or modernise estates because of impairments.

18. The group discussed what it perceived to be the root causes of these issues and sub-groups were created to consider the problems, identify the causes and propose solutions.
19. The solutions fell into three categories:
 - those that required changes to the RICS DRC valuation guidance;
 - those that required changes to the Treasury's budgeting guidance and
 - those that required changes to the accounting guidance.
20. The Public Sector Valuation Group (PVSG) of RICS have independently been reviewing their guidance and its changes are likely to address most of the problems identified by the group.
21. In terms of the Treasury budgeting guidance, the suggestion was that impairments (other than those relating to accidental damage) are scored in Resource Annually Managed Expenditure (RAME) rather than Resource Departmental Expenditure Limit (RDEL). Taking this proposal forward will be difficult because of the potential effects on the golden rule, but the Treasury have undertaken to consider the proposal in detail.
22. The main suggestion made in terms of the accounting guidance was the withdrawal of the requirement to index assets annually between full valuations for the purpose of current cost accounting. The Treasury is happy to consider the proposal in detail, as it might reduce the volatility observed in valuation cycles and relieves the burden that full modified historical cost accounting (MHCA) places on departments. However, the proposal can only be taken forward in the context of the AVCCG's work as a whole.
23. Subgroups to consider the proposed changes in accounting and budgeting guidance have been created. There will be a further progress report at the May FRAB meeting.
24. John Thornton welcomed the effort to reduce the burden on departments but said that care should be taken that departments do not end up with different bigger burdens (eg from professional

valuations). The Treasury confirmed that they had already recognised this issue.

25. While David Heald had sympathy with the need to look at valuation methodology, he was concerned that impairments would not be recognised as a real cost. He also pointed out that this wasn't just a valuation issue and that sometimes renovation was more expensive than building from new.
26. The Secretary expressed his gratitude to departments for their contributions to this group. The group would aim to let the Board have at least some interim conclusions at the FRAB meeting on 8 May.

Item 4: Converging UK GAAP with IFRS: an Update on the ASB's Strategy (FRAB(78)04)

27. The Treasury gave an update on the Treasury's reaction to the developments in the ASB's strategy on converging UK GAAP with IFRS.
28. In 2004 the Treasury decided to follow the ASB's convergence strategy. Some of the original reasons for taking this decision are still relevant, (for instance there is still no single IFRS that corresponds to FRS5, the ASB's standard on reporting the substance of transactions and there are reservations about the EU approach to issues such as concessions). The ASB is currently rethinking its approach and it is likely that it will abandon the phased convergence and adopt a "big bang" approach on or after 1 January 2009. The Treasury is reconsidering its own approach to convergence in the light of this.
29. Mike Ashley outlined the ASB position. It was issuing a further discussion paper. It was keen that it should avoid penalising entities and wanted to ensure that there were no traps within the proposals. The ASB wanted public accountability beyond listed companies, however there was no appetite for change amongst small entities. The ASB itself has mixed views with members preferring either 2 or 3 levels of GAAP. The remit of the ASB doesn't extend to accounting for central government, however it is keen that IFRS should be the ultimate goal for everybody and should be adopted as soon as possible.
30. The Chairman recollected that the Board was disappointed with the Treasury's original decision not to take the lead in adopting IFRS alongside the listed company sector. Ken Wild agreed that he was never comfortable with the previous decision but could understand it in terms of the way in which government departments need to handle big changes. Now that the ASB has decided not to phase implementation, there seemed to be no reason for the Treasury to track it.
31. The Treasury confirmed that there was no question about its commitment to eventually adopting IFRS but that it must consider the best timing for this. For instance, it needs to take into account the CSR

and the effect of changes to information requirements, therefore it is too late to implement for the next CSR but implementation will take place at some point after that. This could mean that government is able to report on an IFRS basis as early as 2008-09, but certainly no later than the ASB timetable.

32. Robin Lynch suggested that we must observe the most current guidance and that time dated boxes could be used in the guidance.
33. The Treasury will return to the Board in May with an update based on what makes sense in terms of government timetables.

