

## **FINANCIAL REPORTING ADVISORY BOARD**

### ***Report for the period April 2003 to March 2004***

*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*

*The report is presented by the Treasury to the House of Commons (the Committee of Public  
Accounts and the Treasury Committee) pursuant to Section 24(4) of the Government Resources  
and Accounts Act 2000*

*This report is laid before the Northern Ireland Assembly under Section 20(3)  
of the Government Resources and Accounts Act (Northern Ireland) 2001*

*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 presented to the National Assembly for Wales by the Welsh Assembly Government*

*Ordered by the House of Commons  
to be printed on 28<sup>th</sup> June 2004*



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REPORT FOR THE PERIOD APRIL 2003 TO MARCH 2004**

## CHAIRMAN'S FOREWORD

Government accounting practices have been increasingly in the spotlight over recent years. Much attention has been focused on the way in which the Government accounts for its liabilities – but the issue might better be expressed as one of determining precisely what the Government's liabilities are.

This is not something that is confined to the United Kingdom. The international accounting community, as noted in this report, has started to address the question of how governments might identify and account for liabilities arising from their social policy obligations. In particular, of course, given the changes in demographics, there is widespread concern about the future costs of state-provided old age pensions. The International Federation of Accountants' Public Sector Committee has issued a thought-provoking paper inviting comments on when a liability might arise in relation to the state pension and other benefits, which the Board will consider.

Closer to home, some commentators are concerned about the treatment of the Government's liabilities arising from Private Finance Initiative projects. The Accounting Standards Board issued clear guidance some years ago on how these projects should be accounted for, based on the transfer of risks. The Treasury supplemented this with further guidance, and the Treasury has continually made clear its view that PFI schemes should only be undertaken where they represent value for money – the accounting treatment is incidental. The Board strongly supports this view.

I remain concerned about the accounting treatment of PFI assets. As noted in this report, it is evident that for a number of projects no fixed asset is shown on either the public sector body's balance sheet or that of the private sector partners. I am pleased that the Treasury has agreed to discuss further the issue of accounting for PFI with the Treasury's Private Finance Unit, departments issuing sectoral guidance, audit agencies and with the Accounting Standards Board, and I look forward to commenting further in next year's report.

On a personal note, I would like to record my thanks to Chris Richards, who served as Secretary to the Board since its inception in 1996 – attending almost every meeting until his retirement in October 2003. I am pleased that his contribution to the introduction of resource accounting was recognised by the award of an OBE in the Queen's New Year's Honours list. The Board wishes

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him well in his retirement and welcomes David Watkins as the new Secretary. I would also like to record the Board's thanks to Sue Gamble and Christine Ruston, who continue to give the Board invaluable support.

Elwyn Eilledge CBE

## EXECUTIVE SUMMARY

This is the seventh report of the Financial Reporting Advisory Board (the Board). It is addressed to the Committee of Public Accounts and the Treasury Committee in the Westminster Parliament, to the Northern Ireland Assembly, to the Scottish Ministers and to the National Assembly for Wales. The report covers key issues discussed by the Board during the year April 2003 to March 2004 (Chapter 2) and looks forward to major developments in future reporting periods (Chapter 3). Chapter 1 of the report explains the nature and role of the Board and its membership.

The Board is an independent body that advises on the application of financial reporting principles and standards for government. The Board welcomes the fact that, during this reporting period, its independent status has been enhanced by its recognition by the Cabinet Office as an ad-hoc advisory body (one of the Cabinet Office's classifications of public bodies), by being included as a separate entity in the Office for National Statistics' classification of the central government sector, and by its inclusion in the list of bodies in Schedule 1 of the Freedom of Information Act 2000. The Information Commissioner has agreed the Board's Publication Scheme.

With the exception of a new Application Note on *Revenue* (Application Note G to Financial Reporting Standard 5 *Reporting the substance of transactions*), the Accounting Standards Board has issued no new accounting standards during the year. The focus of the Board's work during the period has, therefore, been on developments in the way in which the Government complies with generally accepted accounting practice, on other financial reporting issues, and on corporate governance. Of particular interest to the Board is the review of projects financed by the private finance initiative that the Treasury has carried out at the Board's request (paragraphs 2.2-2.5 of this report). Following further work with the audit agencies, the Treasury has concluded that the guidance on how to account for private finance initiative transactions could be tightened as part of a general reinforcement of the message that private finance initiative projects should only be entered into on value for money grounds – not on the grounds of the accounting treatment.

