

MINUTES OF THE 82nd FRAB MEETING HELD ON THURSDAY 31st OCTOBER 2006 AT HM TREASURY

Present: Elwyn Eilledge (Chair)
Kirstin Baker
Martin Evans
Russell Frith
Robin Lynch
Owen Mason
David Thomson
John Thornton
Ken Wild

James Drury
Rob Fello
David Heald
Ian Mackintosh
Martin Sinclair
Jeff Tomlinson
Maureen Wellen

Guest: Adrian Chesson (ONS Presentation)

Secretariat: Larry Pinkney (Secretary)
Sarah Solomon
Billie Sidhu

1. The Chairman welcomed everyone to the meeting. Apologies were received from Ian Carruthers (who was substituted for by Maureen Wellen), Miranda Carter (substituted for by James Drury), Christine Daws, Alastair Matthews, Nigel Reader (substituted for by Owen Mason), Alyson Stafford, and Trevor Woolley (substituted for by John Thornton).
2. Since the last meeting, Mike Ashley has stood down from the Board. The Chairman welcomed Ian Mackintosh who has been nominated as his replacement as the ASB nominee.

Item 1: Minutes of the Last Meeting: Paper FRAB (82)01 and Matters Arising

3. The minutes of the last meeting were agreed subject to the following amendments:
 - In paragraph 11 PBR was amended to FSBR
 - In paragraph 14 the first line should be amended to "Martin Evans questioned whether the Board"
4. The Board asked whether the Treasury had followed its request from the previous meeting and informed departments that the FRAB may recommend withdrawal of the Technical Note. The Treasury agreed to follow this up.

5. It was reported that a WGA update would be provided to the Board at the December meeting, and an update on financial instruments would be provided to the Board at the March 2007 meeting.
6. The Treasury had spoken to the Cabinet Office about interim guidance on the Information Commissioner's decision regarding salary and pension disclosures. The Cabinet Office hadn't sent out guidance but had commented that its guidance wouldn't cover all the entities covered by the FReM. The Board agreed that the FReM amendment could proceed but was concerned that the Cabinet Office issue relevant guidance to departments that prior consent would not be sought from individuals.
7. The MOD Annual Report and Accounts, which won the prize "For Telling It How It Is" in the Public Sector in the Building Public Trust awards, had been circulated to Board members.
8. Following the last meeting, the Board's views were fed into a submission on transformational government to the Chief Secretary. He has agreed that www.financial-reporting.gov.uk, which is the home of the FReM, can remain as a stand-alone website.
9. Following the discussion at the last meeting, the Secretary clarified the reasons for the Cabinet Office's re-classification of the FRAB from an ad-hoc advisory group to an internal stakeholder group. The definitions are as follows:
 10. An ad-hoc advisory group is usually only expected to:
 - have a lifespan of less than 2 years;
 - its remit is only usually focused on a single issue;
 - its membership is drawn from individuals in the wider public sector, voluntary organisations, or the private sector;
 - whereas, an internal stakeholder group:
 - does not have a time limit on its lifespan; and
 - its Members are drawn from stakeholder or expert organisations, who send representatives and whose membership is not predominantly comprised of civil servants.
11. He concluded that the re-classification therefore appears appropriate. The Secretary has gained confirmation from Cabinet Office that the FRAB remains a public body, and there is no material effect on the Board as a result of the re-classification.

Item 2: IASB/FASB Convergence

12. Ian Mackintosh gave an update on the progress towards IASB/FASB convergence. He said that there remained differences in the views on either side of the Atlantic in particular in relation to business combinations, stewardship and the discussions on the conceptual framework.
13. Discussions on IAS 37 were imminent and this was a key issue for government. The proposals will do away with contingent liabilities. The ASB will be holding round table discussions on this subject on 30 November.
14. IAS 39 Financial Instruments is on the research agenda and is likely to be simplified.
15. He concluded that the ASB remained committed to convergence and recognised that it cannot remain isolated. However it didn't want convergence for the sake of convergence, therefore it was making slow but steady progress and that the longer standards were proving hard to agree. He commented that it would need to watch the rest of Europe and in particular their responses to eg business combinations and IAS 37 liabilities. He was unsure what would happen if those standards were not endorsed.
16. The Board discussed the fundamental cultural differences between the North American and European approaches (ie rules versus principles).
17. David Heald asked whether it was the case that the views of the US differed from everyone else or whether there were any other significant minorities to consider. Ian said that the Japanese had a similar approach to Europe. Amongst the emerging economies, the opinions of China and India were likely to become increasingly significant in the future.
18. The Chairman thanked Ian for the useful update.

