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Our ref: ASB/FREDS46 to 48

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Dear Jenny

**THE FUTURE OF FINANCIAL REPORTING IN THE UNITED KINGDOM  
FINANCIAL REPORTING EXPOSURE DRAFTS ("FREDS") 46, 47 AND 48**

**1 The proposals as outlined in FREDS 46, 47 and 48**

We welcome the opportunity to respond to this consultation and believe that the current proposals are an overall improvement on the proposals originally set out in FREDS 43, 44 and 45.

In particular we are pleased that the ASB made the following decisions during their deliberations:

- not to further mandate the application of EU-endorsed IFRS over and above current requirements
- to retain the reporting formats of company law
- to retain accounting policy choices for revaluing tangible and intangible assets
- permitting capitalisation of development costs and interest.

However, we are of the view that there still remains an opportunity for substantial improvements to be made to the proposals as currently drafted.

**2 Entities other than Public Benefit Entities (PBEs)**

There remain specific areas where we believe that further consistency with EU-adopted IFRS or existing UK GAAP (where it provides a better solution than EU-adopted IFRS) can be achieved. In addition as noted in the appendices to this letter (and in our earlier letter on FREDS 43 and 44), there are a number of areas where we believe that further accounting requirements and guidance should be incorporated.

Further, we believe that the ASB may have missed an opportunity to reduce the financial reporting burden in certain complex areas, for example with regard to accounting for business combinations and share based payments.

As we commented in our response letter dated 28 April 2011 on FREDS 43 and 44, we are conceptually not in favour of the reduced disclosure frameworks. However, we understand the reasons as to why these are being pursued.



Appendix I sets out responses to specific questions raised by the ASB.

Appendix II includes our key drafting observations and recommendations for entities other than PBEs.

### **3 Public Benefit Entities (PBEs)**

We are pleased that the Board has taken on board certain concerns of the not-for-profit sector, notably introducing options to capitalise interest and revalue tangible fixed assets, as well as the inclusion of a cost-benefit consideration for recognising donated stock.

We have a number of suggested improvements and additional observations on the requirements for PBEs which are set out in Appendix III.

### **4 Contact Details**

If you wish to discuss any of our comments, please contact:  
Pauline McGee (020 7893 3873) or James Roberts (01293 591 087).

Yours sincerely



Pauline McGee  
Partner  
For and on behalf of BDO LLP

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## THE FUTURE OF FINANCIAL REPORTING IN THE UNITED KINGDOM FINANCIAL REPORTING EXPOSURE DRAFTS ("FREDs") 46, 47 and 48

### Appendix I: Responses 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 users' information needs.

Do you agree?

#### Response

We do not believe that the proposals will achieve the above project objective for the reasons as set out in our letter of 28 April 2011 in response to the proposals in FREDs 43 and 44.

#### 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

We do not believe that a financial institution should be exempt from any of the disclosure requirements of IFRS 7 or IFRS 13. The disclosure requirements in both of these standards are intended to convey the risks of financial instruments to an entity and also key judgements and methodologies surrounding the fair value of financial instruments. These disclosures are of critical importance to the users of the financial statements of financial institutions.

Further, we do not believe that a financial institution reporting under the reduced disclosure framework in FRED 47 should be exempt from making the capital disclosures as required by IAS 1 (134-136).

Please also note our response to question 4 with regard to financial institutions.

**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****Application of IFRS 4 - Insurance Contracts**

We believe that the requirements as set out in FRED 48 regarding the accounting for insurance contracts is an appropriate pragmatic solution given that in the background there is a significant project on insurance accounting underway.

IFRS 4 'Insurance Contracts' is written purely with IFRS reporting in mind but unless a reporter chooses to apply the recognition and measurement rules of IAS 39, FRED 48 will require different accounting rules for financial instruments.

IFRS 4 contains specific scope guidance on its interaction with IAS 39 for example for embedded derivatives, unbundling of deposit components and discretionary participating features. We recommend that application guidance is considered in the final standard covering interaction between IFRS 4 and the equivalent parts of FRED 48.

**Application of IAS 34 - Interim Financial Reporting**

Paragraph 1.4 of FRED 48 appears to mandate the application of IAS 34 for entities whose shares or potential shares are publicly traded, or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market.

It is unclear why the ASB would issue requirements that are over and above the regulation of certain market requirements (for example the AIM, PLUS Quoted and CISX markets). The proposals as drafted would add cost of preparation to interim financial reporting for entities listed on certain exchanges that are currently not required to apply IAS 34.

We believe that the relevant market regulators should retain responsibility for the minimum content of interim financial statements.

IAS 34 contains the following disclosure requirements:

- [Where significant] transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments {IAS 34 (15B) (k)}.
- [Where significant] changes in the classification of financial assets as a result of change in purpose or use of those assets {IAS 34 (15B) (l)}.

There are no related disclosure requirements in FRED 48 for the above. FRED 48 is not entirely compatible with IAS 34.

**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**

We broadly agree with the definition of a financial institution as drafted in the proposals. However there are some possible ambiguities as although it appears to follow legislative definitions of various types of financial institution it does not do this consistently. For example the term 'stockbroker' is used rather than using the relevant part of the Financial Services and Markets Act to define the affected group. We believe the definition could be improved by basing itself on the legislation rather than using generic descriptions.

**Other observations - Capital Disclosures**

We believe that Capital Disclosure Requirements (per IAS 1 (134) to (136)/ FRS 26 (42A) and Appendix E) should be included as disclosure requirements in FRED 48.

This is a surprising omission given that the ASB drew particular importance to the disclosures in Press Notice PN 358 and the associated ASB Study: Financial Capital Management Disclosures.

These are important disclosures for entities with externally imposed capital requirements and we recommend limiting the scope of capital disclosure requirements to such 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 to part (a) - Agricultural Activities**

We do not believe that the model proposed is unduly arduous. However, the ASB should consider whether the models applied under IAS 41 and the IFRS for SMEs achieve adequate financial reporting for a broad range of entities.

We are not in favour of the "undue cost or effort" approach as permitted in the IFRS for SMEs on the basis that IAS 41 adequately caters for situations where the fair value of a biological asset cannot be measured reliably and the circumstances in which that arises, by allowing a cost model in such circumstances.

Whilst we believe that the accounting requirements for applying fair value should be aligned with the requirements of IAS 41 'Agriculture' we acknowledge that for certain UK reporters such as smaller agricultural businesses, that an alternative cost model may also be appropriate for the needs of users.

**Appendix I: Responses to Specific Questions**

Therefore, we recommend that the proposals are redrafted to contain an accounting policy choice for either a cost model (based on Section 13 Inventory and Section 17 Property, Plant and Equipment) or a valuation model (in line with the requirements of IAS 41). This would appear to be an appropriate pragmatic solution for UK reporters in the short to medium term, whilst allowing potential scope for future change to the accounting for agricultural activities as part of the IASB agenda consultation.

