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Our ref: ICAEW Rep 16/10

Your ref:

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By email: ukgaap@frc-asb.org.uk

Dear Ian

THE FUTURE OF UK GAAP

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on the ASB consultation paper *Policy Proposal: The Future of UK GAAP*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

ICAEW REP 16/10

Policy Proposal: The Future of UK GAAP

Memorandum of comment submitted in February 2010 by The Institute of Chartered Accountants in England and Wales, in response to Accounting Standards Board consultation paper ‘Policy Proposal: The Future of UK GAAP’, published in August 2009.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the consultation paper *Policy Proposals: The Future of UK GAAP* published by the Accounting Standards Board (the Board).

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen in the UK by the Financial Reporting Council. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures that these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the Initiative

4. We support the general approach of the Board to the reform of UK GAAP, particularly its willingness over a number of years to undertake extensive consultation. This approach recognises the diversity and complexity of the issues involved. We acknowledge that at least one further stage of consultation will be necessary to deal in particular with cost/benefit considerations, which ought to be assessed to the extent practicable. We will be pleased to offer assistance in this endeavour; one of the relevant cost/benefit factors will be the training needs of accountants, where the institutes will play a key role, both in terms of transition to the new regime and future training. There is also likely to have to be a consultation on the future of the FRSSE, as discussed further below.
5. Although we recognise the many practical challenges involved in taking forward these far-reaching proposals, we urge the Board to maintain the momentum for change and, subject to the responses of constituents, to strive towards implementing a new IFRS-based regime for all UK reporting entities as soon as is realistically possible. Some important actions require early attention, for example regarding the removal of potential legislative barriers. The Board should also press ahead with the further consultation and deliberation required as quickly as possible.

Use of the IFRS for SMEs

6. As discussed in more detail below in our response to Question 5, we welcome the publication by the International Accounting Standards Board (IASB) of the new IFRS for SMEs, and in principle support its use in the UK. One immediate advantage to preparers would be that, as well as being well-written, the standard is much shorter and more manageable than current UK GAAP. A further advantage is that some 'Tier 2' companies will be aiming to join the junior or senior listed markets, and applying the new standard would take them one step closer to full IFRS.

7. We think it probable that the benefits of this tier of companies moving to the IFRS for SMEs would outweigh the costs and efforts involved, assuming a solution is found to the important issue referred to in paragraph 8 below. Certainly current UK GAAP for entities not eligible to use the FRSSE is an uncomfortable mishmash of converged and non-converged standards, lacking any strong underlying cohesion or principle, and we look forward to its replacement with the IFRS for SMEs for at least the middle tier of reporting entities.
8. There are some other issues in relation to interaction of the IFRS for SMEs with the law that would need to be dealt with. In particular, the IFRS for SMEs provides an exemption from preparing consolidated financial statements only where the company is included in the consolidated financial statements of a larger group which prepares those financial statements under IFRS or the IFRS for SMEs (and certain other conditions are met). This is narrower than the exemptions provided under existing UK law and FRS 2 *Accounting for Subsidiary Undertakings*. This would be a significant disadvantage of using the IFRS for SMEs in unamended form as 'Tier 2 UK GAAP' and it would not in our view be helpful for the Board to narrow the scope of the current legal exemption. We explain in the appendix to this submission the steps that could be taken to address this concern.

The Board's continuing responsibility for UK GAAP

9. Whilst we support a move in the UK towards greater use of international standards, in our view the Board must remain active and retain responsibility for the maintenance and appropriateness of UK GAAP for both profit-making entities and the public benefit sector, albeit with a much reduced role in direct standard setting. In particular, the Board should not give up its right to set UK standards, including changing the IFRS for SMEs were this deemed necessary in the future to reflect the needs of UK users and preparers. Nonetheless, the objective should be to influence the IASB at an early stage to ensure that future changes to the standard are acceptable to UK stakeholders.
10. These issues are discussed below in more detail in our response to Question 6.

Sector-specific guidance

11. It is generally agreed that Statements of Recommended Practice (SORPs) have improved significantly the quality of financial reporting in the UK. The use of sector experts in their development has created SORPs that successfully supplement UK reporting requirements to deal with sector-specific issues. The Board's assurance statements provide valuable comfort that SORPs have been developed appropriately and the reference in FRS 18 *Accounting Policies* to SORPs has embedded them in UK GAAP. If this position were to change, there might be a reduction in quality of financial reporting within these sectors. In some sectors, relevant regulations refer directly to SORPs as sources of guidance. In the absence of a SORP reviewed by the Board, regulations in those sectors would need to be rewritten by regulators without the assurance this provides. This outcome would bring with it a real risk of confusion and uncertainty. In addition, in some sectors, such as insurance, a comprehensive international standard is not expected for some time. Robust guidance in the form of a SORP or equivalent will continue to play a valuable role in the UK until such time standards are published.
12. We urge the Board to be proactive in engaging with the relevant SORP-making bodies and relevant sector regulators to ensure that the significance of the proposed changes to UK GAAP is well understood and can be dealt with properly within each sector, particularly in those sectors that have less experience of applying IFRS.

