The new Financial Reporting Standards

1 Overview of the ASB consultation

1.1 The Accounting Standards Board (ASB) has recently published three new financial reporting exposure drafts (FREDs 46 to 48) setting out its revised proposals for UK financial reporting. These substantially revised proposals follow on from the ASB's earlier consultation on exposure drafts (FREDS 43 to 45) that took place in late 2010 and early 2011. The revised proposals put back the implementation date of the new framework to 1 January 2015 and views are sought on the three proposed new standards:

- FRS 100: Application of Financial Reporting Requirements (FRED 46);
- FRS 101: Reduced Disclosure Framework (FRED 47); and
- FRS 102: The Financial Reporting Standard applicable in the UK and Republic of Ireland (FRED 48).

1.2 The ASB's consultation is presented in three parts:

- Part One – contains an explanation of the proposals together with an invitation to comment;
- Part Two – contains the text of the three proposed new financial reporting standards (FRS 100, 101 and 102); and
- Part Three – contains background to the development of the proposed new standards and a revised impact assessment.

The closing date for comment on the consultation is 30 April 2012.

1.3 Committee members can view the drafts FRED 46, 47 and 48 in advance of the meeting by downloading them from the ASB website:

http://www.frc.org.uk/asb/publications/documents.cfm?cat=3

There is a particularly useful 'key fact' document issued by the ASB that can be downloaded at:

http://www.frc.org.uk/images/uploaded/documents/The%20Key%20Facts%20January%202012.pdf

1.4 The following briefing papers are tabled for the SORP Committee's information, consideration and comment:

- This paper (Paper 2) outlines, for information, the new proposed framework;
- Paper 2.1 sets out particular issues for the Committee's consideration;
- Paper 2.2 sets out, for information, the SORP Committee's response to the ASB's earlier consultation on the proposed Standard for Public Benefit Entities (FRED 45 in 2011) and summarises how those issues identified as concerns are now addressed in the current proposals; and
- Papers 2.3 and 2.4 set our a draft response to the ASB's revised proposals for the Committee's comment.

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2 The new proposed framework, PBEs and the SORP

2.1 Under the revised ASB proposals existing UK GAAP will be replaced by a single Financial Reporting Standard (FRS 102) with FRS 101 providing a reduced disclosure framework for certain entities that otherwise apply EU adopted International Financial Reporting Standards (IFRS) and these are primarily subsidiary entities. In addition, the Financial Reporting Standard for Smaller Entities (FRSSE) is to be retained and will be updated for proposed revisions to European Union Accounting Directives that will apply to small and micro companies possibly in 2014. The ASB's stated aim is to provide a framework that will '…enable users of accounts to receive high quality, understandable financial reporting proportionate to the size and complexity of the entity and users' information needs'.

2.2 Earlier ASB proposals for a framework based on 'public accountability' are dropped and there will be no extension of EU adopted International Financial Reporting Standards (IFRS) to entities not currently required to use IFRS. FRS 102 does now cross refer to IFRS where necessary.

2.3 The ASB believe that the proposed framework is now aligned with UK company law and so addresses concerns that earlier proposals where not entirely consistent with company law. This welcome change will help facilitate a common format for the Statement of Financial Activities and Balance Sheet that will apply to all charities preparing accruals accounts.

2.4 Proposals for a separate Financial Reporting Standard for Public Benefit Entities (FRSPBE) have been dropped. In its place FRS 102 incorporates public benefit entity text in section 34 with the relevant paragraphs prefixed 'PBE' which will apply to all types and sizes of PBE. The treatment of certain activities including holding heritage assets, property held for social benefit and assets held for their service potential are now addressed in the general text of FRS 102 and will apply to all entities and not just PBEs.

2.5 An effort is also made to help ensure the PBE specific elements of FRS 102 will have relevance to PBEs adopting the FRSSE. Paragraph 22 (d) of FRS 100 provides that 'Public benefit entities (PBE) as defined in FRS102 should in particular have regard to the PBE specific requirements in FRS 102' when applying the FRSSE. Paragraph 6 of FRS 102 defines a PBE as an entity: 'whose primary objective is to provide goods or services for the general public, community or social benefit'.

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2.6 FRS 102 would apply to all charities except those eligible for, and opting to use, the FRSSE. At just under 250 pages FRS 102 is much shorter than UK GAAP and offers a more condensed form of reporting. In developing FRS 102, the ASB has taken on board a number of concerns however a number of issues remain to be satisfactorily resolved. These issues are explored in papers 2.3 and 2.4 that set out a proposed response to the ASB's consultation.

