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

**Report for the period
May 1999 to March 2000**

JUNE 2000

FOREWORD

This is the Financial Reporting Advisory Board's third report and covers the period from May 1999 to March 2000.

In this report, we follow up on issues raised in our first two reports, 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 as far as possible and that the best possible financial reporting is achieved by Resource Accounting.

The Board looks forward to seeing the results of the Treasury's review of how the Resource Accounting Manual worked out in practice for departments' 1998-99 'dry run' resource accounts. This will have been the first real test of the Manual.

This report saw the extension of the Board's remit to oversee the accounting guidance in respect of non-departmental public bodies and trading funds. The Board also commenced consideration of accounting policies underlying 'Whole of Government Accounts', and discussed the possibility of the remit being extended further to oversight of accounting guidance for the National Health Service. These are welcome developments in improving public sector accounting.

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
Ros Dunn
Heather Jackson
Graham Jenkinson
Caroline Mawhood
David Mayston
Rosamund Sykes
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Main New Issues Arising During the Report Period

8. During the period covered by this report the Board approved amendments to the Manual arising from one new accounting standard and a variety of issues arising from the implementation of resource accounting. Notably, **Financial Reporting Standard (FRS) 15 - Tangible Fixed Assets (Paragraphs 3.6 - 3.7)**, issued by the Accounting Standards Board (ASB) in 1999, was incorporated into the Manual. The Board 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 advised us that it intends to re-examine this, and we await its findings with interest.

9. **Revision of Accounting Guidance for Executive Non-Departmental Public Bodies (NDPBs) and Trading Fund Guidance (paragraphs 3.12 - 3.13)** Following the extension of its remit the Board has offered initial views on the Treasury's proposals for these sets of guidance, and looks forward to considering final proposals later in the year.

Role and Composition of the Board (Section 4)

10. Following the review of the FRAB (*The Review of the Operation of the Financial Reporting Advisory Board: Report by the Treasury* - submitted to Parliament in December 1998,) the Board's remit has been extended to oversee the accounting guidance in respect of executive NDPBs and trading funds and the Board has started to consider this. To reflect this wider remit, a new member to represent NDPB interests was welcomed to the Board. (The Board already has a member who represents trading fund interests as well as those of small departments.)

11. The Board also started to consider the policies underlying Whole of Government Accounts (WGA). We have also discussed the possibility of the remit being extended to oversight of the accounting guidance for the National Health Service (NHS), and would be ready to take this on.

12. The Committee of Public Accounts (PAC), in its *Ninth Report of 1999 - 2000: Government Resources and Accounts Bill*, included the recommendation that the FRAB should report directly to the PAC as well as the Treasury. The Board is in favour of sending its report direct to Parliament, and has notified its view to the Committee.

EXECUTIVE SUMMARY

Introduction

1. This is the third report of the Financial Reporting Advisory Board (FRAB). The aim of the Board has been to ensure that resource accounts meet the best possible standards of financial reporting by following Generally Accepted Accounting Practice (GAAP) as far as possible. This third report covers issues arising from the earlier reports, new emerging issues and subsequent amendments to the Resource Accounting Manual.

2. The Board has to report that there has been one new departure from GAAP arising during the reporting period. This relates to the restrictions that have been applied to salary and pension disclosures.

Main Issues Arising from the Previous Reports

3. **The Departmental Boundary (Paragraph 2.1-2.3)** This remains an area of continuing interest to the Board, but resource accounting is still in its introductory phase, and insufficient new information has emerged in the period covered by this report on which to base a review. The Board, nevertheless, in due course wishes to re-examine the boundary in the light of experience.

4. **Heritage Assets (Paragraphs 2.7-2.8)** The Board's view continues to be that, in principle, heritage assets should be valued and appear on balance sheets. Nevertheless, it accepted the conclusions of a working party of officials that, in practice, the case for incurring additional cost in order to achieve balance sheet recognition of non-operational heritage buildings was unproven.

5. **Salary and Pension Disclosures (Paragraphs 2.9-2.10)** During the year guidance was issued by the Cabinet Office on the application of the Greenbury Report, but it did not fully meet the requirements of the Code of Best Practice to a level acceptable to the Board.

