

**THE FINANCIAL REPORTING
ADVISORY BOARD TO
THE TREASURY**

**REPORT FOR THE PERIOD
APRIL 2000 - MARCH 2001**

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FOREWORD

This is the Financial Reporting Advisory Board's fourth report and covers the period from April 2000 to March 2001.

In this report, we follow up on issues raised in our earlier reports, explain the views we have taken on amendments to the Resource Accounting Manual arising from changes to generally accepted accounting practice; and record our views on amendments arising from the implementation of the Manual by departments. Following the extension of our remit, last year, we reviewed the accounting guides in respect of executive non-departmental public bodies and trading funds. These have now been published. The Board also commenced considering accounting policies and the approach underlying whole of government accounts. These are welcome developments in improving public sector accounting.

Our aim continues to be to ensure that the best possible financial reporting is achieved in all these areas of accounting and that the principles of accounting should meet with generally accepted accounting practice as far as possible.

We are pleased that the Government Resources and Accounts Act 2000 has placed the work of the Board on a statutory basis.

This year saw the first report on the implementation of the Manual in practice, during its first year. We are pleased that the results showed that it was an effective document. The effectiveness of the Manual will be further tested this year with the introduction of resource-based control from 1st April 2001.

We are pleased to have been approached concerning extending our remit further; we have already been involved in the review of our terms of reference and look forward to these being finalised in the coming year.

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

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CONTENTS

Executive Summary

Main Report

- A. Introduction**
- B. Issues outstanding from the previous reports**
- C. Main new issues arising from changes to GAAP**
- D. Main new issues arising from sources other than GAAP**
- E. Whole of government accounts**
- F. Composition and operation of the Board**

Annex A - The Financial Reporting Advisory Board – Operations

Annex B - Other amendments agreed by the Board to the Resource Accounting Manual, the Executive NDPBs Annual Report and Accounts Guidance, and the Trading Funds Accounts Guidance

Annex C - The Chairman of the Board's letter to the Chairman of the Accounting Standards Board and the subsequent reply

EXECUTIVE SUMMARY

Introduction

This is the fourth report of the Financial Reporting Advisory Board and covers issues arising from the earlier reports, new issues arising and developments in whole of government accounts

The aim of the Board is to ensure that resource accounts meet the best possible standards of financial reporting by following generally accepted accounting practice (GAAP) as far as possible. As well as advising on amendments to the Resource Accounting Manual the Board has also reviewed the accounts guides issued for use by trading funds and executive non-departmental public bodies (NDPBs). These also follow GAAP as appropriate.

The Government Resources and Accounts Act 2000 came into force during this reporting period. This Act puts the Board's role on a statutory basis, and requires its report to be laid before the House of Commons. This is the first report from the Board to be published under these arrangements.

The Board is pleased to report that there have been no new departures from GAAP arising during the reporting period.

Main issues arising from the previous reports (section B)

The departmental boundary (section B.1) This remains an area of continuing interest to the Board, and we have asked the Treasury to examine any divergences from GAAP and consider whether they are appropriate or necessary.

Heritage assets (section B.4) The Board's view continues to be that, in principle, heritage assets should appear on balance sheets but accept that it will not be cost effective to do so in all cases. However, we were concerned that the application of the Charities' Statement of Reporting Practice, which requires new additions to collections to appear on the balance sheet, even when that collection does not, would result in a lack of consistency. We, along with the Accounting Standards Board, are looking to review the effect of this practice the year after next.

Salary and pension disclosures (section B.5) Current guidance on the application of the Greenbury Report does not fully meet the requirements of its Code of Best Practice, mainly due to individuals' non-disclosure rights under the Data Protection Act 1998 and the omission of benefits in kind. The Board has been advised that consultations are taking place to remedy these issues, but is disappointed that the Cabinet Office has not yet been able to finalise resolution of these issues.

Success of the Manual in practice (section B.6) The Board attached considerable importance to the Manual being fully reviewed as practical experience is gained of its operation. We were pleased that the review resulted in few substantial amendments. The Board endorses further reviews as a means of improving the Manual.

Private finance initiative (section B.7) As reported previously, following the issue of the revised Technical Note by the Treasury, the Board was keen to monitor the effects of this revised guidance and retrospection. The Treasury has provided some information, but few of the projects of interest had yet reached the stage of having had their accounting treatment agreed with the National Audit Office. The Board's initial reaction was surprise that under retrospection so few private finance initiative assets were to appear on the departments' balance sheets. The Board therefore remains particularly interested in seeing the final results of the retrospection exercise.

Statement of internal control (section B.9) – The Board has endorsed a form of the statement of internal control for use by central government bodies but notes that the timetable given for full implementation of the Turnbull Committee recommendations is longer than that applied in the private sector.

Financial Reporting Standard (FRS) 15: Tangible Fixed Assets (section B.11) – The Board reported last year that it was concerned that the policy of mid-year valuations of fixed assets, currently required by the Manual might conflict with the requirements of FRS 15. The Treasury has reported that it will be re-examining this in the context of resource budgeting developments and we await the outcome with interest.

