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**FINANCIAL REPORTING  
ADVISORY BOARD TO  
THE TREASURY**

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**Second Report  
September 1997 to April 1999**

**JULY 1999**

## Foreword

This is the Board's second report and covers the period from September 1997 to April 1999.

Our initial work, covered in our first report, was to review the whole of the newly created Resource Accounting Manual - a very substantial task indeed. It was aimed at ensuring that the introduction of resource accounting was underpinned by sound accounting principles so that the full benefits of improved reporting of public finances could be achieved.

In this, our second report, we follow up on issues raised in our first report, explain the views we have taken on amendments to the Manual arising from new financial reporting standards; and record our views on amendments arising from the implementation of the Manual by departments. We have continued to be concerned that the principles of resource accounting should accord with generally accepted accounting practice (GAAP) as far as possible and that the best possible reporting is achieved by resource accounting. We are pleased that no new departures from GAAP have been introduced during this reporting period.

Almost inevitably with a project of this nature the report leaves a number of matters still requiring further review. In our first report we highlighted the importance the Board attaches to reviewing the success of the Manual. We look forward to a report from the Treasury on the outcome of the preparation and audit of departments' "dry-run" resource accounts - the first real test of the Manual in practice.

We are pleased that the Board's remit is being extended to oversee the accounting guidance in respect of non-departmental public bodies and trading funds, and look forward to carrying out our expanded role.

The Board wishes to thank the Board Secretariat, Chris Richards and Sue Gamble, for all their hard work and invaluable support which has enabled us to deliver this report.

Elwyn Eilledge (Chairman)  
Colin Balmer  
Mike Barnes  
Heather Jackson  
Graham Jenkinson  
Caroline Mawhood  
David Mayston  
Caroline Slocock  
Ken Wild

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# Executive Summary

## Introduction

1. This is the second report of the Financial Reporting Advisory Board (FRAB). The aim of the Board has been to ensure as far as possible that resource accounts meet the best possible standards of financial reporting by following generally accepted accounting practice (GAAP) as far as possible. This second report covers a period marked by a shift in focus from examining the whole Resource Accounting Manual to examination of issues arising from the first report, new emerging issues and subsequent amendments to the Manual.

2. The Board is pleased to report (paragraph 1.5 of our main report) that there have been no new departures from GAAP introduced during the reporting period.

## Main Issues Arising from the Previous Report - Areas of Concern

3. **The Departmental Boundary (section 2.1.1)** remains an area of ongoing interest. The Board approved an adaptation of Financial Reporting Standard (FRS)9: *Associates and Joint Ventures* (section 3.7), along with some additional criteria to apply to FRS 2: *Accounting for Subsidiary Undertakings*, to ensure compatibility with the resource accounting boundary. The Board wishes to re-examine the limits of the boundary in the light of emerging experience.

4. During the reporting period the Board welcomed the opportunity to comment on the Whole of Government Accounts scoping study which may also impact on the boundary issue.

5. **Interaction with Resource Budgeting (section 2.1.2)** is another area of ongoing interest. The Board awaits the results of various trials being conducted by the Treasury in this area.

6. **Accounting for the Effects of General Inflation (section 2.1.3)** We recognise the Treasury's rationale for wishing to account for the effects of general inflation but we also acknowledge that the introduction of such a convention could have considerable impact on departments.

7. The Treasury has advised that it does not plan to include an adjustment for the effect of general inflation in departments' resource budgets. The Board's view is that if the adjustment is not to be recognised in the departments' budgets the information should be disclosed by way of a note to departments' resource accounts rather than in the accounting schedules. However, the FRAB agreed that a different approach was appropriate in respect of student loans (section 3.3).

**8. Heritage Assets (section 2.1.4)** The Board considers that, in principle, heritage assets should be valued and appear on the balance sheet, but accepts that there are particular difficulties due to the nature of the assets. A working party has been addressing the problem. The Board accepted the amendments to the Manual reflecting the working party's findings to date, and noted that the question of whether non-operational heritage buildings and land should be placed on departments' balance sheets is the subject of further work.

**9. Salary and Pension Disclosures (section 2.1.5)** The Board's view remains that the principles of the Greenbury Report should apply to resource accounts, and we have accepted that revised Cabinet Office proposals are an acceptable approximation of this.

### **Other issues Raised in the First Report**

**10. Success of the Manual in Practice (section 2.2.1)** In our first report we highlighted the importance of the Board reviewing the success of the Manual. We note that the Treasury has feedback systems in place and that it will report back on the outcome of the preparation and audit of departments' "dry-run" resource accounts in respect of 1998-99 - the first real test of the Manual in practice.

