ACCOUNTING STANDARDS BOARD AUGUST 2009 CONSULTATION PAPER

CONSULTATION PAPER

POLICY PROPOSAL:

THE FUTURE OF UK GAAP

ACCOUNTING
STANDARDS
BOARD

For ease of handling, we prefer comments to be sent by email to:

ukgaap@frc-asb.org.uk

Comments may also be sent in hard copy form to:

Peter Godsall
ACCOUNTING STANDARDS BOARD
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

Comments should be despatched so as to be received no later than 1 February 2010. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

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

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

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

Copies of comments will also be forwarded to the UK Department for Business, Innovation & Skills (BIS) to assist it in considering the implications of this consultation on financial reporting requirements in the UK. BIS does not intend to publish comments forwarded to it by the ASB.

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INVITATION TO COMMENT

The ASB is requesting comments by the 1 February 2010. Comments are invited on any aspect of the policy proposal, and in particular the questions outlined in this proposal.

Question 1 – Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the current 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 alternative would be?

Question 2 – Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

Question 3 – Do you agree with the Board's proposal that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS? If not, why not?

Question 4 – 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.

Question 5 – Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?

Question 6 – 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.

Question 7 – Do you agree with the Board's proposal 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.

Question 8 – Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?

Question 9 – 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?

Question 10 – Do you agree with the Board's current views on the future role of SORPs. If not, why not?

Question 11 – Do you agree with the Board's proposal to develop a public benefit entity standard as part of its plans for the future of UK GAAP? If not, how should (converged) UK GAAP address public benefit entity issues?

Question 12 – 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 view 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?

Question 13 – Do you agree the issues listed in the above table are distinctive for the public benefit entity sector and should therefore be covered in a public benefit entity standard? What other issues might the proposed standard include?

Question 14 – 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?

Question 15 – If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as 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?

Question 16 – What are your views on the proposed adoption dates?

SECTION 1 INTRODUCTION

The Future of UK GAAP – What we want to achieve

1.1 The purpose of this document is to set out the Accounting Standards Board's (ASB's) strategy for the future basis of UK/Irish Generally Accepted Accounting Practice (GAAP)* (hereinafter referred to as UK GAAP) and its convergence with International Financial Reporting Standards (IFRS). The intention is to work under the IASB framework and to converge to the fullest extent possible consistent with the needs of UK entities. As a consequence of the Board's proposed approach, the separate body of literature currently referred to as UK GAAP will cease to exist. That said, the ASB is not relinquishing the right to set UK GAAP, but all existing literature would be superseded. The Board's current intention at the end of the consultation process is to issue an exposure draft (ED) withdrawing existing UK literature and putting the new literature in place. It will be through this mechanism that modifications, if any, to the application in the UK of the underlying IFRS literature would be proposed.

1.2 In summary, the Board's proposals set out a differential reporting regime based on public accountability. The Board envisages that the UK framework under the proposals outlined in this document would be as follows:

Accounting Regime	**Type/Nature of Entities**
Tier 1 EU adopted IFRS	EU listed – consolidated AIM IEX† Publicly accountable including Publicly accountable 100%subsidiaries

* *Throughout this policy statement the term "UK GAAP" is used to refer to financial reporting requirements in the United Kingdom and the Republic of Ireland.*

† *Entities with shares listed on the Irish Enterprise Exchange.*

Accounting Regime	Type/Nature of Entities
Tier 2 IFRS for SMEs	Non-Publicly Accountable Entities
Tier 3 FRSSE	Small (as at present)

1.3 Under these proposals all entities will have the option (similar to the arrangements under the current law, with the exception of charitable companies) to voluntarily adopt a higher tier. For example, entities applying the Financial Reporting Standard For Smaller Entities (FRSSE) could opt to apply the IFRS for Small and Medium-sized Entities (SMEs) or EU adopted IFRS and large and medium Non-Publicly Accountable Entities (NPAEs) could opt to apply EU adopted IFRS. An entity may elect to do so because it is part of a group that reports under IFRS or because of the nature of its business IFRS provides better information that in turn may facilitate easier access to capital markets.

1.4 In developing these proposals, the ASB has worked with the UK Department for Business Innovation & Skills (BIS) in considering issues arising from the interaction between accounting standards and the law, including the definition of public accountability to be used. The detail of the major approaches available is set out in paragraphs 2.5 onwards.

Background

1.5 Financial reporting plays a crucial role in communicating information about an entity's financial performance and standing. It is the means by which to evaluate management's stewardship of resources and for investors and creditors, as principal users, to gain an understanding of the financial health of an entity.

1.6 The ASB is committed to strengthening financial reporting requirements in the United Kingdom and the Republic of Ireland to ensure that its requirements remain effective and offer high levels of transparency and accountability.

However, the ASB recognises the ever increasing burden being placed on entities in respect of reporting requirements under various regulatory regimes, so it has been careful to frame these proposals within the context of the principles of better regulation. Those principles require regulation to be *proportionate, accountable, consistent, transparent and targeted*[*].

1.7 Our ambition in setting out the proposals in this policy paper is to develop a high-quality, fit-for-purpose, financial reporting framework that addresses comprehensively all entities required to prepare financial statements (other than those in the public sector whose accounting standards were set by the Government) in accordance with UK GAAP. Realising this ambition will put the UK and the Republic of Ireland at the forefront of financial reporting.

1.8 The Board believes that these proposals will improve financial reporting in the following ways:

(i) reporting arrangements will be simplified by having more targeted and proportionate reporting requirements based on the nature of an entity's accountability obligations and its size;

(ii) basing UK GAAP on IFRS provides a consistent basis for preparing financial reporting and also reduces the burden associated with understanding and complying with differences in reporting requirements and interpretations of accounting principles. There are also advantages in terms of accounting education and professional development of accountants and auditors;

(iii) improved comparability and understandability of financial reports will also assist in accessing capital

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[*] *The latest version (dated April 2009) of the Financial Reporting Council's (FRC's) 'Regulatory Strategy: Our Role and Approach' can be accessed at: http://www.frc.org.uk/publications/pub1960.html.*

markets in building investor and creditor confidence and in strengthening transparency; and

(iv) enables the UK and the Republic of Ireland to devote their standard setting resources to influencing the IASB and ensuring that IFRS satisfies the needs of constituents in the region.

Who will be affected by these proposals?

1.9 These proposals are intended to apply to all entities, other than those in the public sector, in the United Kingdom and the Republic of Ireland that are required to prepare financial statements that give a 'true and fair' view. That includes companies and other corporate structures in both the for profit and public benefit entity (also known as not-for-profit)* sectors. They therefore encompass all the entities that are currently required to apply UK GAAP including those that presently apply the industry-specific guidance contained in the Statements of Recommended Practice (SORPs). It excludes those public sector entities for which government directly sets financial reporting requirements. We acknowledge the scale of such a proposal but consistent with our ambition we want to take this opportunity to deal with UK GAAP in a comprehensive manner to ensure reporting requirements are effective but simplified and produce more relevant, comparable and understandable information.

1.10 This will be a significant step in creating a common financial reporting language in the UK and the Republic of Ireland. In the Board's view, it will potentially reduce costs of compliance with complicated financial reporting requirements and assist those who rely on published financial statements to make well informed decisions.

* *For the purposes of this paper a public benefit entity/'not-for-profit' is defined as 'an entity whose principal objective is to satisfy social and other aims and not the pursuit of profit'.*

Our Approach in Developing these Proposals

1.11 The ASB has been in dialogue with its constituents on the future of UK GAAP since 2004. Consistent with the approach adopted in the European Union (EU), and many other jurisdictions, the ASB's overarching strategy is to achieve convergence with IFRS. The widespread adoption and recognition of IFRS around the world make them the most obvious basis for UK GAAP. That view received strong support from our constituents. However, the view was also expressed to the ASB that the full suite of IFRS may not be the most appropriate basis for preparing financial statements for all entities in the UK and the Republic of Ireland. A summary of the consultations and responses to previous consultations is at Appendix A.

1.12 The proposals set out in this paper provide for a more targeted approach to ensure we achieve an appropriate balance between less complex financial reporting requirements and providing relevant and understandable financial information that contributes to discharging stewardship obligations and decision making.

1.13 The ASB is aware that previous consultations have not directly addressed financial reporting requirements for public benefit entities and we want to use this consultation as an opportunity to consider what would constitute an appropriate financial reporting framework for such entities – recognising the significant diversity not just in terms of the size of such entities but in the breadth of activities they encompass. We do believe that the principles of better regulation that underpin the proposals set out for profit seeking entities apply equally to the public benefit sector. Given we have not directly engaged with the public benefit sector in previous consultations, we have set out our initial proposals for entities in that sector in Section 3: Financial Reporting for Public Benefit Entities.

1.14 We recognise the importance of ensuring these policy proposals can be implemented effectively and achieve the improvements we are seeking. The understanding of the effects of these proposals across the UK and the Republic of Ireland is vitally important to us and is why we have given greater prominence in this proposal to discussing the effects of what we are proposing and our intended outcomes. As standard setters, we take seriously our obligations to ensure that the policies we set are backed up by evidence and are effective. The effects of implementing these proposals are discussed in Section 4: Testing our Assumptions.

The Role of the IFRS for SMEs in UK GAAP

1.15 The ASB has stated on several occasions that it considers that the IFRS for SMEs could play a significant role in the future reporting requirements for UK and Irish entities. The IASB has now finalised the IFRS for SMEs and the standard can be accessed from the IASB's website at http://www.iasb.org/IFRS+for+SMEs/IFRS+for+SMEs.htm. A high-level summary of the scope of the standard is at Appendix C.

1.16 One of the main legal implications of the proposals set out in this document is to confirm that using the IFRS for SMEs as the basis of future UK GAAP for certain categories of entities is compatible with the requirements of the Accounting Directives. The staff of the ASB has undertaken some preliminary work on this issue, and is continuing to examine the issue with a number of other organisations. On the basis of its work to date, the ASB staff view is that there are no conflicts that would present an insuperable legal barrier to the Board using the IFRS for SMEs as the basis of UK GAAP.