Main new issues arising from changes to GAAP (section C)

During the period covered by this report the Board approved amendments to the Manual arising from four new accounting standards. We were pleased to note the intention to adopt **FRS 17 – Retirement Benefits (section C.1)** and have encouraged the Treasury to make good use of the lengthy implementation timetable allowed by the FRS, to ensure that the development of information, to meet the required disclosures, will allow a smooth transition to complying with the standard's full requirements.

Another important Standard for resource accounting was **FRS 18 – Accounting Policies (section C.2)**, which the Board was pleased to note is to be fully applied to resource accounts, executive NDPBs and trading funds. However, we had a concern about possible conflicts with whole of government account requirements and await developments with interest.

Main new issues arising from sources other than GAAP (section D)

International public sector accounting standards (section D.1) The Board was pleased to note that the Treasury would be reporting the degree of compliance with these standards on all relevant issues brought to the Board in the future

Whole of government accounts (section E)

During the reporting period the Board considered various issues relating to the policies underlying the development of whole of government accounts. The Treasury, following initial consultations with the Board, is planning to provide further information as the project develops, on the boundary for whole of governments accounts, the proforma financial statements, accounting for social security benefit expenditure and compatibility of resource

accounts and national accounts balance sheet data. Generally the Board was content that the process was going well and looks forward to further consultations.

Role and composition of the Board (section F)

Following the extension of the Board's remit to oversight of the accounting guidance for both trading funds and executive NDPBs, and the policies underlying government accounts, work has progressed on talks with the Scottish Executive, the Department of Finance and Personnel, Northern Ireland and the National Health Service Executive concerning the possibility of the Board's remit being extended to oversight of the guidance in respect of accounts for Scotland, Northern Ireland, and the National Health Service in England.

The Board agreed a Treasury proposal that there should be a formal cut-off date of November 2001 for the 2001/02 version of the Manual and the other accounting guidance, in an effort to improve the timeliness of the issue of that guidance.

A. Introduction

A.1 General

A.1.1 This is the fourth report of the Financial Reporting Advisory Board (the 'Board'). It covers the period from April 2000 to March 2001. During the period the Board considered all the amendments, as put forward by the Treasury, to the 1999/2000 version of the Manual (the 'Manual') to make it applicable to the 2000/01 resource accounts. We also considered (in February 2001) some amendments for the 2001/02 version of the Manual.

A.1.2 The Board also endorsed the first version of two sets of new accounts guidance, for trading funds - the Trading Funds Accounts Guidance - and for executive non-departmental public bodies (NDPBs) - the Executive NDPBs Annual Report and Accounts Guidance - as well as some further amendments to these publications to maintain their consistency with the developing Manual as appropriate. These two sets of guidance take effect for 2001/02 accounts. Their review follows the extension of the Board's remit to oversee the accounting guidance for these bodies.

A.1.3 This report follows a similar structure to our previous reports – covering

- section B – issues outstanding from our previous report,
- section C – new issues arising from changes to generally accepted accounting practice (GAAP),
- section D – new issues arising from sources other than changes to GAAP (mainly from the post mortem of the Manual (section B.6)),
- section E – new issues relating to whole of government accounts,
- section F – the Board's composition and operation,
- annex B – other issues addressed by the Board not covered in the main report.

In many cases the issues considered have resulted in amendments to the Manual or the other sets of accounts guidance. The Board is pleased to report that no new departures from GAAP have arisen or been identified during this period.

A.2 Government Resources and Accounts Act 2000

A.2.1 This is the first report from the Board since the Government Resources and Accounts Act 2000 came into force. The Act requires that resource accounts and whole of government accounts should be prepared with a view to presenting a true and fair view, and conform to GAAP subject to such adaptations as are necessary in the context of these accounts. The Act requires the Treasury to consult an appropriate advisory group on financial reporting principles and standards. The Treasury, in consultation with the Comptroller and Auditor General in accordance with the Act, has determined that the Board should be that advisory group. In accordance with the Act the Board provides a report summarising its activities on the Treasury consultations and dealing with such other matters, as it considers appropriate. The Treasury is required to arrange for the Board's report to be laid before the House of Commons.

A.2.2 The Act puts on a statutory basis the role that the Board has been performing since it was set up in 1996. The Board's aim has been to help ensure that resource accounting achieves the best possible financial reporting. To achieve this we have aimed as far as possible to ensure that departmental resource accounts¹ are governed by GAAP and that any departure from or modifications to GAAP are fully explained and justified. That aim now extends to the additional forms of accounting guidance within the Board's extended remit.

B Issues outstanding from the previous reports

B.1 Departmental boundary (Manual, section 1.5)

B.1.1 In our earlier reports we expressed concern about NDPBs and trading funds being outside the departmental resource accounting boundary and not consolidated into departmental resource accounts, even though they deliver many of the government's outputs. Our remit has now been extended to include the accounting guidance for these bodies as well as the Manual. This should help to achieve, wherever appropriate, a consistent approach. However, these bodies remain outside the boundary.

