

MINUTES OF THE 80th FRAB MEETING HELD ON THURSDAY 29th JUNE 2006 AT HM TREASURY

Present: Elwyn Eilledge (Chair)
Ian Carruthers
Simon Fiander
David Heald
Robin Lynch
Martin Sinclair
Jeff Tomlinson
Ken Wild

Miranda Carter
Russell Frith
David Jones
Michael Romberg
David Thomson
John Thornton

Secretariat: David Watkins (Secretary)
Sarah Solomon
Chris Ruston

1. The Chairman welcomed everyone to the meeting. Apologies were received from, Mike Ashley, Martin Evans, Rob Ffello (who was substituted for by Simon Fiander), Alastair Matthews (who was substituted for by David Jones), Nigel Reader, Alyson Stafford, and Trevor Woolley (substituted for by John Thornton).
2. The Chairman welcomed Ian Carruthers to his first meeting as observer for the CIPFA/LASAAC joint committee and Simon Fiander from the Scrutiny Unit who was attending the Board for the first time.
3. The Chairman announced that the Board Secretary had been promoted, so was moving on from his current post. A new Board Secretary was being recruited.

Item 1: Minutes of the Last Meeting: Paper FRAB (80)01 and Matters Arising

4. The minutes of the last meeting were agreed.
5. The FRAB Report was published on 6 June and was circulated to all Board members. The Secretary reported the list of journals that the report had been sent to. The Board felt that the report should have a wider press and suggested some further contacts. Whitehall and Westminster World have asked the Chairman for an article in July and he will be submitting something shortly.
6. In response to a question from David Heald the Secretary confirmed that the cost of capital charge group had not yet convened but that this was still on the agenda, once other work had been completed.

Item 2: Board's Response to the IPSASB Exposure draft on Non-Exchange Revenues FRAB (80)02

7. At the last meeting the Treasury presented paper FRAB (79) 03 which included a draft response to the International Public Sector Accounting Standards Board (IPSASB) Exposure Draft (ED) 29 which was issued in January 2006 and detailed its proposals for the treatment of revenue from non-exchange transactions (including taxes and transfers). The draft addressed the two main areas where the proposals in the ED differed to the existing approach. The Board felt that the paper reflected the Treasury position rather than views of the Board and asked that the response should be amended. The Board also requested further background information on tax expenses, in particular, a summary of Robin Lynch's paper FRAB (74) 06A together with the Treasury's response to this paper.
8. A new draft letter was circulated. The Treasury explained its position. It has compared tax systems across the World and there is a huge spectrum of treatments but it favours the OECD system as this splits tax relief into its component parts, splits tax and social security and represents an approach that is somewhere between gross accounting and net accounting.
9. There was a discussion and some difference of opinion about what constitutes payable and non-payable tax credits. This difference would have an effect on the numbers (the overall effect of moving to a gross system would be to make the numbers bigger). Reconciliation would be possible but comparability issues are very complex.
10. The Chairman believed that more guidance was needed both on determining what the tax asset is, (and therefore whether the accounting treatment should be gross or net), and what fair value means in the context of non-exchange revenues. The draft should be amended to call for clearer terminology and better definitions in these areas. The Board agreed the draft response, subject to these additional comments being incorporated.

Item 3: IFRS 6 Exploration for and Evaluation of Mineral Resources (FRAB(80)03)

11. The Treasury presented this paper which considered the implementation of IFRS 6: *Exploration for and Evaluation of Mineral Resources* in the IFRS based FReM.
12. The Board agreed the proposal that IFRS 6 would apply in full but that, since the Treasury is not aware of any entities covered by the FReM engaged in such activities, no detailed guidance needs to be given in the IFRS based FReM. The FRAB working group and RABIG had been consulted, there were no plans to consult further and, if any entities were affected, advice would be given on an ad hoc basis.