1.17 It is also the case that the European Commission is taking forward a number of initiatives to simplify the requirements of the Accounting Directives, which could have an impact on the compatibility with the Directive of the IFRS for SMEs:

a. in February 2009, the Commission put forward a proposal* which would allow Member States to exempt 'micro-entities'† from the accounting requirements under the law. At the time of writing, the proposal is being considered by the European Parliament and the Council of Ministers; and

b. also in February 2009, the Commission launched a review of the Accounting Directives‡ with the aim of modernising and simplifying the legislation. The Commission is working on a legislative proposal for approval by the College of Commissioners, probably in 2010.

How do the proposals fit with the current law?

1.18 In the UK, companies are required to prepare their accounts in accordance with either the Companies Act 2006§ and UK Generally Accepted Accounting Practice (UK GAAP) or international accounting standards (IAS, also referred to as International Financial Reporting Standards, IFRS) as adopted by the European Commission (EU adopted IFRS).

1.19 EU Regulation 1606/2002 on the application of International Accounting Standards|| (the IAS Regulation) requires that companies governed by the law of a Member State, whose securities are admitted to trading on a regulated market in the EU (publicly traded companies) are required to

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* *The proposal and accompanying material can be accessed on the European Commission website at: http://ec.europa.eu/internal_market/accounting/sme_accounting/legal_proposals_en.htm.*

† *Defined as those companies that on their balance sheet dates do not exceed the limits of two of the three following criteria: balance sheet total of EUR 500,000, net turnover of EUR 1,000,000 and an average number of employees during the financial year of 10.*

‡ *The details of the review can be accessed on the European Commission website at: http://ec.europa.eu/internal_market/accounting/sme_accounting/review_directives_en.htm.*

§ *The equivalent legislation in the Republic of Ireland is the Companies Acts 1963 to 2009.*

|| *Regulation (EC) No. 1606/2002 of the European Parliament and the Council of 19 July 2002 on the application of international accounting standards. Official Journal (OJ) L 243/1 of 11 September 2002.*

prepare their consolidated accounts on the basis of EU adopted IFRS, that is accounting standards issued by the International Accounting Standards Board (IASB) that are adopted by the European Commission.

1.20 Article 5 of the IAS Regulation gives Member States the ability to extend the use of EU adopted IFRS to:

a. the individual accounts of publicly traded companies; and

b. the consolidated and/or individual accounts of companies other than publicly traded companies.

1.21 In August 2002, the then Department for Trade and Industry (DTI) issued a consultation document 'International Accounting Standards' on the possible extension of the IAS Regulation. Following that consultation, the Government decided that companies would be permitted to choose whether to switch the basis of preparation of their accounts to EU adopted IFRS. Following a further consultation document 'Modernisation of Accounting Directives/IAS Infrastructure'* issued by DTI and HM Treasury in March 2004, the Government maintained the option for companies (other than charitable companies) to switch to EU adopted IFRS and extended the option to building societies, Limited Liability Partnerships (LLPs), and to certain banking and insurance entities† .

1.22 In the March 2004 document, the Government stated that ultimately it would be preferable for all companies to use the same accounting framework and said that it would review after 2008 the impact of the IAS Regulation to establish

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* *The March 2004 Consultation Document can be accessed on the HM Treasury website at: http://www.hm-treasury.gov.uk/consult_fairvalue_index.htm.*

† *DTI October 2004 'Accounting Modernisation Directive and Arrangements for the Use of IAS for Companies and Building Societies: Summary of Responses to the Consultation on the Implementation'. Available at the HM Treasury website address given in footnote 3.*

whether it would be appropriate to mandate wider use of EU adopted IFRS, with the timing dependent in part on the development by the ASB of a regime for smaller companies.

1.23 The majority of companies and other entities in the UK and Republic of Ireland have not opted to prepare their accounts under EU adopted IFRS and continue to be subject to companies legislation, which implement into national law the provisions of the EU Accounting Directives*, and to prepare their accounts in compliance with the ASB's accounting standards.

* *Primarily the Fourth Council Directive of 25 July 1978 (78/660/EEC) on the annual accounts of certain types of companies (OJ L222/11 of 14 August 1978) and the Seventh Council Directive of 13 June 1983 (83/349/EEC) on consolidated accounts (OJ L193/1 of 18 July 1983), both as amended.*

SECTION 2 PROPOSALS FOR PROFIT SEEKING ENTITIES

2.1 This section deals with companies and other corporate structures that are profit seeking and which are required to give a 'true and fair' view. Public benefit entities such as charities are covered in Section 3.

Proposal for consideration

2.2 The ASB recognises that there are several ways in which it could establish whether an entity has accountability to the public. The core proposal in this consultation is that publicly accountable entities should prepare financial statements in accordance with IFRS as adopted in the EU. All other entities may elect to apply IFRS but are not required to do so. Accordingly, under the proposed framework:

(i) (a) all consolidated accounts of publicly traded companies* continue to comply with EU adopted IFRS†;

(b) a company reporting under the Companies Act may elect to prepare its accounts in accordance with EU adopted IFRS.

(ii) For entities that do not fall into either of the two categories above:

(a) an entity which has public accountability (a "publicly accountable entity") should prepare its accounts (both consolidated and individual accounts) in accordance with EU adopted IFRS.

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* *See paragraph 1.19 for the explanation of what is referred as publicly traded companies.*

† *AIM companies are also required to comply with this requirement in accordance with the AIM Rules for Companies http://www.londonstockexchange.com/companies-and-advisors/aim/documents/aim-rules-for-companies.pdf.*

(b) an entity currently able to use the Financial Reporting Standard for Smaller Entities (the FRSSE), which includes those that do not exceed two or more of the following criteria:

Turnover – £6,500,000,
Balance Sheet Total – £3,260,000,
Average number of employees – 50*

is able to continue to prepare its accounts using the FRSSE.

(c) an entity that is not publicly accountable and is not able to use the FRSSE, could prepare its accounts using the IFRS for SMEs.

2.3 An entity has public accountability if:

(i) 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 (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(ii) it is a deposit-taking entity and/or holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities broker/dealer, mutual funds or investment banks.

2.4 An entity that is not publicly accountable that is currently able to use the FRSSE may, if it chooses, prepare its accounts using the IFRS for SMEs or EU adopted IFRS.

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* *In the Republic of Ireland, section 8 of the Companies (Amendment) Act, 1986 (as amended by Regulation 4 of the European Communities (Accounts) Regulations, 1993 (S.I. No. 396 of 1993) specifies the size criteria for Irish companies: turnover €3,809,214, balance sheet total €1,904,607, employees 50.*

Discussion

Defining a 'publicly accountable entity'

2.5 The notion of public accountability is not a new one and the Companies Act 2006 (CA 2006) and EU directives apply the notion in determining the appropriate reporting requirements for entities under the law. Based on the legal form and nature of an entity's activities, some small and medium sized entities (under sections 384 and 467 respectively) are currently deemed to be publicly accountable and hence subject to more demanding financial reporting requirements (ie existing full UK GAAP). Using the current legal definitions, there is an argument that large entities are effectively deemed to have public accountability too. The definitions in CA 2006 provide that:

(i) Section 384 – companies may not use the small companies regime if they are:

(a) a public company,

(b) a company that –

(i) is an authorised insurance company, a banking company, an e-money issuer, an ISD investment firm or a UCITS management company, or

(ii) carries on insurance market activity, or

(c) a member of an ineligible group.

(ii) Section 467 – companies are not entitled to take advantage of any of the provisions of this part relating to companies qualifying as medium-sized if it was at any time within the financial year in question;

(a) a public company,

(b) a company that –

(i) has permission under part 4 of the Financial Services and Markets Act 2000 (c.8) to carry on a regulated activity, or

(ii) carries on insurance market activity, or

(c) a member of an ineligible group.

2.6 If the current legal definitions are used it could imply a future framework as follows:

Entity Size	**Accounting regime**
Listed Consolidators to which the IAS Regulation currently applies.	EU adopted IFRS
Large*	EU adopted IFRS
Medium†	IFRS for SMEs &/or EU adopted IFRS
Small‡	FRSSE

2.7 The Board's preference is to adopt a more generic definition than that currently in law in order to ensure that all entities that have a public accountability apply financial reporting requirement best suited to discharging their stewardship and accountability obligations. However, the Board recognises that both approaches have their merits.

* *Large means those entities that do not qualify as either 'small' or 'medium' under the Companies Act 2006 (CA 2006).*

† *For individual and consolidated accounts of medium sized companies as defined under sections 465 to 467 in Part 15 of CA 2006.*

‡ *For individual and consolidated accounts of small companies as defined under section 382 of CA 2006. This excludes those companies that do not qualify as 'small' under section 384 of CA 2006.*

2.8 The definition of what is a publicly accountable entity, as set out in paragraph 2.3, is broadly taken from the IFRS for SMEs, with one exception. In paragraph 2.3(ii) the IASB's definition does not refer to deposit-taking entities, but simply those that hold assets in a fiduciary capacity. In the Board's view, deposit-taking entities such as banks and credit unions do not hold assets in a fiduciary capacity, although the Board agrees that they are publicly accountable. The proposed amendment to the definition seeks to make that clear.

2.9 The ASB and BIS will, at the Exposure Draft stage, explore more fully the most appropriate mechanism to implement a public accountability basis for differential reporting framework and its consequential impact on other reporting requirements. Taking these proposals forward may require changes to the law.

Q1 Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the current 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 alternative would be?

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

2.10 The remainder of this section discusses the ASB proposals based on the notion of public accountability set out in paragraph 2.3.

Tier 1 – Those Entities that are 'Publicly Accountable'

2.11 As set out above, the ASB is proposing that all publicly accountable entities should use EU adopted IFRS. The requirement applies to entities regardless of their size, and so a relatively small entity could fall into the top tier.

