

MINUTES OF THE 76th FRAB MEETING HELD ON MONDAY 28th NOVEMBER 2005 AT BROADWAY HOUSE

Present: Elwyn Eilledge (Chair)
Miranda Carter
Gillian Fawcett
David Heald
Peter Morgan
Anne Rylatt
David Thomson
Steve Warren
John Williams
Ken Wild
Martin Evans
Russell Frith
Robin Lynch
Michael Romberg
Alyson Stafford
John Thornton
Maureen Wellen

Secretariat: David Watkins (Secretary)
Sarah Solomon
Chris Ruston

Guest: Ian Carruthers, Director Government Reporting, HM Treasury
(items 1 to 5)

1. The Chairman welcomed everyone to the meeting. Apologies were received from Martin Sinclair (who was substituted for by Peter Morgan), Jeff Tomlinson (who was substituted for by Anne Rylatt) and Trevor Woolley, (substituted for by John Thornton), Alastair Matthews and Nigel Reader. Gillian Fawcett from the Scrutiny Unit stood in for a parliamentary observer.
2. The Chairman welcomed Alyson Stafford to her first meeting representing the Scottish Executive and Maureen Wellen who is joining the Board as an observer for the CIPFA/LASAAC joint committee. CIPFA/LASAAC performs a similar service for Local Authorities as the FRAB does for central government. With the advent of Whole of Government Accounts there is a need for more joint working so that policies align across the sectors. CIPFA/LASAAC already have a central government observer and the FRAB has reciprocated by inviting an observer from the CIPFA/LASAAC joint committee.

Item 1: Minutes of the Last Meeting: Paper FRAB (76) 1 and Matters Arising

3. The minutes of the last meeting were agreed, subject to the following amendments:

- a. Take out the square brackets from the eleventh line of paragraph 6 and
 - b. in the thirteenth line of paragraph 12 “tangible” should be amended to “intangible”.
4. The Chairman wrote again to the Chief Whip on 10 November concerning the appointment of a new Parliamentary Observer. The Scrutiny Unit offered to draft a letter from Alan Williams (Chairman, Public Accounts Commission) to the Chief Whip, if no response was received by the end of the week.
 5. Further information on sustainable development from Nigel Reader was circulated to Board members following the last meeting. A background note on emissions written by Robin Lynch was circulated for discussion at this meeting.

Item 2: Departmental Boundary - ORAL UPDATE

6. Michael Romberg gave an update on the results of the consultation on departmental boundary. The Treasury put a proposal to departments that Estimates should consolidate NDPBs and that resource accounts should show the departmental results and the group results. Under the proposal, Parliament would be invited to vote resources to departments and net resources to NDPBs. The consultation went to NAO and departments. Most departments understood the aim of the proposals: simplification, GAAP consistency. But they mostly also felt that the proposals were not workable as initially specified in the consultation document. The main concerns related to the split of responsibilities of the Accounting Officers of the department and of NDPBs; retaining the independence of NDPBs, as they are brought closer to parliament; and the risk of disrupting the existing faster closing programme for departments. If Estimates were not extended to consolidate NDPBs, no department wanted group accounts on their own, although NAO were in support of this proposal.
7. The Treasury will take away the issues raised in the replies to consultation. Michael was confident that an improved proposal could be found and, in particular, that it would be possible to preserve NDPB independence in the areas where it mattered most and to provide clarity on the relative rôles of departmental and NDPB accounting officers. The Treasury will talk to departments about the issues raised to get to the heart of their concerns. The Treasury will then return to departments with an improved and clearer proposal. However he warned the Board that this would not be a quick process.
8. Ken Wild questioned the concerns about the responsibilities of the Accounting Officer. A parallel could be drawn with the private sector in the case of a major company and a subsidiary. The corporate structure gave a legal responsibility for the subsidiary to be independent. Michael Romberg explained that the issue revolved around the fact that

the departmental Accounting Officer could be seen as having personal responsibility for the final decisions made by the NDPB; it would be important to ensure that the proposal did not lead to a real change in accounting officer responsibilities, so the departmental accounting officer should still be responsible for ensuring that the NDPB had adequate systems, and NDPB accounting officers should continue to be responsible for the spending of the NDPB.

