



 Scotland's Colleges

# Scotland's Colleges Briefing Paper Financial Reporting Exposure Drafts (Fred) 44 and 45

(43 Application of Financial Reporting Standards, 44 Financial Reporting Standard for Medium Sized Entities and 45 Financial Reporting Standard for Public Benefit Entities)

## Introduction

In October 2010 the Accounting Standards Board (ASB) issued two Financial Reporting Exposure Draft's (FRED's). FRED 43 outlines a proposed framework for financial reporting in the UK and Republic of Ireland. FRED 44 proposes a new financial reporting standard to replace current UK and Republic of Ireland reporting standards. The FRED's are part of the ASB's process for setting new accounting standards. The comment period for FRED 43 and 44 closed on 30 April 2011. In February 2011 the ASB issued a supplementary FRED addressing specific needs of public benefit entities. The comment for FRED 45 closed on 31 July 2011.

The proposals in FRED 43 recognise that one size of accounting standard does not fit all entities and proposes a tier system for financial reporting that requires entities to prepare financial statements in one of the three tiers (an entity may voluntary elect to adopt a higher tier):

	Nature of entity	Accounting regime	Reduced disclosures for...
Tier 1	Entities that have public accountability	EU-adopted IFRS	Qualifying subsidiaries
Tier 2	Entities without public accountability; and Small publicly accountable entities that are prudently regulated.	Financial Reporting Standard for Medium-sized Entities	Qualifying subsidiaries
Tier 3	Small entities without public accountability	Financial Reporting Standard for Smaller Entities.	

An entity will fall within Tier 1 if it has public accountability. FRED 43/44 states that an entity has public accountability if:

- a) As at the reporting date, its debt or equity instruments are traded in a public market, or it is in the process of issuing such instruments for trading in a public market;
- b) As one of its primary purposes, it holds assets in fiduciary capacity for a broad group of outsiders and/or is a deposit-taking entity for a broad group of outsiders.

From the above definitions, it is clear that College's in Scotland do not fall into this category. Entities which do not have public accountability and are not permitted to apply the small companies regime may apply the FRSME under Tier 2. The College's would fall under this category and should therefore apply the FRSME.

The Financial Reporting Standard for medium-sized Entities (FRSME) is substantially less complex and easier to use than current UK standards. The Accounting Standards Board (ASB) considers the FRSME will reduce the costs of accounts preparation whilst maintaining the quality of information to users.

The FRSME is based on the IFRS's for SME's but adapted to comply with UK and European legal requirements. The significant changes required to the IFRS for SME's to comply with legal requirements include:

- a) Adjusting the requirement for the preparation of consolidated financial statements, so that this is only required when stipulated under the Companies Act 2006;
- b) Removing certain options permitted by the IFRS for SME's but not available in accordance with the Companies Act; and
- c) Inserting disclosure requirements for certain financial liabilities held at fair value.

The specific proposals to make amendments to International Accounting Standards that may affect the College sector is as follows:

- Proposal to remove the option to present the analysis of results of discontinued operations in the notes to the accounts, and instead require the information to be given on the face of the statement of comprehensive income;

- Proposal to remove the option to present a balance sheet based on liquidity (IAS permits a balance sheet to be presented based on liquidity where this presentation provides information that is reliable and more relevant. However under the Directives this option can only be used by banks and other financial institutions, which would not fall within the reduced disclosure framework. The option is therefore not compliant with the Directives.
- Proposal to remove the prohibition and introduce the definition of extraordinary items;
- Proposal to amend the option to reduce the carrying amount of property, plant and equipment by government grants;
- Proposal to remove the off-setting option whereby it is permitted that the expense relating to defined benefit plans be presented in the statement of comprehensive income net of the amount recognised for a reimbursements;
- Proposal to remove the option which permits grants related to income to be deducted in reporting the related expense.

The ABD carefully considered suggestions to amend the FRS for SMEs for application in the UK but ultimately decided to make only the following amendments:

- a) To replace the chapter on tax with IAS 12 "Income taxes";
- b) Provide transitional relief for dormant companies;
- c) To introduce a parent company cash flow statement exemption.

The above proposals will impact on entities who prepare accounts under a specific SORP

## Financial Reporting Standard for Medium-Sized Entities (Frsme) Fred 44

The changes between current accounting standards used and IFRS's as reported in our briefing paper "*Comparison of UK GAAP and international Financial Reporting Standards*" has been updated in Appendix 2 for the additional amendments noted in FRSME . Detailed below is a summary of the key proposals of the FRSME.

