Chantrey Vellacott DFK

For attention of: Jenny Carter
Accounting Standards Board
5th Floor, Aldwych House
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London
WC2B 4HN

20 April 2012

Dear Madam

FREDs 46-48: The Future of UK GAAP

Please find, in the attached appendix, our response to the specific questions raised by the ASB in the consultation on FREDs 46 to 48.

We have in the attached appendix also added additional observations that address our specific concerns and issues which we feel need to be considered before the exposure draft is finalised..

Chantrey Vellacott DFK LLP is a top 20 firm of chartered accountants and in particular a leading charity specialist auditor. We welcome the opportunity of being involved in the consultation exercise.

Please do not hesitate to contact us if you would like any further information or explanations with regard to our response.

Yours faithfully

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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?

1. On the whole we agree although we have raised certain points below which we feel need to be addressed prior to their finalisation.

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?

2. We believe that in the spirit of simplification it is appropriate that financial institutions should be allowed to apply the reduced disclosure of IFRS 7 and 13 as the application of the full requirements could be deemed onerous, and welcome the ability for only specific paragraphs of the standard to apply.

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.

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

QUESTION 4: Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

4. We agree with the definition.

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?

5. No comment.

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

Perhaps more guidance could be given in relation to pre-existing arrangements at the date of transition and how these should be accounted for.

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?

6. No comments.

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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?

7. We note that wholly owned subsidiaries are exempt and would like to suggest consistency of the wording with Companies Act.

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

8. We do not agree with the proposed effective date. We understand that the intention is for the final FRS to be issued by the end of this year. The sector SORPS are not able to be issued for consultation until the FRS has been finalised which inevitability will lead to a longer transition period for such entities. Therefore we would request that the effective date for Public Benefit Entities (PBEs) that are affected by SORPS takes account of the need for a longer timeframe. We would suggest an effective date of periods beginning on or after 1 January 2016. Early adoption is allowed for all except PBEs which could be encouraged.

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

9. We agree with the spirit of the concepts of simplification proposed by the alternative view and would suggest that there would be merit in pursuing disclosure as opposed to adjustment of the financial statements of smaller organisations.

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ADDITIONAL OBSERVATIONS

Public benefit

Although the definition of a public benefit is clear, there is no accompanying application guidance to clearly determine whether an entity satisfies this definition. We remain unclear as to whether some types of entities were intended to be PBEs such as membership organisations, trade associations, professional associations and trade unions. We would suggest that alternatively the FRS could make it compulsory for an entity to disclose in its accounting policies when it considers itself to be a PBE. Furthermore we note that there is no stipulation that a PBE follows all aspects of the PBE elements of the FRS and would suggest that all PBE elements need to be followed, where relevant, when an entity is considered to be a PBE.

Funding commitments

We are concerned about the recognition criteria of funding commitments.

Paragraph 34.58 states that a funding commitment would not need to be recognised until the corresponding performance condition have been met. We feel that this statement may be too narrowly defined. We have concerns about this criteria from two perspectives – firstly that the fulfilment of the performance conditions will be dependent on a third party – the recipient to fulfil. Often the PBE will fund third parties in advance, with an associated outflow of funds, and require them to account for how these funds were applied at the end of the term or upon application for the next cashflow amount, which can range from monthly to yearly submissions dependent on the precise terms. It is only at this stage that the PBE may need to decide upon the performance of the funder and adjust future amounts, terminate the arrangement or, very rarely, clawback any funds.

Therefore the application of paragraph 34.58 will be extremely onerous on the PBE. It will require any recipient of funding to account for how much has been 'earned' by the PBE's year end (regardless of the funding commitment term) and deferral of any amounts that yet remain to be 'earned' by the recipient.

