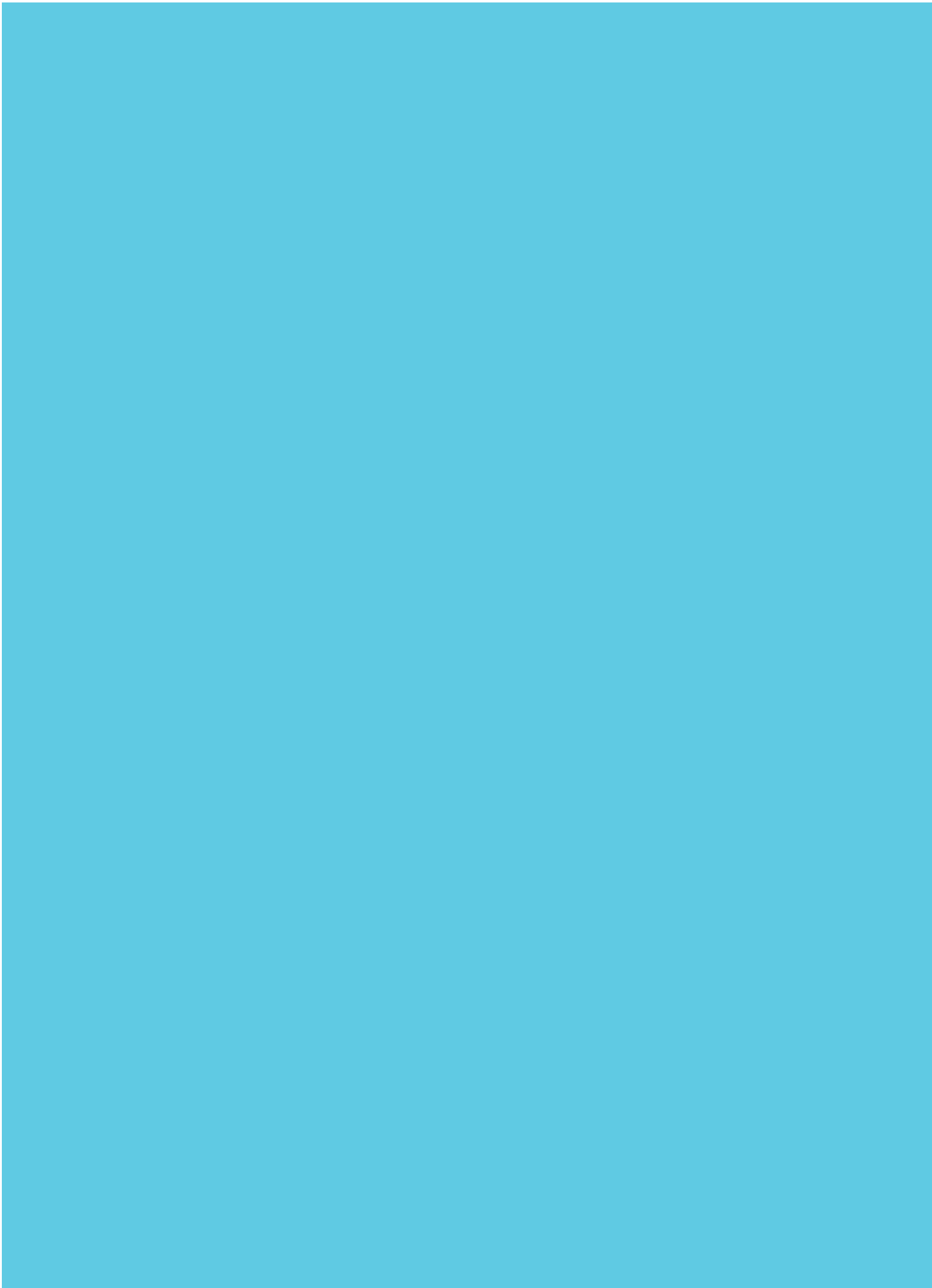




THE FINANCIAL REPORTING STANDARDS FOR MEDIUM- SIZED ENTITIES AND PUBLIC BENEFIT ENTITIES

A cross sector review of the impact of recent
proposals on the future of UK GAAP

2011



PREFACE

It has been 12 months since BDO published [IFRS and Not-for-Profit Entities](#), which gave an overview of the Accounting Standards Board's draft proposals to replace the current UK accounting framework (UK GAAP) with new international standards.

The ASB have now published three financial reporting exposure drafts that put forward its blueprint for the future of accounting in the UK.

FRED 43 APPLICATION OF FINANCIAL REPORTING STANDARDS

FRED 43 sets out the new 3-tier financial reporting framework based on the ASB's August 2009 consultation paper. FRED 43 also sets out the reporting criteria based on public accountability and size, and introduces the concept of a public benefit standard for not for profit organisations.

FRED 44 FINANCIAL REPORTING STANDARD FOR MEDIUM-SIZED ENTITIES

FRED 44 would replace current UK GAAP for those entities that are neither publicly accountable nor small. Known as the FRSME, the proposed framework differs only marginally from the IFRS for SMEs, an accounting standard under the control of the International Accounting Standards Board.

FRED 45 FINANCIAL REPORTING STANDARD FOR PUBLIC BENEFIT ENTITIES

FRED 45 is the long awaited draft public benefit entity standard, dealing with a number of issues common in the not-for-profit sector. However it is not a comprehensive standard, and so not-for-profits will need to refer to the relevant GAAP applicable to them.

As if this is not complicated enough, we await replacement SORPs. The debate is now moving on to consider whether these will need to address issues for entities in each of the three tiers – which include smaller organisations still able to apply old UK GAAP rules.

Many of the concerns expressed by the BDO Public Benefit Accounting Group (PBAG) are still waiting to be addressed. Doubts remain about whether the costs of implementing the proposals outweigh the benefits. Within the not for profit sector especially many argue that there will be a significant loss of comparability of financial reporting, as each sub sector will operate under three or even four different regimes. The new proposals also introduce new areas of concern such as how to account for donated goods, volunteer time and funding commitments. Many old battles fought in the past will have to be reopened.

Perhaps the most contentious issues include the inability to revalue fixed assets, capitalise interest, and match capital grants in the income statement with the related underlying expenditure. Some organisations will conclude that the appropriate accounting treatment can only be achieved by voluntarily applying full IFRS, which is much more complicated than current accounting practice.

In this updated publication, we therefore not only set out how the debate has moved on, drawing out both the changes from the suggestions put forward in the 2009 consultation and covering the requirements of the draft public benefit entity standard, but we have also extended the analysis to include summaries of the effects of applying full IFRS.

As with our publication last year, this document has also been written by our not-for-profit team, who also work with PBAG. The views expressed in this document are not necessarily the views of PBAGs members.

As ever, if you wish to discuss this report or obtain further copies, please feel free to contact us.

Don Bawtree
Head of Not For Profit

GLOSSARY

ASB	Accounting Standards Board of the UK	LSC	Learning and Skills Council
FRED	Financial Reporting Exposure Draft	NFP	Not-for-profit entity
FRS	Financial Reporting Standard	PBE	Public Benefit Entity
FRSME	Draft Financial Reporting Standard for Medium-sized Entities	PFI/PPP	Public Finance Initiative / Public Private Partnership
FRSPBE	Draft Financial Reporting Standard for Public Benefit Entities	RP	Registered provider of social housing
FRSSE	Financial Reporting Standard for Smaller Entities	SOCI	Statement of Other Comprehensive Income
HE&FE	Higher Education and Further Education	SOFA	Statement of Financial Activities
HEFCE	Higher Education Funding Council in England	SOPF	Statement of Financial Position
I&E	Income and Expenditure Account	SORP	Statement of Recommended Practice
IASB	International Accounting Standards Board	SSAP	Statement of Standard Accounting Practice
IFRS	International Financial Reporting Standards	UITF	Urgent Issues Task Force
IFRS for SMEs	International Financial Reporting Standard for Small and Medium-sized Entities	UK GAAP	Generally Accepted Accounting Practice in the United Kingdom

PART I – THE PROPOSALS ON THE FUTURE OF UK GAAP

1. PIECEMEAL CONVERGENCE TO IFRS GIVES WAY TO BIG-BANG CHANGE

Over the last decade or so the ASB has been undertaking a process of piecemeal convergence, aligning UK GAAP with IFRS. Although this has not had a significant impact in the not-for-profit sector due to the financial statement areas addressed, things now look set to change. Following on from their consultation in August 2009 with a proposal that this process of piecemeal convergence with IFRS be replaced by a single big-bang change, the ASB have now issued three exposure drafts that look set to bring in a financial reporting framework that follows the ideas set out in that original consultation:

- FRED 43 Application of Financial Reporting Standards
- FRED 44 Financial Reporting Standard for Medium-Sized Entities (FRSME)
- FRED 45 Financial Reporting Standard for Public Benefit Entities (FRSPBE).

2. FRED 43 APPLICATION OF FINANCIAL REPORTING STANDARDS

THE TIER SYSTEM

FRED 43 sets out the framework for financial reporting in the UK and retains the 3-tier system based on public accountability and size set out in the original August 2009 consultation.

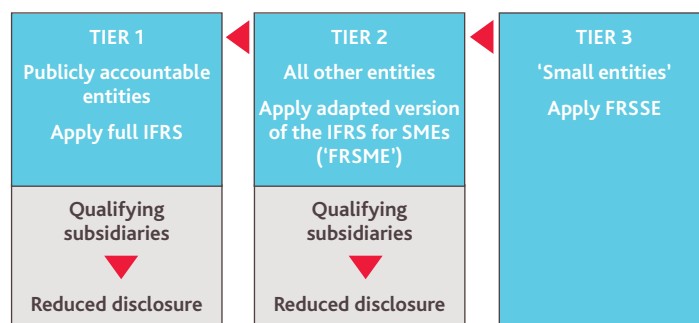
- **Tier 1** comprises those entities that are considered 'publicly accountable'. They would be required to prepare financial statements in accordance with full IFRS published by the International Accounting Standards Board (IASB).
- **Tier 2** comprises those entities that are neither publicly accountable nor 'small'. They would be required to prepare their financial statements in accordance with the proposed Financial Reporting Standard for Medium-sized Entities (FRSME). This is based heavily on the International Financial Reporting Standard for Small and Medium Sized Entities (IFRS for SMEs), a cut-down version of full IFRS published by the IASB.
- **Tier 3** comprises small entities determined by reference to the size criteria in companies' legislation. Such entities would be allowed to prepare their financial statements in accordance with the existing Financial Reporting Standard for Smaller Entities (FRSSE), although it is proposed that in time even the FRSSE would give way to the FRSME.

It will be possible to trade up, but not trade down. Thus an entity falling into tier 2 could voluntarily apply the rules applicable to tier 1 (full IFRS). Similarly, a small entity falling into tier 3 could voluntarily apply the rules applicable to tier 2 (the FRSME) or tier 1 (full IFRS).

The vast majority of NFPs would not fall into tier 1. However, a significant number would fall into tier 2 and hence the FRSME, coupled with the requirements of the PBE standard (see below), would become the new UK GAAP for them.

MORE TIERS OF JOY?

As well as the various acronyms, it is also proposed that tiers 1 and 2 be subdivided into sub-tiers. The proposed framework of reporting for entities in the UK is therefore as follows:



The use of sub-tiers enables subsidiaries to apply the same debits and credits as used by the parent in its consolidated accounts but avoids them having to comply with all the disclosure requirements applicable to the group. It removes the need for potentially complicated consolidation models as most subsidiaries of tier 1 parents would themselves not be publicly accountable and therefore be in tier 2 (where the accounting can be very different) for the purposes of their individual financial statements. Without the use of sub-tiers, subsidiaries would need to voluntarily 'trade up' to tier 1 to avoid this complication.

However, this would come with the need to comply with the voluminous disclosure requirements that is often part and parcel of complying with full IFRS and so the solution is to give disclosure concessions to such subsidiaries. The UK's ASB are seeking views on what disclosure concessions should be given and it is proposed that the reduced disclosure concessions would only be available to non-wholly owned subsidiaries if there is no objection from any minority interest.

Of course, the downside of the proposed framework is that it effectively results in the creation of five tiers of rules, which in turn results in a significant loss of comparability between financial statements of NFPs in the same sector.

PUBLIC ACCOUNTABILITY

An entity has 'public accountability' and would therefore mandatorily fall into tier 1 and have to apply full IFRS if:

- as at the reporting date its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market; or
- as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and / or it is a deposit taking entity for a broad group of outsiders. This is typically the case for banks credit unions, insurance companies, securities brokers/dealers, mutual funds or investment banks.

Some not-for-profit entities will have public accountability, or have subsidiaries that are publicly accountable. Such entities would fall into tier 1 and have to apply full IFRS. For example, some housing associations have listed debt. There are also examples of universities issuing debt in

public markets and reports of others thinking of doing so. Some charities have subsidiary companies that trade as banks or insurance companies.

The ASB have indicated that if a parent company without public accountability has a subsidiary which is publicly accountable, then only the subsidiary would fall into tier 1 and have to apply full IFRS. The consolidated financial statements of the parent entity would fall into tier 2 and apply the FRSME (although it could, of course, voluntarily 'trade up' and apply full IFRS). Where a parent entity is publicly accountable then both its consolidated and separate financial statements would have to be prepared in accordance with full IFRS.

RECENT DEVELOPMENTS – DEFINITION OF PUBLIC ACCOUNTABILITY

Concerns had been raised following the ASB's initial consultation that the definition of public accountability was not clear and would capture many PBEs on the basis that they might be considered 'publicly accountable' in the normal meaning of those words, or that many do hold deposits of some sort. FRED 43 therefore includes application guidance on the definition.

It clarifies that those entities holding deposits in a fiduciary capacity for reasons incidental to their main business (such as rent and membership deposits) would not fall to be treated as publicly accountable. Similarly, although being publicly accountable in a broad sense, unless that accountability is held with respect to public markets the entity would not fall to be treated as such for the purposes of determining which tier they fall into. The vast majority of NFPs would not have public accountability under the proposed framework and so they would fall into tiers 2 or 3.

3. FRED 44 FINANCIAL REPORTING STANDARD FOR MEDIUM-SIZED ENTITIES (FRSME)

FRED 44 is an exposure draft of the single accounting standard (the FRSME) that is intended to replace all SSAPs, FRSs and UITF Abstracts for tier 2 entities. Along with the FRSPBE (see below) it would therefore form the new UK GAAP for PBEs.

As proposed in the original August 2009 consultation this standard is based on the IFRS for SMEs issued by the IASB. Having considered the feedback received from that consultation, the ASB have followed through with their proposal to make as few changes as possible to the IFRS for SMEs, adapting predominantly for areas in which the IFRS for SMEs would not have been compatible with UK law.

Section III of this publication sets out a cross-sector comparison of the current and proposed UK GAAP.

4. FRED 45 FINANCIAL REPORTING STANDARD FOR PUBLIC BENEFIT ENTITIES (FRSPBE)

The ASB acknowledge that some transactions and circumstances common to public benefit entities are not adequately addressed by the FRSME and so, in the absence of any additional guidance, there would be a risk of conflicting and inconsistent interpretations arising on its application. FRED 45 therefore includes additional accounting requirements on certain specific topics to address some of these issues which must be applied by all tier 2 PBEs

WHAT IS A PUBLIC BENEFIT ENTITY?

A public benefit entity is defined as 'An entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members.' This is the same definition as included in the ASB's *Statement of Principles for Financial Reporting: Interpretation for Public Benefit Entities*.

The FRSPBE notes this definition does not require that the purpose of the entity is for the benefit of the public as a whole. Rather it can exist for the direct benefit of a particular group of people, although it is possible that society as a whole also benefits indirectly. It states that the important factor is what the primary purpose of the entity is, and that it does not exist primarily to provide economic benefits to investors. Consequently, organisations such as mutual insurance companies and building societies, as well as co-operatives and clubs that provide dividends or other economic benefits directly and proportionately to their owners, members or participants are not PBEs.

Entities with contributions in the form of equity would still be PBEs if those contributions are made by equity holders primarily to enable the provision of goods or services to beneficiaries rather than with a view to a financial return for themselves.

Based on the above we would therefore consider charities, RPs, and HE&FE institutions to be classified as PBEs. It is unclear what the exact boundaries of the definition are and whether it would capture organisations such as livery companies.

ACCOUNTING MATTERS ADDRESSED BY THE FRSPBE

The specific accounting matters addressed by the FRSPBE are as follows. We discuss each of these in conjunction with the requirements of the FRSME in Part III below as indicated:

TOPIC	REFERENCE IN THIS PUBLICATION
Concessionary loans	Part III Section 11
Property held for the provision of social benefits	Part III Section 16
Entity combinations	Part III Section 19
Impairment of assets: public benefit considerations	Part III Section 27
Funding commitments	Part III Section 21
Incoming resources from non-exchange transactions	Part III Sections 13,17 and 23
Heritage assets	Part III Section 34

Although the FRSPBE is mandatory for tier 2 PBEs, the ASB considers its requirements to be best practice guidance (i.e. persuasive rather than mandatory) for entities in tier 1 and tier 3. Having said that, the ASB also indicate that the specific requirements concerning concessionary loans and entity combinations are not in accordance with full IFRS and so these aspects of the FRSPBE could not be applied by tier 1 PBEs.