- Accounting for Government Grants - The FRSME doesn't specifically state the treatment of grants relating to assets, therefore the assumed treatment is under IAS 20 taking into account UK Companies Act requirements, therefore government grants in respect of assets should be credited to deferred income;
- Intangible assets - An entity shall recognise expenditure for both research and development activities, as an expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria of the FRS. There is therefore no change to the requirements of IAS 38.
- Impairment of assets - In practice, there should be no further changes with the implementation of the FRSME.
- Statement of cash flows - The FRSME gives the option of preparing and presenting the cash flow statement on a direct or indirect basis which would mean that it can be prepared and presented on a simpler basis. The FRSME also requires disclosure of cash or cash equivalents that the entity holds but is not for the entity's use.
- Leases - The FRSME doesn't specifically cover "other" arrangements, however states examples of situations that individually or in combination would normally lead to a lease being classed as a finance lease.
- Property, Plant and Equipment - There is no change from the requirements of IAS 16 and FRS 15
- Employee Benefits -There are differences between current practice and the FRSME in respect of accounting for actuarial gains and losses. This is an area where discussion is taking place and the impact on the current practice regarding these differences has not yet been fully clarified.
- Employee benefits- the FRSME is consistent with IAS 19 in respect of the accounting treatment of short term employee benefits.

## Public Benefit Standard – Fred 45

The ASB also has some different intentions regarding financial reporting by public benefit entities (PBE) which are proposed in FRED 45, as they have different objectives, funding and ownerships from for-profit entities and IFRS was not framed with PBE's in mind. As a consequence, the ASB was minded to develop a public benefit entity standard and it was also suggested that there may be a need to retain the SORP. The PBE standard will address:

- a) The "differences only" – identifying where there are omissions in UK financial reporting standards;
- b) PBE not falling into any of the SORPs would have to follow the PBE standard.

As the colleges already have their own specific SORP, the impact of the PBE standard to Scotland's Colleges will be where there are differences between the SORP and the PBE standard. The PBE standard is drafted in compliance with tier 2, the FRSME. A PBE will be able to adopt a higher tier voluntary.

It is understood that existing SORP would be updated for the PBE standard and FRSME and will provide sector specific interpretation and guidance where necessary.

The proposals for the PBE are included within FRED 45. The PBE standard will be mandatory for PBE's preparing their financial statements under Tier 2 and should be applied in conjunction with the draft FRSME.

The proposed definition of a public entity is as follows; -

*" A PBE is an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any 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".* A college would meet the definition of a public entity.

The other proposals of the standard is as follows; -

- a) Concessionary loans – the proposals requires that these transactions are recorded at either (i) fair value or (ii) the amounts received or paid in the financial statements of the PBE making or receiving the loan and disclosure of the impact of the arrangement;

Impact on existing practice is as follows: There should be no change required.

- b) Entity combinations – the proposals apply 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.

Combinations which are determined to be acquisitions shall be accounted for in accordance with Section 19 of the FRSME.

The following accounting treatments are proposed:

Combinations that are in substance a gift defined as a combination carried out at nil or normal consideration that is not a fair value exchanged but in substance a gift from one entity to another. A combination which is in substance a gift shall be accounted for in accordance with the FRSME except for the following matters:

- a. 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;
- b. If the fair value of the liabilities assumed exceeds the fair value of the assets received, the deficit of the fair value if the liabilities in comparison to the assets is accounted for as a loss. This 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.

Combinations that are a merger, defined as 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 risk and benefits of the newly formed entity and in which no party to the combination in substance obtains control over any other, or it is seen to be dominant. The

following three criteria must be met;

- c. No party is portrayed as the acquiree or the acquirer;
- d. There is no significant change to the class of beneficiaries or the benefits provided;
- e. 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.

Entity's meeting all three criteria should apply merger accounting. Merger accounting will involve the following:

- a. 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;
- b. The results and cashflows 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;
- c. The comparative 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.

Impact on existing practice is as follows: There should be no change required.

#### c) Impairment of assets: public benefit considerations

The 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 the profit and loss.

Recoverable amount is the higher of fair value less costs to sell and value in use.

The standard sets out requirements for determining fair value less costs to sell where the use of an asset is restricted and determining value in use for assets held by PBE for their service potential rather than to generate cash flows.

Impact on existing practice is as follows: There should be no change required.

#### c) Funding commitments

An entity shall recognise a liability, where it has made a commitment that it will provide resources to another party if, and only if, the obligation is such that the entity cannot realistically withdraw from it; and the commitment does not depend on the performance of the recipient. Commitments made which are performance related will be recognised when those performance conditions are met.

Impact on existing practice is as follows: There should be no significant change required.

- e) Incoming resources from non-exchange transactions which is where 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. Non-exchange transactions are limited to, donations (of cash, goods, and services) and legacies.

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

- i) Transactions that do not impose specified future performance conditions are recognised when receivable;
- ii) Transactions that do impose future performance conditions are recognised when the conditions are met;

- iii) Where resources are received before the revenue recognition criteria is met, a liability is recognised.
- iv) An entity shall recognise a liability when any resource with specified performance conditions becomes repayable due to non-compliance with the performance conditions, when the repayment becomes probable.

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 asset.

