



24 Cathedral Road / Heol y Gadeiriau  
Cardiff / Caerdydd  
CF11 9LJ  
Tel / Ffôn: 029 20 320500  
Fax / Ffacs: 029 20 320600  
Email / Epost: [wales@wao.gov.uk](mailto:wales@wao.gov.uk)  
[www.wao.gov.uk](http://www.wao.gov.uk)

Peter Godsall  
Accounting Standards Board  
5<sup>th</sup> Floor  
Aldwych House  
71 – 91 Aldwych  
London  
WC2B 4 HN

Date	26 January 2010
Our ref	0126.mju.godsall
Pages	1 of 1

[ukgaap@frc-asb.org.uk](mailto:ukgaap@frc-asb.org.uk)

Dear Peter,

## RESPONSE TO THE CONSULTATION ON THE FUTURE OF UK GAAP

The Auditor General for Wales welcomes the opportunity to comment on the consultation draft of the above consultation. This response has been prepared on behalf of the Auditor General by the Wales Audit Office.

In preparing this response on behalf of the Auditor General, we have concentrated on the implications for the bodies that fall within his remit, namely public benefit entities, specifically:

- public sector charities in Wales; and
- further and higher education establishments in Wales

We have therefore only responded to the questions contained in Section 3 of the Policy Proposal (Financial Reporting for Public Benefit Entities) and Question 16.

Our response to the consultation questions can be found in the appendix to this letter. I hope that you find our comments useful. If you have any queries regarding our response, please contact Iolo Llewelyn in our Technical Unit at e-mail: [iolo.llewelyn@wao.gov.uk](mailto:iolo.llewelyn@wao.gov.uk) or telephone: 02920 320674.

Yours sincerely,

**Mike Usher**

**Partner**

**Question 11 – Do you agree with the Board’s proposal to develop a public benefit entity standard as part of its plans for the future of UK GAAP? If not, how should (converged) UK GAAP address public benefit entity issues?**

Section 8(5) of the Charities (Accounts and Reports) Regulations 2008 requires charities..... to prepare their *'statement of accounts ....in accordance with the methods and principles set out in the SORP.'*

The FE/HE SoRP notes that *'each (UK) funding body issues an annual accounts direction. These accounts directions require institutions' financial statements to be prepared in accordance with this SORP.'*

Charities and FE/HE institutions are required therefore to comply with their respective SoRPs and, for the former this is a legal requirement. These SoRPs are based on UK GAAP.

If the ASB’s proposals are implemented, UK GAAP, with the exception of that element of it that relates to small entities, will converge with IASB standards. We do not consider that it is tenable for the financial reporting regimes for charities and FE/HE entities to remain based on the current iteration of UK GAAP. This response is therefore predicated on financial reporting for Charities and FE/HE being based in future on UK GAAP, as promulgated by the ASB.

As paragraph 3.2 of the consultation paper notes, IASB standards are not designed to apply to public benefit entities. As a result there will be a need to adapt/interpret the converged UK GAAP to meet the needs of public benefit entities.

We agree with the Board’s proposal that developing a public benefit entity standard would best meet this requirement, as it would embed the relevant adaptations/interpretations into UK GAAP and therefore ensure the authoritative status of the adaptations/interpretations.

**Question 12 – If you do agree with the proposal to develop a public benefit entity standard, should the standard cover all the requirements for preparing true and fair view accounts or should it cover only those issues where IFRS or the IFRS for SMEs needs to be supplemented for the public benefit entity sector?**

The IFRS based Code of Practice on Local Authority Accounting in the United Kingdom tends towards the first approach, while the IFRS based FReM adopts the second approach. Both approaches can therefore work.

However, overall we prefer the second approach, because a document that covers all the requirements for preparing true and fair view accounts will be:

- a very large document, which, to a great extent will duplicate the underlying standards;
- very time consuming and expensive to compile and maintain; and
- requiring amendment each time there is a change to an underlying standard.

Furthermore to simplify the development of the standard we consider that the scope of the standard should be limited to generic issues that are common across all public benefit entities, with any sector specific guidance being contained in public benefit SoRPs (or equivalent). (See also our response to Question 14.)

