

MINUTES OF THE 84th FRAB MEETING HELD ON MONDAY 12th FEBRUARY 2007 AT HM TREASURY

Present: Elwyn Eilledge (Chair)
Kirstin Baker
Miranda Carter
Simon Fiander
David Heald
Ian Mackintosh
Nigel Reader
Martin Sinclair
John Thornton
Ken Wild

Ian Carruthers
Martin Evans
Russell Frith
Robin Lynch
Alastair Matthews
Peter Ryland
David Thomson
Jeff Tomlinson

Secretariat: Larry Pinkney (Secretary)
Sarah Solomon
Christine Ruston

1. The Chairman welcomed everyone to the meeting. Apologies were received from Christine Daws (who was substituted for by Peter Ryland), Robert Fello (substituted for by Simon Fiander), Alyson Stafford, and Trevor Woolley (substituted for by John Thornton).

Item 1: Minutes of the Last Meeting: Paper FRAB (84)01 and Matters Arising

2. The minutes of the last meeting were agreed subject to the following amendments:
 - In paragraph 6 the second sentence should be amended to read "A working group has been set to look into the desirability and practicality of converging the local authority and central government treatments."
 - In paragraph 7 "those" should be inserted into the first line.
 - In paragraph 11 the penultimate sentence should be amended to "There was also a variety of interpretations of the SORP and the Treasury is working towards a programme of work to address this."
 - "Although different issues apply in different sectors." Should be added to the end of paragraph 12.
 - "auditors" should be amended to "public audit bodies" in paragraph 21.

- Paragraph 31 should be amended to “Ian Mackintosh suggested that the changes associated with the suggested treatment for acquisition accounting wouldn’t have a large effect. Miranda commented that Monitor was aiming to reflect a true and fair view in the accounts of FTs and felt that many transactions between FTs and NHS trusts could have the substance of an acquisition. She requested a divergence from the FReM to allow acquisition accounting at the FT level but commented that this could be adjusted out at the whole of government accounts level.”
- The last sentence of paragraph 39 should be amended to “Anne Rylatt suggested that "other government departments and other central government bodies" in the third paragraph of the draft Annex should be amended to read "other government bodies".”
- The penultimate sentence of paragraph 55 should be amended to read “Anne Rylatt said that, if it was appropriate to treat Lottery grants as government grants in the FT FReM, it was also appropriate for the FReM.”

Item 2: PFI Technical Note Working Group – Final Report (FRAB(84)02)

3. The Secretary presented the final report of the PFI Technical Note Working Group, which had the unanimous support of the working group members. The paper summarised the work of the group, as previously reported to the Board, and outlined its conclusions on its further work related to the implications, should the Technical Note be withdrawn. The paper further provided the group’s conclusions and recommendations on how best to achieve greater consistency in accounting for PFI in the public sector.
4. The working group recommended that the FRAB should advise the Treasury to withdraw the TN at the earliest time, but no later than 2008-09; that the FRS 5 Application Note F (AN) should be the sole source of guidance on accounting for PFI and the FReM should be amended to reflect this; and that the FReM should not contain any interpretative guidance related to the AN.
5. In the context of the working group’s recommendations, and in debating the implications of withdrawing the Technical Note, the group considered several issues including:
 - The timing of the withdrawal of the Technical Note;
 - Whether it would represent a change in accounting policy;
 - The issue of retrospection; and

- Whether the AN would need to be interpreted in the FReM.
6. On timing, the working group concluded that if the Treasury decided to withdraw its Technical Note, then the earliest time from an accounting perspective would be from 2007-08. However, the working group felt that realistically the withdrawal of the Technical Note from 2008-09 may permit the Treasury to better manage the change, by providing adequate lead time for all the necessary work involved. The working group believes the timing for the withdrawal of the Technical Note would ultimately be dependent upon when the Treasury is able to confirm its future policy, and put the appropriate procedures in place to provide the necessary guidance on transitional arrangements for accounting for PFI, although the working group is of the opinion that this should be no later than 2008-09.
 7. The working group concluded that for those public sector bodies that have given preference to the Technical Note in accounting for PFI, its withdrawal, and the sole application of the AN, will represent a change in accounting policy.
 8. The working group concluded that it is for the Treasury to consider how it should approach retrospection, and the mechanisms that would be required to complete the exercise.
 9. The working group considered whether there was any merit in interpreting the AN for the public sector in the FReM, and concluded that it would be both unnecessary and undesirable to do so.
 10. The Board congratulated the working group on producing a high quality report. It agreed that a withdrawal of the Technical Note from 2008-09 was more realistic than from 2007-08, and that there are practicality issues associated with retrospection. Ken Wild cautioned the approach of setting a cut-off date. Robin Lynch was clear that there would have to be retrospection to avoid discontinuity in National Accounts.