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

Impact on existing practice is as follows: There should be no change required.

f) Heritage assets – it is proposed that where heritage assets are held at valuation, movements in valuation are accounted for through other comprehensive income

It is envisaged that the draft standard will not require any significant changes from existing practices

## Conclusion

The College's will follow the FRSME as they will fall into the Tier 2 category of entities. The FRSME is a reduced disclosure framework so reduces the disclosure required under the IAS's. In practice the College's SORP will be updated for the requirements of the FRSME and the College's shall continue to follow the College's SORP. The College's in Scotland will fall into the "public benefit" category, however as noted above in practice, this will mean little change to existing accounting requirements.

## Appendix 1

### Profit and Loss Account

<b>Companies Act Requirements</b>	<b>FRSME requirements</b>
Turnover	Revenue
Cost of sales	
Gross profit/loss	
Distribution costs	
Administrative expenses	
Other operating income	
Income from shares in group undertakings	
Income from participating interests	Share of profit or loss of investments in associates and jointly controlled entities accounted for using the equity method.
Income from other fixed asset investments	
Other interest receivable and similar income	
Amounts written off investments	
Interest payable and similar charges	Finance costs
Profit/loss on ordinary activities before taxation	
Tax on profit or loss on ordinary activities	Tax expense
Profit/loss on ordinary activities after taxation	
	A single amount comprising the total of: <ul style="list-style-type: none"> <li>• The post-tax profit or loss of a discontinued operation, and</li> <li>• The post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation.</li> </ul>
Extraordinary Income	
Extraordinary charges	
Extraordinary profit/loss	
Tax on extraordinary profit/loss	
Other taxes not shown under the above items	
Profit/loss for the financial year	Profit or loss
	Each item of other comprehensive income.....classified by nature
	Share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method.
	Total comprehensive income if an entity has no items of other comprehensive income, it may use another term for this line such as profit or loss)

## Balance Sheet

<b>Companies Act</b>	<b>FRSME</b>
Called up share capital not paid	
Fixed assets:	
Intangible assets	Intangible assets
Tangible assets	<ul style="list-style-type: none"> <li>• Property, plant and equipment</li> <li>• Investment property carried at fair value through profit or loss</li> </ul>
Investments	<ul style="list-style-type: none"> <li>• Investments in associates(j)</li> <li>• Investments in jointly controlled entities(k)</li> </ul>
	Deferred tax liabilities and deferred tax assets 9these shall always be classified as non-current)
Current assets:	
Stocks	<ul style="list-style-type: none"> <li>• Inventories</li> <li>• Biological assets carried at cost less accumulated depreciation and impairment</li> <li>• Biological assets carried at fair value through profit or loss</li> </ul>
Debtors	Trade and other receivables (b)
Investments	
Cash at bank and in hand	Cash and cash equivalents (a)
Prepayments and accrued income	
	Financial assets (excluding (a), (b), (j) and (k))
Creditors: amounts falling due within one year	<ul style="list-style-type: none"> <li>• Trade and other payables (l)</li> <li>• Financial liabilities (excluding (l) and (p))</li> <li>• Liabilities and assets for current tax</li> </ul>
Net current assets (liabilities)	
Total assets less current liabilities	
Creditors: amounts falling due after more than one year	<ul style="list-style-type: none"> <li>• Deferred tax liabilities and deferred tax assets (these shall always be classed as non-current)</li> </ul>
Provisions for liabilities	Provisions (p)
Accruals and deferred income	
Capital and reserves:	
Called up share capital	
Share premium account	
Revaluation Reserve	
Other reserves	
Profit and loss accounts	
	<ul style="list-style-type: none"> <li>• Non controlling interest, presented within equity separately from the equity attributable to the owners of the parent</li> </ul>
	<ul style="list-style-type: none"> <li>• Equity attributable to the owners of the parent</li> </ul>

- Under the FRSME the “profit and loss account” can be either a single “statement of comprehensive income” or a separate “income statement” and a separate “statement of comprehensive income”.
- The FRSME confirms that alternative titles may be used, providing they are not mis-leading. The FRSME prescribes line items which must be included within the statement of financial position and statement of comprehensive income, but do not prescribe the sequence of format. There is also some flexibility in the naming of line items in that the descriptions used and the sequencing or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity’s financial position.
- UK Company Law is less flexible in respect of the format of financial statements.
- An unamended profit and loss account would not meet all the requirements of the FRSME and a statement of comprehensive income would not meet all of the requirements of the Companies Act. Care therefore requires to be taken when preparing primary statements which comply with both sets of requirements.
- Providing that all of the line items required by the FRSME are included, their name and position is irrelevant: this means that for most prepares, the format 1 profit and loss account under the Companies Act (as shown above) will comply with the requirements of the FRSME.
- An entity with dis-continued operations, however, may need to use columns and additional sub-totals in order to present the results of those of those operations.
- Careful use of subtotals will be necessary for entities with certain financial assets or liabilities in order to include them within Companies Act headings.
- Careful consideration will need to be given to the definition of current and non-current assets in order to determine the most appropriate presentation.

