ACCOUNTING STANDARDS BOARD MARCH 2011

THE FUTURE OF FINANCIAL REPORTING

IN THE UK AND REPUBLIC OF IRELAND

45

FINANCIAL REPORTING STANDARD FOR PUBLIC BENEFIT ENTITIES

AND

CONSEQUENTIAL AMENDMENTS TO

PROPOSALS IN FRED 44 FINANCIAL REPORTING STANDARD FOR MEDIUM-SIZED ENTITIES

ACCOUNTING STANDARDS BOARD

FINANCIAL REPORTING EXPOSURE DRAFT

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

For ease of handling, we prefer comments to be sent by email (in Word format) to

asbcommentletters@frc-asb.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched so as to be received no later than 31 July 2011. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC and/or any of its operating bodies unless the respondent explicitly requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted.

We aim to publish responses within 10 working days of receipt.

We will publish a summary of the consultation responses, either as part of, or alongside, our final decision.

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ASB

ACCOUNTING
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PREFACE

1 The Accounting Standards Board (ASB) is issuing this Financial Reporting Exposure Draft (FRED) 'Financial Reporting Standard for Public Benefit Entities' (FRSPBE) to set out proposals for specific financial reporting requirements to be applied by public benefit entities (PBEs).

2 The draft Financial Reporting Standard for Medium-sized Entities (FRSME) is based on the International Accounting Standards Board's International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs), which was developed for use by for-profit entities.

3 The draft FRSME does not address the accounting for some transactions and circumstances that are common for PBEs and there is a risk of conflicting and inconsistent interpretations arising in its application to PBEs, because they have different objectives, funding and ownership from for-profit entities. This draft Standard has been developed to address these issues and provide specific financial reporting requirements for PBEs in addition to those set out in the draft FRSME.

APPLICATION OF THE DRAFT FRSPBE

4 The financial reporting framework set out in Financial Reporting Exposure Draft 43 'Application of Financial Reporting Requirements' is summarised in the table below along with the application of the draft FRSPBE for the different accounting regimes.

	Nature of Entity	**Accounting regime***	**Reduced disclosures for…**	**Application of FRSPBE**
Tier 1	Entities that have public accountability	EU-adopted IFRS	Qualifying subsidiaries	Best practice guidance
Tier 2	Entities without public accountability and small publicly accountable entities that are prudentially regulated	FRSME	Qualifying subsidiaries	Mandatory for entities meeting the scope and definition set out in Section 1 of the draft FRSPBE
Tier 3	Small entities without public accountability	Financial Reporting Standard for Smaller Entities (FRSSE)		Best practice guidance

5 This draft Standard will be mandatory for PBEs preparing their financial statements under the Tier 2 accounting regime and shall be applied in conjunction with the draft FRSME.

6 For PBEs preparing their financial statements under the Tier 1 or Tier 3 accounting regime this draft Standard is considered by the ASB to be best practice guidance which is persuasive rather than mandatory.

* *Public benefit entities will prepare financial statements under the relevant legislative framework except for those applying EU-adopted IFRS without the reduced disclosure framework, who will prepare 'IAS accounts'.*

7 Where a PBE prepares financial statements under Tier 1 the requirements of EU-adopted IFRS take precedence over those of the draft FRSPBE. Instances where the requirements of EU-adopted IFRS and the draft FRSPBE conflict are indicated by footnotes.

STATEMENTS OF RECOMMENDED PRACTICE

8 Many PBEs currently prepare financial statements in accordance with UK Financial Reporting Standards as supplemented by the relevant Statement of Recommended Practice (SORP).

9 The requirements in respect of the application of SORPs are set out in paragraph 17 of Financial Reporting Exposure Draft 43 'Application of Financial Reporting Requirements' and apply to PBEs preparing their financial statements in accordance with the relevant sector specific SORP.

10 Public benefit entity SORPs are expected to be updated following publication of this draft Standard and will continue to provide sector specific interpretation and guidance where necessary.

11 In the case of any conflict between SORPs and the requirements of the draft FRSME and the draft FRSPBE, the draft FRSME and draft FRSPBE will take precedence and the disclosure requirements in Section I, paragraph 17 of the proposals made in the Financial Reporting Exposure Draft 43 'Application of Financial Reporting Requirements' shall be applied, which state that, in the event of a departure from the provisions of the SORP the entity should give a brief description of how the financial statements depart from the recommended practice set out in the SORP, which should include:

(a) for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances; and

(b) details of any disclosures recommended by the SORP that have not been provided, and the reasons why they have not been provided.

SECTION I

INVITATION TO COMMENT

SECTION I

INVITATION TO COMMENT

1 The Accounting Standards Board (ASB) is requesting comments by 31 July 2011. The ASB is committed to developing standards based on evidence from consultation with users, preparers and others.

2 Section II of this document sets out the proposals for public benefit entities (PBEs) preparing financial statements in accordance with the draft Financial Reporting Standard for Public Benefit Entities (FRSPBE).

3 Comments are invited on all aspects of the proposals; in particular comments are sought on the questions below. Comments are most helpful if they:

- Address the questions as stated;
- Indicate the specific paragraph or paragraphs to which the comments relate;
- Contain a clear rationale; and
- Describe any alterations the ASB should consider.

Respondents need not comment on all of the questions.

DRAFT FINANCIAL REPORTING STANDARD FOR PUBLIC BENEFIT ENTITIES

1 Application of FRS requirements

Definition of a public benefit entity

The proposed definition of a public benefit entity is summarised in paragraph 1.3 of the Application of FRS Requirements of this Financial Reporting Exposure Draft.

> Q1: Is the definition of a public benefit entity and the accompanying application guidance sufficiently clear to enable an entity to determine if it is a public benefit entity? If not, why not?

Effective date

> Q2: The ASB is proposing an effective date of 1 July 2013 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 [draft] 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?

2 Concessionary loans

The proposed accounting for concessionary loans requires that these transactions are recorded at either (i) fair value or (ii) the amount received or paid in the financial statements of the PBE making or receiving the loan and disclosure of the impact of the arrangement.

> Q3: Do you agree with the proposals for concessionary loans in public benefit entities? If not, what alternative accounting treatment and/or disclosures do you consider appropriate?

3 Property held for the provision of social benefits

This draft Standard proposes that property held for the primary provision of social benefits (such as social housing) shall not be classified as investment properties and shall be accounted for as property, plant and equipment in accordance with Section 17 of the draft FRSME.

> Q4: Do you agree with the proposals for property held for the provision of social benefits? If not, why not?

4 Entity combinations

For the public benefit entity environment merger accounting is required where specific criteria are met in this draft Standard. This draft Standard also clarifies the accounting treatment for combinations that are in substance a gift to ensure it is consistent with the accounting for gifts and other non-exchange transactions noted in Section 7 of this draft Standard.

Q5: Do you agree with the proposals for combinations that are in substance a gift and combinations which are in substance a merger?

Q6: Do you agree with the criteria set out for merger accounting? If not, what criteria in addition to or instead of those suggested should be included in the draft Standard?

5 Impairment of assets: public benefit considerations

This section of the draft Standard allows public benefit entities to apply an alternative method in determining the value in use of assets held for their service potential rather than to generate cash inflows.

Q7: Do you agree with the proposed alternative method of determining value in use for assets held for their service potential? If not, what alternative method would you suggest and why?

6 Funding commitments

The draft Standard sets out the requirements for recognition, measurement and disclosure of a liability where a commitment is made by one entity to another.

Q8: Do you agree with the recognition criteria and measurement and disclosure requirements set out in the proposals? If not, what further criteria and/or disclosure requirements should be included and why?