Item 3: PFI – HM Treasury Response – Oral Report

11. Kirstin Baker gave the Treasury's initial response. The Working Group report was a serious and wide ranging piece of work, which HMT would want to consider properly. Final decisions on if, and when, to withdraw the Technical Note would rest with Ministers. The report raised a number of issues that HMT would need to consider. As Robin Lynch had stated, any accounting changes would have to apply retrospectively to ensure consistency in National Accounts. On retrospection, the Treasury would need to decide whether to take a high level or project based approach and would want to discuss this with the NAO and departments. In addition there would be issues for local government that would need to be addressed. The Treasury would probably need to issue guidance on how any changes would be made. The proposals also may also raise issues for the private sector that would need to be considered.

12. In terms of withdrawing the TN, 2008-9 was seen as a stretching deadline and anything before that would be difficult given the amount of work likely to be needed in departments and other public sector bodies to implement a change. Whatever the timing of any change to accounting policy, it would take a further period before any revised numbers flowed through to National Accounts as ONS would need to work through information in resource accounts. This work would take time and it would only be possible to assess the fiscal impact, if any, once it was complete.
13. Guidance for the CSR, including on PFI had already been issued and departments were clear how future PFI plans would be assessed. Kirstin said that potential changes in accounting policy would not affect this. Nor would any change in accounting policy have an effect on PFI policy. HMT guidance was clear that decisions on whether to use PFI or conventional procurement must be based on value for money criteria and this would remain the case.
14. HMT believed that FRAB should consider whether to make a recommendation on the TN alongside consideration of the timetable for the move to IFRS. It would be important to avoid a situation where departments were expected to make two consecutive changes to accounting policy in a short space of time. Ministers were already committed to a move to IFRS at some stage and HMT were currently considering whether to set a more precise timetable. The Treasury would come back to the Board with further details on timing next month.
15. Kirstin concluded that any potential changes to PFI accounting policy could take place no earlier than 2008-09 and that FRAB should consider what exactly to recommend on this alongside a consideration of the timing for a move to IFRS. HMT will update the Board at the next meeting along with an update on the timetable for the move to IFRS.
16. Ian Mackintosh asked about the link with IFRS. Although no international standard currently existed which covered public sector accounting for PFI, it might be possible to adapt IFRIC 12, the Interpretation on Service Concessions and work had also started in IPSASB to develop a public sector standard. The Board commented that the scope of the interpretation was narrow and that it was aimed at the private sector. They also discussed the likely progress of the interpretation and how close it was to being adopted by the EU.
17. John Thornton welcomed the proposed consultation with departments but commented that there should be direct communication from the Treasury to departments, as the relevant people may not necessarily be monitoring FRAB minutes for progress. He and other departmental representatives supported HMT's view that change any earlier than 2008-9 would be very difficult to implement.

18. The FRAB concluded that it is minded at its next meeting to advise HM Treasury to withdraw its Technical Note, subject to a further presentation and package of proposals from HM Treasury. The Board conveyed its thanks to the working group.

