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# **The Financial Reporting Advisory Board**

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## **Report for the period April 2002 to March 2003**

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## FOREWORD

This is the Financial Reporting Advisory Board's sixth report and covers the period from April 2002 to March 2003. The purpose of the Board is to give independent accounting advice. Its aim is to ensure that the accounting guides within its remit meet the best possible standards of financial reporting by following generally accepted accounting practice as far as possible.

During this period, there was little issued in the way of pronouncements from the Accounting Standards Board. Instead this was a year of steady progress characterised by several improvements to the financial reporting requirements of central government by moving them further towards those of UK GAAP. The removal of the requirement for mid-year valuations brings reporting requirements in line with **FRS 15 Tangible fixed assets** and discount rates for both pension liabilities and provisions will, in the future, be based on the rates required in **FRS 17 Retirement Benefits** and **FRS 12 Provisions, Contingent Liabilities and Contingent Assets**. The more realistic discount rates will lead to improved balance sheet valuations of these liabilities.

Moreover, on the Board's advice the Treasury will adhere to the original timetable for the full implementation of FRS 17 in 2003/04 rather than defer it as now permitted by the ASB. This means that central government accounts will be with the front-runners in improved accounting for pension liabilities.

For the future the Board will be considering the implications for central government accounts of convergence with international accounting standards, and proposals resulting from the collapse of Enron. The Board looks forward also to considering future progress in the implementation of whole of government accounts, and in particular its impact on the accounting boundary for departments' resource accounts, and the accounting treatment of state pensions, two issues in which the Board retains an interest.

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

Elwyn Eilledge CBE (Chairman)



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# EXECUTIVE SUMMARY

## Introduction

This is the sixth report of the Financial Reporting Advisory Board ('the Board') and covers issues arising from the earlier reports, new issues arising and developments in whole of government accounts.

The Board considered amendments to the Resource Accounting Manual (the Manual), the Executive Non-Departmental Public Bodies (NDPB) Annual Report and Accounts Guide (the NDPB Guidance), and the Trading Fund Accounts Guide (the trading fund guidance). Scotland, Northern Ireland and the Department of Health in respect of the National Health Service in England did not propose any further differences from the principles in the three accounting guides to be considered.

The Board is pleased to report that, not only have there been no new departures from generally accepted accounting practice (GAAP) agreed during the reporting period, but the existing departure relating to **FRS 15 Tangible fixed assets** has been removed (see section B.8) and the proposals on discount rates have been better aligned with GAAP requirements (see section D.1).

## Main issues arising from the previous report (section B)

**Departmental boundary (section B.1)** This remains an area of continuing interest to the Board. The Treasury advised the Board that it would consider ways of aligning the boundary with that for resource budgeting without amending legislation. The Board asked the Treasury to examine the extent to which the existing and proposed boundaries for the accounts of individual departments were consistent with GAAP. The Board look forward to considering this further during the coming year.

**FRS 17: Retirement benefits (section B.3)** Following the Accounting Standards Board's permissive two-year extension for implementing FRS 17, the Treasury concurred with the Boards preference for adhering to the original timetable. The Board agreed the disclosure requirements for 2002/03 and look forward to full implementation in 2003/04.

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

**Operating and financial review (section C.2)** The Accounting Board issued a revised statement, **Operating and Financial Review**, in January 2003. The Board agreed amendments to the accounting guidance to reflect its recommendations.

## **Main new issues arising from sources other than changes to GAAP (section D)**

**Cost of capital and discount rates (section D.1)** The Board agreed that, in future, the discount rates for pension liabilities and provisions would be set at each spending review, to achieve the required degree of certainty for resource budgeting. The rates would then apply to the years covered by that spending review. They would be expressed in real terms, based on an AA corporate bond rate for pension liabilities, and on an index-linked gilt rate for provisions, as in the relevant accounting standards. The Board welcomed this move closer to GAAP.

## **Whole of government accounts (section E)**

**Accounting for social security benefit expenditure (section E.3)** The initial findings of the Steering Committee set up by the International Federation of Accountants' Public Sector Committee to develop an International Public Sector Accounting Standard on **Accounting for Social Policies of Government** coincided with those of the Board, including that the treatment of the state old age pension would require further consideration. The UK's accounting treatment for its state pension will be reconsidered by the Board in the light of comments made on the Public Sector Committee's invitation to comment and eventual exposure draft. The Board looks forward to being informed of the progress of this project.

## A Introduction

### A.1 General

A.1.1 This is the sixth report of the Financial Reporting Advisory Board (the 'Board'). It covers the period from April 2002 to March 2003. During the period the Board reviewed amendments, as put forward by the Treasury, to the 2001/02 versions of the Resource Accounting Manual (the Manual) the Executive Non-departmental Public Bodies (NDPBs) Annual Report and Accounts Guidance (the NDPB Guidance) and the Trading Funds Accounts Guidance (the Trading Fund Guidance) to make them applicable to the 2002/03 accounts. The Board also considered (in March 2003) some amendments for the 2003/04 versions of these accounting guides.