7 Incoming resources from non-exchange transactions

The draft Standard requires that incoming resources (including goods and services) from non-exchange transactions are recognised at fair value on receipt unless there are performance conditions to be considered. Guidance is provided on the recognition of liabilities, services and performance conditions.

Q9: Do you agree with the proposals for recognition of incoming resources from non-exchange transactions?

Q10: Is the guidance sufficiently clear to enable an entity to understand and interpret the proposed requirements? If not, what further guidance is required?

CONSEQUENTIAL AMENDMENTS TO THE PROPOSALS IN FINANCIAL REPORTING EXPOSURE DRAFT 44 FINANCIAL REPORTING STANDARDS FOR MEDIUM-SIZED ENTITIES

Heritage assets

The ASB decided during its deliberations on the [draft] FRSPBE that the requirements previously in Financial Reporting Standard 30 'Heritage Assets' should be included in the draft FRSME rather than the draft FRSPBE.

It is also proposed that where heritage assets are held at valuation, movements in valuation are accounted for through other comprehensive income.

Consequential amendments to achieve this are set out in Section III of this Financial Reporting Exposure Draft.

Q11: Do you agree with the proposals for heritage assets and in particular the proposals for recognising subsequent movements in valuation of heritage assets in other comprehensive income?

DEVELOPMENT OF THE [DRAFT] FINANCIAL REPORTING STANDARD FOR PUBLIC BENEFIT ENTITIES

Q12: Do you believe the future issues that may be considered following finalisation of this draft Standard as set out in paragraph 4 of Section IV are appropriate? Are there any additional matters which you believe should be included on the agenda for future updates to this draft Standard?

Q13: Do you believe that further guidance is required to interpret the indicators of control included in Section 9 *Consolidated and Separate Financial Statements* of the draft Financial Reporting Standard for Medium-sized Entities (FRSME)?

Q14: Do you believe that the requirements of this draft Standard should be extended to entities that apply the FRSSE?

SECTION II

DRAFT FINANCIAL REPORTING STANDARD FOR PUBLIC BENEFIT ENTITIES

CONTENTS

The *Financial Reporting Standard for Public Benefit Entities (FRSPBE)* is set out in Sections 1-7 and the Glossary. Terms defined in the Glossary are in **bold type** the first time they appear in each section.

SECTION 1: [DRAFT] FINANCIAL REPORTING STANDARD: APPLICATION OF FINANCIAL REPORTING REQUIREMENTS

OBJECTIVES

1.1 The objective of this [draft] Standard is to set out specific financial reporting requirements for **public benefit entities** (PBEs) in the UK and Republic of Ireland.

SCOPE

1.2 This [draft] Standard applies to entities meeting all of the following criteria:

(a) Entities that meet the definition of a PBE as set out in paragraph 1.3 of this [draft] Standard;

(b) Entities preparing **financial statements** that are intended to give a true and fair view of the **financial position** and **income and expenditure** for a period; and

(c) Entities preparing financial statements in accordance with the [draft] Financial Reporting Standard for Medium-sized Entities (FRSME).

DEFINITION OF A PUBLIC BENEFIT ENTITY

1.3 A PBE is an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any 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.

1.4 The appendix to this section sets out application guidance to assist an entity in determining if it meets the definition of a PBE.

STATEMENT OF COMPLIANCE

1.5 Where an entity prepares financial statements in accordance with this [draft] Standard it shall state in the **notes** to the financial statements that the financial statements have been prepared in accordance with the [draft] FRSPBE.

DATE FROM WHICH EFFECTIVE AND TRANSITIONAL ARRANGEMENTS

1.6 An entity shall apply this [draft] Standard for accounting periods beginning on or after 1 July 2013.

1.7 Early adoption of this [draft] Standard is permitted, except that entities who prepare their financial statements in accordance with a SORP shall follow the requirements of that SORP, rather than this [draft] Standard, for accounting periods before the effective date.

APPENDIX

APPLICATION GUIDANCE ON THE DEFINITION OF PUBLIC BENEFIT ENTITIES

1A.1 The term 'public benefit entity' does not necessarily imply that the purpose of the entity is for the benefit of the public as a whole. For example, many PBEs exist for the direct benefit of a particular group of people, although it is possible that society as a whole also benefits indirectly. The important factor is what the primary purpose of such an entity is, and that it does not exist primarily to provide economic benefit to its investors. Organisations such as mutual insurance companies, other mutual co-operative entities and clubs that provide dividends or other economic benefits directly and proportionately to their owners, members or participants are not PBEs.

1A.2 Some public benefit entities undertake certain activities that are intended to make a surplus in order to fund their primary activities. Consideration should be given to the primary purpose of an entity's (or group's) activities in assessing whether it meets the definition of a PBE.

1A.3 PBEs may have contributions in the form of equity, even though the entity does not have a primary profit motive. However, because of the fundamental nature of public benefit entities, any such contributions are made by the equity holders of the entity primarily to enable the provision of goods or services to beneficiaries rather than with a view to a financial return for themselves. This is different from the position of lenders; loans do not fall into the category of equity.

SECTION 2: CONCESSIONARY LOANS

(FRSME Section 11: *Basic Financial Instruments*)

Scope and definition

2.1 This section deals with the recognition, measurement and disclosure of **concessionary loan** arrangements within the **financial statements** of entities making and receiving concessionary loans.

2.2 Concessionary loans are loans made or received between a **public benefit entity** (PBE) and a third party at below the **prevailing market rate** of interest which are not repayable on demand. This section applies to concessionary loan arrangements only and is not applicable to loans which are at a market rate or to other commercial arrangements.

Accounting treatment

2.3 PBEs making or receiving concessionary loans shall use either:

(a) the recognition, measurement and disclosure requirements in Section 11 *Basic Financial Instruments* of the [draft] FRSME, which requires initial measurement at **fair value** and subsequent measurement at **amortised cost** using the **effective interest method**; or

(b) the accounting treatment set out in paragraphs 2.4-2.11 below.*

A PBE shall apply the same accounting policy to concessionary loans both made and received.

---

* *This treatment is not available for entities applying EU-adopted IFRS.*

Recognition and initial measurement

2.4 A PBE making or receiving concessionary loans (as per paragraph 2.3(b)) to a third party shall initially measure these arrangements at the amount received or paid and recognise them in the **statement of financial position**.

Subsequent measurement

2.5 In subsequent years the **carrying amount** of concessionary loans in the financial statements shall be adjusted to reflect accrued interest payable or receivable.

2.6 To the extent that a loan that has been made is irrecoverable an **impairment loss** shall be recognised in **income and expenditure**.

Presentation and Disclosure

2.7 The entity shall present concessionary loans either as a separate line item on the face of the statement of financial position or in the **notes** to the financial statements.

2.8 Concessionary loans shall be classified separately to disclose amounts repayable within one year and amounts repayable in more than one year.

2.9 The entity shall disclose in the summary of significant **accounting policies** the measurement basis used for concessionary loans and any other accounting policies which are relevant to understanding these transactions within the financial statements.

2.10 The entity shall also disclose the following information relating to concessionary loans:

(a) the terms and conditions of concessionary loan arrangements, including the interest rate, any security provided and the terms of repayment; and

(b) the value of concessionary loans which have been committed but not taken up at the year end.

2.11 Concessionary loans disclosures may be made in aggregate, providing that such aggregation does not obscure significant information.

SECTION 3: PROPERTY HELD FOR THE PROVISION OF SOCIAL BENEFITS

(FRSME Section 16: *Investment Property*)

Property held for the provision of social benefits

3.1 In accordance with the definition of **investment property** set out in paragraph 16.2 of the [draft] Financial Reporting Standard for Medium- sized Entities (FRSME), properties held for the primary provision of social benefits, e.g. social housing, shall not be classified as investment properties and shall be accounted for as **property, plant and equipment** in accordance with Section 17 *Property, Plant and Equipment* of the [draft] FRSME.

