30 April 2012

Michelle Sansom
Accounting Standards Board
5th Floor, Aldwych House
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London
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Our Ref: SJG

Dear Ms Sansom

Response to Financial Reporting Exposure Drafts 46-48

We welcome the opportunity to participate in this important consultation on the future of UK GAAP.

We have provided a response to the specific questions on which the ASB has requested views as well as providing broader comment that we hope is helpful, particularly in terms of the impact of the proposals on Public Benefit Entities and Pensions Schemes.

Our response is set out in the following appendices:

Appendix 1 – General responses to specific questions in the consultation

Appendix 2 – Specific issues in relation to the proposed standards

Appendix 3 – Specific issues relating to Public Benefit Entities

Appendix 4 – Specific issues relating to Pension Schemes

We trust our comments are helpful and are grateful for the opportunity in participating in the process in developing the UK's financial framework.

Yours sincerely

Steve Gale.

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Appendix 1 – General Responses to Specific Questions

Consultation	**Response**
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?*	We believe that the proposed framework set out in the proposals has broadly achieved the project objective. The proposed framework is an appropriate and workable system to govern financial reporting needs in the United Kingdom. We do have specific concerns in relation to certain detailed points, both generally and in relation to the proposals for Public Benefit Entities and Pension Schemes. These issues are addressed in Appendices 2, 3 and 4 to this document respectively.
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?*	We welcome the proposals for a reduced disclosure framework for subsidiary entities. We consider that, in a group, a user of the financial statements obtains the best information from a review of the consolidated financial statements. We do not see any significant benefit to users of financial statements in providing the disclosures in IFRS 7 or IFRS 13 purely for a subsidiary. Accordingly, we believe that qualifying entities that are financial institutions should be exempt from the proposed disclosures set out in those standards.
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.*	We agree with the proposed scope for areas cross-referenced to EU adopted IFRS.
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.*	We agree with the definition of a financial institution except to the extent that the current proposed definition will include Pension Schemes. We have significant concerns as to whether this is appropriate and these are set out in Appendix 4.

Consultation	Response
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?*	We have no specific comment to make.
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?*	We agree with the ASB stated aim of producing a 'single book' of standards for entities to enable users of accounts to "receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and the users' information needs", which includes Pension Scheme financial statements. We do have comments on the detailed proposals and these are set out in Appendix 4.
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?*	We consider the proposals on related party disclosures are sufficient to meet the needs of preparers and users of financial statements.
Question 8 *Do you agree with the effective date? If not, what alternative date would you prefer and why?*	Given the significance of the changes and the need for a number of SORPs to be revised in line with the new standards the proposed effective date is appropriate.
Question 9 *Do you support the alternative view, or any individual aspect of it?*	In our opinion the alternative view raises many interesting questions, a number of which have some merit, for example the position on share-based payments for private companies. Seeking to fair value equity settled share based payments in a private company relies upon too great a range of assumptions to provide useful information to users of private company accounts. Disclosure of the existence of share option schemes and the terms attaching to the options would provide users with the necessary information without the burden of producing theoretical valuations. This approach would seem to meet the ASB's objective of providing "…financial reporting proportionate to the size and complexity of the entity and users' information needs.

Appendix 2 – Specific issues in relation to the proposed standards

We believe that the proposed framework set out in the proposals has broadly achieved the project objective.

We do, however have some specific concerns surrounding specific items within the proposed standards. Our concerns are in the following areas:

Financial Instruments

We note for entities adopting the provisions in Section 11 of FRED 48, equity securities held will be measured at fair value, while debt instruments (which will include those instruments which are traded on a public market) will need to be measured on the amortised cost basis.

Many, if not most, entities which hold an investment portfolio will contain a mix of equity and debt instruments. For these entities all debt instruments would need to be valued on an amortised cost basis, even when an open market value is available. This is likely to be unattractive for most entities, who would consider fair value to be the most appropriate measure for debt instruments which are held as part of an investment portfolio.

We acknowledge that FRED 48 (the exposure draft) permits adoption of the measurement criteria in full IFRS, which would provide the option to measure the debt instruments at fair value. The standard does not seem to achieve its objective in the area of financial instruments if most entities holding an investment portfolio do not apply its measurement criteria.

We suggest that the proposed standard be amended to permit debt instruments to be measured at fair value when a quoted market price is available.

Property, Plant and Equipment

We agree with the proposal that revaluation of property, plant and equipment is permitted in financial statements. We note however that the proposals as drafted do not require an entire class of fixed assets to be revalued. This option is not available, either in full IFRS, or in current UK GAAP and we believe the possibility of revaluing only certain assets within a class has the potential to cause confusion and potentially to be misleading.

We suggest the exposure draft be amended to require all items in a class of fixed assets to be revalued.