B.1.2 While resource accounting has been in its introductory phase there has been insufficient new information emerging to allow a re-evaluation of the resource accounting boundary. We recommend, however, that in the next reporting period the Treasury should examine whether the present boundary accords with GAAP, and if not review whether any departures are appropriate or necessary. This relates to the work on the whole of government accounts boundary (section E.2).

B.2 Interaction with resource budgeting (Manual, section 2.2)

B.2.1 In our previous reports we highlighted 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. This continues to be an important issue.

B.2.2 During this reporting period the Treasury representative on the Board gave an update on the progress of resource budgeting development and implementation. The Board also considered two issues that had significant implications for resource budgeting – mid year valuations of fixed assets (section B.11) and the Manual cut off date (section F.1.6). The Board looks to the Treasury to keep it informed about progress.

B.3 Accounting for the effects of general inflation (Manual, section 2.3)

B.3.1 Our previous report noted that, as there was no plan to include an adjustment for the effects of general inflation in departments' resource budgets, no such adjustment should be included in the resource accounts, other than for one agreed exception. This was in respect of the interest subsidy for student loans, for which budgetary controls already included an

¹ The use of the word 'department' in this context is taken to include other entities that 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 ISBN (0 11 560078 7)

inflation adjustment to enable the provision for the subsidy to be fairly stated. The Board suggested, however, that the Treasury might consider whether departments should disclose what the adjustment would have been in the notes to their accounts.

B.3.2 The Treasury concluded, however, that such a note should not be included at this time. This was because the Treasury considered that it would be more meaningful for the disclosure to extend to all bodies included in a department's resource budget. However, this would raise auditability problems. The Board accepted this position for the time being but maintains an interest in any further developments in this area.

B.4 Heritage assets (Manual, section 3.5; Executive NDPB Guidance, section 8.3)

B.4.1 As previously reported, the Board considers that in principle all heritage assets should be included on the balance sheet, like any other asset. However, we acknowledge that there are some types of heritage assets where this may not be cost effective or where no reliable valuation can be obtained. We have therefore accepted that the Manual should allow non-operational heritage assets not to be capitalised in such circumstances.

B.4.2 In October 2000 a revised Statement of Reporting Practice for Accounting and Reporting by Charities was issued. This allowed similar cost benefit criteria to those included in the Manual to be used to determine whether or not heritage assets should be capitalised. It noted, however, that where assets were purchased, the purchase price could be used as a reference point for fair value. In effect it required that additions to historic assets should generally be capitalised, because a reliable cost would be known. Because this was a development of GAAP, the Board agreed to the inclusion of similar guidance in the Manual. However, we had some reservations about doing so as the effect on the accounts in their present form was untested. In particular we were concerned at the lack of consistency in cases where the main elements of historic collections were not included on balance sheets. The Chairman of the Board therefore wrote to the Chairman of the Accounting Standards Board, expressing our concerns and asking that they consider reviewing this policy in late 2002, once accounts have been produced conforming to the new guidance and the effect can be seen. The Chairman of the Accounting Standards Board replied, personally supporting such a review. (Copies of both letters are reproduced at annex C).

B.5 Salary and pension disclosures (Manual, section 7.5)

B.5.1 In our previous report we stressed our view that the principles of the Greenbury Report, published in July 1995, which contained a proposed Code of Best Practice on the disclosure of directors' remuneration, should apply to resource accounts. We also drew attention to the fact that such requirements included in the Manual fall somewhat short of those applied to the private sector. The shortcomings are the omission of a requirement to disclose benefits in kind and the ability of an individual to prevent disclosures by virtue of the Data Protection Act 1998.

B.5.2 During this reporting period the Cabinet Office helpfully provided further information on the legal position on disclosure and advised us that it was consulting on possible legal remedies to this and on the disclosure of benefits in kind. We are disappointed that the

Cabinet Office has not yet been able to finalise resolution of these issues. This is an issue of public concern in the private sector and there seems to be no reason why treatment in the public sector should be any different.

B.6 Success of the Manual in practice

B.6.1 In our earlier 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. Early in 2000 the Treasury conducted a ‘post mortem’ of the 1998/99 Manual, asking departments and the National Audit Office to identify any areas where they considered that the Manual should be clarified or otherwise improved. The Board was provided with a report on the results of the post mortem and was pleased to note that few substantive amendments were called for. This showed that in the main the Manual was an effective document. Amendments arising from the post mortem are covered elsewhere in this report (section D and several items in Annex B). Uncleared items have been included in the Board’s work programme for the coming year. A further post mortem on the 1999/2000 version of the Manual is currently under way, and the results will be reported to the Board this summer.

B.6.2 We endorse this ‘feedback and refinement’ process as an important means of improving the quality of the Treasury’s guidance.

B.7 Private finance initiative (Manual, section 8.3)

B.7.1 As reported previously, the Board wished to monitor the effect of the revised technical note issued by the Treasury, which followed the issue by the Accounting Standards Board of its Amendment to Financial Reporting Standard (FRS) 5 - Private Finance Initiative and Similar Contracts (September 1998). The Board was particularly interested in the effect of retrospective application, as required by this technical note. During the year the Treasury provided the Board with information on the effect of retrospection, but, as few of the projects of interest had yet reached the stage of having had their accounting treatment agreed with the National Audit Office, further updates were expected. The Board’s initial reaction was surprise that, under retrospection, so few private finance initiative assets were to appear on the departments’ balance sheets. The Board therefore remains particularly interested in seeing the final results of the retrospection exercise.

