

MINUTES OF THE 74th FRAB MEETING HELD ON FRIDAY 24th JUNE AT HM TREASURY

Present: Elwyn Eilledge (Chair)
Mike Ashley
Gillian Fawcett
Russell Frith
Robin Lynch
Michael Romberg
Martin Sinclair
John Thornton
Ken Wild

Miranda Carter
Heather Foster
David Heald
Nigel Reader
Anne Rylatt
David Thomson
Steve Warren

Secretariat: David Watkins (Secretary)
Sarah Solomon
Chris Ruston

1. The Chairman welcomed everyone to the meeting. Apologies were received from Martin Evans (who was substituted for by Steve Warren), Jeff Tomlinson (substituted for by Anne Rylatt), and Trevor Woolley (substituted for by John Thornton). Alyson Stafford, who will be the new representative for the Scottish Executive. Gillian Fawcett from the Scrutiny Unit stood in for a parliamentary observer.
2. The Chairman welcomed Miranda Carter to her first meeting as the new member nominated by Monitor. This was Heather Foster's last meeting and the Chairman thanked her for her contribution to the Board since its inception. Alastair Matthews from Ordnance Survey will succeed her as trading fund representative.

Item 1: Minutes of the Last Meeting: Paper FRAB (74) 1 and Matters Arising

3. The minutes of the last meeting were agreed, subject to the following amendments:
 - a. Heather Foster will be added to the list of attendees of the last meeting.
 - b. There was an error in the title of Item 9 and also in paragraph 39: This will be corrected to read "Foundation", rather than NHS.
4. The Chairman wrote to the Chief Whip on 26 May regarding the appointment of a new parliamentary observer, but there had been no response to date.

5. The Secretary had received a formal response from the Cabinet Office regarding progress towards getting legislation to put the salary and pension disclosures on to a statutory basis. The response was along the lines indicated at the last meeting. The Chairman's original letter and the Cabinet Office response will be published on the FRAB website.
6. Nigel Reader reported back on the meeting of Research Council representatives that had been arranged by the Treasury. The Research Councils have been invited to present a paper to the Treasury with more detail on justifying accounting for grants and grants-in-aid as an exchange transaction, although no new arguments had been introduced at the meeting. There hadn't been any further progress in reaching an agreement at the meeting, but it was hoped that a middle way could be found, for instance giving money for services on a contractual basis. The Treasury would report any further progress back to the Board in September and again in February/March.
7. At the last meeting the Board had agreed a response to IFRIC's draft Interpretations (12 to 14) on service concession arrangements. It was unlikely that IFRIC would come to an agreed position this year. Responses to the interpretation had been overwhelmingly critical. IFRIC's next meeting is in August.
8. Ken Wild reported that IFRIC have decided to withdraw IFRIC 3.
9. On PFI generally, the Treasury has set up an internal committee to examine in detail the suggestions from the national audit agencies with a view to determining what changes are needed to the Technical Note. The Treasury is due to report back to the Board later in the year.
10. Miranda Carter reported the amendments that had been made to the list of divergences from the Resource Accounting Manual (RAM) for the Foundation Trust Manual for Accounts and Capital Accounting Manual 2004/05. Clinical work in progress had been flagged as an exception. The divergence proposal had been removed. The definition of a capital item was amended to remove the reference to single managerial control.
11. The FRAB Report was published on 8 June and a copy was sent to each member of the Board. The Secretary had received one enquiry from the press, but this had not been followed up.

Item 2: The EC Greenhouse Gas Emission Allowance Trading Directive and IFRIC Interpretation 3 Emission Rights (FRAB (74)2)

12. The Treasury presented this paper which noted the accounting implications of the EC Greenhouse Gas Emission Allowance Trading Directive and IFRIC Interpretation 3 Emission Rights and sought the

Board's approval to the proposed accounting treatment and amendments to the FReM.