The Board welcomes the Treasury's commitment to aligning the resource accounting and budgeting boundaries, which will provide benefits to both preparers and users of resource accounts (paragraphs 2.6-2.8 of this report).

The Board has a continuing interest in the development of the Accounting Standards Board's proposed interpretation of the *Statement of Principles for Financial Reporting* for public benefit entities (paragraphs 2.14-2.15 of this report). The Board will consider how the interpretation might be incorporated into the *Resource Accounting Manual* and other accounting guidance.

The disclosure of senior managers' remuneration continues to be of interest to the Board (paragraphs 2.16-2.18 of this report). It is particularly concerned that there is a legal impediment to requiring full disclosure of remuneration by senior managers of some public sector bodies. The Board is disappointed that no legislative slot to address this issue could be found before 2005-06. This is unlikely to result in full disclosure of senior managers' remuneration before the 2006-07 financial year. This will be seven years from when the Board was first notified that a legal impediment existed.

The Board welcomes the various initiatives taken to improve corporate governance in government (paragraphs 2.19-2.20 of this report). It looks forward to the outcome of the review agreed by the Cabinet Secretary and the Permanent Secretary to the Treasury, when the Board will consider whether any changes are required to the Statement on Internal Control in resource and other accounts.

The requirement by a European Union Regulation for listed companies to adopt international accounting standards for their consolidated accounts for accounting periods from 1 January 2005 together with the government's decision to permit other companies to use international standards has raised questions within the government accounting community as to what will be required of government accounts from 2005-06 onwards (paragraphs 3.1-3.8 of this report). The Board is disappointed that the Treasury does not feel the time is right to adopt international accounting standards with effect from 2005-06, but appreciates the reasons for its stance. The Board welcomes the Treasury's commitment to adopt them in the medium term – initially at least in line with the Accounting Standards Board's convergence project to align UK generally accepted accounting practice with international accounting standards. This convergence project will influence heavily the Board's workload over the next two to three years.

In January 2004, the International Federation of Accountants' Public Sector Committee issued Invitations to Comment on two areas that are of paramount importance in the development of accounting standards for the government sector: *Accounting for the social policies of governments* and *Accounting for non-exchange transactions (including taxes and transfers)* (paragraphs 3.9-3.17 of this report). The Public Sector Committee has requested responses to the Invitations to Comment by 30 June 2004. The Treasury is co-ordinating the Government's response, and the Board will consider its own response. It is unlikely that new international public sector accounting standards will be issued within the next reporting period but the Board will report on progress.

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**FINANCIAL REPORTING ADVISORY BOARD  
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## INTRODUCTION

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

1.1 The role of the Financial Reporting Advisory Board was first given statutory footing by the Government Resources and Accounts Act 2000 (the 2000 Act)<sup>1</sup>.

1.2 The main provisions of the 2000 Act require government departments to prepare resource accounts in accordance with directions issued by the Treasury. These resource accounts must follow generally accepted accounting practice (GAAP), adapted as necessary for the public sector context. Before any directions can be issued, section 24 of the 2000 Act requires the Treasury to consult a group of persons who appear to the Treasury to be appropriate to advise on financial reporting principles and standards. Records of the debates during the passage of the Government Resources and Accounts Bill show the importance that Parliament attaches to having the Government's proposals for the application and interpretation of accounting standards scrutinised by an independent body.

1.3 The Treasury had established such a group (the Financial Reporting Advisory Board) in 1996 against the backdrop of the introduction of resource accounting for government departments. The key purpose of the Board was to act as an independent element in the process of setting accounting standards for government during the development of resource accounting. 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, GAAP are justified and properly explained. Given the Board's experience in advising the Treasury on accounting issues, the Treasury retained the Board to fulfil the new, statutory role. The Board's terms of reference are set out in the Annex to this Report.

1.4 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 the Department of Finance and Personnel (Northern Ireland) is required to lay the report before the Northern Ireland Assembly. Scottish Ministers have agreed to lay the report before the Scottish Parliament, and the Welsh Assembly Government has agreed to present the report to the National Assembly for Wales. The report is addressed to the Committee of Public

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<sup>1</sup> Government Resources and Accounts 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)

Accounts and the Treasury Committee in the Westminster Parliament, to the Scottish Ministers and to the National Assembly for Wales.

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

1.5 The role of the Board has changed since 1996. The announcement by the Government of the Whole of Government Accounts programme, which will see the publication of consolidated accounts covering central government, local government and public corporations across the UK, prompted the Treasury to consider the convergence of accounting policies in the sectors for which it has lead responsibility. This has led to a phased extension of the Board's remit.