13. We would emphasise in this context that we do not regard SORPs as necessarily 'interpretations' of IFRS or IFRS-based standard, which are quite properly the sole preserve of the International Financial Reporting Interpretations Committee (IFRIC). However, where any are retained, a title such as 'Practice Statement' might be considered as an alternative to 'Statement of Recommended Practice', a more accurate reflection of the role that these statements play in the UK.
14. We discuss these issues in more detail below in our response to Question 10.

Public benefit entities

15. We support the move to converge the reporting requirements for public benefit entities with IFRS principles, which could provide a model for the rest of the world. It may also provide guidance for UK public benefit entities that at present are not covered by a SORP or other authoritative guidance on their financial reporting, and would enhance the transferability of skills between different sectors. We do not however underestimate the extent of the challenge involved for the Board and, moreover, for the entire UK public benefit sector. It is important to recognise that a move to IFRS-based standards would represent a significant change for a sector with little experience of IFRS and perhaps fewer resources available to meet the challenges of transition than private sector entities.
16. To avoid unnecessary delays in transition, the Board will need to work towards identifying and removing the barriers to convergence and engaging in dialogue with the relevant regulators at the earliest opportunity. Those regulators need to be conversant with the implications of convergence and take steps to ensure an orderly transition. There is also the question of whether some public benefit entities should be deemed to be publicly accountable in the sense defined by the Board, for example because they have listed debt.
17. We discuss these issues in more detail below in our responses to Questions 11-14.

Timing

18. A transition date or dates should be established as soon as possible. The Board makes it clear that the public benefit proposals will be subject to a further separate consultation, and it is important to recognise that the sector faces its own, distinct challenges. We would however not wish any delays in the implementation of changes to the requirements for the regime for public benefit entities to delay changes in the 'for profit' sector. Transition in 2012 may well be achievable outside of the not-for-profit sector. We discuss these issues in more detail below in our response to Question 16.

Retention of the FRSSE

19. The FRSSE is widely regarded as meeting the information needs of the users of small company financial reporting at a reasonable cost, and thus any change to the existing regime should only follow consideration of a further ASB consultation paper exploring the case for reforming the FRSSE regime in more detail than the current document. We therefore support the retention of the FRSSE for the time being whilst the future of financial reporting by small companies is the subject of that further consultation. This should take account of the lessons of implementation of the IFRS for SMEs by larger UK reporters and developments in the debate over changes to the Accounting Directives. The principles of the FRSSE should remain unaltered until this further consultation is complete, even if the decision is made to adopt the

IFRS for SMEs for Tier 2. This would avoid costs for small companies and their advisors which would bring little or no benefits should the further consultation exercise result in the abandonment of the FRSSE in its current form.

20. Our tentative vision, subject to the results of further public consultation, is the eventual introduction of a new-style FRSSE, retaining its current 'one stop shop' features, and based closely on the IFRS for SMEs, whilst excluding a number of its requirements on cost/benefit grounds, for example for a cash flow statement and consolidated accounts.
21. Any analysis by the Board of costs and benefits associated with the FRSSE regime should reflect the additional costs incurred by accounting firms advising clients operating under different financial reporting regimes. Costs of training and updating staff in separate regimes, which could include IFRS, UK GAAP and the FRSSE, can be significant for smaller firms in particular.
22. These issues are discussed in more detail below in our response to Question 9.

Taxation

23. We would welcome early indications from HMRC on how it intends to deal with any significant tax implications arising from the Board's proposals, and would expect the Board to be aware of such implications. The general approach of the Board should, nonetheless, be to establish the best possible accounting regime and then to encourage the tax authorities to deal with any adverse tax consequences, particularly on transition.

Reduced disclosures for subsidiaries

24. As discussed in more detail below in our response to Question 4, we believe that more work needs to be done by the Board on the potential costs and benefits arising if subsidiaries in groups reporting under EU adopted IFRS were exempted from certain disclosures. We look forward to considering this matter further once additional evidence is available.

Regulatory certainty

25. As discussed in more detail below in our response to Question 2, we consider it to be of utmost importance that entities in the UK have as much certainty as possible regarding their place in the new tiered regime. It would be unfortunate if this became a continuing area of debate in different sectors and between audit firms and their clients. Therefore, whichever principles are agreed, it will then be necessary for the Board to work within the UK legislative framework and with regulators to produce clear and detailed guidance on which companies and other entities fall into each Tier by application of the principle.

IFRS knowledge and/or experience

26. We emphasise in a number of places in this submission that many constituents affected by the Board's proposals will have little knowledge or experience of IFRS or the IFRS for SMEs, perhaps particularly in the not-for-profit sector. Some may therefore feel that they are being asked to respond to important questions about the future reporting landscape without sufficient understanding of the issues and the implications of a particular course of action. The Board will need to reach out extensively to explain the practical implications of the proposals, and to understand

the concerns and challenges faced by those new to IFRS reporting, and the much greater degree of judgment involved for those currently applying UK GAAP.

27. The Board may wish to consider at an early stage how constituents would best be supported in terms of education, training and guidance to achieve an orderly transition to an IFRS-based accounting regime.