9. David Heald was concerned about the risk the proposals presented to the faster closing programme. He felt there was strong case to postpone the proposals until the faster closing programme had successfully been completed. Mike Ashley felt that NDPBs should also be reporting faster and that this should be tackled at the same time as departments. Two drivers were identified by the Board: the statutory deadline and Whole of Government Accounts. However there were unresolved issues connected with widening the faster closing programme, such as ensuring that there was a sufficient audit capacity. In addition the Treasury had to decide what resources they could make available in order to bring the deadline forward for NDPBs. Ian Carruthers acknowledged that faster closing had to be looked at in conjunction with the boundary issue and confirmed that this was being approached in a coordinated way. He confirmed that the Treasury was looking at faster closing for NDPBs but that the difficulty in terms of faster closing arose because accounts were completed under a variety of acts, unlike departments who were all covered by the GRAA. The deadline for WGA returns can be brought forward to provide a driver, but there is an issue of materiality in WGA returns versus departmental accounts.
10. Michael mentioned that the Treasury would be consulting parliamentary staff informally on this issue, once the consultation with NAO and departments had been completed; if Treasury Ministers decided that they wished to go ahead with the change the agreement of Parliament would be sought formally. Gillian Fawcett confirmed that the Scrutiny Unit would be happy to give informal observations early.

Item 3: FRED 39 Amendments to FRS 12 Provisions, contingent liabilities and to FRS 17 Retirement Benefits (FRAB (76)3)

11. The Treasury presented this paper which included proposals for implementing the changes stemming from FRED 39. FRED 39 proposes to amend FRS12 Provisions, Contingent Liabilities and Contingent Assets, based on the IASB's proposed amendments to IAS37. The exposure draft also includes changes to FRS 17 Retirement Benefits to reflect proposed amendments to part of IAS 19. The proposals reflect the ASB's convergence agenda and arise from two IASB projects: the Business Combinations project and the Short-term Convergence project.

12. The FRED proposes some key changes in accounting standard terminology, as well as some significant differences that will impact central government.
- a. The Exposure Draft emphasises that IAS 37 should be applied to all non-financial liabilities. It refers to 'non-financial' liabilities rather than using the term 'provision', although 'provision' may still be used to describe some classes of non-financial liabilities in financial statements.
 - b. The terms 'contingent liabilities' and 'contingent assets' are no longer applied in the exposure draft. Contractual rights can be divided into two types: 'conditional' and 'unconditional'. The unconditional right or obligation meets the definition of an asset or liability. When an entity recognises a liability relating to the unconditional obligation, uncertainty about the future event (conditional obligation) is reflected in the measurement of the liability.
 - c. As a consequence of this analysis, the probability recognition criterion has been removed. The proposals require the probability of the expected outcome to be reflected in the measurement of the liability rather than as part of recognition.
 - d. Non-financial liabilities should be measured at 'the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time'. The emphasis will be on measurement using expected cash flow.
 - e. The Exposure draft proposes that non-financial liabilities for costs associated with a restructuring should be recognised on the same basis as if they arose independently of a restructuring, namely when the entity has a liability for those costs.
13. The ASB have set out a number of concerns in their response to the exposure draft and as a result have suggested that the introduction of the changes should be delayed in order that more analysis, including testing can be conducted. These concerns were reiterated in a RABIG consultation. The changes would require considerable effort to identify, analyse and calculate and more central guidance on this issue has been requested.
14. The exposure draft also proposes to amend FRS17 to include definitions of termination benefits and to set out the appropriate accounting requirements. FRS17 will be renamed Retirement and Termination Benefits. The ASB have offered an alternative view of when to recognise voluntary termination benefits. Apart from that, it agrees with the proposed amendments.

