Exposure Draft

FRC

October 2012

Amendment to Financial Reporting Exposure Draft 48

Draft FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'

Section 28 'Employee Benefits'
Section 34 'Specialised Activities'

This draft is issued by the Financial Reporting Council for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched so as to be received no later than 3 December 2012.

The FRC's policy is to publish on its website all responses received to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.

The FRC does not edit personal information (such as telephone numbers or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

Contents of Amendment to FRED 48

Summary of Amendment to FRED 48

1 This Exposure Draft sets out two limited scope amendments to FRED 48: Draft FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' relating to:

(a) Multi-employer defined benefit pension plans; and

(b) Grantors of service concession arrangements.

2 The FRC is issuing these proposed amendments for comment, with comments to be received by 3 December 2012. The FRC decided that because of the limited scope of the amendments, within the context of the consultations already carried out on FRED 48, it was appropriate to depart from its usual procedure of allowing three months for representations to be made on a proposal.

Multi-employer defined benefit pension plans

3 The FRC has become aware of diversity in the accounting for multi-employer defined benefit pension plans, that in accordance with FRS 17 'Retirement Benefits' may be accounted for as if they were defined contribution plans. The diversity relates to whether a liability is recognised where a deficit exists in the plan and the participating employers have agreed a schedule of payments to fund that deficit. The FRC, on advice from its Accounting Council, considered whether to amend FRS 17, but decided that in view of its intention to replace current UK accounting standards, including FRS 17, with draft FRS 102, such an amendment would have a short life expectancy.

4 The FRC agreed with the advice of the Accounting Council that a long-term solution would be to propose an amendment to draft FRS 102.

5 The proposed amendment to draft FRS 102 introduces two additional paragraphs, 28.11A and 28.13A. These paragraphs propose that employers participating in a defined benefit multi-employer pension plan, accounted for as a defined contribution plan, recognise a liability to make payments to fund a deficit relating to past service where they have entered into an agreement to make those payments.

6 The FRC expects that, as this amendment only relates to defined benefit multi-employer pension plans accounted for as defined contribution plans and where the participating employers have an agreement in place to fund a deficit, it will apply to relatively few entities. The FRC notes that multi-employer schemes may be commonly participated in by public benefit entities.

Grantors of service concession arrangements

7 Following a request for clarifications in relation to the accounting for service concession arrangements in draft FRS 102, the FRC agreed with the advice of the Accounting Council and proposes amending it to include accounting requirements for grantors of service concessions. Draft FRS 102 only included requirements for operators of service concessions; respondents noted that grantors may also be within the scope of FRS 102. To avoid future diversity in accounting practice the FRC decided to propose requirements for grantors that complement the requirements for operators.

8 The proposed amendment to draft FRS 102 requires grantors to recognise the infrastructure assets and liabilities for service concession arrangements. The accounting requirements are based on a finance lease liability model.

Invitation to comment

1 The FRC is requesting comments by 3 December 2012. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited on all aspects of the proposed amendments. In particular, comments are sought on the questions below:

Question 1 Do you agree with the proposed additions to Section 28 'Employee benefits'? If not, why not?
Question 2 Do you agree with the proposed amendment to Section 34 'Specialised activities' setting out the accounting requirements for grantors of service concession arrangements? If not, why not?

Amendment to Financial Reporting Exposure Draft 48: Draft Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'

1 Amendments to Section 28 'Employee benefits':

(a) Insert new paragraph 28.11A

> 28.11A Where an entity participates in a defined benefit plan, which is a multi-employer plan that in accordance with paragraph 28.11 is accounted for as if it were a defined contribution plan, and it has entered into an agreement with the multi-employer plan that determines how it will fund a deficit, the entity shall recognise a liability for the contributions payable that arise from the agreement (to the extent that they relate to the deficit) and the resulting expense in profit or loss in accordance with paragraphs 28.13 and 28.13A.

(b) Insert new paragraph 28.13A

> 28.13A When contributions to a defined contribution plan (or a defined benefit plan which, in accordance with paragraph 28.11, is accounted for as a defined contribution plan) are not expected to be settled wholly within 12 months after the end of the reporting period in which the employees render the related service, the liability shall be measured at the present value of the contributions payable using the discount rate specified in paragraph 28.17. The unwinding of the discount shall be recognised as a finance cost in profit or loss in the period it arises.