6. **Success of the Manual in Practice (Paragraph 2.11)** The Treasury has advised that it will report to the Board in the Summer on the outcome of its review of the success of the Manual, following the preparation of departments' 'dry run' resource accounts for 1998/99.

7. **Private Finance Initiative (PFI) (Paragraphs 2.13-2.14)** 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 agreed to provide information on the largest PFI projects and the Board will comment further as necessary.

MAIN REPORT

1. Introduction

1.1 This is the third report of the FRAB. It covers the period from May 1999 to March 2000, during which the Board considered all the amendments to the Resource Accounting Manual to make it applicable to the 1999/2000 accounts.

1.2 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 accounts¹ are governed by UK 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) paragraph 3.13*, which stated that resource accounts would be based on GAAP to the extent that it was appropriate and meaningful in the public sector context.

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 second report there was a shift in the focus of the Board's work - from an examination of a whole version of the Manual, to examination of issues outstanding from that first report, and amendments to the previously agreed version of the Manual.

1.5 The third report follows a similar approach to the second. In section 2 below we describe progress on the issues arising from our previous reports, 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. The Board has to report that there has been one new departure from GAAP. This relates to the restrictions applied to salary and pension disclosures, and is described in paragraph 2.10 of this report. In section 4, we comment on the Board's 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.

¹ 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 Resource Accounting Manual. ISBN: 0 11 702320 5.

1.6 The issues covered by the report have arisen because of: developments in GAAP; developments in resource accounting and budgeting and WGA; amendments in the light of experience; and extensions of the Board's remit to oversee guidance in respect of the accounts of NDPBs and Trading Funds and the NHS.

2. Issues Arising From the Previous Reports

Departmental Boundary (Manual, Section 1.5)

2.1 In our earlier reports we expressed our concerns about NDPBs and trading funds being outside the boundary and not consolidated into departmental accounts, even though many of the government's outputs are delivered through them. As resource accounting is still in the introduction phase, insufficient new information in this period has yet emerged which would allow us to fully evaluate this area. The Board did however consider and agree an amendment to the Manual to clarify the fact that the liabilities of NDPBs should not be recognised in departments' resource accounts (paragraphs 3.3-3.4) even where in practice those liabilities could only be met by future grants from departments. This is consistent with the boundary, but tends to highlight the boundary's artificiality.

2.2 The Board also considered detailed proposals from the Treasury regarding the composition of the 'Resource Budget Outturn' (paragraph 2.12) to be reported in the Operating Cost Statement as one of the three operating results. This figure, designed to serve the Treasury's budgetary control requirements, would in essence require recognition of the operating results of NDPBs, trading funds and other public corporations outside of the boundary through a reconciliation note.

2.3 We therefore continue to feel that the boundary should be re-examined in the light of experience, once it is available. We would hope to take up this issue again in the next two years, although it may not be possible to conclude on this matter until the implementation of WGA.

Interaction with Resource Budgeting (Manual, Section 2.2)

2.4 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. It has been announced in Parliament in response to a parliamentary question that the Government intends to follow a two stage approach to introduce resource budgeting, starting in the 2000 Spending Review. (A copy of the question and answer is reproduced in Annex C). We will be looking to the Treasury to keep us informed about progress.

Accounting for the Effects of General Inflation (Manual, Section 2.3)

2.5 The last report noted the Board's view that, as there was no plan to include any adjustment for the effects of general inflation in departments' resource budgets, then no such adjustment should be included in the resource accounts, other than for the agreed exception (in respect of the interest subsidy for student loans). The Board suggested that the adjustment might, however, be included in the notes to the accounts.

2.6 During the period of this report the Board discussed a Treasury proposal that, in principle, a charge for general inflation should be applied to longer term monetary assets and liabilities and to provisions. The Board's view remained that only if an inflation charge was included in resource budgets should it also be recognised in resource accounts. The Board awaits the Treasury's further consideration of this and of its suggestion that notes to the accounts might otherwise disclose the effect of such an adjustment.