**Item 4: Asset Valuation and Capital Charging Group
(FRAB(84)04)**

19. The Treasury introduced this paper which presented the outcome of the work of the Asset Valuation and Capital Charging Group (AVCCG) and recommended that Board approve the proposed amendments to the FReM and accompanying guidance on asset valuation.
20. David Thomson reported the issues his department had encountered in 2004 related to the valuations of hospitals. The RICS Public Sector Valuation Group (PSVG) started work in December 2004 on a re-examination of the Depreciated Replacement Cost (DRC) guidance. At the same time, the Treasury formed the AVCCG group comprising accountants and valuers from a wide range of departments including the devolved administrations to look at the impact of the existing accounting requirements for fixed assets and how they impact on entities' behaviours.
21. Following the work of the group. Departments were invited to comment on 5 questions.
- Did they support the removal of the adaptations to FRS 15 in the current FReM, and the proposals to give more freedom to entities in determining the most appropriate valuation methodology to measure the current value of their tangible fixed assets? This was supported.
 - Did they agree that depreciated historical cost might be a proxy for current value for certain non-property assets? If so, did they agree that they, in consultation with their auditors, should exercise professional judgment in determining the significance of the difference between depreciated historical cost and a revalued amount? Departments were generally supportive of this.
 - Did they agree that, in order to reflect the economic reality of government policy, entities should generally be required to value the actual site that they occupy, the exception being where there is a clearly stated, and agreed, policy for relocation to other sites? Despite expecting a degree of dissent, only the Department of Health and the Health sector of Scotland were unhappy with these proposals. Scottish Executive later clarified that this was the view of Scotland in general and not just the health sector.

- Did they support the proposal to disregard the phasing of works and the phasing of payments in a DRC approach and to continue to outlaw capitalisation of the cost of capital charge or any other finance charges? There was general support for this proposal.
 - Did they agree that valuers should take into account sub-optimal working conditions when valuing the actual site that an entity is occupying? This proposal was also generally supported.
22. The treatment of impairments will change under the 2007-08 Consolidated Budgeting Guidance. Those impairments that are within management control will normally score as DEL. All other impairments will score as AME. Revaluation losses arising from movements in market prices and which are taken to the Operating Cost Statement will be scored as AME. The FReM will be amended to reflect this change.
23. Jeff Tomlinson was concerned that in this complex area the change in estimating technique may affect the National Accounts. Jeff was concerned that different valuation methodologies could be used in different locations since this could lead to inconsistency within departments, and he wanted to confirm that NAO would accept this approach. Robin Lynch agreed that this needed further consideration and felt that he needed more time to do this.
24. Martin Sinclair was concerned that it was wrong to think that there were no accounting consequences related to the proposals, for example, on the parliamentary reporting schedule, as well as the affect of the changes in the arrangements for impairments on DEL and AME, and the additional burden on auditors to arbitrate on these matters. He was keen that definitions and guidance should be included in the FReM as well as in the consolidated budgeting guidance.
25. David Heald raised the issue of inconsistent accounting related to impairments, raising the example of what happened at Universities. He questioned whether the supplementary guidance sufficiently addressed the issue. The Treasury confirmed that additional guidance was necessary in order to ensure consistency with the new RICS guidance. This is information that it is not possible to include in the RICS guidance, which has to be internationally relevant.
26. Alyson Stafford had sent comments to the Board Secretary. She did not agree with the proposal for the valuation of specific sites. She also expressed the opinion that the FReM was intended to outline accounting principles, and that it was an inappropriate place to include such guidance.
27. John Thornton was keen for the removal of the adaptations to FRS 15 to take place in order for the MOD to gain greater flexibility and has already agreed this approach with NAO. He recognised that the FRAB

had been presented with an extensive package of changes. He suggested that the Board should agree the proposal to remove adaptations in the FReM and to apply FRS 15 in full, but that it should delay its decision on the guidance. Ian Carruthers endorsed the proposals as a step forward which would enable accountants to become intelligent clients of valuers. He agreed that the Board should agree to some of the proposals (FRS 15) and consider the further issues put raised by the Board at the next meeting. Russell Frith also welcomed a large part of the paper and felt that additional guidance was essential.

28. The Board, although approving the proposed amendments related to FRS 15 (Annex A of the paper), wanted additional time to further consider the remaining proposals, which constituted an extensive package of changes. The Board was invited to submit any concerns that it had on the proposals and submit them to the Board Secretary. The Treasury will re-present the paper at the next meeting, addressing the Board's concerns.