15. Whenever they are implemented, the proposed changes will have a significant impact in central government. HM Treasury proposes to work with a number of key departments to identify a methodology and approach to provide additional guidance on valuing the additional non-financial liabilities under the proposed new standard. HM Treasury will ask all departments to provide some indicative figures based on this guidance, linked to their closure of accounts for 2005/06, to inform the Comprehensive Spending Review 2007. Departments will then be expected to produce more accurate figures alongside their 2006-07 accounts allowing full implementation for both budgeting and accounting in 2007/08.
16. Mike Ashley said that it was unlikely that the standard will be implemented in 2007. The ASB were currently considering how to proceed with their convergence programme and were contemplating a “big bang” approach with standards being implemented later but simultaneously – the date being discussed was 2009. In addition, Ken Wild pointed out that submissions from the large firms had also been critical of the exposure draft and the likelihood was that the standard would be delayed substantially whatever happened.
17. The Treasury was keen that it was prepared and understood the likely impact of the revised standard, whenever it was implemented, but also there should not be significant extra burdens on departments. Therefore work would proceed in 2005/06 so that the issues could be considered and it could start to look at the prospect of providing additional advice. It would then be ready to respond, whichever way the situation developed. The Board agreed with this approach.

Item 4: PDC – ORAL UPDATE

18. The Treasury undertook at the last meeting to research whether there was any equivalent to PDC in other countries. It had found that there was nothing similar in New Zealand. Australia, currently in the process of completing its first IFRS accounts, have something akin to PDC which they treat in a similar way to the Treasury proposals.
19. Following on from the last meeting, the Treasury had explored whether the term ‘dividend’ could be altered but found no appetite for change.
20. The Board discussed the reasoning behind the decision that was reached at the last meeting. Mike Ashley expressed some reservations. However the Chairman summed up that whilst he acknowledged that not all Board members were entirely comfortable, in general the Board was happy that the previous decision reached was the best solution available.

Item 5: Financial instruments – ORAL UPDATE

21. The Treasury gave an update on proposals for the implementation of FRS 25 and FRS 26.

22. The current strategy for implementation is for the new standards (probably IFRS 7 rather than FRS 25) to be adopted in (or before) 2006-07 by entities that trade in financial instruments, so matching the ASB's requirements for entities that follow the fair value accounting provisions of the Companies Act. This applies to the central funds, for example the Debt Management Account and the National Loans Fund. Of the departments, only the ECGD trades to any significant degree in financial instruments and that is also preparing to implement in 2006/07. The Treasury is in close contact with the entities concerned and is confident that they will implement in line with these plans.

Item 6: Statement of Principles

23. The ASB issued the Statement of Principles for Financial Reporting in December 1999. In May 2003 they issued a discussion paper seeking comments on the application of those principles to public benefit entities. Comments on the discussion paper have been incorporated into an exposure draft issued by the ASB in August. The Treasury has sought the views of RABIG members and departments on the impact of various aspects these proposals and presented the outcome of this consultation in the following papers.

Item 6a: Statement of Principles – General Consultation (FRAB 76(6a))

24. The general consultation sought views on funders and financial supporters as the defining class of user; definitions of the elements of financial statements; presentation of residual interests and disclosure of restrictions over assets, and budgetary reporting.

Funders and Financial Supporters as the Defining Class of User

25. Paragraphs 2.2.3 and 2.2.4 of the FReM refer to funders and financial supporters. It also refers to the fact that general purpose financial statements produced by some of the entities covered by the requirements of the FReM will meet the needs of that defining class of user. In light of this, those consulted agreed that no changes are required to the FReM and this is the Treasury's recommendation. The Board agreed with this proposal.

Definitions Of The Elements Of Financial Statements

26. The Treasury proposed amending paragraph a.b.c of the FReM to replace 'ownership interest' with 'residual interest' in line with the proposed Interpretation. The Board agreed. Residual interest is referred to as 'taxpayer's equity' in the balance sheets of resource accounts. The consultation revealed that some felt that this term was misleading as it implied that funds are available for distribution to taxpayers. The Chairman pointed out that the term was suggested by a previous parliamentary observer to the FRAB. David Heald agreed that the Board had considered this question before but had been unable to come up with a better term. Users were now used to seeing this term

and it had not elicited any enquiries that would suggest that it was misleading to the public. The Board agreed that no change should be made.

