

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND



Response from
The Institute of Chartered Accountants of Scotland to the
UK Accounting Standards Board

**FINANCIAL REPORTING STANDARD FOR PUBLIC
BENEFIT ENTITIES**

28 July 2011

INTRODUCTION AND KEY POINTS

Introduction

The Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the Accounting Standards Board's (ASB) financial reporting exposure draft (FRED) 45: Financial reporting standard for public benefit entities (FRSPBE) and consequential amendments to proposals in FRED 44: Financial reporting for medium-sized entities (FRSME).

The ICAS Charter requires its Committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key points

Tentative decisions by the ASB

We welcome the tentative decisions by the ASB at its 16 June meeting:

- not to extend the application of EU-adopted IFRS beyond the current requirements in law;

This will remove all Public Benefit Entities (PBEs) from Tier 1, which will bring them within the scope of the [draft] FRSPBE and sector specific SORPs, creating a more consistent accounting framework for the PBE sector. Changes to legislation to enable charities to comply with IFRS will be avoided and there may be other laws and regulations which may no longer require amendment as a consequence.

- to change the principles for amending the IFRS for SMEs to permit or require accounting options that exist in current UK & Republic of Ireland Financial Reporting Standards at the transition date that align with EU-adopted IFRS;

This will enable PBEs to capitalise borrowing/ finance costs, to capitalise development costs and to hold property, plant and equipment at cost or valuation, and defer capital grants, bringing consistency across the three tiers. The decision will also eliminate the potential difficulties that may have arisen for PBEs in relation to loan covenants.

- to defer the effective date to 1 January 2014.

However, this may not be deferred long enough for the PBE sector and we set out our reasons for this in our response to question 2 of the invitation to comment.

Other issues arising from the consultation

We have a number of concerns about the suitability of the material in both the [draft] FRSME and [draft] FRSPBE on entity combinations. We believe that further work is needed to develop more tailored requirements which will enable PBEs to determine whether acquisition or merger accounting is appropriate and what these techniques will involve. In developing guidance for PBEs on entity combinations it is important to determine in the first instance whether transactions are exchange transactions or non-exchange transactions and for the accounting requirements to flow from this.

The issue of whether transactions are exchange transactions or non-exchange transactions is an area where we believe that further work is needed more generally. The sections on concessionary loans, funding and incoming resources from non-exchange transactions make the tacit assumption that funding with performance conditions attached are non-exchange transactions. We believe that performance conditions could impact on the classification of funding-related transactions and is an issue which requires further consideration as the FRSPBE develops.

Accounting requirements for capital grants will require more explicit attention in the [draft] FRSME and [draft] FRSPBE following the tentative decision to change the principles for amending the IFRS for SMEs. In our detailed comments on incoming resources on non-exchange transactions we put forward the approach taken in the ASB's 'Statement of principles for financial reporting: Interpretation for PBEs' (2007) as a possible solution to the concerns already raised in responses to the [draft] FRSME.

Throughout our response we comment on the use of terminology and recommend additional terms which we believe should be defined in the glossary. In particular, we comment on the absence of a definition for 'incoming resources' and the approach towards the use of the terms 'condition', 'performance condition' and 'restriction' in the sections on funding commitments and incoming resources from non-exchange transactions. In charity accounting all 'incoming resources' are recognised in the Statement of Financial Activities (SoFA) when they are receivable, which illustrates how the use of terminology can impact on the presentation of the accounts. However, requirements for accounts presentation for PBEs are almost wholly dealt with in the [draft] FRSME without any clear picture of how the [draft] FRSME and [draft] FRSPBE combined, impact on the presentation of PBE accounts. Therefore, we believe that the [draft] FRSPBE should include illustrative financial statements. This is in addition to our recommendation in our response on the [draft FRSME] that it should include illustrative financial statements formats.

We understand that the ASB is discussing the role of SORPs at its next meeting and we would welcome consideration of the status of the PBE SORPs in relation to the [draft] FRSPBE. The consultation paper gives the [draft] FRSME precedence over the PBE SORPs. We believe that the PBE SORP setting bodies have a responsibility to ensure that SORPs do not conflict with the [draft] FRSME and the [draft] FRSPBE and that there should be a clear message to this effect. Conflicts between different requirements could make it impossible for PBEs to comply with all the requirements placed on them by law or by regulations and we believe that they should not be placed in this position.