SECTION 4: ENTITY COMBINATIONS*

(FRSME Section 19: *Business Combinations*)

Scope of this section

4.1 This section applies only to the following categories of **entity combinations** which involve a whole entity or parts of an entity combining with another entity:

(a) combinations at nil or nominal consideration which are in substance a gift; and

(b) combinations which meet the definition and criteria of a **merger.**

4.2 Combinations which are determined to be acquisitions shall be accounted for in accordance with Section 19 *Business Combinations* of the [draft] Financial Reporting Standard for Medium-sized Entities (FRSME).

Combinations that are in substance a gift

Definition

4.3 A combination carried out at nil or nominal consideration that is not a **fair value** exchange but in substance the gift of one entity to another.

Accounting

4.4 A combination that is in substance a gift shall be accounted for in accordance with the [draft] FRSME except for the matters addressed in paragraphs 4.5 and 4.6 below. The

* *The accounting treatments in this section are not available for entities applying EU-adopted IFRS.*

disclosure requirements set out in paragraph 4.7 apply in place of those of paragraph 19.25 of the [draft] FRSME.

4.5 The excess of the fair value of the assets received over the fair value of the liabilities assumed is recognised as a gain. This gain represents the gift of the value of one entity to another and shall be recognised as income.

4.6 If the fair value of the liabilities assumed exceeds the fair value of the assets received, the deficit of the fair value of the liabilities in comparison to the assets is accounted for as a loss. The loss represents the net obligations assumed, for which the receiving entity has not received a financial reward and will therefore result in a decrease in residual interest.

Disclosure

4.7 For each combination accounted for as the gift of one entity to another the following shall be disclosed in the **financial statements** of the receiving entity:

(a) the names and descriptions of the entities;

(b) the date of the transaction;

(c) an analysis of the principal components of the current year's primary financial statements to indicate:

(i) the amounts relating to the entity after the date of the transaction which includes the gifted entity; and

(ii) the amounts relating to each entity to the combination up to the date of the transaction.

(d) The aggregate carrying value of the net assets of each entity at the date of the transaction.

Combinations that are a merger

Definition and criteria

4.8 A merger is an entity combination that results in the creation of a new reporting entity formed from the combining parties, in which the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant.

4.9 All of the following criteria must be met for an entity combination to meet the definition of a merger:

(a) 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;

(b) there is no significant change to the class of beneficiaries of the combining entities or the benefits provided as a result of the combination; and

(c) 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.

4.10 Entity combinations that meet all of the three criteria set out in paragraph 4.9(a)-(c) shall apply merger accounting as prescribed below.

4.11 Any entity combination which does not meet all of the three criteria set out in paragraph 4.9(a)-(c) shall be accounted for as an acquisition in accordance with Section 19 *Business Combination* of the [draft] FRSME.

Accounting

4.12 Under merger accounting the carrying value of the assets and liabilities of the parties to the combination are not adjusted to fair value, although adjustments should be made to achieve uniformity of **accounting policies** across the combining entities.

4.13 The results and **cash flows** of all the combining entities shall be brought into the financial statements of the newly formed entity from the beginning of the financial period in which the merger occurs.

4.14 The corresponding figures should be restated by including the results for all the combining entities for the previous accounting period and their statement of financial positions for the previous reporting date. The comparative figures should be marked as '**pro forma**' figures.

4.15 All costs associated with the merger shall be charged to **income and expenditure**.

Disclosure

4.16 For each **business combination** accounted for as a merger in the **reporting period** the following shall be disclosed in the newly formed entity's financial statements:

(a) the names and descriptions of the combining entities or business;

(b) the date of the merger;

(c) an analysis of the principal components of the current year's primary financial statements to indicate:

(i) the amounts relating to the newly formed merged entity for the period after the date of the merger; and

(ii) the amounts relating to each party to the merger up to the date of the merger.

(d) an analysis of the previous year's primary financial statements between each party to the merger;

(e) the aggregate carrying value of the net assets of each party to the merger at the date of the merger; and

(f) the nature and amount of any significant adjustments required to align accounting policies and an explanation of any further adjustments made to net assets as a result of the merger.

Transition

4.17 On initial adoption of this [draft] Standard, a PBE may elect not to apply this section to entity combinations that were effected before the date of transition to this [draft] Standard. However, if on first-time adoption a PBE restates any entity combination to comply with this section, it shall restate all later entity combinations.

SECTION 5: IMPAIRMENT OF ASSETS: PUBLIC BENEFIT CONSIDERATIONS

(FRSME Section 27: *Impairment of Assets*)

Scope of this section

5.1 The [draft] Financial Reporting Standard for Medium-sized Entities (FRSME) requires that if, and only if, the **recoverable amount** of an asset is less than its carrying amount, an entity shall reduce the **carrying amount** of the asset to its recoverable amount, and recognise the reduction as an **impairment loss** immediately in **profit or loss**. (FRSME 27.5, 27.6).

5.2 Recoverable amount is the higher of **fair value less costs to sell** and **value in use**. This section sets out requirements for:

(a) determining fair value less costs to sell where the use of an asset is restricted; and

(b) determining value in use for assets held by **public benefit entities** (PBEs) for their **service potential** rather than to generate **cash flows**.

Indicators of impairment

5.3 As a minimum, PBEs must consider the indicators of impairment in the [draft] FRSME paragraph 27.9(a)-(g). However, in addition PBE entities should also consider whether there is any indication that the service potential of an asset has been impaired, for example the cessation, or near cessation, of the demand or need for services provided by the asset.

Fair value less costs to sell

5.4 When determining an asset's fair value less costs to sell, consideration shall be given to any restrictions imposed on that asset. Costs to sell should include the cost of obtaining relaxation of a restriction where necessary in order to enable the asset to be sold. If a restriction would also apply to any potential purchaser of an asset, the fair value of the asset may be lower than that of an asset whose use is not restricted.

Value in use

5.5 Where an entity holds assets in order to derive cash flows, value in use (the present value of future cash flows) is determined in accordance with the [draft] FRSME paragraphs 27.15–27.20.

5.6 However, for assets held for their service potential a cash flow driven valuation may not be possible. In these circumstances, value in use is the present value of the asset's remaining service potential. In many cases this may be taken to be **depreciated replacement cost**, but other approaches may be used where more appropriate.

The following sections (6-7) do not relate to any specific section of the [draft] FRSME.

SECTION 6: FUNDING COMMITMENTS

Scope of this section

6.1 This section applies to funding commitments to provide resources to other entities.

Recognition

6.2 An entity shall recognise a liability, where it has made a commitment that it will provide resources to another party, if, and only if:

(a) the obligation is such that the entity cannot realistically withdraw from it; and

(b) the commitment does not depend on the performance of the recipient.

6.3 Commitments made which are performance-related will be recognised when those performance conditions are met.

Measurement

6.4 An entity shall measure any recognised liability at the **present value** of the total resources committed.

Disclosure

6.5 An entity that has made a commitment shall disclose the following:

(a) the commitment made;

(b) the time-frame of that commitment;

(c) any performance-related conditions attached to that commitment; and

(d) details of how that commitment will be funded.

6.6 The above disclosures may be made in aggregate, providing that such aggregation does not obscure significant information. However, separate disclosure shall be made for recognised and unrecognised commitments.

Appendix to Section 6

Guidance on funding commitments

This guidance accompanies but is not part of the [draft] Standard.