Presentation Of Residual Interests and Disclosure Of Restrictions Over Assets

27. The proposals in this area are likely to affect only charitable non-departmental public bodies and public bodies. Full compliance with the exposure draft is required; and Chapter 7 of the FReM should be applied. The proposals will provide a framework for a revised Charities Statement of Recommended Practice (SORP) by the Charities SORP Working Group. Miranda Carter pointed out that Foundation Trusts already have restrictions over getting rid of assets.

Budgetary Reporting

28. The exposure draft suggests that comparison against budget might be part of general-purpose financial statements where it would be useful to users. An exposure draft issued by IPSASB concurs with this view. Separate developments are taking place to include a reconciliation to the resource budget outturn in a department's Operating Financial Review (OFR). This is the subject of a separate consultation by the House of Commons Scrutiny Unit. In the light of the outcome of that consultation it might be appropriate to mandate the production in accounts of outturns against Government budgets for departments and NDPBs and the FRAB will return to consider the issue. Departments are generally comfortable with the proposals in the exposure draft.

Item 6bi: Statement of Principles – Capital Contributions and Capital Grants including Grant in Aid (FRAB 76(6bi))

Capital Contributions

29. The Statement of Principles defines a capital contribution as one which gives rise to a financial interest in the residual interest of a body. There isn't a direct read across, but the proposals in the Statement of Principles have also been used in the discussions over the treatment of grant in aid. The approach taken is that, unless it can be argued that the amounts paid by the department do not give rise to financial interest in the residual interest of the NDPB (ie because they are given in exchange for the supply of goods and services and hence should be treated as income), then they should be regarded as capital contributions and credited to reserves. Commentators from RABIG agreed with this position and the Research Councils aren't pressing their concerns any further. Nigel Reader, who was not able to attend the meeting, sent comments on this paper. He pointed out that there is a fine distinction sometimes over whether grant in aid is paid for a service.

Capital Grants

30. Those who responded to the consultation were less content with the proposals relating to capital grants and felt that they should be credited to reserves and not treated as income, thereby retaining the status quo, which is line with SSAP 4.
31. David Heald had reservations about the Board being seen to agree what he saw as deviating from a deviation from UK GAAP. Ken Wild noted that there are occasions where the Statement of Principles contradicts an extant standard. Until such time as the standard is changed, the standard takes precedent.

Item 6bii: Statement of Principles – Voluntary Gifts (FRAB 76(6bii))

32. The Statement of Principles draws a distinction between services which, had they not been provided voluntarily, would have had to have been purchased, and those that would not. If a body would have had to purchase the services, it should recognise the value of those services, and match it with notional income. The Statement of Principles proposes that an entity should recognise the value of goods provided voluntarily, again matched by notional income.
33. Those who responded to the consultation did not object to the proposals but highlighted a number of issues. In particular, a mismatch between the proposals for goods provided voluntarily with the current treatment of donated assets, the value of which is credited to reserves. In addition, there were differences between the exposure draft and the charities SORP in respect of the treatment of the value of labour provided voluntarily; and it wasn't always clear to what extent an entity would purchase the same level of service if it were not provided voluntarily. As well as that, there were issues with fees and charges in terms of recovering costs that haven't been incurred. In general those who responded felt that the Statement of Principles was over-complicated and questioned why the information could not be given by way of a note.
34. Mike Ashley felt that the proposals in the Statement of Principles were pragmatic. Ken Wild agreed that gifts needed to be recognised but felt that services was a harder area to identify and carried implications for charities

Item 6c: Statement of Principles – Notional Transactions (FRAB 76(6c))

35. The discussion on this subject area didn't cover capital charging as this will be discussed at the next FRAB meeting in February.
36. The consultation found that there was general agreement in principle with the exposure draft. However several of those who replied expressed reservations including from NAO (who believed that there were good economic and incentivisation arguments for retaining the cost of capital charge and believed that these arguments could be

applied to other notional charges such as the audit fee) and DCA (who felt that professional services should be recognised in financial statements as a voluntary service).