Item 3: IASB/FASB Conceptual Framework Project – IASB Discussion Paper (FRAB(82)03)

19. The IASB issued its Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information* in July 2006, requesting comments by the 3 November 2006. A copy of the Discussion Paper and other relevant papers were circulated to Board members, along with a draft response which focussed on the key issues including treatment of stewardship, the narrowness of the class

of users, the absolute focus on cash flows, the scope of the framework and replacement of 'reliability' with 'faithful representation'.

20. David Heald felt that the paper was of fundamental importance. As they stood, the proposals would make it difficult for the Board to continue to make progress in achieving sector neutral accounting and, indeed, could undo the work that had been done. This could result in the public sector drifting back away from the private sector. Martin Sinclair strongly agreed, reflecting that one of the Board's aims was eliminating the belief that the public sector is different. The discussion paper proposed that not for profit entities (ie including the public sector) will be dealt with in phase G of the project but David felt that they should be considered at the start of the project. Ken Wild also opposed the proposals in the Discussion Paper, and was concerned that the paper directed readers to a particular viewpoint without giving alternatives. Maureen Wellen was disappointed that the concept of stewardship had not been taken on board.
21. The Board was unanimous that it should respond to the paper and agreed with the key issues that the draft response flagged up. The Board felt that cultural differences in the approaches to accounting could be a barrier to getting its viewpoint understood and reaching an agreement. Ian Mackintosh said it was essential that national standards setters continued to talk to each other.

Item 4: ONS Future work on PFI (FRAB(82)04)

22. The Office for National Statistics (ONS) presented this paper. It considered the GAAP accounting treatment for capital assets constructed or improved under PFI or PPP projects which could be scored as both on the private and public entity's balance sheet (known as 'on/-on') or on neither (known as off/off). In National Accounts this should not happen and this potential double counting or omission is an issue for ONS.
23. In September 2006 ONS published the results of its work to produce first estimates of finance lease liabilities, which mainly arise from PFI and PPP projects, in public sector net debt. This was the first phase of its work and as yet the size of the on/on and off/off problem is unknown and the solution is unclear.
24. The ONS had identified reasons for the potential problem:
- GAAP accountants make judgements for the private entity separately and independently from the accountants who make judgements for the public partner
 - PFI/PPP projects are complex and long lasting;

- there are inconsistencies in interpretation of the existing accounting guidance (e.g. between Application Note (AN) G of FRS5 and the Technical Note (TN));
- SNA93 and ESA95 (National Accounts Manuals) do not give guidance on treatment of PFI/PPP projects (although guidance is given in Eurostat's Manual on Government Deficit and Debt).

25. It was difficult to assess the size of the problem for the following reasons:

- there is no complete information about how the private sector has accounted for the capital assets under PFI/PPP;
- there is no comprehensive list of SPVs (Special Purpose Vehicles);
- the approach to obtaining a comprehensive list of SPVs is not clear;
- possible lack of complete data from private partners due to a) ONS survey coverage b) lack of alternative sources;
- SPVs, by their nature, are sometimes difficult to classify.

26. The ONS sought the FRAB's advice and direction on the following proposals:

- it should gather complete information about the accounting treatment of assets constructed or improved/developed under PPP and PFI projects for the private partner for all deals in the UK, but said that it would need help from other public partners to collect this information;
- it will need a full list of Special Purpose Vehicles (SPVs) involved in all projects with details about the primary industry to which the SPV should be classified. ONS will need assistance from government departments including HM Treasury to achieve this;
- once the size of the on/on and off/off problem has been identified the next issue is what to do about it. ONS will need assistance from the accounting community, both national and international and from HM Treasury in order to reflect these assets and any associated transactions correctly in the National Accounts, for which it is not acceptable to have on/on or off/off assets;
- improved consistency between the accounting guidance available on the treatment of PPP and PFI projects and

between national and international guidance could reduce the likelihood of further on/on and off/off issues in the future;

- the possibility of a joined up process between all those accounting for a project - where they communicate and work together to ensure a consistent approach - should be considered. In the event of a disagreement an arbiter would be needed.