We support the ASB's convergence agenda and have commented in other submissions on the topic that we believe that the long-term benefits will outweigh the costs. However, the [draft] regulatory impact assessment which accompanies the [draft] FRSPBE could be more robust and we believe that the approach taken whereby the combined impact on PBEs of the [draft] FRSME and [draft] FRSPBE lacks transparency. We are also concerned that there is no assessment of the cost and opportunity cost of changes to the accounting framework. We recommend that these issues are addressed in the final impact assessment.

Our comments on the consultation questions and detailed comments on other aspects of the consultation are set out in the following section of our submission.

COMMENTS ON THE FINANCIAL REPORTING EXPOSURE DRAFT

SECTION 1 – APPLICATION OF FRS REQUIREMENTS

Question 1

Is the definition of a public benefit entity and accompanying application guidance sufficiently clear to enable an entity to determine if it is a public benefit entity? If not, why not?

Response

We support the definition of a public benefit entity subject to the replacement of the term ‘equity’, which in accounting terms is normally associated with share capital, with the term ‘resources’ to better reflect the nature of the sector.

The revised definition would therefore read as follows:

“A PBE is an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any **resources are** provided with a view to supporting the entity’s primary objectives rather than with the view to providing a financial return to equity providers, shareholders or members.”

Question 2

Do you agree with:

- (a) the proposed effective date of 1 July 2013 which is consistent with the effective date of the FRSME; and*
- (b) the restriction on early adoption for PBEs subject to a SORP?*

If not, what would be your preferred date and why?

Response

We believe that the commencement date of 1 July 2013 is unrealistic for the public benefit entity sector and would prefer a commencement date of 1 September 2014. We believe this is a more suitable date for the following reasons:

- A lead time of 18 months from the publication of all relevant guidance would be necessary to give PBEs sufficient time to establish opening balances. We do not believe that it will be realistic for the FRSME, the FRSPBE and all the PBE SORPs to be in place by 1 January 2012. The content of the FRSME will need to be settled before the content of the FRSPBE and likewise the content of the FRSPBE will need to be settled before the content of the three PBE SORPs can be settled.
- The PBE SORP setting bodies will have to conduct a separate consultation exercise on the revised SORPs they prepare and sufficient time will need to be built in to the implementation timetable to allow for a three month consultation period.
- The financial year for colleges and universities commences on 1 August. With a commencement date of 1 July 2013, educational institutions would be required to comply with the new regime for periods commencing on, or after, 1 August 2013 whereas commercial companies will be largely unaffected until periods commencing on, or after, 1 January 2014. Moving the implementation date to 1 September 2014 would mean that colleges and universities would not have to comply with the new accounting framework in advance of the majority of other entities.

We recognise that our recommended implementation date is later than 1 January 2014, which the ASB has tentatively decided to adopt.

We agree with the restrictions on early adoption of revised SORPs.

SECTION 2 – CONCESSIONARY LOANS

Question 3

Do you agree with the proposals for concessionary loans in public benefit entities? If not, what alternative accounting treatment and / or disclosures do you consider appropriate?

Response

On balance we agree that PBEs should have the option of accounting for concessionary loans at cost or at fair value, provided that the treatment adopted is applied consistently to all concessionary loans made and received.

In the public benefit sector, the level of interest charged may not be the only indicator of whether or not a loan is concessionary. If the provider of the loan specifies to the recipient that particular social outcomes are to be achieved as a performance condition of the loan, then the loan may not be concessionary. This type of arrangement is likely to become more common particularly within the social enterprise sector.

Concessionary loans are unlikely to impact on the housing sector as financing obtained by registered social landlords is either in the form of grants or private finance with commercial rates of return.

SECTION 3 – PROPERTY HELD FOR THE PROVISION OF SOCIAL BENEFITS

Question 4

Do you agree with the proposals for property held for the provision of social benefits? If not, why not?

Response

We fully support the proposal that property held for the provision of social benefits should not be classified as investment property.

SECTION 4 – ENTITY COMBINATIONS

Question 5

Do you agree with the proposals for combinations that are in substance a gift and combinations which are in substance a merger?

