

**8th REPORT  
OF THE  
FINANCIAL REPORTING ADVISORY BOARD**

*April 2004 to March 2005*



## **FINANCIAL REPORTING ADVISORY BOARD**

### ***Report for the period April 2004 to March 2005***

*This report of the Financial Reporting Advisory Board has been prepared in accordance with Section 24(3) of the Government Resources and Accounts Act 2000 and*

*Section 20(2) of the Government Resources and Accounts Act (Northern Ireland) 2001*

*Presented by the Treasury to the House of Commons (the Committee of Public Accounts and the Treasury Select Committee) pursuant to Section 24(4) of the Government Resources and Accounts Act 2000*

*Laid before the Northern Ireland Assembly under Section 20(3) of the Government Resources and Accounts Act (Northern Ireland) 2001 by the Department of Finance and Personnel*

*The report is laid before the Scottish Parliament and presented to the Audit and Finance Committees of the Scottish Parliament by agreement with the Scottish Ministers*

*The report is laid before the National Assembly for Wales by agreement with Assembly Ministers*

*Ordered by the House of Commons  
to be printed 8th June 2005*

**FINANCIAL REPORTING ADVISORY BOARD  
REPORT FOR THE PERIOD APRIL 2004 TO MARCH 2005**

## CHAIRMAN'S FOREWORD

I opened my Foreword to last year's Board report by saying that government accounting practices have been increasingly in the spotlight over recent years. This is a natural consequence of the move to resource accounting. Now that government accounts are prepared under UK generally accepted accounting practice, the accounts themselves are increasingly coming under scrutiny – not least by the various Select Committees of the House of Commons. But resource accounts do not always contain all the information needed to hold public servants to account for their actions.

Company directors are required under companies legislation to provide in the notes to company accounts details of their remuneration packages – including salaries and fees, bonuses, and changes in accrued pension benefits. Senior public servants, on the other hand, can elect not to provide the same information in the notes to government accounts – citing the Data Protection Act and even the Human Rights Act. Those who shelter behind legislation in this way are, in my view, harming the reputation of openness and transparency in public sector accounting.

Parliament and the taxpayer ought to know as much about the remuneration of senior public servants, who are entrusted with the stewardship of enormous sums of money, as they do about company directors. Indeed, parliamentary Select Committees are particularly interested in the information during a time when the civil service is required to produce significant efficiency savings. But they will not have full details of all remuneration packages until such time as public servants are forced to do what their private sector counterparts do. As noted in this report, the Board has pressed for this situation to be remedied since 1996. The Directors' Remuneration Report Regulations, which came into force in 2002, have given added impetus to aligning fully the public and private sectors. Letters of appointment for senior civil servants in departments and agencies now include, as a condition of appointment, a requirement that the necessary disclosures are made in resource accounts. I am pleased that the situation here has improved, and look forward to the time when other public bodies demonstrate the same improvements.

I am pleased that the Treasury has made some progress in addressing the Board's concerns about the accounting treatment of assets under the Private Finance Initiative, although in practice there is a long way to go before we

achieve the consistency of treatment we seek. The International Financial Reporting Interpretations Committee has also entered the debate and, while I am not yet sure that the draft Interpretations will answer all the questions, it does indicate the degree of seriousness with which the accountancy community treats the issue.

Finally, I would like to record my – and the Board’s – thanks to the Secretariat for the continuing work each of them does to ensure that the Board’s work programme is completed, and meetings run smoothly. In particular, I would like to thank Sue Gamble, who served in the Secretariat from its early days. The Board wishes her well in new role in the Treasury, and welcomes Sarah Solomon to the Secretariat.

## EXECUTIVE SUMMARY

This is the eighth report of the Financial Reporting Advisory Board (the Board). It is addressed to the Committee of Public Accounts and the Treasury Select Committee in the Westminster Parliament, to the Northern Ireland Assembly, to the Scottish Ministers and to the National Assembly for Wales. The report, for the period April 2004 to March 2005, discusses the application to the public sector of new accounting standards issued by the Accounting Standards Board (chapter 2), other key issues considered by the Board (chapter 3), guidance on financial reporting (chapter 4) and looks ahead to what the Board expects to consider in the coming year.

An independent body, the Board exists to promote the highest possible standards in financial reporting by government. Its remit extends across the whole of the United Kingdom and covers the accounting guidance for departments, agencies, non-departmental public bodies and trading funds, and influences the accounting guidance for NHS Trusts and, from December 2004, Foundation Trusts (paragraphs 1.4 to 1.6).

The Accounting Standards Board issued eight new standards in 2004. Of most significance for the public sector are the new accounting standards on financial instruments. FRS 25 (IAS 32) *Financial instruments: disclosure and presentation* and FRS 26 (IAS 39) *Financial instruments: measurement* (paragraphs 2.12 to 2.14) are complex for any sector. The Board would not normally consider complexity of application a reason for deferring implementation of accounting standards and best practice in line with the listed company sector. In this case, however, the Board recognises that the circumstances of government, which are discussed in paragraphs 2.15 to 2.20, are such that departments and other entities need adequate time to resolve the complexities. The Board makes it clear (paragraph 2.23) that it expects the Treasury, departments and other entities to ensure that the complexities are resolved in time for the standards to be implemented from 2006-07.

The Board continues to take a keen interest in the accounting treatment of projects financed by the Private Finance Initiative. The Board notes that the Treasury has made some progress in removing some of the obstacles to consistent accounting for these projects (paragraphs 3.3 and 3.4). But the

Board is disappointed that the Treasury has not made the progress promised in the Board's last report: the suggestions for amendments to the Treasury's *Technical Note 1: How to account for Private Finance Initiative Transactions* have not yet been considered. The Board expects the Treasury to report progress by summer 2005 (paragraph 3.5). The International Financial Reporting Interpretations Committee (IFRIC) issued in March 2005 three draft Interpretations of international accounting standards in relation to accounting for service concessions (paragraphs 3.6 to 3.8). Given its interest in accounting for this type of arrangement, the Board will consider the drafts and respond to the IFRIC.

The Board is disappointed that the Treasury has still to complete its work on aligning the resource accounting and budgeting boundaries, which would bring non-departmental public bodies within the resource accounting boundary (paragraphs 3.9 to 3.11).

The Board has expressed many times its disappointment at the failure to remove the legal impediment to requiring full disclosure of remuneration by senior managers of some public sector bodies. The Board believes strongly that the public sector should be at least as open as listed companies in its reporting of the remuneration packages of senior public servants. It notes that the situation with senior civil servants in departments and agencies has improved, but that the extent of disclosure by senior public servants in other entities needs clarification (paragraphs 3.18 to 3.23).

Corporate governance is another area where it is important that the public sector is open in its reporting. The Board has previously welcomed Treasury initiatives to improve corporate governance. But it is disappointed that the Treasury did not take the opportunity provided by the 2004 review to move beyond a consolidation of existing guidance (paragraphs 3.24 to 3.26).

The Board approved the new Government Financial Reporting Manual, which applies across the United Kingdom from 2005-06 and replaces the separate guidance for departments, non-departmental public bodies and trading funds. The new Manual is a major step in demonstrating that the principles of UK GAAP underpin the accounts of central government (paragraphs 4.2 to 4.9).

During the next reporting period, the Board will consider further amendments to accounting standards both as part of the process of convergence with international accounting standards and in the light of amendments to companies legislation (paragraphs 5.2 to 5.7). There are other important developments in financial reporting in which the Board takes a keen interest: accounting for heritage assets (paragraphs 5.9 to 5.11), the proposed interpretation for public benefit entities of the Accounting Standards Board's *Statement of Principles for Financial Reporting* (paragraphs 5.12 and 5.13), and the work of the International Public Sector Accounting Standards Board on accounting for non-exchange transactions and for the social policies of government (paragraphs 5.14 to 5.16).