IMPLICATION FOR SORPS

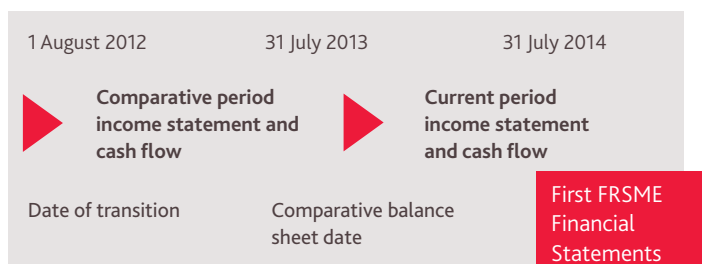
With current UK GAAP being consigned to the history books there are obviously knock-on implications for the various SORPs. The ASB have stated their intention to retain SORPs for the charity, social housing and education sectors, but the current ones would need to be withdrawn and replaced with versions that interpret the new UK GAAP. It is believed that it will be also left to individual SORP making bodies to decide whether to develop guidance only for the benefit of tier 2 entities, or whether to also address the accounting, to the extent different, required by tier 1 and tier 3 entities.

The Charities (Accounts and Reports) Regulations 2008 require charities that are not incorporated as companies to comply with the charity SORP. Unless this legal requirement changes it would seem that the replacement charity SORP will need to provide guidance for charities in each tier. Otherwise charities in tiers 1 and 3 would not be able to comply with these Regulations and the relevant reporting framework at the same time.

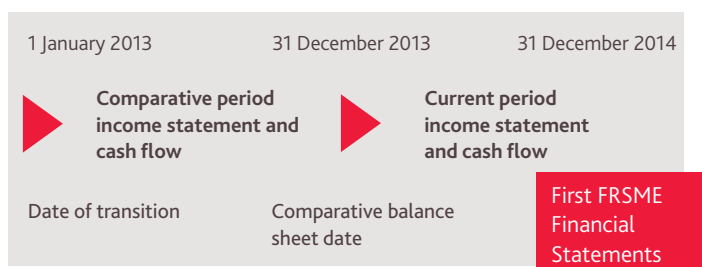
5. TIMETABLE

The ASB are proposing a mandatory adoption of the new financial reporting framework for periods beginning on or after 1 July 2013. This gives rise to the following timelines for typical year ends of PBEs.

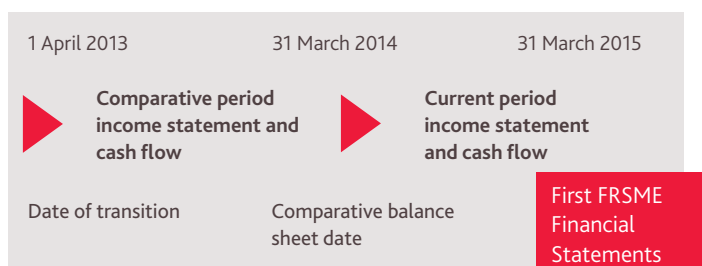
HE&FE INSTITUTIONS



CHARITIES



REGISTERED PROVIDERS



The important point is that in order to be able to prepare a comparative income statement and cash flow statement in the first financial statements affected it will be necessary to prepare a balance sheet two years prior to this date, ie the date of transition.

RECENT DEVELOPMENTS – EARLY ADOPTION PERMITTED FOR SOME BUT NOT OTHERS

Although periods beginning on or after 1 July 2013 would represent the latest date that entities would have to adopt the new tier-based reporting framework, it is also proposed that both the FRSME and the FRSPBE should be available for early adoption by all entities except for tier 2 PBEs subject to a SORP (i.e. charities, RPs and HE&FE institutions).

PART II – ARE THE PROPOSALS JUSTIFIED?

1. COSTS AND BENEFITS

In line with government policy the ASB undertook a cost-benefit analysis to determine whether the proposals in FREDs 43 and 44 will be an improvement on the status quo. The costs and benefits identified by the ASB are listed below. Whereas almost all entities will be able to relate to the costs many PBEs may find some of the identified benefits less tangible.

COSTS

- Initial training
- Software
- Internal preparation costs
- External advice on preparation
- Audit of transition
- Need for more complex calculations due to use of fair value.

BENEFITS

- Tiered system provides targeted response to reporting requirements
- Reduced volume of literature
- Simplified accounting
- Increased stability
- Increased comparability with international quoted entities
- Improved access to capital markets and other finance sources
- Reduced burden for subsidiaries
- Streamlined continuous training based on one framework.

Perhaps one positive aspect that might arise as a result of the proposals would be the removal of some of the divergent interpretations of current UK GAAP taken by the various SORP making bodies, increasing consistency of accounting treatment across the charity, social housing and education sectors for entities within the same tier. A disadvantage, however, is that a 3-tier financial reporting framework driven by public accountability and size might result in a significant loss of comparability by different entities within each of those sectors.

QUANTIFICATION OF COSTS AND BENEFITS

It is of course very difficult to quantify the above costs, although the ASB has nonetheless estimated them to be in the region of £78.9 million in aggregate for those moving from current UK GAAP to the FRSME. Although the actual cost will vary from entity to entity the ASB's analysis also suggests a range of £610 on average for the least affected to £3,370 on average for the most affected. Importantly, though, this impact assessment only looks at the costs to companies, co-operatives, and building societies and does not take into account the cost impact for PBEs.

Understandably the ASB does not attempt to quantify the above benefits noting that they are impossible to quantify in a reasonable way. However, they do suggest that banks would be willing to reduce interest rates charged on borrowings as a result of the perceived improvements in financial reporting that would result from use of the FRSME. However, it seems equally if not more plausible that banks would be looking to re-price borrowings upwards should the FRSME give rise to increased earnings volatility or technical breaches of loan covenants from applying new accounting rules, particularly in the current economic climate. This is certainly an issue for registered providers of social housing, given the level of bank debt in the sector.

FRED 45 also includes an impact assessment, but only looks at the impact on PBEs from adopting the seven accounting treatments it addresses. Importantly, it does not attempt to quantify the costs to PBEs from also having to consider the full implications of FREDS 43 and 44.

The importance of interested parties responding to the proposals on costs and benefits has never been more apparent given the ASB's statement that the limited response rate to previous requests for feedback on costs and benefits 'implies that respondents feel the cost / benefit considerations are not imbalanced'. This might be true. Alternatively, the limited response rate might be a function of the acknowledged inherent difficulties in quantifying costs and benefits coupled with the fact that constituents who are most likely to have a feel for whether costs are outweighed by benefits (ie users and preparers) may not have been fully engaged in previous consultations.

2. COMMERCIAL AND PRACTICAL CONSIDERATIONS

There are a number of commercial and practical considerations to consider if the ASB's proposals come to fruition. Some of these are outlined below.

WHICH TIER?

The first matter to identify is which tier or sub-tier the entity falls into (for the purposes of both the consolidated financial statements and the financial statements of individual entities within the group) and whether there is any merit in trading up to a higher tier. The decision reached will have significant implications for the accounting to be applied across a wide range of transactions and the volume of disclosures to be given. Furthermore, it could also impact on the extent to which the financial statements would be comparable with other entities in the sector.

TRAINING NEEDS

Finance teams, audit committees and volunteer boards will need to be trained in the new accounting rules applicable to the accounting framework adopted. Systems will also need to be put in place to ensure that, for consolidation purposes, the right information is collected by group accountants.

For large and complex groups where, for whatever reason, group companies end up applying different frameworks to each other or to rules applied by the group, organisations will need to consider whether the responsibility for reconciling entity numbers to the rules applied in the consolidated financial statements reporting lay with entity or group accountants. The decision made will have repercussions for the training requirement.

TAX IMPLICATIONS

There will clearly be potential implications on the tax liability of non-charitable group entities as changes to accounting profit could impact the amount of tax due and, consequently, the amount of gift aid donations to be made. It will also be very important to revisit tax structures dependent on current UK GAAP to see if the accounting would change.

LOAN COVENANTS

If loan covenants are set by reference to GAAP amounts in either audited financial statements or management accounts it will be necessary to consider whether new accounting rules will adversely affect an entity's ability to meet those loan covenants. In the current economic climate there is the risk that the banks will use any opportunity to renegotiate loan repayment terms based on breaches of loan covenants that arise purely because of notional changes to the underlying method of financial reporting. The proposals to prohibit entities in tier 2 being able to apply a policy of revaluation to owner-occupied property or capitalise interest will be of paramount importance to consider in this respect.

ONE-OFF TRANSITION COSTS

Entities may incur one-off costs as a result of needing the help of external advisers to assist in the transition from current UK GAAP.

EXEMPTIONS FROM FULL RETROSPECTIVE APPLICATION

The basic principle is that comparatives and current year numbers in the first financial statements affected must be presented using the same accounting policies. As noted above, so that a comparative income statement can be presented in those financial statements it requires a transition date balance sheet to be prepared, which will be two years prior to the first balance sheet date for which numbers are required in accordance with the new regime. However, various exemptions and exceptions from full retrospective application are available in the FRSME, which are discussed in more detail in Part III Section 35. Entities will need to consider which of these exemptions they are going to apply

FUTURE DEVELOPMENTS

As indicated above, the ASB have set out a policy proposal of adapting the IFRS for SMEs for use in the UK only where absolutely necessary, focussing predominantly on areas where it does not conform to the law. The IASB have indicated, meanwhile that they intend to update the IFRS for SMEs every three years to reflect changes made to full IFRS. There are some very significant changes in accounting which the IASB are anticipating bringing into full IFRS, notably in the accounting for leases (which we address in Part III Section 20 below).

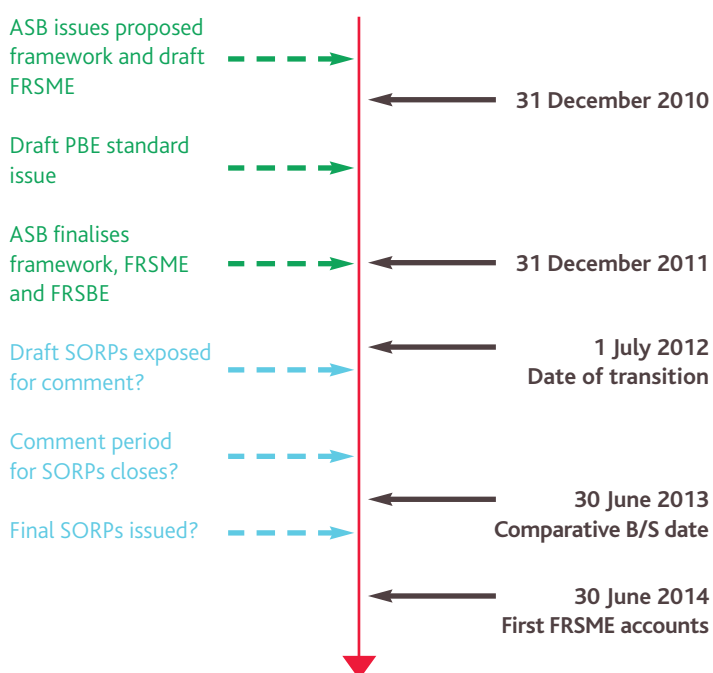
In order to maintain its alignment with standards issued by the IASB it is difficult to envisage situations where the UK's ASB would not in turn update the FRSME for changes made by the IASB to the IFRS for SMEs unless there was some legal impediment. Therefore, entities need to bear in mind not only the immediate accounting that would result from the FRSME in its current form, but other changes looming on the horizon.

3. RESPONDING TO THE PROPOSALS

TIMETABLE

The ASB have set a deadline of 30 April 2011 to respond to the proposals in FREDs 43 and 44, and a deadline of 31 July 2011 for the proposals in FRED 45. This is with the intention of publishing final standards, after considering the responses to these FREDs, by the end of 2011. This would then leave an 18 month lead-in time to the proposed effective date.

However, bearing in mind replacement SORPs can only be finalised once the FRSM and FRSPBE have been issued, and noting that the SORPs will also have to be exposed for public comment before being finalised, the following may be a possible timeline for charities, RPs and HE&FE institutions.



The Charity Commissions has already started work on the new framework with a modular approach to the SORP.

CONSULTATION QUESTIONS

The ASB are asking constituents a total of 41 specific questions related to the proposals on the future of UK GAAP contained in FREDs 43, 44 and 45. For those PBEs that have yet to engage with the ASB as part of the initial consultation, we have identified the following as the most important ones to concentrate on.

FREDS 43 AND 44

1. Do you agree that a differential financial reporting framework, based on public accountability, provides a targeted approach to relevant and understandable financial information that contributes to discharging stewardship obligations?
2. The ASB decided to evaluate possible amendments to the IFRS for SMEs using three guidelines:
 - a) Changes should be minimal;
 - b) Changes should be consistent with EU-adopted IFRS; and

c) Use should be made, where possible, of existing exemptions in Company law to avoid gold-plating.

Do you agree with these guidelines? If not, please explain why.

3. Do you agree with the benefits that have been identified as arising after adoption of the proposed Financial Reporting Framework? If not, why not? Please provide examples, including quantification where possible, of any benefits you believe have not been taken into account.
4. In relation to the case study scenarios identifying the likely costs of transition for certain entities, do you agree with the nature and range of costs identified? If not, please provide details of any alternatives you would propose, including any comments on the assumptions underlying the calculation of the costs.
5. The benefits are hard to quantify; do you agree that they outweigh the costs of transition and any ongoing incremental costs? Do you have any comments on the estimates used?

FRED 45

6. Is the definition of a public benefit entity and the accompanying application guidance clear to enable an entity to determine if it is a public benefit entity? If not, why not?
7. The ASB is proposing an effective date of 1 July 2013 [for the FRSPBE] which is consistent with the effective date of the FRSME. Early adoption will be permitted except for entities subject to a SORP, whereby they will be required to follow the SORP until the effective date of the FRSPBE. Do you agree with
 - (a) The proposed effective date; and
 - (b) The restriction on early adoption?
 If not, what would be your preferred date, and why?

4. FINAL THOUGHTS

The proposals to replace current UK GAAP with the 3-tier framework outlined above could provide a significant challenge to many PBEs. Given the low level of engagement in previous consultations it is important to engage with the ASB, in particular giving opinions as to the cost-benefit trade off that would arise, by the 30 April 2011 deadline. Failure to respond is likely to be inferred as one of ambivalence or tacit agreement to the proposals.

As ever, if you have any queries arising from this publication or want to consider further the impact these proposals would have on your financial reporting, please do not hesitate to get in touch with your usual BDO contact.










PART III – COMPARISON WITH CURRENT UK GAAP

We have analysed the accounting differences into 35 sections, one for each of the sections in the FRSME. Each section discusses the requirements of the FRSME as supplemented by the FRSPBE, and compares it to current accounting practice adopted by charities, registered providers of social housing and HE&FE institutions.

We have updated last year's publication by:

- Including in each section a brief summary of recent developments. This focuses on the impact of the FRSPBE and the extent to which the accounting set out in the FRSME differs from the IFRS for SMEs.
- Commenting, where appropriate, on the accounting required by full IFRS. We feel that, based on the ASB's proposals as they currently stand, a substantial number of tier 2 (i.e. non-publicly accountable) PBEs may voluntarily choose to apply full IFRS so as to obtain a particular accounting treatment that would otherwise not be available to them under the FRSME and FRSPBE.

Where appropriate, the heading of each section makes use of the following key to indicate the level of relevance to NFPs.

Number of entities affected	Charities	HE&FE Institutions	Housing associations
Many			
Some			
Few			

Most sections also end with a bullet point summary making use of a traffic light system to identify the likely significance of the change in accounting for tier 2 entities.

- High significance
- Medium significance
- Low significance

1. SCOPE OF THE FRSME

The FRSME is the new UK GAAP that applies to tier 2 entities. Tier 2 entities are those which:

- irrespective of size do not have 'public accountability' (as defined)
- although 'small' and eligible to apply the FRSS as a tier 3 entity, voluntarily trade up and apply the rules applicable to tier 2 entities.

The FRSPBE does not address this section of the FRSME.

2. CONCEPTS AND PERVASIVE PRINCIPLES

This section of the FRSME describes the objective of financial statements and the qualities that make the information in such financial statements useful, eg relevance, reliability, materiality, and substance over form. It

also acknowledges that the benefits derived from producing financial information in accordance with the FRSME should exceed the cost of providing the information.

This section also sets out the concepts and basic principles underlying such financial statements, including:

- definitions for assets, liabilities, income and expense
- setting the tone for when transactions should be recognised
- discussing the appropriate basis of measuring items in the financial statements (historical cost or fair value).

This is not fundamentally different from the ASB's Interpretation for Public Benefit Entities of its Statement of Principles for Financial Reporting save that the ASB's Interpretation has some change of emphasis and re-expression to make it more relevant to public benefit entities.

The FRSPBE does not address this section of the FRSME.

3 FINANCIAL STATEMENT PRESENTATION

This section explains what is meant by fair presentation of financial statements, what compliance with FRSME requires and what a complete set of financial statements is. Compliance with the FRSME and FRSPBE, with additional disclosure where necessary, will be presumed to result in the financial statements showing a true and fair view. Only in extremely rare circumstances is it envisaged that it might be necessary to invoke a true and fair override.

The FRSME and FRSPBE contain no requirements as to narrative reporting outside of the financial statements (eg operating reviews, trustee reports, etc).

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

None. However, the FRSPBE does suggest that as the standard is developed in the future, consideration will be given to including rules on:

- narrative reporting
- the format of primary statements.