13. In April 2002 the UK launched a voluntary Emission Trading Scheme, administered by DEFRA, whereby some participants accepted a cap on their greenhouse gas emissions and in return received tradable emission rights. In January 2005 the European Union Gas Emission Trading Scheme commenced operation. Entities participating are usually set a target to reduce their emissions. The participant is issued allowances equal in number to its cap by a government or government agency for defined compliance periods. Participants can buy and sell allowances and therefore has three options:
 - a. It can limit its emissions to its cap;
 - b. it can reduce its emissions to below its cap and sell (or in some cases carry forward) surplus allowances that it does not require, or
 - c. it can produce emissions which exceed its cap by buying additional allowances for the excess emissions and/or incur a penalty.
14. IFRIC issued an interpretation (IFRIC 3, which has now been withdrawn). The consensus in the interpretation was that a Cap and Trade scheme gives rise to:
 - a. An asset for allowances held,
 - b. A government grant, and
 - c. A liability for the obligation to deliver allowances equal to emissions that have been made.
15. That is, it does not give rise to a net asset or liability.
16. The UITF issued a draft abstract on accounting for emission rights but the UITF had reservations about the different bases for measuring and presenting changes in the component assets and liabilities of the proposed accounting model and the Abstract has not been issued. UITF members felt that applying the Interpretation could lead to some mismatches in profit and loss and that likely changes to IAS 20 and IAS 38 could make the Interpretation redundant.
17. There is currently no UK guidance for the accounting for cap and trade emission rights schemes. The Treasury could delay issuing guidance until the ASB has issued guidance for the UK; or provide accounting guidance for entities observing the requirements of the FReM, prior to guidance being issued by the ASB. The Treasury has already received requests for guidance. The Treasury view is that the concerns of the UITF do not fully read across to accounts prepared under the FReM – mainly because of the way in which changes in value are accounted for

(through government grant reserve, for example). A benchmark is needed, however, against which entities can prepare their accounts and the NAO can audit them.

18. During consultation, the proposals received support from the Department of Health, but Scotland was more cautious about the guidance being issued. Overall, however, the Treasury recommended that guidance be issued.
19. Nigel Reader supported the recommendations. He also felt it would be helpful to have a worked example. He felt that although the market may not be well developed yet, it would establish itself and he was keen that the FRAB should be supportive of its objectives.
20. However some members of the Board had reservations.
21. Russell Frith felt that more information was needed, in particular, to what extent the scheme was up and running.
22. David Thomson was concerned that there may be budget implications. Although the scheme would be budget neutral over five years, there was a chance that there would be switches in the interim years. It was suggested that there could be budget implications, but not ones that would cause problems in the short term. The first impact would be at the end of 2005/06. Russell Frith pointed out that, based on the matching valuations route, the first year that an impact could be expected to be seen was 2007/08.
23. Steve Warren felt that there was unlikely to be an established market at first, therefore guidance was not urgent and the valuation principles were not so important.
24. Mike Ashley was concerned that giving guidance in advance would set a precedent. In addition he was not convinced that there would be many valuation differences because the market was not well developed yet.
25. Robin Lynch expressed the ONS view, which was that this was a disguised tax and subsidy scheme. Under National Accounts it will be entered under total tax revenue.
26. It was agreed that the Treasury could prepare a paper ready for issue, rather than issuing guidance in advance. Departments will need to consider this in November if it will have an impact on budgets. Therefore, the subject will be brought back to the November FRAB meeting, by which time Ken Wild would be able to report if there is a directional statement from the IASB.
27. Ken Wild was happy to advise the Treasury on further developments. Robin Lynch also suggested that he might have useful examples. The Treasury will produce some worked examples in the meantime.