B.8 Provisions for subsidised loans (Manual, section 3.11; Executive NDPB Guidance, section 8.2)

B.8.1 In our previous report we referred to the Treasury’s agreement to review whether it was necessary to develop general criteria for deciding whether or not provisions should be established for subsidies on loans. This followed the Board’s earlier conclusion that, on balance, a provision should be set up in the case of student loans. The Board noted that there might be other loans where a provision was appropriate but where the subsidy could not be fully measured because of the lack of an adjustment in the accounts for the effect of general price inflation (section B.3). A provision made without such an adjustment would not provide a true and fair view of the liability. (Such an adjustment has been made for student loans). We consequently agreed an amendment to the Manual which made clear that, in such situations, a provision should not be set up. We await the Treasury's further proposals.

B.9 Statement on the system of internal control (Manual, annex 6)

B.9.1 In our previous report we noted the Board's interest in the implementation of the recommendations of the Turnbull Committee on corporate governance. These recommendations require entities to review the overall system of internal control (rather than only the internal financial control), and to include a statement in their accounts. During the period we endorsed for future incorporation in the Manual a form of the statement of internal control, for use by central government bodies from accounting periods commencing on or after 1 January 2001.

B.9.2 We noted however that departments were not being required to include a full Statement until 2003-04 although are being encouraged to do so in previous year. This contrasts with private sector practice, which is to adopt full procedures and statements in 2001-02, and we have urged earlier adoption in central government where possible.

B.10 Provisions - prejudicial information

B.10.1 As we reported last year, the Board considered an amendment to the Manual to allow an entity not to recognise a provision in circumstances where such recognition was considered to be prejudicial to a department's negotiating position with an outside body, and thus also prejudicial to the Exchequer. We did not agree the amendment and asked the Treasury to reconsider the issue.

B.10.2 In response the Treasury proposed an alternative interpretation of FRS 12 – Provisions, Contingent Liabilities And Contingent Assets, which would allow a department not to recognise provisions in specified instances. However, the Board concluded that FRS 12 contained adequate safeguards regarding disclosure of prejudicial information without the need for further interpretation, and these further proposals were withdrawn.

B.11 FRS 15: Tangible Fixed Assets (Manual, section 3.2)

B.11.1 Last year we reported that the Board was concerned that the policy of mid-year revaluations of tangible fixed assets, required by the Manual, might conflict with the requirements of FRS 15. The Treasury advised us that, because the existing policy is based on budgetary control requirements, it intends to re-examine this as part of the Treasury's consideration of proposals for the development of resource budgeting. The Board accepted this, but requested that the topic should be on next year's work programme to resolve the apparent inconsistency with FRS 15.

B.12 Accounting guidance for executive NDPBs and trading funds

B.12.1 In our previous report we noted that we had offered initial views on the Treasury's proposals for substantially revising and re issuing accounting guidance for executive NDPBs and trading funds. The aim was to ensure that the accounting policies adopted by these entities was consistent with those for departmental resource accounts. In Spring last year we further reviewed and made suggestions for these two sets of guidance and in July 2000 the

new Executive NDPBs Annual Report and Accounts Guidance and the Trading Funds Accounts Guidance were issued. The guides apply from 1 April 2001 but entities may adopt them earlier if they wish.

B.12.2 As a result of our review and in the light of the fact that the new accounting guides are based on the principles in the Manual, we are content that they accord as appropriate with GAAP. We note, however, that there are two unresolved issues from the review, being the requirement for mid-year revaluation of fixed assets (section B.11) and - with regard to the trading fund guidance - the application of cost of capital charges to different types of assets and liabilities. We are pleased to report that both these topics are in the Board's programme for the coming year.

B.12.3 Proposed amendments and clarifications to the new guides are being put to the Board at the same time as those for the Manual, to keep them in step. The amendments considered by the Board so far concern government grants payable (section D.3), additions to heritage assets (section B.4), fixed assets remaining for use pending disposal (annex B), FRS 13: Derivatives And Other Financial Instruments (annex B) and provisions for subsidised loans (section B.8).

C. Main new issues arising from changes to GAAP

C.1 FRS 17: Retirement Benefits (Manual, chapters 4 and 15)

C.1.1 This new standard is intended to ensure that financial statements reflect at fair value the assets and liabilities arising from an employer's retirement benefit obligations and any related funding; that the operating costs of providing retirement benefits are recognised in the periods in which the benefits are earned and any other changes in the value of assets or liabilities are recognised in the period in which they arise; and that there are adequate disclosures of the cost of providing retirement benefits. The FRS has a staged and lengthy implementation timetable and the Treasury explained to the Board that it planned to follow that timetable rather than seek earlier implementation. The first stage will have effect from 2001-02 and will entail additional disclosures in the accounts. The Board is content with this approach. It has encouraged the Treasury to make good use of the lengthy implementation timetable allowed by the FRS, to ensure that the development of information, to meet the required disclosures, will allow a smooth transition to complying with the standard's full requirements.