**Response to part (b) - Service Concession Arrangements**

We do not believe that the proposals are sufficient to meet the needs of preparers because they are based on the IFRS for SMEs and are not comprehensive enough.

A preparer would need to refer to IFRIC 12 in order to apply paragraphs 34.12 to 34.16 in an adequate manner.

We believe that certain aspects of the requirements of IFRIC 12 'Service Concession Arrangements' should be added to the section on Service Concession arrangements as follows:

- Clarification of the treatment of the operator's rights over the infrastructure (IFRIC 12 (11))
- Construction or upgrade services (IFRIC 12 (14))
- Contractual obligations to restore the infrastructure to a specified level of serviceability (IFRIC 12 (21)) (Cross refer to section 21 of the proposals)
- Guidance on borrowing costs (Cross refer to section 25 of the proposals)
- Items provided to the operator by the grantor (Cross refer to section 24 of the proposals).

Further, we believe that the transitional exemption 35.10(i) for service concession arrangements is not particularly clear or helpful as currently drafted because it only states what is not required. We recommend that a clear transitional requirement is included reflecting specifically how a first time adopter would account for service concession arrangements entered into before transition, supporting scenarios where FRS 5 or IFRIC 12 had been previously applied.

**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 to part (a)**

In our view, the proposals contain sufficient minimum guidance for Retirement Benefit Schemes.

Preparers will however need to be guided by a SORP in order to minimise the cost burden of applying the requirements in practice and to achieve consistency in reporting. We are therefore pleased that a decision has been made to retain a Pensions SORP.

We do believe that drafting of the part of section 34 that deals with retirement benefits could be improved. Please refer to our drafting observations in Appendix II.



**Appendix I: Responses to Specific Questions****Response to part (b)**

We agree with the proposed disclosures about the liability to pay pensions benefits.

**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 line with our response letter on FREDs 43 and 44 we do not believe that the current proposals should contain a disclosure exemption for transactions between wholly-owned group undertakings.

IAS 24 does not contain such an exemption and we believe that the reporting of related party transactions is an area in which UK GAAP should converge fully with IFRS.

There is great potential for intra group transactions to be undertaken that mask the true operating performance of an entity.

Users of an individual set of accounts need to be aware of the effect of related party transactions on both financial position and performance.

**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 of the proposals. However, we question why entities which are not affected by a SORP should not be able to apply the requirements for accounting periods commencing earlier than the date of issue of the FRSs.

We believe that the ASB should reconsider its proposals in order to allow earlier adoption for entities not affected by a SORP.

**QUESTION 9**

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

**Response**

We do not agree with the overall observations in the alternative view for many of the reasons as set out in our letter of 28 April 2011 in response to the consultation on FREDs 43 and 44.

We do however agree with certain themes, in particular that high quality and understandable financial reporting should be a 'given' and not a specific objective of the project, and that share based payment accounting could be simplified further.

## Appendix I: Responses to Specific Questions

Whilst the alternative view advocates more simple forms of reporting, in terms of the overall proposals, we note that certain aspects are not detailed enough. In particular, we believe that FRED 48 should contain specific additional guidance or references on the following matters:

- Lease incentives (SIC 15)
- Transfer of Assets from Customers (IFRIC 18)
- Barter transactions involving advertising services (SIC 31)
- Treatment of software used in operations (either as tangible or intangible assets)
- Interim Financial Reporting and Impairment (IFRIC 10)
- The effect of the limit on defined benefit assets, minimum funding requirements and their interaction (IFRIC 19).

Further, we believe that the legal appendices that exist in current UK GAAP, to the extent that they remain relevant to these proposals, should be transferred to the final version of the new standards. This is important and useful information which forms guidance as to how financial reporting complies with Company Law and helps to reduce complexity for preparers.



## THE FUTURE OF FINANCIAL REPORTING IN THE UNITED KINGDOM FINANCIAL REPORTING EXPOSURE DRAFTS ("FREDs") 46, 47 and 48

### Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

This particular appendix includes some of our more key detailed drafting observations which are not already covered in Appendix I. Such observations have not been ranked in any particular order but largely reflect their order of appearance in the proposals.

Table 1: FRED 46 and FRED 47

Section	Specific Matter	Observation	Recommendation
FRED 46	Statement of compliance  11, 12 and 13 FRED 47 (7c) FRED 48 1.11(c)	The statements as noted in paragraphs 11, 12 and 13 would appear to suffice as disclosures for a statement of compliance.  It was unclear whether the disclosures in FRED 47 7(c) and FRED 48 1.11(c) were in addition to or repeating those in FRED 46.	We believe that both paragraph 7(c) of FRED 47 and 1.11(c) of FRED 48 are not entirely necessary and would lead to clutter. These paragraphs should be deleted.  If retained then all of the statement of compliance requirement should either be in FRED 46; or in FRED 47 and FRED 48 as appropriate.  The current wording of FRS 101 7(c) and FRS 102 1.11(c) could lead to unnecessary boiler plate - simply repeating the exemption in the standard. It is unclear what is being asked for.
FRED 46 Abbreviations and Definitions	Layout FRED 46 (3,4,5,6) Appendix I: Glossary	Terms are defined at the front but then there is an Appendix I: Glossary.	The defined terms that are used should be recorded in one place, preferably the appendix. This would also avoid unintentional differences. For example in defining a qualifying entity the FRS 100 paragraph 4 definition refers to financial statements which "are intended to give a true and fair view" and the definition in the glossary in FRS 100 Appendix I refer to "financial statements which give a true and fair view".  It is not clear whether all of the defined terms listed are actually used in FRED 46. The Small Companies and Groups (Accounts and Reports) Regulations 2008 do not get specifically mentioned.  Our preference would be that a single glossary is provided in FRS 101 which applies to all of the three FRSs.  There are many instances where the FREDs do not follow this convention.
FREDs 46, 47 and 48	Abbreviations and Definitions	The convention appears to be that when a defined term is first stated then it is included in bold.	
FRED 47 Reduced disclosure framework and	Shareholder objections  7(a)	The second sentence of paragraph 7(a) refers to a shareholder in the singular. We presume it is intended that a number of shareholders who together hold the requisite number of shares should be entitled to object.	We believe that this sentence should be amended to refer to a shareholder or shareholders that together hold the relevant amounts of shares referred to in that sentence.  A similar amendment is required to FRED 48 paragraph 1.11(a).