One of the more recent developments in company reporting is the increasing pressure on companies to report on the way their actions impact on sustainable development, and the Board will consider how sustainability accounting and reporting might be incorporated into central government's reporting requirements (paragraphs 5.20 to 5.22).

**FINANCIAL REPORTING ADVISORY BOARD  
REPORT FOR THE PERIOD APRIL 2004 TO MARCH 2005.**

## CONTENTS

Chapter 1: Introduction	
What is the Financial Reporting Advisory Board?	1.1
The Board's role has evolved	1.4
The Board is independent of the Treasury	1.7
Membership of the Board	1.9
How the Board works	1.14
Chapter 2: New accounting standards	
Introduction	2.1
Convergence strategy	2.5
Convergence in 2004	2.8
Chapter 3: Other issues considered by the Board	
Introduction	3.1
Compliance with generally accepted accounting practice	
Private Finance Initiative	3.2
Service concessions	3.6
Departmental boundary	3.9
Grants and grants-in-aid	3.12
Other financial reporting issues	
Salary and pension disclosures	3.18
Corporate governance	3.24

Chapter 4: Guidance on financial reporting	
Introduction	4.1
Format and content of accounting guidance	
Existing guidance	4.3
The Government Financial Reporting Manual	4.6
Format and content of resource accounts	4.10
Chapter 5: Looking ahead	
Introduction	5.1
Convergence	
Amendments to UK GAAP in 2005	5.3
Other developments in financial reporting	
Heritage assets	5.9
Statement of Principles for Financial Reporting – Proposed Interpretation for Public Benefit Entities	5.12
Revenue from non-exchange transactions	5.14
Accounting for the social policies of government	5.15
Valuation of assets	5.17
Other developing issues	
Sustainability accounting and reporting	5.20
Annex 1: Financial Reporting Advisory Board Terms of Reference	

## INTRODUCTION

### ***What is the Financial Reporting Advisory Board?***

- 1.1 The Financial Reporting Advisory Board (the Board) exists to promote the highest possible standards in financial reporting by government and to help to ensure that any adaptations of, or departures from, generally accepted accounting practice (GAAP) are justified and properly explained. The Board was first established by the Treasury in 1996 and now fulfils the statutory role<sup>1</sup> as the 'group of persons who appear to the Treasury to be appropriate to advise on financial reporting principles and standards'. The Board's terms of reference are set out in the Annex to this Report.
- 1.2 The Government Resources and Accounts Act (Northern Ireland) 2001<sup>2</sup> mirrors the requirements of the Government Resources and Accounts Act 2000. It requires Northern Ireland departments to prepare resource accounts in accordance with directions from the Department of Finance and Personnel, and for that department to consult an appropriate group of persons. The Board was pleased to be asked to fulfil this statutory role for Northern Ireland.
- 1.3 The 2000 Act requires the Board to prepare a report summarising its activities for that year and dealing with any other matters as the Board consider appropriate. The Treasury is required to lay the report before the House of Commons and, although the Northern Ireland Assembly is currently suspended, the Board's report is still required to be submitted to the Assembly under the provisions of the Northern Ireland legislation. Scottish Ministers have agreed to lay the report before the Scottish Parliament, and Assembly Ministers have agreed to lay the report before the National Assembly for Wales. The report is addressed to the Committee of Public Accounts and the Treasury

---

<sup>1</sup> Section 24 of the Government Resources and Accounts Act 2000. The Act can be obtained from the Stationery Office or can be found at [www.legislation.hmsso.gov.uk](http://www.legislation.hmsso.gov.uk)

<sup>2</sup> The Government Resources and Accounts Act (Northern Ireland) 2001 is available from the Stationery Office or can be found at: [www.legislation.hmsso.gov.uk](http://www.legislation.hmsso.gov.uk)

Select Committee in the Westminster Parliament, to the Northern Ireland Assembly, to the Scottish Ministers and to the National Assembly for Wales.

### ***The Board's role has evolved***

- 1.4 The Board's main focus is on examining proposals for amending current, or implementing new, accounting policies in the accounting guidance for departments and executive agencies (in the *Resource Accounting Manual*<sup>3</sup> and the *Northern Ireland Resource Accounting Manual*<sup>4</sup>), and the separate guidance for executive non-departmental public bodies and trading funds. The Board also advises the Treasury on the implementation of accounting policies specific to Whole of Government Accounts.
- 1.5 Since 2001, the Board has accepted invitations to extend its coverage to National Health Service Trusts and Boards in England, Wales and Northern Ireland and also to advise Scottish Ministers, where they are responsible for issuing reporting requirements, on the technical rules of accounting and minimum disclosure requirements.
- 1.6 During the current reporting period, the Board's remit has once again been extended to cover NHS Foundation Trusts and a nominee from Monitor (the Independent Regulator of Foundation Trusts) has been appointed to the Board.

### ***The Board is independent of the Treasury***

- 1.7 The Treasury hosts the Board's meetings, provides a small Secretariat and bears the minimal costs of the Board. Such arrangements do not compromise the Board's independence and, indeed, are common to nearly all such groups and to advisory non-departmental public bodies across Government. As an independent body (recognised as such by both the Cabinet Office and the Office for National Statistics), the Board has been added to the list of bodies in Schedule 1 of the Freedom of Information Act 2000<sup>5</sup>.
- 1.8 Under its Publication Scheme, which has been agreed by the Information Commissioner under the terms of the Act, the Board will publish its reports and will make them available on a website together with its terms of reference, membership details, publication scheme and its press notices. In addition, the Board agreed at its meeting in February 2005 to extend from that date its Publication Scheme to

---

<sup>3</sup> The Resource Accounting Manual is available from the Stationery Office or on the web at [www.resource-accounting.gov.uk](http://www.resource-accounting.gov.uk)

<sup>4</sup> The Northern Ireland Resource Accounting Manual can be found at [www.aasdni.gov.uk](http://www.aasdni.gov.uk)

<sup>5</sup> The Freedom of Information Act 2000 is available from the Stationery Office or can be located on the web at: [www.legislation.hmso.gov.uk](http://www.legislation.hmso.gov.uk)

include Board minutes and associated papers. These will be posted on the website once the Board has approved the minutes of the meeting.

### ***Membership of the Board***

1.9 The membership of the Board reflects the relevant spread of interests, as well as ensuring its independence and accounting expertise. The Board members during this reporting period were:

#### **Chairman:**

Elwyn Eilledge, CBE. Former positions include Director of BG Group plc, Chairman of BTR plc, Senior Partner of Ernst and Young and Member of the Accounting Standards Board and Financial Reporting Council.

#### **Members:**

John Aldridge. Finance Director, Scottish Executive.

Mike Ashley. Partner, KPMG, Member of the Accounting Standards Board and Member of the European Financial Reporting Advisory Group Technical Expert Group (from April 2004).

Mike Barnes. Head of Technical Development, Audit Commission (until October 2004).

Beverley Evans. Assessment Director, Monitor (from December 2004).

Martin Evans. Director of Policy and Appointments, Audit Commission (from November 2004).

Heather Foster. Finance Director, HM Land Registry.

Russell Frith. Director of Audit Strategy, Audit Scotland.

Professor David Heald. Professor of Financial Management, The University of Sheffield Management School (from August 2004).

Graham Jenkinson. Director, National Expenditure and Income Division, Office for National Statistics (until July 2004).

Robin Lynch. Director of National Accounts Group, Office for National Statistics (from August 2004).

Professor David Mayston. Professor of Public Sector Economics, Finance and Accountancy, University of York (until July 2004).

Nigel Reader, CBE. Director of Finance, Environment Agency.

Michael Romberg. Senior Specialist, Budgeting and Statistics, HM Treasury (from April 2004).

Martin Sinclair. Assistant Auditor General, National Audit Office.

David Thomson. Treasury Officer of Accounts, Northern Ireland (Department of Finance and Personnel).

Jeff Tomlinson. Head of Accounting, Department of Health, England.

Ken Wild. Partner, Deloitte & Touche LLP, and Member of the International Financial Reporting Interpretations Committee and former Member of the Accounting Standards Board.

