

MINUTES OF THE 77th FRAB MEETING HELD ON TUESDAY 7th FEBRUARY 2006 AT HM TREASURY

Present: Elwyn Eilledge (Chair)
Mike Ashley
Miranda Carter
Gillian Fawcett
David Heald
Alastair Matthews
Martin Sinclair
John Thornton
Maureen Wellen

Kirstin Baker
Martin Evans
Russell Frith
Graham Jenkinson
Anne Rylatt
David Thomson
Kerry Twyman
Ken Wild

Secretariat: David Watkins (Secretary)
Sarah Solomon
Chris Ruston

Speakers: Mike Hathorn, UK Member and Deputy Chair, IPSASB
John Stanford, Senior Manager, IFAC
Ian Carruthers, Director Government Reporting, HM Treasury
Felicia Gillies, Scrutiny Unit

Guest: Ian Mackintosh, Chairman of the ASB

1. The Chairman welcomed everyone to the meeting. Apologies were received from, Robin Lynch (who was substituted for by Graham Jenkinson), Alyson Stafford (who was substituted for by Kerry Twyman), Jeff Tomlinson (who was substituted for by Anne Rylatt) and Trevor Woolley, (substituted for by John Thornton) and Nigel Reader. Gillian Fawcett from the Scrutiny Unit stood in for a parliamentary observer.
2. The Chairman welcomed Ian Mackintosh, Chairman of the Accounting Standards Board, Mike Hathorn, Deputy Chair of the International Public Sector Accounting Standards Board who was presenting items 2 and 3, John Stanford, Senior Manager, IFAC and Felicia Gillies from the Scrutiny Unit who accompanied Gillian Fawcett in presenting Item 6.

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

3. The minutes of the last meeting were agreed.
4. The Chairman wrote again to the Chief Whip on 10 November concerning the appointment of a new Parliamentary Observer. The

Chief Whip's office has now replied, (the original letter was mislaid) and the Chief Whip is looking for a volunteer.

5. The Board's response to the exposure draft on the Statement of Principles was finalised in light of comments made at the last meeting and was submitted to the ASB on 1 December.
6. The 8 May meeting will mark the tenth anniversary of the Board. The meeting will be followed by a reception at the Treasury. Invitations will be sent out shortly.
7. A discussion on the Operating and Financial Review (OFR) had been planned, however this was postponed to the March meeting, following the Government's decision to have a further consultation period. No significant changes are anticipated to the FReM. Entities covered by the requirements of the FReM should continue with their preparations for preparing an OFR - in line with the requirements in the FReM, which removes the need to report against KPIs because departments etc should be talking about PSAs and aims and objectives.
8. Ian Mackintosh added that the ASB had issued a statement to show that it was still strongly backing the OFR.

Items 2 and 3: IPSASB Presentation

9. Mike Hathorn gave a presentation on the work of the International Public Sector Accounting Standards Board (IPSASB) relating to non-exchange transactions and social policies of governments. IPSASB meets three times a year and before each meeting, Mike receives input from the Treasury, National Audit Office and the Audit Commission. He thanked Ian Carruthers and David Watkins for their input to the recent work on Social Policies, SNA Work and Non-Exchange Revenues.

Item 2: IPSASB Exposure Draft Non-exchange revenues (FRAB 77(02))

10. The exposure draft on non-exchange revenues was published on 30 January with 5 months for comment. Mike gave some background on the content of the exposure draft (ED).
11. IPSASB has taken a principled approach and has therefore decided to include taxes within the ED rather than in a separate ED of their own. There is a focus on stipulations within the ED as this is a contentious issue which has caused a lot of debate within IPSASB.
12. There are two main differences between the ED and current practice in the UK. The ED says that tax expenses should be accounted for gross. In the UK, tax credits, which are a tax expense within the meaning of the ED, are reported net. The UK approach is in accordance with OECD recommendations but the view of IPSASB is that the substance of the transaction is that the tax system is used to pay social benefits.