Legal and regulatory issues

28. We would expect detailed legal and regulatory issues to be addressed at the exposure draft stage of this consultation. We are aware that the European Commission is looking at the extent to which the IFRS for SMEs is compliant with the Accounting Directives. Obviously the interaction of the standard with the law will be important. Representatives of the ICAEW are involved in this process through participation in EFRAG's current review of the Directives on behalf of the Commission. The Board will presumably be able to draw on this work without having to redeliberate the detail, which should expedite the process.
29. Other practical issues include the movement of companies between the different tiers: we would not support a restrictive regime in this respect. Under the current reporting framework, restrictions within the existing Companies Act to stop companies switching back to UK GAAP from IFRS reflect what have turned out to be unwarranted fears: the cost of switching means that companies cannot easily do this and any attempt at tax arbitrage could be prevented by HMRC through other regulatory means. In future companies should be permitted to move to follow the GAAP that suits their circumstances within rules of the tiered approach put in place. We would be happy to contribute to this work.
30. As mentioned above, we also recommend early discussion with HMRC, and the Board needs to address the important issue around the legal exemptions from consolidation, referred to in paragraph 8 and in more detail in the appendix to this submission.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the legal definitions (paragraph 2.5)? Please state the reasons for your preference. If you do not agree with either definition, please explain why not and what your proposed alternatives would be.

31. We prefer the Board's definition of public accountability. We do not regard the legal definitions as a viable alternative that would be workable for these purposes as they are not underpinned by any well-articulated principle.
32. We do nevertheless have some concerns regarding the Board's definition of public accountability and do not believe it yet provides sufficient clarity as to which entities would be caught by the definition and which entities would fall outside it. Detailed guidance is likely to be necessary in this area. In particular further explanation is required as to what is meant by 'a deposit-taking entity' and the phrase 'holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses'. Further guidance could draw on paragraph 1.4 of the IFRS for SMEs, but we would not agree that some entities that take deposits, such as professional firms and travel agents, should be obliged to apply EU adopted IFRS, and their exclusion from the definition should be made clear.

Q2: Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

33. As noted in our answer to Question 1, we believe that there is insufficient clarity in the definition to be certain as to which entities would be deemed to have public accountability. At present we envisage a number of types of entity falling within this definition - and thus being subject to the full rigours of the IFRS reporting regime - where the costs involved may significantly outweigh the benefits, for example some deposit-taking businesses and small friendly societies and credit unions. In practice full IFRS financial statements are probably only relevant to the regulators of such institutions, not their members (as they are likely to need more simplified information in order to understand the performance of the entity). This raises a question as to what 'publicly accountable' means when linked by definition to the need to produce full IFRS accounts, when financial statements are produced primarily for members.
34. One solution might be to permit specified types of public benefit entities - those not subject to the Accounting Directives and operating in sectors where reporting requirements are determined by UK regulators in the public interest - to use the IFRS for SMEs (or, where applicable, the FRSSE), with the proviso that the Board would, in close consultation with the applicable regulator, determine whether certain entities within that regulator's remit should report under a higher tier. The issues involved are, however, complex. The Board should discuss them with relevant regulators and sector groups in order to determine the appropriate regime in each case, or possibly to find a more nuanced approach to what publicly accountable means for these entities and their regulators.
35. We consider it to be of utmost importance that entities in the UK have as much certainty as possible regarding their place in the new tiered regime. It would be unfortunate if this became a continuing area of debate in different sectors and between audit firms and their clients. Therefore, whichever principles are agreed, it will then be necessary for the Board to work within the UK legislative framework and with regulators to produce clear and detailed guidance on which companies and other entities fall into each Tier by application of the principle. In some sectors, legislative and/or regulatory certainty will be necessary before such guidance can be finalised. In addition, it will be important to ensure that all entities remain in compliance with applicable legal requirements and that the regime fits with the statutory legal requirements in a logical and well-understood way.

Q3: Do you agree with the Board's proposals that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS? If not, why not?

36. We agree with the Board's proposal that wholly-owned subsidiaries (and partly-owned subsidiaries too) that are themselves publicly accountable, for example those that have their own listed debt securities, should apply EU adopted IFRS.

Q4: Do you still consider that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures? If so, it would be helpful if you could highlight such disclosure reductions as well as explaining the rationale for these reductions.

37. Subsidiaries that are themselves publicly accountable should not be allowed reduced disclosures. However, this question should be posed more broadly to look at subsidiaries of companies reporting under EU adopted IFRS that are not themselves publicly accountable and whether the reduced level of disclosures in the IFRS for SMEs should be made available to them. Although adopting the IFRS for

SMEs may be an option for non-publicly accountable subsidiaries wishing to take advantage of the reduced disclosures, the differences in recognition and measurement requirements as compared to EU adopted IFRS would give rise to additional consolidation adjustments and is not therefore likely to be helpful from a cost-benefit standpoint.