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

Section	Specific Matter	Observation	Recommendation
shareholders			
FRED 47	Negative Goodwill AG1(c) A1.10	Paragraph 34 of IFRS 3 'Business Combinations' is amended such that a gain on a bargain purchase is accounted for in a similar way to negative goodwill under FRS 10 'Goodwill and Intangible Assets' rather than in accordance with IFRS 3.  Conversely paragraph A1.10 of FRED 47 allows a true and fair override approach in order to retain the accounting in IFRS 3 whereby goodwill is not amortised, in a departure from the Regulations.  There is an additional sentence at the end which is not marked as an addition.	Consideration should be given as to whether a true and fair override could be applied to negative goodwill in order to preserve IFRS treatment.
FRED 47	AG 1 (e)	There is an additional sentence at the end which is not marked as an addition.  We assume that specific reference is made to Schedule 2 to the Regulations (SI 2008/410) because that permits a liquidity basis to be used. However it would seem equally appropriate to say that an entity within the scope of Schedule 1 or Schedule 3 should use a format set out in the relevant Schedule (e.g. FRED 48 4.2).	The amendments to IFRS should be checked to ensure deletions and insertions are correctly marked up.  Make reference to the other Schedules.
FRED 47 Appendix I: Note on Legal Requirements A1.8	Formats and IAS 1 Statement of Financial Position Paragraph A1.8	The legal appendix note states:  "IAS 1 is predicated on the basis of a 'current/non-current distinction', which is not always consistent with the 'fixed assets; current assets; creditors: due within one year; creditors: due after more than one year; provisions for liabilities' presentation set out in the Regulations."  "For example, qualifying entities will need to exercise care around the presentation of long term debtors, deferred tax and provisions to ensure compliance with company law; the presentation in their individual accounts may be different from that prepared for group consolidation purposes in accordance with EU-endorsed IFRS."	FRED 47 should be clearer in respect of how a balance sheet and statement of comprehensive income should be drafted in order to comply with company law. Further, the application guidance should be expanded so as to assist preparers in presenting primary statements.
FRED 47 Appendix I: Note on Legal Requirements A1.8 to A1.13	Formats and IAS 1 Statement of Financial Position Paragraphs A1.8 to A1.13	Whilst these paragraphs cover legal requirements they are important elements of application guidance to the reduced disclosure framework.	Paragraph 4.3 of FRED 48 requires that "An entity shall present additional line items, headings and sub-totals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position." Similar requirement should be included in FRED 47.  The specific requirements discussed should also be included (or clearly cross referenced) from the Application Guidance.

**Appendix II: Key Drafting Observations and  
Recommendations - Entities (Other than Public Benefit Entities)**

**Table 2: FRED 48**

Section	Specific Matter	Observation	Recommendation
Section 2 Concepts and Pervasive Principles	Intermediate Payment Arrangements	Paragraphs 2.53 to 2.56 present particular accounting requirements and are not concepts or pervasive principles.	We believe that the requirements for Intermediate Payment Arrangements should be included in Section 9.
Section 4 4.7	2.53 - 2.56 Creditors: Amounts falling due within one year	There is no specific guidance for covenant breaches.	Please see further comments regarding intermediate payment arrangements below on our comments on section 9. We believe that paragraphs 50A to 50E of FRS 25 should be inserted into the proposals.
Section 9 Consolidated and Separate Financial Statements	Consolidation Exemption Small Companies 9.2	The Companies Act 2006 exempts a parent that is a small company from preparing consolidated financial statements. If a small parent adopts FRED 48 it unclear whether or not 9.2 would override the Act and require consolidated accounts to be presented.	This should be clarified.
Section 9 Consolidated and Separate Financial Statements	Subsidiaries excluded from consolidation 9.9(a) 9.9B 9.9	Paragraph 9.9(a) excludes a subsidiary from consolidation where severe long term restrictions substantially hinder the exercise of rights of the parent over the assets or management of the subsidiary. Paragraph 9.9B then requires that an accounting policy is selected for such subsidiaries in accordance with paragraph 9.26. There may be instances whereby significant influence is retained depending on the facts and circumstances of the restriction. In such cases FRS 2:27 requires equity accounting to be used. Paragraph 9.26 does not permit such an approach. It is unclear why equity accounting is not permitted where significant influence exists.	We recommend that the requirements of paragraph 9.26 are amended such that equity accounting would be required where significant influence is retained.  Further, the wording of paragraph 9.9B should be amended to clarify that it is the parent of a subsidiary that is not being consolidated that is required to make the accounting policy election under paragraph 9.26.
	Subsidiaries excluded from consolidation - investment companies 9.9(b)	This paragraph states that "A subsidiary should be excluded from consolidation where the interest in the subsidiary is held exclusively with a view to subsequent resale and the subsidiary has not previously been consolidated in the consolidated financial statements." The definition of held exclusively with a view to subsequent resale has been extended from that in FRS 2: 11 to include held as part of an investment portfolio.	If may be that subsidiaries that did not fall to be treated as held exclusively with a view to subsequent resale under FRS 2 will under FRED 48. However they will have been previously consolidated. There are no transitional provisions to deal with these cases. We would welcome clarification in the transition requirements of FRED 48.

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

Section	Specific Matter	Observation	Recommendation
	Subsidiaries excluded from consolidation - investment companies	This paragraph (subject to meeting paragraph 9.9(b)) excludes a subsidiary from consolidation where it is held as part of an investment portfolio requiring that subsidiary to be accounted for through profit or loss.	Where paragraph 9.9A is applicable then such investments should also be accounted for at fair value through profit or loss under paragraph 9.26 (c) in the parent's separate financial statements. This would be consistent with treatment in IAS 27(40) (see comments on associates and joint ventures below).  Certain application issues may arise for example: <ul style="list-style-type: none"> <li>Can a basket of investments contain only one subsidiary?</li> <li>What if an investment company sells all of its investee subsidiaries except for one?</li> </ul>
	9.9A		We believe that the proposals should address such situations.  It is not conceptually clear why separate financial statements of a parent should differ to the financial statements of an entity that is not a parent with regard to intermediate payment arrangements.
	Consolidation of SPEs and interaction with intermediate payment arrangements	Paragraph 9.11 states that: "Except as permitted or required by paragraph 9.3, a parent entity shall prepare consolidated financial statements that include the entity and any SPEs that are controlled by that entity."  Paragraph 9.25 states that: "An entity that is not a parent but facilitates employee shareholdings under remuneration schemes, such as Employees Share Ownership Plans (ESOPs) applies paragraphs 2.53 to 2.55 to such arrangements."  The ASB state in Part 3: Development of the FRSs (Section 1) paragraph 5.16 that:  "In clarifying the requirements for consolidation, the ASB noted that the accounting treatment for employee benefit trusts ESOP or similar arrangements would give rise to a change in accounting from current FRS. The removal of UTF 38 'Accounting for ESOP Trusts' would mean that such arrangements would no longer be included in individual financial statements but at consolidation level. However the ASB decided to retain the accounting from UTF Abstract 32 'Employee Benefit Trusts and other intermediate payment arrangements'. As a consequence where the entity is not a parent it will apply these requirements, now included in section 2 of FRED 48."	We believe that the requirements of paragraphs 2.53 to 2.55 should apply equally to parent entities and non-parent entities, and as such the requirements of UTF 38 should be retained.
	9.11 9.25		
	Disposal of subsidiaries	This paragraph requires that the difference between: " (a) the sum of the proceeds received from the disposal plus the fair value of any retained interest, and (b) the carrying amount as of the date of disposal..."	The "sum of the proceeds received" should be replaced by "the fair value of the consideration receivable".
	9.18A		