13. The Board found the distinction between tax expenditure and tax expense confusing and felt that IPSASB should look at using more distinctive terms. It supported the principled approach that the ED took, but felt that this supported the current net treatment of tax credits used in the UK rather than a gross approach as in the ED. Mike Hathorn felt that IPSASB had taken the strongest and best way forward.
14. In addition the ED proposes that revenue be recognised regardless of the asset recognised. As such, revenue will be recognised even where tangible fixed assets are donated to government. However, currently in the UK, where assets are provided to the public sector under a non-exchange transaction (other than in relation to a tax debt) the asset is treated as donated. The credit entry is taken to reserves (donated asset reserve) rather than revenue (income). The result being that the benefit from donated assets is taken straight to reserves without passing through the performance statement as envisaged by the ED.
15. In terms of differences between the Invitation to Comment and the exposure draft, the ED had moved closer to the UK position on the issue of donated services, ie recognition of services was permitted but not required. Apart from that, the changes were more refinements rather than full scale changes, eg time requirements were now treated as a form of stipulation, rather than having a separate section.
16. John Stanford said that the standard would be finalised and issued in 2007. The Board agreed that it would respond to the exposure draft and asked for the item to be included on the agenda for 8 May.

Item 3: Update on IPSASB Work On Accounting for the Social Policies Of Governments

17. Mike gave a brief update on IPSASB's work on accounting for the social policies of government. In considering responses to the Invitation to Comment issued in 2004, IPSASB has reassessed its position several times. It has decided to separate social policy obligations into non-age related social benefits, old age pensions and employee benefits. It has also made some decisions of principle, including:
 - 'Staying alive' is no longer an implicit eligibility criteria
 - Present obligations for cash transfers are limited to amounts due and payable at the reporting date
 - Similar principles to be applied to social security pensions
 - An agreed approach to employee pensions for general government employees administered through composite social security schemes
 - Monitoring of proposals for changes in SNA re: pensions
 - Disclosures of projections of costs of cash transfer programmes for current participants

18. Mike commented that discussions at IPSASB were a useful reminder that the UK concern about pensions is not a concern in other countries. He mentioned, eg, that South Africa is more concerned about social policies relating to children.
19. The Chairman thanked Mike Hathorn and John Stanford for their interesting presentation.

Item 4: *Presentation on Whole of Government Accounts*

20. Ian Caruthers gave a presentation on Whole of Government Accounts. All Board members had been sent a copy of “Delivering the Benefits of Accruals Accounting for the Whole Public Sector” which was published with the 2005 PBR. He outlined the benefits of the programme. These included:
 - Greater comparability of financial information across public sector
 - Improved accounts quality and timeliness
 - Better information for National Accounts
 - New aggregate public sector information
 - Improved accountability
21. He outlined the scope of the project and acknowledged the FRAB’s role, through its expanding remit, in bringing accounting guidance together. This was a key factor in achieving consistency and has been strengthened more recently through the introduction the FReM.
22. Initially the programme focus was on developing policies for areas not already reported on a GAAP basis such as tax, and on the expenditure side including employee pension schemes and debt and reserves. There was a lot of debate on these issues when the policies were being implemented. There have been further moves from cash to accruals which have meant that we now have firm public sector scheme liabilities and accruals accounts for all the material areas of central government income and expenditure.
23. Ian explained how GAAP data was being used in National Accounts. He also described the accounting policies for areas outside the FRAB remit such as local government and public corporations other than trading funds.
24. He also drew the Board’s attention to the way in which the different measures of fiscal sustainability fit together. The easiest measure is the national accounts measure of debt. This means that debt is easily understood and interpreted, can be produced quickly and easily and is a responsive indicator suitable for use in medium-term fiscal frameworks, and it is therefore the fiscal aggregate used in the Government’s sustainable investment rule. Accruals based balance sheets provide another indicator, and increase the scope of the assets

and liabilities taken into account, and are published with useful additional information such as contingent gains and liabilities. Comprehensive projections attempt to incorporate all future spending and revenue, and therefore try to deal directly with the issue of long-term sustainability, namely the Government's ability to meet its obligations if and when they arise in the future.