Trevor Woolley. Finance Director, Ministry of Defence.

**Parliamentary observer:**

Ross Cranston, QC, MP.

**Alternates:**

During the reporting period, the following have served as alternates to Members:

Graham Jenkinson for Robin Lynch

Andrea Keenoy for Ross Cranston

Owen Mason for Nigel Reader

Anne Rylatt for Jeff Tomlinson

John Thornton for Trevor Woolley

Tomas Wilkinson for David Thomson

Aileen Wright for John Aldridge

**Secretariat:**

*Secretary:*

David Watkins

*Secretariat support:*

Sue Gamble (until September 2004)

Christine Ruston

Sarah Solomon (from October 2004)

### ***How the Board works***

- 1.14 The largest part of the Board's work is to consider issues identified by the Treasury, in consultation with others, as needing to be addressed in the various sources of accounting guidance for the bodies covered by the Board's remit. The remainder of the Board's work arises from its requests to the Treasury for information (for example on the accounting treatment of projects undertaken under the private finance initiative, which is discussed later in this report).

- 1.15 The Board met six times during the reporting period. The main topics it considered (discussed in later chapters) included the convergence of UK accounting standards with international accounting standards, salary and pension disclosures and the development of the new Government Financial Reporting Manual. The Treasury also provided the Board with updates on other areas in which the Board has an interest such as accounting for heritage assets and international developments in accounting for non-exchange revenues and for the social policies of government. The Board hopes to consider these topics, which are discussed in chapter 5, in greater depth during the coming year.



## NEW ACCOUNTING STANDARDS

### *Introduction*

- 2.1 This chapter reports on the Board's consideration during the year of new accounting standards issued by the Accounting Standards Board (ASB) as part of its strategy of convergence with standards issued by the International Accounting Standards Board (IASB).
- 2.2 EU Regulation 1606/2002 requires listed companies to prepare their consolidated accounts in accordance with the adopted international accounting standards (or International Financial Reporting Standards (IFRS)) from 1 January 2005. The regulation also allows Member States to permit or require listed companies to produce their individual accounts, and non-listed companies to prepare their accounts, in accordance with IFRS. In July 2003, the Government announced that all such companies (other than charitable companies) would be permitted to adopt IFRS. One of the amendments to the Companies Act introduced by Statutory Instrument (SI) 2004 No. 2947 allows companies to adopt IFRS where they are not required to do so.
- 2.3 SI (2004) 2947 also amended sections 5(4)(a) and 9(5)(a) of the Government Resources and Accounts Act 2000. The sections now refer to the need to have regard to any relevant guidance issued by the Accounting Standards Board (or other body prescribed by section 256 of the Companies Act) "or to the international accounting standards, within the meaning of EC Regulation No.1606/2002 of the European Parliament and of the Council of 19th July 2002 on the application of international accounting standards, adopted from time to time by the European Commission in accordance with that Regulation."
- 2.4 The Board reported last year<sup>6</sup> its view that the government should take the lead in adopting IFRS and recorded its disappointment that the Treasury did not feel the time was right to move to IFRS alongside the listed sector. The Board accepted the Treasury's proposal to follow

---

<sup>6</sup> The Board's report for 2003-04 can be found on the Board's website at [www.frab.gov.uk](http://www.frab.gov.uk).

the ASB's convergence agenda and noted that this would allow the bodies covered by its remit to manage a phased programme of change. The Board requested that the Treasury continue to monitor developments in IFRS and discuss with the Board its conclusions on whether the Government could adopt IFRS in advance of the completion of the ASB convergence strategy. The Board is pleased to note that the Treasury has taken the opportunity to have the legislation amended in such a way as to facilitate faster convergence with IFRS if it proves possible.

### ***Convergence strategy***

- 2.5 During 2004, the ASB issued a batch of standards implementing IFRS in the UK. The application of these standards to the public sector is discussed later in this chapter.
- 2.6 In March 2005, the ASB issued its Technical Plan, which includes details of convergence standards and the ASB's other projects into the future. The Technical Plan gives a timetable for expected publications in 2005, and looks ahead to further batches of standards that might be expected to apply to accounting periods beginning on or after 1 January 2007 and 1 January 2008. The proposed timetable is based on the IASB's current timetable and will need to be adjusted as the IASB's work programme changes. The implications for the Board of the ASB's Technical Plan are discussed in chapter 5.
- 2.7 The Technical Plan reflects the ASB's view that change should be phased in. It seeks to limit burdens on companies by introducing standards dealing with related topics at the same time, postponing the implementation in the UK of an IFRS that is likely to be superseded in the short term, and by introducing a UK standard based on an IFRS where retention of the UK standard would result in a disproportionate burden on companies that report under UK standards.

### ***Convergence in 2004***

- 2.8 The ASB issued eight new standards in 2004. Of these, three (FRS 20 (IFRS 2) *Share-based payments*, FRS 22 (IAS 33) *Earnings per share*, and FRS 27 *Life Assurance*) are not relevant to government accounts. One, FRS 24 (IAS 29) *Financial reporting in hyperinflationary economies*, is not currently relevant, but should it become so, it would apply.
- 2.9 Of the most significance for the public sector are the standards on financial instruments (FRS 25 (IAS 32) *Financial Instruments: Disclosure and Presentation*, and FRS 26 (IAS 39) *Financial Instruments: Measurement*) even though they are largely focused on the private sector. The new FRSs implement IAS 32 and part of IAS 39 – the recognition and derecognition aspects of IAS 39 will be brought in later – and they replace FRS 4 *Capital instruments* and FRS 13 *Derivatives and other financial instruments: disclosures*. At the same time, the ASB issued FRS 23 (IAS

21) *The Effects of Changes in Foreign Exchange Rates* (and FRS 24), the implementation of which is linked to the application of FRS 25 and FRS 26. The Treasury's proposals for the application of these standards are considered below.

- 2.10 The ASB issued FRS 21 (IAS 10) *Events after the Balance Sheet Date* in May 2004 to replace SSAP 17 *Accounting for post balance sheet events*, and this is considered later in this chapter.
- 2.11 The ASB also issued an amendment to FRS 2 *Accounting for subsidiary undertakings* to reflect changes in the law effected by SI (2004) 2947. The main revision, in as far as the amended FRS relates to the public sector, is to delete references to 'participating interest' in the definition of a subsidiary undertaking and introduce references to 'the power to exercise or actually exercise, dominant influence or control'. The Board awaits the Treasury's consideration of the impact that changes to FRS 2 might have on the existing accounting guidance or on Whole of Government Accounts.

*Objectives of the standards on financial instruments*

- 2.12 FRS 25's objective is to provide users of the financial statements with a better understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. Its presentation requirements apply to all entities for accounting periods beginning on or after 1 January 2005 and cover the classification of debt and equity financial instruments and the implications of that classification for dividends and interest expense. Its disclosure requirements apply to entities that apply FRS 26 and require a range of mainly risk-based qualitative and quantitative disclosures to be given about financial instruments held or issued.
- 2.13 FRS 26's objective is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial assets and liabilities. It requires the use of specific measurement bases for financial instruments and for the use of hedge accounting. It applies to listed entities following UK standards for accounting periods beginning on or after 1 January 2005, and to entities preparing accounts in accordance with the fair value accounting rules set out in the Companies Act 1985 for accounting periods beginning on or after 1 January 2006, although such entities may voluntarily apply it for accounting periods beginning on or after 1 January 2005.
- 2.14 Unless and until an entity applies FRS 26 it is not permitted to adopt FRS 23, and if an entity applies FRS 26 it must apply FRS 23. (The objective of FRS 23 is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an

entity and how to translate financial statements into a presentation currency.)