2.12 In the May 2006 consultation on convergence (Press Notice, PN 289), one of the Board's tentative proposals was that all public quoted and other publicly accountable companies should be required to apply full IFRS, irrespective of turnover and whether they prepare group accounts or not. The Board view was that companies whose securities (both equity and debt) are traded on an exchange have a larger duty to the public and should be required to apply full IFRS.

2.13 In thinking about which other entities (other than those publicly quoted) might come within the definition of public accountability, there are two broad issues that could be taken into account: the nature of the entity, and its size. A number of respondents to PN 289 argued that, even if the nature of an entity implied that it fell within the public accountability definition, size was also a factor that needed to be considered. For example, many UK building and friendly societies are small and some argue that there will be no benefit to individual members of the extension of EU adopted IFRS to all such societies. Some argued that being large, even if unlisted, makes an entity publicly accountable. Other respondents, in particular from the public benefit entity sector, argued that the nature of the entity could mean that EU adopted IFRS was not appropriate, even if it was deemed to be publicly accountable, as IFRS was not designed for such entities. Having considered all these views the Board is of the opinion that if an entity is deemed to be publicly accountable it should be required to apply EU adopted IFRS irrespective of size.

Wholly-Owned Subsidiaries

2.14 The Board discussed at some length how wholly-owned, publicly accountable, subsidiaries of group companies that apply EU adopted IFRS should report in the future. The Board's discussions have been held against the backdrop of a wider consideration by the UK Financial Reporting Council

(FRC)* of the role and purpose of the accounting by the wholly-owned subsidiaries of publicly traded companies. The Board has considered the following options for the subsidiary accounts:

- EU adopted IFRS; or
- EU adopted IFRS with reduced disclosure requirements (ie the option the Board was minded to consider in its April 2007 consultation, see Appendix A).

2.15 The Board also discussed the reduced disclosure option. Under current UK GAAP, limited exemptions from disclosures are available to subsidiaries in the following areas: cash flow statements†, related party disclosures‡, segmental reporting§ and financial instruments.||

2.16 The Board considered that there could be two ways to address the reduced disclosure option, namely:

(a) review EU adopted IFRS and 'carve-out' specific disclosure requirements; or

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* *As set out in the FRC discussion paper 'Louder than Words: Principles and actions for making corporate reports less complex and more relevant' (June 2009).*

† *FRS 1 applies to all financial statements except those of subsidiary undertakings where 90% or more of the voting rights are controlled within the group, provided that consolidated financial statements in which the subsidiary undertakings are publicly accountable.*

‡ *FRS 8 grants certain exemptions to 100% subsidiary undertakings whose voting rights are controlled within the group. These subsidiaries do not have to disclose transactions with other group companies or investees of the group qualifying as related parties.*

§ *SSAP 25 permits a subsidiary that is not a public limited company or a banking or insurance company not to comply with the SSAP if its parent provides segmental information in compliance with this SSAP.*

|| *FRS 29 grants exemptions from this standard to subsidiary undertakings, other than banks or insurance companies, 90% or more of whose voting rights are controlled within the group provided that the entity is included in publicly available consolidated financial statements which include disclosures that comply with the standard.*

(b) to allow subsidiaries to use 'full' IFRS for recognition and measurement – to align with group reporting and reduced disclosures as set out in the IFRS for SMEs.

2.17 Option (b) above was considered and rejected by the IASB when developing the IFRS for SMEs. In addition, such an option would create a whole tier of reporting requirements just for publicly accountable subsidiaries.

2.18 The Board decided that the effect of modifying disclosure requirements would be marginal. Given the 'true and fair' requirement for accounts under the law, the Board was unable to identify any significant disclosures that would materially reduce the existing disclosure requirements for subsidiaries. Accordingly, it was not clear to the Board that pursuing a policy of reduced disclosures would lead to a net benefit.

2.19 While acknowledging that reduced disclosures was a preferred option from the feedback to the 2006 consultation, in the light of the above considerations, the Board is currently minded to propose that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS. For all other subsidiaries that are not publicly accountable the option to use the IFRS for SMEs exists.

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

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.

Tier 2 – The IFRS for SMEs

2.20 The Board considers that the IFRS for SMEs could be used by all those entities not deemed to be publicly accountable, ie not included in the 'Tier 1' section of this proposal and not entitled to use the FRSSE as outlined in the 'Tier 3' section.

2.21 The ASB considered whether it should require the IFRS for SMEs as published by the IASB in this tier, or whether it should amend the IFRS for SMEs for UK and Irish application. Some take the view that if the standard in a number of areas was not appropriate (tax in particular is a common area of concern) the ASB should consider amending the IFRS for SMEs for UK and Irish application. Others take the view that it would be preferable not to make amendments (other than any that might be required to meet legislative requirements), as the ASB would then be into its own care and maintenance regime for this standard. Even if the policy is to keep any amendments to a minimum, once the principle of making changes is established, it potentially opens the Board to lobbying for many other changes.

2.22 On balance, the Board considers it should not amend the IFRS for SMEs at the present time.

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

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 you think should be made, as well as the reason for recommending these amendments.

Large Non-Publicly Accountable Entities

2.23 The issue over the most appropriate reporting for large Non-Publicly accountable entities as well as Private companies and Private Equity was given specific consideration. The Board on balance considers, regardless of size, that – as these entities are deemed not to be 'publicly accountable' – they should be permitted to adopt the IFRS for SMEs, although adopting EU adopted IFRS would still remain an option for them. The Board acknowledges that some constituents are very uncomfortable with the prospect of very large entities being able to adopt the IFRS for SMEs, and would particularly welcome comments on this issue.

Q7 Do you agree with the Board's proposal 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.

Tier 3 – FRSSE

2.24 As discussed earlier, the Board considers that the existing FRSSE should remain in force for the foreseeable future, on the grounds that the cost of change to the IFRS for SMEs in its current form would not be justified in the case of entities currently using the FRSSE. The ASB has recently updated the FRSSE for the impact of the UK Companies Act 2006. One major change relates to size – namely qualifying turnover is increased to £6.5 million.

2.25 A decision that the Board may need to make in the longer term is whether the existing FRSSE should be amended to align it more with IFRS or whether the Board should over a period of time require the use of the IFRS for SMEs for FRSSE users. The consideration of these requirements will be effected by current proposals in the European Union regarding financial reporting by micro entities.

2.26 The Association of Chartered Certified Accountants (ACCA) responded to the IASB's invitation to field tests by identifying five practitioners each of whom were required to field test the IFRS for SMEs Exposure Draft on the accounts of five clients using the standard IASB field testing questionnaire and to provide a set of accounts for each of these clients together with a set of accounts using the ED. Twenty–three of the twenty-five companies included in the field test were FRSSE users.

2.27 Overall, the practitioners did not encounter any great problems restating the accounts using the ED and seemed at the end of the exercise, which concluded with a round table, comfortable with the idea that a standard akin to the ED might eventually replace the FRSSE. The results seemed to affirm the view taken by the IASB that most Smaller Entities would not be concerned about the more difficult aspects of the SME standard.

2.28 The Board noted that the results seemed to indicate that a two-tier UK GAAP (using the IFRS for SMEs for the second tier) might be acceptable in the longer run. It was also pointed out that there would be lower costs for practitioners if there were only two tiers and that there would be greater comparability for users.

2.29 The Board is of the opinion that if a two-tier approach was to be considered it should be done so after a transition period to allow a period during which some experience of the use of the IFRS for SMEs by larger entities could build up and a review made of any future changes made by the IASB to the published standard.

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

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?

Industry Specific Issues – The Role of SORPs

2.30 At present there are a number of Statements of Recommended Practice (SORPs) which specific industry bodies develop and maintain (some of them are in the public benefit entity sector, which are dealt with in Section 3). The SORPs are not formally part of the Board's extant literature but it does oversee the development of SORPs through its policy and code of practice on SORPs and provide a negative assurance statement for each SORP confirming that nothing in the SORP conflicts with UK GAAP. The SORPs have played an important role – particularly in providing guidance in areas where there accounting standards do not address specific issues (e.g. insurance or financial reporting by charities). As a general principle the Board's view is that SORPs should only remain where there is a clear and demonstrable need arising from sector specific issues not covered by guidance in accounting standards.

2.31 It will of course remain the prerogative of industry groups to develop sector-specific guidance and best practice and the Board encourages those practices to continue and develop. However, consistent with the Board's overarching principle of simplifying UK GAAP its proposal is to restrict the number of SORPs to which it provides any endorsement.

2.32 The Board notes that the impact of converging UK GAAP with IFRS on the SORPs will be significant. This will vary across the different industries and sectors with some perhaps being required or choosing to adopt full IFRS whilst others might continue preparing accounts in accordance with UK GAAP as proposed in the document. In the latter case, the current SORP process may be able to continue, including the ASB Statement of Assurance. SORP making bodies will need to review IFRS to the extent that these standards might negate the need for SORPs.

2.33 Sectors that move across to IFRS may still want to retain some form of sector specific accounting guidance that retains the 'legitimacy' of the current SORP process. This does, however, raise the issue of whether it would be appropriate for the ASB to continue to provide a Statement of Recommended Practice. The ASB takes the view that IFRIC is the body that should provide authoritative interpretations of IFRS but recognises the need to fill in gaps where there is no IFRS eg Insurance, extractive industries, in which we are looking to codify industry best practice.

2.34 Whether there is a future role for SORPs will depend not only upon the future of UK GAAP but also upon whether there continues to be a benefit in terms of having SORPs. If SORPs do not provide benefits, in terms of contributing to the Board's aim of improving financial reporting, then they should be discontinued and possibly replaced by sector specific standards or guidance.

2.35 The Board is of the opinion that the future of the majority of SORPs is dependent on the progress of IASB initiatives. Until these initiatives are in force the Board accepts that there will be a need for a 'transitional role' for SORPs. The other remaining SORPS should be withdrawn and replaced by full IFRS.