In the meantime the requirements for narrative reports will come from the revised SORPs and guidance issued by the regulatory bodies. The format of primary statements will be driven by the FRSME (see sections 4 to 7 below).

4. STATEMENT OF FINANCIAL POSITION ('BALANCE SHEET')



The statement of financial position is the new name for the balance sheet. The statement of financial position will be different due to changes in the recognition and measurement of certain assets and liabilities. These issues are addressed below from section 11. Furthermore, it is expected that statements of financial position presented under the FRSME might give slightly more detail of liabilities on its face than is the case under current UK GAAP.

A specific issue for HE&FE institutions is that the HE&FE SORP requires endowment assets to be shown separately from other assets in the statement of financial position. It is implicit in the FRSM E that such assets would need to be allocated to the appropriate asset category (eg cash) and not presented as a separate line item. The HE&FE SORP might, therefore, need to be revised in this regard.

The same is true for a charity's programme related investments, a topic which is addressed in the current charity SORP, but not the FRSM E or FRSPBE. The current SORP requires such assets to be presented in the balance sheet as a sub-category of 'investments', but the underlying asset may be more akin to, say, an item of property, plant and equipment.

The FRSPBE does not address this section of the FRSM E.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSM E AND IFRS FOR SMES

In certain situations the IFRS for SMEs permits an entity to present assets and liabilities in order of liquidity rather than requiring a distinction to be made between current and non-current assets and liabilities. In order to comply with European accounting directives, entities applying the FRSM E will have to present assets and liabilities as either current or non-current. Tier 1 entities applying full IFRS, however, would be able to present assets and liabilities in order of liquidity if it is considered that such a presentation would provide information that is reliable and more relevant than separate classification of current and non-current items. It is not expected that the restriction applied in the FRSM E will affect many PBEs.

SUMMARY

Issue	FRSM E and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Creditors	More detail of creditors shown on face.	Creditors often compressed into single line totals for amounts due in less than one year and amounts due after more than one year.	More detail of creditors shown on face.
● Endowment assets for HE&FE institutions	Allocated according to the nature of the underlying endowment asset (implied).	Presented as a separate line item.	Allocated according to the nature of the underlying endowment asset (implied).
● Programme related investment for charities	Allocated according to the nature of the underlying asset (implied).	Presented as a separate line item.	Allocated according to the nature of the underlying asset (implied).

5. STATEMENT OF COMPREHENSIVE INCOME AND INCOME STATEMENT



ONE OR TWO STATEMENT APPROACH

The FRSM E permits performance to be presented in one of two ways. Firstly, it allows the presentation of a single statement of comprehensive income (SOC I). This is similar to the SOFA prepared by charities with 'traditional' items of income and expense giving rise to a net income figure. Other gains and losses (essentially items that under current UK GAAP would be presented in a separate statement of total recognised gains and losses) are then tagged on to the bottom. These other gains and losses are referred to in the FRSM E as items of 'other comprehensive income' which, when added on to the net income figure, give an entity's total comprehensive income for the period.

As an alternative to a single SOC I, the income statement can be presented on its own with a separate statement containing the items of other comprehensive income. This is effectively the same approach as is currently applied by housing associations and HE&FE institutions with separate presentation of (i) an income and expenditure account and (ii) a statement of total recognised gains and losses.

Charitable companies currently present a summary income and expenditure account that excludes endowment receipts and other items of unrealised gains and losses. This arises from the legal requirement to include only realised gains in the profit and loss account, and so the inclusion of such items in the income statement could be open to challenge. The need for charitable companies to present such a summary income statement might fall away with likely developments in company law.

COLUMNAR PRESENTATION

Although not explicitly disallowed, interpretation under full IFRS has tended not to favour 'columnar' presentations. If such an interpretation were to become the norm under the FRSM E, it would represent a significant change for charities that currently have a column for each class of fund in the SOFA. Comprehensive income would instead be allocated to funds in the statement of changes in equity (see below).

In addition, the SOFA ends with a reconciliation of opening and closing funds, effectively making it a statement of changes in equity (see section 6 below). Such an approach is only permitted under the FRSM E if the conditions noted below for presenting such a single statement are met.

ADDITIONAL LINE ITEMS AND EXCEPTIONAL ITEMS

As with current UK GAAP, the FRSM E permits presentation of additional line items, headings and subtotals when such presentation is relevant to an understanding of the entity's financial performance. It does not use the term 'exceptional item', but if an item of income or expense is of such importance to the users' understanding of the financial statements it should be presented separately and so the concept of an exceptional item does exist.

However, unlike current UK GAAP (FRS 3 *Reporting financial performance*) there is no concept of 'operating profit' or of the three types of exceptional items that in accordance with that standard are presented after operating profit (profits or losses on the termination of an operation, costs of a fundamental reorganisation and, most commonly, profits or losses on the disposal of fixed assets).

Although it should be possible to present a line within the income statement called 'operating surplus / (deficit)' under the FRSME, it would appear such exceptional items would have to be charged in arriving at the operating surplus / (deficit). This is the interpretation that has prevailed under full IFRS, which similarly makes no reference to pre- or post-operating exceptional items.

FINANCE COSTS

The FRSME requires finance costs to be shown as a separate line item on the face of the income statement. The charity SORP, however, does not require finance costs to be separately presented. Charities currently allocate interest expense in the SOFA to the expenditure line item which the underlying borrowings are funding.

Note of historical cost profits and losses

The FRSME does not require presentation of a note of historical cost profits and losses.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Presentation of gains and losses	Choice of (i) a single statement of comprehensive income or (ii) income statement presented as a standalone statement with a separate statement of other comprehensive income.	Income and expenditure account presented separately from statement of recognised gains and losses, except for a charity's SOFA which also incorporates a reconciliation of funds.	Choice of (i) a single statement of comprehensive income or (ii) income statement presented as a standalone statement with a separate statement of other comprehensive income.
● Columnar presentation	Might be less prevalent.	Required in SOFA prepared by charities.	Might be less prevalent.
● Exceptional items	All exceptional items charged in arriving at operating surplus / (deficit).	Certain exceptional items may be charged after operating surplus / (deficit).	All exceptional items charged in arriving at operating surplus / (deficit).
● Finance costs	Presented as a separate line item.	Charities do not usually present as a separate line item.	Presented as a separate line item.
● Note of historical cost profits and losses	Not required.	Required.	Not required.

The FRSPBE does not address this section of the FRSME.

6. STATEMENT OF CHANGES IN EQUITY AND STATEMENT OF INCOME AND RETAINED EARNINGS



The term 'equity' is not really used by NFPs, but is essentially the difference between an entity's assets and liabilities and therefore represents its funds or reserves. The FRSME requires a statement of changes in equity as a primary statement, with movements on each component of equity (ie each fund or reserve) being shown separately. Under current UK GAAP and the SORPs, entities usually present a statement of movements on each fund in the notes (for the current year only), and a single statement of the movement in aggregate funds is presented as either a primary statement or in the notes in accordance with FRS 3.

Where the changes in an entity's reserves or funds arise only as a result of:

- profit / surplus (ie income less expenditure) for the period, with no items of other comprehensive income;
- dividends payable (unlikely to be relevant for PBEs); or
- the effects of prior year adjustments,

then the FRSME allows an entity to show a single statement of income and retained earnings. This is the single statement of comprehensive income referred to in section 5, extended further down the statement for these three items to give the total change in net assets during the period. Full IFRS, by contrast does not permit a single statement of retained earnings.

If an entity makes transfers between funds and reserves in the period without affecting aggregate net assets, it is not clear from the FRSME whether or not it would be permissible to make use of this single statement of income and retained earnings, or whether a separate statement of changes in equity would be needed. The same is true when there are no transfers between reserves, only an allocation of total comprehensive income to specific reserves. It is expected that most NFPs would want to show this information clearly and therefore choose to present a separate statement of changes in their reserve and funds position. This is particularly true for charities where total return accounting might apply in respect of their endowment funds.

The FRSME makes no reference to designated funds, which are only internal earmarking decisions common in some NFPs. However, it does not preclude their presentation in the statement of financial position, or transfers between them being made.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Presentation of changes in funds/ reserves	Presented separately as a primary statement except in certain circumstances where it can be appended to the single statement of comprehensive income to form a single Statement of Income and Retained Earnings.	Presented as either a primary statement or in notes, except for charities SORP where it forms part of the SOFA.	Presented separately as a primary statement.

The FRSPBE does not address this section of the FRSME.

7. STATEMENT OF CASH FLOWS

The format of the cash flow statement in the FRSME is divided into only three sections, with all cash flows being classified as relating to operating, investing or financing activities. This contrasts with current UK GAAP (FRS 1 *Cash flow statements*) where cash flows are allocated to potentially nine separate sections of the cash flow statement. Other differences are:

- 'cash' for cash flow statement purposes prepared under UK GAAP means those balances that are available on demand without penalty, whereas the statement of cash flows prepared under the FRSME is a statement of movements in cash and cash equivalents (with deposits accessible within a three month time-frame suggested as meeting the definition of cash equivalents)
- cash flows from operating activities are generally presented on the face of the statement, rather than relegated to the notes as often happens under current UK GAAP
- cash flows from endowment income recognised in the income statement might be presented as operating cash flows under the FRSME rather than cash flows from financing activities
- there are no reconciliations of net debt required under the FRSME.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Categories of cash flows	All cash flows categorised as operating, investing or financing activities.	Potentially nine separate cash flow headings.	All cash flows categorised as operating, investing or financing activities.
● Definition of cash	Includes cash equivalents, ie available in three months without penalty.	Only includes cash available on demand without penalty.	Includes cash equivalents, ie available in three months without penalty.
● Presentation of cash flows from operating activities	Presented on the face of the cash flow statement.	Reconciliation of net operating income to cash flow from operating activities usually presented in the notes.	Presented on the face of the cash flow statement.
● Cash flow from endowment income	Presented as operating cash flows.	Presented as financing cash flows.	Presented as operating cash flows.
● Reconciliations of net debt	Not required.	Required.	Not required.
● Parent company cash flow statement	Not required if parent's separate financial statements are presented along with its consolidated financial statements	No specific exemption, but practice has developed such that it is not given	Required.

The FRSPBE does not address this section of the FRSME.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSME AND IFRS FOR SMES

The FRSME exempts a parent company that presents its own separate financial statements with its consolidated financial statements from having to prepare a cash flow statement for those separate financial statements. As such it incorporates existing practice under UK GAAP, and represents one of the few changes which the ASB are proposing to make to the IFRS for SMEs in arriving at the FRSME. Parent entities applying full IFRS, however, would be required to prepare an individual entity statement of cash flows in addition to a consolidated one.

The exemption in current UK GAAP given to subsidiary companies from preparing a cash flow statement in their separate financial statements is being incorporated into the FRSME for tier 2 entities and would also be extended to qualifying subsidiaries applying full IFRS. Such exemptions are not available in the IFRS for SMEs or full IFRS in their pure form.

8. NOTES TO THE FINANCIAL STATEMENTS (GENERAL REQUIREMENTS)

This section of the FRSME also specifically requires disclosure of:

- judgements made by management in the process of applying the entity's accounting policies
- key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing material adjustments to the carrying amounts of assets and liabilities.

Current UK GAAP (FRS 18 Accounting policies) only requires disclosure of significant estimation techniques.

In addition to these general requirements each financial statement area addressed by the FRSME (see sections 9 to 35 below) requires certain disclosures to be made, and it is estimated there are about 300 in total. This is much fewer than either full IFRS or UK GAAP and could result in shorter annual reports for PBEs.

Of course all disclosure items are not going to be relevant to any single entity (eg an entity without a defined benefit pension scheme can ignore all disclosures relating to such schemes). However, NFPs should still be cognisant of other disclosure requirements imposed by the revised SORPs, the draft PBE standard, legislation and the following regulatory requirements, as these will still be needed in annual financial statements:

- Charities - Charities (Accounts and Reports) Regulations 2008 and the Charities Accounts (Scotland) Regulations 2006
- Housing Associations - Accounting Requirements for Registered Social Landlords General Determination 2006 (expected to be replaced by Accounting Directions)
- HE&FE Institutions - Accounts Directions issued by the LSC and HEFCE.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Volume of disclosures in consolidated financial statements	Potentially less extensive than UK GAAP.	More extensive than FRSME, less extensive than full IFRS.	Extensive disclosure requirements.
● Volume of disclosures in subsidiary financial statements	Reduced disclosure framework available.	No reduced disclosure framework.	Reduced disclosure framework available.

The FRSPBE does not address this section of the FRSME.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSME AND IFRS FOR SMES

The ASB are proposing that certain qualifying subsidiaries should operate under a reduced disclosure framework. Specifically, it is proposed that they would not need to prepare a cash flow statement. In addition some disclosures required by the following sections of the FRSME would not be needed provided the equivalent disclosures are made in the consolidated financial statements of the group in which the subsidiary is included:

- Section 11 'Basic Financial Instruments'
- Section 12 'Other Financial Instrument Issues'
- Section 26 'Share-based Payment' (unlikely to be of relevance to NFPs)
- Section 28 'Employee Benefits'

The ASB has also set out proposals on the disclosure concessions that might be given to qualifying subsidiaries voluntarily applying full IFRS.

9. CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS



ACCOUNTING FOR SUBSIDIARIES

The principles contained in the FRSME concerning the accounting for subsidiaries are very similar to those in current UK GAAP (FRS 2 *Accounting for subsidiary undertakings*) in terms of determining the existence of control and parent-subsidiary relationships as well as the actual consolidation accounting procedures to apply. The ASB did consider the appropriateness of the guidance on control in this section and concluded that it can be interpreted and applied in a PBE context and therefore felt that no separate guidance needed to be included in the FRSPBE. However, they have asked respondents a specific question on this matter as part of the Invitation to Comment in FRED 45.

SEPARATE FINANCIAL STATEMENTS

If a parent entity prepares consolidated financial statements, the FRSME does not require it to publish its own separate financial statements, whereas under current UK GAAP it is common to publish certain information about the parent as an individual entity. The charity and HE&FE SORPs follow the approach in companies' legislation requiring

only the parent entity's individual balance sheet to be presented provided its result for the period is disclosed. RPs, by contrast, are usually present a parent's individual accounts in full as well as its consolidated accounts. There is no indication at present that this approach to presentation of separate financial statements will change.

Under the FRSME, investments in subsidiaries, associates and jointly controlled entities may be measured at cost or fair value. The choice of fair value or cost must be applied consistently to all investments in a single class (subsidiaries, associates and jointly controlled entities). Where fair value is chosen gains and losses must be recognised in the income statement. The accounting for associates and jointly controlled entities in the consolidated financial statements is addressed in sections 14 and 15 respectively.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Sized-based exemption	Requirement for consolidated accounts driven by whether company is incorporated under companies' legislation.	Exemptions exist if group is 'small' as variously defined.	No exemptions from consolidation based on size alone.
● Parent entity's financial statements	No requirement to present a parent entity's individual accounts if consolidated accounts are prepared, although may continue to be required by legislation or regulators.	Usually requirements to present information in relation to the parent (varies depending on type of entity).	No requirement to present a parent entity's individual accounts if consolidated accounts are prepared, although may continue to be required by legislation or regulators.
● Investments in subsidiaries, associates and jointly controlled entities (separate financial statements of investor)	Choice of cost or fair value, with the choice applied consistently to all investments within a particular class. Where fair value chosen, changes in fair value are recognised in the income statement.	Choice of cost or valuation model applied on an investment by investment basis. Revaluations are recognised in reserves.	Fair value or cost model applied consistently to all investments within a particular class. Where fair value chosen, changes in fair value are recognised in income statement. Where an investor has no subsidiaries and therefore does not produce consolidated financial statements, accounts are prepared which include associates and jointly controlled entities using the equity method.

The FRSPBE does not address this section of the FRSME.

10. ACCOUNTING POLICIES, ESTIMATES AND ERRORS



This section of the FRSME distinguishes the required accounting for changes in accounting policies, changes in estimates made in previous periods, and restatements of prior period errors.

The FRSME requires a prior year adjustment for any material prior period error. Current UK GAAP (FRS 3 *Reporting financial performance*) only requires a prior year adjustment for correction of fundamental errors, ie they 'are of such significance as to destroy the true and fair view and hence the validity of those financial statements'. This increases the frequency of any errors found having to be corrected by means of a prior year adjustment, as a fundamental error is generally accepted as meaning an error of greater significance than a material error. Revisions to estimates made in prior periods, however, are not the same as errors and as with UK GAAP are dealt with prospectively in the period the revision arises.

No significant areas of difference between current UK GAAP and the FRSME have been identified with regard to revisions of accounting estimates or changes in accounting policy. However, reference should be made to section 35 below which deals with accounting policy changes arising on transition from current UK GAAP to the FRSME.

For entities that apply full IFRS, any restatement of prior year numbers arising from a change in accounting policy or identification of a material error would also require two years of balance sheet comparatives and notes in the financial statements.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Errors found relating to prior periods	Adjust by means of a prior year adjustment if the error is material.	Adjust by means of a prior year adjustment if the error is fundamental.	Adjust by means of a prior year adjustment if the error is material.
● Two years of comparatives	No requirement	No requirement	Required for any prior year adjustment, whether as the result of a change in accounting policy or the correction of a material error.

The FRSPBE does not address this section of the FRSME.