*Complex areas of unique significance to government accounts*

- 2.15 The Treasury informed the Board that consideration of the standards on financial instruments had highlighted a number of complex areas that were unique to government accounts. Each of the issues needs to be resolved before the standards can be implemented. The Treasury has yet to bring final proposals to the Board, but has indicated that it needs to give careful consideration to these areas, before bringing proposals to the Board.
- 2.16 The classification of issued debt and equity financial instruments in FRS 25 has led to questions as to how Public Dividend Capital<sup>7</sup> should be classified, as this will determine the accounting treatment of dividends. Under FRS 12 *Provisions, contingent liabilities and contingent assets*, entities with Public Dividend Capital record on the balance sheet a liability for dividends payable in the next financial year. FRS 21 relies on FRS25's classification of issued debt and equity financial instruments, and argues instead that proposed dividends do not satisfy the definition of a liability given in FRS 12; FRS 21 requires dividends declared after the year-end to be disclosed only by way of note.
- 2.17 The FRS 25 classification does not read across directly to entities that have Public Dividend Capital, such as trading funds, NHS Trusts and Foundation Trusts. For example, the provisions of the Government Trading Funds Act 1973<sup>8</sup> and the arrangements for resource budgeting mean that trading funds normally pay a dividend, as do NHS Trusts and Foundation Trusts under their own arrangements. In these cases, these entities argue that the dividend would satisfy the definition of a liability at the balance sheet date. In addition, trading funds argue that the correlation between the cost of capital borne by a department and the dividends (and interest) receivable can mean that a trading fund has little discretion over the amount of the dividend payable. The Board accepts that the Treasury, together with the Department of Health and Monitor, need to clarify the classification of Public Dividend Capital before final proposals can be discussed by the Board.

---

<sup>7</sup> Public Dividend Capital is finance provided by government to public sector bodies as an equity stake as an alternative to loan finance.

<sup>8</sup> Section 2A(5) of the GTFA 1973 notes that "for any financial year in which a trading fund has public dividend capital, there shall be paid out of the fund in the Consolidated Fund such sums (if any) by way of return on that capital and its reserves as the responsible Minister may determine, with Treasury concurrence, having regard to any balance in the fund at the end of that year and the amount of the balance which appears to the responsible Minister and the Treasury to be in the nature of distributable profit".

- 2.18 FRS 26 sets out the recognition and measurement requirements for financial assets and financial liabilities. In view of the wide range of such assets and liabilities held by government entities, the Treasury considers that further work is needed to assess the potential impacts of implementing these requirements. There are two major pieces of research that the Treasury, departments and other entities need to undertake.
- 2.19 The first relates to determining to what extent the guarantees, letters of comfort and other indemnities given by the government are financial instruments within the meaning of FRS 26. In the event that these guarantees are financial liabilities, they will need to be measured and brought on balance sheet for the first time. Measurement will include an assessment of the probability that the guarantee will be called on – a lower probability results in a lower fair value of the liability. This treatment differs from that of liabilities that are not financial instruments (reported under FRS 12 (IAS 37)). The IASB intends to amend IAS 37, and the ASB to amend FRS 12, to align the treatments. The current intention is that this will take effect for accounting periods beginning on or after 1 January 2007 when all existing provisions will need to be reviewed for fair value. Under the twin proposals in FRS 26 and an amended FRS 12, it is likely that many of the contingent liabilities and ‘remote’ liabilities currently reported in the notes to resource and other accounts will come on balance sheet.
- 2.20 The second piece of research relates to embedded derivatives and hedges. The Treasury’s view is that, except in those rare circumstances where a department (for example, the Export Credits Guarantee Department) actively engages in hedging activities or has derivatives embedded in certain contracts, departments and other entities are likely to have to review all of their contracts to determine whether this part of the standard applies to them.

*Timetable for implementation*

- 2.21 In the light of the issues that need to be resolved, the Board agreed with the Treasury’s proposal to defer until 2006-07 implementation of FRS 25 and FRS 26, with the consequence that FRS 23 (and FRS 24, should it become relevant) are also deferred, since their implementation is dependent on the adoption of FRS 26. FRS 21 is also deferred, because of the need to determine the appropriate classification of Public Dividend Capital.
- 2.22 The Board notes that the application of the standards on financial instruments will be complex for any sector. The Board would not normally consider complexity of application a reason for deferring implementation of accounting standards and best practice in line with the listed company sector. In this case, however, the Board recognises that the circumstances of government, particularly the existence of a

large number of guarantees, letters of comfort and other indemnities, all of which need to be reviewed, are such that departments and other entities need to be given adequate time to resolve the complexities.

- 2.23 The Board emphasised the need for timely resolution to the issues and asked the Treasury to return to the Board with proposals in late summer 2005. The Board will discuss further the implementation of these standards in its next report.

## OTHER ISSUES CONSIDERED BY THE BOARD

### *Introduction*

3.1 Chapter 3 reports developments on the major topics that the Board has identified in earlier reports<sup>9</sup> as areas of concern that need to be addressed if the Board is to be satisfied that the best standards of accounting apply across the bodies covered by the Board's remit.

### *Compliance with generally accepted accounting practice*

#### *Private Finance Initiative*

3.2 In its seventh report, the Board noted its concern about the number of PFI projects where assets are on neither the public sector nor private sector balance sheet. Initial investigation by the Treasury and the National Audit Office suggested that public sector inconsistencies might stem from a belief, reflected in departmental guidance, that the assets must be treated as off-balance sheet if the project were to proceed. The Board also noted that the Treasury had agreed to consider suggestions from the national audit agencies on how the Treasury's *Technical Note No. 1: How to account for Private Finance Initiative Transactions*<sup>10</sup> might be amended in order to promote improved compliance with the requirements of Application Note F (*Private Finance Initiative and Similar Contracts*) to FRS 5 *Substance of transactions*.

3.3 The Board notes that the Treasury issued new 'Value for Money Guidance' to departments in August 2004, with the primary intention

---

<sup>9</sup> Previous FRAB Reports are available from the Stationery Office or can be located on the web at: [www.frab.gov.uk](http://www.frab.gov.uk)

<sup>10</sup> The *Technical Note* can be available from the Treasury's website at: [http://www.hm-treasury.gov.uk/media/D75/C6/PPP\\_TTF\\_Technote1.pdf](http://www.hm-treasury.gov.uk/media/D75/C6/PPP_TTF_Technote1.pdf)

of ensuring that value for money is the sole determinant in deciding to use PFI in procurement, and that the balance sheet treatment of projects is immaterial to that decision. The Board supports this approach.

- 3.4 The Treasury informed the Board that it has discussed sectoral guidance with the Departments of Health and Education and Skills. The two departments have withdrawn the guidance from their websites, and are reviewing it to ensure that it is consistent with the Treasury's 'Value for Money Guidance' and the *Technical Note*. Whilst the Board agrees that this is progress in the right direction, it has reservations about the efficacy of withdrawing inaccurate guidance without an immediate replacement, since there is no guarantee that departments would not continue to use it and that inconsistencies in accounting treatment will continue. The Board notes that the Treasury is monitoring departments' progress in revising the sectoral guidance, and looks forward to receiving assurances from the Treasury that the departments will promote in the future the proper application of accounting standards in common with the rest of government.
- 3.5 The Board was disappointed to learn that the Treasury had made no progress in amending the *Technical Note*. Although the Board advocates adherence to the principles set out in FRS 5 and Application Note F, the Board recognises that the *Technical Note* is widely accepted as part of the body of guidance available to departments but in the absence of an amended *Technical Note* it did not believe that it should be withdrawn. The Treasury agreed to consider suggestions from the national audit agencies for amending the *Technical Note* and agreed to report progress to the Board in early summer 2005.