A.1.2 This report follows a similar structure to the Board's previous reports, covering:

- ⌘ Section B – Issues arising from the 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
- ⌘ Section E –Whole of government accounts,
- ⌘ Section F –Composition and operation of the Board,
- ⌘ Annex A –The Board's Operations
- ⌘ Annex B – Other amendments to the accounting guidance agreed by the Board.

### A.2 Departures From GAAP

A.2.1 The Board is pleased to report that there have been no new departures from GAAP agreed this year, and welcomes the revised discount rates for pension liabilities and provisions (see section D.1) that moved their treatment closer in line with GAAP requirements. The Board is also pleased to report that the policy of mid-year valuations of tangible fixed assets is being withdrawn to bring the approach in line with the requirements of **FRS 15 Tangible Fixed assets** (see section B.8).

## B Issues arising from the previous report

### B.1 Departmental boundary

B.1.1 In its earlier reports the Board 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. In its report last year the Board referred to initial

proposals from the Treasury that the departmental boundary should be extended to bring it into line with the resource budgeting boundary, and the boundary for central government accounts. This development would result in NDPBs being included within the departmental boundary. In the Treasury's view this would move the boundary closer to one based on GAAP. There would, however, be some legal impediments to address. The Board agreed that the Treasury should carry out further work and report back.

B.1.2 Last year the Board also noted that the Accounting Standards Board's Public Sector and Not for Profit Committee was continuing with a project to develop a Statement of Principles for not-for-profit entities and that, as this project develops, it might inform the Treasury's review of the boundary. The Board had approved this approach.

B.1.3 During this reporting period the Treasury advised the Board that the legal impediments to extending the departmental resource accounting boundary to bring it into line with that for resource budgeting would be onerous in terms of amending legislation. Nevertheless the Treasury would consider other ways to achieve this. In addition, at the Board's request, the Treasury agreed to examine the extent to which the existing and proposed boundaries were consistent with GAAP. The Board expects to consider this further during the next reporting year.

## **B.2 Accounting for the effects of general inflation**

B.2.1 In its previous reports the Board noted that there was no plan to introduce an adjustment for the effects of general inflation (other than in respect of the interest subsidy for student loans) and asked the Treasury to provide a progress report. During this reporting period the Treasury confirmed that this area was unlikely to be further progressed in the foreseeable future. The Board is content with this position.

## **B.3 FRS 17: Retirement benefits (2002/03 versions of the Manual, chapters 4 and 15; the NDPB Guidance, section 3.8; the Trading Fund Guidance, section 2.3)**

B.3.1 **FRS 17: Retirement Benefits** was issued in November 2000 with a staged and lengthy implementation timetable that the Treasury is following. Previously the Board had endorsed the closing balance sheet disclosure requirements to appear in the three accounting guides for 2001/02. In this reporting period the Board endorsed the further requirements for opening and closing balance sheet and accrued costs disclosures for 2002/03 in line with the implementation timetable prescribed by the FRS.

B.3.2 In 2002 the Accounting Standards Board issued an amendment to FRS 17, permitting a two-year extension to the implementation timetable. The Board's preference was for retaining the original timetable. The Treasury concurred and has adopted this approach. The Board looks forward to considering full implementation for 2003/04 (which will come to the Board in the next reporting year).

B.3.3 Last year the Board accepted a departure from FRS 17 concerning the discount rate to be used for public sector pension schemes within its remit. During this reporting year we discussed this further with the Treasury (see section D.1).

## **B.4 Heritage assets**

B.4.1 In 2001/02, the requirement to capitalise additions to heritage collections when the existing collection remained off-balance sheet was incorporated in the accounting guides. This followed the 2000 **Statement of Reporting Practice for Accounting and Reporting by Charities**. Two years ago the Board reported its reservations concerning the resultant lack of consistency. At the Board's request the Chairman of the Board had written to the Chairman of the Accounting Standards Board, proposing a review of this policy in late 2002, once accounts had been produced conforming to the new guidance and the effect could be seen.

B.4.2 The Board is pleased to note that, although the Accounting Standards Board did not feel that it could initiate a review at this time, the National Audit Office representative on the Accounting Standards Board's Public Sector and Not for Profit Committee has agreed to co-ordinate such a review. The Board looks forward to considering the outcome.

## **B.5 Salary and pension disclosures (2002/03 version of the Manual, section 8.5)**

B.5.1 In its previous reports the Board stressed its 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. The Cabinet Office had reported that, as an individual has the ability to prevent disclosures by virtue of the Data Protection Act 1998, Cabinet Office Ministers had agreed that these disclosures should be made a statutory requirement. However, this would be dependent on the Government finding a suitable opportunity within its legislative programme. This remains the position. The Board is disappointed with this lack of progress.

B.5.2 During the previous reporting period the Board agreed that information in respect of ministerial pensions ought to be disclosed by way of note in their departments' resource accounts, even where the expenditure is borne centrally. Following consultations with ministers by the Cabinet Office the Board approved amendments to the Manual that detailed the disclosure requirements.