C.2 FRS 18: Accounting Policies (Manual, section 2.2; Executive NDPB Guidance, sections 1.2, 1.4 and 11.1; Trading Fund Guidance, sections 1.2 – 3 and 10.1)

C.2.1 This standard deals primarily with the selection, application and disclosure of accounting policies. It states that an entity should adopt the accounting policies most appropriate to its particular circumstances; that they should be reviewed regularly; and that sufficient information be disclosed to enable users to understand the accounting policies

adopted and how they have been implemented. As an entirely new requirement it also calls for the basis on which significant accounting estimates are made to be disclosed.

C.2.2 The Treasury proposed that this standard should be fully applied to resource accounts, executive NDPBs and trading funds. The Board accepted this proposal and the associated amendments to the three sets of accounting guidance. The Board noted, however, that as whole of government accounts developed, there could be conflict between the desire for consistency and the most appropriate accounting policies adopted by the various entities within the whole of government accounts boundary in accordance with FRS 18. We would expect that, as a matter of process, any material conflict would be put to this Board for review.

C.3 Other Accounting Standards Board pronouncements

C.3.1 The Treasury also proposed that for FRS 14 - Earnings Per Share and FRS 16 - Current Tax the accounting guides need only acknowledge the existence of the standards and note that they are either not relevant or, in the case of executive NDPBs, applicable only where relevant (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A). Details of the individual standards are listed in Annex B. The Board agreed to these proposals.

C.3.2 Similarly the Treasury proposals on UITFs 23 – 29 (Manual, section 3.2 and annex 3; Executive NDPB Accounts Guidance, section 7.6 and annex C; Trading Funds Accounts Guidance, section 8.18 and annex A) were little more than to update the Manual and other accounts guidance references to take account of the withdrawal of five UITF abstracts, the amendment of two abstracts, and the issue of seven new ones. Details of the individual UITF abstracts are listed in annex B. The Board agreed to these proposals.

D. Main new issues arising from sources other than GAAP

D.1 International public sector accounting standards

D.1.1 The Treasury has proposed that in future all issues brought before the Board should note the degree to which the approach taken complies with the international public sector standards issued by the International Federation of Accountants. The Board agreed that this would be useful for its considerations but noted that, whilst international accounting standards on which the public sector standards are based were likely to become more important over time, the prime concern was to follow UK GAAP. It was also noted that where GAAP was silent on an issue, the international public sector standards could be used as a reference point.

D.2 Cash flow statement (Manual, annex 4)

D.2.1 During the reporting period we agreed substantial amendments to the detailed format of the cash flow statement in the Manual. These were mainly in connection with factors unique to resource accounting, taking into consideration the sometimes complex financing arrangements of departmental expenditure, and reconciliation to the 'net cash requirement', a key component in the new system of parliamentary control to be introduced from 2001-02.

D.3 Government grants payable (Manual, section 4.8; Executive NDPB Guidance, section 7.10)

D.3.1 Following the issue being raised in the post mortem, the Treasury submitted amendments to the Manual and the Executive NDPB Annual Report and Accounts Guidance that refined the point at which a liability for a government grant payable is recognised. The Board agreed these amendments.

E. Whole of government accounts

E.1 Background

E.1.1 We noted in our third report that the Board has accepted the additional role of considering the policies underlying the development of whole of government accounts. The Government Resources and Accounts Act 2000 requires the Treasury to aim to ensure that whole of government accounts present a true and fair view and conform to GAAP subject to such adaptations as are necessary in the context (section A.2).

E.1.2 The Board has been consulted on the extent of the whole of government accounts boundary (section E.3). Whole of government accounts will encompass not just consolidated resource accounts but also bodies and funds not included in those accounts. The Treasury has also consulted us about accounting issues in relation to taxation revenues (section E.6) and we are due to consider accounting for central government funds in the coming year. Given the importance of whole of government accounts in demonstrating the Government's stewardship of the public finances, we hope that our input to this programme will be valuable in terms of ensuring the adoption of appropriate accounting policies that accord with GAAP.

E.1.3 The Board supports the phased approach to the introduction of whole of government accounts, which has been adopted by the Government. We note that the more narrowly based central government accounts will be introduced over a two-year period, with dry runs for 2001-02 and 2002-03. These will exclude trading funds, other public corporations and local government, and will be published for the first time for 2003-04. The Treasury has also restated its overall aim to prepare dry run whole of government accounts for 2003-04 and 2004-05, with published accounts for 2005-06. During the period under review in this report, the Board has been mainly concerned with issues relating to central government accounts.

E.2 Whole of government accounts boundary tests

E.2.1 The Board considered the Treasury's proposed application of the tests of control in FRS 2: Subsidiary Undertakings to the public sector. The Board agrees that there is a need for clear criteria that will facilitate consistency of definitions of the bodies that fall within the boundary for both central government and the wider public sector. We are pleased to confirm that in our view the tests are an appropriate interpretation of the FRS. We are interested in the practical application of the principles and have asked to be consulted if that exercise reveals any inconsistencies that might lead to further consideration of the tests.