*Service concessions*

- 3.6 The International Financial Reporting Interpretations Committee (IFRIC) is a committee of the IASB. Its role is to provide guidance on financial reporting issues not specifically addressed in IFRS or issues where unsatisfactory or conflicting interpretations have developed or seem likely to develop. In reaction to widespread concern at the lack of accounting guidance for service concession arrangements, a working group set up by the IASB recommended that the IFRIC should seek to clarify for 2005 how existing IFRS could be applied to the accounting treatment of service concessions.
- 3.7 The IFRIC issued three draft Interpretations in March 2005, for comment by 31 May 2005: D12 *Service concession arrangements – determining the accounting model*; D13 *Service concession arrangements – the financial asset model*; and D14 *Service concession arrangements – the intangible asset model*. The Interpretations will apply to accounting periods beginning on or after 1 January 2006. They deal with service concession arrangements, such as PFI contracts in the UK. Under

such an arrangement, one party (the grantor), usually a public sector body, grants a concession to another party (the operator) to develop, finance and operate infrastructure and related services over a period of time. The infrastructure may need to be constructed by the operator, or it might already exist and need only to be maintained (and, perhaps, enhanced) by the operator.

- 3.8 The draft Interpretations deal only with the accounting by operators and do not cover the accounting by grantors. The draft Interpretations are also restricted to service concession arrangements where the grantor is deemed to have an asset of the infrastructure on its balance sheet. Given its interest in accounting for PFI, the Board will consider the draft Interpretations and respond to the IFRIC.

*Departmental boundary*

- 3.9 As explained in its seventh report, the Board has expressed concerns since 1996 about compliance with UK GAAP in drawing the resource accounting boundary. In that report, the Board noted the Treasury had advised it that there are no legal impediments to aligning the resource accounting and budgeting boundaries. The Treasury proposal would bring non-departmental public bodies within the resource accounting boundary and the Treasury expected to complete its consultation process on this matter during 2004.
- 3.10 During this reporting period, the Treasury reported to the Board that, in informal consultation with departments during 2004, the proposal has been welcomed as bringing simplification to the accounting and budgeting process. Concerns remain, however, about the accountability arrangements between the Accounting Officer of a department and the Accounting Officers of the department's non-departmental public bodies. The Treasury informed the Board that it has developed proposals to address departments' concerns and will consult formally in 2005.
- 3.11 The Board is disappointed that the Treasury was unable to complete its consultation process in 2004, particularly since officials have raised with the Board in previous years the concerns they have about accountability arrangements. The Board questions why, since this issue had already been identified, proposals to address departments' concerns were not developed for consultation during 2004. The Board expects the Treasury to bring forward proposals to resolve this issue during 2005-06.

*Grants and Grant in Aid*

- 3.12 The Treasury sought the Board's views about the accounting treatment of grants and grants-in-aid. Grants are payments made for specific purposes where the grant-paying body seeks to impose detailed control

over the expenditure. For example, a grant may be given to: support a particular piece of research or other work; offset expenditure; or provide a subsidy in line with schemes to assist agriculture or industry. Grants-in-aid are payments by a government department to finance all or part of the costs of the body in receipt of the grant in aid, typically an executive non-departmental public body.

- 3.13 At present, non-departmental public bodies account for grants and grants-in-aid as income largely on the basis of cash received. The Treasury informed the Board that some non-departmental public bodies have questioned this treatment, on the ground that it is inappropriate to use cash accounting concepts in accruals-based accounts. The Treasury further informed the Board that, based on Government Accounting and the resource budgeting framework, both grants and grants in aid are indeed a cash concept in that they are provided to meet the recipient's cash needs and that accruing for them would be inconsistent with that concept.
- 3.14 The Treasury sought the Board's views on proposals to clarify the accounting treatment of grants and grants-in-aid. In developing the proposals, the Treasury applied the principles outlined in the ASB's draft *Statement of Principles for Financial Reporting: proposed interpretation for public benefit entities*, as well as considering the requirements of accounting standards. The Board agreed with this approach, since the proposed *Interpretation* is based on the ASB's *Statement of Principles*.
- 3.15 The Treasury proposals would result in different accounting treatments for grants and for grants-in-aid. The Treasury argues that grants are given in exchange for goods and services and hence should be accounted for in accordance with SSAP 4: that is, either as income (or as a liability if any conditions have not been met) or, in the case of grants for capital purposes, deferred.
- 3.16 The Treasury argues that grants-in-aid for revenue purposes are analogous to contributions from controlling parties, as defined in the proposed *Interpretation*, in that they are not given in exchange for direct benefits. Thus they should be treated as financing and credited to reserves. In view of that conclusion, the Treasury also argues that grants-in-aid for capital purposes (at present accounted for in accordance with SSAP 4) should be treated similarly. The Treasury reported that this proposal was opposed during consultation on the grounds that the proposed *Interpretation* did not form part of UK GAAP, that it is possible to argue that the grant-in-aid is an exchange transaction in that the whole output of the non-departmental public body is of direct benefit to the department, and that the treatment of grant-in-aid as financing would result in a statement of net expenditure (and not an income and expenditure account).

- 3.17 The Board was concerned whether the objections raised through the consultation were valid. It was agreed that the Treasury would gather more information, including examples from non-departmental public bodies, on the distinction between grants and grants-in-aid, and discuss the issue further with the Board during 2005, with a view to agreeing an accounting treatment for 2006-07.

### ***Other financial reporting issues***

#### *Salary and pension disclosures*

- 3.18 In its first report, the Board stated its belief that the principles of openness and transparency in terms of salary and pension disclosures should apply equally in the public and private sectors. The statement was made in the light of the decision in 1996 that resource accounts should not disclose details about the salaries and pensions of top civil servants and Ministers.
- 3.19 Since then, the Board has welcomed improved disclosures. In its seventh report, it noted that the Treasury and the Cabinet Office had considered the implications of the Directors' Remuneration Report Regulations (SI (2002) 1986)<sup>11</sup> that came into force in August 2002. They recommended broader disclosures on the pension entitlements of senior public servants and Ministers; the Board agreed and these took effect for the 2003-04 accounts.
- 3.20 In its sixth report, the Board reported that Cabinet Office Ministers had agreed that disclosure of senior managers' remuneration should be made a statutory requirement since, currently, an individual has the ability to prevent disclosure by virtue of the Data Protection Act 1998. The Board's seventh report noted that the Cabinet Office has booked a provisional legislative slot for 2005-06, although the Board noted that, even if this were achieved, it was unlikely that the requirements would be in place until 2006-07 at the earliest.
- 3.21 The Board continues to feel strongly that the public sector should be at least as open as listed companies in its reporting of the remuneration packages of senior public servants. At the request of the Board, the Chairman wrote to the Cabinet Office noting that there is increasing parliamentary interest in senior public servants' remuneration packages. The Chairman sought assurances that the Cabinet Office is committed to seeking government legislation in the next parliamentary Session to ensure that public servants cannot shelter behind the Data Protection Act in denying Parliament and the public the right to know what senior public servants receive as a remuneration package.

---

<sup>11</sup> SI (2002) 1986 is available from the Stationery Office or on the website at [www.legislation.hmso.gov.uk](http://www.legislation.hmso.gov.uk)

- 3.22 In responding, the Cabinet Office reiterated its commitment to ensuring that, in principle, the requirements in respect of senior public servants should be no different from those pertaining to company directors. Cabinet Office research shows that few senior civil servants now refuse to disclose details of their remuneration packages. The Cabinet Office informed the Board that the letters of appointment for senior civil servants now include, as a condition of appointment, a requirement that the necessary disclosures are made in resource accounts. The Board welcomes this move.
- 3.23 While the situation with government departments (including executive agencies) has improved, that of non-departmental public bodies and trading funds is less clear. The Board welcomes the commitment of the Treasury and the Cabinet Office to clarifying the extent of any problem, although it is not clear what action, other than legislation, will be proposed to ensure that details of remuneration packages of public servants in these entities are properly disclosed. The Board expects to consider firm proposals during the coming reporting period.