6A.1 Public benefit entities often make commitments to provide cash or other resources to other entities. In such a case, it is necessary to determine whether the commitment should be recognised as a liability. The definition of a liability requires that there be a present obligation, and not merely an expectation of a future outflow. In most cases there is no liability, because entities rarely make irrevocable commitments without requiring future performance from the recipient.

6A.2 A general statement that the entity intends to provide resources to certain classes of potential beneficiaries in accordance with its objectives does not in itself give rise to a liability, as the entity may amend or withdraw its policy, and potential beneficiaries do not have the ability to insist on their fulfilment. Similarly, an undertaking to provide cash made on the expectation of future income will not give rise to a liability if the entity cannot be required to fulfil it if the future income is not received.

6A.3 A liability is recognised only for a specific commitment that gives the recipient a valid expectation that payment will be made and therefore from which the grantor cannot realistically withdraw. One of the implications of this is that a liability only exists where the commitment has been communicated to the recipient.

6A.4 Commitments are not recognised if they are subject to performance-related conditions. In such a case, the entity is required to fulfil its commitment only when the performance-related conditions are met, and no liability exists until that time.

6A.5 A commitment may contain conditions that are not performance-related conditions. For example, a requirement to provide an annual financial report to the grantor may serve mainly an administrative purpose because failure to comply would not release the grantor from its commitment. This may be distinguished from a requirement to submit a detailed report for review and consideration by the grantor of how funds have been utilised in order to secure payment. A mere restriction on the specific purpose for which funds are to be used does not in itself constitute a performance-related condition.

6A.6 Because many commitments are not recognised, it is important that full and informative disclosure is also made of the existence and sources of funding for unrecognised commitments.

SECTION 7: INCOMING RESOURCES FROM NON-EXCHANGE TRANSACTIONS

Scope of this section

7.1 The accounting for **government grants** is addressed in [draft] FRSME Section 24 *Government Grants*.

7.2 This Section applies those requirements to resources received from **non-exchange transactions.** A non-exchange transaction is a transaction whereby 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.

7.3 Non-exchange transactions include, but are not limited to, donations (of cash, goods, and services) and legacies.

Recognition and measurement

7.4 An entity shall recognise receipts from non-exchange transactions as follows:

(a) transactions that do not impose specified future performance conditions on the recipient are recognised in income when the resources are receivable.

(b) transactions that do impose specified future performance conditions on the recipient are recognised in income only when the performance conditions are met.

(c) where resources are received before the revenue recognition criteria are satisfied a liability is recognised.

7.5 An entity shall recognise a liability for any resource with specified performance conditions that becomes repayable due to non-compliance with the performance conditions, when that repayment becomes **probable**.

7.6 Donations of services that can be reasonably quantified will usually result in the recognition of income and an expense. An asset will be recognised only when those services are used for the production of an asset, and the services received will be capitalised as part of the cost of that asset.

7.7 An entity shall measure resources from non-exchange transactions at the **fair value** of the resources received or receivable.

Disclosure

7.8 An entity shall disclose the following:

(a) the nature and amounts of resources received from non-exchange transactions recognised in the **financial statements**;

(b) any unfulfilled conditions or other contingencies attaching to resources from non-exchange transactions that have not been recognised in income; and

(c) an indication of other forms of resources from non-exchange transactions from which the entity has benefited.

Appendix A to Section 7

Guidance on incoming resources from non-exchange transactions

This guidance accompanies but is not part of the [draft] Standard.

Recognition

7A.1 The receipt of resources will usually result in an entity recognising an asset and corresponding income for the fair value of resources when those resources become received or receivable. Instances when this may differ include when:

(a) an entity received those resources in the form of services (see 7A.8-7A.11); or

(b) there are performance conditions attached to the resources, which have yet to be fulfilled (see 7A.12-7A.13).

7A.2 Resources should only be recognised when the monetary value of the incoming resources can be measured with sufficient reliability.

7A.3 The concept of materiality (see [draft] FRSME paragraph 2.6) should be considered when deciding which resources received should be recognised in the financial statements.

7A.4 Where an entity receives a large number of small value donated goods, it is acceptable for that entity to estimate the value of those goods taking into consideration past experience and expectations.

Legacies

7A.5 Donations in the form of legacies are recognised when there is sufficient certainty that the legacy will be received and its value can be measured with sufficient reliability.

These criteria will normally be met following probate once the executor(s) of the estate has established that there are sufficient assets in the estate, after settling liabilities, to pay the legacy.

7A.6 Evidence that the executor(s) has determined that a payment can be made may arise on the agreement of the estate's accounts or notification that payment will be made. Where notification is received after the year-end but it is clear that the executor(s) has agreed prior to the year-end that the legacy can be paid, the legacy is accrued in the financial statements. The certainty and measurability of the receipt may be affected by subsequent events such as valuations and disputes.

7A.7 For entities that are in receipt of numerous immaterial legacies for which individual identification would be burdensome, a portfolio approach may be taken.

Services

7A.8 Donated services that can be reasonably quantified should be recognised in the financial statements when they are received.

7A.9 Donated services that are consumed immediately are usually recognised as an expense. However, there may be circumstances when a service is used in the production of an asset, for example erecting a building. In these cases, the associated donated service (e.g. plumbing and electrical services) would be recognised as a part of the cost of that asset.

7A.10 Donated services that can be reasonably quantified include donated facilities (such as office accommodation; those services that would otherwise have been purchased; and those services usually provided by an individual or an entity as part of their trade or profession for a fee). It may, however, not be possible to reasonably quantify the contribution made by volunteers and, where this is the case, those services need not be recognised.

7A.11 Paragraph 7.8(c) requires an entity to disclose other forms of resources from non-exchange transactions from which the entity has benefited. This will include the disclosure of unrecognised volunteer services.

Performance Conditions

7A.12 Some resources are given with performance conditions attached which require the recipient to use the resources for a particular purpose in order to be entitled to retain the resources. An entity will not recognise income from those resources until these performance conditions have been met.

7A.13 However, some requirements are stated so broadly that they do not actually impose a performance condition on the recipient. In these cases the recipient will recognise income on receipt of the transfer of resources.

Measurement

7A.14 Paragraph 7.7 requires resources received to be measured at their fair value. These fair values are usually the price that the entity would have to pay on the open market for an equivalent item.

7A.15 When there is no direct evidence of an open market value for an equivalent item a value may be derived from sources such as:

(a) the cost of the item to the donor; or

(b) in the case of goods that are expected to be sold, the estimated resale value (which may reflect the amount actually realised) after deducting the cost to sell the goods.

7A.16 Donations of services that are recognised should be measured at the estimated value of the service received. Donated services are recognised as income, and an equivalent amount shall be recognised as an expense in income and expenditure, unless the expense can be capitalised as part of the cost of an asset.

Appendix B to Section 7

Examples of incoming resources from non-exchange transactions

This guidance accompanies but is not part of the [draft] Standard.

Transfer of resources with conditions that do not satisfy the definition of a performance condition

7B.1 A donor makes a cash donation of CU10 million to a social housing entity specifying that it:

(a) increases the stock of social housing by an additional 100 units above what is already planned; or

(b) uses the cash in other ways to support its social housing objectives.

If neither of these conditions are met, the recipient must return the cash to the donor.

7B.2 Because these conditions are so broad and the second condition meets the operating mandate of the recipient entity there is no substantive performance condition to be met and the entity will recognise the transfer as revenue.

Transfer of resources with conditions whereby the resource become repayable

7B.3 A donor donates land for use by an agricultural department of a university for the purpose of developing students' skills in agricultural practices. The condition stipulates that if the land ceases to be used for this purpose it shall be returned to the donor.

7B.4 On transfer of the land, the university recognises an asset and revenue to the land's fair value.

