

10 May 2012

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Dear Ms Sansom

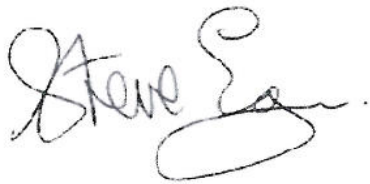
Response to FREDs 46, 47 & 48

This letter provides HEFCE's responses to the consultation questions about FREDs 46 to 48 and our detailed comments and suggestions on the proposed new Financial Reporting Standards 100 to 102. I apologise that this is sent to you after the consultation formally closed, but we have been assured by your colleague, Jo Spencer, that our views will be considered.

HEFCE is responsible for distributing government financial support to designated universities and other higher education institutions (HEIs). They are (with one exception) large charities and will therefore be required to prepare financial statements in accordance with the proposed Standards, albeit as interpreted by the Further and Higher Education SORP. We also make grants to a number of mainly charitable organisations that provide services in support of higher education and will adopt the proposed Standards. We are required to monitor the financial performance and health of all of the organisations we fund and therefore have a direct interest in the proposals.

We have seen the response by the British Universities Finance Directors Group to the consultation questions and, as you will see, are in broad agreement with them.

Please address any questions about this submission to Andrew Malin (0117 931 7332).

A handwritten signature in black ink, reading "Steve Egan". The signature is fluid and cursive, with a large, stylized "S" and "E".

Steve Egan
Deputy Chief Executive

Higher Education Funding Council for England

The Future of Financial Reporting

Response to consultation questions and detailed comments on FREDs 46 and 48

A. Response to consultation questions

We have only answered the questions of direct relevance to the higher education sector

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 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?

Although we are making a number of suggestions to improve the clarity of the final Financial Reporting Standards, we agree that the framework is appropriate and meet the ASB's objective.

Question 3

Do you agree with the proposed scope for 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.

We agree with the cross-referenced areas because this simplifies the draft FRS102 in areas that affect relatively small numbers of entities.

However, we note that some higher education institutions (HEIs) already provide segmental information and it is likely that more will do so, particularly as they extend their overseas operations. It is likely that the Further and Higher Education SORP will need to interpret EU adopted IFRS 8 and provide guidance to the sector.

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?

We think that the proposals are reasonable but, again, note that the F&HE SORP may need to offer guidance to those HEIs that have farms, etc.

b) Whether the proposals for service concession arrangements are sufficient to meet the needs of preparers?

We note the issues raised by the British Universities Finance Directors Group and agree with their suggestion that, if not made explicit in FRS102 the public benefit entity SORPs will need to address the accounting for service concession arrangements by grantors.

Question 7

Do you consider that the related proposal disclosure requirements in section 33 of FRED48 are sufficient to meet the needs of preparers?

We welcome the clear statement in paragraph 33.13 that entities must be able to substantiate that related party transactions have only taken place on terms equivalent to those of arm's length

transactions. However, this still leaves open the question of whether such transactions need to be disclosed for each related party. We consider that disclosure of transactions is appropriate. We also consider that the section should be explicit in paragraph 33.6 that trustees of charities (and their close family members) are 'key management personnel'.

Question 8

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

Yes, and we believe that this will allow time for the development of a revised F&HE SORP as long as the new Standards are published by the autumn of 2012.

Question 9

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

No. As a regulator we are sensitive to the need to keep reporting burden to a minimum, but we need consistent and reliable financial information to allow us to assess financial performance and health. We consider that FRS102 extends current UKGAAP to meet international reporting standards in a proportionate way.

B. Detailed comments on FREDs 46 and 48

Our comments follow the original section and paragraph numbering of the FREDs.

