

Paul Gee - Comments on FREDs 46-48

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Introduction

I fully support the ASB's latest proposals as set out in FREDs 46, 47 and 48 for the future of UK GAAP. ASB has consulted extensively and has considered a diverse range of opinions.

I believe it is now time to move on at reasonable speed and replace existing UK GAAP, regarded by most commentators as outdated and discredited.

For example, under current UK GAAP requirements relating to financial instruments are contained in FRSs 4, 13, 25, 26, 29, parts of SSAP 20, several UITF Abstracts, as well as the Regulations to CA 2006. Working out which of these and which parts apply to different categories of companies can be extremely complex. The new proposals will provide considerable simplification and clarity.

I have responded below to the specific questions raised by ASB in so far as I feel able to comment. I have also added detailed comments on particular aspects of FREDs 46, 47 and 48.

I appreciate there is a desire to keep as closely as possible to the text of the IFRS for SMEs but do not believe that this should tie our hands in developing a fit-for-purpose replacement for UK GAAP. I would very much like ASB to continue to persuade IASB to amend the IFRS for SMEs on areas such as development costs and revaluation of fixed assets where the IFRS for SMEs is deficient and is inconsistent with both UK GAAP and EU-endorsed IFRS.

I consider that it is extremely important to align recognition and measurement principles in FRED 48 as far as practicable with those of EU-endorsed IFRS. This is clearly an important issue for UK groups who adopt IFRS for consolidation but currently use UK GAAP for parent and subsidiaries. The reduced disclosure requirements for certain parents and subsidiaries in FREDs 47 and 48 make this alignment possible and at the same time, cost-effective.

I have not commented on small company issues as further consultations will be taking place, particularly in the light of proposed deregulation in the Draft EU Accounting Directive published in October 2011. I would hope that for the foreseeable future at least that the FRSSE will continue to be available for those small companies that wish to adopt it and there will be no additional requirements imposed on small companies.

Several commentators have raised the issue of the possible implications that different measurement rules may have for tax purposes (I am not a tax specialist). It would be very helpful if HMRC could issue updated guidance on its website. As regards IFRS, the HMRC website currently contains 'International Accounting Standards – the UK tax implications' but this does not appear to have been updated since 24 July 2006. HMRC should be able to express some current views as EU-endorsed IFRS has been in operation in the UK for at least seven years.

Responses to questions in the ‘Invitation to comment’

Question 1

The ASB is setting out 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 primary objective:

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

Do you agree?

Yes – most emphatically.

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).

Qualifying entities should not have to comply with the full requirements of IFRS 7 and IFRS 13 provided equivalent information is contained in the consolidated financial statements. UK listed parent companies preparing individual financial statements under UK GAAP are currently offered an exemption from the disclosure requirements of FRS 29. Any extension of current disclosure requirements should be justified by reference to potential usefulness to users.

I would prefer the status quo but of the two options above, I would definitely prefer the second.

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?

Yes.

Full list and AIM-listed companies who do not have subsidiaries do not have to adopt EU-endorsed IFRS. It makes sense to require these companies whose shares are traded to adopt IAS 33, IAS 34 and IFRS 8.

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.

Yes - the definition looks comprehensive and should be helpful for the future development of UK GAAP.

I have one reservation. Would it be clearer to have 'retirement benefit plans' as a separate category? The first six categories in the definition include entities that 'do business' with external customers. A pension fund is a totally different type of entity.

If a separate category was created, it would be possible to have a ring-fenced section of FRED 48 Section 34 dealing just with retirement benefit plans (taking in paragraphs 34.31 to 34.46 and any parts of 34.17 to 34.30 but only if considered relevant and essential) backed up by an updated SORP.

Question 5

In relation to the proposals for specialist activities, the ASB would welcome your views on:

- (a) Whether and, if so, why the proposals for agricultural 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?**

I am unable to comment on either of these issues.

Question 6

The ASB is requesting comments 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?**

I am unable to comment in detail on this specialist area, but please see response to Question 4 above. The SORP when updated will be crucial in providing guidance.

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?

The needs of preparers are met by the proposals in FRED 48– the current exempt for intra-group transactions involving wholly-owned subsidiaries should be maintained until a change in company law (new EU Accounting Directive) requires otherwise.

Users may take a different viewpoint as they are more likely to require more disclosure rather than less.

I support the proposed drafting of paragraph 33.1A.

Question 8

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

Yes.

When the ASB's Discussion Paper was first published in August 2009, a commencement date of periods commencing on or after 1 January 2012 was proposed. Significant amendments have been made to the original proposals in the IFRS for SMEs following extensive consultations and commentators have had numerous opportunities to put forward their views.

I consider that the commencement date for commercial organisations should be no later than 1 January 2015, with an option for early adoption once the final FRSs have been published.

Question 9

Do you support the alternative view, or any aspects of it?

No.

Comments on specific FREDs

FRED 46/ Draft FRS 100

I am concerned that the scope paragraph of FRED 46 does not give enough detail and explanation. Paragraph 7 has some relevant information but this is under the heading 'basis of preparation'.