**11. Operating Cost Statement - Explanation of the Three Totals (section 2.2.2)** In our first report we suggested that the Treasury should provide a clearer explanation of the three 'bottom line' totals that are to be included in the operating cost statement. The Treasury has advised us that this is being taken forward as part of the resource budgeting developments.

**12. Private Finance Initiative (section 2.2.3)** In our first report we stated that, as detailed guidance was being developed by the Public Sector and Not-for-Profit Committee of the Accounting Standards Board (ASB), we would return to this topic in the future. We have accepted the interim guidance issued in a technical note by the Treasury. Following the issue by the ASB of its Amendment to FRS5: *Private Finance Initiative and Similar Contracts* (September 1998), the Treasury produced a draft revision to its technical note on which it has been consulting. This revised guidance has been accepted by the FRAB subject to the Treasury accepting, in principle, the requirement for retrospection. We are pleased to note that the Treasury has since agreed to this.

## **Main New Issues during the Report Period**

**13. Pension Scheme Statements (section 3.1)** In a major amendment to the Manual, the FRAB approved a new chapter setting out detailed proposals on the form and content of pension scheme statements.

**14. Student Loans (sections 3.2 & 3.3)** The FRAB considered two issues in relation to student loans. The first, in a departure from the FRAB's role of overseeing the principles set out in the Manual, the Treasury asked the Board for a view on the application of the Manual to whether or not a provision should be set up for the future subsidy resulting from the low interest recoverable over the life of the student loans. The Board's view, on balance, was that a provision should be established at the time loans are granted.

15. The second issue related to accounting for inflation. As student loans are currently subject to budgetary controls, which include an adjustment for the impact of general inflation, we agreed in principle that the adjustment should be reflected in the Department for Education and Employment's resource accounts.

**16. Other Items.** During the period covered by this report the Board accepted other amendments to the Manual due to new accounting standards and issues arising from the implementation of resource accounting. Notably, FRSs 10, 11, 12 and 13 were incorporated into the Manual in their entirety.

## **Future Role of the Board (section 4)**

17. The Board sees itself as having a continuing role in reviewing the Manual and considering any proposals for change. The Treasury's report on the operation of the FRAB concluded that the Board had operated independently and that its remit should be extended now to oversee the accounting guidance in respect of executive non-departmental public bodies and trading funds.

18. The Board noted that the Treasury review's conclusions was that the process had worked well. Members did not feel their independence had been compromised and would be ready to accept the extension of their remit.

# Main Report

## 1. Introduction

1.1 This is the second report of the Financial Reporting Advisory Board (FRAB). It covers the period from September 1997 to April 1999. The first report was issued to Parliament (the Committee of Public Accounts (PAC) and the Treasury Committee) in July 1997 and was the subject of a Treasury Committee hearing in December of that year.

1.2 As we reported in the first report the Board's aim has been to help ensure that the best possible financial reporting is achieved by Resource Accounting. As part of this we have aimed as far as possible to ensure that departmental resource accounts<sup>1</sup> are governed by UK generally accepted accounting practice (GAAP) and that departures from or modifications to GAAP are fully explained. This is consistent with the White Paper *Better Accounting for the Taxpayer's money: The Government's Proposals - Resource Accounting and Budgeting in Government* (Cm2929), which stated that resource accounts would be based on GAAP to the extent that it was appropriate and meaningful in the public sector context (paragraph 3.13).

1.3 This remit was emphasised subsequently by recommendations from both the *Committee of Public Accounts (9th Report of Session 1996-97)* and the *Treasury Committee (5th Report of 1995-96)* for close adherence to GAAP, subject to the particular circumstances of central government.

1.4 In the period covered by our first report we examined the whole of the Resource Accounting Manual. In our first report we set out the general criteria we applied in reviewing the Treasury's proposals and the main areas where the treatment prescribed in the Manual either departed from GAAP or put a particular interpretation on it. It also drew attention to those areas which were set out only provisionally or incompletely, pending further examination or practical experience, and to which we intended to return.

1.5 In our second report we have taken the same approach towards the items we have considered. The period covered by our second report has seen a shift in the focus of the Board's work - from an examination of a whole version of the Manual, the subject of our first report, to examination of issues outstanding from that first report, and amendments to the previously agreed version of the Manual. In section 2 below we describe progress on the issues arising from our previous report, and in section 3 we discuss the main new items considered by the Board over this period. In many cases these have resulted in amendments to the Manual. Where these

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<sup>1</sup> The use of the word 'department' in this context is taken to include other entities which come within the departmental boundary, such as On-Vote Agencies and Non-Executive NDPBs accounted for on-vote. For full details, see section 1.6.1 of the Manual.

amendments relate to areas covered by new or revised accounting standards the Board is pleased to report that there have been no new departures from GAAP introduced. In section 4, we comment on our future role. Annex A describes the terms of reference and composition of the Board, and how we carried out our task. Annex B describes other issues addressed by the Board not covered in the main report.