37. David Heald felt that, certainly in the case of the audit fee, hard charging was the answer. If this was not possible then it should be accepted that there is a deviation from the Statement of Principles. Peter Morgan didn't think that audit fees should be classed as notional transactions because they related to a real event.
38. As well as audit fees, and the cost of capital charge, David Thomson added that in Northern Ireland central administration was also included.
39. There was a discussion regarding the move to shared services, some of which might be provided on an allied service basis (where one department bore all the costs). Michael Romberg felt that the exposure draft shouldn't get in the way of how the government wants to organise itself, and one had to distinguish transactions where one part of the public sector made services available for free to other parts from gifts received from outside the public sector.
40. Ken Wild questioned whether some of the things currently regarded as notional charges should be categorised as voluntary gifts. Mike Ashley agreed that there was some confusion between the two concepts and felt that this could be highlighted in the Board's response. It was concluded that the audit fee more properly represented a voluntary service rather than a notional cost, and consequently should be recognised in financial statements.

Item 6d: Statement of Principles – Liabilities: Commitments to provide public benefits (FRAB 76(6d))

41. The Statement of Principles also contains proposals in respect of commitments to provide public benefits. There was general agreement with the proposals in the consultation, although the NAO view is that the Interpretation is flawed and that the approach is inconsistent with FRS 12.
42. The exposure draft acknowledges that it can be difficult to identify the point at which a liability arises when it has not stemmed from a contractual arrangement. FRS 5/FRS 12 still need to be carefully applied to determine whether a liability would exist in specific circumstances. The exposure draft gives 'the old age pension' as an example where the promise to pay is a general commitment that does not give rise to a liability until payment becomes due. The conclusion drawn by the Treasury was that further and more in-depth consideration and discussion is required which should take into account work being conducted by IPSASB.

43. Ken Wild and Mike Ashley felt that the Interpretation was a good attempt to address a difficult question (the complications arising mostly around pensions) and was looking forward to seeing further developments in light of the work that was being conducted by the IPSASB.

Item 7: Statement of Principles – Board Response (FRAB 76(7))

44. A draft response to the exposure draft had been circulated four weeks in advance of the meeting. The Board discussed the draft and asked the Chairman and the Secretary to finalised the response taking account of members' comments. (These have been incorporated into the final response which was submitted to the ASB on 1 December.)

Item 8: FRED 36 Business Combinations (FRAB 76(8))

45. The Treasury presented this paper which outlined proposals for implementing changes arising from FRED 36 which has been issued in response to the Business combinations work being taken forward by the IASB. FRED 36 exposes in the UK the IASB exposure drafts amending IFRS 3 and part of IAS 27. FRED 36 proposes the replacement and amendment of several existing standards.
46. The exposure draft proposes the withdrawal of merger accounting; adoption of the entity concept; provides guidance on the measurement of fair value; and amends the measurement criteria for goodwill on acquisition.
47. Combinations involving the public sector rarely involve acquisitions; and the Treasury's paper concentrated on the implications of the withdrawal of merger accounting and the changes to the fair value basis.
48. The FReM requires Machinery of Government changes to be accounted for using merger accounting. Bodies covered by the FReM are considered to be under common control and such changes are viewed as group reconstructions. The proposals on the withdrawal of merger accounting are not extended to entities or businesses under common control. Therefore, other than in exceptional circumstances, merger accounting should continue to be used for machinery of government changes and transfers of functions for entities covered by the FReM.
49. In the public sector, FRS 7 is only used for guidance on the fair value basis for the transfer of tangible assets between public sector bodies where the transfer is not covered by machinery of government changes. The fair value requirements of FRED 36 do not differ greatly from these. Therefore the Treasury proposes to fair value such transfers using the fair value hierarchy in FRED 36 and that the scope should be widened to fair value all asset and liabilities transferred

between public sector bodies but not subject to machinery of government changes.