Response

We have a number of comments on the proposals for entity combinations. Accounting for acquisitions and mergers is a particularly challenging area for the PBE sector; our experience is that charities in particular have found it difficult to establish the correct accounting treatment for entity combinations. We believe that further work is still needed to provide clear requirements for PBEs and that more detailed application guidance is required. Business combinations in the PBE sector can arise from non-exchange transactions and we believe that accounting requirements should begin with an assessment of whether the transaction is an exchange or non-exchange transaction.

Scope of the section

Combinations at nil consideration which are in substance a gift are included within the scope of section 4 and paragraphs 4.3 to 4.7 must be applied to such transactions. We envisage two possible scenarios being caught by this: scenario one where the net assets (or net liabilities) of an entity (or part therefore) are transferred to a PBE; and scenario two where an entity converts from one form to another form and transfers its net assets (or net liabilities) into the new vehicle. We have reservations about the accounting requirements for both these scenarios:

- Scenario one is essentially a non-exchange transaction and it does not appear appropriate for this type of transaction to be accounted for in accordance with the [draft] FRSME when the [draft] FRSPBE is better placed to set out accounting requirements for non-exchange transactions.
- Scenario two is likely to be a common occurrence in the charity sector and is a particular challenge for unincorporated charities which incorporate as there is no continuity of legal personality when an incorporated entity transfers its net assets (or net liabilities) to a body corporate. We do not believe it is correct in this circumstance for the net assets (or net liabilities) to be fair valued and for the net gain or loss to be recognised in the income statement, or equivalent. We believe that for PBEs the act of incorporation is not in substance an acquisition and although not strictly a merger meets the criteria for merger accounting. Therefore it would make sense for PBEs in this position to follow the requirements in the [draft] FRSPBE for merger accounting, although it would not be appropriate to describe any corresponding figures as ‘pro forma’ as merger accounting methods presume that an entity which results from a merger is merely continuing its existence.

If entity combinations which are in substance a gift are subsequently dealt with entirely within the [draft] FRSPBE, this would leave acquisitions only to be dealt with by the [draft] FRSME. We are not convinced that the guidance in the [draft] FRSME is sufficiently straightforward to adapt to a scenario whereby a PBE acquires another entity which has no equity shares. We would prefer guidance on acquisitions of this nature to be included in the [draft] FRSPBE, leaving only traditional acquisitions to be dealt with in the [draft] FRSME.

Disclosures for combinations which are in substance a gift

We believe that the disclosures required by paragraphs 4.7(c) and (d), relating to the entity which transferred net assets (or net liabilities), are not relevant to the accounts of the entity receiving the net assets (or net liabilities). We believe that the disclosure of gross assets and gross liabilities transferred and the net position would be more relevant to the accounts of the receiving entity.

Combinations that are mergers

Paragraph 4.8 states that “a merger is an entity combination that results in the creation of a new reporting entity formed from the combining parties.” This is not accurate as a merger does not necessarily result in the creation of a new reporting entity. Paragraph 19.2 of the [draft] FRSME describes a business combination as the bringing together of entities or businesses into one reporting entity. This is true of mergers as well as acquisitions. We recommend paragraph 4.8 and any other relevant paragraphs are amended to remove all references to new or newly formed reporting entities.

Paragraphs 4.13 and 4.14 refer to the presentation of corresponding figures. We recommend that these are amended to remind PBEs that adjustments may be required to corresponding figures to align the accounting policies of the merged entities.

Paragraph 4.15 requires all costs associated with the merger to be charged to income and expenditure. For the avoidance of doubt, we recommend that the paragraph states that costs associated with the merger shall not be capitalised.

Paragraph 4.16(d) requires an analysis of the previous year's primary financial statements between each merged party; this appears to duplicate in part the disclosure requirements in paragraph 4.14 except that the requirements refer to the primary statements only. We recommend that the disclosure requirements are reviewed and updated to reflect the intended disclosures.

Question 6

Do you agree with the criteria set out for merger accounting? If not, what criteria in addition to or instead of those suggested should be included in the draft standard?

Response

We agree with the criteria for merger accounting set out in the [draft] FRSPBE.

SECTION 5 – IMPAIRMENT OF ASSETS

Question 7

Do you agree with the proposed alternative method of determining value in use for assets held for their service potential? If not, what alternative method would you suggest and why?