2 Amendments to Section 34 'Specialised activities':

(a) Amend paragraph 34.12 as follows (deleted text is struck through, underlined text is inserted):

> 34.12 A **service concession arrangement** is an arrangement whereby a ~~government or other~~ public sector body, a public benefit entity or other entity (the grantor) contracts with a private sector entity (the operator) to ~~develop~~ construct (or upgrade), operate and maintain ~~the grantor's~~ **infrastructure assets** for a specified period of time (the concession period). The operator is paid for its services over the period of the arrangement. A common feature of a service concession arrangement is the public service nature of the obligation undertaken by the operator, whereby the arrangement contractually obliges the operator to provide services to, or on behalf of, the grantor for the benefit of the public ~~such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals~~.
>
> 34.12A Specifically an arrangement is a ~~In those~~ service concession arrangements when the following conditions apply:
>
> (a) the grantor controls or regulates what services the operator must provide using the infrastructure assets, to whom, and at what price; and
>
> (b) the grantor ~~also~~ controls, through ownership, beneficial entitlement or otherwise, any significant residual interest in the assets at the end of the term of the arrangement.

Where the infrastructure assets have no significant residual interest at the end of the term of the arrangement, then the arrangement shall be accounted for as a service concession if the conditions in (a) are met.

(b) Insert new paragraphs and sub-headings as follows:

34.12B A service concession arrangement shall be accounted for in accordance with the requirements of paragraphs 34.12E to 34.16A.

Accounting by grantors

34.12E The infrastructure assets shall be recognised as assets of the grantor together with a liability for its obligations under the service concession arrangement.

Accounting – finance lease liability model

34.12F The grantor shall initially recognise the infrastructure assets and associated liability in accordance with paragraphs 20.9 to 20.10 of Section 20 *Leases*.

34.12G The liability shall be recognised as a finance lease liability and subsequently accounted for in accordance with paragraph 20.11.

34.12H The infrastructure assets shall be recognised as property, plant and equipment, or as intangible assets as appropriate, and subsequently accounted for in accordance with Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets other than Goodwill*.

34.12I Where the grantor is required, or has an option, to purchase any residual interest in the infrastructure assets at a value other than fair value at the end of the concession period, the difference between the expected fair value attributable to the residual interest at the end of the concession period and the amount to be paid should be recognised on a systematic basis over the life of the arrangement, as a separate component forming part of the asset and associated liability recognised in accordance with paragraphs 34.12F and 34.12G.

(c) Amend the glossary as follows (deleted text is struck through, underlined text is inserted):

Service concession arrangement	An arrangement whereby a ~~government or other~~ public sector body, a public benefit entity or other entity (the grantor) contracts with a private sector entity (the operator) to ~~develop~~ construct (or upgrade), operate and maintain ~~the grantor's~~ infrastructure assets ~~such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals~~ for a specified period of time (the concession period).

(d) Insert a new entry in the glossary as follows:

Infrastructure assets	Infrastructure for public services, such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunications networks.

The Accounting Council's Advice to the FRC for the Amendment to FRED 48: Draft FRS 102

Introduction

1 This report provides an overview of the main issues that have been considered by the Accounting Council in advising the Financial Reporting Council (FRC) to publish the Exposure Draft of 'Amendment to Financial Reporting Exposure Draft 48: Draft Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.' The FRC, in accordance with the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012 (SI 2012/1741), is the prescribed body for issuing accounting standards in the UK. The Foreword to Accounting Standards sets out the application of accounting standards in the Republic of Ireland.

2 In accordance with the FRC Codes and Standards procedures, any proposal to issue, amend or withdraw a code or standard is put to the FRC Board with the full advice of the relevant Councils and/or the Codes & Standards Committee. Ordinarily, the FRC Board will only reject the advice put to it where:

- it is apparent that a significant group of stakeholders has not been adequately consulted;
- the necessary assessment of the impact of the proposal has not been completed, including an analysis of costs and benefits;
- insufficient consideration has been given to the timing or cost of implementation; or
- the cumulative impact of a number of proposals would make the adoption of an otherwise satisfactory proposal inappropriate.