11 BASIC FINANCIAL INSTRUMENTS



INTRODUCTION

A widely held misconception is that accounting for financial instruments is something that is only of relevance to banks and other complex financial institutions. However, if you have any of the following common instruments, for example, then the accounting could be different under the FRSME:

- investments
- derivatives, such as interest rate swaps or foreign currency contracts

- loans granted at off-market rates of interest (both loans payable and loans receivable)
- bad debt provisions.

Depending on accounting choices made, the accounting for certain features of contracts may also be affected. For example:

- contracts where the consideration is denominated in a foreign currency might result in the foreign currency element of that contract being accounted for as a derivative
- a term extension or prepayment feature on a fixed rate loan has value that might need to be accounted for separately from the loan
- the liability to pay rentals that fluctuate by some variable other than inflation might need to be separated into more than one component with the element of the liability that fluctuates accounted for at fair value.

Such features are known as 'embedded derivatives'.

Accounting for most financial instruments under current UK GAAP has developed by convention due to a general lack of guidance in accounting standards and SORPs. However, those accounting conventions are not always consistent with the rules on financial instruments in the FRSME. That is not to say the accounting for financial instruments will necessarily change dramatically on transition from current UK GAAP for all entities, but the extent to which entities will be affected is going to be driven by the types of financial instruments they have and the complexity of the contracts they have entered into.

The accounting for financial instruments is the only topic where the FRSME gives the choice of applying the rules in full IFRS (specifically IAS 39 *Financial Instruments: Recognition and Measurement*) instead of applying the rules contained wholly within the FRSME. We have not included a discussion on the potential impact of making such a choice for two reasons. Firstly, because of the complexity of full IFRS, we suspect that most PBEs would choose to apply the rules in the FRSME outlined above.

Secondly, the accounting for financial instruments under full IFRS is currently undergoing major revisions. Given the ASB's policy of ensuring the FRSME is as closely aligned as possible to the IFRS for SMEs, coupled with the IASB's intention to update the IFRS for SMEs every three years for changes to full IFRS, there is a good chance that by June 2014 the FRSME will not give the choice of cross referring to full IFRS. Or, if it does give such a choice, then it may cross-refer to a revised set of rules rather than IAS 39.

The self-contained rules for financial instruments in the FRSME distinguish between the accounting for 'basic financial instruments' and the accounting for 'other financial instrument issues', specifying the following treatment for basic financial instruments:

- Equity instruments are measured at fair value if publicly traded or fair value can otherwise be measured reliably, with changes in fair value recognised in the income statement. Other equity instruments are measured at cost less impairment. Note that just because an investment is not listed, does not mean that its fair value cannot be measured reliably.
- Debt instruments (as defined) are measured at amortised cost. This would include most monetary payables and receivables, including intercompany balances.

INVESTMENTS

The charity, HE&FE and housing association SORPs take a different approach to the accounting for investments. Both the charity and housing association SORPs require all investments to be measured at fair value. The HE&FE SORP adopts a mixed cost and fair value measurement approach driven by whether the investments are classified as current assets (cost) or fixed assets (fair value if listed).

Changes in fair value are also treated differently. The charity SORP requires changes in fair value to be shown in the 'gains and losses on investments' line in the bottom half of the SOFA. The HE&FE and housing association SORPs require fair value gains and losses to be recognised in the statement of recognised gains and losses, except for falls in value below original cost, which are recognised in the income statement. The FRSME by contrast requires all changes in the fair value of equity investments to be shown in the income statement.

The FRSME requires all equity investments to be measured at fair value with gains and losses reported in the income statement. Investments in all non-complex debt instruments, on the other hand, are measured at amortised cost.

DEBT INSTRUMENTS AND CONCESSIONARY LOANS

Under the FRSME, all debt instruments (payable and receivable) must be initially measured at fair value. This is likely to impact the accounting for loans (including intercompany loans) where the interest rate charged is at an off-market rate. It entails discounting the cash flows under the loan arrangement at a market rate of interest which gives rise to income (for loans payable) and expense (for loans receivable) at the point the loan is made. Subsequently, a market rate of interest is imputed to accrete the loan up to the amount ultimately payable or receivable on settlement.

The FRSPBE, however, introduces an alternative treatment for PBEs for what it terms 'concessionary loans'. A concessionary loan is defined as one that is 'below the prevailing market rate of interest which is not repayable on demand'. As an accounting policy choice, PBEs may choose to apply the vanilla treatment set out above to such concessionary loans (ie initially recognise at fair value with the imputing of interest until repayment). Alternatively they are permitted to record such concessionary loans at the amount paid or received, adjusted in each subsequent period to reflect accrued interest payable or receivable.

Although the inclusion of this accounting for PBEs will be a welcome simplification for some PBEs, where the loan counterparty is a fellow group member that is not a PBE there will be certain complications to deal with on consolidation as the non PBE will have to account for the loan in accordance with the FRSME not the FRSPBE.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE introduces an option to allow PBEs to account for concessionary loans in the same way as is normal under current UK GAAP. Such accounting is inconsistent with the FRSME and therefore would not be available to non PBEs. This is an interesting development as originally it was thought that the FRSPBE would only ever be a 'gap' standard, i.e. setting out the accounting for transactions and balances relevant to PBEs that were not addressed by the FRSME.

Furthermore, the accounting set out in the FRSPBE for concessionary loans would also not be available to PBEs applying full IFRS.

PROVISION FOR BAD DEBTS

There may be changes needed to some entities' accounting policy for bad debts. To provide for a bad debt under the FRSME, there must first be objective evidence of impairment such as the debtor has exceeded credit terms (known as the 'incurred loss basis').

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Equity investments (other than investments in subsidiaries, associates and joint ventures)	Generally measured at fair value, with changes in value recognised in the income statement.	Changes in fair value generally not recognised in income statement. HE&FE SORP does not require all investments to be measured at fair value.	Measured at fair value with gains and losses, other than impairments, generally recognised in reserves. May be designated as being at fair value through profit and loss if performance of the investment is evaluated on a fair value basis in accordance with a documented risk management or investment strategy.
● Investment loans	Measured at amortised cost	Changes in fair value generally not recognised in income statement. HE&FE SORP does not require all investments to be measured at fair value.	Measured at amortised cost if the investor can demonstrate its intention to hold the investment to maturity. Otherwise treatment is as for equity investments.
● Concessionary loans (i.e. loans at below market rates, including interest free loans)	Choice of either (i) recognise at the amount borrowed or lent with interest charge reflecting the rate charged; or (ii) initially recognise at fair value with interest imputed over the term to repayment.	Recognised at the amount borrowed or lent. Interest charge reflects the rate charged.	Initially recognise at fair value with a fair interest imputed over the term to repayment.
● Bad debt provisions	Bad debts provided for on an incurred loss basis.	Bad debts often provided for on an expected loss basis.	Bad debts provided for on an incurred loss basis.

12 OTHER FINANCIAL INSTRUMENT ISSUES



Derivative instruments are not classified as 'basic' financial instruments under the FRSME and are therefore always measured at fair value in the balance sheet. The approach known as 'synthetic accounting' used in UK GAAP (where, say, a floating rate loan and a floating-to-fixed rate swap are combined for accounting purposes and treated as a single fixed rate loan) is not permitted. Instead the hedging instrument and hedged contract must be accounted for separately. It is possible to achieve a similar income statement effect under the FRSME as is achieved under UK GAAP ('hedge accounting'), but it is necessary to adhere to certain procedures and processes. In such circumstances the changes in fair value of the derivative is recognised as an item of other comprehensive income. Where hedge accounting is not applied, then all changes in the fair value of derivatives are recognised in the income statement (top half of the statement of comprehensive income).

The term 'embedded derivative' does not exist in the self contained financial instrument rules in the FRSME. However, their presence might cause a loan contract to fail the 'basic' test, resulting in it being measured in its entirety at fair value with gains and losses taken to the income statement. In addition, any contract for the supply of goods and services that imposes risks on either party to the contract that are not typical of such contracts might need to be accounted for at fair value with gains and losses taken to the income statement. Although most PBEs have probably not entered into contracts with features that would result in the entire contract having to be measured at value, auditors might still want to see evidence that organisations can demonstrate this is the case for contracts in place.

STOP PRESS!

As noted above, the IASB is undergoing a thorough review of the accounting for financial instruments in an attempt to simplify the current requirements of IAS 39 Financial Instruments: Recognition and Measurement. In the past 18 months they have issued revised accounting dealing with the classification and measurement of financial assets and liabilities. In addition, they have issued proposed revisions to the current rules dealing with

- impairment of financial assets;
- hedge accounting
- offsetting of financial assets and liabilities.

The effect of these revised and proposed standards will be to:

- Reduce the categories of financial assets from four down to two (those measured at cost and those measured at fair value) thereby aligning with the simplified accounting already contained in the FRSME.
- All equity investments to be measured at fair value. For each investment choice is made as to whether changes in fair value, dividends and gains/losses on disposal are recognised in the income statement, or whether all such items are recognised as an item of other comprehensive income.
- Remove the concept of an 'embedded derivative' in financial asset contracts but retain them for financial liability contracts.
- Replace the current 'incurred loss' model for recognising bad debts with an 'expected loss' model.
- Simplify the approach to demonstrating hedge effectiveness for the purposes of being able to apply hedge accounting.
- Permit offsetting of financial assets and liabilities only when the right of set-off is enforceable at all times.

It is not yet known when or how the FRSME will be revised on the back of these changes to full IFRS.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Derivative instruments	Measured at fair value. Gains and losses recognised in income statement unless hedge accounting applied, in which case movements in fair value are recognised as an item of other comprehensive income to the extent effective.	Derivatives generally accounted for synthetically by assuming that the derivative changes the terms and conditions of the hedged contract.	Measured at fair value. Gains and losses recognised in income statement unless hedge accounting applied.
● Hedge accounting	Limited number of scenarios in which hedge accounting is permitted. In addition, documentation must be put in place at start of hedge with an expectation that the hedging relationship will be effective.	No specific requirements regarding hedge accounting.	Detailed rules on the circumstances on which hedge accounting can be applied. In addition to documenting the hedge and expecting the hedging relationship will be effective, the degree of hedge effectiveness must be tested on a prospective and retrospective basis.
● Embedded derivatives	Existence potentially results in the entire contract being measured at fair value with changes in fair value recognised in the income statement.	Generally not accounted for separately from the host contract. No requirement to measure the entire contract at fair value if they are present.	Existence potentially results in the embedded derivative feature having to be accounted for separately from the host contract at fair value with changes in fair value recognised in the income statement.

The FRSPBE does not address this section of the FRSME.

13 INVENTORY



Other than a change in terminology (raw materials, work-in-progress and finished goods are referred to as 'inventory' not stock), there are two main challenges facing PBEs: donated goods and capitalised interest.

DONATED GOODS

The FRSPBE requires donated goods to be measured at fair value on receipt. This will represent a significant accounting change for charities with retail operations who, in accordance with the charity SORP, do not account for donated goods until sold. Where a PBE has received a large number of small value donated goods, the FRSPBE states that it is acceptable to estimate their value taking into account past experience and expectations.

Rather than donate items to charity shops, it is becoming increasingly common for charities to offer to act as an agent in the sale of unwanted goods with the anticipation that the proceeds of sale will be donated to the charity. This is more advantageous to both the charity and the donor because gift relief can be claimed on a cash donation but not a donation of goods.

On the one hand, given the incidence of donor-sellers ultimately choosing not to donate the proceeds of sale (or reclaim the goods prior to sale) is so low there appears a strong argument that the asset recognition criteria is met at the point it is asked to act as agent. On the other hand, legally the charity shop is only acting as an agent and therefore any asset or income is contingent until such time as the donor has given up their right to the proceeds of sale. This might be something the replacement charity SORP would give more explicit guidance on.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE includes a section on the accounting for incoming resources arising from non-exchange transactions (such as donated goods), requiring them to be accounted for as an asset at fair value on receipt. The inclusion of such guidance in the FRSPBE will represent a substantial change for charities with retail operations, who currently only account for such transactions once the donated goods are sold.

It is unclear to what extent the FRSPBE would apply these principles through to trading subsidiaries. Given that the FRSPBE does not identify this as something which is incompatible with full IFRS, arguably it should be considered a treatment which is permitted for non PBEs, or perhaps even required.

CAPITALISED INTEREST

Under the FRSME interest cannot be capitalised as part of the cost of inventory. This is a major issue for developer RPs and is addressed further in section 25 below.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Recognition of donated goods	Recognised at fair value when made available, giving rise to donation income.	Not recognised, with income arising only on sale of the goods received.	Implied that accounting would be the same as tier 2.
● Interest incurred on borrowings used to fund the production of inventory	Expensed as incurred.	Expensed as incurred or capitalised.	Must be capitalised if arising on the production of a qualifying asset.

14 INVESTMENTS IN ASSOCIATES (CONSOLIDATED FINANCIAL STATEMENTS)



The key area of difference identified is that under current UK GAAP the share of associates' losses must be recognised in full, even if it results in the investment in associate being presented as a net liability in the balance sheet. This contrasts with the FRSME where the share of losses in excess of the cost of investment would generally not be recognised.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSME AND IFRS FOR SMES

Under the IFRS for SMEs an investor has the choice of three models in accounting for its investments in associates:

- cost;
- equity method; or
- fair value.

However, in developing the FRSME the ASB decided to require the equity method for tier 2 companies to ensure compliance with EU accounting directives and enhance comparability.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Share of losses	No recognition of share of losses in excess of cost of investment.	Share of all losses recognised.	No recognition of share of losses in excess of cost of investment.

The FRSPBE does not address this section of the FRSME.

15 INVESTMENTS IN JOINT VENTURES (CONSOLIDATED FINANCIAL STATEMENTS)



UK GAAP (FRS 9 *Associates and joint ventures*) identifies two types of joint venture activities. The first, joint ventures (JVs), are accounted for using the gross equity method in an investor's consolidated accounts.

The second type of arrangement identified by FRS 9 is a joint arrangement that is not an entity (JANE). JANEs are distinguished from JVs in that the former do not carry on a trade or business of their own, rather are more like a cost- or risk-sharing means of carrying out a process in the participants' trades or businesses. The acronym JANE is arguably a misnomer as some arrangements need to be accounted for as a JANE even though a separate entity may have been legally constituted. Such arrangements are found in property development activities of RPs and shared activities in higher education institutions. FRS 9 requires an investor to account directly for the underlying income and expenditure of a JANE, rather than a share of profits, as this better reflects the substance of the arrangement.

The FRSME, by contrast, identifies three different types of joint venture arrangements: jointly controlled entities (JCEs), jointly controlled operations (JCOs) and jointly controlled assets (JCAs). The difference with current UK GAAP is that anything constituted as a separate legal entity must be accounted for as a JCE, even if the substance of the

arrangement is such that it does not carry on a trade or business of its own. Furthermore, JCEs are accounted for under the equity method - the concept of gross equity accounting does not exist in the FRSME.

The accounting requirements for JCOs and JCAs are similar to that for JANEs, save that what drives the classification as JCO or JCE is the absence of a separate legal entity rather than the absence of a trade or business distinct from the venturers.

As with the accounting for associates, current UK GAAP requires the share of losses in excess of cost to be recognised, even if it results in a net liability in the balance sheet. This contrasts with the FRSME where the share of losses in excess of cost would generally not be recognised.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSME AND IFRS FOR SMES

As with the accounting for associates, under the IFRS for SMEs an investor has the choice of three models in accounting for its investments in JCEs:

- cost;
- equity method; or
- fair value.

However, in developing the FRSME the ASB decided to require the equity method for tier 2 companies to ensure compliance with EU accounting directives and enhance comparability.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Types of arrangement	Distinction made between JCEs, JCAs and JCOs.	Distinction made between JVs and JANEs.	Distinction made between JCEs, JCAs and JCOs.
● Accounting for JANEs	Classification of JCA or JCO only possible if the arrangement does not involve the creation of a separate legal entity.	Classification as JANE where the substance of the arrangement does not constitute a separate trade, irrespective of whether a separate legal entity is created	Classification of JCA or JCO only possible if the arrangement does not involve the creation of a separate legal entity.
● Basis of Accounting for JCEs	Equity method.	Gross equity method.	Equity method.
● Share of losses	No recognition of share of losses in excess of cost of investment.	Share of all losses recognised.	No recognition of share of losses in excess of cost of investment.

The FRSPBE does not address this section of the FRSME.

16 INVESTMENT PROPERTY



MEASUREMENT BASIS

As with UK GAAP (SSAP 19 *Accounting for investment properties*), investment properties are measured at fair value under the FRSME. However an option to account for investment property at depreciated cost is also available if revaluation would entail undue cost or effort. It remains to be seen how 'undue cost or effort' will be interpreted and therefore whether many entities will avail themselves of this option.

DEFINITION OF INVESTMENT PROPERTY

The development of the housing SORP involved considerable debate over whether social housing properties should be classified as investment property under SSAP 19 or owner-occupied property under FRS 15 *Tangible fixed assets*. The conclusion reached was the latter on the basis that the primary purpose of the properties is the provision of social housing rather than to earn rentals. The FRSPBE similarly proposes that properties held for the primary provision of social benefits will be accounted for as owner-occupied, rather than as investment, property.