### ***Corporate governance***

- 3.24 As noted in the Board's past four reports, the Treasury has been developing guidance on corporate governance in central government departments following the recommendations of the Turnbull Report. In its seventh report, the Board noted that the Cabinet Office and the Permanent Secretary to the Treasury had agreed that there should be a review of corporate governance in central government.
- 3.25 The Treasury reported that the review was completed during 2004 and that the Chief Secretary to the Treasury wrote to Cabinet Ministers in January 2005 seeking views on the draft Code, which should be introduced during 2005. The Code largely draws together established and published practice in central government departments, and adds some advisory guidance, drawing on private sector practice set out in the Combined Code for listed companies, published by the Financial Reporting Council. The Board notes that the Code had not been issued at the date it approved this report.
- 3.26 The Treasury reported that the Code reinforces the status quo, but that it will continue to develop, particularly in respect of the role of Ministers in relation to departmental management boards. The Board was disappointed that the Treasury had not taken the opportunity provided by the 2004 review to move beyond the status quo. The Board believes that a more radical review of corporate governance is required and would be pleased to be consulted during any such review.

## GUIDANCE ON FINANCIAL REPORTING

### *Introduction*

- 4.1 In its seventh report, the Board noted that it had taken the view that a new Manual should discuss the accounting principles and standards that should underpin the preparation of accounts. The new Manual would replace the existing separate guidance for different types of bodies. The Board also reported that it had commissioned a review of the form and content of resource accounts. This chapter reports progress in these two areas.

### *Format and content of accounting guidance*

- 4.2 Chapter 1 of this report records the evolution of the Board's remit since 1996 so that the Board has a role in respect of the accounting guidance for the whole of the central government sector and trading funds in the United Kingdom.

#### *Existing guidance*

- 4.3 The Treasury produces accounting guidance for departments and executive agencies (the Resource Accounting Manual) covered by the requirements of the Government Resources and Accounts Act 2000, and separate sets of guidance for non-departmental public bodies and trading funds in England and Wales. These three sets of guidance are identical in the principles and standards they follow, although there are some differences in the presentation of information because of the different nature of the types of entity covered by the guidance.
- 4.4 The Scottish Executive Accountancy Service Team produces guidance for Scottish bodies, and the Department of Finance and Personnel, Northern Ireland produces a Northern Ireland Resource Accounting Manual for bodies covered by the requirements of the Government Resources and Accounts Act (Northern Ireland) 2001. The Department of Health produces separate guidance for National Health Service Trusts, and Monitor produces separate guidance for Foundation Trusts, based on the content of the Resource Accounting Manual.
- 4.5 The Board agreed that there should be a new Manual to replace the two Resource Accounting Manuals, the Scottish guidance and the

guidance for non-departmental public bodies and trading funds. In bringing together these sets of guidance, there was no intention of making significant revisions to accounting practices already approved by the Board. The Board agreed that the Department of Health and Monitor could continue to produce their own sector specific guidance based on the new Manual.

*The Government Financial Reporting Manual*

- 4.6 At its last meeting in this reporting period, the Board approved the new Government Financial Reporting Manual for application from 2005-06. The Manual is available on a dedicated website<sup>12</sup> hosted by the Treasury on behalf of the authorities that have adopted the Manual.
- 4.7 The new Manual is written in the expectation that the user (the audience for the Manual comprises primarily accounts preparers and auditors) will be familiar with generally accepted accounting practice and thus the content of the Manual focuses on accounting standards that have been adapted or interpreted in the public sector context and on accounting practices that are specific to central government. The style of the Manual is, therefore, much less discursive than its predecessors.
- 4.8 The Board noted in its seventh report that the Manual would be supported by worked examples where the Treasury and accounts preparers determine such examples to be necessary. The Board has seen initial versions of the examples the Treasury has developed to illustrate the accounting treatment for types of transactions that are specific to central government, or are expected to be rare in the private sector, in order to assist accountants unfamiliar with the government sector. The examples, which will be available on the same website as the Manual, cover the accounting treatment of parliamentary Supply and Consolidated Fund Extra Receipts, a complex PFI transaction (which includes a barter deal), and accounting for assets using the modified historical cost accounting model.
- 4.9 The Board believes that the new Manual will assist preparers and auditors by encouraging them to refer to accounting standards, leading to the better use of the standards by preparers in judging complex issues and determining appropriate accounting policies in consultation with their auditors. The Board regards the development of the new Government Financial Reporting Manual as a major step in demonstrating that the principles of UK GAAP underpin the accounts of central government, and that adaptations have been kept to a minimum.

---

<sup>12</sup> The Government Financial Reporting Manual is available at [www.financial-reporting.gov.uk](http://www.financial-reporting.gov.uk).

### ***Format and content of resource accounts***

- 4.10 The review of the format and content of resource accounts announced in the Board's seventh report has been completed, and the Board has seen preliminary suggestions for revisions that will take effect from 2005-06. The Board will consider the final proposed changes in the early summer.
- 4.11 The Treasury issued a questionnaire in Spring 2004, seeking the views of preparers, users and auditors on the current format and content of resource accounts and on changes that might be useful in terms of making the accounts more readily understandable. The Treasury reported to the Board that there was general support for changes that would simplify the presentation of the accounts and make clearer the links between the Estimate-based statement and the Operating Cost Statement.
- 4.12 The Board was particularly pleased to note that the Treasury received comments from key users of resource accounts, particularly clerks of Parliamentary Select Committees with input from the Scrutiny Unit of the House of Commons. The Board also notes that the Scrutiny Unit has played an important role in providing comments during the development of the revised content of resource accounts and welcomes the increased involvement of the House of Commons Select Committees in its work.





## LOOKING AHEAD

### *Introduction*

5.1 In this chapter, the Board looks ahead to what it believes will form the bulk of its work during 2005-06. In addition to considering further the accounting treatment of PFI projects and advising on the application of the standards on financial instruments (chapter 2), discussing the accounting treatment of grants and grants-in-aid (chapter 3) and finalising the format and content of resource accounts (chapter 4), the Board expects the bulk of its work to be linked to developments in accounting standards as the ASB issues new standards as part of the convergence strategy. The Board retains its interest in other accounting developments, and has agreed a forward work programme that will include some of these wider issues.

### *Convergence*

5.2 The ASB first issued a Technical Plan on 16 March 2005<sup>13</sup>. Based on the IASB's timetable at the time, it sets out the ASB's view of its forward work programme for the next three years. The ASB acknowledges that the Technical Plan will need to be adjusted to reflect any changes in the IASB's timetable, and that changes to UK company law may be required to put into effect some of the changes in accounting standards brought about by the convergence process.

#### *Amendments to UK GAAP in 2005*

5.3 Within the constraints referred to above, the ASB expects to issue new Financial Reporting Standards in late 2005 covering revenue recognition and inventory, related party disclosures, corresponding

---

<sup>13</sup> The ASB's updated Technical Plan is available from the ASB's website at [www.frc.org.uk/asb/technical/techplan](http://www.frc.org.uk/asb/technical/techplan).

amounts and more on financial instruments. Reporting Standard 1 *Operating and Financial Review* is due to be published in Spring 2005.

- 5.4 The Board expects to consider the proposed amendments to the standards dealing with financial instruments as part of its work on FRS 25 and FRS 26.
- 5.5 The standards on revenue recognition and inventory will replace FRS 5 Application Note G *Revenue recognition* and Statements of Standard Accounting Practice 5 *Accounting for Value Added Tax* and 9 *Stocks and long-term contracts*. This batch of standards implements IAS 2 *Inventories*, IAS 11 *Construction contracts*, and IAS 18 *Revenue*. It will introduce for the first time to the UK an accounting standard on agriculture (IAS 41 *Agriculture*). The new standard on related party transactions will implement IAS 24, replacing FRS 8. The Board will consider the Treasury's proposals on how these standards should be implemented for government accounts.
- 5.6 The Department for Trade and Industry has issued draft Regulations proposing to remove from the law the requirement to restate corresponding amounts where they are not comparable. The requirement to provide corresponding amounts will remain, and the law will permit restatement where they are not compatible. As a consequence, it will fall to the new FRS on corresponding amounts to prescribe whether they should be restated. The Board will discuss the application of the proposals to government accounts.