2.36 The table below represents the proposed approach to the SORP.

SORP	**Future Recommendation**
Financial Reports of Pension Schemes	The SORP should continue until an appropriate alternative is available. The SORP is currently the only guidance available for Pension Schemes.
Accounting for Insurance Business	The Board's view is to leave the issue of the future of the insurance SORP on the ASB's work programme. As long as the insurance SORP was the only guidance available, the Board should retain its oversight. The SORP should continue until the publication of the new IFRS.

SORP	Future Recommendation
Accounting for Oil and Gas Exploration	The SORP should continue until the publication of the new IFRS.
Leases	The SORP should continue until the publication of the new IFRS.
Accounting by Limited Liability Partnerships	The Board noted that the CCAB wanted to continue with the SORP for LLP's (to provide guidance to those LLP's using the FRSSE). This could be achieved by having a very short SORP or by building it into the FRSSE. The latter approach is being considered.
Association of Investment Companies	The SORP should be withdrawn and investment companies should apply IFRS (leaving the question of whether additional guidance was needed as a matter entirely for the AIC).
Financial Statements of Authorised Funds	The SORP should be withdrawn for authorised funds and IFRS applied.
Banks – segments	The SORP should be withdrawn.
HEFE (Universities)	See Section 3.
Registered Social Landlords	See Section 3.
Charities	See Section 3.
Local Authority Accounting	CIPFA/LASAAC has announced a new governance framework for the Code of Practice. This will apply from the 2010-11 Code, when local authorities will complete the move to IFRS based accounting, and the Code will be prepared under the oversight of the Financial Reporting Advisory Board. The SORP will be withdrawn.

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

UK GAAP v IFRS for SMEs

2.37 In order to help respondents in their thinking the Board has prepared an analysis of the significant differences between UK GAAP and the IFRS for SMEs (see below and Appendix B).

- FRS 2 Accounting for Subsidiary Undertakings – exemptions from preparing group accounts under the IFRS for SMEs is different from those set out in UK GAAP.

- FRS 6 Acquisitions and Mergers – the FRS requires business combinations to be accounted for using the merger or the acquisition accounting approach. The SME requires all business combinations to be accounted for by applying the purchase method.

- FRS 8 Related Party Disclosures – certain exemptions to subsidiary undertakings are allowed in the FRS; the SME does not include an equivalent exemption. The SME requires key management personnel compensation disclosure; such disclosure is not required by FRS 8.

- FRS 10 Goodwill and Intangible Assets – there are different recognition approaches between FRS 10 and the SME based on separability. The IFRS for SMEs, for cost benefit reasons, rather than conceptual reasons, requires that indefinite-life intangible assets and goodwill should be considered to have finite lives and should be amortised over their useful lives, with a maximum period of 10 years. The assets under the SME must be assessed for impairment using the 'indicator' approach. This will result in more intangible assets being recognised on the acquisition of a business under the SME than under UK GAAP.

- FRS 19 Deferred Tax – there are significant differences between the standards on non-monetary assets and discounting deferred tax liabilities. There are different disclosure requirements.

- FRS 26 Financial Instruments – the SME allows entities to choose to apply either the provisions of section 11 and section 12 in full or the recognition and measurement provisions of IAS 39: *Recognition and Measurement* and the disclosure requirements of sections 11 and 12 to account for all of its financial instruments.

Other options the Board Considered

2.38 There is a range of possible options that the Board has contemplated in framing these proposals. They range from adoption of IFRS for all entities which is the approach adopted in countries such as Australia, New Zealand and South Africa to retaining existing arrangements (which is the current state of play in the France and Germany – although current proposals are to adopt a differential reporting framework which would involve transition to IFRS). It is difficult to draw comparisons because institutional and legislative frameworks are quite different across jurisdictions. Accordingly, while it is important to ensure cross-border financial reporting requirements are consistent and comparable, the Board's primary responsibility is to set requirements that work effectively within the UK and Republic of Ireland contexts. A principal consideration is to achieve an appropriate balance in cost and benefit terms so that whilst there is a cost involved in some entities having to transition to new reporting arrangements, those costs are outweighed, at least in the medium to long-term, by overall benefits of strengthened and less complex financial reporting requirements.

2.39 While it is not possible to discuss all the options the Board has considered in developing these proposals, we discuss some of these options below.

Status Quo

2.40 The Board considered whether it would be feasible to maintain existing reporting requirements. In our view it did not make sense to maintain UK GAAP in its existing form because it has become overly complicated and having only some accounting standards converged with IFRS has increasingly become difficult to maintain and update. Accordingly, the Board is concerned that the integrity of existing UK-based literature will be compromised as it becomes more divergent from IFRS. The inevitable result will be that users of the financial statements find it increasingly difficult to interpret information prepared under a system of reporting that is only partially converged. For those reasons the Board concluded that maintaining the status quo was not viable nor was it in the interest of financial statement users and preparers.

Differential Reporting Framework based Primarily on Size

2.41 The Board also considered applying different reporting requirements on the basis of entity size – such as turnover etc. Whilst this would have been easier to apply and assessing the effect of such proposals would be more straightforward to determine, as an approach it relies on a somewhat arbitrary way of determining reporting requirements. It also fails to achieve any correspondence between the information needs of users and the financial reporting regime applied – particularly where entities have a demonstrable public accountability because of the nature of their activities or the way in which they raise capital.

2.42 The Board concluded that size alone provided an inadequate basis for differentiating what financial reporting would be appropriate for an entity. For that reason the Board's view is a public accountability override to the size criteria provides a proportionate response to established financial reporting requirements that best serves the public interest. The Board notes that this is consistent with the existing legislative framework which restricts the adoption of the small companies' regime where an entity, has, in substance, a public accountability*.

* *See sections 384 and 385 of the Companies Act 2006.*

SECTION 3 FINANCIAL REPORTING FOR PUBLIC BENEFIT ENTITIES

3.1 This section considers the impact of the Board's proposals on the future of UK GAAP on the public benefit entity sector.

3.2 The move to adopting IFRS based standards has generated a debate around whether the IASB Framework adequately addresses public benefit entity issues. IASB standards are not designed to apply to public benefit entity activities in the private sector, although the Preface to IFRS states that such entities may find them appropriate. This gap in IFRS is forcing national standard-setters to consider the implications of converging with IFRS for entities in the public benefit sector.

3.3 The Board is therefore seeking views on different approaches for setting accounting requirements for public benefit entities that are required to prepare true and fair view accounts in accordance with UK GAAP.

3.4 This consultation does not consider the public sector, where the International Public Sector Accounting Standards Board has a strategic objective of converging its standards with IFRS where appropriate for the public sector and UK Government adopts its own standards.

What is a public benefit (not-for-profit) entity?

3.5 In its simplest sense, a public benefit entity is '*an entity whose principal objective is not the generation of profit*'. A more detailed definition, reflecting what are perhaps the two main characteristics of such entities, is '*an entity that is organised and operated primarily for community or social benefit whose funders and other resource providers do not receive any financial return from the organisation and any surpluses are applied to support the objectives of the entity.*'

3.6 The above definition would include entities such as charities, housing associations and higher and further education institutions. It could also include Community Interest Companies and some co-operatives, although the Board is proposing that credit unions and other entities that take deposits and/or hold assets in a fiduciary capacity, such as building societies and friendly societies, should apply EU adopted IFRS.

The issue

3.7 The Board's proposals for the future of UK GAAP involve ultimately converging FRS with IASB standards. Public benefit entities, that are required to prepare true and fair view accounts in accordance with UK GAAP, will therefore be required to apply the new standards but the fact that IFRS are not framed with public benefit entities in mind raises the issue of whether the standards are appropriate for this particular sector.

3.8 The Board is seeking views as to whether public benefit entities should apply IFRS and whether any requirements for the sector that may be incorporated into UK GAAP should not depart from the principles of IFRS. The issue remains that IFRS does not contemplate their application by public benefit entities and this raises the risk of there being uncertainty and ambiguity in the sector as to how they should be applied. This could give rise to unfortunate consequences, including inconsistent accounting practices and increased complexity as public benefit entities seek to create their own answers to sector-wide issues.

3.9 This consultation is therefore seeking views on whether converged UK GAAP needs to be supplemented if it is to provide an adequate and practicable accounting framework for the public benefit sector.

Why public benefit entities are different

3.10 The ASB's Interpretation for Public Benefit Entities of its Statement of Principles for Financial Reporting (the Interpretation) recognises that public benefit entities have different objectives, different operating environments and other different characteristics to profit-orientated entities. For example, their primary objective is to provide goods and services for the general public or social benefit and any equity is provided with a view to supporting that primary objective rather than with a view to providing a financial return to equity shareholders.

3.11 There are also many similarities between public benefit and profit-oriented entities. As a result, many of the principles set out in the Interpretation are exactly the same as those that are relevant to profit-oriented entities with any re-expression, change of emphasis or additions to the principles designed to make them more relevant to public benefit entities.

How should GAAP address public benefit issues?

3.12 The Board has identified four main options for dealing with public benefit issues under converged UK GAAP. These are as follows:

i. **A public benefit entity framework**, similar to the Interpretation, – covering principles but not specific accounting requirements;

ii. **A public benefit (not-for-profit) standard** – setting out where different accounting is required for public benefit entities;

iii. **Separate standards on public benefit issues** – for example a standard on contributions, a standard on fund accounting, a standard on the presentation of the primary statements, etc; and

iv. **Supplementary text in UK GAAP** – for example separate paragraphs, or Application Notes, in a fixed asset standard on measuring the service potential of assets, or in a business combinations standard on acquisitions at nil or nominal value or merger accounting.

3.13 The Board's preferred approach is option (ii) – to develop a public benefit standard. If the Board decided to take forward this proposal, other issues that would need to be addressed include whether the proposed standard should be stand-alone and cover all accounting areas, even where there are no differences with the requirements for profit-oriented companies, or whether the standard should just cover areas where the accounting requirements need to be modified or interpreted for public benefit entities? If the former option is preferred, the question also arises as to whether the IASB standard for SMEs might provide a more suitable starting point for a public benefit entity standard than EU adopted IFRS.

