BY
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Public Benefit Entities Accounting under FRS 102

"The FRS Applicable in the UK and Republic of Ireland"

In part 11 of our series of articles Robert Kirk provides an overview of how to account for Public Benefit Entities under FRS102.

Background

Although the FRS has still not been finalised the Financial Reporting Council (FRC) has made it clear in recent weeks that the deadline for its introduction will be for reporting entities with accounting periods commencing on or after the 1st January 2015. However, the real work will take place in the transitional year i.e. 2014 with the 1st January 2014 being the key date (the date of transition) when all non listed companies and public benefit entities will have to produce two balance sheets (one under existing SSAPs, FRSs and SORPs and one under the new FRS and revised SORPs) built on the international accounting standards framework. It is therefore crucial for all accountants in Ireland to prepare themselves in time for the big 'kick-off'.

In this article I wish to focus on the specific aspects of FRS 102 that will apply to public benefit entities only. Originally there was a proposal to introduce a standalone standard for those entities but that has now been abandoned and they are now instead incorporated as special sections within the new standard. In addition the various SORPS in that sector are being internationalised hopefully in time for the kick off. Certainly the Charity Commissioners for England and Wales are well on their way to revising the Charities SORP and work has also commenced on the Universities SORP.

What is a Public Benefit Entity?

A public benefit entity (PBE) has been defined in FRS 100 as:

"an entity whose primary objective is to provide goods or services for the general public, community or social benefit and where any equity is provided with a view to supporting the entity's primary objectives rather than with a view to providing a financial return to equity providers, shareholders or members."

Many people would refer to these entities as not for profit entities and certainly they encompass charities, housing associations and universities and colleges. They do have unique accounting issues that are not covered by the IFRS for SMEs which was designed for private sector profit making entities. A number of these specific issues are now covered in FRS 102 but only PBEs can adopt these specialised sections. They are designated as such throughout the document as PBE sections only.

Before looking at these specialised sections it is important to remember that PBEs should not only follow their specific SORP but also follow ALL of the regulations in FRS 102 i.e. they must read two documents when preparing their financial statements. It is also important to remember that most of the SORPS do not have specific authority in the Republic of Ireland but they are often adopted (particularly by charities) as forming best practice.

Concessionary Loans

The first time that PBEs get a specific mention in FRS 102 is in Section 11 *Basic Financial Instruments* which merely states that PBEs that make or receive concessionary loans must refer to the relevant paragraphs in Section 34 *Specialised Activities* on how to account for such loans. They are therefore outside the scope of financial instruments under the standard.

Section 34 paragraphs 88 to 98 cover the rules in accounting for these loans. Concessionary loans are loans made or received between a PBE and a third party at below the prevailing market rate of interest that are not repayable on demand.

Accounting treatment

A PBE must either adopt:

a. the recognition, measurement and disclosure requirements in Section 11, 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 below.

However, a PBE must apply the same accounting policy to both concessionary loans made and received. It is likely that most will adopt the easier option of (b). In that case a PBE making or receiving concessionary loans to a third party must initially measure these arrangements at the amount received or paid and recognise them in the balance sheet (statement of financial position). In subsequent years the carrying amount is then adjusted to reflect accrued interest payable or receivable. To the extent that a loan has been made but is now adjudged to be irrecoverable then an impairment loss must be recognised in income and expenditure.

The loans can be presented either as a separate line item on the face of the balance sheet (statement of financial position) or in the notes. Concessionary loans must be classified separately to disclose amounts repayable within one year and amounts repayable in more than one year.

PBEs must disclose the measurement basis adopted and any other accounting policies which are relevant to understanding these transactions within the financial statements. The PBE should also disclose the terms and conditions of any loans e.g. the interest rate, any security provided and the terms of the repayment as well as the value of concessionary loans committed but not taken up at the year end.

Concessionary loans made or received should be disclosed separately. However multiple loans received or made may be disclosed in aggregate, providing that such aggregation does not obscure significant information.

Incoming resources from non-exchange transactions

These are transactions 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.

Non-exchange transactions include donations and legacies.

Recognition and measurement

Receipts of resources from non-exchange transactions should be recognised as follows:

a. If there are no specified future performance conditions, in income when the resources are receivable.
b. If there are specified future performance conditions, in income only when the performance conditions are met.
c. Where resources are received before the revenue recognition criteria are satisfied then a liability must be recognised.

The existence of a restriction does not prohibit a resource from being recognised in income when receivable. In addition, when applying the requirements above, an entity must take into consideration whether the resource can be measured reliably and whether the benefits to recognise the resource outweigh the costs.

Where it is not practicable to estimate the value of the resources with sufficient reliability or benefit, the income is included in the financial period when the resources are sold or distributed.

A liability is recognised for any resource with specified performance conditions that becomes repayable due to non-compliance with the performance conditions, when that repayment becomes probable.

Donations that can be reasonably quantified will usually result in the recognition of income and an expense. An asset is 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.

Resources from non-exchange transactions should be measured at the fair value of the resources received or receivable.

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Disclosure

The nature and amounts of resources receivable from non-exchange transactions recognised in the financial statements must be disclosed as well as any unfulfilled conditions or other contingencies attaching to resources from non exchange transactions that have not been recognised in income and an indication of other forms of resources from non-exchange transactions from which the entity has benefited.

In the Appendix to Section 34 more specific guidance is given on how legacies should be reported in the financial statements. It particularly requires entities to wait until probate and also ensure that there are sufficient assets in the estate to pay the legacy after paying off the estate's liabilities so as to ensure that benefits will probably flow to the entity before recording the legacies in the financial statements. The guidance also requires donated services to be recognised in the financial statements if they can be reasonably quantified, when they are received.

Public Benefit Entity Combinations

FRS 102 has banned the merger technique when dealing with business combinations but in this part of Section 34 PBEs may apply the technique for:

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.

However, genuine acquisitions are still accounted for under Section 19 of the FRS.

Combinations that are in substance a gift

These are combinations carried out at nil or nominal consideration that are not fair value exchanges but are, in substance, the gift of one entity to another. In these cases 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 should be recognised as income.

The excess of the fair value of the liabilities assumed over the fair value of the assets received is recognised as a loss. This loss is recognised as an expense.

Combinations that are a merger

A merger is a 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 to meet the definition of a merger:

a. no party to the combination is portrayed as either acquirer or acquiree;
b. there is no significant change to the classes of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and
c. all parties to the combination participate in establishing the management structure of the combined entity – based on consensus between the parties.

Entity combinations that meet all of the three criteria set out above should apply merger accounting as follows:

- Under merger accounting there is no fair value exercise, although adjustments should be made to achieve uniformity of accounting policies.
- The results and cash flows of all combining entities are brought into the financial statements of the new entity from the beginning of the period in which the merger occurs.

The comparative figures should be restated by including the results for all the combining entities for the previous accounting period and their balance sheets (statements of financial position) for the previous reporting date. The comparative figures should be marked as 'combined' figures.

All costs associated with the merger must be charged to income and expenditure.

Disclosure

For each merger in the reporting period the following must 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; and
c. an analysis of the principal components of the current year's primary financial statements.

Summary

It is welcome news that the FRC have decided to incorporate the specialised accounting transactions for PBEs within FRS 102 rather than having those entities having to read two or possibly three (if complying with a SORP) separate documents when preparing those financial statements. It is also welcome news that PBEs will not have to go through the complicated rules on acquisition accounting if two or more charities etc decide to merge their interests. Although these accounting treatments are only spelt out for the first time in an accounting standard they are not difficult to follow and most PBEs will already be adhering to the required treatment under the standard.