38. The issue then arises as to whether exemptions for subsidiaries, perhaps few in number, would significantly reduce the financial reporting burden for the group as a whole, and whether this would justify the cost and effort associated with maintaining an additional tier of GAAP, which in principle is unwelcome. We would expect larger groups to be able to provide information on costs of producing full subsidiary accounts and on which reductions in disclosures would be most effective. The views of the user community, including banks and credit rating agencies examining the accounts from a creditor perspective, will be key.
39. At present it seems unclear exactly how subsidiary accounts are used and hence whether users would suffer if some disclosures were reduced, although we note that UK GAAP already allows specific derogations from accounting standards on cash flow statements, related party disclosures and financial instruments. We believe that further research is required in this area, exploring whether exemptions which groups consider advantageous would provide cost savings without disadvantaging users of the accounts. The question would have to be considered in the context of both wholly and partly owned subsidiaries.
40. We therefore recommend that an analysis is undertaken of the additional disclosures required under EU adopted IFRS as compared to the IFRS for SMEs (as a model of reduced disclosure), together with the incremental cost of providing such information, given that much of the information may need to be provided for consolidation purposes. This would also need to take into account the additional burdens created by subsidiaries no longer reporting under EU adopted IFRS; in particular, the requirements of the Accounting Directives would apply to them in full.
41. We look forward to considering this matter further once additional evidence is available. We would note however, for the record, that we are not convinced by the argument in paragraph 2.18 of the consultation paper. If it is correct that reduced disclosure is not possible within the context of the 'true and fair' requirement, then that would undermine fatally the credibility of both the FRSSE and IFRS for SMEs, given their much reduced disclosure requirements compared to full UK GAAP. It would also bring into question whether the financial statements of subsidiaries that currently utilise UK GAAP disclosure exemptions are true and fair. There are therefore considerations worth investigating for subsidiaries in relation to materiality at the individual vs. group accounts level: who the users of subsidiary accounts are (in relation to both minority shareholders and creditors) and whether some subsidiary information is actually more meaningful at a group level where it is included in appropriate segmental and full group information.

Q5: Do you agree with the Board's proposal that the IFRS for SMEs should be used for 'Tier 2' entities?

42. Yes, we believe that the IFRS for SMEs in its present form provides a better alternative than current full UK GAAP for those companies in Tier 2. One immediate advantage to preparers would be that, as well as being well-written, the standard is much shorter and more manageable than current UK GAAP. A further advantage is that some 'Tier 2' companies will be aiming to join the junior or senior listed markets,

and applying the new standard would take them one step closer to full IFRS. From a user perspective, we understand that listed market analysts refer to the financial statements of large private sector competitors in certain sectors. Introducing accounting requirements for such companies more closely aligned with IFRS would be to their advantage too.

43. One potential barrier to use of the IFRS for SMEs is the possible existence of some inconsistencies between the standard and the EU Accounting Directives. Even if this proves to be the case, we think it probable that the benefits of this tier of companies moving to the IFRS for SMEs would outweigh the costs and efforts involved, assuming a solution is found to the important issue referred to in paragraph 8 above. Certainly current UK GAAP for entities not eligible to use the FRSS is an uncomfortable mishmash of converged and non-converged standards, lacking any strong underlying cohesion or principle, and we look forward to its replacement with the IFRS for SMEs for at least the middle tier of reporting entities. The current review of the Accounting Directives will, we hope, make it easier to fit the IFRS for SMEs into the company law structure on accounting and we are urging the European Commission to seek this outcome.

Q6: Do you agree with the Board's proposal that the IFRS for SMEs should be adopted wholesale and not amended? If not, why not? It would be helpful if you could provide specific examples of any amendments that should be made, as well as the reason for recommending these amendments.

44. Our working assumption is that the importance of maintaining the integrity of the standard means that the temptation to tinker should be resisted to the greatest degree possible. Any substantive changes will risk diluting the advantages of its use and undermining its cohesive nature. Thus the IFRS for SMEs should be adopted for Tier 2 entities subject only to any measures to deal with legal requirements which might restrict the use of the IFRS for SMEs in the UK and the consolidation issue referred to above and in the appendix to this submission.
45. At the same time, in our view the Board must remain active and retain responsibility for the maintenance and appropriateness of UK GAAP for both profit-making entities and the public benefit sector, albeit with a much reduced role in direct standard setting. In particular, the Board should not give up its right to set UK standards, including changing the IFRS for SMEs were this deemed necessary in the future to reflect the needs of UK users and preparers. Nonetheless, the objective should be to influence the IASB at an early stage to ensure that future changes to the standard are acceptable to UK stakeholders.
46. In the longer term, the timing of updates to the IFRS for SMEs will be an issue and we believe that the Board should aim to consult simultaneously on any proposed changes to the IFRS for SMEs issued by the IASB. Consideration should also be given at an early stage to how preparers using the IFRS for SMEs should describe the applicable accounting framework, particularly if UK or EU legal requirements affect the application of the standard in the UK. We see some advantage in entities and auditors being able to refer to compliance with IFRS for SMEs (rather than compliance with a special version of it or with UK GAAP). This has been achieved in the recent adoption of IFRS for SMEs in South Africa.
47. The timing of first time adoption may be an issue as companies will want to work towards a 'stable platform'. We recommend that the Board reviews any early feedback from those countries that have already adopted the IFRS for SMEs to ensure that no major issues have emerged in the post-implementation period which

would necessitate significant revision of the standard. This should avoid onerous and costly changes soon after first adoption and will provide a 'stable platform' for those preparing for first time adoption. Thereafter the revision of the standard in the UK should be aligned with the international review cycle.