Item 5: IAS 18: Revenue (FRAB (84)05)

29. The Treasury presented this paper which recommended that IAS 18 should be adopted in full in the IFRS based FReM, pending the development of a new international accounting standard on revenue recognition.
30. At the last meeting, the Board had considered a paper on IAS 18 which proposed interpreting the Standard for the public sector context in the IFRS based FReM. However, the Board felt that as IAS 18 relates solely to revenue rather than the concept of profit, an interpretation was not necessary. The Board had suggested that the Treasury should consider IAS 18's comparability with IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers), which was approved by the IPSASB in November, and re-submit its paper. IPSAS 23 follows the same principles, but will be the subject of a separate paper which will be presented to the Board at a later meeting.
31. Board members considered the Treasury's proposal and suggested minor amendments to the draft. Treasury will liaise with Russell Frith to amend the last sentence in the section on Scotland, in Annex A. Peter Ryland pointed out that the National Assembly for Wales would be separate from the Welsh Assembly Government from April, therefore a further amendment of the Annex may be necessary. Ian Carruthers cautioned that it was important to focus on contributions from owners and funding issues.
32. The Board agreed that IAS 18 should be applied in full, and the IFRS FReM proposed amendment be accepted, subject to minor amendment.

Item 6: IAS 23: Borrowing Costs (FRAB(84)06)

33. The Treasury presented this paper which proposed that IAS 23 should be applied in full in the IFRS based FReM, subject to an interpretation, that entities shall not capitalise any finance costs that are directly attributable to the construction of tangible fixed assets, i.e. entities should not capitalise their cost of capital charge, nor any interest costs an entity exceptionally incurs. This is consistent with the interpretation of FRS 15 in the current FReM.
34. In discussion the Board noted that the IASB is undertaking a convergence project considering whether and how to converge IAS23 *Borrowing Costs* and FAS 34 *Capitalisation of Interest Cost*. FAS 34 does not allow for the immediate expensing of borrowing costs and the IASB exposure draft for convergence also removes this option.
35. The Chairman noted that it might be a requirement to capitalise costs in the future. The Treasury proposals reaffirmed current requirements rather than giving them as an option.
36. Ian Mackintosh acknowledged that whilst the current requirements were likely to change, there was no need to plan for these changes until it was confirmed that they would happen. The Board were content with the the Treasury's proposal and agreed that IAS 23 should be applied in full, subject to the interpretation in the IFRS based FReM.

Item 7: IAS 36: Impairment of Assets (FRAB(84)07)

37. The Treasury presented this paper which proposed that IAS 36 should be applied in full in the IFRS based FReM subject to an interpretation and an adaptation. IAS 36 is similar to FRS 11. The differences between the two standards were previously considered by the Board in 2005. Under IAS 36, unlike FRS 11, losses (impairments) wouldn't necessarily be charged in full to the profit and loss account. The current treatment, under FRS 11, incentivises good management behaviour. The Treasury proposed that the IAS be adapted to continue ensuring this good practice, and to achieve consistency between the budgeting and accounting treatment.
38. The Board discussed the proposed adaptation of the Standard and debated whether aligning budgeting and accounting treatments, and ensuring alignment in National Accounts, was a suitable principled argument for agreeing a divergence from the full application of the Standard. The Board acknowledged that in some cases convergence may mean accepting a less good solution. Ken Wild felt that the Board needed to be clear that it was approving a divergence for the right reason. David Heald felt that the Board needed further time to reflect on the issue and would like to revisit the issue at the next meeting. He also asked that the Board discuss this further and clarify its principled position on the circumstances for approving or rejecting divergences from International GAAP.

39. However, Kirstin Baker emphasised the importance of aligning budgeting and accounting treatments where possible and ensuring alignment with National Accounts. Ian Mackintosh agreed that this could be a reasonable argument for accepting the adaptation, depending upon the real reasons, but was not convinced that the arguments in the paper sufficiently supported the proposal. John Thornton added that there were practical difficulties for departments in maintaining different information for accounting and budgeting.
40. Ken Wild thought that this was an example of a Standard which was not so good for the public sector, but believed there could be a different solution to deviating from International GAAP. He would support the proposal, if for the right reasons. Ian Carruthers supported the proposal, which helped get rid of obstacles to the alignment of the frameworks. Martin Sinclair advised that the Board needed to be clear on when it permits public sector divergences.
41. HM Treasury were requested to re-present the paper at the next meeting, although the Board were minded to agree the divergence, subject to its further deliberations.