## **2. Main Issues Arising from the Previous Report**

### **2.1 Areas of Concern**

#### ***2.1.1 Departmental Boundary (Manual, section 1.5)***

2.1.1.1 In our last report we stated our concerns about the drawing of the boundary for resource accounting, whereby trading funds and non departmental public bodies (NDPBs) are deemed to be outside. This results in the position that these bodies are not consolidated into accounts even though many of the Government's outputs are delivered through them. This is an area of ongoing interest to us that we wish to re-examine in the light of emerging experience.

2.1.1.2 During this reporting period we were asked to comment on the Whole of Government Accounts scoping study. (A copy of the response is at Annex C.) We welcome this development, and look forward being kept in touch with progress. Not least, our interest stems from how it might impact on our views on where the resource accounting boundary is drawn.

#### ***2.1.2 Interaction with Resource Budgeting (Manual, section 2.2)***

2.1.2.1 This is another area of ongoing FRAB interest. The Board believes that careful attention needs to be given to the development of the resource budgeting system for public expenditure planning and control if perverse incentives are to be avoided. The Treasury is conducting various trials to establish the effect of a range of budgeting assumptions. The Board will be interested in the results.

#### ***2.1.3 Accounting for the Effects of General Inflation (Manual, section 2.3)***

2.1.3.1 The Treasury's view is that accounting for the effect of general inflation would reflect expenditure in the same terms that investment decisions were made by departments; that it would more accurately represent the costs of assets consumed; and that it would reflect the basis on which costing and pricing calculations were made in the private sector. We recognise the Treasury's rationale for wishing to account for the effects of general inflation and we accept that there is a case in theory for such accounting treatment. We also recognise, however, that the introduction of such a convention could have considerable repercussions and, under some

methods, costs for departments which may not be worthwhile and that there is debate about the appropriate methodology.

2.1.3.2 The Treasury has advised us that, following further study, it does not plan, at present, to include any adjustment for the effect of general inflation in departments' resource budgets. The Treasury is currently considering whether such an adjustment should, nevertheless, appear in departments' resource accounts. The Board's view on balance is that, although it is important that the effects of general inflation on each department are disclosed in its financial statement, while they are not recognised in the departments' budget no such adjustment should appear in the accounts. Accordingly the Board has suggested that the potential adjustment should be disclosed by way of a note to departments' resource accounts.

2.1.3.3 As an exception to the foregoing the Board has accepted an inflation adjustment in respect of the interest subsidy element of student loans. This is because they are being controlled presently on a basis which includes the inflation adjustment. (See section 3.3)

#### ***2.1.4 Heritage Assets (Manual, section 3.5)***

2.1.4.1 The Board considers that in principle heritage assets should be valued and appear on the balance sheet, like any other asset. However, we accept that there are particular difficulties and that there may be some types of non-operational heritage asset where this is not cost effective to do. This was discussed several times both within the FRAB and with heritage departments.

2.1.4.2 A working party of officials from the Treasury, the National Audit Office (NAO), and the heritage departments has been addressing the problem. As a result of its work to date the Board accepted amendments to the Manual which made the presumption that it would not be cost effective to capitalise certain categories of non-operational heritage asset, such as museum collections, archaeological sites, and monuments.

2.1.4.3 The question of whether non-operational heritage buildings and land should be placed on departments' balance sheets is yet to be resolved. The Board's view remains that, in principle, they should be, and awaits with interest the outcome of the further work.

#### ***2.1.5 Salary and Pension Disclosures (Manual, section 8.5)***

2.1.5.1 The Greenbury Report, published in July 1995, contained a proposed code of best practice on disclosure of directors' remuneration. Our view remains that the principles of this report should apply to resource accounts.

2.1.5.2 We recognise that disclosing salary and accrued pension information of senior management of departments in £5,000 bands and their 'in year' pension information in £2,500 bands would be an acceptable approximation for purposes of complying with the Greenbury Report. We are pleased that the Cabinet Office has been able to meet us on this with a view to implementing these disclosures in respect of 1999-2000 resource accounts.

## **2.2 Other Issues for Further Consideration**

### ***2.2.1 Success of the Manual in Practice***

2.2.1.1 In our first report we highlighted the importance of the Board reviewing the success of the implementation of the Manual after its first year of operation and beyond. It would be for the Treasury to continue to ensure that there are mechanisms for providing the Treasury and the Board with adequate feedback on implementation.

2.2.1.2 We note that the Treasury has in place structures to enable issues arising from interpretation of the Manual by departments to be examined to see if any amendments are needed. The Treasury has advised us that it will report back on the outcome of the preparation and audit of departments' unpublished "dry-run" resource accounts for 1998-99. The Board recognises that this will be the first real test of the Manual in practice.