Q7: Do you agree with the Board's proposals that large Non-Publicly Accountable Entities should be permitted to adopt the IFRS for SMEs? Or do you agree that large entities should be required to use EU adopted IFRS? Please give reasons for your view.

48. Yes, we agree with the Board's proposal. There is no logical reason to insist that any UK entities which are not publicly accountable, which at present are permitted to use UK GAAP, move to EU adopted IFRS rather than the IFRS for SMEs. It should be left to market forces to push entities into moving to a higher tier of reporting, i.e. if their users want fuller information.

Q8: Do you agree with the Board that the FRSSE should remain for the foreseeable future?

49. Yes, as explained below in our response to Question 9.

Q9: Do you agree that the FRSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?

50. It is very important to balance the costs and benefits of change, especially for small entities in both the 'with profit' and public benefit sectors, and to ensure that disruption for such entities is kept to a minimum. The FRSSE is widely regarded as meeting the information needs of the users of small company financial reporting at a reasonable cost, and thus any change should only follow consideration of a further ASB consultation paper exploring the case for reforming the FRSSE regime in more detail than the current document.
51. We therefore support the retention of the FRSSE for the time being whilst the future of financial reporting by small companies is the subject of that further consultation. This should take account of the lessons of implementation of the IFRS for SMEs by larger UK reporters and developments in the debate over changes to the Accounting Directives. The principles of the FRSSE should remain unaltered until this further consultation is complete, even if the decision is made to adopt the IFRS for SMEs for Tier 2. This would avoid costs for small companies and their advisors which would bring little or no benefits should the further consultation exercise result in the abandonment of the FRSSE in its current form.
52. Our tentative vision, subject to the results of further public consultation, is the eventual introduction of a new-style FRSSE, retaining its current 'one stop shop' features, and based closely on the IFRS for SMEs, whilst excluding a number of its requirements on cost/benefit grounds, for example the cash flow statement. In addition, for many small companies the preparation of consolidated accounts would be purely a compliance exercise, giving no useful information to members. We understand that small companies often become small groups through acquisitions which would be difficult to restructure into single entity businesses for operational and contractual reasons, so the exemption from preparing group accounts continues to be a very important one. As noted above, any such replacement of the FRSSE should not be implemented until there is experience of larger UK companies applying the IFRS for SMEs.

53. Any analysis by the Board of costs and benefits of the FRSSE regime should reflect the additional costs incurred by accounting firms advising clients operating under different financial reporting regimes. Costs of training and updating staff in separate regimes, which could include IFRS, UK GAAP and the FRSSE, can be significant for smaller firms in particular. There are already problems when accountants move between firms where they have been trained in, say, IFRS, but then need to apply UK GAAP in their future role. There would be costs involved in making the transition to the IFRS for SMEs, but in the long run we would expect it to be less expensive than running parallel sets of standards. We recognise that those who advise only FRSSE clients may have concerns over any move to change significantly or withdraw the existing standard, but ultimately, if the IFRS for SME regime is successfully implemented, change will also be necessary and desirable for the FRSSE regime.

Q10: Do you agree with the Board's current views on the future role of SORPs? If not, why not?

54. It is generally agreed that Statements of Recommended Practice (SORPs) have improved significantly the quality of financial reporting in the UK. The use of sector experts in their development has created SORPs that successfully supplement UK reporting requirements to deal with sector-specific issues. The Board's assurance statements provide valuable comfort that SORPs have been developed appropriately and the reference in FRS 18 *Accounting Policies* to SORPs has embedded them in UK GAAP.
55. The benefits of this regime should not be discarded lightly. Indeed, we consider that there will continue to be a strong and legitimate demand from particular sectors for guidance specific to the UK regulatory and legal environment, recognising, for example, the importance of narrative reporting requirements in the charities sector. Our main concern is that, if this were not the case, there might be a reduction in quality of financial reporting within these sectors. In some sectors such as Authorised Funds, relevant regulations refer directly to SORPs as sources of guidance. In the absence of a SORP reviewed by the Board, regulations would need to be rewritten by sector regulators without the assurance this provides. This outcome would bring with it a real risk of confusion and uncertainty and, depending on the actions taken by the relevant regulator, it might be harmful to the quality of financial reporting in that sector. In addition, in some sectors, such as insurance and oil and gas, a comprehensive international standard is not expected for some time. Robust guidance in the form of a SORP or equivalent will continue to play a valuable role in the UK until such time standards are published.
56. We recognise that it will be difficult to deal adequately with all the sectors that have a SORP as there is so much variety between the sectors in terms of how a SORP is used, its interaction with regulation and law, and the involvement and attitude of any regulator with responsibilities for reporting in the sector. It may take some time to put the changes into operation in each sector, particularly if regulations or legislation have to be amended. We therefore urge the Board to be proactive in engaging with the relevant SORP-making bodies and relevant sector regulators to ensure that the significance of the proposed changes to UK GAAP is well understood and can be dealt with properly within each sector, particularly in those sectors that have less experience of applying IFRS. Application of the IFRS for SMEs may also have a significant impact on specialised sectors not currently within the SORP regime, such as farming. The Board should ensure that any significant concerns over the proposed changes in accounting requirements are discussed with those sectors at an early stage.