2.7 The goal of the SORP is to ensure that charity specific transactions are treated in a consistent way whatever the nature or size of the charity. An aspect of concern was the extent to which FRSSE users would be required to follow the SORP. Paragraph 22 (g) of FRS 100 amends the FRSSE and provides that 'SORPs and other equivalent guidance developed or revised after the FRSSE was first issued may specify the circumstances, if any, in which entities in the industry or sector addressed in the SORP or equivalent guidance may adopt the current version of the FRSSE'. This could enable the SORP to specify that the use of the FRSSE by charities is conditional on application of the SORP in conjunction with the FRSSE. It would in turn serve to strengthen the SORP as a comprehensive reference source for the charity sector, providing critical support for smaller charities.

2.8 FRS 100 paragraphs 8 to 10 give status to SORPs and requires that 'where an entity's financial statements fall within the scope of a SORP, the entity should state in its financial statements the title of the SORP and whether its financial statements have been prepared in accordance with SORP's provisions currently in effect'. Early adoption of the new framework will only permissible for PBEs if the SORP is also in place (paragraph 14).

3 A reduced disclosure framework (FRS 101) and the SORP

3.1 FRS 101 is a reduced disclosure framework that aims to simplify the reporting requirements placed on eligible subsidiaries of a parent entity reporting under IFRS and to simplify the reporting by the ultimate parent in its entity only statements. FRS 101 relies on the consolidated financial statements prepared for the group to provide the full disclosure of information required by IFRS.

3.2 Unfortunately FRS 101 makes no reference to a subsidiary's adherence to SORPs. However since charities cannot adopt IFRS this omission is acceptable. Instead, it cross refers (paragraph 10) to the application of the reduced disclosure by all entities that qualify to apply FRS 102. The reduced disclosure regime permitted in FRS 102 may benefit non-charitable trading subsidiaries and may also be useful for charity subsidiaries having to file entity accounts. However the adoption of a reduced disclosure framework may be unavailable to charities regulated by Scottish charity law. In most cases these will be company charities.

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3.3 The only area of reduced disclosure that arguably should not apply to charities is the omission from disclosure of related party transactions. FRS 102, paragraph 1.12 would permit non-disclosure of key management compensation and intra group transactions. It would therefore be helpful for FRS 102 were to allow SORPs to specifying the conditions for its application in the same way as SORP may specify conditions for use of the FRSSE.

4 The future of the FRSSE, Accounting Directives and the SORP

4.1 There has been considerable speculation as to whether the FRSSE which is based in existing UK GAAP would be retained in the longer term. The ASB at its meeting of 14 December 2011 confirmed that 'the FRSSE would be maintained, in revised form, following the amendments to the Accounting Directives currently proposed by the European Commission' and 'that a further consultation on the FRSSE would be carried out in 2012'.

4.2 The EU Parliament is considering a new accounting directive which would, under current proposals, mandate a simplified reporting and disclosure regime for small companies. The EC's proposed accounting directive may not be mandatory for not-for profit entities under the Treaty of the European Union but such a simplification may offer an opportunity to reduce complexity in charity accounting. The proposals would also increase the thresholds that define a small company. To be small, a company would need to meet two of the following three criteria:

- total assets not exceeding 5m Euro;
- turnover not exceeding 10m Euro; and
- fewer than 50 employees.

4.3 The proposals would introduce a form of abridged balance sheet and profit and loss account with only five stipulated notes. The implementation of this reform would radically affect the FRSSE particularly if the proposed accounting directive prohibits member states adding to its disclosure requirements. The likely implementation date for this change could be as early as mid-2014.

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4.4 The five notes would be restricted to:
- accounting policies;
- guarantees, commitments and contingencies and 'arrangements' not in the balance sheet;
- long-term and secured debts;
- post balance sheet items; and
- related party transactions.

4.5 The timing of the implementation of proposed EC accounting directive may create a significant logistical issue for the SORP's development. The SORP development work currently being undertaken is based on the current version of the FRSSE. If a new EC Accounting Directive were to be introduced in say 2014 together with a revised FRSSE then significant post consultation changes to the SORP may be necessary unless the direction of change can be anticipated.

4.6 Whilst a simplified reporting framework may be appropriate for smaller owner-managed companies that framework may not be suitable for charities of a similar size. The public interest and the provision of essential stewardship reporting for donors and financial supporters may justify additional notes or a greater level of detail in the Statement of Financial Activities and balance sheet.

4.7 In addition to proposals for a simplified reporting framework for small companies, there are also EU proposals for further simplifications for micro entities. Micro entities meet two of three criteria (BIS figures in brackets):
- total assets not exceeding 350,000 Euro (£220,000);
- turnover not exceeding 700,000 Euro (£440,000);
- fewer than 10 (10) employees.

4.8 The Department of Business Innovation and Skills (BIS) issued a discussion paper in August 2011 on the implementation of the regime for micro entities in the UK which proposed extending cash (receipts and payments) accounting to companies that meet the criteria of micro entities. On 21 February 2012, the Council of the European Union adopted a modified directive which gives member states discretion in allowing certain accounting exemptions for micro-entities which fall short of the more radical proposals contained in the earlier BIS consultation.

Questions:

- **Does the committee have any comments or observations on the framework proposed?**