7B.5 Twenty years after the transfer, a steady decline in student numbers over the past ten years will result in the agricultural department's closure at the end of the current academic year. When the university knows that it will close the department, it will recognise a liability for the return of the land and recognise an expense. On the actual transfer of the land back to the donor, the university will derecognise the asset and liability.

GLOSSARY

Terms with an asterisk * are replicated from the [draft] FRSME.

accounting policies *	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
asset *	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
amortised cost of a financial asset or financial liability *	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.
business combination *	The bringing together of separate entities or businesses into one reporting entity.
carrying amount *	The amount at which an asset or liability is recognised in the statement of financial position
cash flows *	Inflows and outflows of cash and cash equivalents.
cash-generating unit *	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

concessionary loan	A loan made or received between a public benefit entity and a third party at below the prevailing market rate of interest which is not repayable on demand.
date of transition to the FRSPBE	The beginning of the earliest period for which an entity presents full comparative information under the FRSPBE.
depreciated replacement cost	The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.
depreciable amount *	The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value.
depreciation *	The systematic allocation of the depreciable amount of an asset over its useful life.
effective interest method *	A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.
entity combination	See business combination
fair value *	The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

fair value less costs to sell *	The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the cost of disposal.
financial position *	The relationship of the assets, liabilities and equity of an entity as reported in the statement of financial position.
financial statements *	Structured representation of the financial position, financial performance, and cash flows of an entity.
government grants *	Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.
impairment loss *	The amount by which the carrying amount of an asset exceeds (a) in the case of inventories, its selling price less costs to complete and sell or (b) in the case of other assets, its fair value less costs to sell.
income *	Increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity investors.
income and expenditure	The total of income less expenses, excluding the components of other comprehensive income. In the for-profit sector this is known as **profit or loss**.
income statement *	Financial statement that presents all items of income and expense recognised in a reporting period, excluding the items of other comprehensive income.

investment property ⋆	Property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both rather than for: (a) use in the production or supply of goods or services or for administrative purposes; or (b) sale in the ordinary course of business.
liability ⋆	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
material ⋆	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
measurement ⋆	The process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the statement of financial position and statement of comprehensive income.
merger	An entity combination that results in the creation of a new reporting entity formed from the combining parties, in which the controlling parties of the combining entities come together in a partnership for the mutual sharing of risks and benefits of the

newly formed entity and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant.

All of the following criteria must be met for an entity combination to meet the definition of a merger:

(a) 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;
(b) there is no significant change to the class of beneficiaries of the combining entities or the benefits provided as a result of the combination; and
(c) 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.

non-exchange transaction A transaction whereby 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.

notes (to financial statements) * Notes contain information in addition to that presented in the statement of financial position, statement of comprehensive income, income statement (if presented), combined statement of income and retained earnings (if presented), statement of changes

	in equity and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition in those statements.
other comprehensive income	Items of income and expense (including reclassification adjustments) that are not recognised in the income and expenditure as required or permitted by this FRS.
present value *	A current estimate of the present discounted value of the future net cash flows in the normal course of business.
prevailing market rate	The rate of interest that would apply to the entity in an open market for a similar financial instrument.
probable *	More likely than not.
profit or loss	The total of income less expenses, excluding the components of other comprehensive income. For PBEs this is known as **income and expenditure**.
pro forma	Figures presented to illustrate the impact of an event or transaction on unadjusted financial information assuming that the event had occurred or the transaction been undertaken at an earlier date used for the illustration.
property, plant and equipment *	Tangible assets that: (a) are held for use in the production or supply of goods or services, for rental to others, for investment, or for administrative purposes, and

	(b) are expected to be used during more than one period.
public benefit entity	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.
recognition ⋆	The process of incorporating in the statement of financial position or statement of comprehensive income an item that meets the definition of an element and that satisfies that following criteria: (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability.
recoverable amount ⋆	The higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.
reliability ⋆	The quality of information that makes it free from material error and bias and represent faithfully that which it either purports to represent or could reasonably be expected to represent.
reporting date ⋆	The end of the latest period covered by financial statements or by an interim financial report.
reporting period ⋆	The period covered by financial statements or by an interim financial report.

residual value (of an asset) ⋆	The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
revenue ⋆	The gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.
service potential	The economic utility of an entity, based on the total benefit expected to be derived by the entity from use (and/or through sale) of the asset.
statement of cash flows ⋆	Financial statement that provides information about the changes in cash and cash equivalents of an entity for a period, showing separately changes during the period from operating, investing and financing activities.
statement of comprehensive income	Financial statement that presents all items of income and expense recognised in a period, including those items recognised in determining **income and expenditure** (which is a subtotal in the statement of comprehensive income) and items of other comprehensive income. If an entity chooses to present both an income statement and a statement of comprehensive income, the statement of comprehensive income begins with **income and expenditure** and then displays the items of other comprehensive income.

statement of financial position *	Financial statement that presents the relationship of an entity's assets, liabilities, and equity as of a specific date (also called the balance sheet).
useful life *	The period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
value in use *	The present value of the future cash flows expected to be derived from an asset or cash-generating unit.

SECTION III

CONSEQUENTIAL AMENDMENTS TO THE PROPOSALS IN FRED 44 FINANCIAL REPORTING STANDARD FOR MEDIUM-SIZED ENTITIES

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The Board expects to make the amendments described below when it finalises the [draft] Financial Reporting Standard for Medium-sized Entities.

Amendments to [draft] Financial Reporting Standard for Medium-sized Entities

Section 5: Statement of Comprehensive Income and Income Statement

1 Paragraph 5.4(b) is amended to read:

5.4(b) Four types of **other comprehensive income** ...

2 After sub-paragraph 5.4(b)(iii) sub-paragraph 5.4(b)(iv) is added:

(iv) some changes in the valuation of heritage assets (see Section 34 *Specialised Activities*).

Section 34: Specialised Activities

3 Paragraph 34.1 is amended to read:

34.1 ... of this FRS involved in four types of specialised activities—agriculture, extractive activities, service concessions and holding heritage assets.

4 After paragraph 34.16 the following headings and paragraphs are added:

HERITAGE ASSETS

34.17 This applies to accounting for **heritage assets**. It does not apply to other categories of asset such as **investment property** or **property, plant and equipment**.

Recognition and initial measurement

34.18 Heritage assets shall be recognised in the **statement of financial position** at either historic cost or valuation.

34.19 An entity shall report heritage assets as a separate line item in the statement of financial position in accordance with the requirement of [draft] FRSME Section 4 *Statement of Financial Position* paragraph 4.3.

34.20 Where heritage assets have previously been capitalised or are recently purchased, information on the cost or value of the asset will be available. Where this information is not available, and cannot be obtained at a cost which is commensurate with the benefits to users of the **financial statements**, the assets should not be recognised in the statement of financial position, but must be disclosed in accordance with the requirements below.

34.21 Valuation may be made by any method that is appropriate and relevant. There is no requirement for valuations to be carried out or verified by external valuers, nor is there a prescribed minimum period between valuations.

Subsequent measurement

34.22 Where heritage assets are reported at valuation, the **carrying amount** shall be reviewed with sufficient frequency to ensure the valuation remains current with any changes in valuation (other than those arising from impairment as referred to in paragraph 34.24 below) recognised in **other comprehensive income**.

Depreciation and impairment

34.23 Heritage assets shall be depreciated over their useful economic life, but **depreciation** need not be provided on heritage assets which have indefinite lives.

34.24 Heritage assets must be reviewed for impairment to ensure their **carrying amount** remains current and any impairment identified.

34.25 Any **impairment loss** on a non-revalued asset shall be recognised in **income and expenditure**.

34.26 Any impairment loss on a revalued asset shall be recognised in other comprehensive income only to the extent that it reverses a revaluation gain, and any excess shall be recognised in income and expenditure.