Response

We are in agreement generally with the material in section 5, although we believe that paragraph 5.6 should be amended to ensure that the section remains high-level in its nature, with detailed guidance on how to determine value in use being left to sector specific SORPs. Paragraph 5.6 refers to 'depreciated replacement cost' as a method of arriving at value in use. We do not believe that the [draft] FRSPBE should mention depreciated replacement cost specifically as other methods may be more appropriate. Therefore we recommend that the final sentence of paragraph 5.6 is deleted.

SECTION 6 – FUNDING COMMITMENTS

Question 8

Do you agree with the recognition criteria and measurement and disclosure requirements, for funding commitments set out in the proposal? If not, what further criteria and/ or disclosure requirements should be included and why?

Response

We have a number of comments on section 6 and the accompanying material which are intended to make the requirements clearer rather than to change the substance of the guidance. In responding to the [draft] FRSPBE we found the material in section IV on the development of the FRED very helpful. However, there is no material in section IV on the development of section 6. We believe that commentators, including accounts preparers, would have welcomed additional commentary around the treatment of non-exchange transactions and an explanation as to why the material on funding commitments, which are akin to provisions and contingent liabilities, is de-coupled from the material in the [draft] FRSPBE on provisions and contingencies, including an explanation of why the concept of 'constructive obligations' has been omitted.

In finalising the [draft] FRSME, we recommend that paragraph 21.1 is amended to scope out funding commitments made by PBEs.

Our detailed comments and suggested changes on section 6 are as follows:

Difference between a ‘performance condition’ and a ‘condition’

In paragraph 24 of its response to the [draft] FRSME, the Charity Finance Directors’ Group (CFDG) highlighted that there is a difference between a ‘condition’ and a ‘performance condition’, which is acknowledged in the [draft] FRSPBE in the accompanying guidance on funding commitments. However, we do not believe that this difference is adequately reflected in the text of section 6 and this could create uncertainty surrounding the recognition of funding commitments for PBEs. We also recommend that the terms ‘performance condition’, ‘condition’ and ‘restriction’ are defined in the glossary.

Section 6, paragraph 6.3, could be amended as follows to provide a more logical link to the accompanying guidance:

“Commitments made which have conditions attached, including performance conditions, will be recognised when those conditions, including the performance conditions, are met”

Section 6, paragraph 6.5(b) and (c) on disclosure, could be replaced as follows to better acknowledge that funders may place both performance conditions and other conditions on the recipient:

“any conditions, including performance conditions, attached to that commitment.”

It is common for multi-year awards to be made therefore we believe it would be worth stating in section 6 that disclosures about conditions shall include information on time-related conditions, which are not performance related, and the reporting periods they relate to.

Difference between a ‘performance condition’ or a ‘condition’ and a ‘restriction’

Whereas ‘performance conditions’ and ‘conditions’ must be met before a payment becomes due to a beneficiary, ‘restrictions’ must be adhered to by the beneficiary but do not prevent payment becoming due.

The term ‘restriction’ is referred to in the accompanying guidance in paragraph 6A.5 but it is tagged on at the end of material about the difference between conditions and performance conditions’. We recommend that a separate paragraph about ‘restrictions’ is included to avoid confusion about these terms.

SECTION 7 – INCOMING RESOURCES FROM NON-EXCHANGE TRANSACTIONS

Question 9

Do you agree with the proposals for recognition of incoming resources from non-exchange transactions?

We believe that distinguishing incoming resources from exchange transactions with incoming resources from non-exchange transactions is very helpful. At the moment the Charities SORP creates difficulties for charities by placing grants on a continuum with contracts at one end and

grants and donations at the other, without sufficiently clear guidance for determining their recognition.

However, it may be less straightforward than envisaged by the [draft] FRSME and [draft] FRSPBE to classify grants as non-exchange transactions. We mention in our response to question 3 on concessionary loans that the level of interest charged may not be the only indicator of whether or not a loan is concessionary. If the provider of the loan specifies to the recipient that particular social outcomes are to be achieved as a condition of the loan, then the loan may not be concessionary. The same applies to grants with performance conditions attached where in some circumstances the grant may not be a non-exchange transaction. The CFDG also touches on this issue in its response to the [draft] FRSME. We recommend that the ASB considers the implications of this issue on the accounting requirements for government grants and incoming resources from non-exchange transactions.