Heritage Assets (Manual, Section 3.5)

2.7 As previously reported, the Board considers that in principle heritage assets should be valued and appear on the balance sheet, like any other asset. However, we acknowledge that there are particular difficulties and accepted in our previous report that there are some types of non-operational heritage asset where this may not be cost effective to do. A working party of officials from the Treasury, the National Audit Office, and the heritage departments was set up to consider the question of whether non-operational heritage buildings should always be placed on departments' balance sheets.

2.8 The working party concluded that the case for this was unproven. In effect this means that the balance sheet recognition of heritage assets rests on a cost benefit assessment of deriving the value to be placed on such assets, and the reliability of such values. The Board was concerned that the working party mainly focussed on the needs of departments, rather than the external users of accounts. However, we accepted that the existing Manual entry concerning heritage assets should be retained for the present.

Salary and Pension Disclosures (Manual, Section 7.5)

2.9 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, and 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 method of disclosure for purposes of complying with the Greenbury Report.

2.10 Last year we reported that the Cabinet Office had been able to comply with our views on this, with the aim to implement these disclosures in respect of 1999-2000 resource accounts. However, we are informed by the Cabinet Office that, unfortunately, due to the restricted nature of the consultation process and concerns that the individuals might use the Data Protection Act to resist any request to publish information about their salary and pensions, the actual requirements which have been included in the Manual fall somewhat short of those currently being applied to the private sector. The differences relate to the ability of an individual to refuse to allow disclosure and the general omission of benefits-in kind. The Cabinet Office is to progress with the necessary consultation about including benefits-in-kind in the disclosure requirements, and has agreed to review the possible legal remedies to address the possible action under the Data Protection Act and report back to the Board. We will be interested in the Cabinet Office's progress.

Success of the Manual in Practice

2.11 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. The Treasury has advised us that it will report back on the outcome of its review of the success of the Manual, following the preparation and informal audit of departments' unpublished "dry-run" resource accounts for 1998-99. The Board recognised that this will be the first real test of the Manual in practice and looks forward to receiving the Treasury report this Summer.

Operating Cost Statement - Explanation of the Three Totals (Manual, Annex 4)

2.12 In our previous reports 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). During this reporting period the Board accepted an amendment to the Manual (for the 1999/2000 reporting year) that explained and provided a detailed reconciliation between the 'Net Operating Cost' and the 'Net Resource Outturn'. The Board agreed that the requirement to report the 'Outturn Against Resource Budget' should be removed because of the complexity of the reconciliation and concern over the auditability of the reconciliation between this total and the 'Net Resource Outturn'. We understand that the Treasury intends to reintroduce this in a future year once these problems have been solved. The Board is satisfied with this approach.

PFI (Manual, Section 8.3)

2.13 In our second report we stated that, following the issue by the ASB of its Amendment to FRS 5 - *Private Finance Initiative and Similar Contracts (September 1998)*, the Treasury was revising its Technical Note to replace the earlier interim guidance on the detailed accounting for these projects. This revised guidance was accepted by the FRAB subject to the Treasury agreeing an adequate level of retrospective application of the revised guidance to reflect the September 1998 implementation date of the Amendment to FRS 5.

2.14 As mentioned in our previous report, the Treasury agreed to retrospection and has since issued the revised Technical Note. The Board wishes to monitor the effect of the revised guidance and retrospection, and the Treasury has agreed to provide information about its impact on the largest of the PFI projects. We await this information and will comment further as necessary.

Pension Scheme Statements (Manual Section 4.5 and Chapter 15)

2.15 We said, in our second report, that the FRAB had approved a new chapter setting out detailed guidance on the form and content of pension scheme statements, and that we were awaiting a final view of the illustrative pension scheme financial statements. These have now been agreed by the Board and added to the Manual at Annex 7. Further amendments to the Manual, in particular to ensure the proper accounting treatment and disclosure of compensation payments for early retirement were also accepted by the Board.

Student Loans - Provision for Future Subsidy

2.16 In our last report we said that the Treasury had asked the Board for a view on 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. This is to be considered further by the Treasury.

Student Loans - Accounting for Inflation (Manual, Section 3.11)

2.17 As we reported previously, because the interest subsidy on student loans is 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.