Item 4: PFI – Update on Progress (FRAB(80)04)

13. The Treasury gave a further update on the progress made by the PFI working group, which had met for the second time on the 17 May. The meeting and subsequent correspondence between working group members had narrowed the possible options down to three, to improve consistency in accounting for PFI. These were:
- Withdraw the Technical Note (TN) completely;
 - Withdraw the TN but retaining some content, to be placed elsewhere;
 - Major re-write of the TN.
14. However the group had also identified some practical issues that need to be resolved before the working group could realistically consider the options further. The working group had identified areas of Application Note F to FRS 5 (AN) to which different interpretations are being applied by auditors in relation to its application to the public sector, but significantly, this was not an issue in applying the AN to the private sector. Consequently, the audit firms are encountering scenarios in which no party claims ownership of the PFI asset for accounting purposes. The working group were of the view that there is a need to resolve these differences and achieve a mutual and consistent understanding of the AN to the public sector before proceeding further in its work. The group had also discussed the possible role of the UITF in providing a pronouncement in relation to the areas of the Application Note which may give rise to a differing interpretation in practice, but had decided that this was not an appropriate course of action as there was no disagreement in the application of the AN to the private sector.
15. Martin Sinclair reported that the majority of members of the group felt that withdrawing the TN would narrow the inconsistency in accounting for PFI. He also felt that work on the International Financial Reporting Standards (IFRSs) would provide an opportunity for broader discussion.
16. However, the working group discussions had been dominated by the different interpretations of the firms. At the moment the group doesn't have full representation from the four major firms (but it is believed their opinion is split 50:50). The situation was fairly unique in that the difference of opinion only applied in the public sector context. (Ken Wild was worried that firms were referring to the TN rather than the AN.) The Board also wondered whether it might be that the disagreement was at practitioner level rather than at a technical level.
17. The Board members voiced their concerns. Jeff Tomlinson said that the Department of Health PFI team felt that the working group should consider their views, otherwise the working group may over simplify the rules and would not take account of more complex PFI cases. John

Thornton questioned the effect that withdrawing the TN would have on the MOD's balance sheet. Martin Sinclair agreed that the working group would have to think about if and how to make retrospective changes.

18. David Thomson felt that there was a risk that the changes might mean that departments would say that they couldn't afford to complete projects that were currently off balance sheet. John Thornton felt that this was less of a risk now because more projects were being put on the balance sheet.
19. Robin Lynch confirmed that this was supported by the information that the ONS and the Treasury had gathered in their joint exercise with the Office for National Statistics on the PFI data collection strategy. (The results of this exercise would be available in September and the next phase of the project was to build up an overall picture of what has been happening.)
20. David Heald was concerned that the differences identified would delay the conclusions of the project. He felt that it was important to get the accounting treatment correct and that so long as the practical effects were identified, they could be managed out. He was keen that the Board should take a decision as soon as possible. The Chairman was also keen that there should be some action.
21. The Board discussed the implications of warning the firms that the TN will be removed. Michael Romberg was worried this change would entail a significant resource cost and which will be followed by a further change once IFRS were introduced, with related further costs. He felt that the Board shouldn't commit to two changes in potentially quick succession. Jeff Tomlinson was also concerned about timing and withdrawing the TN without knowing the consequences. However Martin Sinclair said that last retrospective exercise had not entailed a great deal of effort and had not resulted in significant cost.
22. The Board agreed that the Treasury should continue to convene working group meetings, but with a revised mandate, in that the working group should proceed on the basis that the Board will recommend the withdrawal of the TN, and the need for firms to resolve their differences in applying the AN to the public sector. They agreed that the working group should also consider retrospection and other practical effects of withdrawing the TN. Michael Romberg suggested that the group should also be expanded to include the other two major firms. Martin Sinclair asked the Secretary to write terms of reference for the group.

Item 5: IAS 38 Intangible Assets (FRAB (80)05)

23. The Treasury presented this paper which considered the implementation of IAS 38: *Intangible Assets* in the IFRS based FReM. It was proposed that IAS 38 be applied in full, as interpreted, in that the

option of using the Cost Model for subsequent measurement be withdrawn.