While this may come as a relief to those who would not have wanted the cost associated with annual revaluations of investment property, there are a number of other considerations:

- The FRSME does not permit a policy of revaluation for owner-occupied property. This is discussed further in section 17 below.
- Given that RPs' new lettings and re-lets could result in up to 80% of the full market rent being charged, it becomes less clear that the primary purpose of all social housing properties owned by RPs is the provision of social benefits. Therefore, for some properties at least, the debate may still be open as to whether they should be accounted for as investment property. This might be an issue on which the replacement housing SORP could give further clarification.
- There are some very significant changes looming under full IFRS which will be relevant to tier 1 RPs with regards to lessor accounting, which could see social housing properties replaced in the financial statements with debtors, and rental income replaced with interest receivable. Such accounting could also be incorporated into the FRSME at a later date. The accounting for leases is addressed further in section 20 below.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE clarifies that properties held for the primary provision of social benefits, eg social housing, should be accounted for as property, plant and equipment (see section 17 below) and not investment property.

PROPERTIES RENTED TO OTHER MEMBERS OF THE SAME GROUP

SSAP 19 specifically precludes properties rented to other members of the same group from being accounted for as investment property. The FRSME definition contains no such exception, resulting in properties rented to other group members having to be accounted for as investment property in the individual accounts of the entity concerned. This might be one area in which it would be valid to claim that applying fair value causes undue cost or effort. This is because any such valuation movements would have to be reversed on consolidation given that from a consolidated perspective the property would be classified as owner occupied to which a policy of cost must be applied.

ACCOUNTING FOR CHANGES IN FAIR VALUE

Where investment properties are measured at fair value, the FRSME requires gains and losses to be reported in the income statement (top half of the statement of comprehensive income). Charities currently present such gains and losses in the bottom part of the SOFA and other PBEs recognise them in the statement of total recognised gains and losses.

LEASEHOLD INVESTMENT PROPERTY

If leasehold property is held as investment property, under UK GAAP it is often valued at the net of future rentals receivable on the sub-leases and rentals payable under the head lease. The FRSME require gross presentation with the value of the rents receivable being presented as an asset and revalued each year, with the liability to pay rent on the head lease accounted for separately as a finance lease obligation.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Changes in fair value	Recognised in the income statement (top half of statement of comprehensive income).	Recognised in statement of total recognised gains and losses (or bottom half of SOFA).	Recognised in the income statement (top half of statement of comprehensive income).
● Properties rented to other group entities	Accounted for as investment property in individual accounts and property, plant and equipment in group accounts.	Classified as owner-occupied property in both the individual and group accounts.	Accounted for as investment property in individual accounts and property, plant and equipment in group accounts.
● Leasehold investment property	Account separately for gross value of property interest and obligations payable on the head lease.	Usually account for the net leasehold interest.	Account separately for gross value of property interest and obligations payable on the head lease.

17 PROPERTY, PLANT AND EQUIPMENT



MEASUREMENT BASIS

All items of property, plant and equipment must be measured at cost under the FRSME. Unlike current UK GAAP, there is no option to adopt a policy of revaluation. There are two exceptions to this rule introduced by the FRSPBE:

- in line with FRS 30 *Heritage assets*, the FRSME permits an entity to adopt a policy of revaluation for heritage assets
- for PBEs, any assets that are received in a non-exchange transaction (ie where the recipient is not required to give up approximately equal value in exchange) are initially recognised at fair value. This accords with the balance sheet treatment currently set out in the SORPs.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

With the publication of the FRSPBE, the ASB have indicated their intention to incorporate into the FRSME rules dealing with the accounting for heritage assets. It is proposed that the accounting for heritage assets will broadly follow the same treatment as set in FRS 30. Heritage assets are not considered to be items of property, plant and equipment (possibly in order to justify why they may be subject to a policy of revaluation) and must be presented separately on the face of the balance sheet. Accordingly the rules are dealt with in section 34 of the FRSME and not this section.

The FRSPBE also introduces a requirement for assets received in a non-exchange transaction (ie where the recipient is not required to give up approximately equal value in exchange) to be recognised initially at fair value. This is consistent with the way the SORPs require donated fixed assets to be accounted for.

The FRSPBE does not indicate that the requirements in relation to donated assets are incompatible with full IFRS. Therefore it might be expected that tier 1 PBEs would also refer to the guidance in the FRSPBE in formulating an accounting policy for the receipt of donated items of property, plant and equipment.

INTEREST PAYABLE

The FRSME, unlike UK GAAP, does not permit the capitalisation of interest on funds borrowed to construct an asset. Tier 1 entities applying full IFRS, by contrast, are required to capitalise interest incurred on borrowings used to fund the construction of a qualifying asset. This is a major issue for RPs and is addressed further in section 25 below.

MIXED USE PROPERTIES

Some entities own property that is partially occupied by the organisation for its own purposes and partially rented to third parties. Under current UK GAAP some entities apportion the property between an investment element and a non-investment element, accounting for the former as investment property and the latter as a tangible fixed asset. Indeed, the charity SORP requires this treatment if the components are clearly identifiable. The housing association SORP is silent on the matter, with some choosing to account for properties as owner-occupied property even though there may be an investment property element (such as ground floor shops, doctor surgeries and community centres) on the basis that the property is predominantly used for social housing purposes and needed in providing amenities to the community served. The HE&FE SORP is similarly silent on the issue.

The FRSME, however, requires mixed use properties to be split into their respective components and accounted for separately. The only basis for not doing such a split, other than materiality, is that to attempt a revaluation of the portion held for investment would give rise to 'undue cost or effort'.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Measurement	Revaluations not permitted.	Revaluations permitted.	Revaluations permitted.
● Borrowing costs	Capitalisation not permitted.	Choice of capitalising or expensing.	Capitalisation required.
● Mixed use property	Account for owner-occupied and investment portions separately.	Split accounting permitted, or alternatively account for entire property based on the main use.	Account for owner-occupied and investment portions separately.

18 INTANGIBLE ASSETS



RESEARCH AND DEVELOPMENT

It is not unknown for higher education institutions to enter into commercial R&D activities. For such entities the HE&FE SORP follows the requirements of current UK GAAP (SSAP 13 *Accounting for research and development*) permitting, but not requiring, development costs to be capitalised if certain criteria are met. The FRSME requires all research and development costs to be written off as incurred. This contrasts with full IFRS where capitalisation is required if criteria similar to those in SSAP 13 are met.

ARISING ON ENTITY COMBINATIONS

The accounting for entity combinations is discussed in Section 19 below. Suffice to say at this point that certain combinations of PBEs are likely to result in the recognition of intangible assets in the financial statements of the acquirer. Those intangibles would then be amortised over their estimated useful economic lives.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● R&D costs	Capitalisation of development costs not permitted.	Choice of expensing development costs or capitalising if specified criteria are met.	Capitalisation of development costs required if specified criteria are met.
● Intangibles identified on acquisitions and in-substance gifts	Initially recognised at fair value whether or not recognised in the acquiree's balance sheet. Thereafter amortised over estimated useful economic life.	Usually subsumed within goodwill.	Initially recognised at fair value whether or not recognised in the acquiree's balance sheet. Thereafter amortised over estimated useful economic life.

The FRSPBE does not address this section of the FRSME.

19 BUSINESS COMBINATIONS AND GOODWILL



The FRSME requires all business combinations to be accounted for using the acquisition method. However, the FRSPBE argues that in many (but not all) combinations involving PBEs the application of acquisition accounting does not necessarily reflect the substance of the combination. It therefore sets out two other treatments which, depending on the circumstances, may be more appropriate than normal acquisition accounting:

- mergers
- combinations at nil or nominal consideration that are in substance a gift.

Importantly, though, the FRSPBE explicitly states these two alternatives would not be available for tier 1 entities applying full IFRS.

ACQUISITIONS

The acquisition method of accounting will apply to situations where one entity has taken over another in an arm's length transaction for valuable consideration. Such transactions do occur in the not-for-profit sector and require the acquiree's identifiable assets and liabilities to be subject to a fair value exercise. Under the acquisition method the acquiree's income and expenditure is only incorporated into the acquirer's consolidated income statement from the date of the combination.

The excess of any consideration paid over the fair value of net assets acquired is classified as goodwill and is depreciated over its useful economic life. Direct costs of an acquisition are capitalised under both current UK GAAP and the FRSME as part of the consideration paid, but must be expensed under full IFRS.

Although not recognised in the balance sheet, much of an acquiree's value might relate to intangible assets (brand names, logos, copyrights, inherent contract value, etc). When accounting for an acquisition under the FRSME, it is likely that more of the acquiree's intangibles would be recognised on consolidation than is the case under current UK GAAP. There are three reasons for this:

- Firstly, current UK GAAP only permits intangibles to be recognised where they are separable (ie can be disposed of separately without disposing of the acquired entity's business). The FRSME contains no such restriction.
- Secondly, the FRSME asserts categorically that 'an intangible asset acquired in a business combination can be measured with sufficient reliability'. By contrast, current UK GAAP implies that only entities regularly engaged in the purchase of unique intangibles are likely to be able to measure such intangibles with sufficient reliability.
- Thirdly, current UK GAAP does not permit the amount of any negative goodwill arising on acquisition to be increased through the recognition of intangible assets. The FRSME, however, contains no such restriction. If an intangible asset has been identified, then it should be recognised on acquisition at fair value even if it creates or increases negative goodwill.

There is a rebuttable presumption in the FRSME that positive goodwill has a maximum useful economic life of 5 years. This contrasts with 20 years under current UK GAAP and a system of annual impairment reviews instead of amortisation under full IFRS.

Under current UK GAAP (FRS 10 *Goodwill and intangible assets*) and the FRSME, negative goodwill up to the fair value of the non-monetary assets acquired is recognised in the income statement in the periods in which the non-monetary assets are recovered, whether through depreciation or sale. Any negative goodwill in excess of the fair values of the non-monetary assets acquired is recognised in the income statement in the

periods expected to benefit. Full IFRS, by contrast, does not permit negative goodwill to be carried forward in the balance sheet. Rather it requires the immediate recognition of a gain in the income statement.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSM E AND IFRS FOR SMES

For goodwill arising on acquisitions, the FRSM E states that goodwill has a rebuttable presumed useful economic life of 5 years. This contrasts with the presumed useful economic life of 10 years specified in the IFRS for SMEs. The amendment was necessary to ensure that the FRSM E did not conflict with European accounting directives.

The IFRS for SMEs, like full IFRS, does not permit negative goodwill to be carried forward in the balance sheet, but rather requires immediate recognition as a gain in the income statement. However, immediate recognition is inconsistent with European directives and so in developing the FRSPBE the ASB decided to retain the same accounting treatment as current UK GAAP.

MERGERS

For a combination to be classified as a merger under the FRSPBE, all of the following criteria must be met:

- no party to the combination is portrayed as either acquirer or acquiree, either by its own board or management or by that of another party to the combination
- there is no significant change to the class of beneficiaries of the combining entities or the benefits provided as a result of the combination
- all parties to the combination, as represented by the members of the board participate in establishing the management structure of the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.

The criteria in FRS 6 *Acquisitions and mergers* concerning the relative sizes of the combining entities has not been carried forward into the FRSPBE and has instead been replaced by an assessment of whether there has been a significant change to the beneficiaries of the combining entities. The accounting for mergers is unchanged from that set out in FRS 6 and requires book values (as adjusted to ensure uniformity of accounting policies) rather than fair values of the combining entities to be used.

Comparatives are presented as if the two combining entities had always formed a single reporting entity, although the FRSPBE contains an explicit requirement that such comparatives be headed up as 'pro-forma' on the grounds that the merged entity did not exist in the comparative period. Interestingly, the current year income statement and statement of cash flows are not required to be headed up 'pro-forma' even though the merged entity also might not have existed for the whole period.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE permits the use of merger accounting where certain criteria are met for tier 2 entities only, but states that such treatment would not be available for entities applying full IFRS.

COMBINATIONS WHICH ARE IN SUBSTANCE GIFTS

Some combinations do not meet the conditions to be classified as a merger, and at the same time acquisition accounting might also not be appropriate due to the absence of any consideration paid in effecting the combination. Where this is the case, the combination might in substance be indistinguishable from the gift by one entity of its assets to another. In

such combinations the FRSPBE requires the receiving entity to measure the assets received and liabilities assumed at their fair value, with the net amount recognised as a gain in the income statement. The housing SORP Update 2010 introduces a similar treatment for accounting periods beginning on or after 1 April 2011.

The FRSPBE notes that except for treating the fair value of assets received as a gift, all other aspects of the transaction should be accounted for in accordance with the FRSM E (ie as an acquisition). Consequently it would seem that the receiving entity should similarly recognise all intangible and heritage assets received in such combinations at fair value, irrespective of whether such assets were recognised in the balance sheet of the donor entity.

It would perhaps be a mistake to assume that in a entity combination involving PBEs there is no value to recognise in relation to the intangibles of the entity identified as the acquiree (in an acquisition) or the donor entity (in an in-substance gift). A decision to mothball intangibles such as brands and logos post combination would give rise to a post combination impairment of such assets rather than attributing them with a fair value of nil on the date of acquisition or donation.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE identifies combinations which are in substance more akin to a gift of net assets rather than an acquisition of one entity by another. Accordingly they should be accounted for as a gift by the donee.

SUMMARY

Issue	FRSM E and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Direct costs of acquisition	Capitalised.	Capitalised.	Expensed.
● Goodwill	Rebuttable presumption that useful economic life is limited to 5 years.	Rebuttable presumption that useful economic life is limited to 20 years.	Goodwill not amortised, rather subject to mandatory annual impairment review.
● Negative goodwill	Negative goodwill deferred in balance sheet and released to income statement over appropriate periods.	Negative goodwill deferred in balance sheet and released to income statement over appropriate periods. RPs recognise negative goodwill in reserves. Others recognise as a credit balance within fixed assets.	Credited immediately to income statement in full.
● Merger accounting	Permitted.	Permitted.	Not permitted.
● Combination that is in substance a gift	Identified and permitted.	Identified and permitted by Housing SORP Update 2010.	Not identified, but explicit in FRSPBE that such accounting is not permitted.

SUMMARY CONTINUED

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Intangibles identified on acquisitions and combinations that are in substance gifts	Initially recognised at fair value whether or not recognised in the acquiree's balance sheet. Thereafter amortised over estimated useful economic life.	Usually subsumed within goodwill.	Initially recognised at fair value whether or not recognised in the acquiree's balance sheet. Thereafter amortised over estimated useful economic life.

20 LEASES



Under the FRSME the broad approach to classifying leases as finance or operating is the same as current UK GAAP (SSAP 21 *Accounting for leases and hire purchase contracts*). There are, however, some specific areas of potential difference in the detail that could affect some NFPs.

LEASEHOLD PREMIUMS PAID

Under current UK GAAP leasehold premiums are normally presented as tangible fixed assets (namely the underlying property interest acquired) and depreciated over the lease term. On transition to full IFRS many entities presented such assets as prepayments of rent and so it might be expected that a similar approach will be taken under the FRSME, which does not address the accounting for such premiums. This also has the effect of reclassifying some of the leasehold premium balance as a current asset, ie the portion that will be expensed in the next accounting period.

OPERATING LEASE INCENTIVES

The FRSME also contains no guidance on the accounting for lease incentives. Current UK GAAP (UITF 28 *Operating lease incentives*) generally requires lease incentives to be spread over the period to the first rent review. Full IFRS, however, requires that lease incentives be spread over the minimum lease term. This generally means to the end of the lease, or possibly earlier if there is a break clause. As the basis of expense recognition in both full IFRS and the FRSME are similarly worded, the accounting required by full IFRS might end up being the default for entities applying the FRSME.

DISCLOSURE

For lessees, the FRSME requires the total future minimum lease commitments to be disclosed, analysed by when the leases expire. By contrast, current UK GAAP requires disclosure of the annual lease commitment, analysed by when the lease expires. In this respect, the FRSME provides information on the total off-balance sheet finance obtained through operating leases as opposed to the approach in current UK GAAP of focussing on the future annual expense and cash outflow.

Entities may find that they are caught by disclosures in their capacity as lessor, which are more extensive than are required under UK GAAP. In addition to a general description of significant leasing arrangements, the FRSME requires a maturity analysis of the total future minimum lease payments receivable to be disclosed, effectively the equal and opposite disclosure that lessees must provide. This could affect housing associations in particular where there is a minimum future rental due under non-cancellable tenancy agreements, although such considerations might get overtaken by developments in lease accounting in general discussed below.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Leasehold premiums paid	Not addressed.	Leasehold premiums paid generally classified as a property asset.	Leasehold premiums paid classified as prepayments.
● Lease incentives	Not addressed.	Lease incentives spread over the period to first rent review.	Lease incentives spread over the minimum lease term.
● Disclosure of operating lease commitments	Disclosure required of the total future minimum lease commitment.	Disclosure required of the annual lease commitment.	Disclosure required of the total future minimum lease commitment.
● Disclosure of operating lease receivables	Disclosure required of the total future minimum lease receivable.	Disclosure of aggregate rentals receivable in the period.	Disclosure required of the total future minimum lease receivable.

The FRSPBE does not address this section of the FRSME.

STOP PRESS!

The accounting for leases under full IFRS is expected to change in the near future, which will obviously impact those PBEs that are publicly accountable, or those who voluntarily 'trade up' to tier 1. However, given that:

- the IASB has indicated that it intends to update the IFRS for SMEs every 3 years to incorporate changes made to full IFRS
- the UK's ASB has formulated a policy with regards to the FRSME of keeping it as closely aligned to the IFRS for SMEs as is legally possible
- there is the prospect that in time the FRSSE will also give way to the FRSME,

the implications of the proposals on lease accounting should arguably be borne in mind by all PBEs, not only those in tier 1.

