



RESPONSE TO ASB EXPOSURE DRAFTS 46, 47 & 48: THE FUTURE OF FINANCIAL REPORTING IN THE UK AND REPUBLIC OF IRELAND

30 April 2012

INTRODUCTION

The Institute's Accounting Standards, Charities and Pensions Committees have considered the above exposure drafts and I am pleased to forward their comments to the ASB.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Our general comments and responses to the questions in the invitation to comment are set out below.

Any enquiries should be addressed to Amy Hutchinson, Assistant Director, Technical Policy and Secretary to the Accounting Standards Committee.

GENERAL COMMENTS

We are supportive of the ASB's proposals for the future of financial reporting and believe that they meet the objective stated for the project. In particular, the ASB is to be commended for the extent of their outreach programme to discuss the proposals with constituents and the extent to which the views of constituents have been considered in arriving at the revised proposals. We detail below a number of areas in which we still have some concerns, or which we believe require further clarification from the ASB. We have set out some more detailed comments on certain aspects of section 34 of FRS 102 on specialised activities in an appendix to this response.

Reduced disclosure framework – entities otherwise using EU-adopted IFRS

Entities using the reduced disclosure framework will thereby be preparing Companies Act accounts, and must comply with the Companies Act provisions on the format of financial statements. Although Application Guidance I to draft FRS 101 sets out the necessary amendments, we do not think that the draft standard currently contains sufficient guidance to enable entities to ensure that their financial statements comply with both the Companies Act and IFRS formats without undue effort. Example formats would be preferable.

FRS 100 proposes that an entity applying FRS 101 makes a statement in the notes that 'These financial statements were prepared in accordance with FRS 101 'Reduced Disclosure Framework.' It may be helpful both to preparers and users to provide some further guidance on how an entity using EU-adopted IFRS might amend its statement of compliance as required by paragraph 16 of IAS 1, given the amendments necessary to comply with the Act and the Regulations and the disclosure exemptions. We suggest that this is provided within FRS 101.

Statement of cash flows

Section 7 of draft FRS 102 contains the requirements for the presentation of a statement of cash flows, which, in accordance with section 3 of the standard, is one element of a complete set of financial statements. FRS 1 currently contains exemptions for wholly-owned subsidiaries, small entities, mutual life insurance companies, pension funds and open-ended investment funds. Under FRS 102, the exemption for the last three types of entity is retained, and the exemption for subsidiaries is available via the reduced disclosure framework. This means that only the exemption for small entities has not been carried forward from existing UK GAAP. It is unclear why this is the case as we cannot find an explanation for this within the consultation documents. There is a risk that the absence of an exemption for small entities could discourage such entities from voluntarily adopting FRS 102 as opposed to the FRSE. We would encourage the ASB to clarify the position.

Consolidated and separate financial statements

Paragraph 9.3 of draft FRS 102 lists the exemptions from the requirement to prepare consolidated financial statements, including the exemptions permitted by company law. This does not currently include the exemption for parent companies that head up a small group. Although paragraph 9.1 can be read as meaning that the section only applies to parent companies that are already required to prepare group accounts, to avoid confusion, the exemption for small companies should be explicitly referred to in paragraph 9.3. Again, there is a risk that the absence of this explicit exemption could discourage small entities from voluntarily adopting FRS 102 as opposed to the FRSE.

Employee benefits

Recovery plan payments

The accounting treatment for recovery plan payments which are required by law to maintain the solvency of defined benefit pension schemes are not specifically dealt with under the new proposals in section 28 of FRS 102.

Under existing UK GAAP the recognition of liabilities relating to recovery plan payments has been a grey area, falling between FRS 12 and FRS 17. Under EU adopted IFRS, IFRIC Interpretation 14 (IAS 19 – The limit in a defined benefit asset, minimum funding requirements and their interaction) states that a minimum funding requirement may give rise to a liability and we believe that recovery plan payments are covered by this.

We believe that the accounting requirements for recovery plan payments should be clarified and would welcome the inclusion of accounting guidance on this topic within FRS 102.