Appendix 3 – Specific issues in relating to Public Benefit Entities

The ASB has made a number of useful amendments after the original consultation that addresses some of the concerns of Public Benefit Entities (PBEs).

It is apparent that the general thinking of the proposed standard is good and strong and the principles will work well for PBEs. However, it is of particular concern that new concepts have been introduced in the PBE sections, which seem in certain areas not to recognise the concerns behind the many responses to FRED 45 from charities, umbrella bodies, professional institutions and auditors.

More worrying is the apparent conflict of the PBE sections with other parts of FRED 48 (the exposure draft). It also seems that much of the useful work carried out by the ASB when they published, in 2007, the Interpretation for Public Benefit Entities of the Statement of Principles for Financial Reporting has largely been ignored and even contradicted. This document was well received by PBEs and was a careful exposition of the principles that should underlie the preparation and presentation of financial statements of PBEs. Many of the areas that are of concern in the exposure draft are dealt with in a sensible way in the 2007 Interpretation.

However, resolving these few but important issues is not difficult and small changes to definitions and conflicting sentences will in most cases provide an easy fix whilst still being in agreement with the concepts and pervasive principles.

Many of the areas of confusion for PBEs are caused by the guidance sections in the appendices of the exposure draft that make conflicting statements and seem in some areas to confuse more than guide. Perhaps the more detailed application guidance should be left to the sector specific SORPs.

Income recognition – restricted income

The exposure draft has introduced new definitions that will be problematical and arguably conflict with the requirements of charity law.

The exposure draft defines a restriction as: ‘a requirement that limits or directs the purposes for which a resource may be used but does not require that resource to be returned to the donor if the resource is not used as specified’. We do not believe that a restriction should be defined by the absence or presence of a repayment clause. This new concept that restricted income does not include funds that have to be returned to a donor if they are not used as specified flies in the face of well recognised principles of charity accounting and charity law.

We believe that the words “but does not require that resource to be returned to the donor if the resource is not used as specified” should be removed from the definition. This will be in line with existing PBE practice, the 2007 Interpretation and existing SORPs; it will also be in line with the definition of a restriction in FASB 116.

The exposure draft then explains that a performance condition is ‘a requirement that specifies that the resources is either to be used by the recipient as specified, or if not so used, to be returned to the donor’.

This means that any restriction imposed on a donation, legacy, grant or gift which has a possibility of repayment would be treated as a performance condition. This new nuance about repayment will fundamentally change how PBEs account for restricted income with many unfortunate consequences. The proposal means that restricted income as defined in the Charity SORP and the Charity Commission’s published guidance could not be recognised as income when receivable.

This will completely change the accounting presently followed by PBEs. It is hard to understand why this should be – the relevant principles of income recognition have not been changed by the exposure draft so why should the income recognition principles for PBEs change so dramatically.

The confusion between restrictions and conditions is compounded by the application guidance that states ‘Some resources are given with performance conditions attached that require the recipient to use the resources for a particular purpose in order to be entitled to retain the resources. An entity will not recognise income from those resources until these performance conditions have been met.’ This fails to recognise that a requirement that resources must be used for a particular purpose is a purpose restriction and not a performance condition that prevents entitlement to income. This should be the case even if the income may be repayable in certain circumstances.

Existing practice and the ASB’s 2007 Interpretation recognise that performance conditions are quite different to restrictions. Performance conditions are conditions that require the provision of specified service or goods where the entitlement to payment is conditional on the specified good or services being provided. This definition clarifies that performance conditions are analogous to contract terms which would not normally exist with a restricted grant/donation which fall under trust law. In addition income is often received with conditions that are not performance conditions.

Introducing the principle that a repayment requirement means that income can no longer be treated as restricted will complicate and confuse the preparation and understanding of accounts.

The Concepts and Pervasive Principles in the exposure draft explain that income/expenditure should be recognised when an inflow/outflow of economic benefit is probable. In most cases where funds are received with restrictions on their use it is highly probable that economic benefit will flow to the entity and usually very low probability that a repayment will be made even if there is a clause that may require repayment in certain circumstances.

This is an easy fix and changing the definitions of a restriction and a performance condition so that they are aligned with existing practice will resolve most of the concerns in this area and also address many of the concerns on the recognition of grants which is also discussed in this briefing.

Income recognition – grants

With the performance model the recognition mirrors the requirements discussed above in relation to the recognition of restricted income. In essence, the problem is the same as for restricted income with issues of repayment clauses confusing the definitions of restrictions and conditions.

In explaining the option of the accrual model the exposure draft explains that grants should be classified either as a grant relating to revenue or a grant relating to assets. Grants relating to revenue shall be recognised in income over the periods in which the entity recognises the related costs for which the grant is intended to compensate. Grants relating to assets shall be recognised in the income on a systematic basis over the expected useful life of the asset.

