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25 April 2012

For the attention of Michelle Sansom
Accounting Standards Board
5th floor, Aldwych House
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Our ref: tp2504

Dear Sirs

Invitation to comment: Revised proposals for the future of financial reporting in the UK and Republic of Ireland

We are pleased to respond to your invitation to comment on the revised exposure drafts, FRS 100-102, which address the future direction of travel of financial reporting in the UK and the Republic of Ireland. We have answered the specific questions posed in the Invitation to Comment in turn below: however we do have some overall observations. We have also commented on some issues in respect of the proposals for public benefit entities where specific questions were not posed in the consultation.

We are pleased to note that some helpful amendments have been made to the 'FRSME'. We are pleased that the name of the Standard has been changed to one which is more accurate and also that a number of the inconsistencies in the FRSME – for instance the lack of an option to carry property at valuation when this is permitted by both the FRSSE and full IFRS – have been addressed.

For the most part, the options which have been introduced are consistent with full IFRS, although this is clearly not the case for deferred tax. The proposed solution of a 'timing differences plus' framework for deferred tax is, in our view, preferable to the initial proposal of mandating cross reference to the full version of IAS 12, as it will be more straightforward for companies to apply; however, incorporating a simplified version of IAS 12 in the revised Standard would in our view have been a better solution. IFRS and UK GAAP are fundamentally different in concept in this area and comparability with full IFRS has therefore been lost by retaining a UK GAAP based solution. However, we do recognise that this was a practical solution and that for many companies there will be no significant differences in practice.

We are also pleased that the issue of the format of financial statements has been addressed and the Companies Act formats retained as the IFRS style formats in the FRSME and the Companies Act formats as currently set out were essentially incompatible. However, there is still significant potential for confusion in terms of the differences in terminology used in the legislation and in the

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Standard, and perhaps particularly in respect of qualifying entities preparing accounts under IFRS but with the reduced disclosure framework set out in the draft FRS 101. Because their accounts will be 'Companies Act accounts' in law and therefore will not fully comply with IFRS there may well be practical difficulties in ensuring that they comply as far as possible with both frameworks.

Clearly, the revised Standard diverges to a greater extent from the IFRS for SMEs than the previous draft, but given that it already diverged in some areas in order to comply with company law, and that the IFRS for SMEs has not in any event been adopted in the EU, we can appreciate that this was necessary in order to ensure a robust solution and to avoid inconsistencies such as in respect of revaluations.

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 users' information needs. Do you agree?**

On the whole and subject to various reservations expressed elsewhere in this letter, we agree that the proposals will result in high quality and understandable financial reporting. However, we would note that a number of the changes move the proposed Standards further away from IFRS – for instance the proposals in respect of deferred tax – and whilst we can see as noted in our introduction that this was a practical solution, it does lessen the degree of comparability of financial statements prepared under the Standard with those prepared under full IFRS.

We have further concerns about the application of the reduced disclosure framework and how companies adopting IFRS but taking advantage of the reduced disclosure framework will prepare their financial statements in practice. Further guidance may well be necessary and indeed in the long term it may be necessary for BIS to consider changes in the Companies Act if we are ultimately to move to a financial reporting framework that is truly based on IFRS, although we accept that changes to the Accounting Directives would be required first (for instance in respect of the treatment of negative goodwill).

2. **The ASB has decided to seek views on whether:**
   a. **as proposed in FRED 47, a qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements in IFRS 7 or IFRS 13; or**
   b. **a qualifying entity that is a financial institution should be exempt from the disclosure requirements of IFRS 7 and IFRS 13 except for certain disclosures specified in the Exposure Draft.**

We agree that a qualifying entity that is a financial institution and preparing its accounts in accordance with FRS 101 should not be exempt from the disclosure requirements of IFRS 7 or IFRS 13 as clearly for such entities the level of risk is greater.

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.**

Given that companies that would have been defined as publicly accountable under the previous proposals – for instance Plus companies that have not as yet adopted IFRS – will now be able to apply the proposed Standard, the cross references to full IFRS appear sensible with the potential exception of IAS 34. The application of IAS 33 will not result in any significant changes in practice as IAS 33 was converged with UK GAAP. There will be some differences in application of IFRS 8 as compared to SSAP 25 but these should not create any significant difficulties in practice.

There may be practical difficulties however for companies applying the proposed Standard that are also required to prepare half yearly reports. The obvious example is Plus companies that currently still prepare their financial statements under UK GAAP and that are therefore likely to apply the proposed Standard going forward rather than full IFRS. For such companies to apply IAS 34 to half yearly reports as required by paragraph 1.4 would technically appear to require them to prepare such reports in the summarised IFRS formats required by that Standard, which will clearly be different from the 'Companies Act accounts' formats required in their full year financial statements.