3 The FRC has established the Accounting Council as the relevant Council to assist it in the setting of accounting standards.

Background

Multi-employer defined benefit pension plans

4 The Accounting Council is aware that diversity in accounting practice has arisen in relation to FRS 17 'Retirement Benefits'. FRS 17 permits entities that are unable to identify their share of the underlying assets and liabilities of a defined benefit multi-employer pension plan on a consistent and reasonable basis, to account for that multi-employer defined benefit pension plan as if it were a defined contribution plan, and make additional disclosures. FRS 17 requires the recognition, as an expense, of contributions payable in respect of the accounting period, where a plan is a defined contribution plan. FRS 17 does not explicitly require entities who participate in a defined benefit multi-employer plan, who account for that plan as a defined contribution plan and who have entered into a funding agreement for future payments relating to past service liabilities, to recognise a liability in relation to the deficit in the plan in their financial statements.

5 In view of the imminent changes to current accounting standards, the Accounting Council advised not to amend FRS 17 but advises issuing an amendment to draft FRS 102 to clarify when a liability should be recognised.

6 Consistently with the guidelines for amending the IFRS for SMEs*, the Accounting Council advises the FRC to amend draft FRS 102 by incorporating the relevant requirement from

* These can be found on the FRC website, and were discussed at the Accounting Council meeting on 5 July 2012.

IAS 19 *Employee benefits*. The IASB noted in its basis for conclusions* that 'In relation to the funding of a deficit, [...] this principle [is] consistent with the recognition of a provision in accordance with IAS 37†.'

7 The Accounting Council also advises clarifying the measurement requirements where an entity recognises a liability in accordance with paragraph 28.11A. Draft FRS 102 paragraph 28.13 requires an entity to recognise a liability for the contributions payable for a period after deducting any amount already paid. In the circumstances that the entity has entered into a funding agreement for future payments relating to past service, in accordance with paragraph 28.13, it recognises these future payments as a liability. The Accounting Council noted that IAS 19.52 requires contributions to a defined contribution plan not expected to be settled wholly within 12 months after the end of the annual reporting period to be discontinued using the discount rate specified in IAS 19.83. The Accounting Council advises the inclusion of this paragraph in draft FRS 102 so that entities discount the liability to present value. Consequently, an entity will recognise a liability for the present value of the agreed future contributions payable relating to past service, after deducting any amounts already paid.

8 Draft FRS 102 defines group plans separately from multi-employer plans. The proposed amendment, therefore, does not apply to individual employers participating in a group plan for which the proposed accounting continues to be set out in draft FRS 102 paragraph 28.38.

Grantors of service concession arrangements

9 A number of respondents to draft FRS 102 noted that some grantors of service concession arrangements are within the scope of draft FRS 102, which contains only accounting requirements for operators of service concession arrangements. To determine the appropriate accounting grantors would need to apply the requirements of draft FRS 102 paragraphs 10.4–10.6, which could lead to diversity in practice. The Accounting Council advises making amendments to draft FRS 102 to set out the accounting requirements for grantors of service concession arrangements.

10 EU-adopted IFRS does not address accounting by grantors of service concession arrangements; grantors are expected to be outside the scope of EU-adopted IFRS. As a result, and consistently with the guidelines for amending the IFRS for SMEs, the Accounting Council sought to develop accounting for grantors that is consistent with the principles underpinning the accounting by operators of service concession arrangements, which is set out in IFRIC 12 *Service concession arrangements*. The scope of IFRIC 12 is such that the grantor controls the residual interest in the infrastructure asset, and therefore for service concession arrangements meeting the definition in draft FRS 102, the amendment that the Accounting Council advises be made proposes that the grantor recognises its interest in the infrastructure asset usually as property, plant and equipment, with a corresponding liability measured using a finance lease model.