## **B.6 Private finance initiative**

B.6.1 The Treasury's revised technical note **How to account for Private Finance Initiative Transactions** was issued following the publication by the Accounting Standards Board of its Amendment to **FRS 5 - Private Finance Initiative and Similar Contracts (September 1998)**. The Board reported previously that it wished to monitor the retrospective application of the revised technical note. The Board also

wants to maintain some monitoring of its application, including, in particular, the consistency of the accounting treatment being adopted by the private and public sectors in individual cases.

B.6.2 During this reporting period the Treasury presented its final update on projects affected by retrospection. The Board observed that the treatment of assets was very specific to the substance of the terms of the contract rather than to the nature of the service being provided. It did not consider that there was any need for further monitoring of the effect of retrospection.

B.6.3 The Treasury reported on the accounting treatment being adopted by both the private sector and the public sector in an agreed sample of projects. The Board was concerned to note that there were inconsistencies in the accounting treatment between the bodies in approximately a third of the cases where adequate information was available, and asked the Treasury to investigate further the reasons for these. The Board also agreed with the Treasury an approach to monitor the accounting treatment being adopted by both the private and public sectors in future major projects. The Board looks forward to further progress reports on these issues during the coming year.

## **B.7 Statement on the system of internal control (2003/04 versions of the Manual, annex 6; the Executive NDPB Guidance, annex D; the Trading Fund Guidance, annex B)**

B.7.1 The Board previously noted its 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 and to include a statement in their accounts. The Board noted that departments were not being required to include a full Statement until 2003/04 although they were being encouraged to do so earlier. This contrasted with private sector practice, which required adoption of the full procedures and statements from 2001/02. The Board recognised that the processes for reporting on corporate governance in central government were started later than in the private sector. Nevertheless the Board had urged earlier adoption in central government where possible.

B.7.2 The Board noted from a Treasury review that some 80% of public entities had all the risk management and review processes developed and in place by the end of the 2002/03 financial year, in order to produce a full statement of internal control for 2003/04 in line with the public sector timetable. Nearly a third of these bodies had been ahead of this timetable. The Board agreed to the Treasury proposals for the handling of those bodies which have not fully met the deadline. These required them to report on the progress of the work remaining for complete implementation of all relevant risk management and review processes during the course of 2003-2004.

B.7.3 The Board also agreed the contents of the revised proforma statement of internal control to encourage fuller entity-specific information on risk management for the future, on which users of the accounting guidance would be asked to comment.

## **B.8 FRS 15: Tangible fixed assets (2002/03 versions of the Manual, sections 3.2, 3.9 and 7.5; the NDPB Guidance, sections 7.6 and 8.14; the Trading Fund Guidance, sections 6.4 and 7.7)**

B.8.1 Previously the Board had reported its concern that the policy of mid-year revaluations of tangible fixed assets, required by the Manual for in-year control purposes, conflicted with the requirements of **FRS 15 – Tangible Fixed Assets**. Last year's report noted that the Treasury had put firm proposals to departments that they should fully adopt FRS 15. The Board is pleased to report that detailed amendments to the three accounting guides for 2002/03 have been approved. Over a two-year period, these withdraw the policy of mid-year valuations in the Manual.

B.8.2 To assist in-year control, the options allowed by FRS 15 for basing depreciation of tangible fixed assets on opening, closing or average balance sheet values could be followed. The amendments in the relevant accounting guides extend this approach to amortisation of intangible fixed assets, and introduce an optional approach to the calculation of cost of capital charges that does not require use of closing balance sheet values.

## **B.9 Returns on capital for trading funds**

B.9.1 In its previous report the Board noted an unresolved issue in the application of cost of capital charges to different types of assets and liabilities of trading funds. During this reporting period the Treasury informed the Board that progress on this topic was being taken forward outside of the accounting guidance, as the rates of return that trading funds were required to achieve were a control issue rather than an accounting issue. The Board was content with this approach and has removed the item from its agenda.

## **B.10 Treatment of asset disposals in Schedule 1 of resource accounts (2003/04 version of the Manual, section 12.1 augmented by a Dear Accounting Officer letter)**

B.10.1 The Board previously noted that the Treasury intended to review, in consultation with the National Audit Office, the accounting treatment of asset disposals in Schedule 1 of departmental resource accounts for 2003/04. The Board accepted the resulting revised treatment - that disposal proceeds, rather than carrying value, should be recognised as non-operating appropriations in aid. The Board agreed a revised approach to accounting for profits on disposal in Schedule 2 and will be considering the amendments to the Manual in the next reporting period.

## **B.11 Extension of the Board's remit: consistency of accounting guidance (2002/03 version of the Manual, sections 11.2 and 12.1; and 2003/04 versions of the Manual, section 11.2, the NDPB Guidance, section 4.2; the Trading Fund Guidance, sections 3.2)**

B.11.1 Following the extension of the Board's remit to advising on the technical rules of accounting and minimum disclosure requirements of the devolved government in Scotland, the Board examined and agreed as acceptable differences between the requirements of the Manual and of the Scottish Executive Resource Accounting Manual Application Notes.