### ***2.2.2 Operating Cost Statement - Explanation of the Three Totals (Manual, annex 4)***

2.2.2.1 In our first report we suggested that the Treasury should provide a clearer explanation of the three 'bottom line' totals that would be included in the operating cost statement. These three totals comprise the 'net operating cost' (which is the total of the items appearing in the operating cost statement), 'outturn against resource budget' (which is for Treasury control purposes), and the 'net resource outturn' (which is for purposes of Parliamentary control). These are three important totals, and to minimise the potential complexity in disclosing them the Board considers that, not only should the adjustments between them be made more clear, but also that they should be the subject of an explanatory note in the illustrative accounts.

2.2.2.2 The Treasury has advised us that this is being taken forward by the Treasury as part of the resource budgeting developments.

### ***2.2.3 Private Finance Initiative (Manual, section 9.3)***

2.2.3.1 In our first report we stated that, while detailed guidance was being developed by the Public Sector and Not-for-Profit Committee of the Accounting Standards Boards (ASB), the Manual could only give a broad indication of the accounting treatment. However, we would return to this topic in the future.

2.2.3.2 The FRAB accepted the interim guidance issued in a technical note by the Treasury on the detailed accounting for these projects in September 1997. Following the issue by the ASB of its Amendment to Financial Reporting Standard (FRS)5: *Private Finance Initiative and Similar Contracts* (September 1998), the Treasury revised this technical note. This revised guidance has been accepted by the FRAB subject to the Treasury accepting the requirement for an adequate level of retrospective application of the revised guidance. We are pleased to note that the Treasury has since agreed to this.

### **3. Main New Issues during the Report Period**

#### **3.1 Pension Scheme Statements (Manual, section 4.5 and Chapter 15)**

3.1.1 In a major amendment to the Manual, the FRAB approved a new chapter setting out detailed guidance on the form and content of pension scheme statements. This included an illustrative pension scheme statement, which has been the subject of further discussion between HM Treasury, the various pension schemes and the National Audit Office, in particular to ensure the proper accounting treatment and disclosure of compensation payments for early retirement. The FRAB is still awaiting a final view of the illustrative pension scheme statement which will include appropriate treatment of compensation transactions and which will then form an annex to the Manual.

#### **3.2 Student Loans - Provision for Future Subsidy**

3.2.1 In a departure from the FRAB's role of overseeing the content of the Resource Accounting Manual, the Treasury asked the Board for a view on its application to whether or not a provision should be set up for the future subsidy resulting from the low interest to be paid over the life of student loans. The Board's view on balance was that a provision should be established at the time such loans are granted. The Board explained that this view was in respect of the circumstances surrounding student loans only, and was not to be taken as a precedent for any other subsidised loans. The Treasury agreed to review whether it was necessary to develop general criteria for deciding whether or not provisions should be set up for subsidies on loans.

#### **3.3 Student Loans - Accounting for Inflation**

3.3.1 Because the interest subsidy element of student loans are currently subject to budgetary controls which include an adjustment for the impact of general inflation, we agreed in principle that the adjustment should be reflected in Department for Education and Employment's resource accounts.

This was a one-off exception to our view concerning accounting for general inflation, which is reported at section 2.1.3.

### **3.4 Schedule 1 (Manual, annex 4)**

3.4.1 In our first report we noted that we wanted to see the link to Estimates before agreeing to a revised schedule 1. We have now seen an illustrative example and are content for the revised schedule to be incorporated into the Manual. We understand that this has been sent to interested Parliamentary Committees and acknowledge that as Parliament will be the main user of this schedule its views will be paramount.

3.4.2 The Board approved an amendment to the Manual in respect of the non-application of the principles of consolidation to schedule 1. Accordingly, transactions between a department's individual requests for resource (RfRs) will not be eliminated on consolidation. In the context of resource budgeting, we accept the Treasury's view that consolidation of a department's RfRs would reduce Parliamentary control. Non-consolidation applies only to the unique circumstances of schedule 1. Consolidation applies to the remaining schedules, 2 to 5.

### **3.5 Application of the Manual to Non-Agency Parts of Departments (Manual, section 1.6)**

3.5.1 Where departments have agencies or other entities within their boundary the Manual requires separate disclosure of the financial results of the non-agency part of the department if omission of the information would impair departmental accountability. Departments should consult the Treasury, the PAC and Parliamentary select committees on this. The Board accepted this amendment to the Manual.

### **3.6 Infrastructure Assets (Manual, section 3.6)**

In its Memorandum to the PAC and the Treasury Committee in July 1997, responding to the Board's first report, the Treasury commented that it wished to consult further with relevant departments on the detailed application of accounting for infrastructure assets. A subsequent clarification of the Manual was put to the FRAB and this has been agreed.