3.14 The Board could develop a standard that required public benefit entities to follow converged UK GAAP '*other than*' for specific areas where there are issues that are pervasive for such entities and where the proposed standard would set out additional requirements. This approach would have advantages in terms of not requiring amendment every time IASB updated its standards.

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

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 view 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?

What issues should a public benefit entity standard cover?

3.15 Public benefit entities face a number of accounting issues that profit-oriented entities rarely encounter. The following table sets out examples of issues that are distinctive to the public benefit sector and could therefore usefully be covered in a public benefit standard. The list of issues is not intended to be exhaustive:

Accounting issues	**What is different about public benefit entities**
The presentation of the primary financial statements	Specific requirements may be needed for issues such as restricted assets; classification of expenditure (by object, function or programme?); how residual interest should be presented, etc.
Fund accounting	How to report different kinds of funds (restricted and unrestricted), the effect of conditions when resources are received and the way in which they are subsequently treated.
Revenue from non-exchange transactions	Non-reciprocal transfers, such as income from donations, legacies and grants, including the impact of any restrictions and conditions that might be attached to these contributions.
Valuation of assets, including impairment	Assets are generally held to deliver services to members of the public that are often free or subsidised. The absence of any direct cash inflows to the entity may result in these assets being valued in terms of their service potential.

Accounting issues	What is different about public benefit entities
Business combinations	Acquisitions may take place at nil or nominal consideration and there may sometimes be an alternative to acquisition accounting.
Financial instruments, e.g. soft loans	How to account for loans that are made (or received) at a below market rate of interest to support the economic and social policy objectives of a public benefit entity.
Liabilities	How to report liabilities for non-performance related commitments to provide public benefits or obligations arising from multi-year grant awards made by grant-giving charities.
Identifying the reporting entity	The boundary of a reporting entity is determined by the scope of its control – but how does this principle apply in the not-for-profit context, particularly in terms of the indicators of control?
PFI schemes and similar contractual arrangements	How should not-for-profit entities account for PFI/PPP contracts and similar arrangements?
Narrative reporting	How to report the extent to which the entity is achieving its strategic objectives, particularly with regard to service delivery and, more broadly, to promote accountability.

3.16 If the Board were to take forward the option to develop a public benefit entity standard it would need to consider the accounting requirements for issues such as those raised in the above table.

3.17 It would also need to consider whether all the disclosures required by IFRS are appropriate for public benefit entities and whether there are other disclosures that should be provided.

3.18 If the Board were to decide to take forward work on developing a public benefit entity standard, the detailed accounting requirements would be the subject of a separate consultation.

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

The future role of Public Benefit Entity SORPs

3.19 The ASB currently has in place a Policy and Code of Practice for specialised industries or sectors to publish Statements of Recommended Practice (SORPs). SORPs are not issued by the ASB but by industry or sectoral bodies that are recognised for this purpose by the ASB and undertake to follow the requirements of the Code. Each SORP includes a Statement that outlines the limited nature of the review the ASB has undertaken and confirms that the SORP is consistent with UK GAAP and does not appear to contain any fundamental points of principle that are unacceptable in the context of current accounting practice.

3.20 There may still be a need for certain public benefit sectors to continue to provide supplementary guidance on how to apply the accounting requirements of a public benefit entity standard. This need could arise where there are special accounting or financial reporting issues in specific sectors that require clarification or interpretation of accounting standards and that it would not be appropriate to cover these issues in a public benefit entity standard. An example of such issues could be component accounting and accounting for shared ownership sales in the housing sector.

3.21 There is the issue of whether the Board should continue to oversee the development of sector specific guidance and whether it should continue to provide a Statement confirming that any supplementary guidance that is produced is consistent with UK GAAP, including the public benefit entity standard.

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?

SECTION 4 HOW WE WILL TEST OUR ASSUMPTIONS

Assessing the Effect of these Proposals

4.1 As outlined in Section 1, the Board's intention is to improve UK GAAP to ensure high quality financial reporting in the UK and the Republic of Ireland. However, an important part of this consultation is to understand whether constituents agree with the assumptions we are making about the overall effects of these proposals. The Board considers there to be a range of effects:

(i) costs and benefits borne by preparers and users of financial statements in terms of implementing these proposals;

(ii) costs and benefits arising from the ongoing operation of UK GAAP and the implications this has for accounting and auditing professionals and the overall regulation of financial reporting; and

(iii) broader costs and benefits to the economies of the UK and the Republic of Ireland of having transparent financial information that promotes good governance and accountability.

4.2 As the Board is basing the operation of the proposed financial reporting framework on a combination of size and a 'public accountability' test it is difficult for it to establish the number of entities that are likely to be affected by these proposals in terms of a change to the basis on which they prepare their financial statements.

4.3 However, the Board expects that moving to this concept of 'public accountability' (and not size alone) is likely to result in a number of entities moving up to the top tier (ie EU adopted IFRS). It is important to stress that these proposals do not attempt to alter existing requirements about which entities should prepare financial statements in accordance with UK GAAP. They only relate to which set of standards should apply where an entity *already* has a statutory requirement to prepare audited financial statements in accordance with UK GAAP.

4.4 We anticipate that this will most likely impact building societies, credit unions, friendly societies[*] and investment trusts (although we note there may be banks and insurers that do not currently report under IFRS that will move up to the top tier) that satisfy the definition of 'public accountability'. In the Board's view, most co-operatives will not fall within the definition of public accountability, as they do not meet the criteria outlined in paragraph 2.3. Setting a higher standard of reporting for entities that have a demonstrable public accountability appears, in the Board's view, reasonable and consistent with the objective of setting financial reporting requirements in the public interest. It is also consistent with the *Principles of Better Regulation* in ensuring a proportionate response to setting regulatory requirements. The table below indicates the number of entities in each of those categories[†].

Type of Entity	**Number**[‡]
Building Societies	55
Co-operatives	8,000[§,||]

* *The UK Government amended relevant legislation relating to these types of entities with the introduction of the IAS regulation in the European Union.*

† *These figures are for the United Kingdom only.*

‡ *These figures are from the Financial Services Authority 'Annual Report 2007-08'. They refer to entities regulated by the FSA.*

§ *HM Treasury (2007) Review of the cooperative and credit union legislation in Great Britain: summary of responses to consultation*, available at www.hm-treasury.gov.uk. These figures are for the United Kingdom only and there are over 8,000 cooperatives. As cooperatives vary significantly in size and activities it is difficult to estimate how many of these entities are currently required to prepare accounts in accordance with UK GAAP.

|| *In 2007 there were 1027 cooperatives in the Republic of Ireland registered under the Industrial and Provident Societies Acts*: from the *Report of the Registrar of Friendly Societies 2007.*

Credit Unions	529*
Friendly Societies	157†
Investment Trusts	1,928

4.5 The Board recognises that the transition from existing UK GAAP to reporting under IFRS may be a significant step for some of these entities and for that reason it is particularly keen to understand the likely effect of these proposals on those preparers. The Board would also appreciate comments from users to confirm the likely benefits that may flow from implementing these proposals.

4.6 Over the last few years the UK Government has been reviewing the requirements imposed on cooperatives and credit unions to modernise the legislative framework under which those entities operate. The consultation process has underscored the overall principle that these entities should not be treated any differently from companies[‡]. A similar review was undertaken of the accounting framework for friendly societies. Respondents to that consultation expressed 'unanimous agreement that there should be consistency between companies and friendly societies'[§].

4.7 The Government of the Republic of Ireland issued a consultation paper on cooperative legislation in April 2009[||]. This review process is also aimed at modernising the legislative framework for cooperatives. Specifically, the

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* *In 2008 there were 419 credit unions in the Republic of Ireland regulated by the Financial Regulator: Annual Report of the Financial Regulator 2008.*

† *In 2007 there were 97 Friendly Societies in the Republic of Ireland: from the Report of the Registrar of Friendly Societies 2007.*

‡ *HM Treasury (2007) Review of the cooperative and credit union legislation in Great Britain: summary of responses to consultation*, available at www.hm-treasury.gov.uk.

§ *HM Treasury (2005) Summary of Responses to the HM Treasury consultation* "Updating the accounting framework for friendly societies", available at www.hm-treasury.gov.uk.

|| *Department of Enterprise, Trade and Employment (2009) Co-operative Societies: Consultation Paper on the Industrial and Provident Societies Acts 1893-2005*, available at www.entemp.ie/commerce/cooplaw.

consultation seeks to address, amongst other things, the financial reporting requirements applicable to these entities.

4.8 In 2004 the then Department of Trade and Industry (now the Department for Business, Innovation and Skills) in its final Regulatory Impact Assessment on the adoption of IFRS* in the EU noted that there were significant economic benefits for UK entities moving to IFRS in terms of reducing the cost of capital because financial statements would be more accessible to potential investors across the EU and worldwide. There could also be savings in only having to follow a single set of accounting standards for those entities operating across several jurisdictions (particularly within the EU). In terms of costs, the DTI noted that there would one-off IT and training costs in moving to IFRS but that these should be minimal. The training costs for small companies were estimated at £1,700 per business. For medium to large business and building societies the costs range from £5,100 to £8,500 each. It was anticipated that there would be no ongoing costs for medium to large companies but that for some small companies and building societies there may be a nominal annual cost in the order of £200 pa (one person for two days at an annual salary of £25,000).

4.9 The Institute of Chartered Accountants in England and Wales (ICAEW) undertook a study in 2007 to assess the implementation of International Financial Reporting Standards (IFRS) in the EU through the IAS Regulation and about the implementation of the Fair Value Directive†. The study found that the typical cost of preparing the first set of IFRS consolidated accounts ranged from 0.31% of turnover for companies with a turnover below €500m and 0.05% of turnover for those companies with a turnover

* *Department of Trade and Industry (2004) 'Final Regulatory Impact Assessment on The Exercise of Member State Options in the International Accounting Standards (IAS) Regulation.*
† *ICAEW Financial Reporting Faculty (2007), EU Implementation of IFRS and the Fair Value Directive*, available at www.icaew.com.

above that. In terms of ongoing costs of preparing IFRS consolidated statements in the following financial year these were as follows: 0.06% of turnover for companies with turnover below €500m; 0.01% of turnover for companies with turnover from €500m to €5,000m; and 0.008% of turnover for companies with turnover above €5,000m*. The study also found that those figures were much more variable for entities at either end of the size distribution. The authors of the study note that the costs referred to may not be truly incremental and may impound some preparation costs that would have otherwise been incurred under pre-existing reporting requirements†.