Rows with a line in one column but no matching line item in the other are those where additional detail will be required to ensure that a set of FRSME accounts also complies with Company Law.

## Appendix 2

### Medium significance

IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance</b></p> <p>IAS 20 permits grants relating to assets to be presented in the balance sheet either by crediting the grant to deferred income or deduction from the cost of the asset. The two methods of presentation in financial statements of such grants are regarded as acceptable alternatives.</p>	<p><b>FRS 5 – Reporting the substance of transactions</b>  <b>SSAP 4 – Accounting for Government Grants</b></p> <p>SSAP 4 also has provisions for treating capital grants using the two methods which are similar to those of IAS 20.</p>	<p>Although both UK GAAP and International Accounting Standards have provisions for treating grants using two different methods, in the UK, the Companies Act does not permit a grant to be credited to fixed assets. Government grants must be credited to deferred income.</p> <p><b>FRSME Update</b></p> <p><i>The FRSME doesn't specifically state the treatment of grants relating to assets, therefore the assumed treatment is under IAS 20 taking into account UK Companies Act requirements, therefore government grants in respect of assets should be credited to deferred income.</i></p>

IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 38 – Intangible Assets</b></p> <p>Accounting treatment for research expenditure is to write off the costs to the profit and loss account when they are incurred.</p> <p>Costs in the development phase are expensed unless all of the following criteria have been met :-</p> <ul style="list-style-type: none"> <li>• The technical feasibility of completion is assessed;</li> <li>• The intention to complete the asset and use or sell it;</li> <li>• The ability to use or sell it;</li> <li>• How the intangible asset will generate future economic benefits;</li> <li>• The availability of adequate resources to complete the development; and</li> <li>• The ability to measure reliability the expenditure during development.</li> </ul> <p>If all of the above criteria are met then the development costs must be capitalised.</p>	<p><b>SSAP 13 - Accounting for Research and Development</b></p> <p>Accounting treatment for research expenditure is to write off the costs in the period in which they are incurred.</p> <p>SSAP 13 permits but does not require the capitalisation of development expenditure that meet certain criteria.</p> <p>SSAP 13 states that there may be an argument for capitalisation should there be a “reasonable expectation” of specific commercial success and of future benefits arising from the development work, either from increased revenue and related profits or from reduced costs.</p> <p>SSAP 13 states that it will only be practical to evaluate the potential future benefits of development expenditure if there is a clearly defined project and the related expenditure is separately identifiable. The outcome of the project would need to be examined for its technical feasibility and its ultimate commercial viability (considered in the light of various factors). Furthermore a project will be of value only if further costs on the projects will be more than covered by related revenues and if adequate resources exist, or are reasonably expected to be available, to enable the project to be completed.</p>	<p>The treatment of research expenditure is the same for both SSAP 13 and for IAS 38.</p> <p>The main differences are that SSAP 13 permits, but does not require, the capitalisation of development expenditure that meets certain criteria.</p> <p>IAS 38 requires the capitalisation of development expenditure that meets certain criteria.</p> <p>The criteria to be met in both of the standards are similar.</p> <p><b>FRSME Update</b></p> <p><i>An entity shall recognise expenditure for both research and development activities, as an expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria of the FRS. There is therefore no change to the requirements of IAS 38.</i></p>

IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 36 – Impairment of assets</b></p> <p>The main types of assets that IAS 36 applies to are property, plant and equipment, intangible fixed assets and goodwill.</p> <p>For the purposes of the briefing paper we have considered the requirement of impairment of individual assets below as this is considered to be the area which would affect the FE/HE sector.</p> <p>The directors of a company should assess at each balance sheet date whether there are any indications of impairment. If there are any such indications then the recoverable amount should be calculated.</p> <p>For an individual asset, when impairment occurs, the asset should be written down to the recoverable amount.</p> <p>The loss should be an expense in profit and loss account, except when the asset has been revalued.</p> <p>If the asset is carried at a revalued amount the impairment loss should be treated as a revaluation loss. If an impaired asset has been revalued the impairment loss should be treated as a new revaluation. If the asset is at cost the impairment loss is additional depreciation.</p> <p>After the impairment loss has been recognised depreciation is based on the adjusted carrying value.</p>	<p><b>FRS 11 - Impairment of fixed assets and goodwill</b></p> <p>FRS 11 also applies to tangible fixed assets and goodwill.</p> <p>The provisions in this standard are similar to the IAS.</p> <p>The aim of the FRS is to ensure that fixed assets and goodwill are recorded in the Balance Sheet at no more than its carrying value.</p> <p>To the extent that the carrying amount exceeds the recoverable amount, the asset has been impaired and should be written down.</p> <p>The impairment loss should be written to the profit and loss account unless the asset has previously been revalued.</p> <p>An impairment loss on a revalued asset should be recognised in the profit and loss account if the loss is caused by a clear consumption of economic benefits.</p> <p>Other impairments of revalued assets should be recognised as a revaluation loss.</p> <p>The useful life of the asset going forward should be considered and depreciation charged accordingly on the revised carrying value.</p>	<p>FRS 11 adopts the same general approach to impairment reviews as IAS 36. The main difference between the standards, which is considered to be the difference that would impact the FE/HE Sector is noted below.</p> <p>FRS 11 requires any loss due to “Clear consumption of economic benefits” e.g. wear and tear of an asset to be written off to the profit and loss account. This applies to revalued assets as well as assets held at cost, however under IAS 36 if the asset is revalued then the impairment loss should be treated as a revaluation loss.</p> <p>There are other differences between IAS 36 and FRS 11, however these are in relation to the accounting treatment of impairments of intangible assets which we haven’t considered for the purposes of this paper.</p> <p><b>FRSME Update</b></p> <p><i>An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If, and only if, the recoverable amount of an asset is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its recoverable amount. The reduction is an impairment loss and shall be recognised as an impairment loss immediately in the profit and loss.</i></p>