Status of SORPs

We would welcome a clear statement from the ASB on the relationship between SORPs and the new UK GAAP. In the past there have been examples of SORPs seeming to go beyond the interpretation of accounting standards for a sector to providing material which departs from those standards. We believe that this is an opportunity to ensure that SORPs do not go beyond the interpretation of standards and a statement from the ASB to this effect would be helpful.

For example, while we agree that it will be necessary for FRSSE charities to have regard to FRS 102, we also recognise that this could make their accounting framework more complicated. Charities, especially FRSSE charities, view the Charities SORP as a one-stop shop therefore it is essential that the ASB and the Charities SORP Committee have a clear view on how the phrase 'have regard to FRS 102' actually means in practice.

INVITATION TO COMMENT

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 users' information needs.

Do you agree?

RESPONSE:

We agree that the proposals in FREDs 46 to 48 meet the ASB's project objective. We believe the ASB has taken a pragmatic approach which has struck the balance between achieving consistency with international financial reporting principles and maintaining consistency between the different layers of financial reporting in the UK. The draft FRS 102 is a relatively concise document containing clear principles which will result in high-quality, understandable financial reporting by a wide range of entities. The adoption by the UK of this simplified version of IFRSs could provide evidence as to how full IFRS might be simplified and improved in future, and therefore could have a major impact on financial reporting worldwide.

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?

RESPONSE:

The disclosure requirements proposed in the second alternative appear to equate to the additional financial instruments disclosures required in draft FRS 102 for financial institutions. This is therefore the preferable option as there does not seem to be a valid reason why more extensive disclosures should be required for qualifying entities choosing to apply EU-adopted IFRS in their individual accounts compared to those using FRS 102.

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.

RESPONSE:

We agree with the proposed scope for the areas cross-referenced to EU adopted IFRS as set out in section 1 of FRED 48.

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.

RESPONSE:

The approach of listing the types of entities considered to be financial institutions is a practical one, which avoids the problems associated with using the public accountability criterion and as well as avoiding any confusion as to which entities are included. In general we are happy with the proposed list – the disclosures may appear onerous for very small, straightforward entities such as small friendly societies or credit unions although if these organisations have very straightforward transactions and financial instruments, the disclosures should also be relatively simple.

The Pensions Committee welcomes the decision to remove pension schemes from compliance with full EU-adopted IFRS. However, there are two main concerns regarding the inclusion of pension schemes within the definition of a financial institution.

- Our first concern is that the additional financial instruments disclosure requirements within section 34 of the proposed FRS 102 would be voluminous without being meaningful. The disclosures would be one-sided as they would largely relate to scheme investments at a point in time and not the scheme's liability to pay pensions over time. This does not mean we are suggesting that scheme liabilities should be brought on balance sheet or otherwise disclosed in the accounts. We set out our views on the disclosure of pension liabilities in our response to question 6.
- Our second concern is that for smaller pension schemes with few members the financial instruments disclosures would be even less meaningful and disproportionately onerous.

As an alternative to the requirements for pension schemes to provide disclosures on the nature and extent of risks arising from financial instruments in the accounts, we would prefer the development of a management commentary framework tailored for pension schemes which would report on risks associated with continuing to make pension payments. We believe that this would be a suitable project for PRAG.

If the ASB continues to be minded to apply the additional disclosure requirements to pension schemes, we believe that these should be restricted only to large pension schemes which are also public interest entities.

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?

RESPONSE:

We have concerns about the proposals for agricultural activities, both in terms of the practicality of application and the general principle of applying fair value accounting in this sector.

We support the use of fair values in areas such as complex financial instruments, as we believe this provides the most relevant and useful information, but the vast majority of agricultural entities are more akin to traditional manufacturing and production businesses, where stock is measured at the lower of cost and net realisable value. We note that there is considerable pressure on the IASB to revise IAS 41, and there is a wide divergence in how the standard is applied internationally, demonstrating the difficulties of applying fair values to agricultural produce and biological assets.