4.10 The ACCA field testing referred to on page 25 indicated that there the preparers involved in the testing did not encounter any significant costs in implementing the IFRS proposals for SMEs. Whilst this study was not extensive it provides a reasonable indication of the potential costs involved in implementing the second tier of the proposals in this paper.

4.11 The Board notes there have been significant developments in IFRS implementation since 2005 in the United Kingdom and the Republic of Ireland and there is now a substantial knowledge base in both countries. This may have ameliorated some of the costs associated with the transition to the IAS Regulation since 2005. However, the Board is keen to hear from those entities that are most likely to be affected and to be provided with evidence of the likely impact these proposals will have. The Board would like to understand both the *positive* and *negative* effects that entities and other bodies are concerned may flow from these proposals. Where possible, the Board would appreciate respondents attempting to quantify those effects (e.g. staff training costs, system changes, etc) but in some cases quantification will be difficult or not particularly

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* *Ibid., p. 8.*

† *Ibid., p.9.*

meaningful in which case a more descriptive statement of likely effects may be more appropriate.

4.12 In addition to issuing this document the Board will conduct a number of consultation events to better understand the implications of adopting these proposals. These will also provide an opportunity for the Board to gather evidence to assist its decision-making about how to take these proposals forward.

4.13 The Board is also interested in field testing these proposals to gain an understanding of the nature of changes that will be required by those entities that will face a significant change in the basis on which their financial statements are prepared. The objective of field testing is look at ways these proposals can be refined to be more effective in achieving the Board's overall objective.

Q15 If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as 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?

How effects will be taken into account in finalising these proposals

4.14 The evidence and understanding the Board gathers through this consultation process will be a key input to the final decision the Board takes forward formally as a Financial Reporting Exposure Draft (FRED). It is expected that the FRED will set out in more detail the specific changes that will be required to adopt these proposals into UK GAAP. The Board will have to weigh up the evidence and determine what is likely to achieve the best outcome in terms of serving the public interest. Essentially that involves not just looking at the costs and benefits that accrue to users and preparers of the financial statements but broader economic considerations. It is also our intention that the decision about the future shape of UK GAAP is situated within the broader context of regulatory reform. It is also important to consider emerging thinking about the role of accounting standards in the operation of domestic and global capital markets along with fiduciary and stewardship obligations on management.

4.15 Once a set of proposals are implemented the Board intends to have an ongoing process of review to ensure that they are having their desired effect. Where necessary, it is the Board's intention to make modifications as appropriate to ensure that UK GAAP is operating effectively in line with intended outcomes.

SECTION 5 NEXT STEPS

5.1 It is the Board's intention that an Exposure Draft will be published, after the consultation process, outlining the Board's recommendations for the Future of UK GAAP after due consideration to the feedback on this Policy Proposal.

5.2 The Board and BIS will explore more fully the most appropriate mechanism to implement a public accountability basis for differential reporting and its consequential impact on other reporting requirements.

5.3 The Board is planning a 'change' date for financial years beginning on or after 1 January 2012 for the proposals in this document.

Q16 What are your views on the proposed adoption dates?

APPENDIX A: SUMMARY OF PREVIOUS CONSULTATIONS

Discussion Paper (March 2004)

1 In March 2004 the ASB published a discussion paper (DP) 'UK Accounting Standards: A strategy for convergence with IFRS'. The paper proposed a phased approach to convergence, including:

- new standards effective in 2005 and 2006 that would enhance existing UK financial reporting requirements, maintain their position as highly regarded internationally and adapt to changes in the law; and
- thereafter, a series of 'step changes' replacing one or more existing UK standards based on IFRS as prospective IASB projects were completed.

2 The ASB received 40 letters of comments in response to the DP. The respondents demonstrated strong support for the fundamental principles underlying the ASB's convergence strategy and for a phased approach. The Board agreed that it should publish its policy on its role and convergence strategy, including detailed plans for new standards to provide information about its intentions for introduction of IFRS in sufficient time to allow preparers to plan for an orderly transition.

Policy Statement Exposure Draft (March 2005)

3 In March 2005 the ASB published an exposure draft (ED): 'Accounting Standard-setting in a changing environment. The Role of the Accounting Standards Board'. The draft Policy Statement focused on the most significant future roles of the ASB and argued that it would be in contributing to the development of a set of high quality global accounting standards with IASB and others. The ASB had the capacity as an established national standard-setter to be a valuable

source of accounting thought and insight for the IASB and an influential voice in debates on new accounting standards.

4 While the focus was on the future role of the ASB, the ED also included a discussion on convergence issues, which reaffirmed the Board's intention to adopt a phased approach to convergence, with the aim of bringing UK standards fully into line with IFRS within a period of 3-4 years.

5 The ASB received 21 letters of comments in response to the ED. It was clear from the responses that recent events, in particular the fact that publicly traded companies were now using IFRS for the first time, had forced respondents to reconsider their position in respect of convergence. Consequently, it appeared that an important issue for consideration was whether the convergence strategy as outlined in the ED continued to be the most appropriate one.

Convergence Strategy Public Meeting (January 2006)

6 The ASB hosted a public meeting on the ASB's convergence strategy in January 2006. The meeting discussed various issues such as whether there could be a case for maintaining differences between the principles underlying UK accounting standards and IFRS, should the ASB move from a phased approach to a 'big bang' approach to convergence with IFRS, which accounting standards should apply to which entities and what was the most appropriate implementation strategy.

7 The Board agreed that a convergence programme should be pursued, though there was a need for further debate on the shape of that programme. The IASB's NPAE (IFRS for SMEs) project did not justify a pause in the convergence programme. Further work was commissioned on a possible 'big bang' approach to convergence.

Press Notice on tentative proposals for convergence (May 2006)

8 In May 2006 the ASB issued a Press Notice – PN 289 in which the Board's tentative proposals, on which it sought views, were:

1. All UK Public Quoted and other publicly accountable companies would be required to apply full IFRS, irrespective of turnover and whether they present group accounts or not. This would mean that approximately another 1,000 to 1,500 companies would be required to report under IFRS.

2. The use of the ASB's Financial Reporting Standard for Smaller Entities (FRSSE), which enables small entities to take advantage of simplified requirements, would be extended beyond small companies as defined to include some larger entities. This would mean that approximately another 30,000 companies would be able to use the FRSSE.

3. UK subsidiaries of group companies that apply full IFRS would also be required to apply full IFRS in respect of measurement and recognition, but with reduced disclosure requirements (yet to be defined). This would affect approximately 14,000 companies.

4. There had not yet been a decision on companies that do not fall within 1, 2 or 3 above. There are approximately 7,000 companies in this 'gap'. The alternatives seem to be (i) extend the application of the FRSSE further, (ii) apply IFRS to more companies, (iii) maintain UK GAAP for them, or (iv) some combination of these three alternatives.

9 The ASB received 43 letters of comments to the Press Notice. In summary, the responses broadly supported a two-tier approach, with the lower level potentially (and ideally) being based on the IASB's SME project. The ASB stated that it would need to review the IASB's proposals when the ED

was published to judge whether or not they are suitable for the UK's and Republic of Ireland's needs and then determine the future of the FRSSE. In the meantime further research would be put in hand.

Consultation on ED of IASB's IFRS for SMEs (April 2007)

10 The IASB published its ED of an IFRS for SMEs in February 2007. In April 2007 the ASB published a consultation paper; 'IASB exposure draft of a proposed IFRS for Small and Medium-sized entities'. Given the importance of the document, the ASB issued the ED in full for consultation together with an accompanying ASB invitation to comment on the ED and the potential implications for UK and Irish entities.

11 The ASB was of the opinion that there are three main implications that need to be considered by constituents. Firstly, constituents need to consider what role the IFRS for SMEs may play within the ASB's convergence project ie is it suitable for a mid-tier of companies above the current range for the FRSSE but below those currently required to apply full IFRS? Secondly, is the IFRS for SMEs an appropriate replacement for the FRSSE? Finally, if the IFRS for SMEs is to be considered a suitable basis for middle tier companies, or as a replacement for the FRSSE, what changes would need to be made to it?

12 The ASB's previous tentative decision on UK convergence was to support a two-tier approach, with the lower level potentially (and ideally) being based on the outcome of the IASB's IFRS for SMEs project. Consequently, the ASB decided to defer any final decisions on convergence until feedback from the above ITC had been analysed and discussed by the ASB; at which time a judgement could be made as to whether or not it is suitable for the needs of the UK and Republic of Ireland.

13 The ASB received 22 letters of comment to the discussion paper. Overall, respondents reflected a favourable response to

the IFRS for SMEs – it was considered that the standard represents a significant achievement for the IASB, is well organised, easy to navigate and readable. In their view, the special needs of smaller organisations have been considered and the IFRS for SMEs is the way forward in the UK and the Republic of Ireland to replace UK GAAP. The debate still continued over whether there should be a three tier or two tier system of reporting in the UK and the Republic of Ireland.

14 Many respondents thought the standard would not be suitable for 'micro entities' and that the IFRS for SMEs would not be suitable replacement for the FRSSE. They also proposed that the FRSSE should remain in force for the foreseeable future.