<p>The directors should assess at each balance sheet date whether a previously recognised impairment loss on an asset may no longer exist or has decreased. Accounting for a reversal of an impairment loss is essentially the opposite of accounting for the original loss i.e. the asset should be increase to a maximum of its carrying amount should the impairment have never happened (anything above this amount is a revaluation). The reversal should be credited to the profit and loss account as income unless the asset is carried at the revalued amount in which case this would be treated as a revaluation. Depreciation should be based on the revised carrying amount after the reversal of the impairment.</p>		<p><i>If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful life, the depreciation method or the residual value for the asset and adjust it, this should be done even if no impairment loss is recognised for the asset.</i></p> <p><i>In practice, there should be no further changes with the implementation of the FRSME.</i></p>
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IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 7 – Statement of cash flows</b></p> <p>Under IAS 7, entities are required to prepare a cash flow statement.</p> <p>IAS 7 specifies that “cash inflows and outflows consist of both cash and cash equivalents.</p> <p>The definition of cash is “cash on hand and demand deposits”. There is no definition of “demand deposits” within the IAS, however they should be considered as cash that entity can obtain anytime they wish without penalties or notice given.</p> <p>IAS 7 specifies that “Cash equivalents are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value”.</p> <p>The IAS states that cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes”.</p> <p>As a cash equivalent must be readily convertible to cash, an investment normally qualifies as a cash equivalent only when it has a short maturity date i.e. 3 months.</p> <p>Both cash and cash equivalents can be denominated in foreign currencies.</p> <p>When bank overdrafts form an</p>	<p><b>FRS 1 – Cash flow</b></p> <p>Under FRS 1 – entities are required to prepare a cashflow statement (Note there are occasions when a cash flow statement won’t form part of the statutory accounts e.g. when companies incorporated under the companies legislation and are entitled to the exemptions applicable to entities.</p> <p>The definition of cash per FRS 1 is as follows: -</p> <p>“Cash in hand and deposits repayable on demand, with any qualifying institution less overdrafts from any qualifying institution repayable on demand.”</p> <p>“Deposits can be repayable on demand if they can be withdrawn at any time without notice and without penalty or if a maturity or period of notice of not more than 24 hours or one working day can be agreed”.</p> <p>Cash includes cash in hand and deposits denominated in foreign currencies.</p> <p>FRS 1 requires that cash flows are disclosed under the following headings: -</p> <ul style="list-style-type: none"> <li>• Operating activities;</li> <li>• Returns on investments and servicing of finance;</li> <li>• Taxation;</li> <li>• Capital expenditure and financial investment;</li> </ul>	<p>Both FRS 1 and IAS 7 have the requirement of preparing a cash flow; however there are differences in the actual cash flow reported and the presentation of these. The main differences between these standards are noted below.</p> <p>FRS 1 does not include cash equivalents. The definition of cash in FRS 1 is defined more strictly than in IAS 7.</p> <p>FRS 1 has up to 8 different headings within the statement; where as IAS 7 has 3.</p> <p>FRS 1 has additional disclosure requirements.</p> <p><b>FRSME Update</b></p> <p><i>The FRSME also has a requirement for a cash flow – “the statement of cash flows”. Under the FRSME, both cash and cash equivalents are reported as within IAS 7 and the definition of cash equivalents under the FRSME is similar to IAS 7. The FRSME requires that cash flows are reported under the following headings – operating activities, investing activities and financing activities which is consistent with IAS 7. Cash from operating activities can be presented under the indirect method – which is the traditional method adjusting profit or loss in the year for the effects of changes in the period of stock, debtors and creditors and then adjusting for</i></p>