Item 5: The Future of the Operating and Financial Review in Government Accounts (FRAB (78)05)

34. The Treasury presented this paper which considered the requirement for the preparation of a management commentary in the light of the removal of the statutory requirement for the preparation by quoted companies of an Operating and Financial Review (OFR). The Treasury proposed that the requirement for a management commentary along the lines of an OFR should be retained and suggested that it be called an Annual Review. The ASB also regard the inclusion of a management commentary as best practice. The proposals have the approval of the Chief Secretary to the Treasury.
35. The Board approved of the decision to retain the requirement but David Heald suggested that a different name should be considered. It was agreed that it should be called the management commentary. It was also agreed that NHS bodies (as they were not directly covered by the FReM) could call it something other than this, if they wished.
36. The requirement to prepare a management commentary will apply for 2005-06 onwards, The Treasury will issue a note to RABIG shortly after the meeting (RABIG 2006(03) has since been issued) and the FReM will be amended to reflect these changes.

Item 6: Update on Salary and Pension Disclosures (FRAB(78)06)

37. The Treasury presented an update on the progress towards getting more comprehensive disclosure of salary and pension entitlements in resource and other accounts. The Cabinet Office wrote to departments in the summer/autumn of 2005 urging full disclosure of the salary and pension entitlements of their senior officials and those in their sponsored bodies. These letters were too late to affect the disclosures in the 2004-05 accounts, but departments have indicated full disclosures in 2005-06. However, the Cabinet Office's remit only extends to civil servants and there appears to be a more mixed picture for sponsored bodies.
38. John Thornton felt that the list of sponsored bodies might be misleading in relation to the Ministry of Defence. He explained that

some of the appointments listed are filled by army personnel on a tour of duty. Miranda Carter asked if Monitor should be on the list. Northern Ireland Civil Service were also excluded from the list, but David Thomson explained how he had written to Accounting Officers there and was expecting full disclosure this year.

39. It was agreed that HMT would write to departmental Finance Directors or Accounting Officers asking them to remind their NDPBs of the requirement for bodies covered by the FReM to disclose salary and pension information. Martin Sinclair noted that there was something of a bandwagon effect, and publicising the disclosure requirements may encourage individuals to come into line with their colleagues (it is unusual for there to be a blanket refusal to disclose).
40. John Thornton said that it would be useful to see the full statistics for non-compliance, ie the total number of bodies as well as those for non-compliance. The Treasury will explore this.

Item 7: Charging for the Cost of Capital: Measurement and Disclosure (FRAB(78)07)

41. At the last meeting in February the Board accepted the usefulness and necessity from the public sector perspective of including the cost of capital charge in financial statements, but asked for further consideration on how the charge should be best described and presented in financial statements. At that meeting David Thomson made a point that if the cost of capital charge increased, then the resources available for other things are reduced and thus there is a real cost to a department. As such, the Treasury believe that this proves that the cost of capital charge is not notional, is a GAAP compliant charge and therefore, there is no need for a change in presentation.
42. On this basis, the Treasury proposed that the existing presentation should be maintained, because the charge has a real effect in practice, and is accepted and taken seriously by departments. The Treasury paper presented three options for the base of the charge:
- i. use the existing base of Total Net Assets (Taxpayers Equity) (this is the current treatment);
 - ii. capital charge based on Total Assets less current liabilities
 - iii. capital charge based on Total Assets less current liabilities, plus long term creditors
43. Some Board members remained unconvinced by the paper. The Board debated the merits of retaining the current treatment (option i) against option iii and whether the charge was indeed GAAP compliant. Ken Wild thought that the charge could be regarded as GAAP compliant if it were regarded as a finance charge. Mike Ashley concurred, but not on

the current basis of presentation. On the base for the charge the main difference in opinion stemmed from the treatment of provisions. There was also a debate over the inclusion of pensions and the perverse results that could result from their inclusion.

44. In terms of presentation Mike Ashley was keen that the charge was linked to a statement (on the face of the operating cost statement) and not hidden in the notes. The Treasury confirmed that, in principle, this was possible and that the MOD was already presenting the charge in this way. John Thornton felt that the calculation should be kept as simple as possible.
45. The Chairman suggested that a small group should be formed to look at this issue. David Heald, Russell Frith and Ken Wild agreed to work with the Treasury to take this forward.