There is real difficulty in reconciling this with the underlying concepts and pervasive principles which state that they do not allow the recognition of items in the statement of financial position that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the 'matching concept'

This volte-face on income recognition will lead to much confusion and anomalies. Charities will have to show liabilities on their balance sheet that do not meet the definition of a liability.

The exposure draft requires a gift of a tangible asset to be recognised on receipt even if it was to be used by a charity. The proposals mean that if a charity was left a building that it would be using as a hospice it would be required to recognise the income when the gift was received. However, if it was gifted the money to buy the hospice the income could be deferred over many years. Similarly, if an asset is financed by a mix of funding for example through individual donations and grants the proposals in the exposure draft would allow different accounting for essentially the same type of income for the same purpose.

A principles based approach should focus on the income recognition principles in the exposure draft and it is a shame that this opportunity has not been taken to resolve this issue.

We believe that it is important that the Section on Grants should explain that it only apples to Performance related grants and other grants should be treated as donations. If this is not done then simply calling a donation a grant would allow a fundamentally different treatment for the same transaction.

Funding commitments

We question the need for a separate section on this. In the last consultation a number of responses took the view that the general requirements for accounting for provisions and liabilities should be followed. There is scope for confusion as the section on funding commitments seems to contradict the section on provisions.

The exposure draft continues to recognise the well-established accounting principle that there can be an accounting liability even where there is no legal liability. However, this is confused by counter intuitive statements in the guidance that if an entity was simply to state that a grant payment was dependant on future funding there would be no liability. Almost all PBEs have such a clause in their grant agreements but they award grants with a valid expectation to pay and the recipients have a valid expectation that they will receive.

The accounting should reflect the operational realities and it is of course possible not to have to account for a multi-year grant award if there is a form of break clause that requires a mid-term review.

Despite general caveats on future payments being dependant on the availability of funds it is in fact usually highly probable that there will be an out flow of funds. Therefore the definition of a liability is met. The substance of the transaction is often the same regardless of whether such caveats on the dependency of future funding are included as PBEs strongly expect to have the necessary funding and to make the payment.

Therefore the charity SORP specifically mentions that a condition that states that payments are dependant of future funding is not enough to prevent the recognition of a liability.

The concepts and principles in the general sections of the exposure draft that deal with expenditure recognition and the creation of liabilities are clear. They are the basis on which the Charity SORP has been written and the basis on which charities prepare their accounts. It would be a retrograde step if the PBE sections conflict with the body of the standard by introducing new features.

Fair value and valuation of gifts in kind

The proposals refer to open market value and cost to the donor. The Charity SORP requires that the value placed on gifts in kind or donated services and facilities should be the estimated value to the charity of the service or facility received. This is the price the charity estimates it would pay in the open market for a service or facility of equivalent utility to the charity.

The now superseded SORP 2000 did recommend a value to the donor approach but this was changed as many charities receive goods and services that may be valued by the donor at a value which is quite different to the value to the charity.

The ASB considered whether being able to achieve the same service potential from a lower value asset might suggest that the value of the donated asset should be at the lower value. They concluded that such circumstances would rarely occur and in many cases, an entity would be able to sell the donated asset and if appropriate, purchase a cheaper asset with the equivalent service potential. In fact these circumstances are not uncommon and in many cases the PBE would not be able to or would not be expected to “sell” the donated asset.

There is concern that there needs to be recognition that fair value should also consider the concept of ‘value to the entity’ being the cost a PBE would pay for an equivalent resource that meets its service potential requirements rather than simply considering an open market value or cost to the donor. If conversion to cash was possible then this would be the value to the charity. This should address the ASB’s concerns.

Business Combinations

In the case of combinations which are in the nature of a gift the exposure draft requires them to be accounted for as an acquisition except for the matters addressed in paragraphs PBE34.77 and PBE34.78. There is concern that this could mean that the disclosure requirements for acquisition accounting will be required for combinations that are in substance a gift.

Appendix 4 – Specific issues relating to Pension Schemes

Definition of a financial institution

Pension schemes hold significant investment portfolios and we agree with the ASB's aim of ensuring greater transparency with regard to investment risk, the significance of financial instruments and the nature and extent of investment risks.

We recognise however the need for different types of disclosures for defined benefit and defined contribution schemes:

- Defined benefit schemes will often have in place strategies which are in part return seeking and in part liability matching and any disclosures requirements should have in mind these types of strategies to ensure that the disclosures are meaningful for pension schemes.
- Defined contribution schemes offer a range of investment funds to their members and each fund has a different risk profile. Member risk varies depending upon the funds in which they invest, and in most schemes the majority of members invest in the default fund.