<p>integral part of an entity's cash management then overdrafts should be included within cash and cash equivalents as negative cash.</p> <p>If overdrafts are used for longer-term funding, they should be included in the financing section of the cash flow statement.</p> <p>IAS 7 requires that cash flows are disclosed under the following headings: -</p> <ul style="list-style-type: none"> <li>• Cash flows from operating activities;</li> <li>• Cash flows from investing activities;</li> <li>• Cash flow from financing activities</li> </ul> <p>The total of these three headings must equal the net increase (or decrease) of cash and cash equivalents in the period.</p> <p>The IAS states that an entity should present its cash flows under the heading which is most appropriate – this could potentially lead to different entities classifying certain transactions differently.</p>	<ul style="list-style-type: none"> <li>• Acquisitions and disposals;</li> <li>• Equity dividends paid;</li> <li>• Management of liquid resources;</li> <li>• Financing.</li> </ul> <p>The total of these headings must equal the net increase or decrease in cash.</p>	<p><i>other non cash items. Cash flows for operating activities can also be presented under the direct method, which discloses information about major classes of gross receipts and payments and this info can come from the accounting records or adjusting sales, expenditure and other items. The entity shall disclose, together with a commentary by management the amount of cash or cash equivalents held by an entity that are not available for use due to legal restrictions, foreign exchange controls etc.</i></p> <p><i>There are some differences between the FRSME and the IAS. The FRSME gives the option of preparing and presenting the cash flow statement on a direct or indirect basis which would mean that it can be prepared and presented on a simpler basis. The FRSME also requires disclosure of cash or cash equivalents that the entity holds but is not for the entity's use.</i></p>
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IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 17 – Leases</b></p> <p>Under IAS 17 – the following disclosures for operating leases are required:-</p> <p>The future minimum lease payments under non-cancellable operating leases in aggregate and for each of the following periods:-</p> <ul style="list-style-type: none"> <li>• Not later than one year;</li> <li>• Later than one year and not later than five years;</li> <li>• Later than five years.</li> </ul> <p>Total contingent rents recognised as income in the period.</p> <p>A general description of the lessee’s leasing arrangements.</p> <p>Under IFRIC 4, an arrangement that meets the following criteria should be accounted for as a lease, under IAS 17: -</p> <ul style="list-style-type: none"> <li>• Fulfilment of the arrangement depends upon a specific asset.</li> <li>• The arrangements detail a right to control the use of the asset. This would happen if any of the following conditions is met:-</li> <li>• The purchaser of the arrangement has the right to operate the asset (or direct others to operate it);</li> <li>• The purchaser has the right to control physical access to the asset;</li> <li>• There is only a remote possibility that any other party will have more than an insignificant amount of the output of the asset.</li> </ul>	<p><b>SSAP 21 – Accounting for leases and higher purchase contracts</b></p> <p>Under SSAP 21 – the following disclosures for operating leases are required: -</p> <p>Payments which are committed to be made during the next year analysed between those in which the commitment expires within that year, in the second to fifth year inclusive and over five years.</p>	<p>There is difference between the standards for disclosure of operating leases. Under IAS 17 the total committed lease liability should be disclosed and analysed between financial periods. Under SSAP 21, the payment in the next financial year (ie the annual commitment) should be disclosed along with details of when the lease expires.</p> <p>The accounting treatment and definitions of leases do not differ between the standards.</p> <p>In recent years, various arrangements have developed which don’t take the legal form of a lease, however the arrangement allows right to the use of an asset in return for a payment. An example would be outsourcing arrangements.</p> <p>IFRIC 4 sets out conditions where an arrangement should be treated as a lease.</p> <p><b>FRSME Update</b></p> <p><i>Under the FRSME the disclosures should be as follows:</i></p> <ul style="list-style-type: none"> <li>• <i>The total of future minimum payments under non-cancellable operating leases for each of the following periods: Not later than one year; later than one year and not later than five years; and later than five years.</i></li> <li>• <i>A general description of the lessee’s significant leasing arrangements</i></li> </ul> <p><i>This disclosure is in line with IAS 17.</i></p> <p><i>The FRSME doesn’t specifically cover other arrangements, however states examples of situations that individually or in combination would normally lead to a lease being classed as a finance lease.</i></p>