**Appendix II: Key Drafting Observations and  
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Section	Specific Matter	Observation	Recommendation
	Cost 9.26	Cost is not defined and this lack of definition may lead to application issues.	Cost should be defined in the glossary.
	Fair Value Disclosure 9.27B	This paragraph states that: "Where a parent adopts a policy of fair valuing investments in subsidiaries, associates and joint ventures at fair value with changes in fair value recognised in profit or loss it is required to make disclosures under paragraph 11.48A."  Paragraph 11.48A itself does not contain disclosures that are aligned the accounting for investments at fair value.	Paragraph 9.27B should instead refer to paragraphs 11.43 and 11.48A and also paragraphs 34.17 to 34.30 to the extent relevant. In this context we note that sections 14 and 15 refer a preparer which holds associates and/or joint ventures at fair value to paragraphs 11.43 and 11.44.  Further, the basis of the disclosures appears to stem from paragraph 36(4) of Schedule 1 to the Regulations [S(2008/410)] which would apply to non-parent companies also.
Section 11 Basic Financial Instruments	Equity Instruments 11.14(c)	This paragraph requires investments in equity instruments to be accounted for at fair value with changes in fair value recognised in profit or loss.  Both IAS 39 and IFRS 9 permit a designation to allow changes in fair value through other comprehensive income.  Investments in subsidiaries, joint ventures and associates in certain circumstances may be accounted for at fair value with changes in fair value recorded as revalued PPE or through profit or loss.  The impairment of financial assets section omits discussion of events that are NOT NECESSARILY an indication of an impairment of a financial asset, for example in particular credit rating and declines in market values of assets.	An accounting policy choice to permit changes in fair value of equity instruments through other comprehensive income should be permitted to align with the requirements in IFRS 9.
	Impairment of financial assets 11.22		A paragraph should be inserted between paragraph 11.23 and 11.24 similar to IAS 39:60.
	Impairment of financial assets 11.24	Paragraph 11.24 (a) requires the entity to review all equity instruments individually for impairment regardless of their significance.  In accordance with paragraph 11.14(c) some equity instruments will be carried either: <ul style="list-style-type: none"> <li>• fair value, with changes in fair value recognised in profit or loss; or</li> <li>• at cost less impairment.</li> </ul>	Paragraph 11.24 (a) should be clarified so that it is required to be applied to equity instruments that are carried at cost, less impairment.
		For equity instruments carried continually at fair value we do not	

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

Section	Specific Matter	Observation	Recommendation
		believe that impairment is a particular issue, on the basis that the fair value measurement and its recording in profit or loss would cover impairment.	
	11.44	This disclosure requirement is only mandated for equity instruments.	The disclosure requirement should be amended so that it also addresses contracts linked to equity instruments.
	11.48(c)	The disclosure requirement is for impairment by each class of financial asset.	Class of financial instrument should be defined in the glossary. The definition is only included in paragraph 34.20.
	11.42 11.48A(f)	These disclosure requirements should be mandated for all entities to the extent material.	Paragraph 11.42 and 11.48A (f) appear to be key principles for all entities in terms of financial instruments disclosures. These disclosure requirements should be stated up front. The more detailed disclosure requirements should be drafted to follow in support of these principles.
		Further, paragraph 34.23 is a principle which should be stated up front; however this requirement is also covered by paragraph 11.48A.	
	34.19	The disclosure requirement in paragraph 34.19 is already included in section 11 - 11.42.	Paragraph 34.19 should be deleted.
	34.26	This paragraph will require a maturity analysis of financial assets that are individually determined to be impaired.	IFRS 7 (37) (b) requires an age analysis of financial assets that are past due but not impaired. We do not believe that a maturity analysis of impaired financial assets would be useful information. Paragraphs 34.26(a) and (b) should be drafted to reflect the requirements of IFRS 7 37(a) and (b).
	34.28	The maturity of financial liabilities is critical information for users to understand future cash flows. The proposals only mandate this for financial institutions.	This is important information for all entities.
Section 14 Investments in Associates	Equity accounting 14.4A 14.4B	Paragraph 14.4A states that an investor parent shall equity account for its investments in associates in consolidated accounts.	Further, IFRS 7 39(c) requires disclosure as to how the risk inherent in the maturity analysis is managed. This disclosure requirement should be included.
Section 15 Investments in Joint Ventures	15.9A 15.9B	Paragraph 15.9A states that a venturer parent shall equity account for its investments in associates in consolidated accounts.	The linkage between 14.4A and 14.4B (and 15.9 A and 15.9B) are not perfectly clear. Paragraph 14.4A needs to be linked to 14.4B so that the applicable accounting is clearly laid out.
	Fair value model 14.10 15.14	The paragraph 14.9 - 14.10 fair value model requires an investor which is not a parent to account to record gains or losses in a similar manner to PPE revaluations.  Paragraph 15.14 contains the same requirements for a venturer which is not a parent.	Further, where paragraphs 14.4B and 15.9B are relevant we believe that such investments should also be accounted for at fair value through profit or loss in the investor's separate financial statements. This would be consistent with treatment in IAS 27(40).  In separate financial statements we believe that the accounting policy choices that exist for a parent should be the same for an entity which is not a parent.
	Fair value model Undue cost or effort 14.10	These paragraphs will allow cost under a fair value approach for a particular investment where "it is impracticable to measure fair value reliably without undue cost or effort".	Therefore the accounting policy elections in paragraph 9.26 should be available to non-parents also. We do not understand why the proposals would preclude an investor in an associate or joint venture from fair valuing its investment through profit or loss if it could do so if the investor also had a subsidiary.  On the basis that the scope of FRED 48 could apply to certain listed companies the concept of undue cost or effort does not fit well.  References to undue cost or effort should be removed; this given that such