FRED 46

Summary Para 4 Bullet 2	After 'businesses' we suggest adding 'and public benefit entities' to more accurately reflect the revised scope of proposed the proposed Financial Reporting Standards (FRS) 100, 101, and 102.
Proposed FRS100 Para 6 and glossary	The definition of a public benefit entity (PBE) would be improved by adding 'and/or accumulated' after 'any equity is provided'. As currently drafted, the first part of the definition reflects a shareholder/investor concept that is insufficient to capture the full characteristics of PBEs and is at odds with the second half of the definition itself..
Para 8	In line 4 we suggest 'those' not 'these'.
Appendix 2 (general comment)	The legal framework would be improved by acknowledging that many charities are companies and therefore required to apply the accounting requirements of both the Companies Act 2006 and the Charities Act 2011. It would also help to acknowledge that there are currently (and expected to be) three SORPs available to PBEs: Charities, Further and higher education, and registered social landlords.
Appendix 2 Para A2.14	This paragraph covers a parent company with a subsidiary that is a charity (itself an interesting concept given the requirement for charity trustees to have unfettered responsibility to manage their charity) but not that of a charity (unincorporated or incorporated other than as a company) that has subsidiary (non-charity) companies.
Appendix 2 Para A2.19	If the Companies Act prohibits charities from applying IAS, it might be helpful to explain why/how they are able to apply an accounting standard closely aligned to IAS. The table refers to the Charities SORP but we would suggest that it also needs to refer to the other SORPs used by public benefit entities: Further and Higher Education and Registered Social Landlords.

FRED 48

Contents page	We note that Section 34 (Specialised activities) covers several discrete topics, such as agriculture, financial institutions, etc. We suggest that they could usefully be signalled on the Contents page and again as the first paragraph of Section 34 itself.
Section 2 Paragraph 2.8	In the light of paragraph 2.7, it would be helpful to provide more guidance about situations when 'substance over form' improves the reliability of transactions. This has particular resonance for PBEs given the continuing debates about income recognition of grants and donations which may be subject to more or less rigorously enforced or enforceable performance conditions.
Paragraphs 2.15(c) and 2.22	The two definitions of equity are slightly different and could be aligned. But we take the core definition to be that equity is 'the difference between assets and liabilities'. This needs clarification for PBEs, especially charities that hold endowments and special trusts that are subject to restrictions as to use and availability to creditors. The status of deferred capital grant balances also needs to be included in the definition: are they liabilities or part of the 'capital' of the reporting entity?

Paragraphs 2.25 and 2.26	The definitions of both income and expenditure refer to transactions 'in the course of ordinary activities'. Can or should PBEs treat endowment transactions as 'ordinary activities'? Does this hold true for all such transactions: new endowments (with greater or lesser flexibility as to use); investment income and capital gains/losses; expenditure of endowment (within the reporting entity and or to third parties); etc. We suggest that creditor expectations in relation to the assets underpinning endowment funds should be a major factor in determining the disclosures.
Paragraphs 2.25 and 2.26	We suggest that it would be helpful, and consistent with the principle that FRS 102 applies to PBEs to include grants payable and receivable (or just 'non-capital grants') in the lists of examples of revenue and expenses at 2.25 (a) and 2.26 (a). Similarly it would be helpful to include deferred capital grant releases at 2.25 (a) to mirror depreciation in 2.26 (a).
Section 3 Paragraph 3.8	We would hope that the outcome of Lord Scarman's consideration of going concern reporting by listed companies will, if appropriate, be reflected in the final version of FRS102. We would also argue that management's assessment should reflect at least twelve months from the approval date rather than the reporting date.
Paragraph 3.9	We suggest that this paragraph might need to be split into two, after 'uncertainties'. Alternatively, it should be clearly stated that the existence of 'material uncertainties' means that the financial statements cannot be prepared on a going concern basis. As currently drafted material uncertainties appear to reflect a 'halfway house' between going concern and not.
Paragraph 3.11	We suggest adding '(c) this FRS is amended'. This would cover the situation of updated accounting or reporting standards between formal revisions of FRS102.
Section 5 (general comment)	We suggest that this is another section that needs to acknowledge that some PBEs are not companies – indeed, may not even be incorporated. (Several higher education institutions are unincorporated trusts and it would be helpful to make it clear that such entities should, notwithstanding their formal constitutions, report like companies.)
Section 5 (general comment)	We think that the numbering of paragraphs after 5.7A is incorrect: paragraph 5.7B should be 5.8, paragraph 5.7C should be 5.8A, and 5.8 should be 5.9 – with consequent renumbering to the end of the section.
Paragraph 5.4 (a)	This seems unnecessary since it is effectively covered by paragraph 5.8 (before renumbering suggested above).
Paragraph 5.11	This section seems to rule out analysis of expenses by both nature and function. Reporting in both ways enhances transparency, so the 'or' should become 'and/or' – with consequential redrafting. For example: '...entity. If only one classification is reported, the entity shall use the one which ...'.
Section 6 (general comment)	We have commented already on the definition/concept of equity in both the draft FRS100 and in paragraphs 2.15 and 2.22 of the draft FRS102. The same comments apply to this section. In particular, PBEs do not have 'owners' or 'ownership interests'.
Section 7 Paragraph 7.2	The text in this paragraph is more expansive than the definition given in the glossary. We suggest the two should be aligned. It would be possible to go further and delete paragraph 7.2 on the grounds that it is simply definitional and not actually about reporting.
Paragraph 7.4	Again, the first sentence is not consistent with the glossary.
Paragraph 7.6t	We suggest it would be helpful to explain what might constitute 'contributed equity' to a PBE, including the extent to which it is necessary for PBEs to distinguish the cash flows of endowments and special trusts from those of the