B.11.2 Last year the Board had noted that there were some disclosures identified in the English NHS Trusts Manual of Accounts that were not required in the Resource Accounting Manual. The Board asked the Treasury to consider whether these disclosures were in fact appropriate to the Manual. This year the Board approved amendments to the Manual to include the following disclosure requirements in line with the English NHS Trusts Manual of Accounts: ill health retirements; payment practice of bills; and detail of consultation with employees being included in the annual report. Further amendments concerning relevant business interests of directors were approved by the Board late in the reporting year and will be included in the 2003/04 version of the Manual.

B.11.3 In order to promote convergence of the accounting principles applied by the various bodies under its remit the Board looks forward to reviewing the remaining groups of National Health Service Trusts in Northern Ireland, Wales and Scotland, which are planned to be included in the Board's remit during the next reporting period.

## **B.12 Non-cash charges and Income**

B.12.1 Last year the Board approved amendments clarifying the recognition of non-cash charges, but was concerned that the suggested definition of 'non-cash income' would be open to misinterpretation. The Treasury agreed to consider this further. This issue remains outstanding, and will be taken forward in the next reporting period.

## **B.13 International developments**

B.13.1 The Board reported last year that it would continue to monitor international developments – namely:

- €# The impact of the new International Accounting Standards Board,
- €# The impact of International Public Sector Accounting Standards issued by the International Federation of Accountants' Public Sector Committee and
- €# The collapse of Enron, underlining the need for strong corporate governance and accounting practices.

The outcome of the Board's discussions on each of these topics is summarised below.

B.13.2 With regard to the impact of the new International Accounting Standards Board, the mandatory adoption of international accounting standards by listed companies in their consolidated accounts throughout Europe in 2005 will have a consequential impact across the whole of UK GAAP. During this reporting period the Board's initial view was sought regarding what UK GAAP post 2005 should be for public sector accounts. The Board's view was that it was possible that these international standards could become the relevant requirements for UK GAAP. However the Board would need to consider the results of the Department of Trade and Industry consultation, regarding the possible extension of International Standards to other accounts, and any subsequent Government decisions before the implications for the public sector could be identified. The Board awaits these further developments with interest.

B.13.3 The Board has been particularly interested in the development of the International Public Sector Accounting Standard on **Accounting for Social Policies of Government**. Details of the Board's involvement are in section E.3 of this report.

B.13.4 A series of reports and a government announcement of a package of reforms were issued in January 2003, resulting from the collapse of Enron. The Treasury identified, for the Board, implications for the public sector in a number of areas, in particular – financial reporting, auditor independence, and corporate governance. The Board has asked the Treasury to keep it informed as reforms are developed and implemented.

## **B.14 Whole of government accounts**

B.14.1 During the reporting period some issues outstanding from last year relating to whole of government accounts were addressed, namely:

- Corporate governance
- Accounting for social security benefit expenditure
- Increasing the compatibility of resource accounts and national accounts balance sheet data.

Progress on these items is addressed in section E of this report.

## **C. New issues arising from changes to GAAP**

### **C.1 Amendment to FRS 17: Retirement Benefits**

C.1.1 The Accounting Standards Board issued an amendment to FRS 17, permissively extending the implementation timetable. This is addressed in more detail in section B3 of this report.

## **C.2 Operating and financial review (2002/03 version of the Manual, section 11.2, augmented by a Dear Accounting Officer Letter)**

C.2.1 The Accounting Standards Board issued a revised statement **Operating and Financial Review** in January 2003. The Board agreed amendments to the accounting guidance to reflect its recommendations.

## **C.3 Urgent Issues Task Force Abstracts (2002/03 versions of the Manual, annex 3; the NDPB Guidance, annex C; the Trading Fund Guidance, annex A)**

C.3.1 The Treasury proposals on Urgent Issues Task Force (UITF) Abstracts 34 and 35 were little more than to update the Manual and other accounting guidance to take account of the issue of these two abstracts. Details of the individual UITF abstracts are listed in Annex B. The Board agreed to these proposals.

## **D. New issues arising from sources other than changes to GAAP**

### **D.1 Cost of capital and discount rates (2003/04 versions of the Manual, sections 4.3-4 and 7.5; the NDPB Guidance, sections 7.6 and 8.13)**

D.1.1 During the report year the Board accepted the Treasury's change of cost of capital rate to 3.5% in real terms to take effect from 2003/04.

D.1.2 The Board agreed that, in future, the discount rates for pension liabilities and provisions would be set at each spending review, to achieve the required degree of certainty for resource budgeting. These rates would then apply to the years covered by the spending review. This would take effect from the 2004 spending review, which meant that the rates determined in that review would apply for the years 2005/06 and 2006/07. The rate for pension liabilities would be expressed in real terms, based on an AA corporate bond rate, and that for provisions on an index-linked gilt rate. These are the rates set out in the relevant accounting standards. The Treasury had previously argued that the index-linked gilt rate should also apply to pension liabilities primarily because of the more limited ability, compared with private sector schemes, of central government to reduce its liability in respect of public sector schemes. The Board had accepted the more prudent and onerous approach, compared with the AA corporate bond rate required by FRS 17, which this departure from GAAP represented. However, given that FRS 17 envisaged the AA corporate bond rate encompassing a wide spectrum of abilities to reduce pension liabilities, the Board welcomed the Treasury's proposal to move closer to GAAP on this point.