### **3.7 FRS 9: Associates and Joint Ventures (Manual, sections 1.5 & 10.3)**

3.7.1 The Board approved the incorporation of FRS 9 into the Manual as adapted in order to make it compatible with the resource accounting boundary. The adaptation involves the introduction of further criteria to be met, in addition to those in FRS 9 in respect of associated undertakings and joint ventures before these bodies should be accounted for in accordance with

the accounting standard. It was agreed that such criteria should also be brought in in relation to FRS 2: *Accounting for Subsidiary Undertakings*. The Board nevertheless wishes to examine the boundary further in the light of emerging experiences (see section 2.1.1).

### **3.8 Other New Accounting Standards**

3.8.1 During the period covered by the report the Board approved the incorporation into the Manual of the following other new accounting standards in their entirety:

- **FRS10 - *Goodwill and Intangible Assets*** (Manual, section 3.10)
- **FRS11 - *Impairment of Fixed Assets and Goodwill*** (Manual, sections 3.2 & 3.10)
- **FRS12 - *Provisions, Contingent Liabilities and Contingent Assets*** (Manual, section 4.3)
- **FRS13 - *Derivatives and Other Financial Instruments*** (Manual, section 8.7)

3.8.2 In the case of FRSs 10, 11, and 12 the preceding exposure drafts had already been incorporated in the Manual. As a result the changes due to the introduction of these new standards were minimal.

3.8.3 Although FRS 13 will apply in full we do not expect bodies within the resource accounting boundary to have many transactions or arrangements falling within its scope.

### **3.9 Urgent Issues Task Force (UITF) Abstracts**

3.9.1 During the period of the report we considered the applicability of the following UITFs which were issued:

- **UITF Abstract 17 - *Employee Share Schemes***
- **UITF Abstract 18 - *Pension costs following the 1997 tax changes in respect of dividend income***
- **UITF Abstract 19 - *Tax on gains and losses on foreign currency borrowing that hedge an investment in a foreign enterprise***
- **UITF Abstract 20 - *Accounting for Year 2000 issues***
- **UITF Abstract 21 and Appendix - *Proposed Introduction of the Euro*** (Manual, section 8.1)
- **UITF Abstract 22 - *The acquisition of a Lloyds Business***

We agreed that only UITFs 20 and 21 were relevant, and that they should apply in full.

3.9.2 It was accepted that there was no requirement to amend the Manual in respect of UITF Abstract 20 due to the short term nature of the problem. In respect of UITF Abstract 21 the Board accepted that the existing section 8.1 was adequate to cover the requirements for the proposed introduction of the Euro.

### **3.10 Financial Reporting Standard for Smaller Entities (FRSSE) (Manual, section 8.6)**

3.10.1 The Board agreed that, in the interests of public accountability, the Manual should not extend the option for reduced disclosures allowed by the FRSSE to bodies within the resource accounting boundary.

### **3.11 On-Vote Agencies which are not Whole Departments**

3.11.1 The Board approved a series of amendments to various sections of the Manual to clarify its application to those on-vote executive agencies which are not whole departments. These amendments were necessary so that those agencies intending to follow the Manual for their 1998-99 agency accounts would be able to do so.

### **3.12 Cost of Capital Charges on Cash Balances (Manual, section 7.4)**

3.12.1 The Board agreed that the Manual should be amended to exclude departments' cash balances with the Office of HM Paymaster General from cost of capital charges. This is because these balances are available for use to reduce Government borrowing, and so do not represent money tied up in the same way as with other assets eg fixed assets, stocks, and debtors.

### **3.13 Golden Shares (Manual, section 3.11)**

3.13.1 This amendment was submitted because the Government holds special (or 'golden') shares that have unique properties which require addressing separately to ordinary shares. The FRAB agreed to the suggested amendments.

### **3.14 Housing Revenue Accounts**

3.14.1 In the context of its consultation paper, *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account*, the Department of the Environment, Transport and the Regions (DETR) asked the Board if it would give a view on whether the interpretation of "value in use" adopted in the Manual was valid in the case of local authority housing. Although this relates largely to local authority accounts and, therefore, is outside the FRAB's direct remit, the Board considered the issue and its view is contained in the letter of 9 March 1999 to DETR (reproduced at Annex D).

## 4. Future Role of the Board

4.1 The Board envisages having a continuing role in reviewing the Manual and considering any proposals for material change arising from the experience of its implementation or from changes to GAAP.