E.3 Boundary for central government accounts

E.3.1 The Board accepts as a pragmatic approach the proposal by the Treasury to define the boundary for central government accounts as that sector as defined by the Office for National Statistics. This uses the internationally agreed framework documented in the European System of Accounts. We were pleased to note that classifications to that sector were tested against the criteria derived from FRS 2 (section E.2) to ensure that the central government boundary is consistent with UK GAAP. However, we expressed some reservations: the boundary differs from the resource budgeting boundary and it excludes trading funds. There is also a risk that, without a firmer commitment to move beyond central government accounts to whole of government accounts, the boundary might prove to be inadequate to meet the stated purposes of whole of government accounts. We will return to the boundary issue as part of our planned re-examination, in the light of experience, of departmental boundaries for resource accounts (section B.1).

E.4 Proforma financial statements

E.4.1 The Treasury has prepared proforma financial statements for whole of government accounts that the Board has considered in detail. We accept that the accounts should show a high level view; departmental resource accounts and other accounts consolidated into whole of government accounts will continue to provide the detail. The Board is pleased to report that the proforma largely conforms to GAAP. However, we raised some issues relating to the way that expenditure is to be analysed, and statements on remuneration, corporate governance and related party transactions. The Treasury has agreed to undertake further work and we will consider these issues further in the coming year.

E.5 Consolidation officers

E.5.1 Although not strictly a matter for the Board, we recognise the sense of the Treasury's plans for appointing consolidation officers to each of the bodies designated for inclusion in central government accounts (and, later, whole of government accounts). On that basis we agreed the Treasury's proposed consolidation officer memorandum setting out their responsibilities for providing audited information as part of the consolidation process.

E.6 Accounting for taxation revenues

E.6.1 Taxation revenues are outside the resource accounting boundary and we were therefore asked for the first time to consider their treatment in whole of government accounts. We agreed the principle that taxation revenues will be deemed to accrue evenly over the (tax return) period for which they are due, but will be recognised only at the point that they can be reliably measured.

E.6.2 We also reviewed the proposed accounting policies to be applied in preparing the dry run central government accounts. We were pleased to note that most taxation streams will be accounted for on an accruals basis and accepted that where, for some streams, there were intractable difficulties in obtaining a timely and reliable accruals-based measurement these would be accounted for on a cash basis (for example – capital gains tax, where amounts due are not notified by the tax payer until ten months after the end of the financial year at the earliest).

E.7 Accounting for social security benefit expenditure

E.7.1 We have given some initial consideration to the accounting policies to be adopted for expenditure on social security benefits - in particular the extent to which future liabilities should be recognised. Our early view has been that it is unlikely that long-term commitments for social security benefits will meet the criteria laid down in FRS 12 Provisions, Contingent Liabilities and Contingent Assets for inclusion in the whole of government accounts balance sheet, although they should be disclosed in the notes to the accounts. However, we understand that work on accounting for social security benefit expenditure is continuing and we expect to consider this further in due course.

E.8 Increasing the compatibility of resource accounts and national accounts balance sheet data.

E.8.1 In our previous report we commented that we had accepted the principle that account disclosures should be expanded to provide audited data suitable for direct use in the national accounts, but were concerned about possible practical difficulties. We look forward to considering the results of work on the possible practical difficulties, following the Treasury's consultations with departments, and the opportunity to see some worked examples.

F.1 Composition and operation of the Board

F.1.1 As noted in the Introduction to the report (A.2.1) the Board's role and reporting arrangements have been placed on a statutory basis. This is the first of our reports to be prepared under these requirements.

F.1.2 As reported last year, the remit of the Board has been extended to include oversight of accounting policies underlying whole of government accounts (section E) and the accounts guides for executive NDPBs and trading funds (B.12). During the year, in response to an approach from the Scottish Executive, the Chairman of the Board gave his agreement in principle for the Board's remit to be extended to advising on the financial reporting standards and principles in respect of accounts for which Scottish Ministers are responsible for issuing reporting requirements. The Board discussed revised terms of reference (although these have not yet been finalised) effecting this change, and, subject to consultation with the Audit Committee of the Scottish Parliament and approval by Scottish Ministers, looks forward to taking on this additional responsibility.

F.1.3 The Treasury is also in discussion with the National Health Service Executive and the Department of Finance and Personnel, Northern Ireland concerning the possibility of the Board's remit being extended to oversight of the accounting guidance for the NHS in England and for Northern Ireland's resource accounts. The Board would be willing to take on these additional roles.

F.1.4 In the light of these changes, the Board has some concerns about the increasing number of members, but believes that the importance of the changes being proposed warrant this expansion.

F.1.5 In fulfilling its role the Board was grateful to have the input of a Parliamentary observer until April 1997. The Board believes that an informal parliamentary viewpoint would be beneficial to carrying out its role, and that it would still welcome a proposed candidate.

F.1.6 In an effort to improve the timeliness of the issue of accounting guidance the Board agreed a Treasury proposal that there should be a formal 'cut-off' date of November for the 2001/02 version of the Manual and the accounting guidance for executive NDPBs and trading funds. The Board accepted that the need for accounting guidance to be as up to date as possible had to be balanced against the operational requirements of giving adequate time to facilitate in year control, in respect of changes in accounting treatment, and implementing those changes.