The headline difference is that all lease liabilities would come on balance sheet with a corresponding 'right of use' asset recognised. To the extent a PBE leases offices, equipment or vehicles under operating leases, these proposals will of course be of relevance with the impact driven by the extent of its leasing activities. Where a lease contract combines both the right to use an asset as well as on-going services (as is common in, say, leases of car fleets, photocopiers or computers) it is necessary to disaggregate the contracted payments into their component parts with the service component not included as part of the 'right of use' asset or lease liability.

However, there could also be a profound impact for lessors, notably for RPs in their capacity as lessors of social housing. The proposals for lessors only apply to the extent that the leased asset is not carried at fair value, which would be the case for social housing properties given that:

- the PBE standard will scope such assets within the rules for owner occupied not investment property

- the FRSM requires owner-occupied property to be accounted for at depreciated historical cost in all cases.

In essence, the proposals would result in RPs recognising a debtor for the present value of rentals to be received by each tenant over the expected tenancy period. The credit side of this debtor entry is either:

- a reduction in the carrying value of the social housing asset (known as the 'derecognition approach'); or
- the recognition of a 'linked' liability representing the registered provider's obligation to supply tenants with housing (known as the 'performance obligation' approach).

The derecognition approach would also see immediate recognition of profit or loss based on the difference between the present value of future rental income and the amount of housing property derecognised, with subsequent years only showing interest receivable (as the discount on the debtor unwinds) rather than rental income. Under both approaches reassessments would be needed at each balance sheet date for revisions to estimates. Which of the two approaches adopted will depend on the facts and circumstances of each tenancy agreement, and an assessment as to whether the registered provider retains exposure to the significant risks and benefits associated with the underlying asset. This might be something which the revised housing SORP could provide guidance on for various types of tenancy agreements.

Further complications also arise from the need, inter alia, to

- make adjustments from the effects of revising estimates of lease payments (eg as a result of changes to expected inflation rates where lease payments are indexed linked) and tenancy periods
- consider which components of a property should be derecognised under the derecognition approach
- make judgements about the extent to which a rental comprises a payment for the use of the property and a payment for services
- apply the above in subsidiary and holding company accounts, i.e. there is no exemption available for intra-group leasing arrangements.

21 PROVISIONS AND CONTINGENCIES

No significant areas of difference in the accounting for provisions and contingencies under UK GAAP (FRS 12 *Provisions, contingent liabilities and assets*) as applied by PBEs have been identified. The FRSPBE however does contain additional guidance on the accounting for funding commitments.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE contains a requirement for PBEs to recognise a liability where it has made a commitment that it will provide resources to another party if:

- the obligation is such that the entity cannot realistically withdraw from it
- the commitment does not depend on the performance of the recipient.

Such commitments should be measured at present value.

Commitments made which are performance-related can only be recognised as a liability when those performance conditions are met.

The application guidance states that in most cases there will not be any liability to recognise because irrevocable commitments are rarely made without requiring future performance from the intended recipient. However, where the only condition is to provide an annual financial report to the PBE, this would not represent a performance condition if failure to produce the report would not release the PBE from its commitment. However, this is distinguished from a report which is used by the PBE to consider how funds have been utilised in order to secure payment.

Consistent with the existing charity SORP, a general statement that the entity intends to provide resources to certain classes of beneficiaries in accordance with its objectives would not give rise to a liability. Furthermore, a necessary condition to be able to recognise a liability is that the decision to provide funding must have been communicated to the recipient.

Given the absence of the definition of a performance condition in either the FRSM or the FRSPBE it is difficult to gauge whether the term used in relation to funding commitments is synonymous with the term as used in relation to the recognition of incoming resources from non-exchange transactions (see section 23 below). Furthermore it is also unclear whether the probability of the intended recipient achieving a performance condition should be taken into account in recognising a liability in the same way as a PBE should assess its own performance conditions to be able to recognise income from non-exchange transactions.

22 LIABILITIES AND EQUITY

No significant areas of difference in the accounting for liabilities and equity under UK GAAP as applied by PBEs have been identified.

The FRSPBE does not address this section of the FRSM.

23 REVENUE



The accounting for revenue from commercial activities is unlikely to be affected on transition to the FRSME. With the exception of donated goods discussed in section 13 above, the requirements in the FRSPBE on incoming resources received from non-exchange transactions also means that the majority of potential differences identified in our report last year have also been removed.

The accounting by HE&FE institutions for endowments, however, looks likely to undergo a change. The HE&FE SORP requires institutions to categorise donations as either income or endowments. Donations classified as income are recognised in the income statement, whereas endowments are recognised in the statement of total recognised gains and losses. It is difficult to see how it would be possible under the FRSME to classify the receipt of any donation under the FRSPBE as an item of other comprehensive income, rather it would need to be presented within the income statement (top half of the statement of comprehensive income).

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Recognition of donated goods	Recognised at fair value when made available, giving rise to donation income.	Not recognised, with income arising only on sale of the donated goods.	Implied that accounting would be the same as tier 2.
● Endowment income received by HE&FE institutions	Receipt of endowments recognised in the income statement.	HE&FE SORP requires endowments to be recognised in the statement of total recognised gains and losses.	Receipt of endowments recognised in the income statement.
● Recognition of volunteer time	Not prohibited.	Prohibited.	Not prohibited.

recognised until all other conditions have been met. Other paragraphs meanwhile, state that a liability for repayment of resources received should only be recognised to the extent that it is thought probable the performance conditions will not be met.

There is no discussion in the FRSPBE as to how the need to consider performance conditions relates to restricted funds.

Application guidance is included in the FRSPBE for legacies receivable and donated services.

Legacies

Legacies should be recognised when there is sufficient certainty that the legacy will be received and its value can be measured with sufficient reliability. The FRSPBE states that this will usually be the case following probate once the executor of the estate has established there are sufficient assets to pay the legacy. Where entities are in receipt of numerous immaterial legacies, a portfolio approach may be taken.

Donated Services

Where donated services can be reasonably quantified the FRSPBE requires that they should be recognised in the financial statements when they are received. This will typically be the case for those services supplied on a pro bono basis which would otherwise have been purchased by the entity. It notes that it may not be possible to reasonably quantify the contribution made by volunteers and, where this is the case, those services need not be recognised. Whereas the current charity SORP makes an explicit statement that all volunteer time should be excluded, there is no such blanket prohibition in the FRSPBE.

The FRSPBE does not indicate that the requirements relating to the accounting for incoming resources from non-exchange transactions is incompatible with full IFRS. Therefore it might be expected that tier 1 PBEs would also refer to the guidance in the FRSPBE in formulating an accounting policy for such income.

24 GOVERNMENT GRANTS



MATCHING CONCEPT VERSUS RIGHT OF RECEIPT

Unlike UK GAAP (SSAP 4 *Accounting for government grants*) and full IFRS, the FRSME does not set out different accounting treatments for grants received for revenue and capital expenditure, and in this respect the FRSME is the same as the charity SORP. However, it represents a very different accounting treatment for housing associations and HE&FE institutions.

A liability to repay a conditional grant received under the charity SORP is only recognised if it is thought probable that the conditions for retention would not be met. Where repayment is considered to be only a possibility, then the grant would still be recognised in the income statement, but with disclosure made of the contingent liability. Under the HE&FE SORP, revenue grants are recognised in the income statement when the related costs are expensed. HE&FE institutions that receive grants for capital expenditure are required to credit a deferred capital grant balance and release it to the income statement as the cost of the asset is recovered through depreciation or sale.

Similarly, under the housing SORP, revenue grants are matched to the related expenditure, both being recognised in the income statement at the same time. Although the FRSME does not permit the deferral of grants on the basis that the related costs have not been recognised in the income statement, it does not permit any grant received to be recognised as income until performance conditions attaching to the grant have been met. However, the FRSME does not define what is meant by a performance condition.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSPBE includes a section dealing with the accounting for incoming resources from non-exchange transactions. Non-exchange transactions are defined as those in which 'an entity receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange'

PBEs would be required to measure resources from non-exchange transactions at fair value with income recognised based on an assessment of any performance conditions. Where there is no evidence of an open market value, it may be derived from sources such as the cost to the donor or, in the case of goods expected to be sold, the estimated net realisable value. The existence of unfulfilled performance conditions would result in the income being deferred on balance sheet as a liability.

Arguably the draft requirements are a little confusing as to the extent to which performance obligations should be satisfied before revenue is recognised. Some paragraphs infer that other than performance conditions that are so broadly drafted they cannot be said to actually impose any meaningful condition on the entity, revenue should not be

SOCIAL HOUSING GRANT (SHG)

Under the housing SORP, if the policy is to measure social housing properties at depreciated cost then SHG is netted against the cost of the acquired property making use of a 'linked presentation' approach on the face of the balance sheet. Where a policy of revaluing social housing properties is applied, the impact of this netting is disclosed in the notes rather than shown on the face of the balance sheet. Either way, depreciation of the properties is charged on the net carrying amount.

As already discussed in section 17 above, the FRSME does not permit a policy of revaluation for social housing properties. For assets measured at depreciated historical cost it is difficult to see that the linked presentation approach on the face of the balance sheet would be permitted under the FRSME or FRSPBE. This could therefore impact on the amount of depreciation to charge each period on properties which are funded through SHG.

Furthermore, the SORP working party may want to consider whether SHG would ever be recognised on balance sheet as a liability or whether it is appropriate to recognise it as income in full on receipt. The need to repay SHG only arises in the event of a disposal of the related property and only then if the RP fails to reinvest the proceeds within three years. Given that both the decision to sell and the decision to reinvest are within the control of the RP arguably SHG does not meet the definition of a liability and therefore should be recognised as income in full as a government grant. Such accounting might also give rise to an immediate impairment charge, which is discussed further in section 27 below.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Concept of matching grant income to related expense in the income statement	Matching concept does not exist, with all grants recognised as income statement in full when performance conditions have been met.	Charity SORP similarly requires all grants to be recognised on receipt, except to the extent repayment is considered probable. Other NFPs apply matching concept to recognition of grants received in the income statement.	Recognition of grant income in the income statement matched to the related expenditure.
● SHG Grant	Likely to be presented separately from the related property, which in turn could impact the amount of depreciation to charge. Unclear whether SHG would be accounted for in the income statement on receipt or as a liability.	Netted against the cost or value of the funded property, with depreciation charged on the net amount. Where a RP applies a policy of cost, the housing SORP requires a 'linked presentation' on the face of the balance sheet.	Likely to be presented separately from the related property, which in turn would impact the amount of depreciation to charge. Unclear whether SHG would be accounted for in the income statement on receipt or as a liability.

The FRSPBE does not address this section of the FRSME.

25 BORROWING COSTS



The FRSME requires all borrowing costs to be expensed as incurred. By contrast, current UK GAAP (FRS 15 *Tangible fixed assets*) permits the capitalisation of finance costs as the assets are being constructed. The cost of properties classified as stock can also include interest under UK GAAP. RPs in particular often choose to capitalise interest during the construction phase of properties, whether categorised as stock or tangible fixed assets.

Furthermore, on first-time adoption of the FRSME the carrying value of properties would require adjustment for all prior years' interest capitalised to date unless the entity has a valuation of such assets and chooses to treat those valuations as deemed cost going forward.

Full IFRS, by contrast requires interest on qualifying assets to be capitalised. Given that a policy of capitalisation is almost universally adopted by developer RPs due to the manner in which loan covenants are set, this issue alone could cause many non-publicly accountable RPs to voluntarily 'trade up' to tier 1 and apply full IFRS.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Capitalisation of interest	Not permitted.	Permitted.	Required.

The FRSPBE does not address this section of the FRSME.

26 SHARE-BASED PAYMENT

This section is unlikely to be of relevance to PBEs. The main difference is that on grounds of 'undue cost or effort' it is permissible to use directors' valuation of instruments granted rather than performing a proper fair value exercise.

27 IMPAIRMENT OF ASSETS



RECOVERABLE AMOUNT AND LINK TO CAPITAL GRANT ACCOUNTING

The broad approach to impairment under the FRSME is the same as UK GAAP (FRS 11 *Impairment of fixed assets and goodwill*), ie impairments are recognised when the recoverable amount of an asset falls below its book value. Recoverable amount is in turn defined under both reporting frameworks as the higher of (i) net realisable value less costs to sell and (ii) the present value of cash flows generated from continued use of an asset (its 'value in use').

For PBEs, many assets are not acquired for the amount of cash flows that they generate, rather for their service potential. The ability to assess such assets' recoverable amount by reference to service potential has been incorporated into the FRSPBE, suggesting that in many cases the present value of an asset's remaining service potential will be represented by its depreciated replacement cost. This approach has the effect of matching the assets' cost in the periods in which they are employed through depreciation. Under the FRSPBE any grant income is, in the absence of performance conditions, recognised in full in the income statement on receipt irrespective of how long that asset will be employed for and is

therefore not matched to the recognition of expense. As noted above charities are already used to this treatment, although for other entities this will seem counterintuitive.

However, the FRSPBE also suggests that approaches other than depreciated replacement cost may be used to assess assets' service potential where more appropriate. This could give rise to some interesting issues for RPs that are used to assessing impairment by reference to planned subsidy. Should it be determined that social housing grant (SHG) be recognised in full as income, then there may be a contemporaneous impairment to recognise, thus bringing about some matching of income and cost. This is because the level of planned subsidy would be assessed by reference to the gross cost of the asset, not its carrying amount net of SHG. If, on the other hand, the service potential of social housing is assessed by reference to depreciated replacement cost then there would not be an immediate impairment. The appropriate manner to assess impairments of social housing properties might be something which the replacement housing SORP would address.

RECENT DEVELOPMENTS AS A RESULT OF THE FRSPBE

The FRSME only looks at an asset's ability to generate future cash flows (either through sale or use) in determining whether it is impaired, whereas the FRSPBE permits assets held for their service potential (otherwise known as planned subsidy by RPs) to be assessed for impairment in other ways. It does not restrict the approaches that may be used by PBEs to determine an asset's service potential, but notes that in many cases the present value of an asset's remaining service potential may be taken to be its depreciated replacement cost.

The FRSPBE does not indicate that the requirements in relation to assessing impairment by reference to assets' service potential are incompatible with full IFRS. Therefore it might be expected that tier 1 PBEs would also refer to the guidance in the FRSPBE in formulating an accounting policy for impairment.

LEVEL AT WHICH IMPAIRMENT IS TESTED

In undertaking an impairment review the FRSME requires individual assets to be reviewed for impairment to the extent their recoverable amount can be estimated. Where it is not possible to estimate the recoverable amount of individual assets, impairment reviews are carried out at the 'cash generating unit' level. This is the smallest group of assets that generate cash flows independently from other groups of assets. There could be significant implications for some housing associations that, under the current SORP, group assets together for impairment review purposes based on the way they are managed in practice. This could either be on a scheme by scheme or single portfolio basis. The replacement SORP may need to consider whether this approach is acceptable under the FRSME.

The HE&FE SORP incorporates the term 'income generating unit' as used in FRS 11 to determine appropriate groupings of assets for carrying out impairment reviews. Although this will often be the same as a cash generating unit, the SORP notes that as many income generating units should be identified as is reasonably practical. This acknowledgement of reasonable practicality does not exist in the FRSME and therefore might result in income generating units having to be broken down into more than one cash generating unit.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Link to capital grant accounting	Income and expense often not matched.	Income and expense matched.	Income and expense matched.
● Level at which impairment is carried out	Individual asset or cash generating unit level.	For housing associations, assets are grouped according to the way they are managed internally. Cash generating unit potentially is smaller than one income generating unit.	Individual asset or cash generating unit level.

28 EMPLOYEE BENEFITS



HOLIDAY PAY

Due to the fact that the FRSME specifically refers to paid annual leave as a benefit given to employees, it is likely that entities would need to record accruals in respect of employees who have taken less than their accrued entitlement, or prepayments in respect of employees who have taken more than their accrued entitlement, at the balance sheet date. Such adjustments are rarely made under current UK GAAP, possibly on grounds of materiality.

DEFINED BENEFIT PENSION PLANS

The accounting for defined benefit schemes under the FRSME follows the same principles as current UK GAAP (FRS 17 *Retirement benefits*). Where it is considered there would be 'undue cost or effort' to apply the projected unit credit method in measuring the defined benefit liability, the entity is permitted to make the following simplified assumptions in the calculation:

- pensions will be paid based on current salaries, ignoring future expected salary increases
- no further benefits will accrue to employees in respect of future service
- possible in-service mortality of current employees prior to drawing down pensions is ignored.

Full IFRS follows the same approach as FRS 17, although permits entities not to recognise actuarial gains and losses up to 10% of the scheme's gross assets or liabilities. The remaining actuarial gains and losses would be spread over employees remaining service lives, although must be recognised in the income statement (top half of the single statement of comprehensive income).

There is no concept of a separate pension reserve in the FRSME or full IFRS.

MULTI EMPLOYER AND GROUP SCHEMES

Current UK GAAP, the FRSME and full IFRS all acknowledge the difficulties of applying defined benefit accounting to multi-employer schemes. They instead permit an entity to account for participation in such schemes as defined contribution schemes if it is not possible to identify its share of the underlying assets and liabilities of the scheme.