Any investment risk disclosures should take into account this structure to ensure that the risk disclosures are meaningful. Although we agree that investment risk disclosures should be included in pension scheme accounts, we believe that the requirements in the exposure draft should be high level so that the precise nature of these disclosures can be clarified in the SORP, to ensure that they are appropriate and relevant for pension schemes. The challenge for investment risk disclosures is to ensure that these disclosures demonstrate how trustees address risk rather than becoming 'boiler plate' disclosures that add no value.

We do not believe that pension schemes should be defined as financial institutions. Pension schemes are trusts which are set up for the benefit of employees of companies in order to pay the benefits promised to members and not to make a profit. Occupational pension schemes are not the same as banks, building societies and investment trusts for example which hold funds for the general public.

The definition of financial institution if applied to pension schemes may mean that future investment disclosures requirements which are designed for banks, building societies and investment trusts may have to be applied to pension schemes without consideration for the different nature of occupational pension schemes and which therefore may not be appropriate and over burdensome. There is already a separate section for pensions in the exposure draft and this section could set out the high level disclosures required for pension schemes in respect of investment risk. Otherwise it is expected that exemptions will need to be made for pension schemes for some of the current or future disclosure requirements which are not appropriate for pension schemes. Clarity is also required in the exposure draft in respect of what investment risk information would need to be disclosed were investments are held through pooled funds as well as directly held investments. Many pension schemes hold all or a significant proportion of their investments through pooled funds.

It could be argued that the disclosures of investment risks for defined benefit schemes is less meaningful given the financial statements do not include liabilities to pay future pensions. For many defined benefit schemes part of the investment strategy is to match liabilities and part is return seeking. We believe that some high level investment risk disclosures are still just as relevant and that under the current SORP pension schemes can refer to the actuarial position in order to explain the liability matching aspect of their investment strategy and the associated risks of the success or otherwise of the strategy. This can be done either in the notes to the accounts or in the Trustee's Report.

Under the SORP investment values are based on their fair value or market value. The exposure draft states that the net assets available for benefits should be valued at fair value. However another section states that for all entities the effective interest rate method should be used to value bonds, which may produce a slightly different valuation to a current market price based valuation. This approach appears questionable for securities where there is a market price and it would appear to be more appropriate to use the market price available. If there is no market price then the effective interest rate method may be applied.

The exposure draft states that there should be disclosure of assets at fair value using the hierarchy set out in the standard. This hierarchy is different to the hierarchy described in IFRS 7 and it is unclear whether this was the intention.

Proposed guidance and disclosures relating to pensions schemes

The exposure draft includes reference to additional disclosures which should be included either as part of the financial statements or alongside the financial statements. Some of this information such as significant actives in the year fit better in the Trustees Report and not in the financial statements. There are already specific disclosures for the Trustees Report referred to in the regulations and in the SORP; FRS 102 would be a third source of such requirements adding to confusion.

In our view it would be helpful if accounting standards were considered alongside the disclosure regulations for pension schemes to ensure that there is joined up thinking. A comparison with the regime for charities is perhaps helpful.

The Charities (Accounts and Reports) Regulations 2008 for example state in regulation 8 (5) “the statement of accounts must be prepared in accordance with the methods and principles set out in the SORP”. The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 make no reference to the pensions SORP.

Accordingly, we believe that regulations should be amended to include a requirement for pension scheme reports and accounts to be prepared under the SORP. The SORP should also be amended to include the detailed disclosure requirements, including those for the Trustees Report. In this way, both the regulations and FRS 102 could be free of detailed disclosure requirements.

The exposure draft requires pension schemes to disclose the actuarial position including:

- the ongoing position
- the technical provision and the actuarial estimate of scheme solvency and
- significant assumptions and method used to calculate the valuation.

The ASB recognises that much of this information is included in the Summary Funding Statement, although it is noted that information on assumptions is not currently included in that document. Where the Summary Funding Statement or extracts thereof are included in the Annual Report, significant additional cost should not be incurred in implementing this requirement. There is an option to include actuarial information in the notes to the financial statements; however this would bring such information into audit scope. This would clearly have cost implications for pension schemes for little, if any, benefit and therefore it is expected that very few schemes would adopt this option.

Accordingly, we believe there should be a single consistent practice in the UK which should focus on disclosing relevant clear actuarial information, including information about the assumptions, in the annual report (possibly through a revised Summary Funding Statement) but not in the notes to the accounts. We note that the exposure draft makes it clear that the financial position should exclude the liability to pay pension benefits, as required by The Occupational Pensions Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996.

Defined benefit schemes have an employer or employers that stand behind the liabilities of a scheme. Information on the employer’s covenant is not included in the Annual Report, and there are some with a view that this should be included in the Annual Report. It may be appropriate for the trustees to comment on the process that they undergo in considering the employer’s covenant, although we believe that such comments would be more appropriate in the Annual Report rather than the accounts.

Overall more care and attention is required in the drafting of the final version, before it is issued to ensure that the requirements are clear and appropriate.