2.18 During this reporting period the Board agreed amendments to the Manual which put this into effect.

3. Main New Issues During the Report Period

Statement on the System of Internal Financial Control (Manual, Annex 6)

3.1 The Board is pleased that the Treasury has been able to agree to include a reference to the intended compliance with the recommendations of the Turnbull Committee in the example of the statement on the system of internal financial control, included in the Manual. The Board notes that the wording of the statement for 2000-01 and subsequent years will be subject to further consideration in the light of guidance being developed by the Treasury, with a view to full compliance in 2001-02 (planned to be the first year that resource accounts replace appropriation accounts).

3.2 Board members are also interested in how the recommendations of the Turnbull Committee will be implemented, and are pleased that the Treasury has agreed to keep the FRAB up to date with developments.

Provisions by Departments for Liabilities of NDPBs (Manual, Section 4.8)

3.3 The Board approved an amendment to the manual whereby departments would not generally recognise provisions in respect of the liabilities of the NDPBs whose cash requirements they finance by way of grant or grant-in-aid. FRAB members accepted that recognition of such provisions would have resulted in the rather perverse situation of partial consolidation of NDPBs, which would not be compatible with the way the resource accounting boundary is defined.

3.4 However, this approval does not detract from the Board's wish to revisit the definition of the boundary (see paragraphs 2.1-2.3).

Provisions - Prejudicial information

3.5 The Board considered an amendment to the Manual to allow an entity not to recognise a provision where it was considered that to do so would be prejudicial to a department's negotiating position and thus to the Exchequer. We accepted that there could be times, in exceptional circumstances, when this was appropriate but did not consider that the criteria were adequately specific. The Treasury agreed to reconsider this.

FRS 15: Tangible Fixed Assets (Manual, Section 3.2)

3.6 The Board approved the Manual amendment putting FRS 15 into effect. This required a "not for profit" interpretation to be placed on recoverable amount in cases of a revaluation loss to below depreciated historical cost. Although the Board accepted this interpretation, it intends

to return to this when the ASB has published further material on this matter. The ASB has indicated that it intends publishing a supplement to its Statement of Principles as regards the public and not for profit sectors which may address some of the issues in this area.

3.7 Separately, the Board was concerned that the policy of mid-year valuations of fixed assets, already in the RAM, might conflict with the requirements of FRS 15. The Treasury has advised us that it intends to re-examine this (see paragraph 3.13 below).

Mergers and the Transfer of Functions (Manual, Section 8.8)

3.8 The Board accepted the application of merger accounting to both departmental mergers and transfers of functions between public sector bodies. In discussing this with the Treasury the Board was concerned to ensure that there was no mixture of merger and acquisition accounting. The Treasury accepted this view.

Transfer of fixed Assets between Departments (Manual, Section 3.2)

3.9 The Board accepted the 'fair value' basis of calculating the transfer price where tangible fixed assets are transferred between departments (other than in connection with a transfer of functions or merger between departments), but did not support the proposal that there should be a transfer of the relevant proportion of the revaluation reserve. The Board considered that there was no good reason in this case to depart from GAAP principles.

Prior Period Adjustments (Manual, Section 7.6)

3.10 The Board was asked to consider an amendment to the Manual which requires disclosure of prior period adjustments to Parliament by way of their inclusion in Schedule 1 of the accounts. The Treasury reported that this disclosure was needed to provide a suitable mechanism for reporting the effects of prior period adjustments to allow for adequate parliamentary scrutiny and control. The Board approved the amendment.

Increasing the Compatibility of Resource Accounts and National Accounts Balance Sheet Data

3.11 In view of the proposed extension of the remit of the FRAB to encompass WGA, the Board was asked to consider the principle that account disclosures (particularly in respect of fixed assets) should be expanded to provide audited data suitable for direct use in the national accounts, where this is possible within the GAAP framework and does not involve significant additional costs. The Board accepted the principle but was concerned about possible practical difficulties. The Board awaits with interest the results of the consultation by the Treasury with departments, and the opportunity to see some worked examples.

