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[www.hmrc.gov.uk](http://www.hmrc.gov.uk)

Dear Ms Sansom

**Financial Reporting Exposure Drafts:**

**46 – Application of financial reporting requirements [Draft FRS 100]**

**47 – Reduced disclosure framework [Draft FRS 101]**

**48 – The financial reporting standard [Draft FRS 102]**

Thank you for the opportunity to comment on these financial reporting exposure drafts. We would be happy to discuss any of the points raised in this letter if you so wish.

**Our perspective**

1. HM Revenue & Customs (HMRC) administers and collects tax in the United Kingdom. In doing so, we use the financial statements of most businesses in the UK, and a number of overseas businesses. The managers and owners of those businesses directly use the numbers reported in financial statements as the basis of their corporate or personal tax liabilities. We check those numbers and the tax liabilities based on them, and we use many of the disclosures in financial statements to help us to check those and other tax liabilities.
2. In the UK, it has long been the case that the starting point for most businesses for calculating a business's corporate or income tax liability is its commercial profit. It is now enshrined in UK tax law that the starting point for taxable business profits is the "profit prepared in accordance with Generally Accepted Accounting Practice" (GAAP).
3. HMRC's direct interest is with a reliable measure of commercial profit, or profit before tax, which businesses can use to measure their liability to corporate or income tax. HMRC also uses the information disclosed in financial statements to check entities' returned tax liabilities.

## General comments

4. HMRC welcomes the consolidation of UK GAAP and the proposals detailed in FRS 100; FRS 101; and FRS 102. There has been a need for some time to consolidate UK GAAP and we consider that the development of these standards should introduce a simpler and better framework to improve reporting.
5. HMRC recognises the efforts the ASB has made in trying to produce a single and clear basis for all GAAP in the UK and we see major benefits for businesses (singly and as an economy) of these proposals. However, these proposals have major implications for the administration of corporation tax, in particular the mandatory online filing of company tax returns. The costs to businesses, accountants, the software industry and HMRC are significant. There will also be the need for consequential tax legislation. The ASB should understand these implications and take them into account, in its impact assessment but most importantly in the proposed timetable for implementation. (We have given more detail in the response to Question 8).
6. We note that the ASB has made proposals to issue guidance on its website, on the detailed interpretation of the FREDs. We question what due process it would have, and how it would deal with implementation dates and transition. We suggest either formal Application Guidance after due process or leave to commentators to issue their own guidance in due course.
7. In relation to how the new standard fits with the FRSSE, we understand the need to wait until developments at a European level for micro-entity reporting are complete. However we believe that, although the ASB has committed to consultation in relation to the FRSSE, the benefits of full harmonisation with the EU micros legislation is being missed. There are good indications that BIS may wish to introduce the micro-entity reporting with an accelerated timetable, therefore we would urge consultation with BIS as soon as is practical.

## Answers to specific questions

*Question 1: The ASB is setting out the proposals in this revised FRED following a prolonged period of consultation. The ASB considers that the proposals in FREDs 46 to FRED 48 achieve its project objective:*

*To enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and the users' information needs.*

*Do you agree?*

8. Yes, we agree. We appreciate the work the ASB has undertaken to get the standards to this point. Below are some suggested improvements which could be made to the draft standards before they are finalised. Overall we consider that the proposed FRSs 100-102 are fit for the purpose stated, but we suggest that the ASB consider:-
  - a. Speedy consultation on the continuing use of the FRSSE;
  - b. Including the Companies Act formats as an appendix to FRS 102;
  - c. Clarity in respect of 'inventories held for distribution'. It is not clear how this is envisaged to work in practice and there is no equivalent provision in IFRS. There also appears to be scope for different interpretations which could have significant impact on inventory values. Please can you clarify when this applies?

- d. In relation to financial instruments section 12 some of the sections may need further clarification:-
- i. Para 12.18(a) lists the hedging instruments which can be used for hedge accounting purposes. However, its exact meaning is difficult to follow and it would be good to clarify whether the ASB's intention was that a financial liability can be used as a hedging instrument in the hedge of a net investment in a foreign operation (only) or that the scope of hedging instruments has been widened to include a financial asset and a financial liability as hedging instruments;
  - ii. Para 12.17 (d) suggests that the foreign exchange risk in a net investment in a foreign operation can be a hedging risk in individual entity financial statements, and this would be consistent with the intention to permit certain current UK GAAP accounting treatments. However para 5.13 (d) of Part Three *Development of the Financial Reporting Exposure Drafts and Impact Assessment* states that FRED 48 includes the accounting opinion in respect of hedge accounting of a net investment in a foreign operation in **consolidated** financial statements (which is consistent with the IFRS treatment). There appears to be an inconsistency here.
  - iii. Para 12.23 provides that the exchange movements on the hedging instrument (e.g. the foreign currency borrowings) shall be recognised in OCI but there shall be no recycling to profit or loss on disposal or partial disposal of the foreign operation. As a result, this proposed treatment is neither consistent with SSAP 20 or IFRS.
- e. In relation to the impairment of assets (chapter 27), the draft does not clearly specify whether the reversal of impairment on revalued assets should be booked to the profit and loss account or other comprehensive income.
- f. In relation to Specialist Activities: Heritage Assets (Section 34.47 – 34.61) funding commitments should be clarified. A commitment is recognised as a liability at the time it is made if there are no performance conditions and the entity cannot realistically withdraw from the commitment. If there is a performance obligation, then the liability is only recognised when that performance obligation has been satisfied. It appears that it might be possible for an entity making an unconditional multi-year commitment to another entity to recognise the whole of the liability at the outset whereas the recipient would only recognise the asset as it was passed across: a mismatch allowing recognition of the cost of the commitment to be accelerated.
- g. A minor point, but under the glossary the term insurance risk should be defined. The definition of financial risk is included, as is the definition of insurance contract, and the latter refers to insurance risk. So, it would be helpful, and complete the circle, to include the insurance risk definition as well.