24. The proposal will also remove the adaptation of SSAP 13 which is currently in the FReM. The application of the Standard will mean that some entities previously not capitalising internally generated intangible assets will be required to do so if the relevant recognition criteria are met. Assets would be carried at valuation at the balance sheet date. The Treasury, in considering the impact this will have on public sector accounts, concluded that the implementation of the Standard will have a material effect on the accounting and budgetary regime for some public sector entities in comparison with the current FReM requirements. The full application of the Standard, as interpreted, is also likely to raise practical difficulties for some entities in relation to initial cost recognition of the assets and subsequent measurement at valuation, which will need to be addressed. However in principle, it was recommended that the Standard be implemented in full, as interpreted.
25. The Treasury had consulted departments on the proposal and received several responses. It proposed that a working group be set up in the Autumn for entities that are affected by the proposed changes to discuss the practical aspects of implementing the Standard.
26. David Jones felt that there was a broad net for assets which require recognition which went beyond Treasury funded items. The obvious example for Ordnance Survey being databases. He asked whether the Board was comfortable with the new concept of amortised replacement costs. He felt that the opportunity should be taken to clarify the requirements since it would be equally difficult to determine current value and there was a risk of inconsistency. The Secretary agreed that more consistency on valuation was required. He acknowledged the Ordnance Survey's concerns and felt there should be more guidance on measurement. Ian Carruthers commented that Australia had increased its levels of capitalisation and that there may be lessons to be learnt from its experience. Martin Sinclair said that there were other sources of guidance that could be drawn on (such as IAS 16).
27. Robin Lynch said that under the revised SNA, freely available assets are not required to be capitalised, ie if research of a general nature is not protected and if the product of that research and development is freely available with no economic benefit to its owners, then the effort should not be capitalised.
28. John Thornton was concerned about the implementation of the standard for the MOD. MOD was not in favour of capitalising internal costs. He was particularly concerned that there were currently a large number of in-house project teams and capitalisation of their cost would mean an apparent increase in capital costs for the department. This would have significant consequences which should be recognised. The introduction of IAS 38 will represent a sea change and needs to be fully thought through, especially in terms of the interpretation applied.

29. The Secretary agreed that this should be discussed further outside the meeting and will be incorporated into the work on valuation issues.
30. The Board agreed, however, with the Treasury's proposal that the standard should be applied in full, as interpreted.

Item 6: SIC-32 Intangible Assets – Web Site Costs (FRAB(80)06)

31. The Treasury presented this paper which considered the implementation of SIC Interpretation 32: *Intangible Assets – Web Site Costs* in the IFRS based FReM.
32. No significant issues were raised and the Board agreed that SIC 32 would apply in full as interpreted for the public sector context.

Item 7: Pension Liabilities: Discount Rate (FRAB(80)07)

33. The Treasury gave an update on the discussions concerning the rate for discounting pension liabilities.
34. At the last meeting the Board agreed that the real rate of 2.8% used at present should be reviewed for 2007-08 and possibly for 2006-07. Since then the Treasury has had discussions internally, with the Government Actuary's Department and some of the pension schemes and has agreed that the rate could be reviewed annually. In order to comply with the timetable for completion of Estimates, it would be necessary to use the rate as at 31 January each year which would be used to determine (a) the pension provision for that year (ie that ending in March) and (b) the estimated figures for the interest charge and (perhaps) current service costs for the following year (ie that starting in April). The use of a rate determined as at 31 January will not affect the Estimates for the current (as was feared at the last meeting) as these are based on the rate determined at the previous 31 January. (Thus the rate determined at 31 January 2007 will be used to determine the pension provision at 31 March 2007 and the Estimates for 2007-08. The Estimates for 2006-07 are unaffected.) The effect of using different discount rates in determining the pension provision would be taken through reserves. The advantage of using a rate determined as at 31 January is that it avoids the timing problem caused by using a year end rate.
35. The Board discussed the application of the rate in Scotland and Northern Ireland. Although Northern Ireland works to a different timetable it was thought that it would be able to accommodate the 31 January rate. However this wouldn't be acceptable to Scotland as it had to complete its Estimates by December in each year.
36. The Board agreed an annual review date of 31 January for England and Wales, with the option to change to 31 March if bond rates changed significantly between January and March. It was suggested that Scotland could use a AA corporate bond rate determined as late

as practical in the budgets/estimates cycle (this may mean September or October) with the rate at 31 January being used for the end of year accounts for consistency with other parts of the UK.

37. The Treasury will confirm that these arrangements are acceptable to the Scottish Executive and will promulgate the changes through a PES paper. (In subsequent discussions, Scotland has agreed that the arrangements are acceptable and a draft PES paper has been prepared.)

Item 8: Grants in Aid – Revised Wording for the FReM (FRAB (80)08)

38. The Treasury presented this paper which asked the Board to agree amendments to the 2006-07 FReM to reflect their earlier decision on Grants and Grants in Aid (FRAB 76(6bi)).
39. The Board agreed the suggested amendments.