4.2 As anticipated in the Treasury's memorandum *Resource Accounting and Budgeting in Government*, dated February 1996, to the then Treasury and Civil Service Committee and the PAC, the Treasury has carried out a review of the FRAB. *The Review of the Operation of the Financial Reporting Advisory Board: Report by the Treasury* was submitted to Parliament on 12 December 1998. It examined:

- a. The independence of the Board in terms of whether its composition has in practice ensured independence in its proceedings, the role of the chairman in maintaining the Board's independence of action and decisions, and the adequacy of the arrangements for reporting the Board's views to Parliament.
- b. Whether the Board's remit should be drawn more widely to include for example the financial reporting arrangements for NDPBs.

4.3 In conducting its review the Treasury consulted the Board members and Principal Finance Officers in departments and, in its report, concluded that:

- a. The FRAB has operated independently in terms of the requirements set out in paragraph 4.2.
- b. The FRAB's remit should be extended now to oversee the accounting guidance in respect of executive NDPBs and trading funds. This conclusion is based on the added value the FRAB is expected to give. The remit may possibly be further extended, after discussion with the board at the appropriate time, to cover National Health Service providers (depending on discussions between the Treasury and appropriate departments) and policies underlying Whole of Government Accounts.

Parliament has made no comment on the report.

4.4 The Board's view of the topics covered by the Treasury review was that:

- a. Although the Treasury involvement might give rise to the Board's independence being challenged, overall the process had worked well and members did not feel their independence had been compromised.
- b. It would be ready to accept the extension of its remit.

# Operation of the Financial Reporting Advisory Board

## Introduction

1. The Financial Reporting Advisory Board was set up in the summer of 1996 against the background of the introduction of resource accounting for government departments, on the terms set out in the appendix to this Annex. Its purpose was to introduce an independent element into the process of setting financial reporting standards for government.

## Terms of Reference

2. The Board's terms reference were to advise the Treasury on the application of financial reporting principles and standards in respect of central government bodies for which the Treasury has responsibility for issuing or approving accounts directions.

3. Following completion of the Board's main task in the first year (the examination of the Resource Accounting Manual and any proposals for significant changes to this guidance), the Board would keep the Manual under review and consider any future proposals for material change. The Treasury would ensure that all relevant matters were drawn to the attention of the Board and consider all advice received from the Board. In addition it would forward to Parliament a report on the Board's activities, setting out the resource accounting policies to be adopted and subsequent material changes together with the views of the Board.

## Composition

4. The Board is independent of government and has a wide membership drawn so as to represent the relevant spread of interests. Members are drawn from the private sector, academia, the public sector audit bodies and government departments as follows:

### Chairman

Elwyn Eilledge - Director of BG plc and former Chairman of BTR plc, Senior Partner of Ernst and Young and Member of the Accounting Standards Board.

## Members

Colin Balmer, Principal Finance Officer, Ministry of Defence

Mike Barnes, Head of Technical Support, Audit Commission

Heather Jackson, Director of Finance, HM Land Registry

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

Caroline Mawhood, Assistant Auditor General, National Audit Office

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

Caroline Slocock, Senior General Expenditure Policy Adviser,  
HM Treasury

Ken Wild, Partner, Deloitte & Touche, Member of the Accounting  
Standards Board and Chairman of its Public Sector and Not for Profit  
Committee

The Treasury provided a secretariat headed by Chris Richards with support  
from Sue Gamble. During the period covered by this, the second report,  
Harry Wilkinson has substituted for Mike Barnes, Brian Grubb has  
substituted for Caroline Mawhood, and Bill Davis and David Jones have  
substituted for Colin Balmer.

## Proceedings

5. During this reporting period the Board has held 8 meetings at  
approximately bimonthly intervals. It has been considering a variety of  
resource accounting issues including matters outstanding from the first re-  
port, improvements to the Manual in the light of experience and amend-  
ments resulting from new and revised accounting standards (GAAP). The  
Board also considered and commented on the Whole of Government  
Accounts scoping study. (The response is at Annex C).

6. Three members of the Board (Ken Wild, Caroline Mawhood and  
Heather Jackson) appeared before the Treasury Committee on 4 December  
1997 to give evidence on our first report. The Board's independence and  
the main issues identified in the report were discussed. Full details can be  
seen in the *Treasury Committee Resource Accounting and Budgeting  
Minutes of Evidence (ISBN 0 10 212398 5)*.

7. The head of the Treasury's Resource Accounting and Budgeting team, Ros Dunn, attended most meetings to answer Board members' questions. Other members of the Treasury, either responsible for, or having an interest in, specific topics, also attended for particular agenda items - Nick Bailey, Tim Drew, Tracy Gordon, Helen John, Paul Johnston, Peter Jolly, Andrew Likierman, David Loweth, Stephen Matthews, Alan O'Connor, Larry Pinkney, Doug Rayner, Chris Ridley, Helen Roberts, Mark Thomas, and Tim Wilson.