#### *Operating and Financial Review*

- 5.7 The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005 (SI (2005) 1011) require quoted companies in Great Britain to prepare Operating and Financial Reviews for financial years ending on or after 1 April 2005. Separate Regulations (SI (2005) 692) specify the ASB as the body that should issue reporting standards in relation to matters to be contained in reports which are required by Part 7 of the Companies Act to be prepared by directors of a company (the Operating and Financial Review (OFR)). Preparation of OFRs is currently based on best practice as advised by the ASB, and the Treasury has used this as the basis of its guidance in the separate sets of guidance. The new Reporting Standard will form part of UK GAAP, and the Board will consider the Treasury's proposals for applying it to government accounts.

#### ***Other developments in financial reporting***

- 5.8 In its seventh report, the Board reported on the work of the International Federation of Accountants' (IFAC) Public Sector Committee (now the International Public Sector Accounting Standards Board (IPSASB)) in developing proposals for the accounting treatment

for the social policies of governments and for revenue from non-exchange transactions. IFAC IPSASB had issued Invitations to Comment on both topics. During this reporting period, the Board considered the two Invitations to Comment, and responded to the IPSASB. The Board welcomed the initiative taken by the IPSASB in addressing the development of guidance on key issues of specific interest to the public sector that are not addressed in existing international public sector accounting standards.

*Heritage Assets*

- 5.9 The Board has expressed its reservations (fourth and sixth reports) about the accounting treatment for heritage assets that resulted from the implementation in the Treasury's accounting guidance of the requirements set out in the 2000 *Statement of Recommended Practice (SORP) for Accounting and Reporting by Charities*. The SORP requires heritage assets to be capitalised, but recognises that it may be difficult or expensive to attribute a cost or valuation to inalienable or historic fixed assets. Assets might be excluded from the balance sheet, therefore, where reliable cost information is not available and conventional valuation approaches lack sufficient reliability, or where significant costs are involved which may be onerous in comparison with the additional benefit derived by users of the accounts. Examples given in the SORP of heritage assets that might be excluded on these grounds include museum and gallery collections and other collections including the national archives. In practice, this has led to a situation from 2001-02 where additions to collections have been capitalised, while the collections in existence at that date have not.
- 5.10 At the request of the Board, the Chairman wrote to the Chairman of the ASB proposing a review of the policy in late 2002, once accounts had been produced conforming to the new policy and its effects could be seen. Although the ASB did not feel that it could initiate a review in 2002, the Board was pleased to note that the Chairman of the ASB's Public Sector and Not-for-profit Committee (PSNC) agreed to co-ordinate such a review.
- 5.11 A revised SORP comes into effect from 2005. The accounting treatment of heritage assets has not changed. But the Board is pleased to note that, as a result of the review by the PSNC, the Invitation to Comment on the exposure draft invited views on the different perspectives (capitalisation and non-capitalisation) for accounting for all heritage assets, and how the issue might be resolved. The ASB aims to issue a UK Discussion Paper in the Autumn of 2005 and the Board looks forward to considering the proposals.

*Statement of Principles for Financial Reporting – Proposed Interpretation for Public Benefit Entities*

- 5.12 The ASB's *Statement of Principles* sets out the principles that the ASB believes should underlie the preparation and presentation of general purpose financial statements. The proposed *Interpretation* applies these principles to public benefit entities, which are defined as entities whose primary objective is to provide goods or services for the general public or social benefit and where any risk capital has been provided with a view to supporting that primary objective rather than with a view to a financial return to equity shareholders.
- 5.13 The Board acknowledged the significance of the *Interpretation* in its seventh report. The consultation period ended on 1 August 2003, and the Board had anticipated that a final version of the *Interpretation* would be issued during this reporting period. This has not proved to be the case, and the Board understands that an Exposure Draft is expected in mid-2005. The Board has already approved the incorporation of the principles outlined in the *Statement of Principles* into the Government Financial Reporting Manual (see chapter 4 of this report), but will discuss with the Treasury whether the text needs to be amended in the light of the content of the *Interpretation*.

*Revenue from non-exchange transactions*

- 5.14 The Board supported the intent behind the proposals in the IPSASB's Invitation to Comment to move to accruals accounting for taxation revenues, but noted that experience in the UK has shown that significant issues can arise in practice in attempting to apply the principles. The Board expressed the view that it is not impossible that the move to accruals accounting for taxation revenues internationally might take several years. In commenting on the proposals in relation to transfers to or between government entities (for example, through the parliamentary Supply process whereby departments' activities are financed from the Consolidated Fund or grant-in-aid financing, which is discussed earlier in this report), the Board noted that the financing treatment required in departmental resource accounts means that the focus of the Operating Cost Statement will be on the cost of government and not on a spurious profit or loss of an individual component of government.

*Accounting for the social policies of government*

- 5.15 On accounting for the social policies of government, the Board noted that the conclusions in the IPSASB's Invitation to Comment broadly mirrored the Board's own discussions and conclusions on accounting for social security benefits, including the state old age pension (as set out in the Board's sixth report). The Board supported the view set out in the Invitation to Comment that cash transfers to individuals should

be accounted for as and when those individuals have satisfied all the eligibility criteria. The Board noted that the options on accounting for the old age pension set out in the Invitation to Comment coincided with the views of the Board – that is, that arguments can be made for treating the old age pension in the same way as other benefits, and that opposing arguments can be made for accruing a liability for the old age pension over the some period of time, which might, for example, be the working life of the potential beneficiary.

- 5.16 During the reporting period, the Secretariat has monitored the progress that IPSASB is making in taking the results of its consultation forwards to Exposure Draft stage. IPSASB hopes to issue an Exposure Draft on accounting for revenue from non-exchange transactions later in 2005. Work on accounting for the social policies of governments is ongoing, however, with IPSASB requesting further material to be included on different types of state pension provision. IPSASB has also decided that separate Exposure Drafts will be developed to cover social benefits other than pensions, state old age pensions, and an additional Exposure Draft to explore how existing standards (IAS 19 *Employee benefits* – FRS 17 *Retirement benefits* in the UK) might apply to government employee pensions and benefits. The Board will continue to monitor developments and discuss with the Treasury potential impacts on government accounts.

#### *Valuation of assets*

- 5.17 During a discussion on charging for the cost of capital in the National Health Service, the Board was made aware of general concerns that had arisen about the application of the guidance on valuing assets at depreciated replacement cost issued by the Royal Institution of Chartered Surveyors (RICS). The Board notes that RICS has a Public Sector Valuation Group (PSVG), which recognised the issue at least two years ago. However, the profile had been raised by the problems that the health service in Scotland has experienced. The PSVG has commissioned a review of the guidance by a respected academic in surveying and valuation issues, and the Treasury officials have met with her to discuss concerns that have been expressed in relation to valuation practices across central government.
- 5.18 The Board welcomes this involvement in the development of the guidance on valuing assets using depreciated replacement cost and will comment further in future reports.

#### ***Other developing issues***

- 5.19 Company reporting has developed over the past few years, with some companies introducing new sections in their annual reports covering such issues as community involvement, equality of opportunity, workforce diversity and human rights.

*Sustainability accounting and reporting*

- 5.20 One of the more recent developments is the concept of sustainability reporting. In 1987, the World Commission on Environment and Development defined sustainable development as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’. With attention on the environment increasing, so has pressure for companies to report on the way their actions impact on sustainable development.
- 5.21 The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Discussion Paper *Advancing sustainability accounting and reporting: an agenda for public service organisations* in January 2005. Other individuals and organisations have also published articles about the need for strategies for sustainable development – in the UK and world wide.
- 5.22 The Board will consider the question of sustainability accounting and reporting in the context of the CIPFA Discussion Paper and other commentary, including Reporting Standard 1 *Operating and Financial Review*, to determine what changes central government might need to make in reporting requirements if it is to keep pace with the developments in the corporate sector.