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*Question 2: The ASB has decided to seek views on whether:*

*As proposed in FRED 47*

*A qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements in either IFRS 7 or IFRS 13; or*

*Alternatively*

*A qualifying entity that is a financial institution should be exempt in its individual accounts from all of IFRS 7 except for paragraphs 6, 7, 9(b), 16, 27A, 31, 33, 36, 37, 38, 39, 40 and 41 and from paragraphs 92-99 of IFRS 13 (all disclosure requirements except the disclosure objectives)*

*Which alternative do you prefer and why?*

9. No comments.

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*Question 3: Do you agree with the proposed scope for the areas cross-referenced to EU-adopted IFRS as set out in section 1 of FRED 48? If not, please state what changes you prefer and why.*

10. No comments.

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*Question 4: Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.*

11. We agree with the definition and consider the list is clear enough to be effectively applied.

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*Question 5: In relation to the proposals for specialist activities, the ASB would welcome views on:*

- (a) Whether and, if so, why the proposals for agriculture activities are considered unduly arduous? What alternatives should be proposed?*
  - (b) Whether the proposals for service concession arrangements are sufficient to meet the needs of preparers?*
12. We are aware of the practical concerns over the requirement to fair value Biological Assets; however we understand that this information is available relatively easily. We therefore consider that the proposed exemption within the standard may potentially cause divergent practice and a lack of consistency. We suggest that the ASB issues clear guidance as to when the exemption may apply in order to mitigate this.
13. In respect of service concession arrangements we consider that more guidance is needed on the exemption for pre-existing service concessions, primarily to determine whether this is prospective or retrospective.
14. In para 34.13 we believe the explanation of the difference between the 2 categories of SCAs is misleading. It appears to be inconsistent with other elements of GAAP. The wording appears to come from IFRIC 12. However, given that the text is explanatory rather than a definition we wonder whether this can be rectified. In the last sentence of 34.13 (b) – In this category/type of arrangement, the asset is not an intangible because the amounts are contingent on the extent to which the public uses the service. It is an intangible because the holder of the asset has to exploit its right under the SCA to generate income; the SCA itself creates no right to cash. The cash comes not from the government but from the public, so the operator has to enter into business arrangements with the users/customers first before it has a right to any cash. The financial asset category is different because the SCA itself creates a right to cash direct from the government. But it is nothing to do with contingency. In the financial asset category, the amount of cash receivable from government might also vary with the extent of use, or with the extent of services provided. That doesn't matter – the right is still a right to cash.
15. Financial assets can be contingent. FRS 13 and IAS 32 made that explicit, and it is not too difficult to think of assets which are clearly financial instruments under which the cash flows are contingent on factors outside the entity's control. So we suggest that the last sentence of 34.13 (b) needs to be amended.

16. Less importantly, we think the explanation under 34.13 (a) is also problematic. Why do the cash flows have to be "specified or determinable"? That is asking for more than is demanded in the basic financial asset definition.

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*Question 6: The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:*

- (a) Do you consider that the proposals provide sufficient guidance?*
  - (b) Do you agree with the proposed disclosures about the liability to pay pension benefits?*
17. No comments.

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*Question 7: Do you consider that the related party disclosure requirements in section 33 of FRED 48 are sufficient to meet the needs of preparers and users?*

18. The exclusion of transactions between wholly owned subsidiaries of a group (33.1A) is consistent with FRS 8, however the wording of this paragraph seems to apply to transaction between parents and their subsidiaries only. It does not appear to cover transactions between fellow subsidiaries (due to the requirement that they must be 'wholly-owned by such a member'). We believe the ASB should clarify this wording to ensure the relevant exclusions are made.

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*Question 8: Do you agree with the effective date? If not, what alternative date would you prefer and why?*

19. We consider that the effective date is satisfactory; however the suggestion that early adoption should be allowed may be impractical. Aside from the costs to UK business, accountants, users of accounts - banks' lending departments, suppliers' credit controllers, HMRC - there needs to be consideration of the amount of time required for revisions to software and tax legislation. Changes to users' processes, scoring mechanisms, tax legislation and filing systems will only take place once the Standard is issued.
20. Almost all companies are now required to produce a version of their accounts tagged in eXtensible Business Reporting Language (XBRL) for submission with their company tax return. This may require the use of specialised software products. Every accounting standard requires detailed consideration of the taxonomy to see whether changes are required, and each change brings cost.

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*Question 9: Do you support the alternative view, or any individual aspect of it?*

21. No comments.

Yours faithfully



**Matt Blake, FCA**  
Commissioners' Advisory Accountant