Many group schemes are also run on a basis that does not enable individual entities in the group to identify their share of the underlying assets and liabilities of that scheme. Although the consolidated financial statements would reflect the full surplus or deficit in the scheme, each participating entity is able to account for the scheme as a defined contribution scheme under current UK GAAP. Full IFRS, by contrast, specifically excludes group schemes from being treated as multi-employer schemes. Instead it requires the overall surplus or deficit to be allocated to each participating entity based on any contractual agreement or stated policy. If there is no agreement or policy then the entity that is legally sponsoring the plan (usually the parent) must account for the net defined benefit cost, with other group entities reflecting a cost for the contributions paid. The FRSM, however, is silent on whether group schemes may be accounted for as multi-employer schemes in the separate financial statements of participating entities.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Holiday pay accruals	Holiday pay to be recognised as an accrual or prepayment as appropriate.	Accrued and prepaid holiday pay generally not accounted for.	Holiday pay to be recognised as an accrual or prepayment as appropriate.
● Presentation of actuarial gains and losses	Actuarial gains and losses recognised as an item of other comprehensive income.	Actuarial gains and losses recognised in the statement of total recognised gains and losses (or for charities in bottom part of SOFA).	Actuarial gains and losses on defined benefit pension schemes are recognised as an item of other comprehensive income in full. Alternatively a policy of deferral / non-recognition may be adopted, in which case they are presented in the income statement.
● Measurement basis for defined benefit scheme liabilities	Certain simplifications to projected unit credit method for measuring defined benefit liabilities on grounds of 'undue cost or effort'.	Projected unit credit method applied without simplifications.	Projected unit credit method applied without simplifications.
● Presentation of a separate pension reserve	No concept of a separate reserve.	Required by HE&FE and charity SORPs.	No concept of a separate reserve.
● Group schemes	Not addressed.	Usually accounted for as multi-employer schemes.	Cannot be accounted for as multi-employer schemes.

The FRSPBE does not address this section of the FRSM.

29 INCOME TAX



CURRENT TAX

Many PBEs are not subject to tax on profits. Those that have corporate subsidiaries usually apply gift aid to the taxable profits otherwise arising, resulting in no current tax liability. There is nothing to suggest that this will be any different for financial statements prepared in accordance with the FRSM or full IFRS. However, those corporate subsidiaries could have new accounting treatments to apply, which could result in the restatement of prior years' accounting profits. Depending on how the profit restatements arise there could be current tax implications for companies using gift aid to manage their tax position.

DEFERRED TAX

There is a different model in the accounting for deferred tax under UK GAAP (FRS 19 *Deferred tax*) and the FRSM. UK GAAP provides for deferred tax on timing differences (comparing gains and losses reported in the financial statements and their treatment in the tax computation) whereas the FRSM provides for deferred tax on temporary differences (looking at the tax consequences of recovering assets and settling liabilities at their carrying amounts). Although the approaches often produce the same answer, this is not always the case.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSM AND IFRS FOR SMES

The section in the IFRS for SMEs on deferred tax was based on proposals intended to come into full IFRS, which were roundly criticised and have to a large extent been put on the back burner. Therefore, the ASB have decided to incorporate into the FRSM the entire text of the accounting standard in full IFRS, namely IAS 12 *Income Tax*.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Current tax issues arising on transition to IFRS for SMEs	Arises due to restatement of prior year taxable profits, which may be difficult to manage using gift aid.	n/a	Arises due to restatement of prior year taxable profits, which may be difficult to manage using gift aid.
● Basis of recognising deferred tax	Recognised on the basis of temporary differences.	Recognised on the basis of timing differences.	Recognised on the basis of temporary differences.

The FRSPBE does not address this section of the FRSM.

30 FOREIGN CURRENCY



The main difference identified is in relation to overseas operations. Both the FRISME and full IFRS require exchange gains and losses arising on retranslation of foreign operations to be tracked individually and presented in aggregate in a separate reserve. Under current UK GAAP (SSAP 21 Foreign currency translation) such exchange differences are usually subsumed within the retained surplus/deficit.

The FRISME and full IFRS also require goodwill and intangibles arising on consolidation of a foreign operation to be treated as assets and liabilities of that foreign operation. This means they need to be retranslated each year end. Under SSAP 21 most entities would have considered these to be assets of the parent entity and therefore always translated at the historic exchange rate that applied on the acquisition date.

The FRISME does not define the term 'foreign operation', although it is defined in full IFRS as 'a subsidiary, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.' This will be an issue that international charities and other organisations operating overseas like professional bodies will need to consider.

SUMMARY

Issue	FRISME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Treatment of exchange gains and losses arising on the retranslation of foreign operations	Cumulative exchange gains and losses arising on retranslation of foreign entities to be presented as a separate component of equity.	No requirement to keep track of cumulative exchange gains and losses.	Cumulative exchange gains and losses arising on retranslation of foreign entities to be presented as a separate component of equity. On disposal of a foreign operation the cumulative exchange gains and losses are recycled through the income statement.
● Translation of goodwill, intangibles and other fair value adjustments arising on consolidation	Translated at rates ruling at the balance sheet date.	Usually translated at historic rate of exchange.	Translated at rates ruling at the balance sheet date.
● Retranslation of income, expenditure and cash flows of foreign operations	Use of average rate permitted only to the extent it provides a reasonable approximation to the actual rate on the date of the transactions of the foreign operation	Use of average rate permitted.	Use of average rate permitted only to the extent it provides a reasonable approximation to the actual rate on the date of the transactions of the foreign operation.

The FRSPBE does not address this section of the FRISME.

31 HYPERINFLATION

It is anticipated this section will affect very few PBEs. The extent of any impact on transition to IFRS will depend largely on whether an entity has applied FRS 24 Financial reporting in hyperinflationary countries (an IFRS-converged standard) or UITF Abstract 9 Accounting for operations in hyperinflationary economies. Where an entity has applied FRS 24 there will be relatively little impact. If the entity has applied UITF Abstract 9 then there could be differences, largely because it is less prescriptive than the FRISME on how to eliminate the distortions caused by hyperinflation.

The FRSPBE does not address this section of the FRISME.

32 EVENTS AFTER THE END OF THE REPORTING PERIOD

FRS 21 *Events after the balance sheet date*, which has been effective since 2005, is an IFRS-converged UK standard. As the principles in the FRISME are very similar to those contained in FRS 21 and full IFRS, no significant areas of difference have been identified.

The FRSPBE does not address this section of the FRISME.

33 RELATED PARTY TRANSACTIONS



DISCLOSURES

There are three key disclosure differences identified between the FRISME and current UK GAAP (FRS 8 *Related party disclosures*). Firstly, FRS 8 requires both the names of related parties and the nature of their relationship to the reporting entity to be disclosed, whereas the FRISME only requires disclosure of the nature of the related party relationship.

Secondly, the FRISME requires transactions between one group entity and another to be disclosed in the individual financial statements of the entities concerned. UK GAAP contains an exemption from disclosing such intra-group transactions provided the transacting entities are 100% controlled within the same group

Thirdly, the charity SORP gives exemptions from disclosure of certain transactions, including certain donations made by related parties. No such exemption is available under the FRISME and therefore it might be difficult for the replacement SORP to justify this additional exemption.

KEY MANAGEMENT COMPENSATION

FRS 8 excludes from its scope remuneration paid to key employees. Disclosures of such information tend to be covered by other legislative or regulatory requirements, thus:

- companies' legislation sets out detailed requirements for remuneration of directors of companies (including charitable companies)
- the charity SORP requires disclosure of remuneration and expenses received by trustees as well as the number of employees that receive remuneration in excess of £60,000 (in bands of £10,000)
- accounts directions issued by the HEFCE and the LSC require disclosure in the financial statements of colleges of higher and further education respectively of remuneration received by certain key members of staff and governors

- the *Accounting Requirements for Registered Social Landlords General Determination 2006* requires disclosure of the aggregate directors' and other board members' remuneration in the financial statements of RPs, as well as the aggregate compensation paid for loss of office. In addition it requires separate disclosure of the highest paid director's remuneration and details of the chief executive's pension arrangements.

The FRSME, however, requires disclosure of the aggregate amount of all forms of consideration paid and payable to key management personnel for services rendered. Key management personnel are defined as 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly', and sometimes comprises a wider body than just the board of directors. Therefore PBEs will need to consider whether the need to disclose the remuneration of key management personnel imposes additional disclosure requirements over and above those required by the relevant regulatory body.

SUMMARY

Issue	FRSME and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Identity of related party	Name of related party does not need to be disclosed, only the nature of the relationship.	Both the name of the related party and the nature of the relationship need to be disclosed.	Name of related party does not need to be disclosed, only the nature of the relationship.
● Disclosure of transactions with group entities	No exemption from disclosing transactions in an entity's individual financial statements between itself and other entities within the same group.	No requirement to disclose transactions between 100% owned entities of a group.	No exemption from disclosing transactions in an entity's individual financial statements between itself and other entities within the same group.
● Disclosure of donations from related parties	No exemption.	Exemption given in charity SORP.	No exemption.
● Remuneration of key management personnel	Details of key management remuneration must be disclosed.	Disclosures driven by relevant legislation and regulators. Not necessarily the case that these capture all members of 'key management personnel'.	Details of key management remuneration must be disclosed.

The FRSPBE does not address this section of the FRSME.

34 SPECIALISED ACTIVITIES



This section of the FRSME provides guidance on the financial reporting by entities engaged in four types of specialised activities: agriculture, extractive industries, service concession arrangements (essentially addressing certain PFI and PPP arrangements) and heritage assets.

The accounting set out in the FRSME for agricultural and extractive industries is unlikely to be of relevance to many NFPs. In summary:

- 'Biological assets' (ie related to agricultural activities) can be accounted for using either a cost or fair value model. If the latter is chosen, changes in fair value are recognised in the income statement.
- Entities in the extractive industry must apply the requirements in Section 17 and Section 18 above, which could mark a significant departure from current practice.

SERVICE CONCESSION ARRANGEMENTS

Some NFPs, housing associations in particular, do enter into PFI and PPP arrangements. Under UK GAAP, there is guidance on such contracts in FRS 5 *Accounting for the substance of transactions*. The key consideration under UK GAAP is whether or not the entity has property (eg social housing) used to provide the contracted services, or alternatively a debtor, being the right to receive payment for constructing the property (in which case the property is an asset of the public body). Which of the two contracting parties should be recognising the property asset is driven by an assessment of who is exposed to the associated risks and rewards of that asset.

The FRSME, by contrast, only addresses the accounting for PFI and PPP arrangements where the public sector body (i) controls or regulates what services the operator must provide, to whom, and at what price, and (ii) also controls any significant residual interest in the property at the end of the term of the arrangement. If either of these conditions is not met, then the FRSME does not address the accounting for the arrangement. Furthermore, because the public body effectively has control of the property where such terms are present, it means the counterparty does not recognise any property asset.

Where these two conditions are met the accounting follows one of two models depending on the nature of the contract. Under the first model the entity recognises a debtor representing its unconditional right to receive payment (often called a unitary charge) for having constructed the property, and also for its subsequent operation and maintenance. Judgement is likely to be needed in determining the revenue in relation to the construction of the property and the revenue for subsequent operation and maintenance.

Under the second model, the entity does not have a right to receive fixed or determinable payments from the public body, rather it is given a right to charge end users. Under this model, the entity recognises an intangible asset (the right to charge users) in exchange for having constructed the property. Under full IFRS, this gives rise to revenue both on recognition of the intangible (with the construction costs being a cost of sale) and revenue when the public is charged for using the property. As such total revenue does not equal total cash inflow. The FRSME is less explicit on this point, although one might expect the same approach to prevail.

HERITAGE ASSETS

No significant areas of difference have been identified in the accounting for heritage assets between current UK GAAP (FRS 30 *Heritage assets*) and the FRSME.

RECENT DEVELOPMENTS – DIFFERENCES BETWEEN FRSM E AND IFRS FOR SMES

With the publication of the FRSPBE, the ASB have indicated their intention to incorporate into the FRSM E rules dealing with the accounting for heritage assets. It is proposed that the accounting will broadly follow the same treatment as set in FRS 30 Heritage assets. The reason for incorporating these rules in the FRSM E rather than dealing with them solely in the FRSPBE is to enable the same accounting to be applied by non PBEs in tier 2 that also happen to own heritage assets.

The ASB have not indicated that the accounting it sets out for heritage assets is incompatible with full IFRS. Therefore it might be expected that tier 1 PBEs would also refer to the guidance in the FRSPBE in accounting for heritage assets.

SUMMARY

Issue	FRSM E and FRSPBE (Tier 2)	Current UK GAAP and SORPs	Full IFRS (Tier 1)
● Types of PFI/PPP contracts covered	Contracts that do not result in recognition of property assets.	All types.	Contracts that do not result in recognition of property assets.
● Focus of PFI/PPP accounting	Focuses on a limited number of arrangements and whether an entity should recognise a financial asset (debtor) or an intangible asset.	FRS 5 addresses all arrangements, with the entity usually considering whether it should recognise a financial asset (debtor) or a tangible fixed asset.	Focuses on a limited number of arrangements and whether an entity should recognise a financial asset (debtor) or an intangible asset.

35 TRANSITION TO THE FRSM E

When an entity transitions from current UK GAAP, the basic rule is that the financial statements for both the current year and comparatives are presented in accordance with the requirements of the new regime (full IFRS for tier 1 entities and FRSM E for tier 2 entities). In order to present a comparative statement of comprehensive income and cash flow it is therefore necessary to have a balance sheet two years prior to the date of the first financial statements prepared under the new financial reporting framework.

Recognising that the costs of requiring entities to prepare opening balance sheets on the basis that the entity had always complied with the new framework would exceed the likely benefits, certain exemptions are given from full retrospective application in preparation of the transition balance sheet. The key reliefs are:

- Business combinations effected before the date of transition do not need to be restated.
- Certain assets can be measured at fair value on the date of transition and used as deemed cost. Additionally, a previous UK GAAP valuation of certain assets at the date of transition can be used as deemed cost.
- The accounting for service concession arrangements only has to be applied to arrangements entered into after the date of transition.
- The cumulative translation difference arising on the consolidation of foreign entities can be set to zero as at the date of transition.
- Deferred tax need not be recognised on temporary differences as at the date of transition if it would involve 'undue cost or effort'.

In addition, there are situations where entities are not permitted to restate the transition date balance sheet. In the context of PBEs, the key situations are:

- accounting estimates made under current UK GAAP are revised only prospectively
- hedge accounting applied under current UK GAAP is reflected in the transition date balance sheet with the subsequent accounting considering the rules in the FRSM E on financial instruments (ie whether or not hedge accounting should be discontinued).

The following disclosures are required in the first financial statements prepared in compliance with the FRSM E:

- a description of the nature of each change in accounting policy
- a reconciliation of net assets determined in accordance with UK GAAP and the FRSM E for both the date of transition and the comparative period
- a reconciliation of the income statement determined in accordance with UK GAAP and the FRSM E for the comparative period.

Similar rules and disclosures would also apply to those entities required or choosing to apply full IFRS.

The FRSPBE does not address this section of the FRSM E.