8. Andrew Ramsey and John Kempzell from the Department of Culture, Media and Sport, Laurie Pavelin from the Welsh Office, Ian Smith from the Scottish Office, and Nigel Gale and Brian Grubb from the National Audit Office attended a joint discussion with the Board on the treatment of heritage assets. John Barker and Derek Pain from the Cabinet Office attended one of the discussions on salary and pension disclosures (Greenbury). Maureen Wellen from the Chartered Institute of Public Finance and Accountancy, and Margaret Slack from the Department of the Environment, Transport and the Regions attended the discussion on Housing Revenue Accounts.

9. The Board proceeded by examining papers on the agenda items, along with any related Resource Accounting Manual draft amendments and in the light of these, additional written or oral explanations and arguments as appropriate. It raised questions about proposed treatments or drafting as it proceeded and made suggestions for amendment. The Treasury's representatives were either able to agree there and then to such suggestions or undertook to consider them further, and subsequently amended the Manual to the extent that they considered appropriate. These changes were then considered by the Board and further changes made where necessary until there was a unanimous or majority agreement to the resulting text. This iterative process has resulted in a more effective and relevant Manual. The Board considers that it has added significant value by the approach it has taken.

## The Terms of Reference of the Financial Reporting Advisory Board to the Treasury - 8 February 1996

### Appendix to ANNEX A

#### 1. Context

- 1.1 The primary aims of financial reporting by central government bodies are to demonstrate to the public and their representatives in Parliament:
- that public monies have been used for the purposes intended by Parliament;
  - the financial performance of the bodies; and
  - their stewardship of public funds and assets;
- and to provide Parliament with information which is reliable and sufficient as a basis for
- its consideration and approval of the levels of finance voted to services; and
  - its examination of performance in carrying out policies, functions, programmes and projects.
- 1.2 Financial reporting is also intended to underpin the Government's planning, monitoring and management of public expenditure.
- 1.3 The authority to develop financial reporting requirements is delegated to HM Treasury.
- 1.4 The Government has decided that 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.

## **2. Reasons for Establishing the Board**

2.1 The Board will introduce an independent element into the process of setting financial reporting standards for government.

2.2 The Board will help ensure that:

- (i) as far as possible departmental resource accounts are governed by GAAP;
- (ii) departures from, or modifications to, GAAP are fully explained.

## **3. Terms of Reference**

3.1 The Board will advise HM Treasury on the application of financial reporting principles and standards in respect of central government bodies for which the Treasury has responsibility for issuing or approving accounts directions.

3.2 The Board

- (i) will examine the Resource Accounting Reference Manual and any proposals for material changes to this guidance;
- (ii) will keep the Manual under review and consider any proposals for material change.

3.3 HM Treasury will:

- (i) ensure that all relevant matters are drawn to the attention of the Board;
- (ii) consider all advice received from the Board;
- (iii) forward to Parliament a report on the Board's activities, setting out the resource accounting policies to be adopted and subsequent material changes, together with the views of the Board.

## **4. Membership**

4.1 The Board will comprise:

1 member nominated by the Chief Accountancy Adviser to the Treasury

1 member nominated by the Comptroller and Auditor General

1 member nominated by the Audit Commission

2 members nominated by the Principal Finance Officers of government departments and Finance Directors of Executive Agencies.

1 member nominated by the Head of the Government Statistical Service

1 member nominated by the Accounting Standards Board

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

4.2 In addition, an independent Chairman of the Board will be nominated by the Chief Accountancy Adviser.

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

## **5. Future Developments**

5.1 The accounting policies contained in the Reference Manual are designed to meet the particular circumstances of the public sector. As such, they may have persuasive force in other areas where bodies produce accounts which are not covered by their own accounting code.

5.2 As other bodies come within the boundary of resource accounting principles, the membership of the Board may be increased to reflect this wider community.

5.3 The Government has accepted that research on "whole of government" accounts should be taken forward as suggested by the Treasury and Civil Service Committee and Committee of Public Accounts, reporting in due course. Depending on the outcome of this work, the remit of the Board would widen to include such accounts.