Item 3: Sustainability Reporting (FRAB (74)3)

28. The Treasury presented this paper which considered the issues of sustainability reporting in the annual accounts of government departments and other entities covered by the FReM. It proposed that current reporting arrangements are adequate and that no further amendments to the FReM are required.
29. The question of reporting on sustainability issues has been given more prominence by the need for the Operating and Financial Review to include information on environmental matters and social and community issues and by the publication by CIPFA of a discussion paper *Advancing Sustainability Accounting and Reporting: An Agenda for Public Service Organisations*.
30. The CIPFA report suggests that the public sector is not as advanced in its environmental reporting as the private sector. However a significant number of bodies within central government and several NDPBs currently produce sustainability reports. Evidence suggests that the practice is evolving. The Treasury feels that the FReM goes as far as it can at present, in terms of financial reporting for sustainability.
31. Sarah Solomon had carried out some further research. She reported on the work of the Prince of Wales's Accounting for Sustainability Group, whose report *Realising Aspirations* was launched by HRH at the ICAEW Annual Dinner on 25 May. (Copies of the report were distributed to the Board.) The main focus of the paper was procurement but it also mentioned that sustainability depends on the generation, analysis, reporting and assurance of financial and non-financial information. However, the paper also highlighted the amount of guidance and definitions of sustainability available as a barrier to progress and it was felt that this further supported the Treasury's proposal.
32. Ken Wild supported the Treasury's conclusions. He felt that progress was being driven, at the moment, by those with a particular interest in sustainability and that being more prescriptive (eg in the FReM) could discourage further advances. Further guidance in the FReM should be considered once sustainability reporting has become more widespread.
33. Nigel Reader agreed that sustainability accounting should not be stifled by too many rules at this stage, but he was also keen that the Board should lead the way as much as it could and encourage progress. DEFRA had just published environmental KPIs as part of the OFR. He felt that the subject should be approached with rigour, shouldn't be disassociated from the mainstream and that the Board should return to the subject.

34. Robin Lynch reported that the ONS had been producing environmental accounts for a long time. However these existed as satellite accounts and were very different from financial accounts.
35. Although it was agreed that the FReM was not the right place for any further guidance on sustainability accounting at this stage, the Board was keen to encourage development in this area. This could be incorporated into the OFR and the Practical Examples and Proformas section of the FReM website (www.financial-reporting.gov.uk) should be used to give examples. Nigel Reader agreed to provide examples.

Item 4: Operating and Financial Review (FRAB 74(4))

36. The Treasury presented this paper which proposed amendments to the FReM to reflect the requirements for an Operating and Financial Review. The requirement for quoted companies to include an Operating and Financial Review (OFR) has recently been formalised by amendments to the Companies Act and the publication of Reporting Standard 1 (RS1). Before that the preparation of an OFR, although best practice, was not a statutory requirement.
37. The OFR is incorporated into current arrangements for departments and the annual report for agencies and trading funds, to a large extent mirrors the requirements for an OFR.
38. NDPBs, other than charities and limited companies prepare a foreword that forms part of their accounts. Some also produce an Annual Report either as part of a statutory obligation or voluntarily. In some cases the accounts and Annual Report are presented to Parliament as a combined document, where there is a statutory requirement for an annual Report, if not, the Annual Report may be published separately from the accounts.
39. The proposals will make little difference to entities covered by the FReM with the exception of some NDPBs who are required by statute to prepare an Annual Report covering a period that is not the financial reporting period. In addition, some NDPBs use their Annual Reports as publicity documents and may be resistant to the idea of combining them with the Resource Accounts.
40. The Scottish Executive supported the Treasury's proposal to have different arrangements where legislation provides for the preparation of an annual report covering a different period from that for the accounts.
41. Martin Sinclair was concerned about the mixed messages that this approach would give and was keen that the new arrangements shouldn't be shaped by historical precedent.
42. Mike Ashley felt that entities shouldn't produce an OFR unless it complies with the regulations and that it shouldn't be separate from the accounts.

43. The Board agreed that the document should be called the Annual Report and Accounts. In terms of the proposed changes to the FReM, the following amendments were suggested:
- a. Paragraph 7.2.4 should be clarified or removed.
 - b. A sentence should be added to say that where entities produce other reports, these should be mentioned.
 - c. Paragraph 7.2.11 should cross-reference to the relevant paragraph of RS1.
 - d. Paragraph 7.2.12 should be removed to encourage departments to publish all their information in one place. (The reference to 7.2.12 in paragraph 7.2.13b will also need to be removed).

