



Proposed amendments to FRED 48

30 November 2012

INTRODUCTION AND KEY POINTS

Introduction

ICAS welcomes the opportunity to comment on the FRC's proposed amendment to Financial Reporting exposure draft 48 (draft FRS 102). The following ICAS technical committees have contributed to this submission: Accounting Standards; Charities; Pensions; and Public Sector.

The ICAS charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and 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.

Any enquiries should be addressed to Ann Buttery, Assistant Director, Technical Policy at abuttery@icas.org.uk

Key points

We agree with the proposals on the recognition of deficit payments by employers to multi-employer defined benefit pension schemes. We also support the inclusion of material on accounting for service concession arrangements by operators.

We raise concerns about the content of the draft impact assessment on both these topics and recommend a number of changes to the drafting of the material on service concession arrangements. We also question why transitional exemptions, on first-time adoption, which are available to the operators of service concessions, are not also available to grantors. We would favour a consistent approach to first-time adoption for both operators and grantors.

COMMENTS ON CONSULTATION QUESTIONS

Question 1

Do you agree with the proposed additions to section 28 'employee benefits'? If not, why not?

Response

We agree with the two proposed additional paragraphs to section 28 'employee benefits', including the requirement in proposed paragraph 11.13A to measure any liability at its net present value, discounted "by reference to market yields at the reporting date on high quality corporate bonds" as used for the calculation of defined benefit obligations.

Public benefit entities, specifically charities, housing associations and educational institutions, which account for defined benefit pension arrangements as defined contribution arrangements and do not already recognise deficit payments, are the organisations most likely to be affected by these proposed amendments.

We believe that the recognition of deficit payments will provide employers/users with greater visibility of pension related liabilities.

However, the ICAS Pensions Committee draws your attention to section 5(3)(b) of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377) which states as follows: "the rates of interest used to discount future payments of benefits must be chosen prudently, taking into account either or both – (i) the yield on assets held by the scheme to fund future benefits and the anticipated investment returns, and (ii) the market redemption yields on government or other high-quality bonds". Having different bases for discounting liabilities, particularly in the context of SMEs and smaller charities, housing associations and educational institutions, is not helpful to general understanding by users through financial reporting practices which differ from legislation and regulation.

While we agree with the draft impact assessment to the extent that this particular change will generally have a positive impact on financial reporting (notwithstanding the narrower discount rates used in draft FRS 102 compared with the rates used in UK occupational scheme funding regulations), we do have concerns about the overall quality of the draft assessment. The draft assessment only considers the potential cost to employers of the proposed amendments from the perspective of actually obtaining the information necessary to implement the recognition of deficit payments. However, the most significant impact on employers will be the practical implications of addressing the presentation of a weaker financial position. For example, lenders may seek to renegotiate loan covenants as a result and some employers may find themselves already in breach of some covenants as a result. We believe that the final impact assessment should include consideration of the wider implications for employers in this position.

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?

Response

Draft FRS 102 has already been tailored significantly to meet the needs of Public Benefit Entities. We understand that this was required as the IFRS for SMEs is derived from full IFRS which was developed for profit orientated entities and as a consequence full IFRS and the IFRS for SMEs includes accounting requirements for operators but not for grantors. This proposed amendment is designed to address this omission. Therefore, we agree that UK GAAP should include accounting guidance for the grantors of service concession arrangements, which requires their accounts to properly reflect the substance of these transactions. We understand that in practice these proposals will significantly impact the higher education sector and, given the complexity of accounting in this area, we envisage that the anticipated revised Education SORP will need to provide additional guidance.

We have a number of detailed comments on the approach taken towards these proposals.

UK public sector bodies apply EU-adopted IFRS, with interpretations and adaptations, to suit that sector. Therefore, any grantor applying draft FRS 102 would not be a public sector body. With this in mind and for consistency with other material specifically directed at public benefit entities, it may be preferable to separate out the material which applies to grantors from the material which applies to operators and to prefix the paragraph references with the letters 'PBE'.

We are unconvinced by the Accounting Council's reasoning for giving operators transitional exemptions from complying with the accounting requirements for service concession arrangements on first-time adoption but not giving those same concessions to grantors. The Accounting Council argues that the proposals could result in the recognition of assets and liabilities for infrastructure assets which are not presently recognised and that this provides more relevant useful information to users. The same argument could be used with regard to the accounts of operators which could be required to recognise financial or intangible assets for the first time. We would prefer a consistent approach towards the availability of transitional exemptions for operators and grantors. If the Accounting Council is not minded to provide grantors with transitional exemptions, we believe that the draft impact assessment should be extended to consider the potential impact of the proposals on higher education institutions' loan covenants and their compliance with the education funding councils' financial memoranda.

The approach taken by the limited scope exposure draft to accounting by grantors appears to be consistent with accounting requirements set out in the UK Government's Financial Reporting Manual (FReM) 2012-2013. We believe that it is appropriate for PBEs, which are grantors, to follow an approach which is consistent with both EU adopted IFRS and the FReM. However, we believe that an additional paragraph is required on guarantees made by the grantor as part of a service concession arrangement. Guarantees are addressed in paragraph 6.2.64 of the FReM and we recommend that a similar paragraph is included in FRS 102. The FReM requires the grantor to recognise any guarantees to the operator that it will meet any shortfalls in revenue or repay the debt if the operator defaults, in line with the financial instrument's requirements.

The numbering of paragraphs in the service concessions section appears to suggest that there is material missing from draft FRS 102:

- Paragraph 34.12B refers to paragraph 34.16A. However, there is no paragraph 34.16A in either the limited scope exposure draft or the previous exposure draft of FRS 102.
- There is a gap in the paragraph numbering between paragraph 34.12B and paragraph 34.12E. Should there also be paragraphs numbered 34.12C and 34.12D?

If it is not possible to separate the material for grantors from the material for operators, then we recommend that care is taken to ensure it is clear which paragraphs apply to grantors and which apply to operators as this may not be clear if the changes are made to draft FRS 102 as currently proposed.