We agree that there needs to be consistency between the material in the [draft] FRSME and the [draft] FRSPBE in relation to the treatment of government grants and other non-exchange transactions. The change to the principles for amending IFRS for SMEs [through the FRSME] may make this approach achievable, although it is likely that when IAS 20 on government grants is revised the ability to defer capital grants or to deduct the deferred grant from the carrying value of the asset will be removed raising the treatment of grants and incoming resources from non-exchange transactions as an issue once more.

We have a number of more detailed comments on the proposals on the recognition of incoming resources from non-exchange transactions.

Definition of incoming resources

'Incoming resources' is not defined in the glossary of the [draft] FRSPBE, nor is it used consistently throughout the document, with the term 'income' often being used instead. It is important that such a key term is defined and used consistently to avoid any confusion in the application of requirements which deal with income/ incoming resources.

Other comments on terminology

Section 7 and accompanying guidance use the terms 'sufficient reliability' and 'reasonably quantified' in relation to measurement. These appear to be used interchangeably and we would prefer that a single term was used, in this instance '[measured with] sufficient reliability'. The use of this term would be consistent with the use of the term 'sufficient certainty' which is used in relation to recognition. We also note that the term 'reliability' is defined in the glossary. The term 'certainty' is not defined and for consistency we recommend that it is.

Recognition of capital grants

This is an issue where flexibility may be needed to avoid unintended consequences for PBEs. The proposed approach in the [draft] FRSPBE, although not explicit, is for funding which is given specifically for the purchase of fixed assets to be recorded in the income statement, or equivalent, when receivable. This treatment is consistent with the treatment currently required by the Charities SORP.

We have a preference for an approach whereby a capital grant is deferred and released to fund depreciation over the life of the asset, as this approach reflects an entity's consumption of the asset over its useful life. We also have a preference for showing the asset and the deferred grant separately, without any offset on the balance sheet, or equivalent.

We recognise that our preferred approach could create challenges both for charities and registered social landlords (RSLs), and that the approach in the [draft] FRSME and [draft FRSPBE] could have an adverse impact on the finances for RSLs. We set out these issues and a possible solution below:

- The recognition of capital grants by charities as incoming resources when receivable facilitates the accounting of charity reserves through a single primary statement i.e. the SoFA. The deferral of capital grants would change this arrangement with the potential for added complexity in accounting for reserves.
- The accounts of RSLs currently show both the carrying value of assets and deferred capital grants on the face of the balance sheet. A total is struck which shows the carrying value less the deferred capital grant on the face of the balance sheet. This is not our preferred presentation of the capital grant. However, we understand that this was one of the accounting treatments, which if prohibited by the new accounting framework for PBEs, could have caused RSLs to breach loan covenants triggering their renegotiation and resulting in less favourable terms.
- The ASB's Statement of principles for financial reporting: Interpretation for PBEs (2007) states "...once all conditions have been met, a capital grant which results in an increase in net assets should be recognised as a gain." (Paragraph 33, Appendix 4). The Interpretation defines gains as 'increases in residual interest not resulting from contributions establishing a financial interest in the residual interest'. This approach does not limit the accounting treatment of capital grants to being either a credit to the income statement when receivable or as deferred income on the balance sheet, or equivalent. We fully understand that this approach does not foster consistency and comparability but we believe that it would be wrong for changes in the accounting framework to place PBEs in a less favourable position with providers of finance or create difficulties for SORP setting bodies which cannot be satisfactorily resolved without detailed consideration at sector level. This approach could offer a possible solution to the current debate around the treatment of government grants and incoming resources from non-exchange transactions.

Use of fair values and goods donated for resale

We do not agree that goods which are donated for resale, such as donations to charity shops, should be measured at their fair value on receipt. This is on the grounds that we do not believe it is practical or reasonable to require PBEs, which in this instance are most likely to be charities, to devote resources to the implementation and maintenance of such a process. We would prefer an approach which required PBEs to recognise incoming resources arising from goods donated for resale when the goods are sold.

Inalienable assets

Paragraph 34 (in section IV: The development of the FRED) states that "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." This argument is used to justify the use of fair values for donated assets. However, some charities hold inalienable assets, i.e. assets which cannot be sold without the permission of the third party. Inalienable assets are often unique and may also fall within the heritage assets category. While material in the [draft] FRSME will apply to heritage assets, we recommend that consideration is given to whether the fair value approach is reasonable for other inalienable assets.