Presentation and disclosure

34.27 An entity shall disclose the following for all heritage assets it holds:

(a) An indication of the nature and scale of heritage assets held by the entity.

(b) The policy for the acquisition, preservation, management and disposal of heritage assets (including a description of the records maintained by the entity of its collection of heritage assets and information on the extent to which access to the assets is permitted).

(c) The **accounting policies** adopted for heritage assets, including details of the measurement bases used.

(d) For heritage assets not reported in the statement of financial position, the reasons why shall be explained and the **notes** to the financial statements shall explain the significance and nature of those assets not reported in the statement of financial position.

(e) Information helpful in assessing the value of heritage assets not reported in the statement of financial position should be disclosed.

(f) Where heritage assets are reported in the statement of financial position the following disclosure is required:

   (i) the carrying amount of heritage assets at the beginning of the **reporting period** and the **reporting date**, including an analysis between classes or groups of heritage assets reported at cost and those reported at valuation; and

   (ii) where assets are reported at valuation, sufficient information to assist in understanding the valuation being reported (date of valuation, method used, whether carried out by external valuer and if so their qualification and any significant limitations on the valuation).

(g) A summary of transactions relating to heritage assets for the reporting period and each of the previous four reporting periods disclosing:

   (i) the cost of acquisitions of heritage assets;

(ii) the value of heritage assets acquired by donations;

(iii) the carrying amount of heritage assets disposed of in the period and proceeds received; and

(iv) any impairment recognised in the period.

The summary shall show separately those transactions included in the statement of financial performance and those that are not.

(h) In exceptional circumstances where it is not practicable to obtain a valuation of heritage assets acquired by donation the reason shall be stated.

Disclosures can be aggregated for groups or classes of heritage assets, provided this does not obscure significant information.

34.28 The disclosures required by paragraph 34.27(g) need not be given for any accounting period earlier than the period immediately before the period in which this Standard is first applied where it is not practicable to do so and a statement to the effect that it is not practicable is made.

Glossary of Terms

5 After the definition of 'hedging instrument' and before the definition of 'highly probable' the following definition is added:

heritage asset An asset with historic, artistic, scientific, technological, geophysical, or environmental qualities that is held and maintained principally for its contribution to knowledge and culture.

SECTION IV

THE DEVELOPMENT OF THE FINANCIAL REPORTING EXPOSURE DRAFT

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THE DEVELOPMENT OF THE FINANCIAL REPORTING EXPOSURE DRAFT

DEVELOPMENT OF THIS [DRAFT] STANDARD

1 This [draft] Standard has been developed to address specific financial reporting issues for public benefit entities (PBEs) which are not addressed in sufficient detail in the [draft] Financial Reporting Standard for Medium-sized Entities (FRSME) or require further interpretation and guidance to consider specific PBE issues.

2 The ASB's original consultation on the Future of UK GAAP in August 2009 set out ten issues that could be included in a PBE Standard. Following discussion with the Accounting Standards Board (the Board) the sections included in this [draft] Standard have been refined to deal with issues identified as most significant and relevant to the PBE sectors and are not satisfactorily addressed in the [draft] FRSME.

3 The Board did discuss the issue of reporting entity control and the indicators of control that may be specific to the PBE sectors. The indicators of control set out in Section 9 *Consolidated and Separate Financial Statements* of the [draft] FRSME focus on benefits, and in the PBE sectors benefit can be in the form of indirect benefit through a PBE's beneficiaries or benefit which furthers a PBE's activities. Following discussion of these issues the Board believes that the [draft] FRSME can be interpreted and applied to PBEs and therefore no separate guidance for PBEs is considered necessary. A specific question on this matter is in the Invitation to Comment (See Q 13).

4 A number of additional topics have been identified through the development of this [draft] Standard which may be considered in the future and as possible future updates to this

[draft] Standard. The following table summarises these subjects.

Narrative reporting	To consider narrative reporting requirements for public benefit entities and any specific matters.
Format of primary financial statements	To consider the format of financial statements for PBEs.
Fresh start accounting	To consider the concept of fresh start accounting as an alternative accounting treatment for entity combinations where the effect of a combination is to create a new entity that cannot be reasonably portrayed as the enlargement of a pre-existing party.
Associates	To consider the definition of associates under the revisions to UK Financial Reporting Standards and international standards and the potential impact on the PBE sectors.
Social Benefit Obligations	To consider if and how social benefit obligations should be recognised and measured in the financial statements. The International Public Sector Accounting Standards Board currently have a project addressing this issue and it is likely to be most productive to await the outcome of that work.
Fund Accounting	To consider how fund accounting would be applied under the [draft] FRSME and [draft] FRSPBE in regards to segmental reporting.

Concessionary Loans (Section 2)

5 This section has been drafted to address the accounting requirements for concessionary loans in PBEs making and receiving loans.

6 There are two options to consider when determining the basis for the measurement of concessionary loans; the amount paid or received or fair value. This has been the subject of significant discussion and debate by the Board, taking into account the information that readers and users of PBE accounts may consider useful and the difficulties that may be posed to smaller organisations in measuring concessionary loans at fair value, where the requirement to account at fair value may be considered onerous and overly complex.

7 The Board considers that requiring PBEs to measure and recognise concessionary loans at their fair value is not in the interests of the readers or users of the financial statements and may be a significant burden on the PBE sectors.

8 Accounting for concessionary loans at the amount paid or received rather than fair value is not consistent with the accounting requirements set out in either the [draft] FRSME (which measures such arrangements at fair value and amortised cost), or EU-adopted IFRS and IPSAS 29 *Financial Instruments: Recognition and Measurement* (which require that such arrangements are measured and recognised in the financial statements at their fair value).

9 However, because of the difficulties that smaller PBEs may face with using fair value, the Board decided that PBEs which make or receive concessionary loans may have the option of measuring such loans at either the amount paid or received or at fair value.

10 The Board further decided that PBEs which make and receive concessionary loans must apply the same measurement method to both.

11 The requirement to disclose the terms and conditions of the concessionary loan will enable users of PBE financial statements to assess the 'income foregone' in issuing this type of loan and will provide them with the information they need to understand the impact of this transaction.

12 Presentation and disclosure of concessionary loan arrangements are an important part of the proposals for concessionary loans and the Board concluded that the disclosure requirements in the [draft] Standard will provide sufficient information to understand and interpret the impact of this type of transaction on the financial statements.

Property held for the provision of social benefits (Section 3)

13 Consideration was given as to whether properties that are held for the provision of social benefits meet the definition of an investment property. The definition of investment property in the [draft] FRSME paragraph 16.2 excludes properties that are held for use in the production or supply of goods and services or for administrative purposes. A property that is held to earn rentals and/or capital appreciation, but is not used in the production or supply of good or services, meets this definition. The Board noted that although many PBEs that engage in the provision of social housing receive rental income, their primary purpose is to provide social benefits. Such entities hold properties in order to provide that service.

14 Provision of social housing returning a below market rate rental is akin to supplying a service and therefore, property held for the primary purpose of providing social benefits should be excluded from the scope of investment property and be accounted for as property, plant and equipment.

15 The Board acknowledges that PBEs may hold 'investment properties' which will return market value rentals and/or are held for their capital appreciation and are not held primarily to provide social benefits. This [draft] Standard does not exclude those properties from being accounted for as investment properties.

Entity combinations (Section 4)

16 In considering the issue of entity combinations in the PBE sectors there is some debate over whether the use of acquisition accounting for all combinations would be appropriate and in particular whether it reflects the substance of a transaction if there is a gift of one entity to another in a combination at nil or nominal consideration, or where two or more organisations genuinely merge to form a new entity.