1.6 The Board retains its remit of examining proposals for amending current, or implementing new, accounting policies. Accounting guidance for departments, executive agencies and any executive non-departmental public body within the resource accounting boundary is contained in the *Resource Accounting Manual*<sup>2</sup>. Early in 2000, the Board agreed to advise the Treasury on the separate sets of accounting guidance prepared for executive non-departmental public bodies and trading funds. The Board also agreed to advise the Treasury on the implementation of accounting policies specific to Whole of Government Accounts.

1.7 During 2001-02, the Board accepted the invitation to extend its coverage to National Health Service Trusts in England and also to advise Scottish Ministers, where they are responsible for issuing reporting requirements, on the technical rules of accounting and minimum disclosure requirements.

1.8 The Government Resources and Accounts Act (Northern Ireland) 2001<sup>3</sup> mirrors the requirements of the 2000 Act. 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. As the Northern Ireland Assembly is currently suspended, the Board's report is submitted to the House of Commons under the provisions of the 2000 Act, rather than to the Assembly under the provisions of the Northern Ireland legislation.

1.9 During the current reporting period, the Board's remit has extended further, to cover National Health Service Trust and Boards in Wales and Northern Ireland.

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<sup>2</sup> The Resource Accounting Manual is available from the Stationery Office or can be located on the web at: [www.resource-accounting.gov.uk](http://www.resource-accounting.gov.uk)

<sup>3</sup> Government Resources and Accounts Act (Northern Ireland) 2001 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)

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

1.10 The reports of the Board's operations since 1996 demonstrate how the Board is independent of the Treasury. The Board does not always agree with Treasury proposals for certain accounting treatments: ongoing discussions might resolve some issues during the reporting period, but others might remain areas of concern. These are reported to the Committees. The Board normally expects to question the Treasury on such issues each year, and they are discussed in the next chapter.

1.11 During this reporting period, the Board's independent status has been enhanced by being recognised by the Cabinet Office as an ad-hoc advisory body (one of the Cabinet Office's classifications of public bodies), and by being included as a separate entity in the Office for National Statistics' classification of the central government sector. Although 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.

1.12 As an independent body, the Board has been added to the list of bodies in Schedule 1 of the Freedom of Information Act 2000<sup>4</sup>. The Board is now subject to the requirements of the Act, and the Information Commissioner has agreed the Board's Publication Scheme. 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.

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

1.13 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. Director of BG Group plc and former Chairman of BTR plc, Senior Partner of Ernst and Young and Member of the Accounting Standards Board.

#### **Members:**

John Aldridge. Finance Director, Scottish Executive (from September 2003).

Colin Balmer, CB. Finance Director, Ministry of Defence (until September 2003).

Mike Barnes. Head of Technical Development, Audit Commission.

Dr Peter Collings. Finance Director, Scottish Executive (until September 2003).

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<sup>4</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)

Heather Foster. Finance Director, HM Land Registry.

Russell Frith. Director of Audit Strategy, Audit Scotland.

Graham Jenkinson. Director, National Expenditure and Income Division, Office for National Statistics.

Professor David Mayston. Professor of Public Sector Economics, Finance and Accountancy, University of York.

Liz Passman. Head of Resource Budgeting, HM Treasury (until March 2004).

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

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 until the end of 2003.

Trevor Woolley. Finance Director, Ministry of Defence (from December 2003).

**Parliamentary observer:**

Ross Cranston, QC, MP (from July 2003).

**Alternates:**

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

Peter Coates for Jeff Tomlinson

David Dipple for Liz Passman

David Hobbs for Graham Jenkinson

Bruce Mann for Colin Balmer

Owen Mason for Nigel Reader

Peter Morgan for Martin Sinclair

Anne Rylatt for Jeff Tomlinson

Aileen Wright for Peter Collings and John Aldridge

Carole Tolley for Trevor Woolley

**Secretariat:**

*Secretary:*

Chris Richards (until October 2003)

David Watkins (from October 2003)

*Secretariat support:*

Sue Gamble

Christine Ruston

1.14 Mary Keegan, Chairman of the Accounting Standards Board, attended the Board's March 2004 meeting.

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

1.15 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).

1.16 The Board met six times during the reporting period. It considered a variety of accounting issues; the main topics are discussed in the following chapter. The *Resource Accounting Manual* and other accounting guidance has existed now for some years; not surprisingly, the Treasury's annual consultation exercise in early 2003 – which was one source of the Board's work programme for this reporting period – identified for consideration only relatively minor amendments to the accounting guidance.