Heritage assets

We recommend that heritage assets are scoped out of section 7 as the recognition and measurement requirements for heritage assets are to be dealt with in section 34 of the [draft] FRSME.

Question 10

Is guidance sufficiently clear to enable an entity to understand and interpret the proposed requirements for recognition of incoming resources from non-exchange transactions? If not, what further guidance is required?

Response

In our response to question 9 we highlight that the attachment of performance conditions to a grant could mean that it is not a non-exchange transaction and we believe the topic of non-exchange transactions requires consideration by the ASB. We anticipate that further guidance will be required on this issue. We also have the following comments to make on understanding the recognition requirements:

Difference between a 'performance condition' and a 'condition'

In paragraph 24 of its response to the [draft] FRSME, the CFDG, highlighted that there is a difference between a 'condition' and a performance condition', which is not acknowledged in the material on government grants. The same issue arises in the [draft] FRSPBE in relation to incoming resources from non-exchange transactions. Specifying that a grant should be applied in a particular time period seems to us to be a 'condition' rather than a 'performance condition' and without defining both these terms and without incorporating these into the accounting framework for PBEs, there is likely to be continued uncertainty about the correct treatment.

Difference between a 'performance condition' or a 'condition' and a 'restriction'

Whereas 'performance conditions' and 'conditions' must be met before income can be recognised, 'restrictions' must be adhered to but do not prevent income being recognised.

The term 'restriction' is referred to in the accompanying guidance to section 6 on funding commitments, contained in appendix 6. As in section 6, it would be helpful if this concept was explained in the accompanying guidance to section 7, in paragraph 7A.12.

Appendix B

The examples in Appendix B are not terribly common and it may be more helpful to include illustrative examples within sector specific SORPs and to identify examples which are more common among PBEs which will not have sector specific SORPs for inclusion in the [draft] FRSPBE.

CONSEQUENTIAL AMENDMENTS TO THE FRSME – HERITAGE ASSETS

Question 11

Do you agree with the proposals for heritage assets and in particular the proposals for recognising subsequent movements in valuation of heritage assets in other comprehensive income?

Response

We agree with the proposals on accounting for heritage assets, except for:

- The requirement for the impairment of heritage assets. We do not agree that the material in paragraph 34.24 of the [draft] FRSME is sufficiently clear as there is no reference to the existence of indicators of impairment as is the case in paragraph 27.7 in the section on impairment of assets. Paragraph 34.24 states that “heritage assets must be reviewed for impairment to ensure that the carrying amount remains current and any impairment is identified” whereas paragraph 27.7 states that “An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset. If there is no indication of impairment, it is not necessary to estimate the recoverable amount.” We would prefer an approach to the impairment of assets which follows as closely as possible the material in section 27 of the [draft] FRSME. If section 27 of the [draft] FRSME is not to apply to heritage assets and impairment requirements are to be included entirely within section 34, then heritage assets should be included in the list of assets referred to in paragraph 27.1.
- The disclosure of transactions over a four year period. We do not see the value to users of including such disclosures on the basis that the information will be available to those who are interested in the published accounts of prior years. Disclosing information for so many periods will also increase the likelihood that accounts will be overwhelmed by heritage asset disclosures.

DEVELOPMENT OF THE FRSPBE

Question 12

Do you believe that future issues that may be considered following finalisation of this draft standard as set out in paragraph 4 of section IV are appropriate? Are there any additional matters which you believe should be included on the agenda for future updates of this draft standard?

Response

We believe that the list of future issues to be considered is appropriate and, of the issues referred to, consideration of the concept of fresh start accounting would in our view be a priority. We remain unconvinced that the [draft] FRSME and [draft] FRSPBE will provide sufficiently clear guidance for PBEs on accounting for business combinations.