We would also note that paragraph 1 of IAS 34 states 'This Standard applies if an entity is required or elects to publish an interim financial report in accordance with International Financial Reporting Standards.' The application of IAS 34 appears to imply the application of IFRS, and clearly companies applying the proposed FRS 102 will not be applying IFRS.

Whilst we do not think the application of either the IAS 34 formats or IFRS itself in interim financial statements is what paragraph 1.4 intended to imply, we do think more clarity is needed in this respect. A better solution, in our view, would be to include a brief section in the final FRS for companies preparing interim reports that apply the FRS. This could essentially précis the requirements of IAS 34 but apply them to the accounting, and format, requirements of the proposed FRS.

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.

Overall we agree with the definition of a financial institution; however we remain concerned about the inclusion of pension schemes. As noted in previous correspondence, many occupational pension schemes, particularly those operated by smaller entities, may be very small and to require such schemes to give the disclosures required for financial institutions by the draft Standard, as well as those specifically required for pension schemes, could potentially be very onerous. As also noted in previous correspondence, whilst we could see a technical argument for pension schemes fitting the previous definition of public accountability – and indeed can see that there is a technical argument for their being classed as a financial institution – they simply do not take deposits, or act in a fiduciary capacity for, a broad group of outsiders in the same way a bank, a building society or a credit union does. We do not therefore agree that single-employer pension schemes should be required to apply the same disclosures as such entities although we would agree that there is a case for large multi-employer schemes to do so because of their wider accountability.

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?

We do not agree that the proposals for agriculture activities are unduly arduous. Given that biological assets are only required to be measured at fair value (as required in IAS 41) if fair value is readily determinable without undue cost or effort, and indeed the cost of the asset is only recognised if that can be measured reliably, many entities will be able to continue to apply current accounting practices. We believe that the proposals in the Standard are, on the whole, appropriate.

However, we do believe that there is a need for guidance as to what constitutes 'undue cost or effort' both in the context of this part of the Standard and also in the context of investment properties (which are also required to be measured at fair value if this can be determined without undue cost or effort, and otherwise at cost less depreciation). In both cases we believe that there is a risk these requirements may be open to abuse as entities may decide that any cost or effort is 'undue'. We would be grateful if the Board could consider this point further in their final deliberations.

We have no particular objections to the proposals in respect of service concession arrangements, although we believe that the fair value of financial assets or intangible assets arising from service concession arrangements could be difficult to determine in practice.

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?**

The proposals for the financial statements of retirement benefit plans appear acceptable, with the exception as noted above of them being classified as a financial institution. We do agree with the proposed disclosures about the liability to pay pension benefits as these will be of benefit to the members of the scheme.

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?**

Yes, we believe that the disclosure requirements of this section are appropriate.

We would note that there is a typo in paragraph 33.1A 'The requirements of this section need not be given for transactions entered into between two or more members of a group, provided that any subsidiary undertaking which is a party to the transaction <u>are</u> wholly owned by such a member'.

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

In previous correspondence we have argued that previous proposed effective dates were too early; as noted before, this represents probably the most fundamental change in UK financial reporting for a generation and it is vital that the businesses affected have sufficient time to bring themselves up to speed with the new requirements. The proposed application date of accounting periods beginning on or after 1 January 2015 is, in our view, much more appropriate as it allows a reasonable time frame for the relevant knowledge to be obtained. This does, however, assume that a final Standard is released in a reasonably short time frame after the consultation period finishes, and that changes from the exposure draft are relatively minor. The process of establishing the future shape of UK financial reporting has already been lengthy and businesses need to know as soon as possible the form that it is going to take, particularly given that UK GAAP as it stands is no longer being maintained.

We remain unconvinced that the retention of the FRSSE is viable in the long term although we note that certain modifications will be made to the FRSSE as a result of the change in financial reporting framework. Our view remains that all companies should transition to the new framework at the same time, even if this means a further short delay in application, and that introducing further exemptions from the proposed FRS 102 for small companies, perhaps through the medium of company law, would be the most appropriate course of action. We do recognise that the issue of financial reporting for very small companies is still very much a topic of discussion due to EU and BIS deliberations, but many small companies will not qualify as 'micro' so this issue does still need to be addressed.