57. We would emphasise that we would not regard SORPs as necessarily 'interpretations' of IFRS or IFRS-based standards, which are quite properly the sole preserve of IFRIC. However, where any are retained, a title such as 'Practice Statement' might be considered as an alternative to 'Statement of Recommended Practice', a more accurate reflection of the role that this type of accounting literature plays in the UK. Discussion with relevant regulators and with industry bodies may also identify issues currently dealt with in SORPs which are unique to the UK, for example where issues arise as a result of the interaction of accounting standards with UK legislation. Care must be taken in assessing whether such issues should remain the subject to review by the Board or whether they could be dealt with outside the annual financial reporting process and it may take some time to put appropriate arrangements in place.
58. Notwithstanding our support for a continued role for SORPs, we would sound a note of caution. The scope and length of SORPs or successor guidance should be kept to a minimum to avoid the development of a complex body of accounting literature, and we would expect that the number of SORPs will fall in the near future, firstly as gaps in IFRS are filled by the IASB, for example in relation to the oil and gas sector and insurance, and secondly, perhaps, with the introduction in the UK of a standard for public benefit entities. In the meantime, whilst the sectors themselves remain best placed to oversee the development and drafting of any future guidance, it is as indicated above important that the Board continues to provide negative assurance statements confirming that nothing in the SORP conflicts with applicable accounting requirements. The Board also has a role here in ensuring that guidance is not given for areas already dealt with in standards, that it does not stray inappropriately into interpretation, and that principles are applied consistently.
59. SORPs relating to public benefit entities are considered in more detail in our response to the next question. Considering each 'for-profit' SORP in turn:

SORP	Recommendation
Financial Reports of Pension Schemes	We agree that a SORP would provide valuable application guidance after convergence.
Accounting for Insurance Business	We agree that the SORP should continue until the publication of the new IFRS. As there is no equivalent to FRS 27 <i>Life Assurance</i> we recommend that the requirements are built into the SORP, ensuring that they are compliant with IFRS 4 <i>Insurance Contracts</i> .
Accounting for Oil and Gas Exploration	We agree that the SORP should be maintained until publication of a new IFRS.
Leases	We agree that the SORP should be maintained until publication of a new IFRS.
Accounting by LLPs	We believe that guidance for LLPs on the application of debt/equity and presentational issues arising from the requirements in IFRS will continue to play a valuable role. (The existence of large LLPs means that this cannot be addressed in the FRSE.)

Association of Investment Companies	The guidance should not be withdrawn while it is still considered to be useful. There may therefore be a period of transition. In the longer term, if the issues are considered to be of a regulatory nature, solutions might be found outside the annual accounts.
Financial Statements of Authorised Funds	This SORP is embedded in a number of regulations from which it would be complicated and costly to extract it. Its contents should be retained where it provides essential guidance on the application of accounting principles to circumstances created by UK regulations.
Banks – segments	We agree that this SORP should be withdrawn.

60. Finally in this context, we would emphasise that the Board should begin working towards the convergence of current SORPs (to the extent they are retained) with IFRS and the IFRS for SMEs at an early date to allow a simultaneous transition to the new UK regime by all UK 'with profit' reporting entities. SORPs can play a major role in assisting specialised sectors navigate the transition to an IFRS based regime.

Q11: Do you agree with the Board's proposal to develop a public benefit standard as part of its plans for the future of UK GAAP? If not, how should (converged) UK GAAP address public benefit entity issues?

61. We support the move to converge the reporting requirements for public benefit entities with IFRS principles, and agree in broad terms with the Board's proposal to develop a public benefit standard in some form, although the Board will need to consider how to put this approach into practice given that the existing SORP regime has generally improved standards of financial reporting. Also, like profit-making entities, some public benefit entities will be publicly accountable, some will satisfy the FRSSE criteria, and others will fall into the mid-tier - unless the public benefit standard is simply applied to all relevant entities in the same way, irrespective of size and public accountability (applying the Board's meaning of the term). In addition to clarifying which tier particular types of entity fall into, the Board will also need to clarify which entities are deemed to be 'public benefit' in nature and therefore within the scope of the standard, and which are not.
62. We do not underestimate the extent of the challenge involved for the Board in this venture and, moreover, for the entire UK public benefit sector. It is important to recognise that a move to IFRS-based standards would represent a significant change for a sector with little experience of IFRS and perhaps fewer resources available to meet the challenges of transition than private sector entities. Despite the challenges involved in establishing an IFRS-based regime for UK public benefit entities, we believe that this is a venture worthy of investigation. It could improve the quality and consistency of financial reporting in the UK, including by public benefit entities that at present are not covered by a SORP or other authoritative guidance on their financial reporting. Indeed, consideration should perhaps also be given to the impact on the financial reporting of a wide variety of entities that have no accounting framework, such as trade unions and livery bodies. A UK standard might also encourage a similar approach in other jurisdictions, and the inclusion of UK public benefit entities in a regime based on IFRS would enhance the transferability

of skills between different sectors and make it easier for any trustees to understand the financial statements. Many public benefit entities operate in 'mixed' groups which include both for-profit and not-for-profit entities, so a universal IFRS-based regime ought to simplify the reporting process; in any case, such mixtures of for-profit and not-for-profit companies within a group will need to be catered for.