## THE TERMS OF REFERENCE OF THE FINANCIAL REPORTING ADVISORY BOARD

### 1. Context

1.1 The primary aims of financial reporting by central government bodies are to demonstrate to the public and their representatives in the UK and Scottish Parliaments, the Northern Ireland Assembly and the National Assembly for Wales:

- the financial performance of the bodies;
- their stewardship of public funds and assets; and
- that, where appropriate, public monies and other resources have been used for the purposes intended by the Parliaments or the Assemblies;

and to provide the Parliaments and the Assemblies with information which is reliable and sufficient as a basis for:

- their consideration and approval of the levels of resources and cash voted to services; and
- their examination of performance in carrying out policies, functions, programmes and projects.

1.2 Financial reporting is also intended to underpin the UK Government's planning, monitoring and management of public expenditure.

1.3 The authority to develop financial reporting requirements rests with HM Treasury, the National Assembly for Wales, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland in respect of accounts meeting the criteria set out in paragraph 2.1.b. below.

1.4 Financial reporting by central government bodies should be based on generally accepted accounting practice (GAAP) adapted where appropriate to take account of the public sector context. For Resource Accounts prepared by government departments for which an Estimate

is laid before the House of Commons and for Whole of Government Accounts (UK) this requirement is set out in sections 5 and 9 of the Government Resources and Accounts Act 2000. A similar requirement is included in sections 9 and 14 of the Government Resources and Accounts Act (Northern Ireland) 2001.

- 1.5 Under section 24 of the Government Resources and Accounts Act 2000 the Treasury is required to consult an advisory group on financial reporting principles and standards for resource accounts and Whole of Government Accounts. Under section 20 of the Government Resources and Accounts Act (Northern Ireland) 2001, the Department of Finance and Personnel, Northern Ireland is also required to consult with and take account of the recommendations made by this advisory group before issuing directions on resource accounts or determining the form and content of Whole of Government Accounts (Northern Ireland). The Scottish Ministers, with the agreement of the Audit Committee of the Scottish Parliament, have determined that they should be similarly advised on such matters. The Financial Reporting Advisory Board will be the advisory group, and thus will provide an independent element into the process of setting financial reporting standards for the UK Government, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.

## **2. Terms of reference**

### 2.1 Responsibilities of the Board:

- a. The Board will provide independent advice to HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.
- b. The Board will advise HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland on the application of financial reporting standards and principles:
  - i where HM Treasury, the National Assembly for Wales and the Department of Finance and Personnel, Northern Ireland are responsible for issuing reporting requirements, in respect of:
    - Departmental resource accounts
    - Supply financed executive agencies
    - Non-departmental public bodies
    - Trading funds
    - Whole of Government Accounts

- NHS trusts in England and Wales, and HSS trusts in Northern Ireland
- NHS Foundation Trusts in England
- ii. Where the Scottish Ministers are responsible for issuing reporting requirements, in respect of:
  - accounts falling under sections 19 and 20 of the Public Finance and Accountability (Scotland) Act 2000<sup>14</sup>.
  - accounts of executive non departmental public bodies where the Scottish Ministers have the power of direction
- c. The Board will decide how it reaches its conclusions.
- d. The Board's advice to the Scottish Ministers will be restricted to the technical rules of accounting and to minimum disclosure requirements. It will not extend to the format of accounts or to disclosures beyond the minimum requirements.
- e. The Board's advice to the Department of Finance and Personnel, Northern Ireland will incorporate accounting, formatting and minimum disclosure requirements.
- f. The Board will examine all amendments to the guidance in respect of the bodies listed in b above, with the aim of ensuring that they comply with GAAP, and that departures or modifications from GAAP, due to public sector and spending control contexts, are fully explained and justified. The Board will also examine, with the same aim, amendments to accounts directions referred to the Board, issued by HM Treasury, the National Assembly for Wales, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.
- g. The Board will prepare an annual report of its activities, including its views on the changes made during the period to the accounting guidance, or, as appropriate, accounts directions, issued by HM Treasury, the National Assembly for Wales, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland in respect of bodies listed in 2.1 b. above, and will send a copy of its report direct to the Committee of Public Accounts and Treasury Select Committee of the UK

---

<sup>14</sup> Public Finance and Accountability (Scotland) Act 2000 is available from the Stationery Office or can be located on the web at: [www.legislation.hmsso.gov.uk](http://www.legislation.hmsso.gov.uk)

Parliament, the National Assembly of Wales, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.

- 2.2 HM Treasury (in conjunction with the Department of Health in respect of NHS trusts in England and the Independent Regulator of Foundation Trusts in respect of NHS Foundation Trusts in England), the National Assembly for Wales, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland:
- a. Will ensure that all relevant matters, including proposed changes to the guidance, or, as appropriate, accounts directions, in respect of accounts meeting the criteria in 2.1.b above, are brought to the Board's attention within a reasonable time. In particular, changes to Financial Reporting Standards and other elements of GAAP that affect such guidance or accounts directions will, as far as possible, be brought to attention in sufficient time to enable their implementation, as appropriate, within the same timescale as changes are to be made generally.
  - b. Will examine all issues raised by the Board within its terms of reference.
  - c. Will consider all advice received from the Board.
- 2.3 HM Treasury, the Scottish Ministers, the Department of Finance and Personnel, Northern Ireland, and the Finance Division of the National Assembly for Wales will formally lay the Board's report before the House of Commons, the Scottish Parliament, the Northern Ireland Assembly, and the National Assembly for Wales respectively.
- 2.4 HM Treasury will provide the secretariat to the Board.

### **3. *Membership***

- 3.1 The Board will comprise:

An independent Chairman, nominated by the Chief Accountancy Adviser to the Treasury, and in respect of future appointments, in agreement with the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.

1 member nominated by the Treasury (a Treasury Official)

1 member nominated by the Scottish Ministers

1 member nominated by the Department of Finance and Personnel, Northern Ireland

1 member nominated by the Comptroller and Auditor General

1 member nominated by the Auditor General for Scotland

1 member nominated by the Audit Commission

3 members nominated by the Finance Directors of UK government departments to represent respectively departments, trading funds, and non-departmental public bodies.

1 member nominated by the Department of Health

1 member nominated by the Executive Chair of Monitor, the Independent Regulator of Foundation Trusts

1 member nominated by the National Statistician

1 member nominated by the Accounting Standards Board

1 member, an independent economist, nominated by the Head of the Government Economic Service.

1 independent member nominated by the Chief Accountancy Advisor to the Treasury and approved by the Chairman.

3.2 Members will normally be appointed for five year, renewable, terms.

3.3 The Board will meet as required in each year to discuss matters relating to financial reporting as they arise.





Published by TSO (The Stationery Office) and available from:

**Online**

[www.tso.co.uk/bookshop](http://www.tso.co.uk/bookshop)

**Mail, Telephone, Fax & E-mail**

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/General enquiries 0870 600 5522

Fax orders 0870 600 5533

Order through the Parliamentary Hotline *Lo-call* 0845 702 3474

Email [book.orders@tso.co.uk](mailto:book.orders@tso.co.uk)

Textphone 0870 240 3701

**TSO Shops**

123 Kingsway, London WC2B 6PQ

020 7242 6393 Fax 020 7242 6394

68-69 Bull Street, Birmingham B4 6AD

0121 236 9696 Fax 0121 236 9699

9-21 Princess Street, Manchester M60 8AS

0161 834 7201 Fax 0161 833 0634

16 Arthur Street, Belfast BT1 4GD

028 9023 8451 Fax 028 9023 5401

18-19 High Street, Cardiff CF10 1PT

029 2039 5548 Fax 029 2038 4347

71 Lothian Road, Edinburgh EH3 9AZ

0870 606 5566 Fax 0870 606 5588

**The Parliamentary Bookshop**

12 Bridge Street, Parliament Square,  
London SW1A 2JX

Telephone orders/General enquiries 020 7219 3890

Fax orders 020 7219 3866

**TSO Accredited Agents**

(See Yellow Pages)

*and through good booksellers*

ISBN 0-10-293296-4



9 780102 932966