1.17 The Board considers topics on the basis of written papers submitted by Treasury officials (and, on rare occasions where the topic is more relevant to another government department, officials from that department). The relevant official gives a brief resumé of the issue and the proposals. Board members might question officials and seek additional written or oral explanations before the Board gives its final opinion.

1.18 Treasury proposals for the application and implementation of new accounting standards issued by the Accounting Standards Board have, in the past, formed a considerable part of the Board's work. During this reporting period, however, no new standards have been issued (with the exception of an Application Note (G) to Financial Reporting Standard 5<sup>5</sup> on the accounting treatment of revenue, which had no impact on accounting guidance reviewed by the Board).

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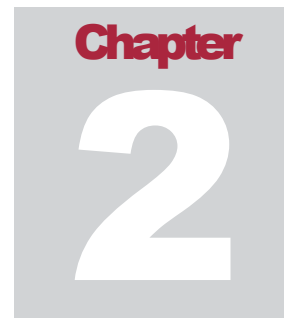
<sup>5</sup> Application Note (G) to Financial Reporting Standard 5 is available from: ASB Publications, 145 London Road, Kingston-upon-Thames, KT2 6SR

1.19 This situation is set to change. EU Regulation 1606/2002<sup>6</sup> requires, as a minimum, listed companies to prepare their consolidated financial statements for financial years commencing on or after 1 January 2005 on the basis of accounting standards issued by the International Accounting Standards Board<sup>7</sup> and adopted by the European Commission. 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 adopted international accounting standards. The impact of the Regulation on GAAP for the bodies covered by the Board's remit and on the Board's future work programme is considered later in this report.

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<sup>6</sup> EU Regulation 1606/2002 can be located at:  
[www.europa.eu.int/comm/internal\\_market/accounting/officialdocs\\_en.htm](http://www.europa.eu.int/comm/internal_market/accounting/officialdocs_en.htm)

<sup>7</sup> International Accounting Standards are available from: International Accounting Standards Publications Department, 30 Cannon Street, London, EC4M 6XH



## ISSUES CONSIDERED BY THE BOARD IN THE REPORTING YEAR

### *Introduction*

2.1 Chapter 2 reports developments on the major topics that the Board has considered in the year. It covers both new issues and those identified in earlier reports<sup>8</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*

2.2 In its sixth report, the Board noted its findings of inconsistencies in the accounting treatment being adopted by the private and public sectors in individual PFI projects and had asked the Treasury to investigate further the reasons for these inconsistencies. Although there was some reluctance on the part of the private sector partners to provide the information, the Treasury has been able to provide the Board with full details of the accounting treatment adopted in 21 out of the 23 projects that the Board had selected for review.

2.3 The Board considers that the general expectation, under extant accounting standards, is that the PFI asset should be on one of the partners' balance sheets. Of the 23 sample cases examined by the Board, there were 4 cases where the asset was on both balance sheets and 3 cases where the asset was on neither balance sheet. As part of the Treasury's consultation with the national public audit agencies, the National Audit Office reviewed a further 25 projects from the health and local authority sectors. They found that in 20 schemes the relevant fixed assets were on neither balance sheet. The Board is

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<sup>8</sup> Previous FRAB Reports are available from the Stationery Office or can be located on the web at: [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

particularly concerned about this 'off-off' accounting treatment and asked the Treasury to investigate further.

- 2.4 Initial investigation by the Treasury and the National Audit Office suggested that the public sector inconsistencies might stem from a belief that the assets must be treated as off balance sheet by the public sector if the project is to proceed. It appears, too, that certain departmental guidance reflects this view. The Board accepted the Treasury proposals for review of this area and notes that the Treasury's Private Finance Unit intends to hold a seminar to reinforce the message that departments should enter into PFI arrangements only where this provides value for money.
- 2.5 The Treasury's revised technical note *How to account for Private Finance Initiative Transactions*<sup>9</sup> was issued following the publication by the Accounting Standards Board of its Amendment to FRS 5<sup>10</sup> - *Private Finance Initiative and Similar Contracts (September 1998)* (Application Note F – Private Finance Initiative and similar contracts). Subsequent announcements by the Treasury have reinforced the message that decisions on proceeding with a PFI project should be based on value for money considerations, and not on the accounting treatment. The Board supports this statement and stresses that the accounting treatment of individual PFI projects should reflect the reality of the situation. The Board also notes that the Treasury has agreed to consider suggestions from the National Audit Office, the Audit Commission, Audit Scotland and the Northern Ireland Audit Office on how the *Technical Note* might be amended in an effort to improve compliance with the requirements of Application Note F to FRS5.