Item 5: Statement of Principles for Financial Reporting – proposed interpretation for public benefit entities (FRAB 74(5))

44. The Secretary presented this paper which updated the Board on the progress and potential impact on the FReM of the proposed interpretation for public benefit entities of the ASB's Statement of Principles.
45. The ASB have been considering a draft Exposure Draft (ED) which will be finalised on 21 July. The intention is that the ED will be published in September. The Board's views were sought on the areas where general and specific consultation is required. The Board was also invited to agree that it should respond formally to the ASB later in the Autumn, once the Exposure Draft has been published.
46. The Secretary had specific questions in relation to the paper:
- a. **Funders and Financial Supporters as the Defining Class of User.** The Board agreed that there were no further changes required in respect of the defining class of user.
 - b. **Definitions of the Elements of Financial Statements.** The Board discussed whether the reference in paragraph 2.2.1 of the FReM should be changed from "ownership interest" to "residual interest". David Heald suggested that "residual interest" had an economic meaning and that use of the term would create confusion. Ken Wild was concerned about the difference between the public and charity sectors, although Michael Romberg felt that different terms could be used in each sector. The Secretary will consider the matter further.
 - c. **Liabilities: Commitments to Provide Public Benefits.** There was a discussion about the proposals in terms of the text on recognition of liabilities. This was a difficult area and the Board

agreed that the Treasury should be working on this to produce specific proposals on what the proposals in the *Interpretation* mean in relation to liabilities to entities covered by the FReM. Robin Lynch said the National Accounts view of provisions was different. Ken Wild said that the IASB would also be putting forward proposals.

- d. **Presentation of residual interest and disclosure of restrictions over assets.** The Board agreed that the proposals on presentation of residual interest and disclosure of restrictions over assets were only likely to affect charities and that there was no reason not to require full compliance.
- e. **Notional transactions.** The Board was content that the Treasury has started a project on charging for cost of capital and that this would address the proposals regarding notional transactions.
- f. **Voluntary Gifts.** It was uncertain how widespread the application of the section on voluntary gifts would be; it was thought that it applied mostly to the hospital sector. The Treasury would seek specific views on the extent to which the proposals would impact and will consider how best to present them in the FReM.
- g. **Capital Contributions/Capital Grants.** Capital grants and capital contributions would be dealt with as part of the work on grants and grants in aid.
- h. **Budget reporting.** The Exposure Draft is likely to say that comparison against budget might be part of general purpose financial statements where it would be useful to users. Michael Romberg suggested that it would be useful to consider the implications in terms of the public sector and that it would be interesting to see the FRAB imposing this requirement.
- i. **Business Combinations.** The Treasury is considering the impact of changes in FRS 2 on the FReM. The Board agreed that this work should incorporate a consultation on the proposals in the Interpretation.

Item 6: National Accounts: Update (Presentation) (FRAB 74(6))

- 47. Robin Lynch gave a presentation on the SNA 1993 Review. Some of the Revision items are being considered by the International Advisory Expert Group on National Accounts in July. These include research and development; computer software and databases; capital services in the production account; return on capital for government assets; goodwill and obsolescence and depreciation. Robin gave an update on these issues. The Review was also looking at tax credits where the

ONS have an opposing view to the Treasury. The ONS believe that payable tax credits should be recorded on a gross basis in the national accounts, to allow appropriate measures of tax payments and social benefits to be available for policy analysis, and reflect the reality of the economic flows. The Treasury view focuses on the cash payments made under the tax system, and the definition of tax revenues implies that all credits should be netted off, whether payable or not. This subject will also be going to the International Advisory Expert Group on National Accounts in July; the majority are in favour of the split treatment. The Board will be discussing non-exchange revenues in November.

Item 7: Forward Work Programme (FRAB 74(7))

48. The Secretary introduced the paper on the forward work programme which included agendas for the next three meetings. Mike Ashley asked that items on PFI and grants and grants in aid should be at the start of the agenda, rather than the end.

Item 8: Date of the Next Meeting

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

Wednesday 28th September 2005
Monday 28th November 2005