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Section	Specific Matter	Observation	Recommendation
	15.14		companies could elect to account for investments at cost under paragraphs 14.4 and 15.9 in any case.
Section 16 Investment Property	Measurement and Undue cost of effort 16.7	Current UK GAAP is silent on this matter.  We are concerned that this will create short cuts to application in practice leading to divergence, difficulty for auditors to implement, and also will reduce comparability.	We recommend that the wording regarding undue cost or effort is removed from paragraphs 16.1, 16.4 and 16.7 of FRED 48. We note that the FRSE contains no such exemption.  Instead of paragraph 16.8, paragraphs 53, 54 and 55 of IAS 40, as relevant to investment property should be included in FRED 48. We also note that paragraphs 17.15B (revaluation of property, plant and equipment) and 18.18B (revaluation of intangible assets) do not contain an exception for undue cost or effort.
	Group Companies and Scope Section 16	Unlike IAS 40, FRED 48 does not contain a definition of owner-occupied property.  SSAP 19 8(b) states that a property let to and occupied by another group company is not an investment property for the purpose of its own accounts and the group accounts. As currently drafted it is not entirely clear what accounting treatment FRED 48 would require in individual financial statements.	We recommend that paragraph 8 (b) of SSAP 19 is added to the end of paragraph 16.2 in order that a property let to and occupied by another group company is not treated as investment property in individual financial statements. This accounting treatment would be less complex to apply in practice and would follow existing UK GAAP as opposed to IAS 40.
Section 17 Property, plant and equipment	Compensation for impairment 17.25	This paragraph has been amended so that compensation for impairment is not recognised until 'virtually certain'.  Both IAS 16(65) and IFRS for SMEs (17.24) require recognition of such compensation when it is receivable.	It is not clear why there now exists a GAAP difference between FRED 48 and EU-endorsed IFRS and the IFRS for SMEs in respect of this.
	Revaluation disclosures 17.32A	We believe that the disclosure requirements in this paragraph do not address the significance of valuation methodologies and assumptions.	We believe that the recognition requirement should be the same as EU-endorsed IFRS. We recommend that the following additional disclosure requirements are included: <ul style="list-style-type: none"> <li>the extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques.</li> </ul>

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

Section	Specific Matter	Observation	Recommendation
	Web-site costs	FRED 48 contains no guidance on website costs. Many entities within the scope of FRED 48 have either developed or will develop web-sites for a variety of reasons (for example advertising/promotion/specific revenue generation e.g. on line sales).	Divergence in the accounting treatment of web-site costs may arise.  Additional guidance should be included in FRED 48 with regard to the accounting treatment of web site costs.
Section 18 Intangible Assets other than goodwill	Examples of expenditure that cannot be capitalised	With the intended withdrawal of UITF 29 'Website Development Costs' preparers may need to look at SIC 32 Intangible Assets - Web Site Costs.  The paragraph 18.15 used to state initially "As an example..." in the opening sentence. This wording differs from IAS 38.	The wording of this sentence should be clearly aligned to IAS 38 (68) otherwise preparers may consider 18.15 to be an exhaustive list. We assume that is not the intent.
	18.15		
	Revaluation disclosures	We believe that the disclosure requirements in this paragraph do not address the significance of valuation methodologies and assumptions.	Disclose additionally: <ul style="list-style-type: none"> <li>the carrying amount of the revalued intangible assets</li> <li>the methods and significant assumptions applied in estimating the fair values.</li> </ul>
	18.29A		
Section 19 Business Combinations including goodwill	Separation of intangible assets 19.15(c)	This paragraph requires the separation of the fair value of acquired identifiable intangible assets from goodwill when their fair value can be measured reliably.  On the basis that FRED 48 will require goodwill to be amortised over a potentially short useful life of 5 years (where an entity is unable to make a reliable estimate of the useful life), then it appears to be an excessive exercise for preparers to incur significant external cost in order separate out intangible assets which will also be amortised.	In order to reduce complexity we believe that Section 19 should be amended so that it will not require the separation of identifiable intangible assets from goodwill.  On the basis that the requirements for goodwill accounting do not follow IFRS the process feels largely un-necessary because: <ul style="list-style-type: none"> <li>If negative goodwill arises this will be credited to profit or loss in similar periods over which intangible assets are amortised</li> <li>If positive goodwill arises then the intangible that would otherwise arise will be amortised to profit or loss over a similar period to goodwill amortisation.</li> </ul>
	Goodwill 19.23 Transition	This paragraph states that if an entity is unable to make a reliable estimate of the useful life of goodwill, the useful life shall be presumed to be 5 years.	Whilst there is useful application guidance on the ASB website for an entity which has goodwill at transition with a remaining life of less than five years additional guidance should be developed for an entity which has goodwill at transition with a useful life under FRS 10 in excess of 5 years (say 12 years) so that preparers can understand how to implement FRED 48 in such a situation.
	Negative Goodwill 19.24	Neither section 19 nor section 4 states the specific presentation requirements for negative goodwill in the statement of financial position.  Paragraph 'm' in the summary to FRS 10 clarifies the presentation treatment of negative goodwill under UK GAAP.	A similar paragraph should be added following paragraph 19.24(b) of FRED 48.  Further, a clarification should be added following paragraph 19.24(b) stating that: "Goodwill (positive or negative) arising on a single transaction should not be

**Appendix II: Key Drafting Observations and  
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Section	Specific Matter	Observation	Recommendation
			divided into positive or negative components.”
			An additional disclosure should be added to the above as follows: “19.25(h) In addition disclose: (iii) the financial statements should disclose the periods over which negative goodwill is being released (per 19.24(b))”
	Acquisition and Results 19.25 19.25A	Paragraph 19.25A requires disclosure in aggregate or separately for each material business combination the revenue and profit or loss since acquisition included in consolidation.	The aggregation requirement is inconsistent with paragraph 19.25 which requires specific disclosure for each business combination.
Section 20 Leases	Lessee and lessor disclosures 20.16 All disclosures	Paragraph 20.16 (c) has been deleted however such disclosure is required for lessors.  The Disclosure requirements are too simple for some entities in the scope of FRED 48.	We believe that the disclosures should be made separately for each material business combination. We believe that the disclosure requirements should be consistent with IAS 17.
	Operating Leases - Escalating Leases 20.15 20.25	Lessees and Lessors  FRED 48 includes paragraph 20.15(b) for lessees and 20.25(b) for lessors which proscribe the accounting treatment for escalating leases in particular situations where they are linked to inflation. No such requirements are contained in either UK GAAP or IAS 17.  The inclusion of paragraphs 20.15(b) and 20.25(b) will mean that FRED 48 treatment for operating leases in the financial statements will diverge from existing IFRS requirements.  There is no guidance in FRED 48 on lease incentives. Applicable guidance in UK GAAP would be withdrawn. Lease incentives are a common area of lease transactions.	For lessees, paragraph 20.15 of FRED 48 should be based upon the requirements of IAS 17(33) and (34).  For lessors paragraph 20.15 of FRED 48 should be based upon the requirements of IAS 17(49) to (55).  The above would be subject to amending the terminology of wording of paragraph 54 of IAS 17 so that it reflects the requirements of section 27 of FRED 48.
	Lease Incentives Section 20 Possibility to reduce complexity for certain entities		FRED 48 should be amended to reflect the principles of SIC 15.
Section 26 Share Based Payment	Section 26	FRS 20 for private companies has not been a positive step, often the valuation methods are differing and the accounting results are less meaningful.  A share based payment charge has more meaning where the entity has equity securities that are traded on an active market.	Whilst the ASB has taken steps to simplify the proposals we would recommend, in order to reduce complexity, to draft the share based payment section to be entirely based on FRSSE with the exception of entities with equity shares listed on a market which would apply IFRS 2 methodology.
Section 26	Group share based	FRED 48 requirements permit the subsidiary to measure the share-	We believe that the accounting requirements for group share based payment