25. Balance sheet data for 31 March 2007 is planned to be the first WGA information to be published. This first balance sheet data for the whole public sector is likely to take about a year to produce.
26. David Heald felt that there was an important issue of educating readers of the accounts to ensure that there weren't any misplaced fears in issuing the first balance sheet. The Treasury confirmed that it was working on how the first balance sheet would be presented. The Secretary asked if there were any plans to produce something on how to read government accounts to accompany the first balance sheet. Ian Carruthers confirmed that he had seen something similar from the USA. Mike Hathorn agreed that this was a good approach; IPSASB have recognised that explanation and reporting is an important issue.
27. John Thornton asked about the agreement of balances and transactions. Ian felt that this was a process problem arising from the initial system set up, and was not specifically a Government issue. It was important to get the message about the need for agreement as part of good financial management across.
28. Gillian Fawcett asked about the effect that demands on departments would have on the quality of accounts. Ian replied that departments were laying their accounts earlier with fewer qualifications. Departments would need to ensure that they had good in-year processes and this would reap good benefits throughout.
29. Graham Jenkinson pointed out that National Accounts already exist and, although the presentation is different, it should mean that the first whole of government accounts balance sheet held few surprises.

Item 5: Charging for the Cost of Capital in Financial Statements (FRAB 77(05))

30. The Treasury presented this paper which, in response to the Board's discussion in September, gave more detail on what the cost of capital base is and does, and alternative ways of presenting it in financial statements to make it as UK GAAP compliant as possible.
31. There are a number of ways in which pension costs impact on liabilities and therefore cause inconsistencies in terms of the cost of capital:
 - Major unfunded schemes, such as the Principal Civil Service Pension Scheme are reported in separate scheme statements where there is no recognition of a cost of capital credit on net pension liabilities.

- Wholly unfunded pension schemes where pension costs are met entirely on a pay as you go basis. These bodies generally have net liabilities and by including the pension liability in the calculation for the cost of capital it results in a continual cost of capital credit within their individual financial statements.
- A number of central government bodies are members of the Local Government Pension Scheme (LGPS) for some or all of their staff. This is a funded scheme administered as separate schemes by administering authorities. Most of these schemes are in deficit. The schemes are able to identify the share of assets and liabilities of each employer and accordingly are treated as defined benefit schemes in resource accounts. In accordance with the FReM bodies should include their share of the net deficit of the pension scheme in the cost of capital calculation in the accounts (and by implication in their budgets), although in practice this does not always occur due to the problem of volatility in assets. Any net deficit attracts a cost of capital credit.

32. The Treasury presented four options.

- i. Retain the existing presentation in financial statements.
- ii. Reverse the cost of capital charge in financial statements.
- iii. Exclude the cost of capital charge and disclose it in financial statements, eg by boxing figures, for administrative purposes only.
- iv. Include a disclosure of cost of capital charge by way of Note to the accounts only.

33. FRAB representatives from departments were generally in favour of retaining the charge. The purpose of the accounts was to provide accountability. Removing the cost of capital charge would mean leaving a large element out of the operating cost statement. The cost of capital is voted by parliament and is taken out of an entities budget so is there is no doubt that departments treat it as a real cost. This was reinforced by the fact that cost of capital continued to be part of the budgetary framework. Users of the accounts are used to seeing the cost of capital charge. If it was removed it could give the impression that net operating costs had gone down.

34. David Heald and Ken Wild also supported the charge because it communicated information that was useful to the users and prevented entities from incurring unnecessary costs by holding capital items that they didn't need. The private sector achieved this through self-regulation, therefore didn't need this device.

35. There had been debate previously on whether hard charging would be appropriate but it was agreed that it causes considerable practical problems and it was noted that departmental accounts are drawn up with reference to GAAP but not to meet GAAP. John Thornton agreed that hard charging was an unnecessary step: departments already took the charge seriously and this would provide no further benefits.
36. Mike Ashley explained that the charge was used in the private sector to see if an appropriate return was being made. He also noted that pension liabilities were discounted so he couldn't see why the cost of capital charge was being paid in addition. He felt that the cost of capital charge was a management tool with arbitrary figures and no cash flow associated with them. Ian Mackintosh asked whether another department showed a credit to balance the charge.
37. The Chairman felt that the Board's decision on this matter should continue to support what the users of the accounts and departments found most useful. The Chairman suggested that the cost of capital charge could be at the end of the operating cost statement, but separately identified.
38. The Board agreed that the charge should left in. The Treasury will produce a further paper recommending an appropriate disclosure format for the cost of capital charge.