50. David Thomson highlighted transfers between local government and central government which were causing problems. The Secretary said that the response to Interpretation of the Statement of Principles on Public Benefit Entities could be strengthened to emphasise this point.
51. Maureen Wellen highlighted the fact that under Whole of Government accounts local and central government fell within the same sphere.
52. Mike Ashley felt that it was unlikely that the standard would be issued in the near future.

Item 9: *EC Greenhouse Gas Emissions (FRAB 76(9))*

53. The Treasury presented this item in which the Board was asked to note the accounting implications of the EC Greenhouse Gas Emission Allowance Trading Directive. Since this subject was last discussed by the Board (FRAB 74), there had been an increase in trading amongst public sector entities, although the stock amounted to around 1% of the total held.
54. In view of this, the Chairman confirmed that guidance from the Treasury should be issued.
55. Following discussion with the Canberra II Task Force, Robin Lynch felt that the allowances being traded were tax raising devices rather than intangible assets. Therefore they were relative assets rather than absolute ones. He asked whether he could bring a paper to the Board once the discussions of the Canberra group have been completed. Other National Accountants were considering the scheme. Robin asked whether any consultation had taken place amongst others in the EC. This had not happened since it was felt that the UK was ahead of others in the EC in terms of accrual accounting.
56. The Secretary confirmed that the allowances had been classified as intangible assets since this was how they were classified in the IFRIC 3 draft. The UITF draft abstract left the possibility open to them being classified as either current or fixed assets.
57. Ken Wild pointed out that there was still a mismatch between the international accounting standards and GAAP. The Treasury acknowledged this was the case but the number of government entities trading was low and the prices were not currently volatile. Therefore the advice was to follow the International Standards.
58. Mike Ashley added that there would be a grey market in 2006-07 but that the market would become more relevant in the second phase of the scheme.

59. The Treasury got information on trading through a broker. The Treasury will look at the possibility of adding a link to the FReM website. A worked example will also be made available on the FReM website. The Board agreed that the FReM should be amended to refer to the guidance on the scheme.

Item 10: NHS Foundation Trusts Financial Reporting Manual 2005/6 (FRAB 76(10))

60. Miranda Carter presented this item which included a proposed list of divergences between the NHS Foundation Trusts Financial Reporting Manual and the FReM. The latest draft incorporated comments from NHS Foundation Trust auditors, HM Treasury and the NAO. A short consultation will follow with responses being incorporated after Christmas. The final version of the manual will be released in February 2006.
61. The list of divergences appears shorter than last year, but this is because of the rewording of the FReM. The main change is the requirement to apply fully SSAP 4.
62. NHS Foundation Trusts have fewer divergences from GAAP than the FReM, another example being that they fully apply FRS 15.
63. The Board was content with the list of divergences and approve the NHS Foundation Trusts Reporting Manual.

Item 11: Public Private Partnerships (FRAB 76(11))

64. Robin Lynch had circulated a paper written by a member of the Canberra II Task Force on the proposed treatment of Public Private Partnerships, which incorporated comments from the ONS and HM Treasury. The aim was to identify more accurately what was on and off balance sheet. The ONS has made a commitment to estimate by the summer of 2006 the amount of government debt implied by on balance sheet PFI. The Board was invited to comment on the paper.
65. David Heald pointed out that differences can be due to different auditors and that both government accountants and auditors were subject to institutional pressures.

Item 12: Forward Work Programme (FRAB 76(12))

66. Forward agendas had been circulated. Mike Hathorn from IPSASB would be attending the February meeting and Andrew Lennard from ASB had offered to give a presentation on Heritage Assets at the March meeting. Board members were happy to accept this offer.

Item 13: Any Other Business

67. The Secretary highlighted a Financial Times report that Gordon Brown was to scrap the OFR Regulations and announce a review. The DTI regulations on OFR will be amended to align with the European

Accounts Directive. An announcement will be made in the PBR on 5 December.

68. FRS 28 (previously FRED 35) has been published and the FReM has been updated accordingly.

Item 14: Date of the Next Meeting

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

Tuesday 7th February 2006
Monday 20th March 2006
Monday 8th May 2006