Item 8: *Charging for the Cost of Capital in Financial Statements – Oral Update (FRAB (84)08)*

42. The Treasury provided an oral update on the Treasury discussions related to the Review on charging for the cost of capital in financial statements. The Board had previously asked the Treasury to form a working group to look at this. The Treasury discussions revealed that a much more fundamental review of the cost of capital charge was needed than originally envisaged and previously discussed with the Board. The timetable for this work is this autumn, following the CSR. The Treasury welcomed the Board's comments, including those on fundamental issues. The three Board members who originally volunteered to join the Working Group (Ken Wild, Russell Frith and David Heald) confirmed that they were content to remain involved. Robin Lynch added that the ONS would be discussing the cost of capital charge at an international meeting at the end of February.

Item 9: *IAS 40: Investment Property (FRAB (84)09)*

43. The Treasury presented this paper which proposed that IAS 40 should be applied in the IFRS based FReM, subject to an interpretation and an adaptation.
44. Under IAS 40 an entity may choose to apply either the fair value model or the depreciated cost model to all of its investment property (with some specified exceptions). SSAP 19 *Accounting for Investment Properties* requires investment properties to be held at open market value. IAS 40 states that gains or losses arising from changes in fair value should be recognised in the income statement. Under SSAP 19, such gains or losses are recognised in the Statement of Total Recognised Gains and Losses (STRGL), unless it is a permanent

deficit (or its reversal), in which case the charge (or credit) is taken to the profit and loss account. The Treasury proposed that IAS 40 be interpreted to require use of the fair value model and that the option of subsequent measurement at cost be withdrawn. This is in line with the interpretation of FRS 15 in the current FReM. An adaptation to IAS 40 is proposed to limit the impact of unrealised gains and losses on profit or loss by adopting an approach consistent with the treatment of property, plant and equipment under IAS 16. Consistent with this adaptation, impairment should be accounted for in accordance with IAS 36 (as adapted). A similar adaptation is also proposed for IAS 41 *Agriculture*.

45. The Board discussed the nature of investment property in the public sector context. They felt there would only be a limited number of cases where the Standard would apply. Ken Wild felt that investment property was different from IAS 16 *Property, Plant and Equipment* and therefore the IAS treatment was correct. Ian Mackintosh disagreed with the argument in the paper that increased volatility, due to the recognition of unrealised gains and losses in the operating cost statement, would not enhance transparency. He suggested that there needed to be careful consideration of what is considered an investment property. He felt that rejecting the adaptation would not lead to much change in the profit and loss account. The Chairman agreed with Ken Wild and Ian Macintosh.
46. The Treasury reported that properties owned by English Partnerships were considered as investment properties and questioned whether adoption of the unadapted standard would be manageable under current budgetary arrangements. Kirstin Baker added that if the Standard was not adapted then this would open up a difference with budgets, which would have to remain aligned with National Accounts. This would unhelpfully add to complexity for departments and reduce transparency.
47. Again, the Board felt a discussion of the principles when the Board may permit adaptation would be useful. Ken Wild felt there was a tendency to compare the new standards to existing requirements. The Chairman reminded that Board that there would be a presentation by the Treasury on National Accounts and budgeting at the next meeting, but felt that it was likely that the Board would reject the proposed adaptation. The paper on IAS 40 would be considered again at the next meeting.

Item 10: IAS 41: Agriculture (FRAB (84)10)

48. The Treasury presented this paper which proposed adapting the Standard for reasons similar to those for IAS 40 *Investment Property*. The Board deferred its decision on the proposal to its next meeting, although it was not minded to agree the proposed adaptation.