27. The ONS recognise that its proposals are complicated and will be time consuming and challenging to implement. It sought the FRAB's confirmation that it had correctly identified the issues and its agreement on the proposals for moving forward. ONS is keen to work with the FRAB and HM Treasury to move forward and to achieve a resolution to this potential problem.
28. The Board agreed the issues identified and discussed further some of the possible reasons for this situation. Ken Wild felt that there was a disincentive for either side to communicate. John Thornton advised that departments didn't keep information about projects where they didn't need to.
29. David Heald asked what the incentive was for the private sector to keep a project off the balance sheet. Ken Wild felt that this was to do with the nature of the deals – ie the risks and rewards of an asset are transferred to the private sector but, because the deals rarely last longer than 25 years, and the asset life is predominantly longer with the purchaser often having a residual interest, it never really has the asset.
30. The first stage of the ONS project had gathered information from the public sector. The Board discussed the problems of gathering information from the private sector. In a previous similar exercise, this had proved difficult.
31. Martin Sinclair felt that the PFI Working Group will provide greater clarity on the accounting treatment that should be used and this might narrow the range of off/off cases.
32. At the last meeting the Board was told that the Working Group had found that differences in professional opinion could lead to projects being considered as off/off (or on/on). (It had addressed this issue through members of the group considering case studies.) Therefore the Board couldn't agree that this would never happen even if guidance were clarified. However some members did feel the number of projects that were currently accounted for in this way was significantly higher than it should be and it was the aim of the Working Group to explore how best to narrow the differences in professional opinion.

Item 5: IFRS 1 First time adoption of IFRS (FRAB (82)05)

33. The Treasury presented this paper which considered the implementation of IFRS 1 *First Time Adoption of International Reporting Standards* in the IFRS based FReM.
34. IFRS 1 deals with the first time adoption of international accounting standards. It requires bodies to prepare a balance sheet (although this doesn't have to be published). It describes how the first IFRS based financial statements should be determined; the key feature is whether statements contain an explicit and unreserved statement of compliance with IFRSs. It will mean that all accounts prepared in accordance with the FReM will need to include an explicit and unreserved statement of compliance with IFRSs.
35. IFRS 1 requires the first set of IFRS based accounts to include IFRS based comparative figures. The Treasury proposed that to avoid complications reconciling figures with those used in previous Estimates and accounts, the first IFRS based accounts should include UK GAAP based comparative figures, unless there are material differences between figures determined on a UK GAAP and IFRS basis.
36. The Chairman asked how it would be possible to tell if this was the case without preparing the comparatives on both bases and asked what the definition of material would be. However some Board members conceded that the advantage of this approach would be keeping consistency of estimates. The Treasury will reconsider the issue, including considering whether the first opening IFRS balance sheets should be published (although there did not seem to be any support for publication within the FRAB), and switching the emphasis in the FReM amendment to one of using IFRS based comparative figures.

Item 6: IAS 20 Accounting for government grants and disclosure of government assistance/ SIC 10 Government assistance – no specific relation to operating activities (FRAB(82)06)

37. The Treasury presented this paper which recommended that IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, should apply as interpreted in the IFRS based FReM. The requirements of IAS 20 are very similar to those of the equivalent standard in the United Kingdom – SSAP 4. The standard only applies to grants that are given in exchange for goods and services, therefore most do not fall within the scope of IAS 20. For completeness, the paper also provided guidance on accounting for grants in aid. As previously agreed, grants in aid should be treated as contributions from controlling parties and credited to reserves. They are to be accounted for on a cash basis for consistency with the current estimates arrangements.

38. The Board agreed that IAS 20 and SIC 10 should be applied in full subject to a minor interpretation to allow grants to be credited to a government grant reserve rather than to a deferred income.

Item 7: IFRS 3 Business combinations (FRAB(82)07)

39. The Treasury presented this paper which recommended the continued use of merger accounting for transfers of functions within the public sector in the IFRS based FReM. This issue was previously considered by the Board as part of ED 36. IFRS 3 *Business Combinations* requires that all combinations are accounted for using the purchase (acquisition) method effectively outlawing the use of merger accounting. However, IFRS 3 excludes from its scope combinations involving business under common control. Public sector entities have long been held to be under such common control. The Treasury therefore proposed that machinery of government changes and group reconstructions continue to be accounted for using merger accounting. This is presented as a scope limitation in the draft IFRS-based FReM text annexed to the paper. David Thomson asked whether machinery of government changes between central government and local government bodies would be considered as merger accounting. Maureen Wellen thought that this wasn't an issue. This proposal will be reviewed once the IASB have finalised Phase II of its Business Combinations project, which will consider the accounting for combinations of entities under common control. The Board was content with the current proposals.

Item 8: IAS 21 The effects of changes in foreign exchange rates/ SIC 7 Introduction of the Euro (FRAB (82)08)

40. The Secretary presented this paper which recommended that IAS 21, *the effects of changes in foreign exchange rates/ SIC 7 Introduction of the Euro*, should apply in full as interpreted in the IFRS based FReM. IAS 21 will be interpreted in the same way as FRS 23 – in that the presentational currency will be the same as the functional currency (ie pounds sterling).