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

Section	Specific Matter	Observation	Recommendation
Share Based Payment	Payment arrangements 26.16	based payment expense (and the related capital contribution by the parent) on the basis of a reasonable allocation of the expense recognised for the group.	arrangements should be drafted entirely on the basis of what is contained in IFRS 2. There should be no divergence in practice in this area and IFRS 2 contains an adequate basis for group entities to reflect the charge. We are concerned that in practice that different reporters may apply differing methodologies.
Section 28 Retirement Benefits	Undue Cost or Effort for Defined Benefit Schemes. 28.18 28.19	Companies in the UK with retirement benefit scheme are already used to either accounting for such schemes under IAS 19 or FRS 17. We are concerned that an alternative approach on the basis of "undue cost of effort" is unnecessary and has the potential to create short cuts to application in practice therefore leading to divergence and a reduction in comparability.	The 'undue cost or effort' measurement exemption in paragraphs 28.18 and 28.19 should be removed. Certain listed companies will now be under the scope of FRED 48. The majority of reporters will already be applying the measurement requirements of FRS 17.
	Reconciliations for Defined Benefit Schemes 28.41(e)	The disclosure requirements are short. Certain important line items could become omitted or aggregated.	The FRSSE contains no such exemption. We believe that the disclosure requirement should be improved such that material reconciling items would require disclosure.
	Disclosures for Defined Benefit Schemes 28.41	There are no sensitivity disclosures provided for as is in the case of FRS 17 and IAS 19. There are no disclosures about specific risks (see IAS 19 (139)(b)).	Disclosure of risk and sensitivity should be required by FRED 48 reporters based on clear principles so that users can understand the impact of reasonably possible changes to assumptions.
Section 29 Income Tax			
	Definition of timing differences 29.6	The definition of timing differences used in 29.6 differs to the definition used in the glossary of terms.	The correct definitions should be applied consistently. Further, all defined terms should be bold.
	Enactment/ substantive enactment 29.12	There is useful guidance in UK GAAP regarding the process of enactment in UK.	Paragraph 15 of FRS 16 should be retained.
	Guidance Section 29	Deferred tax can be a difficult concept for preparers.	Application Guidance should include some common examples so that the requirements are understood.
	Disclosure	Regarding the requirement to disclose:	Paragraph 29.27(b) should be replaced by the requirements of IAS 12.81(c)

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Section	Specific Matter	Observation	Recommendation
	29.27(b)	<p>"An explanation of the significant differences in amounts presented in the statement of comprehensive income and amounts reported to tax authorities" this is an onerous requirement. Further, amounts may not have yet been reported to tax authorities at the time that financial statements are authorised for issue.</p>	<p>regarding a tax reconciliation.</p>
	Disclosure 29.27(c)	<p>There is no such disclosure requirement in IAS 12.</p> <p>Regarding the requirement to disclose "A statement, for at least the next three years, of expected significant differences between the current tax charge and the standard rate of tax applied to the reported profit or loss for the period and a brief explanation of the reasons for those differences."</p> <p>This disclosure requirement appears quite onerous and forward looking.</p>	<p>This requirement does not appear particularly useful. Circumstances may change in future periods.</p> <p>The wording in paragraph 64(b), (c), (d), (e) of FRS 19 should be used instead as adapted for the requirements of FRED 48.</p>
Section 34 Retirement Benefit Plans: Financial Statements	34.31	<p>It is not clear why paragraph 34.31 is included under the heading of Defined Contribution Plans.</p>	<p>We believe that this paragraph is relevant to all retirement benefit plans and therefore this paragraph should appear above the defined contribution plan heading.</p> <p>Further, we believe that paragraph 34.31 should be reworded such that it reads in a consistent manner to IAS 26 (2) such that "the requirements of FRED 48 apply to the extent that they are not superseded by paragraphs xx.xx to xx.xx which apply to Retirement benefit Schemes".</p>
	34.31	<p>FRED 46 Appendix A2.19 states that the accounts of pension funds within the scope of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a statement from the Auditor) Regulations 1996 ('the pensions regulations') are required to show a true and fair view of the transactions during the year, assets held at the end of the year and liabilities of the scheme, other than those to pay pensions and benefits.</p>	<p>This particular requirement should be clearly stated or referred to in the relevant part of section 34 to FRED 48 in order to set the scene for the overall requirements of the section.</p> <p>Also, conceptually (in terms of the concepts and pervasive principles) FRED 48 would appear to require the inclusion of the liability to pay pension benefits. The ASB, in the section dealing with the development of the standard should include the reasoning as to why the liability to pay pension benefits is not included in the requirements in Section 34.</p>
	34.39	<p>The proposals require a defined benefit scheme to account for the net assets available for benefits at fair value but only cross references to the financial instruments section for fair value information.</p>	<p>Further cross referencing should be made to investments in subsidiaries, associates and joint ventures and investment properties, and other fixed assets to the extent that FRED 48 includes a fair value accounting requirement or option.</p>

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

Section	Specific Matter	Observation	Recommendation
	Defined Terms	Certain terms should be clearly defined and emboldened as necessary.	The following terms could be derived from IAS 26 'Accounting and Reporting by Retirement Benefit Plans') and included in the glossary of terms: <ul style="list-style-type: none"> <li>• net assets available for benefits</li> <li>• funding</li> <li>• actuarial present value of promised retirement benefits.</li> </ul>
Section 34 Transition	Deferred Tax 35.10(n)	This paragraph reflects an approach under IAS 12 with regard to temporary differences (for example the differences between the tax bases and the carrying amounts of assets and liabilities).	The proposals should be updated to reflect the wording of the revised section 29 on income taxes. Further, references to undue cost or effort should be removed. Differences arising on transition should not be overly complex.
	Separate Financial Statements - deemed cost of investments in subsidiaries, associates and joint ventures	IFRS 1 would also permit a fair value at date of transition to be a deemed cost.	As a matter of consistency with IFRS 1 and with the treatment of property on acquisition this choice should also be permitted.
Appendix I	35.10(f) Amendments to IFRS for SMEs Section 12	Section 12 (paragraph 12.23) requires that the cumulative amount of foreign exchange differences relating to hedge of a net investment in a foreign operation is not reclassified to profit or loss on disposal or partial disposal.	Appendix I Section 12 needs to be redrafted in order to reflect the requirements of paragraph 12.23. There is a 'not' missing in the appendix.
Appendix II	Table of Equivalence of terminology	The paragraph preceding this table refers to minor differences between broadly equivalent definitions.	Revenue, as defined in FRED 48 and EU-endorsed IFRS has a different meaning to the definition as provided in the Companies Act 2006 [s474 (1)].