APPENDIX B: SIGNIFICANT DIFFERENCES BETWEEN UK GAAP AND THE IFRS FOR SMEs

UK GAAP	SME	Differences
FRS 1 – Cash Flow Statements	Statement of Cash Flows (section 7)	**GAAP Differences:** Whereas FRS 1 exempts entities such as certain subsidiary undertakings from preparing cash flow statements, the SME offers no such exemption. FRS 1 focuses on movements in cash, whereas the SME is concerned with movements in cash and cash equivalents. **Level of Disclosure:** The SME requires fewer heading classifications (operating, investing and financing) and does not mandate the order in which they are presented.
FRS 2 – Accounting for Subsidiary Undertakings	Consolidated and Separate Financial Statements (section 9)	**GAAP Differences:** The most important difference between the definitions of subsidiaries is that the SME focuses on the power to control, whereas the UK GAAP definition also encompasses situations in which control is actually exercised in practice notwithstanding that the power to control is not present. The exemptions from preparing group accounts under the SME are different from those set out in UK GAAP. **Level of Disclosure:** For UK and Irish companies certain additional disclosures are required by the Companies Act.

UK GAAP	SME	Differences
FRS 3 – Reporting Financial Performance	Financial Statement Presentation (section 3) Statement of Financial Position (section 4) Statement of Comprehensive Income and Income Statement (section 5) Statement of Changes in Equity and Statement of Income and Retained Earnings (section 6) Notes to the Financial Statements (section 8) Liabilities and Equity (section 22) Revenue (section 23)	**GAAP Differences:** In general, the requirements of the SME are less prescriptive than those of UK GAAP. **Level of Disclosure:** As above
FRS 4 – Capital Instruments	N/A	FRS 25 *Financial Instruments: Disclosure and Presentation* has the effect of withdrawing FRS 4, except for material on the measurement of debts and gains and losses on the repurchase of debt.
FRS 5 – Reporting the Substance of Transactions	Concepts and Persuasive Principles (section 2)	**GAAP Differences:** There is under the SME no direct equivalent of FRS 5, but there are no fundamental differences between the SMEs *Concepts and Persuasive Principles* and the ASB's Statement of Principle. **Level of Disclosure:** None

UK GAAP	SME	Differences
FRS 6 – Acquisitions and Mergers	Business Combinations and Goodwill (section 19)	**GAAP Differences:** The FRS requires business combinations to be accounted for either using the merger accounting approach whereby the carrying values of assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consideration or by the acquisition accounting model, whereby the identifiable assets and liabilities of the companies acquired should be included in the acquirer's consolidated balance sheet at their fair value at the date of acquisition. The SME requires all business combinations to be accounted for by applying the purchase method. In particular, the acquirer shall measure the cost of the business combination as the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus any costs directly attributable to the business combination. **Level of Disclosure:** Different disclosure requirements are required by the SME as outlined in section 19.25 of the SME.
FRS 7 – Fair Values in Acquisition Accounting	Business Combinations and Goodwill (section 19)	**GAAP Differences:** Refer to FRS 10 – Goodwill and Intangible Assets. **Level of Disclosure:** Significant disclosures are required by the UK GAAP dependent on which accounting method is utilised as outlined in FRS 6 paragraphs 21–37.

UK GAAP	SME	Differences
		Different disclosure requirements are required by the SME as outlined in section 19.25 of the SME.
FRS 8 – Related Party Disclosures	Related Party Disclosures (section 33)	**GAAP Differences:** The FRS grants certain exemptions to subsidiary undertakings 90 per cent or more of whose voting rights are controlled within the group – these subsidiaries do not have to disclose transactions with other group companies and investees of the group qualifying as related parties provided group financial statements including the subsidiary are publicly available. The SME does not include an equivalent exemption. *The final standard should reflect the final amendments to IAS 24, currently in exposure draft phase.* **Level of Disclosure:** The SME requires entities to disclose key management personnel compensation in total. Such disclosure is outside the scope of FRS 8, although the Companies Act requires detailed disclosures in relation to director's remuneration.
FRS 9 – Associates and Joint Ventures	Investments in Associates (section 14) Investments in Joint Ventures (section 15)	***Associates*** **GAAP Differences:** The FRS requires a reporting entity that prepares consolidated financial statements should include its associates in those statements using the equity method in all the primary financial statements. In the investor's individual financial statements, its interest in associates should be treated as fixed asset investments and shown either at

UK GAAP	SME	Differences
		cost, less any amounts written off, or at valuation. In the SME the investor shall account for its investments in associates using one of the following – the cost model in section 14.5, the equity method in section 14.8 or the fair value through profit and loss model in section 14.9 of the SME. **Level of Disclosure:** Similar general disclosure requirements exist. However, additional requirements may be required dependent on which method an entity adopts. ***Joint Ventures*** **GAAP Differences:** The FRS requires in consolidated financial statements that an investor should include its joint ventures using the gross equity method in all its primary financial statements. In the investors individual financial statements, investments in joint ventures should be treated as fixed asset investments and shown either at cost, less any amounts written off, or at valuation. In the SME the investor shall account for its interest in all its jointly controlled entities using one of the following – the cost model in section 15.10, the equity method in section 15.13, or the fair value through profit and loss model in section 15.14 of the SME. **Level of Disclosure:** Similar general disclosure requirements exist.

UK GAAP	SME	Differences
FRS 10 – Goodwill and Intangible Assets	Intangible Assets other than Goodwill (section 18) Business Combinations and Goodwill (section 19)	**GAAP Differences** FRS 10 and the SME take different approaches to recognition based on separability. This will result in more intangible assets being recognised on the acquisition of a business under the SME than under UK GAAP. For cost-benefit reasons, rather than conceptual reasons, indefinite-life intangible assets and goodwill should be considered to have finite lives and should be amortised over their estimated useful lives, with a maximum period of 10 years. The assets must be assessed for impairment using the 'indicator' approach. **Level of Disclosure:** None
FRS 11 – Impairment of Fixed Assets and Goodwill	Property, Plant and Equipment (section 17) Impairment of Assets (section 27)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 12 – Provisions, Contingent Liabilities and Contingent Assets	Provisions and Contingencies (section 21)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 13 – Derivatives and other Financial Instruments: Disclosures	Basic Financial Instruments (section 11) Other Financial Instruments Issues (section 12)	N/A – FRS 13 was withdrawn in full once FRS 29 'Financial Instrument – Disclosures' came into effect on 1 January 2007.
FRS 15 – Tangible Fixed Assets	Property, Plant and Equipment (section 17)	**GAAP Differences:** None **Level of Disclosure:** None

UK GAAP	SME	Differences
FRS 16 – Current Tax	Income Tax (section 29)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 17 – Retirement Benefits	Employee Benefits (section 28)	**GAAP Differences:** None, except IAS 19 has more extensive scope. **Level of Disclosure:** Similar extensive disclosure requirements are required as outlined in FRS 17 – paragraphs 75–93 and sections 28.40 and 28.41 of the SME.
FRS 18 – Accounting Policies	Accounting Policies, Estimates and Errors (section 10)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 19 – Deferred Tax	Income Tax (section 29)	**GAAP Differences:** The SME requires deferred tax to be recognised on the basis of temporary differences rather than on the basis of obligations arising from timing differences. In addition, the FRS does not in general require deferred tax to be provided for when non-monetary assets are revalued or when they are adjusted to their fair value on the acquisition of a business. In addition, the FRS allows (but does not require) deferred tax liabilities that will not be settled for some time to be discounted to reflect the time value of money. In contrast, the SME prohibits discounting. **Level of Disclosure:** The FRS requires additional disclosures of the effect of discounting, a general explanation

UK GAAP	SME	Differences
		of the circumstances that have affected the current and total tax charges for the current and future periods, the circumstances in which deferred tax relating to revaluation and rolled over gains would be payable. The SME requires disclosure for each type of temporary difference and for each type of unused tax losses and tax credits for which no deferred tax asset is recognised.
FRS 20 (IFRS2) – Share-based Payment	Share-Based Payment (section 26)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 21 (IAS 10) – Events after the Balance Sheet Date	Events after the end of the Reporting Period (section 32)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 22 (IAS 33) – Earnings per share	N/A	The SME does not address Earnings per share.
FRS 23 (IAS 21) – The Effects of Changes in Foreign Exchange Rates	Foreign Currency Translation (section 30)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 24 (IAS 29) – Financial Reporting in Hyperinflationary Economics	Hyperinflation (section 31)	An entity whose functional currency is the currency of a hyperinflationary economy shall apply IAS 29 *Financial Reporting in Hyperinflationary Economies* in preparing and presenting its financial statements.
FRS 25 (IAS 32) – Financial Instruments: Presentation	Basic Financial Instruments (section 11)	FRS 29 *Financial Instruments: Disclosure* replaces the disclosure requirements of FRS 25 and is mandatory on or after 1 January

UK GAAP	SME	Differences
	Other Financial Instruments Issues (section 12)	2007. FRS 29 applies to entities applying FRS 26 – the scope of that standard covers listed entities and entities that use the fair value accounting of the Companies Act 1985 to produce their financial statements.
FRS 26 (IAS 39) – Financial Instruments: Recognition and Measurement	Basic Financial Instruments (section 11) Other Financial Instruments Issues (section 12) Borrowing Costs (section 25)	The SME allows entities to choose to apply either the provisions of both section 11 and section 12 in full or the recognition and measurement provisions of IAS 39 *Financial Instruments: Recognition and Measurement* and the disclosure requirements of section 11 and 12 to account for all of its financial instruments. The IFRS for SMEs Basis for Conclusions Paragraphs BC99–BC107 explain the significant simplifications that the IASB proposes to the recognition and measurement principles in IFRS. In summary, the significant simplifications cover: The complexities of classifying financial instruments into four categories, the 'pass-through' and 'continuing involvement' tests for derecognition, and the detailed calculations required to qualify for hedge accounting. However, although sections 11 and 12 are a simpler approach to accounting for financial instruments than IAS 39, some of the simplifications involve eliminating options that are available to companies with public accountability under IAS 39, for instance: the fair value option,