IFRS	UKGAAP	Summary of Key Differences
<p><b>IAS 17 - Leases</b></p> <p>IFRS lease incentives are recognised over the whole lease period.</p>	<p><b>UITF 28 – Operating Lease Incentives</b></p> <p>UITF 28 sets out the accounting treatment of lease incentives.</p> <p>SSAP 21 – Accounting for leases and higher purchase contracts does not deal specifically this accounting treatment, however requires lessees to charge operating lease rentals on a straight line basis over the term of the lease, even if the payments are not made on such a basis, unless another systematic and rational basis is more appropriate.</p> <p>In accordance with the accruals concept, any incentive should be allocated to match the effect of the increased rentals payable in later periods, so that the financial statements reflect the true effective rental for the premises, irrespective of the particular cash flow arrangements agreed between the parties.</p> <p>Many leases provide for periodic reviews whereby the rental can be adjusted to the prevailing market rate. In such a case it is necessary to recognise the incentive over the period in which, before taking account of the incentive, the rentals will be other than the market rate.</p>	<p>The treatment between IAS 17 and UITF differs. Under UITF 28, the incentive is recognised over the shorter of the lease period or the time when the rentals revert to market rate. In IAS 17, incentives are recognised over the whole period of the lease.</p> <p><b>FRSME Update</b></p> <p><i>The FRSME doesn't specifically cover the treatment of lease incentives, however states that that a lessee shall recognise lease payments under operating leases as an expense on a straight-line basis unless either, a) another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis, or b) the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then this condition (b) is not met.</i></p> <p><i>The lease incentive is a benefit so this paragraph implies that another systematic basis applies e.g. if a rent free period is given on a rental lease then, then no payments will be made during the rent free period although the lessee is receiving the benefit, therefore the payments should still be recognised for that period of time and the lease incentive consequently if accounted for over the whole lease.</i></p> <p><i>Therefore there is no change to the accounting treatment noted in IAS 17.</i></p>

IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 16 – Property, Plant &amp; Equipment</b></p> <p>IAS 16 requirements are similar to UK GAAP and thereby FRS15, however there has historically been more prominence given to ‘component accounting’ under IFRS and thereby greater distinction has been made between individual components and their economic lives.</p>	<p><b>FRS 15 – Tangible Fixed Assets</b></p> <p>FRS 15 requires that where a Tangible Fixed Asset comprises two or more components with substantially different useful economic lives, each component should be accounted for separately for depreciation purposes and depreciated over its individual economic life. The requirements of FRS 15 to capitalise and depreciate separately the components of what could previously have been treated as a single item ensures that the assets are charged to the income and expenditure account over the periods in which they are consumed.</p> <p>For example a building should be split for depreciation purposes between the structure and items within the structure such as fittings or windows.</p>	<p>The College SORP 2007 gave more prominence to this topic than in the past, leading some people to believe this was a change in accounting policy. It is not a change in policy and the increased prominence brings more into line with IAS than prior to the 2007 College SORP.</p> <p>In our experience this is an area that historically colleges have not addressed and with the increased prominence given under IFRS, now applied by UK GAAP, it is worth highlighting at this time.</p> <p><b>FRSME Update</b></p> <p><i>The FRSME specifically says that Land and Buildings are separable assets, and an entity shall account for them separately, even when they are acquired together.</i></p> <p><i>The FRSME further states that if the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life.</i></p> <p><i>There is no change from the requirements of IAS 16 and FRS 15.</i></p>

IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 19 – Employee Benefits</b></p> <p>In accordance with the requirements of IAS 19 there are various methods by which to account for employee benefit gains and losses. The cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee.</p> <p>A company should recognise a <b>portion</b> of its actuarial gains or losses if the net cumulative unrecognised actuarial gains and losses at the end of the preceding period exceeds the greater of 10% of the present value of the defined obligation at the beginning of the year, and 10% of the fair value of the plan assets at the same date.</p> <p>These limits should be calculated and applied separately for each defined plan. The excess determined by the above method is then divided by the expected average remaining lives of the employees in the plan. This is the most common method under IAS19 and is called the ‘corridor approach’</p> <p>An entity can however adopt any other method that results in faster recognition of actuarial gains and losses as long as it’s applied consistently.</p>	<p><b>FRS 17 – Retirement Benefits</b></p> <p>In accordance with the requirements of FRS 17 the actuarial gains and losses arising from any new valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date should be recognised in the statement of total recognised gains and losses for the period in question.</p> <p>Full actuarial valuations by a professionally qualified actuary should be obtained for a defined benefit scheme at intervals not exceeding three years. The actuary should review the most recent actuarial valuation at the balance sheet date and update it to reflect current conditions.</p>	<p>On 29 April 2010, the IASB published for public comment an exposure draft (ED) of proposed amendments to IAS 19 <i>Employee Benefits</i>. The proposals would amend the accounting for defined benefit plans. Among the amendments proposed to IAS 19 are immediate recognition of all estimated changes in the cost of providing defined benefits and all changes in the value of plan assets. This would eliminate the various methods currently in IAS 19, including the ‘corridor’ method, that allow deferral of some of those gains or losses and bring into line with FRS 17.</p> <p>There are currently no proposals to change the definition of a defined benefit scheme or a defined contribution scheme; therefore there are currently no proposed changes to how current pension schemes are treated.</p> <p><b>FRSME Update</b></p> <p><i>FRSME provides a number of simplifications where the valuation basis (the Projected Unit Credit Method) would require undue cost or effort. FRSME also does not require the use of an independent actuary to provide a triennial valuation as current UK GAAP does provided the entity is able to do so without undue cost or effort.</i></p> <p><i>There are therefore differences between current practice and the FRSME. This is an area where discussion is taking place and the impact on the current practice regarding these differences has not yet been fully clarified.</i></p>