## Other Amendments to the Resource Accounting Manual Agreed by the Board

- 1. Downward Revaluation of Fixed Assets (eg IT): Impact on Revaluation Reserve (Manual, section 3.2)** The Manual was amended to correct an unintended anomaly. The Board accepted this amendment.
- 2. European Union (EU) Financed Fixed Assets (Manual, section 3.8)** The Treasury advised the Board that it was deleting from the Manual the accounting policy in respect of EU Financed Fixed Assets, pending consideration of the resource budgeting, implications. This has now been reinstated.
- 3. Capitalisation of In-House Software (Manual, sections 3.9 & 3.10)** The FRAB accepted the minor amendments put to them to clarify the requirements on this.
- 4. Intangible Assets (Manual, section 3.10)** The Board accepted a minor amendment to this section to clarify the application of FRS 10: Goodwill and Intangible Assets.
- 5. Investments (Manual, section 3.11)** The Board accepted the minor amendments put to them which clarified this section.
- 6. Interpretation of “current year prices” (Manual, section 4.3)** The FRAB accepted an amendment to the Manual clarifying what is meant by “current year prices.”
- 7. Foreign Currency Translation - Clarification (Manual, section 8.1)** It was recognised that the wording in the Manual threw up a potential inconsistency. The Treasury drafted some alternative words to clarify the situation, which we accepted.
- 8. Disclosure of Staff Costs. (Manual, section 8.5)** The Board agreed to two separate amendments: firstly, to include, as members of senior management boards, non-civil servants; secondly, to clarify the elements of cost to be included in wages and salaries.
- 9. Consolidation of Schedule 5 (Manual, sections 10.1 and 13.2)** The FRAB was content with amendments to the Manual clarifying that schedule 5 should be consolidated.
- 10. Separate Statements of Taxation Revenue (Manual, section 12.1)** The Board agreed to an amendment clarifying the reference to separate statements of taxation revenue.

**11. Schedule 5 Terminology (Manual, chapter 13 and annex 4)**

Following the Comprehensive Spending Review the departments will have a single aim with several supporting objectives. The FRAB agreed the required amendments to the Manual associated with this change.

**12. Privatisation Proceeds. (Manual, annex 2)** Because privatisation proceeds could relate to the sale of departments' assets the Treasury recommended that they should not be specifically excluded from resource accounts. The FRAB agreed.

## **Whole of Government Accounts (WGA) Scoping Study: the Board's Response**

1. The Board welcomes the study into WGA.
2. The Board sees this as a natural development from departmental resource accounts. By its nature WGA can only be of benefit as a further useful source of information for Parliament and the taxpayer.
3. It will be useful also in ensuring that all items of Government expenditure and income are accounted for. At present, various bodies produce individual sets of accruals accounts and the introduction of departmental resource accounts will extend significantly the coverage of accruals accounting in Government. While the Board endorses the introduction of departmental resource accounts as a major development in Government accounting, even in total they will only, as presently proposed, give a partial picture of the Government's overall financial position. There will remain significant areas of Government expenditure and income not brought to account in the same way. In the case of the Consolidated Fund, for example, the Board notes that there will be an overlap in the coverage of the accounts for that Fund and departmental resource accounts. WGA would rectify that and bring to account any areas which may not be reported at all.
4. However, the Board does not underestimate the task and resources involved and acknowledges that whether it is practical to do will be explored further, not least the different bases for accounting in different areas of Government.
5. The Board would welcome being kept in touch with progress in this important development and look forward to being informed of the outcome of the scoping study.

## ANNEX D

# Resource Accounting in the Housing Revenue Account: the Board's Response

*(Text of the letter sent to the Department of the Environment, Transport and the Regions (DETR) on 9 March 1999.)*

The Board was asked by DETR for its view on whether the interpretation of "value in use" adopted in the Resource Accounting Manual was valid in the case of council housing. The issues were set out in the paper submitted to the Board 'Resource Accounting and Council Housing'.

This was discussed at the Board's meeting on 8 February, and was attended by Paul Johnston from the Treasury, Margaret Slack from DETR, and Maureen Wellen from CIPFA (*the Chartered Institute of Public Finance and Accountancy*.)

The Board has asked me to advise you of the outcome of its discussion.

The Board recognised that for central government resource accounts it would be useful to know the total subsidy associated with providing council housing, and that this suggested a valuation which was not reduced to reflect sub-market rent income. The reason why this is an appropriate valuation basis under GAAP is that the level of subsidy, or indeed whether to subsidise at all, is a matter of government policy and should not, therefore, affect the value of the properties from the Government's perspective. By excluding the effect of the subsidy in the valuation, the full level of annual cost of the subsidy naturally flows into the accounts. However, a local authority is constrained by the guideline rents set by DETR, and, therefore, the extent to which the level of housing subsidy reduces the rental stream on a property is, in practice, outside its control. Consequently, the reduction in the value of the property from the local authority perspective is externally imposed and real.

Accordingly, the Board felt that it would be more appropriate for valuations for local authority housing revenue accounts in the accounts of the local authorities, and therefore to be viewed from their perspective, to be based on existing use value with a reduction for sub-market rental income. A note to the housing revenue accounts could show the higher valuation. The Board considered that DETR's resource accounts were where the total subsidy should be shown.

As you know, local authority accounting is outside the Board's remit, so its views are not binding.

**CHRIS RICHARDS,**  
Secretary to the FRAB