	entity generally.
Paragraph 7.15 and 7.16	Both paragraphs permit alternative treatments in the statement of cash flows, yet it is not clear how entities should determine the underpinning income and expenditure disclosures in the first place. Again, there are implications for PBEs that receive interest, etc. on both general funds and on endowment/special trust funds.
Paragraph 7.21	This paragraph is clearly relevant to PBEs and links to both of the previous comments. To assist PBEs, it may be helpful to expand on the phrase 'other reasons ... legal restrictions' to make it clear that some endowments and special trusts may constitute 'legal restrictions'.
Section 10 Paragraph 10.1	The idea that the section provides 'guidance' is different from the wording of the scope of other sections. Better might be: 'This section requires the selection and application ...'.
Paragraph 10.4(b)(i)	We suggest that the word 'faithfully' should be replaced by 'truly and fairly'.
Paragraph 10.4(b)(ii)	See previous comments about substance over form.
Section 13 Paragraph 13.5A	The cross-reference to Section 34 should be more precise, since that section is so long and covers a range of topics.
Sections 14 and 15 (General comment)	This is an area where substance over form might improve the reliability of reporting, yet Section 15 in particular appears to emphasise form over substance. We would suggest that an Appendix to these two sections could helpfully set out 'model' layouts for the different disclosures resulting from the various alternatives for 'parents' and 'non-parents', for the different valuation methods, and for the different types of joint activity/structure.
Paragraph 15.7	The various subsections appear to suggest that a venture might incur expenses and liabilities on its own account as well as income and expenses derived from jointly controlled or owned assets. Yet there is not a similar suggestion about deriving income on its own account. Sub-paragraphs (a), (c) and (d) appear to be the main transactions and balances expected in this type of joint venture, and we would suggest that they be renumbered as (a), (b) and (c). Sub-paragraphs (b) and (e) could become part of a new paragraph explaining both the circumstances in which such transactions and balances (including income and assets (e.g. debtors)) might arise and how those circumstances should be disclosed.
Section 17 Paragraph 17.3	We suggest splitting sub-paragraph (a) on the basis that there is no connection between biological/agricultural assets and heritage assets. The cross-references could then be to the specific paragraphs of Section 34.
Paragraph 17.17	We suggest a specific cross reference to paragraph 13.8 rather than a general reference to Section 13.
Section 19 Paragraph PBE19.2A	We suggest a specific reference to paragraph 34.73 to paragraph 34.86.
Paragraph 19.6	The cross-references are actually to paragraphs 19.27 to 19.33.
Section 20 Paragraph 20.1	Again, it would be helpful to have specific paragraph references to Sections 16, 18 and, particularly, 34.
Section 22 Paragraph 22.3	The definition of equity in this paragraph includes 'additions or reductions resulting from profitable or unprofitable operations'. Although the sense is clear enough, we note that public benefit entities do not generally use the words profitable and unprofitable. More significantly, this definition would usefully cover the point made in our