IFRS	UK GAAP	Summary of Key Differences
<p><b>IAS 19 Employee Benefits</b></p> <p>IAS 19 identifies short-term employee benefits as being, such things as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit sharing and bonuses (if payable within 12 months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.</p> <p>Under IAS 19, when a person has been an employee of an organisation during an accounting period then the organisation shall recognise the amount of any short term employee benefits expected to be paid as:</p> <p>An accrued expense, after deducting any amount paid. If the amount paid exceeds the amount of the benefit then the organisation shall recognise a prepayment.</p>	<p><b>FRS 12 Provisions, Contingent liabilities, Contingent Assets</b></p> <p>FRS 17 Retirement Benefits does not set out accounting requirements of short term employee benefits.</p> <p>Therefore whether an expense would be included in the financial statements would depend on whether the expense met the definition of a provision under FRS 12.</p> <p>A provision should be recognised if an organisation has a legal or constructive obligation as a result of a past event and it is probable that a transfer of economic benefits will be required to settle this obligation and a reliable estimate of the obligation can be made.</p>	<p>The UK and International treatment differs as IAS 19 now specifies how short term benefits should be treated.</p> <p>The key difference is that accruals/prepayments relating to short term employee benefits will now have to be included within organisations financial statements.</p> <p>Examples, included in IAS 19, of how this will work in practice are detailed below.</p> <p>As with all accounting transactions, organisations should consider the materiality of the adjustments that these proposed changes will make.</p> <p><b>FRSME Update</b></p> <p><i>The FRSME is consistent with IAS 19. An entity shall recognise the cost of all employee benefits to which its employees have become entitled to as a result of service rendered to the entity during the reporting period as a liability. If the amount paid exceeds the obligation arising, an entity shall recognise that excess as an asset (prepayment).</i></p>

## Low significance

The following UK Accounting standards, which may have an impact on the FE/HE sector in Scotland, have minor differences to International accounting Standards: -

- FRS 9 Accounting for Associates and Joint Ventures – the main differences from IAS 28 Investments in Associates are as follows: -
  - o FRS 9 requires Joint ventures to be accounted for using a minor variation of equity method (gross equity method). Proportionate consolidation is not permitted. IAS 28 recommends accounting for joint ventures by proportionate consolidation in group accounts.
  - o FRS 9 has greater disclosure requirements particularly of significant associates and joint ventures.

## FRSME Update

*The FRSME states that an investor, who is a parent, in its consolidated financial statement, account for all of its investments in associates and joint ventures using the equity method.*

- FRS 8 Related Party Disclosures – FRS 8 has a wider definition of a related party and requires more detailed disclosure of related party transactions than the IAS.

## FRSME Update

*The requirements and definitions of the FRSME are similar to the requirements of FRS 8.*

- FRS 3 Reporting Financial Performance – there are several differences between FRS 3 and the international standards. These are as follows; -
  - o An acquisition category is included as well as continuing and discontinued operations;
  - o There is no hold for sale category;
  - o Term exceptional item is used for material items. Three particular exceptional items have to appear after operating profit but before interest
  - o A separate Statement of Total Recognised gains and losses is required (similar to the Other Comprehensive income
  - o A note of Historical Cost Profits and Losses is required – this is a statement of what the profit of the company would have been had it applied pure historical cost;
  - o A reconciliation of shareholders funds is required. This is similar to the total column of the statement of changes in equity.

## **FRSME Update**

The FRSME is a reduced disclosure framework and therefore includes various reductions in the disclosure required. A template of the proposed main statements within accounts is included within Appendix 1 of this report. It should be noted that the College's are not likely to follow this format therefore the template is included for information only. The College's will still follow the FE HE SORP which will be updated to incorporate the requirements of the FRSME.

- FRS 6 Acquisitions and mergers – under FRS 6 merger accounting is permitted if certain conditions are met. Under IFRS 3 all business combinations should be under acquisition accounting. Note IFRS 3 does not apply to business combinations involving entities or businesses under common control – therefore making it possible to exempt certain group re-organisations from its scope.

## **FRSME Update**

The FRSME follows the accounting treatment under IFRS 3, in that all business combinations should be accounted for under the purchase method (acquisition accounting).

- SSAP 20 Foreign Currency Translation - Under SSAP 20 the actual, or an average, rate can be used for foreign currency translations in the income statement. Under IAS 21 an actual (or near actual proxy) exchange rate is required to be used for the income statement.

## **FRSME Update**

The FRSME requires the rate at date of transactions to be used, however it does permit average rate to be used in certain circumstances i.e. an average rate for a week or month could be used for all transactions during that period, however if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

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