63. To avoid unnecessary delays in transition, the Board will need to work towards identifying and removing the barriers to convergence and engaging in dialogue with the relevant regulators at the earliest opportunity. Those regulators need to be conversant with the implications of convergence and take steps to ensure an orderly transition. There will be many issues to be dealt with, such as the approach to consolidation by charities reporting under UK GAAP with non-charitable trading subsidiaries potentially reporting under the IFRS for SMEs.
64. As indicated above, there is also the question of whether some public benefit entities should be deemed to be publicly accountable in the sense defined by the Board, for example because they have listed debt. Such entities are rare, and it is not clear whether it would be appropriate for such entities to follow full EU-endorsed IFRS or instead follow the rest of the public benefit sector in order to be comparable with it. Before a practical solution is determined, it would be useful to better understand how many entities would fall into this category, and whether the work already undertaken by IPSASB in modifying IFRS for use in the public sector provides a useful starting point.

Q12: If you do agree with the proposal to develop a public benefit entity standard, should the standard cover all the requirements for preparing true and fair accounts or should it cover only those issues where IFRS or the IFRS for SMEs needs to be supplemented for the public benefit entity sector.

65. Whilst recognising that in some areas some significant rewriting will be necessary, we would urge that in developing any such standards, those adaptations of IFRS and the IFRS for SMEs necessary to reflect the special features of the public benefit sector be kept to a minimum to ensure a broad consistency in UK financial reporting. This will also ease the updating process. In terms of what is actually published by the Board, it would probably be helpful to preparers to publish a stand-alone public benefit standard that included all the relevant standards, both changed and unchanged from the for-profit version. The adaptations made to the source IASB standards should be clearly highlighted in the public benefit versions.
66. It may be necessary to supplement the core standard(s) with additional application guidance for individual sectors within the not-for-profit sector (such as charities, housing, higher education), retaining the broad approach of the current SORPs. Such additional guidance should be as 'light touch' as possible to reduce the amount of updating required and minimising the risk of it not keeping pace with the underlying standard. This guidance will need to be drawn up in consultation with relevant regulators. A particular issue to be addressed will be the approach to providing guidance to public benefit entities deemed to be publicly accountable (if this distinction is retained in the public benefit sector) and hence subject to the full IFRS regime.
67. We recognise that there is likely to be demand for a separate standard for each major type of public benefit entity, but this is unlikely to be practicable or desirable. Maintenance of the separate standards would be resource-intensive, and there would be a risk of individual standards becoming out of date. A key objective of the current proposals is, moreover, to achieve consistency across all sectors where the

financial reporting considerations are the same. It therefore follows that principles in the public benefit standard(s) should be applied consistently to all transactions with similar characteristics, irrespective of the type of entity, unless a different treatment can truly be justified. The current review of the UK reporting regime is an opportunity to revisit those areas where different practices have evolved in the public benefit SORPs with a view to eliminating inconsistency to the greatest extent possible, and to consider at the same time what other improvements to the content and structure of the current SORPs may be desirable.

68. The Board will need to explore further all the practical implications of operating a parallel three-tier system for the public benefit sector, if that is what is proposed. There will be considerable challenges in maintaining a version of EU adopted IFRS for publicly accountable public benefit entities (as, for example, some UK public benefit entities have publicly traded debt) as well as a public benefit IFRS for SME standard and public benefit FRSSE. As an alternative, the Board might explore whether or not it is feasible to produce a single standard that meets the needs of all public benefit entities, including those very small entities that prepare GAAP financial statements.

Q13: Do you agree the issues listed in the above table are distinctive for the public entity sector and should therefore be covered in a public entity standard? What other issues might the proposed standard include?

69. We agree that the issues listed are distinctive and should therefore be covered either in the public benefit entity standard or supplementary practice guidance. The list is a good starting point but there will inevitably be more issues to add. We therefore suggest that it may be more useful to identify broad categories of issues, such as:
- Non-reciprocal arrangements;
 - Presentation/narrative; and
 - Revenue from non-exchange transactions.

Q14: The Board accepts there may be a continuing need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. Where this is the case, do you think the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?

70. As noted above, we consider that some supplementary guidance for individual sectors is desirable and that the Board should provide assurance that any guidance is consistent with the IFRS for SMEs as applied in the UK.

Q15: If you are an entity whose basis for preparing financial statements will change under the proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as is appropriate. If you are a user of financial statements (such as an investor or creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?

71. Whilst it is reasonable for the Board to pose these questions, based on past experience we doubt that sufficient information will be elicited by this means and that the Board will need to approach relevant interested parties more directly to get the information. We would suggest that the cost/benefit analysis should be conducted as broadly as possible and should include the taxation impacts of moving to the IFRS for SMEs, and the benefits of a simplified regime, including a reduced risk of error.

The Board should also consult with regulators to ensure that benefits are not claimed simply by shifting undue costs to other agencies.