9. Do you support the alternative view, or any individual aspect of it?

No, we do not support the alternative view. We agree with the ASB's objective of providing high quality financial information proportionate to the size and complexity of the entity and the information needs of users, rather than the alternative view's proposal of information in an accessible format subject to cost/ benefit constraints. We are not in favour of any further significant amendments to the IFRS for SMEs to tailor it to a UK context, other than as referred to elsewhere in this letter or in our previous correspondence on this subject. Whilst we would concur that for some users of the accounts, understanding requirements such as those in respect of financial instruments and share-based payment may be complex, we believe that their retention is essential in order for progress to be made towards a broadly consistent UK financial reporting framework based on IFRS. For smaller entities, relief from some of these requirements will continue to exist in any event given the proposed retention of the FRSSE and medium size entities and above have had to comply with many of these requirements (e.g. share-based payment) for a number of years.

We have commented further below on certain issues in respect of the revised proposals for public benefit entities.

Income recognition

This is the most significant concern we have about the proposals for public benefit entities. Getting the definition, and the treatment, of income recognition right is key to ensuring that the Standard works in practice for such entities. Whilst we welcome what the Board has done in attempting to simplify and consolidate the various categorise of income, we do not think the requirements as currently drafted can be effectively applied in practice. In particular, there appears to be a conflict between 'restricted' income and the 'performance conditions' that would determine recognition under the Standard.

FRS 102 defines a performance condition as 'a requirement that specifies that the resources are either to be used by the recipient as specified, or if not so used, to be returned to the donor'. We are concerned that this definition would catch most restricted income and therefore preclude its recognition. We would suggest that it would be better to focus the definition of performance conditions on the supply of a particular level of service or units of output rather than focusing on repayment.

We would also note that the definition of a 'restriction' is not in line with charity law. FRS 102 states that a restriction 'does not require that resource to be returned to the donor if the resource is not used as specified'. In the context of charity law we believe these words are both unnecessary and inaccurate.

The location of income recognition requirements for public benefit entities in two sections of the draft FRS – grants and non-exchange transactions – also gives rise to complications. (Indeed any commercial revenue would be covered by a third section under section 23). Conceptually it may be difficult to distinguish a grant from a donation and indeed the terms can be used interchangeably. The performance condition requirement for grants accounted for under the performance model may well give rise to the same concerns noted above.

We therefore believe that the income recognition requirements for public benefit entities need further consideration in general. Conceptually, the charity sector distinguishes between contractual arrangements, performance related grants, grants subject to conditions which are substantive, and grants subject to conditions which are not substantive e.g. where there is a requirement to provide progress reports, and unconditional grants. We believe that the Board might consider distinguishing between these in the final version of the FRS, although some of the detail could perhaps be incorporated in the SORP. In doing so, the application of section 24 could potentially be limited to those grants that have conditions attached, perhaps by providing a definition of 'grant' in the Standard. Some of the helpful definitions and guidance on income recognition currently contained within the SORP could usefully be considered by the Board during final redrafting.

Finally in respect of grants, we would note that grants may contain a great deal of detail about outputs without being contractual and that this is key to many charities. A grant proposal may, for instance, contain targets in terms of schools to be built as part of an overall education programme but without the payment of the grant being specifically contractually linked to that number of outputs.

Non-exchange transactions

We are pleased to note the progress made by the Board in developing the requirements in this area as we had serious concerns in respect of the proposals in the previous draft FRSPBE, indeed this was one of the most problematic elements of the exposure draft. Whilst generally supporting the requirement in paragraph 34.71 to measure such transactions at fair value, it should be noted that this will require a change to current practice in some areas and that there will inevitably be a degree of subjectivity in determining a method for agreeing such fair values. We would therefore suggest that the Board consider this further in their final deliberations.

We are pleased with the relaxation in paragraph PBE34B.12 of the requirement to fair value small value donated goods which we believe would have been extremely difficult to apply in practice.

Funding commitments

We believe that this section should be deleted as it is inconsistent with the principles of IAS 37 (and therefore with current UK GAAP, which is converged with IFRS in this area, and current practice for public benefit entities). We would urge the board to consider this suggestion in their final deliberations as we believe inclusion of this section will create a number of issues in practice, not least because these requirements are no longer explicitly restricted to public benefit entities.

Other issues affecting public benefit entities

We believe that the requirements for public benefit entity business combinations still require some clarification. In addition, in respect of grants, paragraph 24.3 refers explicitly to income taxes but it is not clear whether this requirement would also apply to indirect taxes. We believe this needs to be clarified.

Conclusion

In overview, we believe that the latest draft proposals for the future of UK financial reporting represent for the most part an improvement on the previous draft Standards, and have ironed out some of the inconsistencies. We do, however, believe that there is still some further work to be done. We continue as noted above to have concerns about the retention of the FRSSE in the medium to long term as we do believe that a consistent, across the board, IFRS-based financial reporting framework has to be the way to go and the current proposals do not as yet quite achieve that aim.

If you have any questions on the contents of this letter, then please contact either Tessa Park or Nick Brooks.

Yours faithfully

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