THE FINANCIAL REPORTING ADVISORY BOARD – OPERATIONS

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, and to help ensure that, as far as possible, departmental resource accounts are governed by generally accepted accounting practice, and that any departures from or modifications to it are fully explained.

Terms of Reference

2. The Board's terms of 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.

Extension of the Board's Remit

4. The Board's remit has subsequently been extended to oversee accounting guidance in respect of executive non-departmental public bodies and trading funds, and also to the accounting policies underlying the whole of government accounts.

Government Resources and Accounts Act 2000

5. The Act places the Board's role on a statutory basis, by requiring the Treasury to consult an advisory group on financial reporting principles and standards applied to resource accounts and the whole of government accounts. The Treasury has determined that the Board should be that advisory group.

6. In accordance with the Act the Board must prepare a report summarising its activities and dealing with such other matters as the Board considers appropriate. The Treasury is required to lay the Board's report before the House of Commons.

Composition

7. The Board is independent of government and has a wide membership drawn in order to represent the relevant spread of interests. Members are drawn from the private sector, academia, the public sector audit bodies, government departments and non-departmental public bodies. During this reporting period the membership comprised as follows:

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:

Colin Balmer, Principal Finance Officer, Ministry of Defence

Mike Barnes, Head of Technical Development, Audit Commission

Ros Dunn, Head of Devolved Countries and the Regions Team, HM Treasury

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

Rosamund Sykes, Director of Finance and Central Services, Victoria and Albert Museum

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 fourth report, Ciaran Martin has substituted for Ros Dunn, Brian Grubb has substituted for Caroline Mawhood and David Jones and Derek Blackhall have substituted for Colin Balmer.

Proceedings

8. During this reporting period the Board has held 7 meetings. It has considered a variety of resource accounting issues including matters outstanding from earlier reports, improvements to the Manual in the light of experience of implementing resource accounting and amendments resulting from four new accounting standards (GAAP).

9. Treasury Officials who attended the Board meetings for particular agenda items were - Nick Bailey, Steven Cain, Andrew Carpenter, Ian Carruthers, Jenny Carter, Tracy Gordon, Glen Hull, David Loweth, Larry Pinkney and David Watkins. Derek Pain from the Cabinet Office also attended a meeting for a particular agenda item.

10. The Board proceeded by examining papers on the agenda items, along with related Resource Accounting Manual and other accounts guidance draft amendments, and 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, for re-submission to the Board. The Board feels that this iterative process has resulted in more effective and relevant accounts guidance, and considers that it has added significant value through this approach.

THE TERMS OF REFERENCE OF THE FINANCIAL REPORTING ADVISORY BOARD TO THE TREASURY - 8 FEBRUARY 1996

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. Membership²

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 National Statistician

1 member nominated by the Accounting Standards Board

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

² One further member has joined the Board - 1 member nominated to represent non-departmental public bodies. The Board member representing small departments' interests now also represents trading funds.

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 that 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 Agreed by the Board to the Resource Accounting Manual, the Executive NDPBs Annual Report and Accounts Guidance and the Trading Funds Accounts Guidance

Incorporated into the 2000/01 version of the Manual and other accounting guidance

Fixed assets remaining for use pending disposal (Manual, section 3.2; Executive NDPB Guidance, sections 8.6 and 8.7) – clarifies that an asset's useful economic life should be revised to reflect the remaining period of service, the residual value adjusted to the expected disposal proceeds less costs and the depreciation charge adjusted accordingly, rather than treated as an impairment.

Clarification of disclosure requirements within the resource accounting boundary (Manual, sections 1.5 and 1.6 and annex 4) – clarifies the boundary requirements to improve consistency between departments regarding transparency in the disclosure of bodies included.

FRS 13 - Derivatives and other Financial Instruments – arrangements for National Loan Fund loans, voted loans and public dividend capital (Manual, section 8.7; Executive NDPB Guidance, section 8.19; Trading Funds Guidance, section 7.13) – clarifies that, for departments, FRS 13 applies to all three of these types of financial instrument and provides additional guidance on their fair valuation. Also clarifies that, for trading funds, public dividend capital is akin to an equity stake and therefore is outside of the scope of FRS 13.

Clarification of treatment of revaluation surpluses following revaluation losses (Manual, section 5.3) – correction to remove an unintended possible divergence from the requirements of FRS 15 - Tangible Fixed Assets.

Consolidated Fund extra receipts – recognition of debtors (Manual, section 6.7) – achieves consistency in accounting treatment between Consolidated Fund extra receipts treated as income in the operating cost statement, and those which are not.

Materiality (Manual, sections 2.1 and 2.2) – introduces a revised reference to the Accounting Standards Board's Statement of Principles and changes the wording of the section on materiality to reflect the content of the Statement.

Statements requiring signature by the Accounting Officer (Manual, section 11.4) – clarifies which statements the Accounting Officer is required to sign and date in annual accounts.