Item 9: IAS 19 Employee Benefits (FRAB (80)09)

40. The Treasury presented this paper which considered the implementation of IAS 19: *Employee Benefits* in the IFRS based FReM.
41. The paper assumes that IAS 19 will be applied in respect of pension and termination benefits. An exposure draft issued in June 2006 will bring the disclosure requirements of FRS 17 into line with IAS 19. However, since this hasn't been finalised, the Treasury will return to the Board at a later stage to finalise the wording which will go into the IFRS based FReM. The paper concentrated on retirement benefits, rather than other benefits such as holiday pay.
42. The standard will be adapted for IFRS based FReM users in that it will apply to pension schemes rather than to the accounts of employing entities. This will reflect the current treatment under FRS 17. IAS 19 allows alternative treatments for the treatment of actuarial gains and losses. The standard will be interpreted to clarify that actuarial gains and losses can only be recognised through reserves. This would restrict the standard to what we currently allow.
43. Russell Frith asked about the requirements in IAS 19 regarding the treatment of "termination benefits" as the current treatment was subject to refinement if the proposals in a recent exposure draft were adopted. He felt that it would be good if there were a consistent approach across all schemes. The Treasury acknowledged that the proposals in the paper were "work in progress" and would be reviewed once the position on the proposals in the exposure draft were clearer.

Item 10: IAS 26 Accounting and Reporting by Retirement Benefit Plans (FRAB (80)10)

44. The Treasury presented this paper which considered the implementation of IAS 26: *Accounting and Reporting by Retirement Benefit Plans* in the IFRS based FReM.
45. This standard has limited application to the entities, funds and flows covered by the IFRS FReM. Implementation should be straightforward. There are a few areas where options are given but the IFRS based FReM will be worded to limit those options (through adaptations and interpretations) to ensure consistency with current practices. The proposed wording is similar to the current FReM.
46. The Board was content with the proposals.

Item 11: IFRS 5 Non-Current Assets Held for Resale and Discontinued Operations (FRAB (80)11)

47. The Secretary presented this paper which considered the implementation of IFRS 5: *Non-current assets held for sale and discontinued operations* in the IFRS based FReM. It suggested that the standard should apply in full but should be interpreted to scope out machinery of government changes.
48. During the consultation, there was some question as to whether the requirement for assets held for sale to be measured at the lower of carrying amount and fair value, less costs to sell, could lead to assets held for sale being held at an amount that could be described as being inconsistent with the general approach of current value. However those who commented said that, generally, assets will be written down to fair value, less costs of sale, and it will be rare that the opposite would be true (that is, that someone is willing to pay more for the asset than its book value) and thus rare that assets would be carried at an amount lower than fair value less costs of sale.
49. Russell Frith felt that this scenario was possible where hospital sites are valued while they are still in use. He asked whether it should be possible to value them at the open market value, as this is what they would be valued at once they were closed.
50. The Secretary felt that since such scenarios were rare, they should be dealt with by the Treasury on a case-by-case basis. The Board agreed with the Treasury's proposal that the standard should be applied in full as interpreted.

Item 12: IAS 10 Events After the Balance Sheet Date (FRAB (80)12)

51. The Secretary presented this paper which considered the implementation of IAS 10: *Events after the balance sheet date* in the IFRS based FReM.

52. The Board approved amendments to the FReM for 2006-07 to implement FRS21 (IAS 10) *Events after the balance sheet date*. This paper asked the Board to approve the FReM text, amended for references to IAS 10, for inclusion in the IFRS based FReM.
53. IAS 10 will be interpreted in the same way as FRS 21 – the dates of authorisation for issue of the financial statements of the entities covered by the Manual have been interpreted in Practice Note 10 *Audit of financial statements of public sector entities in the United Kingdom*. In addition, IAS 10 needs to be interpreted in relation to the treatment of “dividends” on PDC.
54. The Board was content with the proposals.

Item 13: Forward Work Programme (FRAB (80)12)

55. The forward agendas for the FRAB had been circulated. Ian Mackintosh will make a presentation to the Board in October on the IASB/FASB convergence programme.

Item 12: Any Other Business

56. The Secretary presented a paper which proposed that the 2006-07 FReM should be amended to clarify the requirements for the remuneration report to be signed. The Board agreed the proposed amendments.
57. David Thomson brought to the Board’s attention a ruling by the Freedom of Information Commissioner regarding salary disclosure. He had ruled that personal data of this nature was not exempt and that departments were entitled to publish it without the agreement of the person concerned. This could have an impact on the ongoing discussions on salary and pensions disclosure. An update will be included in the paper for the next meeting on Salary and Pensions disclosures. As this decision represented a major change, it was felt that something should be issued from the Cabinet Office. (The Cabinet Office has been informed of the Information Commissioner’s decision, and the Treasury is awaiting a response.)

Item 13: Date of the Next Meeting

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

Thursday 21st September 2006
 Tuesday 31st October 2006
 Monday 11th December 2006