Revision of Accounting Guidance for Executive NDPB and Trading Fund Guidance

3.12 We noted in our last report that the Board's remit was being extended to oversee the accounting guidance in respect of NDPBs and trading funds. During this reporting period the Treasury has reviewed the differences between the existing guidance for these bodies and the Manual. It has, with a view to amending that guidance to achieve greater consistency, put proposals for dealing with these to departments and the bodies concerned for consultation. The Board has offered initial views on this and looks forward to considering final proposals in June this year.

3.13 In offering initial views, the Board registered its concern at one of the differences identified by the Treasury: mid-year valuations of fixed assets. The Board has already noted its concern that this policy presently in the Manual might conflict with the requirements of FRS 15: Tangible Fixed Assets (see paragraph 3.7 above). The Treasury has advised us that it intends to re-examine this, taking into account its impact on departments, NDPBs and trading funds.

3.14 As well as considering the revision of existing guidance to NDPBs and trading funds the Board was also asked to consider some new guidance in the form of Dear Accounting Officer (DAO) Letters. These are used by the Treasury to notify departments, trading funds and NDPBs about the introduction of new accounting standards. During the reporting period the Board approved two DAO letters, one on FRS 11 (Impairment of Fixed Assets and Goodwill) and the other on FRS 15 (Tangible Fixed Assets).

4. Role and Composition of the Board

4.1 As we reported last year, 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 - submitted to Parliament in December 1998j*). This examined the independence of the Board and whether the Board's remit should be drawn more widely. The report concluded that the FRAB had operated independently and that the FRAB's remit should be extended now to oversee the accounting guidance in respect of executive NDPBs and trading funds. This conclusion was based on the added value the FRAB is expected to give. The report also concluded that the remit may possibly be further extended, after discussion with the Board at the appropriate time, to cover NHS providers (depending on discussions between the Treasury and appropriate departments) and policies underlying WGA.

4.2 The Board has commenced its consideration of accounting guidance in respect of NDPBs and trading funds (reported in paragraphs 3.12-3.14).

4.3 The Board has discussed the possibility of its remit being extended to oversight of the accounting guidance for the NHS, and would be ready to take on this additional role.

4.4 The Board accepted the proposed additional role of considering the policies underlying WGA and has already been consulted on one WGA issue (see paragraph 3.11) - WGA balance sheet items. We look forward to the topics which we are due to look at in the future. These include the WGA consolidation boundary, pension liabilities, format of accounts, taxation and accounting policies for central government funds and financial liabilities.

4.5 The PAC, in its *Ninth Report of session 1999-2000: Government Resources and Accounts Bill*, included the recommendation that the FRAB should report directly to the PAC as well as the Treasury. The Board's view is that it is important, not only that it should be independent, but that it should be seen to be independent, and consequently is in favour of sending a copy of its report direct to the PAC, and also to the Treasury Committee instead of via the Treasury. (The Chairman's letter to the PAC is shown at Annex D.)

4.6 To reflect the wider remit of the FRAB, a new member was welcomed on the Board. Rosamund Sykes is the Director of Finance and Central Services at the Victoria and Albert Museum and brings experience of NDP13s to the Board. Experience of trading funds was already available through Heather Jackson, who was already a Board member, representing small government departments.

4.7 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 view point would be beneficial to carrying out its role, and would welcome a proposed candidate.

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 appendix A 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 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 as follows:

Chairman:

Elwyn Eilledge - 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, Resource Accounting and Budgeting Project Manager, HM Treasury (*From February 2000*)

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 (*until January 2000*)

Rosamund Sykes, Director of Finance and Central Services, Victoria and Albert Museum (*From October 1999*)

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 third report, Michael Romberg has substituted for Caroline Slocock, Brian Grubb has substituted for Caroline Mawhood and David Jones has substituted for Colin Balmer.

Proceedings

5. During this reporting period the Board has held 7 meetings. It has been considering 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 one new accounting standard (GAAP).

6. Ken Wild appeared before the Treasury Committee in March 2000. Although the Committee was aware of his role as a FRAB member, he was asked to appear because of his accounting knowledge and professional expertise.