Item 8: Update on Accounting for PFI Projects (FRAB (78)08)

46. The Treasury gave an update on the progress towards bringing about greater consistency in accounting for PFI. Since the last update the Treasury had considered the suggested amendments to Treasury Taskforce Technical Note 1 (TN1) from the National Audit Agencies in order that the technical note might be amended; commenced joint work with the Office for National Statistics on the PFI data collection strategy; continued to monitor work undertaken internationally on service concessions (publication of the final Interpretation is due by the third quarter of 2006) and monitored the ASB stance on its proposed timetable for the adoption of International Accounting Standards and the potential impact on the public sector, including accounting for PFI.
47. The Treasury gave a overview of this work.
48. It has produced a first draft of an amended TN1 but there remain fundamental issues which need to be resolved:
- The potential difficulty from a drafting perspective in understanding how in practical terms the effects of proposed amendments to TN1 may manifest themselves in practice on future auditing determinations and the need to achieve consensus on the practical interpretation of any amendments.
 - Following the consultation, there could be a lengthy process to gain ASB agreement to the proposed changes.
 - It is concerned about amending the existing guidance without taking into account any international developments, as adopted by the ASB, such as the work being undertaken on service concession arrangements.

- It is conscious of the burdens and additional expense that would be imposed on bodies having to revisit the accounting treatments in the light of changes in TN1, especially as there could be further changes with the introduction of new international guidance.
49. The joint work with ONS involves building a comprehensive database of PFI projects (totalling over 800). Until now there have only been relatively small sampling exercises conducted by HM Treasury and the NAO which were limited in scope. This exercise will provide valuable information on the scale of inconsistency for accounting for PFI between the public and private sectors. The exercise is due to be completed this summer.
50. Robin Lynch confirmed that they were pleased with the information that they were gathering in this joint project, that they were making good progress and that they were hopeful that they would have information in July which would reveal the scale of inconsistencies. Ken Wild felt that the survey was useful but there remained barriers to achieving consistency.
51. Martin Sinclair highlighted the practical considerations of the implementation of whole of government accounts in 2006-07 and the need to reconcile the inconsistencies of the treatment of PFI between central government, the health service and local government by that time. Indeed, David Heald feared that these inconsistencies may be a reason to qualify the whole of government accounts. Martin had argued before that the technical note should be abandoned and felt that the differences of opinion between the audit agencies over the technical note had been over emphasised in the Treasury's paper. Maureen Wellen pointed out that the local government SORP had never adopted the technical note and took a straight FRS5 approach.
52. The Chairman was both encouraged and discouraged by the progress made. The survey could reveal the scale of inconsistency but may also raise greater questions. Martin Sinclair highlighted the Board's position. It wanted consistency of treatment, it wanted the guidance amended and agreed, and it was concerned at the length of time it was taking to do this.
53. Ian Carruthers reiterated his concern about revising TN1 in advance of the guidance on service concessions being issued, not least because of the question of resources and priorities.
54. However the Board was not convinced with the arguments for not progressing with the amendment of the guidance at this time, which were similar to those expressed a year earlier. It was worried that the current guidance is not being applied consistently across the public sector. Ken Wild pointed out that the IFRIC interpretation should narrow the options for the private sector so departments should retain some stability.

55. It was agreed that a small working group comprising NAO, the Audit Commission and somebody from the private sector (Ken Wild or Mike Ashley would be able to suggest someone) should meet with HM Treasury to discuss how the technical note might be amended to the agreement of the audit agencies and report back to the Board.

Item 9: Accounting for Financial Instruments – Update re EEA (FRAB (78)09)

56. The Treasury had reported in November 2005 on its strategy for implementation of the new accounting standards for financial instruments in or before 2006-07 by entities that trade in financial instruments, principally the central funds. It was happy to report that one of these funds, the Exchange Equalisation Account (EEA), will be adopting these standards earlier, in 2005-06, through an Accounts Direction.

Item 10: FRAB Report (FRAB (78)10)

57. The report writing group had met. The design of the report was being revised and the report would be publicised more widely. The report is due to be published on 6 June. A revised draft of the report was circulated. Further suggestions were made regarding the draft. The report will be amended as suggested and circulated to the report writing group. The final version of the report will be agreed at the next meeting.

Item 11: Forward Work Programme

58. The agenda for May was tabled at the meeting. The forward agenda will be reconsidered at the next meeting in the light of the convergence programme. The agenda for May will also include a session on the discount rate for pension liabilities.

Item 12: Date of the Next Meeting

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

Monday 8th May 2006
29th June 2006

60. The May meeting will start later than usual (either at 2pm or 2.30pm depending on the likely timings of agenda items. Board members will be notified nearer the time).