17 Where there is a combination of entities at nil or nominal consideration which is in substance a gift, it is appropriate to follow the same accounting principles as donations of assets (as set out in 'Incoming resources from non-exchange transactions') by recognising the fair value of the assets received and liabilities assumed as a gain or loss in the income and expenditure. This accounting treatment reflects the substance of the transaction more clearly.

18 Accounting for combinations which meet the definition of a merger requires a different methodology to acquisition accounting in order to reflect the true substance of the transaction. Whilst it is not anticipated that all combinations in the PBE sectors are mergers or that merger accounting will generally be applicable to combinations in the PBE sectors it is considered appropriate to retain merger accounting. In considering this matter it was noted that the accounting requirements in some jurisdictions, for example, the US and Australia were reviewed and noted that merger accounting has been retained for the public and not-for-profit sectors.

19 In retaining merger accounting, the Board has considered the criteria to be met for a merger. The criteria set out in Financial Reporting Standard 6 'Acquisitions and Mergers' provide a starting point, but are framed in the context of the commercial sector and therefore the criteria have been adapted to make them more appropriate for the PBE sectors. In particular the criteria include consideration of the impact of the combination on beneficiaries and the benefits to which they are entitled.

20 One specific concern highlighted with existing UK Financial Reporting Standard requirements of FRS 6, is the need to restate comparatives by adding together the previous periods' reported figures of each of the combining entities. This does not reflect the true substance of the transaction as the newly formed entity did not exist in the previous accounting period and therefore the Standard requires that comparatives are marked as 'pro forma' to make it clear that they are a combination of previously reported figures in the combining entities.

21 The concept of 'Fresh start accounting' provides an alternative accounting treatment for entity combinations, which may be particularly appropriate where the effect of a combination is to create a new entity that cannot reasonably be portrayed as the enlargement of one of the pre-existing parties. Fresh start accounting would require the newly formed entity to fair value its assets and liabilities at the date it was formed. Although fresh start accounting is conceptually attractive, it would be a departure from existing practice and from accounting methods used elsewhere. Considerable research and consultation would be required before undertaking such a major innovation, which could not be carried out in the development of this Standard. The [draft] Financial Reporting Standard for Public Benefit Entities (FRSPBE) therefore proposes to require merger accounting for those combinations that result in the creation of a new reporting entity. It is, however, possible that fresh start accounting will be considered in the development of future accounting standards.

Impairment of assets: public benefit considerations (Section 5)

22 The [draft] FRSME on impairment of assets requires measurement of an asset's fair value less costs to sell and its value in use.

Indicators of impairment

23 Although the indicators provided in the [draft] FRSME are mainly linked to the expected cash flow of an asset and as such may not necessarily be relevant to some PBE assets, the Board considered that they must, as a minimum, be considered by PBEs as possible indicators of impairment.

24 In addition, the Board noted that other accounting literature (IPSAS 21 *Impairment of Non-Cash-Generating Assets* and SORPs) identified other indicators of impairment including:

- Cessation, or near cessation of the demand or need for services provided by the asset;
- Social, demographic or environmental changes resulting in a reduction of beneficiaries; and
- A major loss of key employees associated with particular activities.

25 The Board concluded that it would not be appropriate to include these indicators in the [draft] Standard, as they are not exclusively specific to PBEs and because the indicators given in the [draft] FRSME will continue to apply to PBEs. Therefore, their inclusion would make such entities subject to a confusing list of overlapping indications. The indicators given in the [draft] FRSME are merely minimum requirements, and recognition of an impairment loss is required irrespective of whether any of the given indicators are met.

26 It was also considered whether to specify that an indicator of impairment was present where an asset's service potential was not fully utilised. It was noted that an entity may require standby or surplus capacity to ensure that it has adequate capacity to provide services at all times. For example, a building that provides accommodation for the homeless may not be used to full capacity during the summer months but is used fully during winter. In this circumstance, the surplus capacity is part of the required service potential of the asset and the asset is not impaired. For this reason, it was concluded that it would be inappropriate to specify that the unutilised capacity should be treated as an indicator of impairment.

Fair value less costs to sell

27 The Board discussed whether a restriction on the use of an asset would affect its fair value. Because an asset's fair value is based on the amount that an entity could obtain, it was understood that restrictions might impact on the fair value obtainable where they prevented a purchaser from using the asset for another purpose that would be more valuable than that required by the restriction. In addition, the cost to sell should include the costs of breaking the restriction.

Value in use

28 In a for-profit context, value in use is determined by measuring the present value of the cash flows derived from that asset. However, often PBE assets are held for their service potential and not their ability to generate cash flows: in such a case it is sometimes impossible to determine value in use by reference to cash flows and it is more appropriate to regard value in use as the present value of future service potential rather than cash flows.

29 IPSAS 21 permits value in use to be determined by any of three approaches: depreciated replacement cost (DRC); restoration cost and the service units approach. Restoration

cost and the service units approach are applications of DRC as DRC is used as the starting point.

30 DRC reflects the cash outflows that are saved through ownership of an asset. It is therefore likely to be widely applicable and appropriate. However, its use is not mandated and other methods that value service potential rather than cash flows may be used if those methods are more appropriate in those particular circumstances.

Incoming resources from non-exchange transactions (Section 7)

31 The receipt of non-exchange resources by an entity represents an inflow of resources which is highly significant for many PBEs and was one issue that was identified in the Consultation Paper 'The Future of UK GAAP' which was issued in August 2009.

32 This issue was identified as being particularly important to PBEs because for many PBEs, receipts of donations, grants, and legacies from non-exchange transactions are a major source of their funding and this issue is not addressed in the [draft] FRSME apart from Section 24 *Government Grants*.

33 The Board considered that for PBE financial statements to be complete, they should reflect the benefit that the inflow of these resources had on the entity.

34 This [draft] Standard requires PBEs to value the resources they receive from non-exchange transactions at their fair value. The Board discussed whether using a fair value would overstate the value of a donation where the entity is unable to exploit fully an asset and the equivalent service potential could be derived from a lower value asset. Being able to achieve the same service potential from a lower value asset might suggest that the value of the donated asset should be at the lower value. However, this [draft] Standard requires donated assets to be valued at their fair value. This reflects

that the circumstances described above would rarely occur. In many cases, an entity would be able to sell the donated asset and if appropriate, purchase a cheaper asset with the equivalent service potential.

35 Incorporating an exception for donated assets which may not be fully exploited would make the application of the [draft] Standard more onerous, as it would require all entities in receipt of donated assets (except those intended for resale) to consider whether they would be able to exploit fully the asset. This would be subjective and may incur the risk of understatement of the value of donated assets.

36 The Board discussed that where goods are donated for subsequent sale (for example donations to charity shops), it could be argued that the donated goods should be valued only when they are sold. The [draft] Standard does not allow this as it is not consistent with the accruals concept which requires the financial statements to recognise goods when they are received. The [draft] Standard therefore requires that goods be accounted for at their fair value if any, when received. However, for individual items such value may be immaterial in which case they may be recognised on a portfolio basis.

37 The Board considered that the requirement to recognise income on receipt of donated goods will enable that the income from donations and the income from sales activity will be separately identified and reported which will provide an informative depiction of the entity's sources of income and provide more useful information to users.

38 However, the [draft] Standard reaffirms that the concept of materiality needs to be applied when considering if all donations received will have to be recognised as income. Donations of items which have little or no value might not necessarily be recognised on receipt because their fair value is not material and their omission is not likely to result in misleading financial statements.