Recognition of any asset relating to the un-expensed proportion by the funder would be extremely misleading as it would not be returnable to the PBE and nor could the PBE cancel the arrangement and recover these funds. It could only do so on the failure of the recipient to fulfil the funding commitment terms. We believe that the PBE should account for the outflow of the funds as a liability in full. Secondly for PBEs with many funding commitments, such as major grant makers, we feel that the costs of collating such information for the preparation of their PBE accounts would far outweigh any benefit; and further costs would also need to be incurred in the auditing of such estimations in the PBE's accounts. We believe that this is inconsistent with the overarching principles of the FRS in relation to the recognition of a liability and also with paragraph 34A.3 of the FRS.

We suggest that where funds have been remitted, or will be remitted regardless of any conditions attached where such performance conditions are outside the control of the PBE, that this should give rise to a liability and should be recognised as such because the funds will have already been provided to the recipient. We believe that the funding commitments paragraph in 34.58 and 34A.4 needs to be updated to only refer to multi-year grants where future funding in subsequent years will only be provided when the performance conditions relating to the first years funding have been fulfilled by the recipient. Therefore the PBE will only account for the first year's grant as a funding commitment, or liability In its accounts, with the remainder being an unrecognised commitment requiring disclosure.

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Paragraph 34A.2 states that a funding commitment which is promised only on the basis of the receipt of future income should not give rise to a liability. As noted above, the principles outlined in the FRS (and also in UK GAAP and the current SORP) would require the recognition of a liability where it has been communicated to a third party and there is a probable outflow of funds, and would expect the recognition of the funding commitment regardless of this future income condition. Almost all PBEs have such clauses in their grant agreements, and as it is a fact that it is highly probably that there will be an outflow of funds a liability should therefore be recognised. We suggest that the wording relating to future cash are removed.

Paragraph 34A.6 implies many funding commitments are not recognised which we believe is incorrect. We would question the need for this statement and would suggest that the guidance is re-drafted to purely state the disclosure requirements in respect of funding commitments that have not been recognised.

Entity combinations that are a merger

In respect of merger accounting, we remain concerned with the criteria outlined in paragraph 34.80(b) that 'there is no significant change to the class of beneficiaries of the combining entities or the benefits provided as a result of the combination'. In our experience, often in merger discussions the intention exists from the start of the merger process to streamline services, expand to new areas and consider services to beneficiaries etc. We would suggest that paragraph 34.80(b) is removed.

Concessionary loans

We welcome the proposals outlined in paragraph 34.88 to 34.98 for the accounting treatments and disclosures in respect of concessionary loans in PBEs. But we do have concerns in relation to group situations where the concessionary loan may be between a PBE and a related commercial organisation, such as a trading subsidiary in the group. In such circumstances the commercial organisation will need to follow the fair value approach, and the benefits of the concessionary loans accounting treatment are lost.

We would welcome consideration of concessionary loans accounting treatment being extended to cover a PBE group - so that all entities in the PBE group can apply this accounting treatment, subject to the restriction that they are not a financial institution or otherwise give loans as part of their business operations.

Income recognition – restricted fund versus performance condition.

Firstly we believe that the explanation of the term 'performance condition', referred to in paragraph 24.5B, 34.65 (b) and the definition of performance conditions needs amendment. Similarly the definition of restriction also needs to be re-visited. There appears to be some confusion in the guidance between a performance condition and a restricted grant/fund.

The performance condition definition of '*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*' is more akin to the definition of a restricted fund with a repayment condition added. We believe that the performance condition should be changed to *'a condition which linked with the supply of a particular level of services, goods or units of outputs'* so that it is clearly differentiated from that of a restricted income, which should *be 'a requirement that specifies that the resources is to be used by the recipient as specified'*.

By so changing the definition of a performance condition it can be linked to entitlement rather than repayment, so that income is recognised in accordance with the stage of completion in line with paragraph 23.22 of the FRS. The definition of a restriction has no relevance as to

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whether or not the amount needs to be repaid to a donor – and this element of the current definition needs amending.

If the drafting in the FRS is amended so that restrictions are recognised as a limitation or narrowing of the use of the income received, and performance conditions are linked with conditions and assessment of entitlement of the income (via stage completion as referred to above), then the confusion between the two definitions and accounting treatment can be resolved.