72. As explained in more detail in paragraph 53 above, any cost/benefit analysis should reflect the additional costs borne by accounting firms which advise clients and prepare accounts under more than one reporting regime. Although there will be costs associated with moving to a new reporting regime, in the long run we expect this to be less expensive than running parallel sets of standards. The costs involved will of course vary from firm to firm depending on the diversity of their clients and their reporting needs. Some cost/benefit considerations can also be gleaned from the transition to IFRS in the listed and AIM sectors, including for example the need to change relevant documentation, including financial statement-based covenants in loan agreements.

Q16: What are your views on the proposed adoption dates?

73. A transition date (or, as discussed below, dates) should be established as soon as possible, but the priority should be minimising disruption and cost for entities affected. The Board makes it clear that the public benefit proposals will be subject to a further separate consultation, and it is important to recognise that the sector faces its own, distinct challenges. We would not wish any delays in the implementation of changes to the requirements for the regime for public benefit entities (of for FRSE companies) to delay changes for Tier 2 entities in the 'for-profit' sector.
74. It is important to avoid a period of protracted changeover, whilst recognising the difficulties many will face in moving to IFRS, and ensuring adequate resources are in place to provide support for the entities affected. In some areas, notably accounting for financial instruments, the requirements of the IFRS for SMEs are substantially different from UK GAAP. Reporting entities, training organisations, software houses and other interested parties should have sufficient time to plan an efficient and orderly transition. Transition in 2012 may well be achievable for Tier 2 entities in the 'for profit' sector, depending on the duration of any further consultation process, although the Board should consider carefully whether current economic circumstances mean that such an early date might result in unnecessary additional burdens for business. However, given the complexity of the issues to be addressed in relation to the not-for-profit sector, 2012 might not be a realistic objective for that sector.
75. We assume that early adoption will be permitted, and this may prove a popular option. However, the key objective is to get the new regime in place as early as possible before any mandatory application date, to enable reporting entities and their advisers to plan accordingly, aware of which standards they will be required to follow under the new regime well before the mandatory application date.
76. Finally, we note that it will be necessary to agree upon a definition of "public benefit entity" at an early stage to facilitate a phased implementation.

APPENDIX

CONSOLIDATED ACCOUNTS - UK COMPANY LAW EXEMPTION

- A1. The IFRS for SMEs provides an exemption from preparing consolidated financial statements only where the company is included in the consolidated financial statements of a larger group which prepares those financial statements under IFRS or the IFRS for SMEs (and certain other conditions are met). This is narrower than existing UK GAAP under company law and FRS 2. This may be seen as a significant disadvantage of using the IFRS for SMEs in unamended form as Tier 2 UK GAAP.
- A2. Those companies eligible to use the small companies' regime under the law will not be affected while they continue to prepare their financial statements in accordance with the FRSSE. Medium-sized groups no longer benefit from an exemption under the 2006 Act on the grounds of size. However, many companies use the exemptions in ss.400 and 401 of the Companies Act 2006 based on consolidation into a larger group. Under the law, the consolidated financial statements of the larger group may be prepared under the GAAP of another EEA state or one that is deemed to be equivalent, for example US GAAP. These groups would not be eligible for an exemption from preparing consolidated financial statements under the IFRS for SMEs.
- A3. The same companies would be entitled to use the exemptions in ss.400 and 401 if they prepared their financial statements under IFRSs as adopted by the EU. Thus, it appears that a company which makes use of one of the exemptions in the law but would be required by IAS 27 to prepare consolidated financial statements will nevertheless be able to claim compliance with IFRSs as adopted by the EU. This matter has been discussed on various occasions by the Accounting Regulatory Committee of the European Commission, including at its meeting on 2 February 2007. No formal guidance has been issued by the Commission on this matter but substantive agreement has been reached that the requirements of IAS 27 for consolidated financial statements do not apply, for IFRSs as adopted by the EU, if the company is not required by the Seventh Directive to prepare group accounts. This is a surprising conclusion given that IAS 27 was adopted by the EU without any amendments. Nevertheless, it is the view of the Commission that those parts of IAS 27 that deal with consolidated financial statements are relevant only in those cases where such financial statements are required by EU law. Companies which make use of this interpretation of EU law should recognise that they will not be able to claim compliance with 'full' IFRSs as issued by the IASB and should consider any commercial or regulatory implications of this.
- A4. It would be unacceptable for Tier 2 companies applying the IFRS for SMEs to have to prepare consolidated financial statements in circumstances where they would not have to do so if they were required (or chose) to apply IFRS as adopted in the EU.
- A5. There are potentially two ways to address this.
- (a) Apply an argument similar to the one set out above for companies reporting under IFRS. However, the conclusion was in the context of the IAS Regulation and is not directly applicable to the relationship between the law and national accounting standards. Also, following this route may set a doubtful precedent that exemptions in the law may take precedence over the requirements of accounting standards. For example, this would imply that medium-sized companies should be exempt from making related party disclosures even though this is required by FRS 8.

- (b) The alternative, which appears to be preferable, is to make a specific amendment to the way that the IFRS for SMEs is applied in the UK. Thus, add that:
'In addition to the exemption in paragraph 9.3, a parent company need not present consolidated financial statements if it is entitled to one of the exemptions in ss.400 or 401 of the Companies Act 2006, or would be so entitled if it were a company.'

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