07 July 2010

Our ref: ICAEW Rep 64/10

Your ref:

David Tyrrall
Corporate Law & Governance Directorate
Fair Markets Group, 1 Victoria Street
London SW1H 0ET

Dear David

THE PARTNERSHIPS (ACCOUNTS) REGULATIONS 2008 (S.I. 2008/569): TECHNICAL DEFECT IN DEFINITION OF "QUALIFYING PARTNERSHIP"

1. The ICAEW welcomes the opportunity to comment on the consultation paper The Partnerships (Accounts) Regulations 2008 (S.I. 2008/569): Technical Defect In Definition Of "Qualifying Partnership"published by The Department for Business Innovation and Skills (BIS) in April 2010.

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 by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with 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. We ensure these skills are constantly developed, recognised and valued.

4. We are aware that many partnerships in the Private Equity and Venture Capital sector have interpreted the regulations in S.I. 2008/569 (and in its predecessor, S.I 1993/1820, which contained the same provisions but was reissued to take account of the Companies Act 2006) as meaning that a qualifying partnership is one in which all the partners have limited liability (or be partnerships all of whose members have limited liability). S.I. 2008/569, Regulation 2(2) provides that members of a 'qualifying partnership' should be read as meaning only the General Partner. However, Regulation 3 determines whether a partnership is a 'qualifying partnership' by reference to each of its members. Arguably, this is circular (which you acknowledge in your consultation letter) and the confusion is exacerbated by the Explanatory Note, which provides that the scope of the regulations includes, in effect, partnerships and limited partnerships all of whose members have limited liability" *[our emphasis]* and so would appear to support this interpretation.

5. This interpretation, which is also favoured by the leading text on partnership law, Lindley and Banks on Partnership[1], effectively means that provided at least one of the partners (including a limited partner) has unlimited liability, the partnership is not a qualifying limited partnership and thus is not required to file accounts drawn up as if subject to the Companies Act 2006. We are aware that many partnerships have established themselves with a UK general partner with limited liability on the basis of this interpretation, having obtained various legal opinions to this effect.

6. Given the widespread support for this interpretation, and the circularity that you yourself acknowledge in your consultation letter, we are very concerned that any amending regulations should not put such existing partnerships in an untenable situation. Therefore, the amending regulations should make it very clear that this interpretation of 'qualifying partnership' in S.I. 2008/569 is not invalid, and that partners in such partnerships that have not filed accounts prepared in accordance with the Companies Act have not committed offences under Regulation 16. We do not believe the amending regulations currently achieve this, in particular, the Explanatory Note merely states they are clarifying how the regulations apply in relation to limited partnerships, and we believe a clearer acknowledgement of the validity of the above mentioned interpretation is needed.

7. We note that, once the proposed amendment regulations come into force, they will require investment funds that have been set up as partnerships with a general partner with limited liability to file accounts prepared in accordance with the Companies Act consolidating any investee entities where the partnership is deemed to have control over them (likely to be the case in buy out funds). In order to meet the consolidation requirement, such partnerships would need to obtain financial information from each such investee entity prepared under UK GAAP, not only for the current year and the prior year but also so as to enable acquisition accounting adjustments to be made. This information may not be readily available from such investee entities, for example, they may have non-co-terminus accounting periods or be situated outside the UK, and so these existing partnerships will need time to prepare in order to ensure they can obtain the necessary information. If the amended regulations were to apply to accounting periods commencing on or after 1 October 2010 (as is proposed in the consultation), this would put such existing partnerships in a difficult position as the information would have to be gathered relating to prior years (ie years commencing before 1 October 2010, all the way back to original acquisition). This is no small task. It may not be possible to effect an accurate transition to a consolidated basis in the time available. Therefore, we believe that at least in respect of existing partnerships, the amending regulations should apply to accounting periods commencing on or after 1 October 2011 at the earliest.

8. We are very concerned that, if the Government pushes ahead with the proposed shorter timetable for the proposed amending regulations, this will impose a period of disproportionate burden and expense for existing limited partnerships that have established themselves under S.I. 2008/569 (or predecessor instrument) and their portfolio companies (many of which are already suffering from the recession and most of which will be private companies) that have established themselves under S.I. 2008/569. We therefore strongly disagree with the assertion in the final paragraph of the explanatory note stating that: "*An Impact Assessment has not been produced for these Regulations because it is not expected that they will cause any additional costs."* We are also concerned that new funds will be set up outside the EU so as to avoid this burden, leading to an inferior competitive position for those funds already in existence as UK Partnerships.

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[1] Lindley and Banks on Partnership, 31-25 [p154], which states that where <u>all</u> partners are companies, the accounts of the partnership will have to be drawn up in compliance with the regulations. It refers to speculation that a limited partnership comprising a corporate general partner and individual limited partners may be affected by the [regulations], but states in the editor's opinion that would be to mis-read the [regulation], which does not purport to amend the definition of qualifying partnership but merely the subsequent references to it members eg preparing accounts. Had such a provision not been made, the limited partners might have been obliged to undertake functions that would place them in breach of the prohibition on participation in management and thus lead to forfeiture of their limited liability.

9. We also believe that the consolidation of private equity portfolio companies does not produce the most meaningful information to investors as such organisations are not run as operating groups and investments are made to obtain income and capital gains over a limited period. This is supported by the recent deliberations of the IASB who have concluded that investment entities such as private equity should not consolidate such portfolio companies but adopt fair value accounting. A new exposure draft in this regard is expected soon, so it is likely to become an IFRS requirement within the next few years (and we're not aware of any obstacles to EC endorsement of such a requirement). We would hope that the UK ASB would be supportive of this initiative but such a change in UK GAAP might require a change to the EU seventh company law Directive which will take time to achieve.

10. The consequences of this amendment would therefore be to require an expensive and sub-optimal exercise of consolidation for a short period until either: IFRS is amended and endorsed and thus partnerships can switch to IFRS; or the EU seventh company law Directive is brought in line with IFRS to enable UK GAAP to adopt the same consolidation exemption. Conversion to IFRS would be a burdensome exercise and so the less costly approach is to amend UK GAAP, but given the time it takes to change Directives, the UK private equity industry could be faced with this dilemma even if the implementation is delayed as is suggested in this letter.

11. We would therefore urge BIS to seek amendment to the EU seventh company law Directive as a priority so as to avoid the above and require single line fair value accounting. This needs to be done on a pro-active basis so as to shorten the timetable as much as possible. That is to say, it would be unhelpful to do nothing until the IASB has issued an amendment. The EC needs to have the work done and be ready to move forward with a Directive amendment as soon as the IASB issue its own amendment. This would also avoid a major discrepancy between IFRS and the Companies Act which, in principle, we believe should be discouraged as a matter of policy. We would also urge BIS to consider delaying the implementation as long as possible to allow fair value accounting to be implemented rather than consolidation as this would be more meaningful for investors, and would be less burdensome but more valuable than consolidation.

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

Yours sincerely

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