**Question 13 – Do you agree the issues listed in the above table are distinctive for the public benefit entity sector and should therefore be covered in a public benefit entity standard? What other issues might the proposed standard include?**

We agree with the issues listed in the table under paragraph 3.15 subject to the two issues outlined below.

***Soft loans***

We do not consider that there are *'issues that are distinctive to the public benefit sector'* regarding loans *'that are made (or received) at a below market rate of interest to support the economic and social policy objectives of a public benefit entity.'*

Under IAS 39, such loans are (normally) measured at amortised cost. While this approach can give rise to apparently anomalous results (e.g. where an entity makes a loan at below market rate of interest, this will result in an immediate impairment in the value of the loan and a charge to the revenue account, which is then reversed over the period of the loan), this simply reflects the economic reality of the transaction.

Although:

- for local government entities, regulations have been made to mitigate the impact of this requirement, this is as a result of the desire to remove any impact on the council tax, rather than to reflect the underlying economic logic of the transactions; and
- the current version of the FReM also requires certain loans to be measured at historical cost less impairment, FRAB has recommended that this requirement be removed.

***Long term peppercorn finance leases between public sector/public benefit entities.***

It sometimes occurs that assets are leased in perpetuity or for a long time period between public sector/public benefit entities at a peppercorn rental, with no other form of consideration.

Under IAS 17 the balance sheet values of assets supplied/obtained under finance leases are calculated as:

Lessor – the aggregate of the minimum lease payments receivable by the lessor and any unguaranteed residual value accruing to the lessor, discounted at the interest rate implicit in the lease.

Lessee – the lower of the fair value of the leased property, or the present value of the minimum lease payments.

Where the unguaranteed residual value accruing to the lessor is very small, or zero (for example where the term of lease is perpetuity, or is at least equal to the expected life of the leased asset), this will result in the leased asset being measured at a nil valuation, or a very low valuation, in the balance sheets of both the lessee and lessor. However in practice, the lessee has effectively acquired an asset which can be used to generate future economic benefits (either in terms of cash inflows and/or service delivery).

We would suggest that the accounting treatment for such a scenario is included in the public benefit entity standard. One option could be to treat the leased asset as a 'donated asset' in the accounts of the lessee.

**Question 14 – The Board accepts there may be a continuing need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. Where this is the case, do you think the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?**

We agree it is likely that there will be a continuing need for additional guidance to supplement the public benefit entity standard for the following reasons:

- in addition to simply interpreting UK GAAP to meet the financial reporting needs of public benefit entities, the current charity and FE/HE SORPs also :
  - reflect the specific requirements of the two sectors (e.g. the need for a Trustees Annual Report, the treatment of restricted/unrestricted funds etc); and
  - ensure consistency in some areas (e.g. the disclosure of exchequer interests in FE/HE institutions, the categorisation of historical assets used to deliver services etc.).
- as stated in our response to question 12, we consider that any sector specific supplementary guidance should be contained in public benefit SoRPs (or equivalent).

- research commissioned by the Charity Commission (Charity Reporting and Accounting: Taking stock and future reform: 2009) has shown that practitioners value highly the Charities SORP *'...it is clear that the SORP product is overwhelmingly supported by stakeholders. Support was unanimous across all groups .... The SORP was seen to be driving improvement in accounting and reporting; and encouraging appropriate structure and discipline in charities by focussing the attention of trustees on key issues'*.

We consider that a Statement issued by the ASB confirming any supplementary guidance/SoRP is consistent with UK GAAP, including the public benefit entity standard, would be very helpful and would increase confidence in financial reporting in these sectors.

The current charity and FE/HE SORPs are structured differently from each other. We consider that from the perspective of consistency, the ASB's Policy and Code of Practice on the development of SoRPs should be extended to include guidance on the structure and content of future SoRPs (or equivalent).

**Question 16 – What are your views on the proposed adoption dates?**

We agree with the proposed adoption date. This will provide adequate time to develop the public benefit entity standard and any supplemental guidance/SoRPs.