APPENDIX 1

RECONCILIATION OF HYPOTHETICAL CHARITY SOFA TO STATEMENT OF COMPREHENSIVE INCOME

	As reported under UK GAAP £'000	Adjustment 1 £'000	Adjustment 2 £'000	Adjustment 3 £'000	Adjustment 4 £'000	Adjustment 5 £'000	Adjustment 6 £'000	As reported under IFRS for SMEs £'000
INCOMING RESOURCES								
Incoming resources from generated funds	50,000							50,000
Incoming resources from charitable activities	15,000						250	15,250
Other incoming resources	3,000			(500)				2,500
Total incoming resource	68,000	0	0	(500)	0	0	250	67,750
RESOURCES EXPENDED								
Costs of generating funds	20,000							20,000
Charitable activities	10,000							10,000
Governance costs	2,000							2,000
Finance costs						1,000		1,000
Other resources expended	3,000		2,500		(100)	(1,000)		4,400
Total resources expended	35,000	0	2,500	0	(100)	0	0	37,400
Net incoming resources before transfers	33,000							
GROSS TRANSFERS BETWEEN FUNDS	0							
Net income for the period	33,000	0	(2,500)	(500)	100	0	250	30,350
OTHER COMPREHENSIVE INCOME								
Gains on revaluation of fixed assets for charity's own use	5,000	(5,000)						
Gains/(losses) on investment assets	(2,500)		2,500					
Actuarial loss on defined benefit pension schemes	(350)							(350)
Total comprehensive income for the period	35,150	(5,000)	0	(500)	100	0	250	30,000
RECONCILIATION OF FUNDS								
Total funds brought forward	100,000							
Total funds carried forward	125,150							

Adjustment 1	Removes revaluation gains and losses on owner-occupied property
Adjustment 2	Recognises gains and losses on equity investments in profit and loss
Adjustment 3	Net movement on grant income where all conditions for receipt not met
Adjustment 4	Net reduced pension cost arising from taking advantage of simplified projected unit credit method on grounds of undue cost or effort
Adjustment 5	Separate presentation of finance costs (including unwinding of discounted liabilities such as pensions)
Adjustment 6	Increase in donated stock over the period

RECONCILIATION OF HYPOTHETICAL CHARITY BALANCE SHEET TO STATEMENT OF FINANCIAL POSITION

	As reported under UK GAAP £'000	Adjustment 1 £'000	Adjustment 2 £'000	Adjustment 3 £'000	Adjustment 4 £'000	Adjustment 5 £'000	Adjustment 6 £'000	As reported under IFRS for SMEs £'000
LONG-TERM ASSETS								
Tangible assets	100,000		(5,000)	(5,000)				90,000
Financial assets	25,000							25,000
Investment property	10,000							10,000
Prepayments				4,900				4,900
	135,000							129,900
CURRENT ASSETS								
Stocks and WIP [Inventory]	750						3,000	3,750
Investments	500							500
Other financial assets including debtors	2,500							2,500
Prepayments	25			100				125
Cash at bank and in hand	7,500							7,500
	11,275							14,375
CURRENT LIABILITIES								
	6,500	(6,500)						
Bank loans and overdrafts		2,000						2,000
Short term creditors		4,000			250			4,250
Other short-term financial liabilities		500						500
Provisions		750						750
Employee benefits		250				(50)		200
								7,700
NET CURRENT ASSETS	4,775							
TOTAL ASSETS LESS CURRENT LIABILITIES	139,775							
LONG-TERM LIABILITIES								
	30,000	(30,000)						
Bank loans		28,000						28,000
Other long-term financial liabilities		2,000			1,500			3,500
Provisions		2,500						2,500
Employee benefits		6,275				(1,225)		5,050
								39,050
PROVISIONS	3,250	(3,250)						
DEFINED BENEFIT PENSION SCHEME LIABILITY	6,525	(6,525)						
TOTAL ASSETS LESS TOTAL LIABILITIES	100,000	0	(5,000)	0	(1,750)	1,275	3,000	97,525
FUNDS								
Endowment Funds	10,000							10,000
Restricted income funds	20,000							20,000
Unrestricted income funds								0
Net accumulated surplus	56,525		8,475		(1,750)	1,275	3,000	67,525
Revaluation reserve	20,000		(20,000)					
Pension reserve	(6,525)		6,525					
	100,000	0	(5,000)	0	(1,750)	1,275	3,000	97,525

Adjustment 1 Reanalysis of liabilities

Adjustment 2 Removal of revaluation reserve to recognise carrying value at deemed cost and elimination of pension reserve

Adjustment 3 Presenting lease premiums as a prepayment of rent

Adjustment 4 Recognises liability in respect of grant income where all conditions for receipt not yet met

Adjustment 5 Recognises reduction to defined benefit pension liability arising from taking advantage of simplified projected unit credit method

Adjustment 6 Fair value of donated goods at the balance sheet date

APPENDIX 2

RECONCILIATION OF HYPOTHETICAL HOUSING ASSOCIATION INCOME STATEMENT

	As reported under UK GAAP £'000	Adjustment 1 £'000	Adjustment 2 £'000	Adjustment 3 £'000	Adjustment 4 £'000	Adjustment 5 £'000	Adjustment 6 £'000	Adjustment 7 £'000	Adjustment 8 £'000	Adjustment 9 £'000	Adjustment 10 £'000	As reported under IFRS for SMEs £'000
Turnover	30,000			(250)				2,000				31,750
Cost of sales	(8,000)						50	(2,200)				(10,150)
Operating costs	(17,500)			150	100		750			(1,500)		(18,000)
Other operating income		100	2,000			500						2,600
Operating surplus	4,500	100	2,000	(100)	100	500	800	(200)	0	(1,500)	0	6,200
Surplus on sale of fixed assets - housing properties	100	(100)										
Interest receivable and other income	2,000											2,000
Interest payable and similar charges	(2,750)			50			(2,000)		(450)		(50)	(5,200)
Other finance costs	(50)										50	
Share of profit of joint ventures				40								40
Surplus on ordinary activities before taxation	3,800	0	2,000	(10)	100	500	(1,200)	(200)	(450)	(1,500)	0	3,040
Tax on surplus on ordinary activities	(800)			10			80	40				(670)
Surplus for the year	3,000	0	2,000	0	100	500	(1,120)	(160)	(450)	(1,500)	0	(2,370)

Adjustment 1	Reclassification of post-operating surplus exceptional item to pre-operating surplus
Adjustment 2	Recognition of SHG as income, with depreciation charged on gross carrying value of properties
Adjustment 3	JANE accounting represented as JCE accounting
Adjustment 4	Reversal of negative goodwill arising in previous period amortised through income statement
Adjustment 5	Negative goodwill arising in period treated as combination which is in substance a gift
Adjustment 6	Effects of reversing policy of capitalisation of borrowing costs
Adjustment 7	Recognition of PFI arrangement - intangible received in exchange for construction of asset
Adjustment 8	Change in fair value of interest rate swap during the year and other adjustments to interest payable as a result of discontinuing hedge accounting
Adjustment 9	Recognition of impairment of assets linked to recognition of SHG as income
Adjustment 10	Reclassification of pension finance cost

Note

The example makes the following assumptions:

1. All social housing properties, irrespective of rent level charged, is not treated as investment property
2. Impairment of social housing property is assessed by reference to planned subsidy rather than depreciated replacement cost
3. The entity decides not to apply hedge accounting for its interest rate swaps

RECONCILIATION OF HYPOTHETICAL HOUSING ASSOCIATION BALANCE SHEET TO STATEMENT OF FINANCIAL POSITION

	As reported under UK GAAP £'000	Adjustment 1 £'000	Adjustment 2 £'000	Adjustment 3 £'000	Adjustment 4 £'000	Adjustment 5 £'000	Adjustment 6 £'000	Adjustment 7 £'000	Adjustment 8 £'000	As reported under IFRS for SMEs £'000
LONG-TERM ASSETS										
Intangible asset							2,000			2,000
Housing properties	200,000			(20,000)		(25,000)			(50,000)	105,000
Social housing grant	(100,000)		100,000							0
Other grants	(20,000)		20,000							0
Other items of property, plant and equipment	6,000									6,000
Financial assets - homebuying loans advanced	10,000									10,000
Grants received related to homebuying loans	(7,000)									(7,000)
Investment in jointly controlled entity				20,600						20,600
	89,000									136,600
CURRENT ASSETS										
Properties for sale	10,000			(1,000)		(1,000)	(2,200)			5,800
Debtors	4,000			(400)						3,600
Cash at bank and in hand	2,000			(200)						1,800
	16,000									11,200
CURRENT LIABILITIES										
Bank loans	(12,000)	12,000								(900)
Short term creditors		(1,000)		100						(8,800)
Other short-term financial liabilities		(9,000)		200						(2,250)
Provisions		(2,000)						(250)		(100)
Employee benefits		(100)								(250)
		(250)								(12,300)
NET CURRENT ASSETS	4,000									
TOTAL ASSETS LESS CURRENT LIABILITIES	93,000									
LONG-TERM LIABILITIES										
Bank loans	(70,000)	70,000								(67,300)
Other long-term financial liabilities		(68,000)		700						(6,750)
Provisions		(2,000)						(4,750)		(1,900)
Employee benefits		(1,900)								(2,750)
		(2,750)								(78,700)
PROVISIONS	(2,900)	2,000								
DEFINED BENEFIT PENSION SCHEME LIABILITY	(3,000)	3,000								
Total net assets	18,000	0	120,000	0	0	(26,000)	(200)	(5,000)	(50,000)	56,800
RESERVES										
Share capital	0									0
Designated reserve	2,750									2,750
Negative goodwill	2,000				(2,000)					0
Revenue reserve	13,250		120,000		2,000	(26,000)	(200)	(5,000)	(50,000)	54,050
	18,000	0	120,000	0	0	(26,000)	(200)	(5,000)	(50,000)	56,800

Adjustment 1	Reanalysis of liabilities
Adjustment 2	Derecognition of SHG
Adjustment 3	JANE accounting re-presented as JCE accounting
Adjustment 4	Derecognition of negative goodwill
Adjustment 5	Effects of reversing policy of capitalisation of borrowing costs
Adjustment 6	Recognition of PFI arrangement - intangible received in exchange for construction of asset
Adjustment 7	Recognition of interest rate swaps at fair value
Adjustment 8	Recognition of impairment of assets linked to recognition of SHG as income

APPENDIX 3

RECONCILIATION OF HYPOTHETICAL HIGHER EDUCATION INSTITUTION INCOME STATEMENT

	As reported under UK GAAP £'000	Adjustment 1 £'000	Adjustment 2 £'000	Adjustment 3 £'000	Adjustment 4 £'000	Adjustment 5 £'000	Adjustment 6 £'000	Adjustment 7 £'000	Adjustment 8 £'000	As reported under IFRS for SMEs £'000
Income										
Funding body grants	60,000		5,000							65,000
Tuition fees and education contracts	36,000									36,000
Research grants and contracts	30,000									30,000
Other income	40,000			900						40,900
Profit on disposal of property		750								750
Negative goodwill arising on acquisition of XYZ college										0
Endowment and investment income	3,000					250		(2,500)		750
Total income	169,000	750	5,000	900	0	250	0	(2,500)	0	173,400
Less share of joint venture income	(2,100)									
Expenditure										
Staff costs	90,000				25				(2,000)	88,025
Other operating expenses	60,000				200		250			60,450
Depreciation and amortisation	10,000			(100)			(50)			9,850
Fundamental restructuring costs		3,000								3,000
Interest and other finance costs	2,500									2,500
Total expenditure	162,500	3,000	0	(100)	225	0	200	0	(2,000)	163,825
Income less expenditure	6,500	(2,250)	5,000	1,000	(225)	250	(200)	(2,500)	2,000	9,575
Share of loss in joint venture	(400)									(400)
Share of profit in associate	100									100
Taxation	(200)									(200)
Surplus after tax	6,000	(2,250)	5,000	1,000	(225)	250	(200)	(2,500)	2,000	9,075
Surplus attributable to the parent										8,975
Surplus attributable to non-controlling interest	(100)									100
Surplus for the year before exceptional items	5,900									9,075
Disposal of fixed assets	750	(750)								
Fundamental restructuring costs	(3,000)	3,000								
Surplus on continuing operations after depreciation of assets at valuation, disposal of assets and tax	3,650									
(Deficit) / surplus transferred to accumulated income in endowment funds	(100)									
Surplus for the year retained within general reserves	3,550									

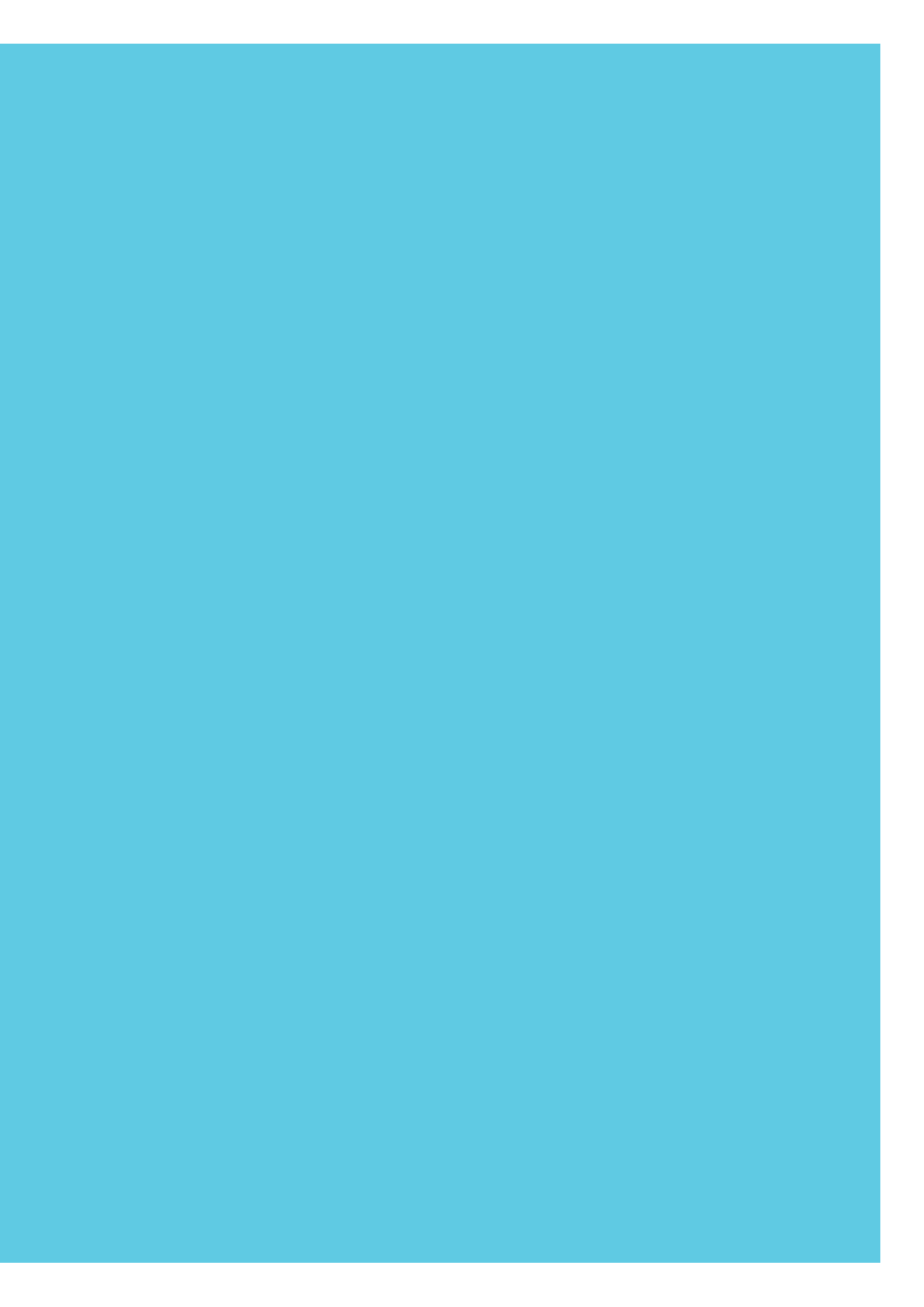
Adjustment 1	Reclassification of exceptional items as 'operating' expenses
Adjustment 2	Recognition of grants for capital items received in period
Adjustment 3	Gains on investment property element of mixed-use property, and removal of associated depreciation previously charged
Adjustment 4	Effect of spreading lease incentive over lease term rather than period to first rent review and staff holiday accrual
Adjustment 5	Endowment income previously recognised in Statement of Total Recognised Gains and Losses
Adjustment 6	Development costs expensed, and reversal of amortisation charge, as a result of change of UK GAAP policy of capitalising such costs
Adjustment 7	Fair value gains on fixed and current asset equity investments recognised in income statement not statement of total recognised gains and losses
Adjustment 8	Effect of using simplified approach for measuring defined benefit pension liabilities

RECONCILIATION OF HYPOTHETICAL HIGHER EDUCATION INSTITUTION BALANCE SHEET TO STATEMENT OF FINANCIAL POSITION

	As reported under UK GAAP £'000	Adjustment 1 £'000	Adjustment 2 £'000	Adjustment 3 £'000	Adjustment 4 £'000	Adjustment 5 £'000	As reported under IFRS for SMEs £'000
LONG-TERM ASSETS							
Intangible assets	1,000			(1,000)			0
Tangible Assets	125,000		(6,000)				119,000
Benefits arising on past acquisition	(4,000)	4,000					
Investment property			8,000				8,000
Investments	2,000	250					2,250
Investments in joint venture		500					500
Share of gross assets	1,750	(1,750)					
Share of gross liabilities	(1,250)	1,250					
	124,500						129,750
ENDOWMENT ASSETS	1,500	(1,500)					
CURRENT ASSETS							
Debtors	13,000						13,000
Investments	25,000					3,500	28,500
Cash at bank and in hand	10,000	1,250					11,250
	49,500						52,750
CURRENT LIABILITIES	(50,000)	50,000					
Bank loans and overdrafts		(2,500)					(2,500)
Short term creditors		(47,500)					(47,500)
Provisions		(500)					(500)
Employee benefits		(1,000)					(1,000)
							(51,500)
NET CURRENT LIABILITIES	(500)						
TOTAL ASSETS LESS CURRENT LIABILITIES	124,000						
LONG-TERM LIABILITIES	(30,000)	30,000					
Bank loans		(24,000)					(24,000)
Other long-term financial liabilities		(9,000)					(9,000)
Provisions		(2,750)					(2,750)
Employee benefits		(19,000)			6,000		(13,000)
							(48,750)
PROVISIONS	(3,250)	3,250					
DEFINED BENEFIT PENSION SCHEME LIABILITY	(20,000)	20,000					
TOTAL NET ASSETS	70,750	1,000	2,000	(1,000)	6,000	3,500	82,250
DEFERRED CAPITAL GRANTS	30,000	(30,000)					
ENDOWMENTS							
Expendable	1,000						1,000
Permanent	500						500
RESERVES							
Income and expenditure account	49,250	21,000	2,000	(1,000)	6,000	3,500	80,750
Pension reserve	(20,000)	20,000					
Revaluation Reserve	10,000	(10,000)					
Foreign exchange reserve							0
TOTAL FUNDS	70,750	1,000	2,000	(1,000)	6,000	3,500	82,250
Attributable to the parent	69,000						80,800
Attributable to minority interests	1,750			(300)			1,450

Adjustment 1	Reanalysis of liabilities, reserves, endowment assets, and release of negative goodwill and capital grants (except where performance conditions remain)
Adjustment 2	Investment property element of mixed-use property measured at fair value
Adjustment 3	Reversal of capitalised development costs
Adjustment 4	Effect of using simplified approach for measuring defined benefit pension liabilities
Adjustment 5	Effect of measuring current asset investments at fair value

NOTES



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