11 The Accounting Council noted that the International Public Sector Accounting Standards Board (IPSASB) has issued a standard IPSAS 32 *Service concession arrangements: Grantor*, which includes two models for accounting by the grantor, depending on the terms of the arrangement with the operator. In addition to the finance lease model advised by the Accounting Council, IPSAS 32 includes a 'grant of right to the operator model'. The Accounting Council does not advise the application of this model because it appears to result in the recognition as liabilities of amounts that may not meet the definition of a liability.

* IAS 19 Basis of Conclusion paragraph BC37 (Multi-employer plans: Amendments issued in 2004).

† The principles of IAS 37 *Provisions, Contingent liabilities and contingent assets* are consistent with Section 21 *Provisions and contingencies* of draft FRS 102.

12 Where the amount to be paid by the grantor, over the service concession period, is less than the expected market value of the residual interest at the end of the arrangement, it is also recognised as an asset to represent the future economic benefit expected for the grantor. This may arise where the grantor is not required to make payments during the life of the concession period but the residual interest will revert to the grantor for a nominal, or nil, amount at the end of the concession period.

13 The Accounting Council considered whether transitional provisions should be available for grantors. It noted that for some grantors, the proposals would result in recognising assets and liabilities for the infrastructure assets that are not presently recognised. It considered that this provides more relevant information to users, and therefore advised the FRC that transitional provisions should not be available. As a result grantors will not be permitted to apply the transitional exemptions that are available to operators, as set out in draft FRS 102 paragraph 35.10(i), by analogy.

14 In addition, and also in response to comments from respondents, the Accounting Council advises making amendments to draft FRS 102 before it is issued, relating to accounting for service concession arrangements by operators. These drafting amendments will clarify the principles in draft FRS 102 to avoid diversity in practice, and will be based on IFRIC 12. These amendments are not set out in this exposure draft.

Draft Impact Assessment

1 As published in its Regulatory Strategy, the FRC is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

2 This Exposure Draft proposes an amendment to FRED 48: Draft FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'. The material published alongside FRED 48 included a [Revised Draft] Impact Assessment. This draft impact assessment considers any incremental changes arising from the proposed amendments.

3 The FRC does not believe the impact of the proposed amendments to draft FRS 102 alters its overall assessment that the introduction of draft FRS 102 will have a positive impact on financial reporting, and that the benefits of more consistent, transparent information for decision-making outweigh the transition costs of implementing the new standards.

4 The following paragraphs note how the case study scenarios included in the [Revised Draft] Impact Assessment would be revised if the entities concerned were affected by the proposals in this amendment to FRED 48.

Multi-employer defined benefit pension plans

5 Entity X is a participating employer in a multi-employer defined benefit pension plan. It accounts for the pension plan as if it were a defined contribution plan and has entered into an agreement with the pension plan to make additional payments in respect of a deficit in the plan.

6 Entity X would need to recognise a liability to make the payments in respect of the deficit. As the key features of the agreement would at least have been disclosed in accordance with FRS 17 'Retirement benefits', and the underlying data is set out in the agreement with the pension plan there should be no significant costs arising for Entity X. Although users will already be aware of the existence of the agreement, there will be benefits to users from reducing diversity in practice in the accounting and reporting of a liability for the obligation to make the payments in respect of a deficit in the plan.

Grantors of service concession arrangements

7 Entity Y is a higher education institution and has entered into an arrangement relating to the management and maintenance of some of its student accommodation. The arrangement meets the definition of a service concession arrangement, as set out in draft FRS 102 because the provision of higher education is a matter of public policy, partly funded by government grants. Entity Y has previously concluded that, in accordance with FRS 5 'Reporting the substance of transactions': Application Note F 'Private Finance Initiative and Similar Contracts', it should not recognise the student accommodation on its balance sheet.

8 Entity Y will need to reconsider the terms and conditions of its arrangement in accordance with draft FRS 102, and recognise its interest in the student accommodation on its balance sheet, measured using the finance lease liability model. The costs involved in measuring the liability and associated asset will be minimal because they will be based on data available within the terms of the arrangement. However accounting records will require updating.

9 There should be no significant impact on the net assets of Entity Y. Users of the financial statements will benefit from having more information available on the arrangements Entity Y has entered into.

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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