Volunteer Services

39 The [draft] Standard requires that donated services that can be reasonably quantified are accounted for at their estimated value to the recipient. The [draft] Standard recognises that there are potential issues in determining a value for volunteer services and their contribution to the organisation and notes that quantifying this type of service may not be practicable. There is an argument to suggest that valuing volunteer services could be measured by reference to a metric such as the minimum wage; however, this measure does not take into consideration an organisation's requirements for volunteers. In addition, this would be attributing an arbitrary value onto a volunteer's time which may not be reflective of their skills, experience or role and to determine a different method of valuation would be very subjective.

40 However, when a service is provided voluntarily for which the entity would otherwise have to pay (e.g. legal or financial advice) the value of that service should be recognised in the financial statements if its value can be reasonably quantified.

Heritage Assets

41 The future economic benefits associated with heritage assets are primarily in the form of their service potential rather than cash flows and therefore conceptually heritage assets do meet the definition of an asset as they provide the 'rights or other access to future economic benefits controlled by an entity as a result of past transactions or events' and should be accounted for as such within the financial statements. It is considered to be important to retain the accounting and disclosure requirements developed in Financial Reporting Standard 30, 'Heritage Assets' which marked a significant development in the UK for heritage assets.

42 Heritage assets are held for their contribution to knowledge and culture and are not assets consumed by an entity in the course of its business. Therefore, it is relevant to present

heritage assets as a distinct category of asset from an entity's property, plant and equipment in accordance with Section 4, paragraph 4.3 of the [draft] FRSME.

43 It is also considered to be important to allow these assets to be measured at either cost or valuation as the availability of cost information in relation to heritage assets may be limited and entities are encouraged to adopt a valuation approach to heritage assets as it should provide more relevant and useful information as these assets are usually unique in nature.

44 The issue of where within the financial statements movements in subsequent valuation of such assets should be accounted for was debated by the Board in approving this [draft] Standard. It is considered most appropriate to account for such movements within other comprehensive income, rather than within income and expenditure to make a clear distinction between changes in valuation and the financial effects of an entity's operations.

45 In order to be consistent with the principles for revalued assets in IAS 36 *Impairment of Assets* any impairment in excess of a previously recognised revaluation gain is to be recognised in income and expenditure.

46 During its discussions on the [draft] FRSPBE, the Board decided that the accounting for heritage assets should be part of the [draft] FRSME so as to be available to all entities and not just PBEs. The Board also decided that the examples of heritage asset accounting and disclosures set out in FRS 30 should not be included in the [draft] FRSME but rather be made available on the ASB's website.

SECTION V

IMPACT ASSESSMENT

SECTION V

IMPACT ASSESSMENT

[Draft] Impact Assessment

[Draft] Financial Reporting Standard for Public Benefit Entities

1 This [draft] Standard is being proposed as a supplementary Standard to be applied by public benefit entities (PBEs) in conjunction with the [draft] Financial Reporting Standard for Medium-sized Entities (FRSME). As such this Impact Assessment accompanies the [draft] Impact Assessment provided in Financial Reporting Exposure Drafts 43 & 44.

2 Many of the issues have not been previously addressed in existing UK Financial Reporting Standards (FRSs), but rather have been dealt with in the relevant Statement of Recommended Practice (SORP). Therefore, it is not envisaged that the requirements of this [draft] Standard will require any significant changes from existing practice.

3 The following topics are addressed in this [draft] Standard and any anticipated change from existing practice is noted.

Concessionary Loans

4 Concessionary loans are loans made or received at a below market interest rate and are not repayable on demand which are often for the purpose of furthering the objectives of the PBE.

5 These types of loans are currently addressed by FRS 26 ‘Financial Instruments: Recognition and Measurement’. Further, the ‘Accounting and Reporting by Charities Statement of Recommended Practice’ (Charities SORP) also refers to ‘programme related investments’ which appear to be essentially a concessionary loan although they are

referred to as investments rather than loans. No adjustment is made for these arrangements when they are entered into at a below market rate. The [draft] FRSPBE provides an option for makers and recipients of concessionary loans either to:

(a) apply the requirements of the [draft] FRSME, that is recognition at fair value and subsequent measurement at amortised cost; or

(b) recognise and subsequently measure the loans at the amount paid or received less any impairment losses.

Therefore, there should be no change required.

Property held for the provision of social benefits

6 Accounting for an investment property is addressed in the [draft] FRSME, where the definition of an investment property is a property that is held to earn rentals or for capital appreciation or both. An investment property shall be recognised at fair value if practicable.

7 However, social housing – although earning rentals – is generally held primarily for the provision of social benefits and therefore is not within the scope of the investment property section in the [draft] FRSME. Therefore any such property shall be accounted for as property, plant and equipment at cost less depreciation and impairment.

8 Accounting for properties held for their social benefit is not currently addressed by UK FRSs. However, the Statement of Recommended Practice: Accounting by registered social housing providers Update 2010 (RSL SORP) precludes social housing from being accounted for as investment properties.

9 Although both the Charities SORP and the Statement of Recommended Practice: Accounting for further and higher education (Education SORP) require investment properties to be accounted in accordance with SSAP 19 'Investment

Properties' which are recognised at market value, they both state that an investment property is held for its investment potential, any rental income being negotiated at arm's length and therefore would not include property let for a social benefit.

10 Therefore the requirements in the [draft] FRSPBE should not change practice.

Entity Combinations

11 The [draft] FRSPBE proposes accounting treatments for two types of entity combinations:

(a) those that are essentially a gift; and

(b) mergers.

12 Combinations which are essentially a gift are not addressed under current UK FRSs; however, the RSL SORP requires such combinations to use acquisition accounting with any excess or deficit over the fair value of the assets and liabilities received to be recognised as income or an expense. The [draft] FRSPBE is requiring the same treatment, consequently for these types of combinations there should be no impact on existing practice for entities applying the RSL SORP.

13 FRS 6 'Acquisitions and Mergers' requires the use of merger accounting when set criteria are met. The [draft] FRSPBE also proposes requiring the use of merger accounting when certain criteria are met. The criteria in the [draft] FRSPBE are adapted from those in FRS 6, therefore the requirements in the [draft] FRSPBE should not change existing PBE practice.

Impairment of assets: public benefit considerations

14 The proposals in the [draft] FRSPBE suggest other valuation methods which can be used to determine 'value in use' as

required in the [draft] FRSME, in that it is proposed that PBEs can value an asset's service potential rather than cash flows to determine whether an asset is impaired.

15 Both the Charities and RSL SORPs note that valuing cash flows may not always be appropriate and therefore consideration should be given to valuing service potential. Consequently, it is not expected that the requirements in the [draft] FRSPBE will change existing PBE practice.

Funding commitments

16 The proposals in the [draft] FRSPBE only provide extra guidance on when a PBE should recognise a liability. This guidance has been substantially drawn from the 'Statement of Principles for Financial Reporting – Interpretation for Public Benefit Entities' therefore it is not expected that these requirements will significantly change existing PBE practice.

Incoming resources from non-exchange transactions

17 Accounting for incoming resources from non-exchange transactions other than government grants is not addressed in current UK FRSs.

18 The proposals in the [draft] FRSPBE require income to be recognised when assets are received from non-exchange transactions unless performance conditions are attached to the asset. This is consistent with the requirements in the 'Statement of Principles – Interpretation for Public Benefit Entities'.

19 Both the Charities and Education SORPs provide guidance on donations, which is consistent with the proposals in the [draft] FRSPBE, therefore it is not expected that there will be any impact on existing PBE practice.

Heritage assets

20 The [draft] FRSPBE contains a consequential amendment to the [draft] FRSME to include the requirements of FRS 30 'Heritage Assets'. Therefore, there will be no change to existing practice.

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