#### *Departmental boundary*

- 2.6 The Board has expressed concerns from its inception about compliance with GAAP in drawing the resource accounting boundary within which financial results will be consolidated. In particular, trading funds and non-departmental public bodies are not within the resource accounting boundary. In the interests of the timely introduction of resource accounting, the Board accepted the definition now shown in the *Resource Accounting Manual*. The Board has, however, expressed its reservations in each of its reports. In its second report, the Board welcomed the then new development of Whole of Government Accounts not least because of the potential impact on the Board's views on where the resource accounting boundary should be drawn.

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<sup>9</sup> The Treasury's revised technical note *How to account for Private Finance Initiative Transactions* is available from HM Treasury, 1 Horse Guards Road, London SW1A 2HQ

<sup>10</sup> The amendment to FRS 5 is available from: ASB Publications, 145 London Road, Kingston-upon-Thames, KT2 6SR

- 2.7 The definition of the boundary for Central Government Accounts, which is the intermediate stage in the development of Whole of Government Accounts, is not fully GAAP compliant, in that trading funds and public corporations are not included, but it does include non-departmental public bodies. It is, therefore, aligned with departmental resource budgeting boundaries.
- 2.8 The Treasury has reported to the Board that there are benefits arising from aligning the resource accounting and budgeting boundaries in addition to compliance with GAAP – including clarity and simplicity of presentation, efficiency savings and in the effectiveness of spending controls. The Treasury has informed the Board that there are no legal impediments to aligning the resource accounting and budgeting boundaries in England and Wales, although further investigation needs to be done into the legal position in Scotland. The Treasury expects to complete its consultation process in 2004. The Board looks forward to reporting an improvement in GAAP compliance in its next report.

*FRS17: Retirement benefits*

- 2.9 In its fifth and sixth reports, the Board noted that it had considered the application of FRS 17: *Retirement Benefits*<sup>11</sup> (issued in November 2000) to public service pension schemes. The original deadline for implementation was for accounting periods beginning on or after 1 January 2003, but in November 2002 the ASB extended this period by two years. The Board expressed a preference for applying the requirements of the FRS, as adapted to meet the requirements of the public sector, in accordance with the timetable originally proposed in the FRS. The Treasury concurred. In 2003 the Board considered and endorsed the full implementation of FRS 17 for 2003-04. The liabilities of the main public service pension schemes (those that have separate Supply Estimates) will be accounted for on the scheme balance sheets. Those bodies that have their own pension schemes (mainly non-departmental public bodies) will account for any liabilities on their balance sheets.
- 2.10 In its sixth report, the Board noted that it had accepted that the discount rate for pension scheme liabilities promulgated by the Treasury on the advice of the Government Actuary's Department should remain at 3.5 per cent in real terms for accounting periods prior to 2005-06. This rate was based on a review of long-term historical patterns of real rates of return on gilts. However, as also noted in the Board's sixth report, the Treasury accepted the Board's proposal that the discount rate ought to be set in line with the requirements of the FRS – the AA corporate bond rate. The Board agreed that, in order to

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<sup>11</sup> FRS 17: *Retirement Benefits* is available from ASB Publications, 145 London Road, Kingston-upon-Thames, KT2 6SR

achieve budgetary certainty, the rate would be reviewed for each Spending Review period.

- 2.11 The Treasury reported to the Board at its March 2004 meeting that the Government Actuary's Department had concluded its review of the discount rate for provisions for pension scheme liabilities. Based on the yields of AA corporate bonds with maturity dates of more than 15 years, measured over a three month period, the Actuary has determined that the rate to be used, with effect from 2005-06, in discounting pension provisions is 2.8 per cent real. The impact of a reduction in the discount rate is an increase in the level of the provisions; the overall impact of the change will be accounted for in Central Government Accounts for 2005-06.
- 2.12 The Board is now content that the Treasury has adopted GAAP (adapted as necessary in the context of schemes being financed directly through the Supply process) for the accounting treatment of public service pension scheme liabilities, with effect from 2005-06.

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

### *Discount rate for non-pension provisions*

- 2.13 As part of its review of discount rates, the Government Actuary's Department determined that the main non-pension provisions relate to nuclear decommissioning, which have a potential duration not dissimilar to that of pension liabilities. The Actuary measured over a period of three months the yield of index-linked government securities with a maturity date of 15 years or more and obtained a discount rate of 2.2 per cent in real terms. This rate will take effect from 2005-06; as with the reduction in the discount rate for the provision for pension liabilities, there will be an increase in discounted provisions, the effect of which will be accounted for in Central Government Accounts for 2005-06.