7. The head of the Treasury's Resource Accounting and Budgeting Team, Ros Dunn (prior to becoming a Board member) attended most meetings to answer Board members' questions on resource budgeting. Other members of the Treasury also attended for particular agenda items - Gordon Adam, Nick Bailey, Andrew Carpenter, Ian Carruthers, Tracy Gordon, Glen Hull, Jamie Hutchinson, Dave Phillips, Larry Pinkney, Doug Rayner, Nick Towers and Tim Wilson.

8. The Board proceeded by examining papers on the agenda items, along with related Resource Accounting Manual 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 a more effective and relevant Manual, and considers that it has added significant value through this approach.

9. To expedite the approval process the Board adopted a procedure whereby minor amendments to the Manual were not automatically discussed at meetings. Instead details of the proposed changes were sent to all FRAB members, but did not appear as agenda items. If any FRAB member wished to discuss any of the minor amendments they were raised under Any Other Business.

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 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.

² One further member has joined the Board - 1 member nominated to represent Non-Departmental Public Bodies. The Board member representing small department's interests now also represents trading funds.

OTHER AMENDMENTS TO THE RESOURCE ACCOUNTING MANUAL AGREED BY THE BOARD

1. **Departmental Boundary: Investments** (Manual, section 1.5) - clarifies that only formal investments in non-consolidated bodies should be recognised as investments.
2. **Devolution - Impact on Wording used in the RAM** (Manual, sections 1.6 and 3.6) - removes references to the special circumstances of infrastructure assets in Scotland and Northern Ireland, and clarifies the applicability of the Manual to Wales.
3. **Revised Expenditure Control Regime - Amendments to Terminology** (Manual, sections 1.7 and 3.2) - reflects current terminology and progress of the Resource Accounting and Budgeting Project.
4. **Modified Historical Cost Accounting and Revaluation Reserve** (Manual, sections 2.3 and 5.3) clarifies the treatment of current asset investments in marketable securities, and in stocks.
5. **Mid Year Revaluations of Fixed Assets** (Manual, section 3.2) - allows for the use of either historic indices or forward looking indices.
6. **Valuation of Antiques** (Manual, section 3.5) - clarifies the treatment of antiques which do not meet the heritage asset criteria.
7. **Development Expenditure: Modified Historical Cost Accounting** (Manual, section 3.10) - clarifies the requirement to apply Modified Historical Cost Accounting and mid-year revaluations to development expenditure.
8. **Valuation of Investments where there is no Market Value** (Manual, section 3.11) - allows departments to value such investments on a current cost basis.
9. **Cash Control Issues** (Manual, sections 3.14, 5.2 and 6.7) - clarifies various aspects of the accounting treatment of voted cash and Consolidated Fund Extra Receipts.
10. **National Insurance Fund and Pension Payments** (Manual, section 7.2 and annex 1) - clarifies that departments other than the Department of Social Security have expenditure financed from the National Insurance Fund.

11. **Treatment of Insurance - Intervention Board** (Manual, section 7.3) - removes a paragraph on the treatment of insurance by the Intervention Board which will now be fully subject to FRS 12 - Provisions, Contingent Liabilities and Contingent Assets.
 12. **Foreign Currency Translations** (Manual, section 8.1) - clarifies the treatment of exchange rate gains and losses in respect of valuations of overseas non-monetary assets and liabilities.
 13. **FRS 13 - Derivatives and Other Financial Instruments** (Manual, section 8.7) clarifies the financial instruments to which this standard applies.
 14. **Departmental Annual Financial Planning and Reporting Documents** (Manual, section 11. 1) clarifies the requirements of the two main financial planning and reporting documents.
 15. **Disclosure Requirements of Agencies** (Manual, section 11.2) - incorporates the disclosure requirements of On-Vote Executive Agencies in the foreword to the accounts.
 16. **Government Accounting Reporting Requirements in Resource Accounts** (Manual, section 12.1) - highlights the need to meet the reporting requirements set out in Government Accounting.
 17. **Schedule 5: Total** (Manual, sections 12.1 and 13.1) - clarifies the scope of expenditure covered in schedule 5.
 18. **Annex 2: Business Rates** (Manual, annex 2) - clarifies that this relates only to the receipt of business rates.
 19. **Schedule 1: Illustrative Estimate Figures** (Manual, section 12.1 and annex 4, schedule 1) - clarifies the derivation of illustrative Estimate figures in the years prior to the introduction of resource-based Estimates.
 20. **Disclosure of Movements in Donated Asset And Government Grant Reserves in the Statement of Recognised Gains And Losses** (Manual, annex 4, schedule 2) - clarifies the inclusion of movements in these reserves in the Statement of Recognised Gains And Losses.
 21. **Cash Flow Statement - Amended Format** (Manual, annex 4, schedule 4) - clarifies the treatment of sources of funding other than from Parliamentary Vote, and how these and other flows are treated in the Cash Flow Statement.
 22. **Note 8 to Department Yellow** (Manual, section 12.1 and annex 4, note 8) - provides a comparison of outturn to Estimate in note 8 of the illustrative account.
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23. **Model Certificate and Report of the Comptroller and Auditor General** (Manual, section 14.2 and annex 5) - provides an updated version of the Audit Certificate and a new certificate for pension scheme statements.