	comments on FRED 46 (see proposed FRS100, paragraph 6 and glossary above).
Section 23 Paragraphs 23.1 and 23.2	<p>We suggest that either:</p> <ul style="list-style-type: none"> a) Paragraph 23.1 should be extended to cover grants and donations (both of which are income from non-exchange transactions) and Sections 24 and the relevant paragraphs of Section 34 incorporated later in Section 23, or b) Paragraph 23.2 should be extended to include grants and donations as income dealt with elsewhere (with appropriate cross references to Sections 24 and the relevant paragraphs of Section 34). <p>We favour the former on the basis that grants and donations are a significant component of revenue for many public benefit entities.</p>
Paragraph 23.30	We note that subparagraph (b)(vii) includes grants as a disclosable category of revenue, supporting our suggestion on paragraph 23.1.
Section 24 General comments	<p>Whether this section is retained separately or included in Section 23 (see previous comments) we suggest that it be retitled 'Grants receivable' since it does not address accounting for grants payable.</p> <p>Paragraph numbering after paragraph 24.3 seems to have slipped: i.e. 24.3A should be 24.4 and so on. We have retained the original numbering in comments below.</p>
Paragraph 24.1	<p>The first sentence makes it clear that the section covers grants by government and 'others'. The second sentence then defines a government grant in terms that would apply equally to grants by 'others'. We therefore suggest dropping the word government in that sentence.</p> <p>We also suggest making it more clear that the section applies to both capital and revenue grants: the term 'operating activities' could be taken as excluding capital grants, yet these are clearly covered by paragraph 24.5F.</p>
Paragraphs 24.2, 24.3, 24.6 and 24.7	Both paragraphs refer to 'government assistance' other than grants. Paragraphs 24.2 and 24.3 explain what is not covered in the section, while paragraph 24.7 gives example of government assistance that is covered. We suggest that the latter is moved to become part of the 'scope of this section' – with consequential changes to the cross-referencing, including in paragraph 24.6(d).
Paragraphs 24.3A and 24.5B	We are aware of concerns about the performance model for recognising grants. We suggest that this is an area where substance can often provide more reliable information than form. In practice, and certainly in our experience, few grant makers enforce performance conditions so strictly that no income can be recognised until after 'certified completion'. In virtually all cases the grantee will deliver most of what the grantor expected and, in the event of a performance shortfall, will negotiate to retain and/or reschedule most, if not all, of the grant. This is true for both short- and long-term projects. If the grantee's performance is so short of expectation that the income can't be recognised, this should be clear from a related lack of expenditure. There will normally be correspondence between grantor and grantee to support the amount of grant recognised in any accounting period.
Paragraph 24.5F	We support this deferred grant accounting treatment of capital grants ('grants relating to assets').
Section 33 Paragraph 33.6	<p>Since it is definitional, we suggest that the first sentence (as amended for our next comments) could become part of paragraph 33.2.b(vii) or as a separate paragraph 33.3.</p> <p>It would be helpful if this section was clear about the status of charity trustees in the context of disclosing 'key management personnel compensation'. Both higher education institutions (HEIs) and students' unions have trustees who are</p>