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

- 2.14 In December 1999 the Accounting Standards Board published its *Statement of Principles for Financial Reporting*.<sup>12</sup> This set out the principles that should underlie the preparation and presentation of general-purpose financial statements. However this document was primarily intended to be relevant to the financial statements of profit-oriented entities. The Accounting Standards Board stated that it believes that a common set of principles should underlie the financial reporting of all

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<sup>12</sup> the *Statement of Principles for Financial Reporting* is available from ASB Publications, 145 London Road, Kingston-upon-Thames, KT2 6SR

entities, but some of the principles in the *Statement of Principles for Financial Reporting* need to be re-expressed and others need a change of emphasis before they could be applied to these entities. The Accounting Standards Board issued the discussion paper on the *Statement of Principles for Financial Reporting – Proposed Interpretation for Public Benefit Entities* in May 2003.

- 2.15 The Board recognises that this document is a significant step on the way to providing an important base document for government accounting, and the Chairman wrote to the Accounting Standards Board noting the importance of the development. The Board awaits the final version of the *Interpretation* with interest and will discuss with the Treasury how it might be incorporated into the *Resource Accounting Manual* and other accounting guidance.

#### *Salary and pension disclosures*

- 2.16 The Board considers that the level of salary and pension disclosures should be the same as for the private sector to the extent that they are relevant. The Treasury, in consultation with the Cabinet Office, considered the implications of the Directors' Remuneration Report Regulations (SI (2002) 1986)<sup>13</sup> that came into force in August 2002 and recommended broader disclosures on pension entitlements of senior managers and ministers. Consultation with departments and ministers meant that the Board was unable to consider and approve these changes until the very end of the 2003-04 financial year. The Cabinet Office is continuing to consider the further implications of the Regulations including replacing the lengthy disclosures in the current note to the account with a separate remuneration report. The Board looks forward to the Treasury's and the Cabinet Office's proposals in good time for application in 2004-05 accounts.
- 2.17 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, as currently an individual has the ability to prevent disclosures by virtue of the Data Protection Act 1998. This year the Board noted that Statutory Instrument (2002) 1986 amended the Companies Act and made the requirement to disclose information about individuals' salary and pension entitlements part of GAAP. As section 5(3)(b) of the Government Resources and Accounts Act 2000; section 9(3)(b) of the Government Resources and Accounts Act (Northern Ireland) 2001; and the Accounts Directions in Scotland require resource accounts to follow GAAP as adapted for the public sector, there is now no need for separate legislation to require the disclosure of salary and pension information in departmental resource accounts. However the position is less clear for agencies, trading funds, non-departmental public bodies and NHS Trusts, as there is no

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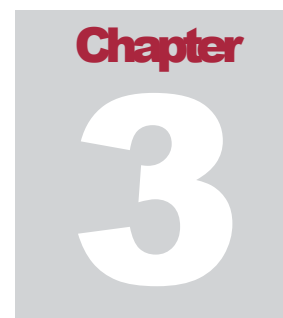
<sup>13</sup> Directors' Remuneration Report Regulations (SI (2002) 1986) is available from the Stationery Office or can be located on the web at: [www.legislation.hmso.gov.uk](http://www.legislation.hmso.gov.uk)

direct equivalent Act that applies to these bodies. The Cabinet Office has, therefore, booked a provisional legislative slot for 2005-06.

- 2.18 The Board notes that even if this legislative slot is achieved it is unlikely that the requirements for disclosure of senior managers' remuneration will be applicable until financial year 2006-07 at the earliest. The Board is extremely disappointed that this issue is taking so long to resolve. The delay has resulted in some public sector accounts not attaining the high standards of financial reporting by government that the board has a duty to promote.

### ***Corporate governance***

- 2.19 As noted in the Board's past three reports, the Treasury has been developing guidance on corporate governance following the recommendations of the Turnbull Report. The Board is supportive of the further developments of the Statement on Internal Control, which is included with the accounts and requires central government bodies to identify internal control issues of concern. Amendments to the Statement on Internal Control were approved.
- 2.20 The Board welcomes the initiatives taken by the Treasury to improve corporate governance in government. In particular, the Board notes that the Cabinet Secretary and the Permanent Secretary to the Treasury have agreed that there should be a review of corporate governance in central government. The Treasury is in the process of setting up the review, which will consider the need for a set of high level principles for corporate governance in central government that promote good performance, accountability and transparency. The Board looks forward to being kept informed of the progress of the review and to considering any changes to the Statement on Internal Control that might follow.