24. **Statement of Accounting Officer Responsibilities** (Manual, annex 8) - provides an updated version of the Statement of Accounting Officer Responsibility, in line with the requirements of the Statement of Auditing Standard 600, expressed in central government terms.

EXTRACT FROM HANSARD: PARLIAMENTARY WRITTEN QUESTION ON RESOURCE BUDGETING

Resource Accounting

Mrs. Lawrence (Lab - Preseli Pembrokeshire): To ask the Chancellor of the Exchequer when he plans to proceed with the introduction of resource budgeting. [104121]

Mr. Andrew Smith (Lab - Oxford East): The next spending review, in 2000, will be conducted on a resource basis. This will fulfil the Government's commitment in the Code for Fiscal Stability to adopt, as soon as reasonably practicable, a resource accounting and budgeting approach for planning and accounting for the costs of resources consumed by government.

The decision to proceed with resource budgeting follows a successful "dry run" of the new procedures carried out by all Departments during the course of 1999. This confirmed that the procedures were workable. However, it also highlighted a transitional issue in relation to Departments' ability to forecast the large new non-cash elements of resource budgets (depreciation, capital charges and provisions) for three years ahead.

To allow time for a track record in forecasting, monitoring and controlling these items to be established, resource budgeting will therefore be introduced in two stages. In the first stage, in the plans drawn up in the 2000 spending review, the big non-cash elements of resource budgets will be part of Annually Managed Expenditure rather than Departmental Expenditure Limits. The intention is that, in the light of experience, these items will be moved into Departmental Expenditure Limits following the 2002 spending review.

Details of the new arrangements are being placed in the Libraries of the House.

21 Dec 1999: Column: 583 W

THE CHAIRMAN OF THE BOARD'S LETTER TO THE COMMITTEE OF PUBLIC ACCOUNTS

Elwyn Eilledge

Chairman of the Financial Reporting Advisory Board

Rt Hon David Davis, MP
Chairman of the Public Accounts Committee
House of Commons
London
SW1A 0AA

15 April 2000

INDEPENDENCE OF THE FINANCIAL REPORTING ADVISORY BOARD

The Treasury has drawn to the attention of the Financial Reporting Advisory Board (FRAB) the recommendation of the Public Accounts Committee that the "FRAB should report directly to" the Committee (conclusion (xxix) of the Committee's Ninth Report -Government Resources and Accounts Bill).

The Board discussed this and considered that it would like to respond positively to the recommendation.

The Board, as you are aware, was set up to introduce an independent element into the process of setting financial reporting standards for Government. In fulfilling this remit the Board has always acted independently. Nevertheless, I acknowledge there is an external perception that this may not be the case. It is important that, not only the Board should be independent, but it should also be seen to be independent. I believe this external perception would be enhanced by the Board sending its published report direct to the Public Accounts Committee, and also to the Treasury Committee, instead of via the Treasury.

The Treasury consulted me about its own response to the Committee's recommendation, and for the reason given above I agree with what is proposed.

I and other Board members are, of course, always ready to be questioned by the Committee on any aspect of the Board's work, including its independence.

Yours sincerely
Elwyn Eilledge
ELWYN EILLEDGE