	<p>employees (including some senior managers) of the entity – but who are not paid specifically as trustees. Some HEIs also have independent (i.e. not employed) trustees who receive payment for their services as trustees.</p> <p>As the principal regulator (under the Charities Act 2011) we require disclosure of any payments to trustees for their services as trustees, and consider that this is consistent with the spirit of this paragraph.</p>
Paragraph 33.10C(c)	We support the principle of separate disclosure of aggregate transactions with key management personnel, but suggest that the broader term ‘with or on behalf of’ would be helpful.
Paragraph 33.12	We consider that this list should include expenses (other than benefits in kind that are covered elsewhere) paid or payable to or on behalf of related parties.
Paragraph 33.13	We support the principle that entities should substantiate any statement that transactions with related parties are only carried out on arm’s length terms.
Section 34 General comment	As noted above, we suggest that this long section would benefit from an opening paragraph listing and giving paragraph references to the various topics covered.
Heading before paragraph 34.55	This section is called ‘Funding commitments’. We consider that this term should either become ‘Grants payable’ or should be extended to include that phrase. The heading should also be underlined (c.f. Agriculture, Heritage assets, et cetera.)
Paragraph 34.58	As with our comments on grants receivable (Section 24), and notwithstanding paragraph 34.56) we note that an absolute requirement for performance commitments to be met is unlikely to provide reliable information. In most cases, the grant-maker will have established precedents by its behaviour in terms of withdrawing, withholding or claiming repayment of grants offered. It is likely that its behaviour will demonstrate a constructive obligation even when there has been a performance shortfall or delay.
Paragraph 34.59	Most grant makers offer grants out of existing funds and monitor their capacity to make grants on a cash basis. We suggest that it is unhelpful – possibly misleading – to reduce the liability to its present value.
Paragraphs PBE34.62 to PBE34.72 General comment	<p>Although both are ‘income from non-exchange transactions’, we consider that there is a difference between grants receivable and donations. Some donations can resemble grants, in that they are intended to fund more or less specific activity to be carried out in a reasonably short period of time (which could, nevertheless, be several years). But others have very specific conditions or restrictions as to future use. Most restrictive are endowments whereby only the income generated by investing the donation can be utilised – for general or specified activities.</p> <p>We have noted in previous comments that it would be helpful for FRS102 to address endowment accounting in relation to income statements and statements of cash flow.</p> <p>There may be merit in bringing this part of Section 34 together with Section 24 – either as a standalone section or within Section 23.</p>
Paragraph PBE34.63	In the second sentence we suggest twice adding the words ‘or person’ after the word ‘entity’.
Paragraph PBE34.65(c)	This requirement does not recognise that some donations (endowments) are, in effect, part of the entity’s equity and should be accounted for as such rather than as liabilities.
Paragraphs PBE34.73 to PBE34.87	We support the principle that public benefit entities should apply merger accounting if the conditions are met. However, it is not clear to us why ‘combinations that are in substance a gift’ are referred to at all, let alone why

General comment	they should be accounted for in accordance with Section 19 rather than paragraphs 34.62 to 34.72 – i.e. as donations.
Paragraphs PBE34.79 and PBE34.80	We accept the definitions of merger and believe that most, but possibly not all, combinations in the HE sector will therefore be accounted for using merger accounting.
Paragraph PBE34.91	We suggest adding the words ‘or from’ before ‘a third party’.
Paragraph PBE34.92	We suggest adding the words ‘if any’ after ‘receivable’ on the basis that some concessionary loans will be interest-free.
Appendix to Section 34 General comment	We suggest that this appendix is intrinsic to and should therefore be included in the sub-section ‘Funding commitments’.
Paragraph 34A.4	We have commented already that the behaviour of grant makers seldom results in the withdrawal or demand for repayment of part or all of a grant when performance conditions are not met. Such behaviour needs to be factored in to the decision to recognise a liability or not.
Paragraph 34.A6	It follows from our previous comment that we consider most commitments should be recognised. We would suggest re-wording this paragraph along the following lines: ‘The value of any commitments that are not recognised as liabilities should be fully disclosed – either in aggregate or with appropriate classes of commitment aggregated.’