## FORWARD WORK PROGRAMME

### ***Convergence of accounting standards***

- 3.1 As noted in Chapter 1, 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 would be permitted to adopt IFRS. The Department of Trade and Industry (DTI) is currently preparing Regulations to amend the Companies Act 1985 to provide a mechanism for companies to choose to adopt IFRS where they are not required to do so.
- 3.2 The Accounting Standards Board (ASB) has published a Discussion Paper setting out its strategy for convergence with IFRS, taking the view that there can be no case for the use in the UK of two sets of different accounting standards in the medium term. The ASB acknowledges that this will require a concerted effort to bring UK accounting standards into line with IFRS.
- 3.3 The Board has discussed with the Treasury how accounting policies for the bodies covered by the Board's remit will change as a result of the EU Regulation and in the light of the announcement by the DTI, given that the Government Resources and Accounts Act 2000 requires the Treasury to issue directions to departments to produce resource accounts that conform to generally accepted accounting practice subject to such adaptations as are necessary in the context of departmental accounts.
- 3.4 The Treasury confirmed that GAAP could be either IFRS or existing GAAP, which, under the ASB's proposals, will converge with IFRS over a period of time. The Treasury proposes to follow the ASB's convergence strategy. There are several reasons for this approach; the main reasons are reported in paragraphs 3.5 to 3.7.
- 3.5 There is no single IFRS that corresponds to FRS5 *Reporting the Substance of Transactions*. The accounting treatment of PFI and similar contracts is of great importance in the public sector, and an issue of concern to the Board, and the Treasury believes that the loss of FRS5 would be a

major retrograde step. Although the IASB's International Financial Reporting Interpretations Committee is taking forward work on accounting for service concessions, which might meet the UK's need for an accounting standard for PFI contracts, this work is unlikely to be finished in the near future.

- 3.6 Other uncertainties also exist. The International Accounting Standards Board (IASB) has embarked on an ambitious programme to improve most of the IFRS. Some of the work has been completed, and a batch of new IFRS was issued by the IASB in December 2003. The programme is not complete, however, and the timetable is such that the Treasury has concerns about the number of changes in accounting policies that would be required year-on-year if IFRS were to be adopted from 2005-06.
- 3.7 Some uncertainty exists over whether some of the IFRS will be adopted by the European Commission. If this proves to be the case, there will be gaps in the body of accounting standards that would be unfilled in the case of listed companies. This uncertainty makes it very difficult for the Treasury to produce appropriate accounting guidance for the Board's consideration in time for the bodies under the Board's remit to apply them for the financial year 2005-06.
- 3.8 In the Board's view the government should take the lead in adopting IFRS and is disappointed that the Treasury does not feel the time is right to move to IFRS alongside the listed company sector, but appreciates the reasons for its stance and welcomes the Treasury's commitment to adopting IFRS in the medium term. The Board accepts the Treasury's proposal to follow the ASB's convergence agenda and notes that this will allow the bodies covered by its remit to manage a phased programme of change. Nevertheless, the Board has requested the Treasury to continue to monitor developments in IFRS. The Treasury will discuss with the Board its conclusions on whether the Government could adopt IFRS in advance of the completion of the ASB convergence strategy.

### ***International Public Sector Accounting Standards***

- 3.9 The International Federation of Accountants' Public Sector Committee (IFAC PSC) is responsible for reviewing international accounting standards and interpreting them in the public sector context. These interpretations are issued as International Public Sector Accounting Standards (IPSAS)<sup>14</sup>. In 2000 IFAC PSC announced that it would start to consider complex accounting issues specific to the public sector that were attracting interest from various commentators, accountants, politicians and others across the international community. The first two issues to be considered were *Accounting for the social policies*

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<sup>14</sup> Publications from the International Federation of Accountants are available from the IFAC on-line bookstore through their website: [www.ifac.org](http://www.ifac.org)

*of governments and Accounting for non-exchange transactions (including taxes and transfers).*

- 3.10 IFAC PSC established Steering Committees to consider each of the topics, with the eventual aim of producing IPSAS addressing the accounting treatment of these two areas. The membership of the Steering Committees came mainly from public sector bodies from a range of countries. As the first stage in developing the IPSAS, IFAC PSC has issued the Invitations to Comment written by the Steering Committees. Comments are due to IFAC PSC by 30 June 2004. The Treasury will co-ordinate the Government's response. The Board will consider the proposals in the Invitations to Comment, note the contents of the government's response and submit its own response as appropriate.