In addition, we believe that the following matters require to be addressed either now or in the future:

- The presentation of financial statements. Presentation is dealt with only partially within the [draft] FRSPBE and we are not convinced the presentation requirements of the [draft] FRSME combined with the [draft] FRSPBE will provide a clear and consistent framework for PBEs. We envisage that sector specific SORPs will also provide illustrative accounts formats. However, the absence of an illustrative format within the [draft] FRSPBE will leave a gap for PBEs which do not have a sector specific SORP. It will also make the work of the SORP setting bodies more onerous and could lead to greater differences between charities, RSLs and educational institutions than may otherwise have been the case. Accounts which if produced under an IFRS based framework are quite different from those PBEs will be familiar with under existing UK GAAP. Therefore, we recommend that the ASB addresses this issue as a priority, preferably as part of finalising the first edition of the FRSPBE. The process of preparing an accounts format may also help ensure that consistent terminology is used throughout the [draft] FRSPBE, which we have found to be an issue.

- Non-exchange transactions generally. We believe that accounting for non-exchange transactions is likely to remain a challenge beyond publication of the first version of the FRSPBE. In our response we highlight that when performance conditions are attached to funding, it may not always be clear if the transaction is an exchange or non-exchange transaction.
- Accounting for ‘strain payments’ which fall on former employers. ‘Strain payments’ are additional contributions which employers make to a pension fund to top up the pension of an employee who has retired early and the employer has agreed to fund additional years’ worth of pension contributions. This scenario applies equally to all defined benefit pension scheme funds regardless of sector and we are mentioning it here as it has arisen as an issue for charity accounts. We are aware that these payments, which may be made into the pension fund over a period of years, are not always being recognised as provisions although we believe they should be under existing UK GAAP. We would welcome guidance within the [draft] FRSME which clarifies this requirement.

Question 13

Do you believe that further guidance is required to interpret the indicators of control included in section 9 consolidated and separate financial statements of the draft FRSME?

Response

We believe that the indicators of control included in the [draft] FRSME are suitable in circumstances where a PBE acquires an entity with equity shares. However, we believe where a PBE acquires an entity which has no equity shares, separate guidance should be provided in the [draft] FRSPBE on accounting for acquisitions.

Question 14

Do you believe that the requirements of this draft standard should be extended to entities that apply the FRSSE?

Response

No, we do not believe it is appropriate for the requirements of the [draft] FRSPBE to be extended to entities which apply the FRSSE. The [draft] FRSPBE is derived from a different conceptual framework than the FRSSE therefore there is a risk that conflicting requirements could arise for FRSSE entities which are also PBEs.

Where an entity, which is eligible to adopt the FRSSE, chooses to adopt the [draft] FRSPBE, we believe that the preparation of a cash flow statement should not be compulsory.

COMMENTS ON THE [DRAFT] IMPACT ASSESSMENT

We believe that the [draft] impact assessment understates considerably the impact of the [draft] FRSPBE on PBEs. We also believe it is incorrect to exclude the combined impact of the [draft] FRSME and [draft] FRSPBE on the sector. For example, the ASB estimates that the UK-wide impact of the changes will be £80 million but no information is provided on how much of this it estimates will be incurred by PBEs.

The ICAS response to the [draft] FRSME stated that “We agree with the commentary on the nature of costs in the case study scenarios, but believe that the quantification of the estimated cost is understated in all cases. This is not of primary importance, however, as we believe that the ASB has adequately justified in the introduction to the proposals why the evolution of UK GAAP is necessary, therefore in the long-term benefits will outweigh costs.” Nevertheless we believe that the [draft] impact assessment should provide a realistic assessment of both the cost and opportunity cost of implementing the new accounting framework.

The [draft] impact assessment focuses primarily on the impact of recognition and measurement issues and does not seek to quantify the costs relating to education and training, the time spent assessing the impact of the changes by individual PBEs, the cost of changing processes and systems to cope with the changes, and addressing changes arising from new presentation and disclosure requirements, which we believe are significant.

We recommend that the [draft] impact assessment is updated to address the shortcomings we have identified.

THE RELATIONSHIP BETWEEN THE FRSPBE AND THE PBE SORP (PAGES 5 AND 6)

The ASB’s position on the status of SORPs set out in paragraph 11 of the proposed standard could be more robustly stated. It does not seem sufficient to state that the [draft] FRSME and [draft] FRSPBE take precedence over SORPs as SORP setting bodies should have a clear duty to prepare SORPs which are consistent with the [draft] FRSME and [draft] FRSPBE. This is important for two key reasons:

- to promote the application of a consistent accounting framework for Tier 2 PBEs.
- to ensure consistency with the law and regulations, for example, both English and Scottish charity law require charities to comply with the Charities SORP.