Item 6: *Resource Accounts: Reconciliation of Estimates, Budgets and Accounts*

39. The Scrutiny Unit gave a presentation reporting the results of their consultation on the proposal to include in resource accounts a reconciliation between resource accounts and resource budgets and estimates. All select committees review resource accounts on a cyclical basis.
40. The Scrutiny Unit consulted interested parties on four options for reporting a reconciliation of the Resource Accounts to the budgets:
 - i. Including a note to the accounts
 - ii. Including a reconciliation in the Operating Financial Review
 - iii. Publish with the Autumn performance report
 - iv. Do nothing
41. Option (i) would give access to audited budgetary information on a timely basis; it was the next natural step in the existing reconciliations, so would not be burdensome to calculate in most cases and may result in improved financial management.
42. Anne Rylatt and Miranda Carter advised that there could be a timing problem for the Department of Health since it would have to await

aggregate information on Foundation Trusts from Monitor to be able to prepare the note.

43. The NAO supported moves to provide more timely information but were concerned that there may be an additional cost falling on both the auditor and the auditee. Another concern was that there was currently no central guidance giving a framework for interpreting Treasury's consolidated budgeting guidance when preparing and auditing the reconciliation.
44. Option (ii) would provide more timely information than the status quo. It was also in line with other requirements for reporting variances in the OFR. This was the NAO's preferred option. However, this option would mean that the budgets would not be subject to the same level of scrutiny as accounts.
45. Parliamentary users commented that Option (iii) was less preferable because of the timing of the Autumn Performance Report and the fact this option would mean that information would be dispersed further rather than being consolidated into a single source.
46. All those consulted recognised the parliamentary desire for budgetary information in order to improve the level of scrutiny that users can apply to evaluate a department's financial management and achievement of targets. Therefore, none of those consulted favoured Option (iv).
47. The consultation also highlighted the fact that there needs to be consideration of what happens if departments exceed their budget limits. This is currently a grey area. In addition, the move to international auditing standards may provide a better framework for auditing eg budgets.
48. NAO supported the option of including budgetary reconciliations in the OFR and the Scrutiny Unit recommends that it is included there from 2006-07, with a view to more detailed guidance on its future inclusion within the resource accounts being developed by the appropriate bodies.
49. Martin Sinclair said that while the demand for information must be met, and he supported parliament's right to this information, the costs and benefits must also be understood, as well as consolidation and boundary issues for NDPBs. He confirmed that the NAO believed that including the reconciliation in the OFR was the best option. The NAO audits against externally provided guidelines and would not be able to make any allowances for changes in budgetary practice.
50. Ian Carruthers confirmed that the Treasury has addressed this issue and that consolidated budgetary guidance has been issued.

51. John Thornton had no problems with the preferred option. The figures would be taken just as seriously in the OFR as if they were in the narrative. He felt that problems could arise with the audit in having information in the notes. He was concerned that flexibilities at the year-end mean that departments will have to be careful that they don't get qualified because they have overspent against a control total. However Martin Sinclair reassured him that the NAO would not be able to qualify on the basis of an administrative budgetary issue. John agreed that the OFR should be used as a first step.

52. The Board approved option (ii).

Item 7: FRAB Report (FRAB 77(07))

53. A skeleton draft of the report was circulated. Martin Evans, Martin Sinclair and Ken Wild agreed to join the report writing sub-group. A meeting will be arranged before the next FRAB meeting in March, when a fuller draft will be circulated. The meeting has since been arranged for 15 March. Some suggestions were made regarding the draft. The Board agreed that a photo should be included.

Item 8: Forward Work Programme (FRAB 76(08))

54. Forward agendas had been circulated. Andrew Lennard from ASB has offered to give a presentation on Heritage Assets at the March meeting. Board members were happy to accept this offer.

Item 9: Any Other Business

55. The secretariat would contact Board members to confirm a date for the July meeting. (This has since been confirmed as 29 June.)

Item 10: Date of the Next Meeting

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

Monday 20th March 2006
Monday 8th May 2006