For many types of agricultural produce it will be difficult to obtain a reliable fair value e.g. a growing crop is unlikely to be sold in its current state, and the ultimate quality of a harvest cannot be predicted, therefore expected profits may not be realised. Many agricultural businesses in the UK would likely need to rely on expert assistance to produce fair value information, which would add cost without any corresponding benefit to the users of their accounts, who are accustomed to agricultural stock being measured on a historic cost basis. Additionally, we believe there is significant scope for the “measured reliably without undue cost or effort” exemption being applied inconsistently across entities.

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?

RESPONSE:

Proposals on the financial statements of retirement benefit plans

We welcome the additional material on the presentation of financial statements for retirement benefit plans. However, we believe that the additional narrative disclosure requirements would be more appropriately placed within an accompanying management commentary.

We also note that narrative information which FRS 102 envisages could fall outside the scope of the accounts is referred to using different terms and different approaches:

- Paragraph 34.38 refers to actuarial information and a description of investment strategies being disclosed as part of the financial statements or alongside the trustees’ report
- Paragraph 34.45 refers the description of its funding policy being disclosed either within or alongside the financial statements.
- Paragraph 34.46 requires certain information to be disclosed either as part of the financial statements or in the annual report.

Should any of these narrative disclosure requirements remain with FRS 102, we recommend that these are described consistently.

We do not believe that providing an option as to whether certain information is provided within or alongside the financial statements is helpful. Schemes which disclose information within the financial statements would likely incur additional audit fees (as if the information is given alongside the financial statements e.g. in the trustees’ report, the auditor is only required to report if material inconsistencies with the accounts are identified). This would be particularly true for schemes which choose to provide actuarial information on scheme liabilities within the financial statements. There should be clarity as to where such information should be located.

There is no reference within the material on retirement benefit plans which addresses issues for pension schemes which have accumulation funds. Due to the difficulties which schemes may experience in obtaining information on investment income, additions or profits or losses on disposals movements are often wrapped up within gains or losses. We recommend that this practice continues to be permitted following the implementation of FRS 102 and should be covered by the Pensions SORP.

Disclosure about the liability to pay pensions

We do not agree with the proposed disclosure around the liability to pay pension benefits. We believe that the cost of complying with this requirement would outweigh the benefits of disclosure. Pension schemes would bear the cost of any additional professional fees incurred and we do not see how this information would actually benefit scheme members as the information would not give an indication as to a scheme's ability to continue to pay pensions.

The Pensions SORP requires that the Summary Funding Statement is included as part of the narrative information accompanying the accounts. This Statement is also sent to all scheme members and it comments on the relationship between the assets and liabilities on an on-going and buyout basis. Therefore, we do not believe that the disclosure of scheme liabilities within the accounts would add anything to the usefulness of the annual report and accounts.

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?

RESPONSE:

In general we consider the related party disclosure requirements in section 33 of FRED 48 to be sufficient to meet the needs of preparers and users, however we would urge the ASB to drop the exemption for transactions between wholly-owned members of a group. This exemption, while available in company law, is not available in EU-adopted IFRS, therefore this creates an inconsistency between the different layers of reporting. While we understand the desire not to gold-plate existing legal requirements (and the ideal solution would be for the law to be changed in this area), we believe there is a strong public interest argument against the exemption. As the ASB's feedback found, users are interested in information about transactions between members of a group, and experience has shown that many financial and accounting scandals have involved exploiting group structures or intra-group transactions.

QUESTION 8:

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

RESPONSE:

We agree with the effective date which gives sufficient time for transition as well as coinciding with the effective date of IFRS 9.

We believe that there should be a minimum of 18 months between the publication of all the material relevant to PBEs and the date of implementation. This would include the publication of any sector specific SORPs. The Charities SORP and the Registered Social Landlords SORP would need to be published by 1 July 2013, for periods commencing on or after 1 January 2015 and the Education SORP would need to be published by 1 February 2014, for periods commencing on or after 1 August 2015.