**Appendix II: Key Drafting Observations and  
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**Table 3: Consequential Amendments to the FRSSE (Pages 15 to 21 of Part Two: The Draft Standards)**

Section	Specific Matter	Observation	Recommendation
Consequential amendments to the FRSSE	Financial Institutions Status of FRSSE (9)	The scope of the FRSSE has not changed.	Part 4: Section II - 4.12 appears to suggest that a financial institution will be required to apply FRS 102.  There is no indication in the FRSSE that a Financial Institution (other than such an institution scoped out of the Small Companies Regime) cannot apply the FRSSE.
	Disclosures Status of FRSSE (1)	The revised paragraph will delete "The disclosure requirements exclude a number of those stipulated in other accounting standards".	We are not sure whether the above comment requires a change in scope to the FRSSE, or whether the comment was intended.
	Small entities requirements Status of FRSSE (1)	Paragraph 1 states for the generality of small entities the requirements "are the same as those previously required by other standards or a simplified version of the requirements".	We are not so sure why this sentence has been deleted. It still appears to be applicable.
	Status of the FRSSE Status of FRSSE (4)	This paragraph states that "The only significant differences between this version of the FRSSE (effective January 2015) and the FRSSE (effective 6 April 2008) are in respect of the revised reporting framework introduced to the UK effective [January 2015]..."	This is not true in the context of goodwill amortisation (see below), or a requirement to review fixed assets annually for impairment.
	Hierarchy for transactions or events not dealt with in the FRSSE Status of FRSSE (5)	The FRSSE does not contain a conceptual framework. It relied on the ASB Statement of Principles which will be withdrawn.  The hierarchy for transactions or events not dealt with in the FRSSE is therefore: <ul style="list-style-type: none"><li>the entity's own accounting policies</li><li>FRS 102, but only as a means of "establishing current practice".</li></ul>	It would be of more help to preparers to refer to the specific amendments: <ul style="list-style-type: none"><li>Dealing with new transactions and events</li><li>Amortisation of goodwill and intangible assets</li><li>Annual reviews for indicators of impairment</li><li>Revisions to related party disclosure requirements.</li></ul> More detailed application guidance should be given for the implementation of the requirements for goodwill amortisation. This will be a significant amendment for many FRSSE preparers.  Referring to a document in a non-mandatory way in order to establish current practice is in effect "mandating the approach". The hierarchy also falls short of what exactly a preparer does when it has "established current practice".  The hierarchy should refer to the following order: <ul style="list-style-type: none"><li>the entity's own accounting policies</li><li>areas of the FRSSE that deal with similar matters</li><li>FRS 102 as a means of establishing current practice - to apply in the preparation of the financial statements.</li></ul> However when dealing with FRS 102 additional comment should be made to the extent that:  "Care is needed with regard to current practice on accounting for financial

## Appendix II: Key Drafting Observations and Recommendations - Entities (Other than Public Benefit Entities)

			instruments to the extent that FRS 102 application may invoke fair value accounting for financial instruments. Where accounting of this nature is consequently applied then an entity would not be permitted to apply the FRSSE."
			Inconsistent application will arise for entities that did not have their own accounting policies dealing with a range of matters (for example consolidation).
			There is no consequential amendment to the transition paragraphs in section 19 of the FRSSE to cater for this change so it would be unclear how a company would apply the revised requirements on transition. Implementation guidance should be included for FRSSE preparers.
Goodwill amortisation Paragraph 6.13 of FRSSE	The FRSSE will contain the requirement that "if an entity is unable to make a reliable estimate of the useful life of goodwill or intangible assets, that life shall presume to be five years".		It is not clear in such circumstances what an entity would exactly be required to do when applying FRS 102 which contains complex requirements.
Consolidated Financial Statements	Where the reporting entity is preparing consolidated financial statements, it should have regard to paragraph 5 of the status of the FRSSE as a means of developing its policies and practices for the preparation of consolidated financial statements.  The hierarchy in paragraph 5 now refers to: <ul style="list-style-type: none"><li>the entity's own accounting policies</li><li>FRS 102, not as a mandatory document, but as a means of "establishing current practice".</li></ul>	The application guidance should be made clearer in a bid to reduce complexity for small companies.  Further transitional guidance should be included in the FRSSE based on the requirements of FRED 48 paragraph 35.10(a) which does not require the restatement of business combinations before the date of transition.	
Early adoption of the FRSSE Paragraph 16.2 of FRSSE  FRED 46 (14) FRED 47(10) FRED 48(1.14)	The FRSSE (2015) is stated to be applicable for periods beginning on or after 1.1.2015 with early adoption being permitted.  Neither FRED 46, 47, nor 48 permit early adoption at a date before the issue of the FRSs 100-102.	On the basis that the FRSSE (2015) is introduced to coincide with the requirements of the FREDs, then the early adoption criteria for the FRSSE (2015) should be the same as those of the FREDs.	



## THE FUTURE OF FINANCIAL REPORTING IN THE UNITED KINGDOM FINANCIAL REPORTING EXPOSURE DRAFTS ("FREDs") 46, 47 and 48

### Appendix III: Public Benefit Entities (PBEs)

#### 1 Suggested Improvements

We believe that the following suggestions, noted in our response to FRED 45, would further improve the Board's proposals:

- Including guidance for the definition of a public benefit entity by applying the definition to different categories of not-for-profit organisations indicating why any specific category would or would not be a PBE.
- Incorporating illustrative examples of situations where there has and has not been "significant change to the class of beneficiaries of the combining entities" with regards to the use of merger accounting
- Including guidance on the accounting for assets that are held both for their service potential and to generate cash flows.

As the decision has been made not to deal with PBE issues in a separate document, we believe the ASB should give consideration to including aspects of the *Statement of Principles: Interpretation for Public Benefit Entities* in Section 2 of The FRS to ensure that future developments in accounting take into account the needs of PBEs.

#### 2 Key Observations on PBE requirements

We make the following observations with regards to accounting by PBEs which are not the subject of specific consultation questions.