41. The Board agreed that IAS 21 should be applied in full as interpreted.

Item 9: IAS 29 Financial reporting in hyperinflationary economies (FRAB (82)09)

42. The Secretary presented this paper which recommended that IAS 29, *Financial reporting in hyperinflationary economies*, should apply as interpreted in the IFRS based FReM. IAS 29 will be interpreted in the same way as FRS 24 – as all entities covered by the FReM have a functional currency of pounds sterling, HM Treasury will notify classification of hyperinflationary economy if appropriate.

43. The Board agreed that IAS 29 should be applied in full as interpreted.

Item 10: NHS Foundation Trusts – accounting for mergers and acquisitions (FRAB (82)10)

44. Monitor presented this paper, which proposes accounting treatments for mergers between NHS Foundation Trusts and NHS Trusts, and for acquisitions of NHS Trust activities and private sector businesses by Foundation Trusts, to be included in the 2006-07 Foundation Trust FReM.
45. For statutory mergers (under the Health and Social Care Act 2003 (“the 2003 Act”)) it proposed merger by absorption accounting (where reserves and PDC are not combined but are written off/repaid – and new PDC equivalent to the net assets of the new body is issued) – similar accounting is carried out by the NHS. It feels that this treatment best represents the substance of the business combination; that the rules relating to the transfer of PDC and other reserves may preclude any other accounting treatment.
46. When a Foundation Trust acquires an NHS Trust or a private sector business, Monitor considers that this should not fall within the scope of ‘machinery of Government’ changes as it does not meet the FRS 6 criteria for merger accounting, i.e. the initial five criteria within the Standard, or alternatively the ‘group reconstruction’ criteria, based largely on the argument that unlike NHS Trusts, Foundation Trusts have greater freedoms than NHS Trusts to operate and to pursue their own business objectives and are largely free from the control of the Secretary of State for Health. Monitor considers that acquisition accounting should apply in these scenarios.
47. In the rare case of a merger of an NHS Trust’s business with a Foundation Trust (not under the 2003 Act) Monitor proposes merger accounting and FRS 6 will apply in full.
48. Monitor identified three key reasons why they felt that machinery of government changes do not apply to Foundations Trusts, and thus why there should be deviation from the requirements of the FT FReM as opposed to the FReM:
- The transaction may not meet the FRS 6 criteria for merger accounting or group reconstruction
 - PDC may not transfer between NHS Trusts and Foundation Trusts, which means that the strict application of merger accounting would be precluded
 - The transaction will not result in a movement of functions across departmental boundaries
49. Monitor’s proposals would have no impact on NHS or Department of Health Accounts and it proposed that it would give a true and fair view in the Foundation Trust Accounts and Monitor Summarised Accounts

of Foundation Trusts. To the extent that adjustments were made in the individual Foundation Trust Accounts or Monitor Summarised Accounts of Foundation Trusts these may be reversed in the Whole of Government accounts.

50. Some Board members felt that the scenarios suggested were Machinery of Government changes since all the entities concerned were within the WGA boundary and controlled by government. David Heald pointed out that by 2008 all NHS Trusts have the opportunity to become Foundation Trusts and that these proposals would be seen to imply that at that point none of them would be under government control. Robin Lynch pointed out that the proposals could have serious knock on effects in Europe, as the proposals could allow for the movement of debt on and off the balance sheet.
51. Other Board members were more comfortable with Monitor's proposals and felt that Foundation Trusts were different to the rest of government (operating on a commercial basis) and should be able to apply the accounting treatment that best suited.
52. There was a clear split in the opinions of Board members. However, they agreed the application of the accounting treatment was clear and merger accounting should be used where entities are under common control. The question therefore centred on whether there was common control. Under the Health and Social Care (Community Health and Standards) Act 2003, the accounting treatment for Foundation Trusts has to be agreed with the Treasury and the NAO. Treasury confirmed that it viewed Foundation Trusts as being under common control and therefore required Foundation Trusts to apply merger accounting. David Heald was of the view that this issue represented a 'test case' for common control, and the Board agreed that Treasury should present a paper on this at the December meeting, linked to Monitor's proposal.

Item 11: Forward Work Programme (FRAB (82)11)

53. The forward agendas for the FRAB had been circulated. An additional meeting was planned for April. Robin Lynch flagged that he may want to bring a paper on Public Sector Pensions to the February meeting

Item 12: Any Other Business

54. No further issues were raised.

Item 13: Date of the Next Meeting

55. The Board confirmed the dates of the next meetings as:

Monday 11th December 2006
 Monday 12th February 2007
 Monday 19th March 2007