QUESTION 9:

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

RESPONSE:

We do not support the alternative view.

DRAFT FRS 102 SECTION 34 – SPECIALISED ACTIVITIES**Incoming resources from non-exchange transactions**

We have a number of points on the accounting requirements for incoming resources from non-exchange transactions:

- PBE 34.62 scopes out accounting for grants from the requirements for incoming resources from non-exchange transactions. However, other categories of non-exchange transaction are dealt with in other sections but are not specifically scoped out. For clarity, we recommend that transactions relating to the donation of heritage assets (34.49 to 34.54), entity combinations (PBE 34.73 to PBE 34.87) and concessionary loan interest receivable (PBE 34.88 to PBE 34.98) should be scoped out of this section.
- The term 'incoming resources' is not defined within FRED 48. From a charity accounting perspective, 'incoming resources' is a term which encompasses transactions relating to the funding of fixed assets, which must be recorded in the Statement of Financial Activities. However, under existing UK GAAP other entities would not normally record such transactions in their statement of financial performance. Therefore we believe that it is important this term is defined in the glossary.
- We are not convinced that recognising incoming resources from donated goods and services is appropriate accounting practice. Therefore, we welcome the concessions available in paragraph PBE 34.67 on the recognition and measurement of goods and services. However, we believe that further clarification is required in relation to donated services, where these can be reliably measured, as the proposed standard creates a grey area between services delivered by professional firms or other third party organisations on a voluntary basis and services delivered by individual volunteers. We do not envisage a scenario where it would be ever be appropriate to recognise the services provided by individual volunteers and we recommend that this is made clear within FRS 102. We believe that the trustees' annual report is the appropriate place for the reporting of volunteer assistance.
- This section uses the terms 'sufficient reliability', 'reasonably quantified' and 'measured reliability' in relation to measurement. These appear to be used interchangeably and we would prefer that a single term was used, in this instance '[measured with] sufficient reliability'.

Public Benefit Entity combinations

We largely welcome the changes to the proposals on public benefit entity combinations. The proposals address our earlier recommendation that normal acquisitions should be dealt with in the same way as they are by private sector companies, with specific guidance for PBEs on combinations at nil or nominal consideration which are in substance a gift and combinations which meet the definition and criteria of a merger. However, the proposals are still unclear as to how a charity should account for a change in legal personality or the acquisition of legal personality. Under existing standards this is a grey area. We support the use of merger accounting when a charity changes form rather than a fair value approach and recommends that this is clarified within this section of the FRS.

Heritage Assets

Paragraph 34.53(b) requires entities to disclose their policy on the acquisition, preservation, management and disposal for heritage assets. We believe that this information is more appropriately included within accompanying narrative commentary, for example, the Trustees' Annual Report, than within the accounts (which is consistent with the approach currently taken in FRS 30). Therefore, we recommend that this requirement is not included in FRS 102.

Funding Commitments

We broadly welcome the changes made to the material on funding commitments, in particular the linkage to the material in section 21 on recognition and measurement of provisions. However, the material is not adequate in one important respect; it does not provide clarification about the treatment of multi-year grants.

The FRS only refers to performance conditions but does not refer to other conditions.

However, the guidance on funding commitments in Appendix 1 to section 34 does:

- Paragraph 34A.2 refers to 'a promise to provide cash conditional on the receipt of future income' not giving rise to a liability;
- Paragraph 34A.5 refers to conditions which are not performance related and gives a grantor imposed requirement to provide an annual financial report as an administrative condition which would not release the grantor from the commitment.

It is not clear from the above whether a time-related condition would be an administrative condition or a condition of a similar but unclassified type of condition such as the grantor's dependency on receiving future income.

If conditions which are not performance related can release a grantor from a commitment, then the FRS should address non-performance related conditions directly rather than within guidance. It is important for the charity sector and for the Charities SORP Committee to have clarity on the treatment of multi-year grants where there is a time related condition in order to resolve a grey area which has existed since the Charities SORP 2005 was first published.