##### 2.1 Definition of a PBE

As noted above, we believe the application guidance previously drafted in relation to the definition of a PBE would have usefully benefitted from further clarification. In light of the decision to remove all application guidance associated with the definition of PBE, we believe that the ASB should include a disclosure requirement for any entity making use of PBE accounting to:

- state in their financial statements the fact that the entity considers itself a PBE;
- and include an explanation of why it is considered a PBE.

##### 2.2 Incoming resources from non-exchange transactions

We do not believe the definitions formulated for "performance conditions" and "restrictions" are appropriate. It could be argued that in principle all donations to charities must be repaid if not applied in furtherance of its charitable objectives. Consequently all donations are subject to "restrictions" as defined in The FRS. The definition of a "performance condition" is more usually referred to in not-for-profit accounting parlance as a restriction. Meanwhile performance conditions (as used in general parlance) refer to conditions that impose on the entity some kind of required level of output rather than the need to merely spend money or apply resources in a specified manner. We believe it would make more sense if the ASB would align its definition of the terms "performance conditions" and "restrictions" with those used in common parlance to avoid unnecessary confusion amongst those tasked with applying and interpreting The FRS.

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Looking more specifically at the required accounting for non-exchange transactions, we do not believe it is appropriate for an entity to only recognise income once it has satisfied “performance conditions” (as defined). To reiterate our comments in FRED 45, a requirement to apply resources in a specified manner is a condition wholly within the control of the recipient entity and, as such, it would seem inappropriate to defer such income on balance sheet as a liability. Given that the inability to recognise income subject to performance conditions (as defined) will represent a very significant change in accounting practice for many PBEs, we believe the ASB should have provided a justification for its proposals in the Basis of Conclusions. We also note that the requirement in paragraph 34.69 to “recognise a liability for any resource with specified performance conditions due to non-compliance with the performance conditions, when that repayment becomes probable” seems only to have relevance if the entity had previously been able to recognise the resource received as income. However, as the draft FRS precludes income recognition until all performance conditions (as defined) have been met, i.e. it must be deferred on balance sheet as a liability, it is difficult to see when paragraph 34.69 would ever be invoked.

We note that the wording used to set out the accounting for recognition of volunteer time as income has been tightened up in FRED 48 compared to FRED 45. However, in our opinion we believe the wording used could be clearer if, as appear to be the case, it is the ASB’s intention to introduce a rule precluding the recognition of volunteer time. E.g. “Volunteer time cannot be reasonably quantified and therefore these services shall not be recognised.” Alternatively, if it is not the intention to preclude recognition of volunteer time in all cases, then we believe this should similarly be made explicit in the guidance. E.g. “It is not expected that contributions made by volunteers can be reasonably quantified, therefore these services shall not be recognised. However, this is not to be interpreted that all entities will be unable to reasonably quantify the value of services provided by volunteers”.

We similarly believe that the guidance provided for legacy accounting is unclear and arguably unnecessary. In particular we are unsure whether the following is intended to be a rule representing the back-stop date, the earliest possible date or the specific point in time, when legacy income should be recognised “[The income recognition criteria for legacies] are normally met following probate once the executor(s) has established there are sufficient assets in the estate, after settling liabilities, to pay the legacy”. Ultimately, the recognition of each legacy should be driven by the need to demonstrate that receipt is probable and its value can be measured reliably. In our opinion, this is a matter of judgement and will depend on the facts and circumstances of each specific legacy. We also consider the first sentence of paragraph 34B.6 will cause confusion when read in conjunction with the paragraph 34B.5, and therefore should be removed. Arguably it enables preparers to simply not recognise legacy income until notification of payment, which may be some time after probate or determination that there are sufficient assets to pay the legacy. Therefore we would prefer the accounting guidance to make it clear whether the recognition of legacy income is driven by a specific rule (which may be desirable from a pragmatic perspective) or whether it is driven by principles of revenue recognition generally. If the latter, then it is perhaps unnecessary for The FRS to try and explain when in the period between death and receipt this will be, as it is unlikely to be the same point in time for every legacy.

**2.3 Distinction between grants and non-exchange transactions**

We note that it is not immediately apparent how an entity should distinguish a grant from a non-exchange transaction. Making the distinction, however, is an important one as the accounting for grants is subject to an accounting policy choice (accrual or performance model) whereas the accounting for the donations does not (performance model only). We believe, therefore, that further guidance (or clarification of the definitions) needs to be

## Appendix III: Public Benefit Entities (PBEs)

provided to distinguish “grants” from “non-exchange transactions” so as to ensure it is clear which of these two sections applies to any particular transaction.

### 2.4 Funding commitments

As with our response to FRED 45, we still do not believe that the guidance on funding commitments is particularly useful. Most funding is provided in advance of the recipient incurring the related expenditure. FRED 48, however, only seems to be addressing commitments to reimburse expenditure already incurred by the intended recipient of the funding given that it only permits recognition of a liability if the intended recipient has satisfied “performance conditions” (as defined). For performance conditions (as defined) to be satisfied, it necessarily requires the recipient to have spent money (i.e. in advance of receiving the funding). We do not believe that there is any real contention over when to provide for liabilities where a promise has been made to fund expenditure already incurred by the intended recipient, as the principles in section 21 on provisions appear adequate.

If guidance is to be provided on the accounting to be applied by a grant-making entity, then we believe this should focus on funding provided in advance of the intended recipient spending the money received, i.e. before they have satisfied performance conditions (as defined). After all, as noted above, most funding is provided in advance of the recipient incurring the related expenditure. Specifically, we believe that guidance is needed to enable a grantor to decide when payment of a grant gives rise to an expense and when it gives rise to a different asset, such as a prepayment. For promises to provide future funding (as opposed to the actual payment of a grant) guidance is similarly needed on when this gives rise to the need for the grantor to recognise a liability (and associated expense), and when it gives rise only to disclosure of a financial commitment. It should be noted that the current accounting treatment would be to recognise both liability and expense when the conditions have passed outside the grant makers control. The proposals will therefore clearly give rise to a significant change in current practice.

The discussion in paragraph 34A.5 refers to submission of a report for review and consideration of how funds *will* be utilised in making an assessment as to whether provision should be made for a funding commitment. This is confusing if, as we identify above, the intention of The FRS is to preclude recognition of liabilities for funding commitment prior to the recipient having satisfied all “performance conditions” (as defined).

### 2.5 Other Drafting Observations

We note that The FRS as currently drafted includes numerous references to “performance conditions”, sometimes emboldened and sometimes not emboldened when discussing the accounting for non-exchange transactions and funding commitments. We presume that wherever the term performance condition is used it is always to be interpreted by reference to the definition and therefore suggest that the term should be emboldened in all cases. However, the guidance also makes use of the undefined term “performance-related conditions” and it is not so clear whether this has a meaning subtly different from the defined term “performance conditions”. Assuming it is intended to have the same meaning, we believe that the terminology should make use of the defined term only.