D.1.3 The Board agreed that for the period prior to 2005/06, the discount rates for both pension liabilities and provisions should be at 3.5% in real terms. This rate was already being applied in respect of pension liabilities, but provisions were being discounted at 6% in real terms. The Board would have preferred bringing the

discount rate for provisions into line with that for pension liabilities in 2002/03 but reluctantly accepted, that implementation should be deferred to 2003/04. This was because by the time of its decision it was impracticable for departments to seek parliamentary authority to cover the additional expenditure.

## **D.2 Related party transactions – application to ministers (2002/03 version of the Manual, section 8.4)**

D.2.1 The current guidance on the application of FRS 8 *Related Party Disclosures* does not make clear whether ministers are to be regarded as parties related to their departments for these purposes. During discussions on amendments to the guidance specifically to include ministers there was general acceptance of the principle that ministers were related parties, but there remained the practical difficulties of implementation. The Board looks forward to this issue being fully addressed in the future.

## **D.3 Post Mortem on the success of the three accounting guides in practice**

D.3.1 The Board is pleased to note that the Treasury has continued with its annual review of the success of the accounting guides in consultation with the users. 2001/02 was the first year that the NDPBs and trading funds were required to use the accounts guides endorsed by the Board. A variety of issues were raised in the post mortem and have been added to the work programme for consideration over the coming reporting periods. The Board approved this approach.

## **D.4 Format of the accounting guides**

D.4.1 Last year the Board asked the secretariat to consider whether a single accounting guide should replace the individual accounting guides falling within the Board's remit. The Board has agreed the two-stage development proposal put forward. The first stage will be to develop a single set of accounting guidance to replace the guidance prepared separately by the Treasury, and in Scotland and Northern Ireland, in respect of departments and agencies. There will continue to be separate guidance for the accounts of other bodies. Stage 2 will be to develop the accounting guidance to include NDPBs and trading funds, but not National Health Service trusts.

# **E Whole of government accounts**

## **E.1 Introduction**

E.1.1 The issues arising out of the development of whole of government accounts and central government accounts continue to be a significant driver of the Board's agenda. One of these issues, which also touch on departmental accounts, has been reported in an earlier section of this report – the departmental boundary (section B1). In addition, the following issues which are specific to whole of government accounts and central government accounts were brought before the Board.

## **E.2 Corporate governance**

E.2.1 In its previous reports the Board noted that the Treasury had advised the Board that development of a statement of internal control for central government accounts would take account of a planned assessment of departmental progress in implementing statements of internal control. In this reporting period the Treasury has advised that a decision on the format of a statement of internal control will be taken as part of the preparation of the second dry run central government accounts (for 2002/03) and should be brought to the Board in Spring 2004. Proposals on the signatory of central government accounts will then be developed in the light of the statement's content. The Board awaits the Treasury's proposals on these matters.

## **E.3 Accounting for social security benefit expenditure**

E.3.1 In previous reports the Board had noted that the Treasury was represented on the Steering Committee set up by the International Federation of Accountants' Public Sector Committee to develop an International Public Sector Accounting Standard on **Accounting for Social Policies of Government**, and welcomed the Treasury's commitment to invite the Board to comment on the Committee's proposals as they developed. During this reporting period the Steering Committee has made significant progress in examining the accounting treatment of governments' social policy obligations. Its initial findings coincided with those of the Board: ie that in general social security expenditure (excluding the state old age pension) does not give rise to a liability, but the treatment of the state old age pension would require further consideration. The International Federation of Accountants' Public Sector Committee will consider the draft invitation to comment in April and it is hoped that it will be issued shortly thereafter. As previously agreed, the accounting for the UK's state pension will be reconsidered by the Board in the light of the comments made on the invitation to comment and the eventual exposure draft, which is likely to emerge during the second half of 2004. The Board looks forward to being informed of the progress of this project.

## **E.4 Increasing the compatibility of resource accounts and national accounts balance sheet data (2002/03 versions of the Manual, sections 3.10, 4.2 and 6.4, the NDPB Guidance, sections 7.11, 8.1 and 8.14; the Trading Fund Guidance, sections 6.5, 7.1 and 7.15)**

E.4.1 The Board considered Treasury proposals to standardise disclosures, primarily in connection with fixed assets, that would meet both GAAP and European System of Accounts requirements and would provide greater consistency for the whole of government accounts consolidation. The Board approved the amendments that introduced these disclosure requirements to the three accounting guides.

## **E.5 Accounting for taxation revenues**

E.5.1 The Board notes that departments have made progress in implementing accruals based accounting policies for taxation revenues, but that, due to the nature of the revenue streams, the Inland Revenue faces some significant implementation issues that require new systems to resolve. The Board looks forward to further progress reports on this work.