Item 11: Discount Rate for Pension liabilities: IPSAS Exposure Draft 31 Employee Benefits (FRAB (84)11)

49. The Treasury presented this paper which proposed that the Board approve the continued use of the AA corporate bond rate for discounting pension liabilities.
50. IPSASB published an exposure draft ED 31 *Employee Benefits* based on IAS 19 *Employee Benefits*. For defined benefit plans, the ED requires an entity to determine the discount rate by reference to a risk-free rate based on market yields at the reporting date on government bonds of a currency and term consistent with the currency and term of the post-employment benefit obligations. Where there is no deep market in government bonds, the discount rate should be determined by reference to market yields on high quality corporate bonds of a currency and term consistent with the currency and term of the post-employment benefit obligations. FRS 17 and IAS 19 require entities to apply a discount rate based on yields on high quality corporate bonds consistent with the currency and estimated term of post-employment benefit obligations.
51. The Board previously considered the issue of an appropriate discount rate for pension liabilities in March 2003. At that meeting, the Board agreed that a rate based on the AA corporate bond rate should be used to calculate the discount rate. At its meeting in June 2006 the Board agreed that the rate should be calculated annually from 2005-06. The Treasury reported that, as a result of the 2006-07 review of the discount rate, a PES paper was issued at the start of February 2007, which changed the discount rate for pensions liabilities to 1.8%, a reduction from the previous rate of 2.8%.
52. The Treasury also presented a draft response to IPSASB from the FRAB related to the Exposure Draft (ED) 31 *Employee Benefits*, particularly related to the proposal to use gilts for discounting pension liabilities.
53. The Board agreed with the Treasury's proposal to continue to use the corporate bond rate, as it was an established market. The Board felt that it was unnecessary for it to respond to the ED.

Item 12: IFRS 4: Insurance contracts (FRAB (84)12)

54. The Treasury presented this paper, which proposed the full application of IFRS 4: *Insurance Contracts* in the IFRS based FReM. IFRS 4 has limited requirements for the recognition and measurement of insurance contracts and more extensive ones for disclosures. Its impact in government is likely to be only that additional information will need to be disclosed by the few entities that issue significant insurance contracts. The Board agreed that the standard should be applied in full.

Item 13: IAS 34: Interim Financial Reporting (FRAB (84)13)

55. The Secretary presented this paper, which proposed that IAS 34: *Interim Financial Reporting* be applied in full in the IFRS based FReM, where applicable. There is no requirement for public entities covered by the current FReM to publish interim financial reports and the Manual is silent on this issue. It is anticipated that entities covered by the IFRS based FReM will not be required to publish interim financial reports, however to cover any eventuality, should entities be required, or elect, to publish interim financial reports, then the Standard will apply in full. The Board agreed the proposal.

Item 14: FRAB Report (FRAB (84)14)

56. The Secretary presented this paper, which asked the Board to confirm that it was content with the general format, topics to be included and skeleton framework for the report. He also invited the Board to identify any additional issues to be included. Last year's subgroup (Martin Evans, Martin Sinclair and Ken Wild) volunteered to participate in the Report Writing subgroup once again. Martin Sinclair suggested that the structure of the report should be revised. Miranda Carter suggested that the report should make a feature of current hot topics. The Secretary confirmed that he would arrange the convening of the Report Writing Sub Group.

Item 15: FReM Amendments (FRAB (84)15)

57. The Secretary presented this paper which summarised FReM amendments for 2006-07. Some of the changes had already been incorporated into the Manual. The rest, including some minor corrections, would be added following the meeting. In addition UITF 41 *Scope of FRS 20 (IFRS 2)* and UITF 43 *The interpretation of equivalence for the purposes of section 228A of the Companies Act 1985* will be added to the list of UITFs as "not applicable". The Board had no comments on the proposed amendments.

Item 16: Forward Work Programme (FRAB (84)16)

58. The Board discussed its forward work programme and noted that it was planned that the complete draft IFRS based FReM would be presented to the Board at the June meeting, prior to the Treasury consulting departments on the Manual over the Summer. The Board noted that the Treasury will give a presentation on budgeting at the next meeting.

Date of the Next Meeting

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

Monday 19th March 2007
 Tuesday 24th April 2007
 Wednesday 6th June 2007