By contrast, scope para 1.2 of FRED 48/ Draft FRS 102 gives detail on scope.

There is useful material in paragraphs 6 – 9 of the Summary to FRED 46 which I feel would provide useful intro paragraphs within the text of Draft FRS 100. These would then provide a useful lead-in to detailed material in the later parts of Draft FRS 100.

FRED 48/ Draft FRS 102

Section 2 – Concepts and pervasive principles

This Section is identical text to the IFRS for SMEs.

I think the title of this Section is dreadful and off-putting (I can't see a definition of 'pervasive principles', apart from a reference in 2.35 to the IASB Framework. The latest version of the IASB Conceptual Framework is still work in progress, and is a confusing mixture of newly written material and old material.

The material in the IFRS for SMEs, replicated in FRED 48, is neither consistent with the IASB's latest version of the Framework, nor the 2011 Draft EU Accounting Directive.

The IASB's underlying assumptions used to be going concern (now in FRED 48 in paragraphs 3.8 and 3.9 under financial statements presentation) and accruals (lost in paragraph 2.36).

FRED 48/ Draft FRS 102 is supposed to be UK GAAP and therefore compliant with EU Accounting Directives.

Could this not be made simpler and in line with the October 2011 draft EU Directive) ie make the title of Section 2 ‘General financial reporting principles’ and then include all the principles in Article 5 starting with going concern (cross-referred to Section 3), consistency, prudence etc and using terminology long familiar to users of UK GAAP. Article 5 is just about a single page and easy to understand.

Section 3 – Financial statements presentation

Will the financial statement titles in 3.17 be mandatory, or for example could the Statement of financial position still be referred to as the balance sheet (as is the case with IAS 1 in EU-endorsed IFRS)?

Section 5 – Statement of changes in equity and Statement of Income and Retained Earnings

The text of this Section differs from that of the IFRS for SMEs. The Section refers to the ‘Act’ and the ‘Regulations’ but uses different terminology such as ‘comprehensive income’. Section 5 of the IFRS for SMEs has been omitted.

It would be helpful to have guidance as to how this Section should be applied, and what options are available. The Staff guidance papers and examples on the ASB website include a ‘before and after’ example of a cash flow statement. A further example relating to Section 5 would be really useful, to illustrate the contrast with FRS 3 and how the Regulations kick in.

Section 18 – Intangible assets other than goodwill

I understand that in principle that the revaluation option for intangibles gives consistency with the option for property, plant and equipment.

However, revaluation of intangibles appears to be very rare in UK GAAP.

IAS 38 paragraph 78 puts revaluation into context by using the word ‘uncommon’ and gives some examples (taxi and fishing licenses etc). Is it essential to include the option in Section 18 paragraphs 18B – 18G if it is hardly likely to be used given the difficulty of applying the ‘active market’ criterion? Alternatively, if the option is left in the text, could an additional paragraph be inserted after 18.18D, on the lines of IAS38.78?

Section 26 – Share-based payment

This Section is based almost entirely on the text of the IFRS for SMEs apart from a few differences such as paragraph 26.11(c) of FRED 48.

The IFRS for SMEs is used all over the world (except for EU countries) but Section 26 would hardly get a clear English award.

For example, Paragraph 26.9 is a single paragraph with over 13 lines and including 7 complicated sentences. It would help if paragraphs such as this could be broken down into a few sub-paragraphs with useful signposting.

Section 27 – Impairment

Paragraph 27.27 is another example of IFRS for SMEs text which could be explained rather more clearly.

Section 29 – Income tax

This section is a huge improvement compared with the equivalent Section in the IFRS for SMEs and has the advantage of conciseness.

It would be helpful if the recognition part of the Section included reference to deferred tax on revalued property, plant and equipment, and revalued investment property (referred to in 29.15 and 29.16 under ‘Measurement of deferred tax’). It would then emphasise differences compared with current UK GAAP.

It would also be helpful if 29.27(c) explained what exactly has to be disclosed in a note to the financial statements - this is a new disclosure requirement (and does not appear in the IFRS for SMEs).

Section 32 – Specialised activities

This Section contrasts with all the remaining Sections in that it does not deal with a single topic, but rather a number of unrelated topics grouped together.

The Section in the IFRSs for SMEs has been considerably extended to accommodate UK issues such as financial institutions, retirement benefit plans, and public benefit entities.

It might help navigation of this Section by breaking it down into major sub-headings, eg

34A Scope and list of specialised activities

34B Agriculture

34C Extractive industries

34D Service concession arrangements

34E Financial institutions

34F Retirement benefit plans

34G Heritage assets

34H Funding commitments

Query – is 34.55 to 34.61 intended to be a separate specialised activity or could it be included in Section 21? Presumably these paragraphs could relate to either commercial businesses or to PBEs?

At the moment it is sandwiched between heritage assets and incoming resources from non-exchange transactions, and could get ‘lost’

34I Public benefit entities