E.5.2 During the reporting period, departments examined the practical application of the accounting principles for taxation revenues approved by the Board in 2000. Minor changes to recognition principles were identified, which the Board approved.

## **E.6 National Loans Fund: format of account and accounting Policies.**

E.6.1 The Board endorsed the Treasury proposed format of an accruals based National Loans Fund account, noted how the boundary tests had been applied and confirmed its acceptance of the accounting policies.

## **E.7 Format of accounts for the Consolidated Fund standing services trust statement**

E.7.1 The Board noted the progress towards introducing an accruals based trust statement for Consolidated Fund standing services and the need for additional research into the relationship between the European Investment Bank and the Department for International Development before accounting policies and the format of the trust statement could be completed. The Board awaits further consideration of this in the next reporting period.

## **E.8 Disclosure of the United Kingdom's financial relationship with the European Union**

E.8.1 The Treasury reported to the Board the various duties and levies through which the United Kingdom contributes to the European Community budget, and the sources of funds received from the European Union. It explained how it intended to disclose, in whole of government accounts, the net contributions to the European Union. The Board welcomed this disclosure, which would be of interest to users of whole of government accounts. The Board asked the Treasury to look again at the accounting treatment of the element of VAT payable to the European Union.

## **E.9 Situation report on the format of accounts and accounting policies of other central funds**

E.9.1 The Board noted that much of the work on developing accruals accounting policies for the central funds has been completed. The main areas that remain are the Public Works Loan Board (due to be complete by the end of 2003) and the

National Insurance Fund (due to be complete by the end of 2004), and the Board awaits the outcome of these developments with interest.

## **F Composition and operation of the Board**

### **F.1 Composition of the Board**

F.1.1 During the year the following Board members stood down: Ciaran Martin, HM Treasury; Brian Delaney, Department of Finance and Personnel, Northern Ireland. They were replaced by: Liz Passman and David Thomson respectively.

F.1.2 During the Board's initial phase, until April 1997, a member of parliament was nominated to attend its meetings as an observer and was able to bring a direct parliamentary perspective to the Board's considerations. The Board continues to feel, as it has said in its previous reports, that such an input would be useful and welcome. It has therefore asked the Board's secretariat to see again whether a suitable and willing member of parliament can be found to resume such representation.

### **F.2 Freedom of Information Act 2000**

F.2.1 The Board was informed about the requirements of the Freedom of Information Act 2000 and asked the Treasury to investigate whether the Board should be listed as a public body in its own right rather than being included in the Treasury publication list, and what the implications of a separate listing would be. The Board awaits the Treasury's findings.

## **THE BOARD'S 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. 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, with any departures from or modifications to it fully explained.
2. The Board's initial task was to review the Treasury's Resource Accounting Manual and proposals for subsequent amendments. This is a continuing role.

### **Extension of the Board's remit**

3. The Board's remit has subsequently been extended to advise on accounting guidance in respect of executive non-departmental public bodies and trading funds; accounting policies underlying whole of government accounts; and the financial and reporting standards and principles in respect of accounts for which the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland are responsible for issuing reporting requirements, and in respect of the National Health Service Trusts in England. The Treasury has advised that the Board's remit is planned to be extended to cover National Health Trusts in Wales, Scotland and Northern Ireland.

### **Terms of reference**

4. The Board's current terms of reference are shown in the appendix to this annex.

### **Parliamentary requirements**

5. The Government Resources and Accounts Act 2000 and the Government Resources and Accounts Act (Northern Ireland) 2001 place the Board's role on a statutory basis, by requiring the Treasury (which also has responsibility for the financial reporting standards for accounts produced by the National Assembly of Wales) and the Department of Finance and Personnel, Northern Ireland to consult an advisory group on financial reporting principles and standards applied to resource accounts and whole of government accounts. Both departments have determined that the Board should be that advisory group.
6. Scottish Ministers, with the agreement of the Audit Committee of the Scottish Parliament, have determined that they should be similarly advised on such matters.
7. In accordance with the Acts the Board must prepare a report summarising its activities and dealing with such other matters as the Board considers appropriate.

The Treasury and the Department of Finance and Personnel, Northern Ireland are required to lay the Board's report before the House of Commons and the Northern Ireland Assembly respectively.