*Accounting for the social policies of governments*

- 3.11 The debate on accounting for social policies for governments tends to concentrate on the state old age pension – not only in the UK but also, as evidenced in this Invitation to Comment, in many countries across the developed world. The old age pension is not the only social policy of governments that gives rise to expenditure, and the Steering Committee considered a wide range of expenditure types including collective goods and services (such as defence and law and order), individual goods and services (such as health and education), and cash transfers (social security benefits). Given the topicality of old age pensions, the Invitation to Comment discusses them in a separate chapter.
- 3.12 In its sixth report, the Board noted that the IFAC PSC Steering Committee's initial findings coincided with those of the Board – that, in general, social security expenditure (excluding the state old age pension) does not give rise to a liability, but the treatment of the old age pension would require further consideration. The Steering Committee's views as expressed in the Invitation to Comment are unanimous on the accounting treatment of collective and individual goods and services: no liability arises prior to the provision of the goods or services. The Steering Committee was also unanimous in its view that no liability exists in respect of social security benefits (other than the old age pension) until such time as the recipient has demonstrated complete satisfaction of all eligibility criteria.
- 3.13 The Steering Committee was not unanimous in its views on the accounting treatment of the old age pension. The majority view expressed in the Invitation to Comment is that the old age pension is no different from other social security benefits and that no liability arises until such time as the beneficiary has demonstrated complete satisfaction of all eligibility criteria – including remaining alive. The minority view is that, as soon as people enter the workforce, they start making economic decisions based on the expectation that they will

receive an old age pension in the future and that the liability builds up over the working life of the potential beneficiary.

- 3.14 The Board will consider the arguments put forward in the Invitation to Comment. It will also consider the Treasury's proposals for the accounting treatment of UK social security expenditure in the light of these international developments and will publish its conclusions in a future report.

*Accounting for non-exchange transactions (including taxes and transfers)*

- 3.15 Non-exchange transactions are those transactions where one party does not receive or provide goods, services or other benefits in direct proportion to the amount they pay or receive for them. An example of a non-exchange transaction is taxation revenues – the taxpayer receives indirect benefits from paying tax, but not in direct proportion to the amount of tax paid. There is no generally accepted accounting practice in respect of non-exchange transactions, particularly in respect of taxation revenues from which governments derive most if not all their revenues. The IFAC PSC believes it is important to produce an IPSAS to cover this area.
- 3.16 The Board has reported previously the work of the Treasury and the revenue collecting departments in developing accruals accounting policies for taxation revenues. The Board endorsed the Treasury's proposals that the underlying principles of accounting for taxation revenue should be for recognition at the time of the underlying economic activity, subject to the ability to obtain a reliable measure of the taxation due. Much of what the Steering Committee says in this Invitation to Comment is in line with these proposals. However, the Invitation to Comment covers other topics that might have implications for the way in which the Treasury has developed certain treatments in resource accounts (for example, the accounting treatment of Parliamentary Supply) and the Board will consider these in developing its response to the IFAC PSC.
- 3.17 The Treasury and revenue collecting departments are committed to reconsidering their taxation accounting policies in the light of these international developments and will bring proposals to the Board. The Board will consider these and publish its conclusions in a future report.

***Reporting financial performance***

*Format and content of resource accounts*

- 3.18 Resource accounts were first published for the financial year 1999-2000, and the latest published accounts were for 2002-03. The Board considers it is now appropriate to review the format and content of

resource accounts to ensure that they provide meaningful information that can be understood readily by users of the accounts who have some knowledge of the way in which the government sector is managed. The Board has commissioned a review and will consider its recommendations in time to implement them for resource accounts for 2005-06.

*Format and content of accounting guidance*

- 3.19 The Board informed the Committees in its sixth report that it had started a review of the accounting guidance and had agreed that the separate sets of guidance for departments and agencies, for non-departmental public bodies and for trading funds should be brought together into a single set of guidance. The Board has considered this further and is now of the view that the accounting guidance should comprise two elements. The main, high level Manual should discuss the accounting principles and standards that should underpin the reporting of financial performance by the entities covered by the Board's remit. This Manual will be supported by worked examples where the Treasury and accounts preparers determine such worked examples to be necessary. The Board intends the revised guidance to be in place for 2005-06.

**FINANCIAL REPORTING ADVISORY BOARD  
REPORT FOR THE PERIOD APRIL 2003 TO MARCH 2004.**



## 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 in England and Wales 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
  - 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>15</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 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), 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

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<sup>15</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)

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 Welsh Assembly Government 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 Principal Finance Officers 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 National Statistician

1 member nominated by the Accounting Standards Board

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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.







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