Accounting for National Loans Fund loans (Manual, section 6.6) – changes the accounting treatment so that they are recorded as liabilities to the National Loans Fund as well as assets in respect of loans to recipient bodies.

Amounts due to be paid to the Consolidated Fund (Manual, sections 5.2, 6.1, 6.7 and 12.1) – defines these more clearly.

Definition of income (Manual, section 6.1) – refines the definition.

Pension costs – end of the pre-funding scheme (Manual, section 4.6; Executive NDPB Guidance, section 3.8; Trading Fund Guidance, section 2.3) – updates to reflect that the facility to pre-fund part of the liability to provide early retirement benefits is no longer available and offers a simplified alternative to accounting each year for the financial benefit of pre-funding.

Pension scheme statements (Manual, annex 7) – improves the consistency of schedule 1 of the model pension scheme accounts with that of departmental resource accounts, with a further simplification, suggested by the Board, to make it more pension scheme specific.

Accounting for capitalised decommissioning costs (Manual, section 4.4) – deletes a section that had become out of date.

Cash (Manual, section 3.14) – improves the terminology; clarifies the separate disclosure of amounts due to and from the Consolidated Fund; and specifies that for the last year of parallel running with cash-based Appropriation Accounts, the amounts shown in resource accounts as due to or from the Consolidated Fund are what would be due to or from the Fund under resource-based Supply.

Cost of capital charge – National Loans Fund loans, public dividend capital, voted loans to public sector bodies outside the resource accounting boundary (Manual, section 7.4) – amends the calculation of the cost of capital charge in respect of loans and confirms that this is a non-cash item in the accounts.

Output and performance analysis statement (Manual, section 12.1) – updates the terminology of the Manual to refer to public service agreements and service delivery agreements.

Department Yellow improvements (Manual, annex 4 and various related sections) – updates the illustrative resource accounts to reflect better what is contained within the Manual.

Government grants receivable (Manual, section 3.8) – clarifies the fact that government grants receivable may be either for revenue purposes or as a contribution towards fixed assets.

Programme costs (Manual, section 7.1) – improves the definition of what is included in programme costs.

Staff costs (Manual, section 7.1) – refines the definition of staff costs.

Schedule 1 (Manual, section 12.1 and annex 4) – provides a more detailed format and clearer descriptions to assist departments.

FRS 14 – Earnings per Share (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, Annex A) – entry made noting that the Standard was not relevant.

FRS 16 – Current Tax (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, Annex A) – entry made noting that the Standard was either not relevant or in the case of NDPBs only applicable where relevant.

Incorporated into the 2001/02 version of the Manual and other accounting guidance

Definition of income (Manual, sections 6.1, 6.5 and 7.2) – updates further the definition of income, and the resulting effect on wording in the section on EU income and on the description of expenditure included in the operating cost statement.

Updating the RAM in relation to the transitional year (Manual, various sections and annexes) – removes redundant references to the development of resource budgeting, appropriation accounts and other implementation timetable issues; and introduces appropriate references to the Government Resources and Accounts Act 2000.

UITF Abstract 3 – Treatment of Goodwill on Disposal of a Business (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry removed as superseded by FRS 10 – Goodwill and Intangible Assets.

UITF Abstract 6 – Accounting for Post-retirement Benefits other than Pensions (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry removed as superseded by FRS 17 – Retirement Benefits.

UITF Abstract 7 – Revisions to Estimates of the Useful Economic Life of Goodwill and Intangible Assets (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry made noting that the Abstract applies.

UITF Abstract 12 – Lessee Accounting for Reverse Premiums and Similar Incentives (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry removed as superseded by UITF Abstract 28 – Operating Lease Incentives.

UITF Abstract 15 – Disclosure of Substantial Acquisitions (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry updated to refer to the 1999 revision.

UITF Abstract 17 – Employee Share Schemes (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry updated to refer to the 2000 revision.

UITF Abstract 18 – Pension Costs Following the 1997 Tax Changes in Respect of Dividend Income (Manual, annex 3; Executive NDPB Guidance, annex C; Trading

Fund Guidance, annex A) – entry removed as superseded by FRS 17 – Retirement Benefits.

UITF Abstract 20 – Accounting for Year 2000 Issues (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry removed as the Abstract was withdrawn.

UITF Abstract 23 – Application of the Transitional Rules in FRS 15 (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry made noting that the Abstract applies.

UITF Abstract 24 – Accounting for Start up Costs (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry made noting that the Abstract applies.

UITF Abstract 25 – National Insurance Contributions on Share Option Gains (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry made noting that the Abstract was not relevant.

UITF Abstract 26 – Barter Transactions for Advertising (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry made noting that the Abstract applies.

UITF Abstract 28 – Operating Lease Incentives (Manual, annex 3; Executive NDPB Guidance, annex C; Trading Fund Guidance, annex A) – entry made noting that the Abstract applies.

UITF Abstract 29 – Website Development Costs (Manual, section 3.2 and annex 3; Executive NDPB Guidance, section 7.6 and annex C; Trading Fund Guidance, section 8.13 and annex A) – entry made in both the text of the guidance and the relevant annex noting that the Abstract applies.