8. The Scottish Ministers will lay the report before the Scottish Parliament.

## **Composition**

9. The Board is independent of government and has a wide membership representing a relevant spread of interests. Members are drawn from the private sector, academia, public sector audit bodies, government departments, devolved authorities 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, CB, Finance Director, Ministry of Defence

Mike Barnes, Head of Technical Development, Audit Commission

Dr Peter Collings, Principal Finance Officer, Scottish Executive

Brian Delaney, Head of Accountability and Accounting Services Division, Northern Ireland (Department of Finance and Personnel) (Until September 2002)

Russell Frith, Director of Audit Strategy, Audit Scotland

Heather Jackson, Director of Finance, HM Land Registry

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

Ciaran Martin, Head of Resource Budgeting, HM Treasury (until October 2002)

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

Liz Passman, Head of Resource Budgeting, HM Treasury (from March 2003)

Nigel Reader, Director of Finance, Environment Agency

Martin Sinclair, Assistant Auditor General, National Audit Office

Jeff Tomlinson, Head of Accounting, Department of Health, England

David Thomson, Treasury Officer of Accounts, Northern Ireland  
(Department of Finance and Personnel) (From October 2002)

Ken Wild, Partner, Deloitte & Touche, Member of the Accounting  
Standards Board and Member of the International Financial Reporting  
Interpretations Committee

The Treasury provided a secretariat headed by Chris Richards with support from Sue Gamble. During the period covered by this, the sixth report, Anne Rylatt has substituted for Jeff Tomlinson, Ian Smith for Peter Collings, Allan Cook for Ken Wild, and Bruce Mann for Colin Balmer.

## **Proceedings**

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

11. Treasury officials who attended the Board meetings for particular agenda items were – Gordon Adam, Nick Bailey, Chris Butler, Nick Buxton, Steven Cain, Ian Carruthers, Mark Davidson, David Deaton, Joe Grice, David Loweth, Phillip Mind, Larry Pinkney, Adam Sharples, Jeremy Skinner, Colin Stratton, and David Watkins. Grant Ballantine from the Government Actuary's Department also attended a meeting for a particular agenda item.

12. The Board proceeded by examining papers on the agenda items, along with related draft amendments to the relevant accounting guidance, 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 accounting guidance, and considers that it has added significant value through this approach.



# The terms of reference of the Financial Reporting Advisory Board

## 1. Context

1.1 The primary aims of financial reporting by central government bodies are to demonstrate to the public and their representatives in the UK and Scottish Parliaments and in the Northern Ireland Assembly:

- the financial performance of the bodies;
- their stewardship of public funds and assets; and
- that, where appropriate, public monies and other resources have been used for the purposes intended by the Parliaments or the Assembly;

and to provide the Parliaments and the Assembly with information which is reliable and sufficient as a basis for

- their consideration and approval of the levels of resources and cash voted to services; and
- their examination of performance in carrying out policies, functions, programmes and projects.

1.2 Financial reporting is also intended to underpin the UK Government's planning, monitoring and management of public expenditure.

1.3 The authority to develop financial reporting requirements rests with HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland in respect of accounts meeting the criteria set out in paragraph 2.1.b. below.

1.4 Financial reporting by central government bodies should be based on Generally Accepted Accounting Practice (GAAP) adapted where appropriate to take account of the public sector context. For Resource Accounts in England and Wales and for Whole of Government Accounts (UK) this requirement is set out in sections 5 and 9 of the Government Resources and Accounts Act 2000. A similar requirement is included in sections 9 and 14 of the Government Resources and Accounts Act (Northern Ireland) 2001.

1.5 Under section 24 of the Government Resources and Accounts Act 2000 the Treasury is required to consult an advisory group on financial reporting principles and standards for resource accounts and Whole of Government Accounts. Under section 20 of the Government Resources and Accounts Act (Northern Ireland) 2001, the Department of Finance and Personnel, Northern Ireland is also required to consult with and take account of the recommendations made by this advisory group before issuing directions on resource accounts or determining the form and content

of Whole of Government Accounts (Northern Ireland). The Scottish Ministers, with the agreement of the Audit Committee of the Scottish Parliament, have determined that they should be similarly advised on such matters. The FRAB will be the advisory group, and thus will provide an independent element into the process of setting financial reporting standards for the UK Government, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.

## **2. Terms of reference**

### **2.1 Responsibilities of the Board:**

- a. The Board will provide independent advice to HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.
- b. The Board will advise HM Treasury, the Scottish Ministers and the Department of Finance and Personnel on the application of financial reporting standards and principles:
  - i. Where HM Treasury and the Department of Finance and Personnel are responsible for issuing reporting requirements, in respect of:
    - Departmental resource accounts
    - Non-departmental public bodies
    - Trading funds
    - Whole of Government Accounts
    - NHS trusts in England (HM Treasury only)
  - ii. Where the Scottish Ministers are responsible for issuing reporting requirements, in respect of:
    - Accounts falling under sections 19 and 20 of the Public Finance and Accountability (Scotland) Act 2000.
    - Accounts of executive non departmental public bodies where the Scottish Ministers have the power of direction
- c. The Board will decide how it reaches its conclusions.
- d. The Board's advice to the Scottish Ministers will be restricted to the technical rules of accounting and to minimum disclosure requirements. It will not extend to the format of accounts or to disclosures beyond the minimum requirements.
- e. The Board's advice to the Department of Finance and Personnel, Northern Ireland will incorporate accounting, formatting and minimum disclosure requirements.
- f. The Board will examine all amendments to the guidance or accounts direction, where instead this is referred to the Board, issued by HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland in respect of the bodies listed in b. above, with the aim of ensuring the guidance or accounts direction complies with GAAP, and that

departures or modifications from it, due to public sector and spending control contexts, are fully explained and justified.

g. The Board will prepare an annual report of its activities, including its views on the changes made during the period to the accounting guidance, or, as appropriate, accounts direction, issued by HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland in respect of bodies listed in b. above, and will send a copy of its report direct to the PAC and Treasury Select Committee of the UK Parliament.

2.2 HM Treasury (in conjunction with the Department of Health in respect of NHS trusts in England), the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland:

a. Will ensure that all relevant matters, including proposed changes to the guidance, or, as appropriate, accounts direction, in respect of accounts meeting the criteria in 2.1.b above are brought to the Board's attention within a reasonable time. In particular, changes to Financial Reporting Standards and other elements of GAAP that affect such guidance or accounts direction will, as far as possible, be brought to attention in sufficient time to enable their implementation, as appropriate, within the same timescale as changes are to be made generally.

b. Will examine all issues raised by the Board within its terms of reference.

c. Will consider all advice received from the Board.

2.3 HM Treasury, the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland will formally lay the Board's report before the House of Commons, the Scottish Parliament and the Northern Ireland Assembly respectively.

2.4 HM Treasury will provide the secretariat to the Board.

### **3. Membership**

3.1 The Board will comprise:

1 member nominated by the Treasury

1 member nominated by the Scottish Ministers

1 member nominated by the Department of Finance and Personnel, Northern Ireland

1 member nominated by the Comptroller and Auditor General

1 member nominated by the Auditor General for Scotland

1 member nominated by the Audit Commission

3 members nominated by the Principal Finance Officers of UK government departments to represent respectively departments, trading funds, and non departmental public bodies.

1 member nominated by the Department of Health

1 member nominated by the National Statistician

1 member nominated by the Accounting Standards Board

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

3.2 In addition, an independent Chairman of the Board will be nominated by the Chief Accountancy Adviser to the Treasury, and in respect of future appointments, in agreement with the Scottish Ministers and the Department of Finance and Personnel, Northern Ireland.

3.3 The periods of appointment will be determined by the nominating bodies.

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

## **Other amendments to the accounting guidance agreed by the Board.**

The accounting guidance includes the following publications:

- The Resource Accounting Manual (the Manual),
- The Executive NDPBs Annual Report and Accounts Guidance (the NDPB Guidance) and
- The Trading Funds Accounts Guidance (the Trading Fund Guidance)

### **Incorporated into the 2002/03 versions of the accounting guides**

- **amendments arising from GAAP changes**

**UITF abstract 34 – Pre-contract costs** (Manual, annex 3; NDPB Guidance, annex C; Trading Fund Guidance, annex A) Notes that the Abstract applies.

**UITF abstract 35 – Death-in-service and incapacity benefits** (Manual, annex 3; NDPB Guidance, annex C; Trading Fund Guidance, annex A) Notes that the Abstract applies.

- **amendments arising from the post mortem on the Manual**

**Accounting treatment of EU transactions in resource accounts** (Manual, section 6.5; NDPB Guidance, section 8.10; Trading Fund Guidance, section 7.14) Clarifies the accounting treatment and improves the consistency between the three accounting guides.

**Administration costs and administration costs limit** (Manual, section 7.1-2) Clarifies the definition of administration and programme costs and the requirements of current internal control arrangements.

**Accounting for seconded staff and any related reimbursements** (Manual, section 8.5; NDPB Guidance, section 11.4; Trading Fund Guidance, section 10.3) Clarifies the reporting requirements for payments, reimbursements and staff numbers.

**Accounting treatment of grant-in-aid** (NDPB Guidance, section 7.2) Improves the consistency of treatment of grants due to a NDPB from its sponsoring department.

- **amendments arising from other sources**

**Disclosure requirements relating to entities within resource accounting boundary** (Manual, section 12.1) Clarifies the requirement to disclose an analysed list of entities within the departmental boundary.

**Update references to on-vote agencies** (Various sections throughout the Manual and Trading Fund Guidance) Reflects the change in terminology to 'Supply-financed agencies'.

**Year related changes** (Various sections throughout the Manual, NDPB Guidance, and Trading Fund Guidance) Updates various sections because of changes in terminology, completion of individual schemes or just the passing of time.

**Accounting treatment of bank overdrafts:** (Manual, sections 3.14, 4.2 and 12.1 and Annex 4) Clarifies the disclosure and reconciliation requirements, which stem from treating overdrafts as creditors.

**Cost of capital rate on departments' investments in trading funds** (Manual, section 7.6) Clarifies the "appropriate rate" to be used in determining the cost of capital charge borne by departments on their trading fund investments.

**Format of accounts and disclosures** (Manual, Annex 4) Refines and updates the illustrative primary statements.

**Contents of annual reports** (Manual, section 11.1; Trading Fund Guidance, chapter 2) Reflects the improvements to the Cabinet Office guidance on annual reports.

**Pension disclosures for ministers** (Manual, annex 4) discloses an explanation of the difference between the funding arrangements of ministers and the new disclosures required in relation to the changes in the Principal Civil Service Pension Scheme.

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