UK GAAP	**SME**	**Differences**
		available for sale classification and option, held–to-maturity classification, partial derecognition and the use of hedge accounting for hedges other than the four specific types identified in BC101(c).
FRS 27 – Life Assurance	N/A	N/A
FRS 28 – Corresponding Amounts	Financial Statement Presentation (section 3)	**GAAP Differences:** None **Level of Disclosure:** None
FRS 29 (IFRS 7) – Financial Instruments: Disclosures	Basic Financial Instruments (section 11) Other Financial Instruments Issues (section 12)	FRS 29 only applies to entities applying FRS 26 *Financial Instruments: Recognition and Measurement* – the scope of that standard covers listed entities and entities that use the fair value accounting of the Companies Act 1985 to produce their financial statements. For entities applying it, FRS 29 replaces the disclosure requirements of FRS 25 and is mandatory on or after 1 January 2007.
SSAP 4 – Accounting for government grants	Government Grants (section 24)	**GAAP Differences:** None **Level of Disclosure:** None
SSAP 5 – Accounting for Value Added Tax	N/A	N/A
SSAP 9 – Stocks and Long-term contracts	Inventories (section 13) Revenue (section 23)	***Inventories*** **GAAP Differences:** None

UK GAAP	SME	Differences
		Level of Disclosure: The SSAP requires stocks to be sub-classified in the Balance Sheet or in the notes to the Financial Statements so as to indicate the amounts held in each of the main categories in the standards balance sheet format. The SME requires more detailed disclosure as outlined in section 13.22 of the SME. ***Long-Term Contracts*** **GAAP Differences:** None **Level of Disclosure:** None
SSAP 13 – Accounting for Research and Development	Intangible Assets other than Goodwill (section 18)	**GAAP Differences:** The SSAP requires the costs of fixed assets to be capitalised over their useful lives through the profit and loss account. Research expenditure should be written off in the year of expenditure through the profit and loss account. Development expenditure should be written off in the year of expenditure except in circumstances when it can be deferred to future periods as outlined in the SSAP paragraph 25. The SME requires an entity to measure an intangible asset initially at cost. **Level of Disclosure:** The SSAP requires additional disclosure of the movements on deferred development expenditure and the amount carried forward at the beginning and end of the period.

UK GAAP	SME	Differences
SSAP 19 – Accounting for Investment Properties	Investment Property (section 16)	**GAAP Differences:** The SSAP requires investment properties to be included in the Balance Sheet at their open market value. Value changes should be taken to the statement of total recognised gains and losses. The SME requires an entity's investment property whose fair value can be measured reliably without undue cost or effort at fair value at each reporting date with changes in fair value reflected in profit or loss. **Level of Disclosure:** The SSAP requires disclosure of the bases of valuation and specific details of the valuers whereas the SME requires disclosures based on the model adopted by the entity.
SSAP 20 – Foreign Currency Transaltion	Foreign Currency Translation (section 30)	**GAAP Differences:** SSAP 20 refers to 'local currency' whereas IFRS for SMEs uses the term 'functional currency'. **Level of Disclosure:** None
SSAP 21 – Accounting for Leases and Hire Purchase Contracts	Leases (section 20)	**GAAP Differences:** None **Level of Disclosure:** Different disclosure requirements exist as outlined in SSAP 21 paragraphs 49–60 and sections 20.23 and 20.30 of the SME.
SSAP 25 – Segmental Reporting	N/A	The SME does not address Segment Reporting.

The following sections of the IFRS for SMEs are not addressed in UK GAAP:
Section 1 – Small and Medium-sized Entities
Section 34 – Specialised Activities
Section 35 – Transition to the IFRS for Small and Medium-sized Entities

APPENDIX C: HIGH-LEVEL SUMMARY OF THE IFRS FOR SMEs

International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities.

Section
1 Small and Medium-sized Entities
2 Concepts and Pervasive Principles
3 Financial Statement Presentation
4 Statement of Financial Position
5 Statement of Comprehensive Income and Income Statement
6 Statement of Changes in Equity and Statement of Income and Retained Earnings
7 Statement of Cash Flows
8 Notes to the Financial Statements
9 Consolidated and Separate Financial Statements
10 Accounting Policies, Estimates and Errors
11 Basic Financial Instruments
12 Other Financial Instruments Issues
13 Inventories
14 Investments in Associates
15 Investments in Joint Ventures
16 Investment Property
17 Property, Plant and Equipment
18 Intangible Assets other than Goodwill
19 Business Combinations and Goodwill
20 Leases
21 Provisions and Contingencies
22 Liabilities and Equity
23 Revenue
24 Government Grants
25 Borrowing Costs
26 Share-Based Payment
27 Impairment of Assets
28 Employee Benefits
29 Income Tax
30 Foreign Currency Translation

31 Hyperinflation
32 Events after the End of the Reporting Period
33 Related Party Disclosures
34 Specialised Activities
35 Transition to the IFRS for SMEs

Section 1: ***Small and Medium-sized Entities***

The *IFRS for Small and Medium-sized Entities* is intended for use by **small and medium-sized entities** (SMEs). This section describes the characteristics of SMEs.

Section 2: ***Concepts and Pervasive Principles***

This section describes the **objective of financial statements** of small and medium-sized entities (SMEs) and the qualities that make the information in the financial statements of SMEs useful. It also sets out the concepts and basic principles underlying the financial statements of SMEs.

Section 3: ***Financial Statement Presentation***

This section explains fair presentation of **financial statements,** what compliance with the *IFRS for Small and Medium-sized Entities* requires, and what is a complete set of financial statements

Section 4: ***Statement of Financial Position***

This section sets out the information that is to be presented in a **statement of financial position** and how to present it. The statement of financial position (sometimes called the balance sheet) presents an entity's **assets, liabilities** and **equity** as of a specific date-the end of the **reporting period.**

Section 5: ***Statement of Comprehensive Income and Income Statement***

This section requires an entity to present its **total comprehensive income** for a period – ie its financial **performance** for the period – in one or two **financial statements.** It sets out the information that is to be presented in those statements and how to present it.

Section 6: ***Statement of Changes in Equity and Statement of Income and Retained Earnings***

This section sets out requirements for presenting the changes in an entity's **equity** for a period, either in a **statement of changes in equity** or, if specified conditions are met and an entity chooses, in a **statement of income and retained earnings.**

Section 7: ***Statement of Cash Flows***

This section sets out the information that is to be presented in a **statement of cash flows** and how to present it. The statement of cash flows provides information about the changes in **cash** and **cash equivalents** of an entity for a **reporting period,** showing separately changes from **operating activities, investing activities** and **financial activities.**

Section 8: ***Notes to the Financial Statements***

This section sets out the principles underlying information that is to be presented in the **notes** to the financial statements and how to present it. Notes contain information in addition to that presented in the statement of financial position, statement of comprehensive income, income statement (if presented), combined statement of income and retained earnings (if presented), statement of changes in equity, and statement of cash flows. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for **recognition** in those statements. Nearly every section of this IFRS requires disclosures that are normally presented in the notes. The disclosures required by this IFRS are listed in the *Presentation and Disclosure Checklist* that accompanies the IFRS.

Section 9: ***Consolidated and Separate Financial Statements***

This section defines the circumstances in which an entity presents **consolidated financial statements** and the procedures for preparing those statements. It also includes guidance on **separate financial statements** and **combined financial statements**.

Section 10: ***Accounting Policies, Estimates and Errors***

This section provides guidance for selecting and applying the **accounting policies** used in preparing **financial statements**. It also covers **changes in accounting estimates** and corrections of **errors** in prior period financial statements.

Section 11 and 12: ***Basic Financial Instruments/Other Financial Instruments Issues***

Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* together deal with recognising, derecognising, measuring and disclosing **financial instruments** (**financial assets** and **financial liabilities**). Section 11 applies to basic financial instruments and is relevant to all entities. Section 12 applies to other, more complex financial instruments and transactions. If an entity enters into only basic financial instrument transactions then Section 12 is not applicable. However, even entities with only basic financial instruments shall consider the scope of Section 12 to ensure they are exempt.

An entity shall choose to apply either:

(a) the provisions of both Section 11 and Section 12 in full, or

(b) the recognition and measurement provisions on IAS 39 *Financial Instrument: Recognition and Measurement* and the disclosures requirements of sections 11 and 12 to account for all of its financial instruments. An entity's choice of (a) or (b) is an accounting policy choice.

Section 13: ***Inventories***

13.1 This section sets out the principles for recognising and measuring **inventories**.

Inventories are **assets**:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

13.2 This section applies to all inventories, except:

(a) work in progress arising under construction contracts, including directly related service contracts (see Section 23 *Revenue*);

(b) financial instruments (see Section 11 *Basic Financial Instruments* and Section 12 *Additional Financial Instruments Issues*);

(c) biological assets related to agricultural activity and agricultural produce at the point of harvest (see Section 34 *Specialised Activities*).

13.3 This section does not apply to the measurement of inventories held by:

(a) producers of agricultural and forest products, **agricultural produce** after harvest, and minerals and mineral products, to the extent that they are measured at **fair value** less costs to sell through profit or loss; or

(b) commodity brokers and dealers that measure their inventories at fair value less costs to sell through profit or loss.

Section 14: ***Investments in Associates***

This section applies to accounting for **associates** in **consolidated financial statements** and in the financial statements of an investor that is not a parent but that has an investment in one or more associates. Paragraph 9.26 establishes the requirements for accounting for associates in **separate financial statements**.

Section 15: ***Investments in Joint Ventures***

This section applies to accounting for **joint ventures** in **consolidated financial statements** and in the financial statements of an investor that is not a parent but that has a **venturer**'s interest in one or more joint ventures. Paragraph 9.26 establishes the requirements for accounting for a venturer's interest in a joint venture in **separate financial statements**.

Section 16: ***Investment Property***

This section applies to accounting for investments in land or buildings that meet the definition of **investment property** in paragraph 16.2 and some property interests held by a lessee under an operating lease (see paragraph 16.3) that are treated like investment property. Only investment property whose fair value can be measured reliably without undue cost or effort on an ongoing basis is accounted for in accordance with this section at fair value through profit or loss. All other investment property is accounted for as property, plant and equipment using the cost-depreciation-impairment model in Section 17 *Property, Plant and Equipment* and remains within the scope of Section 17 unless a reliable measure of fair value becomes available and it is expected that fair value will be reliably measurable on an ongoing basis.

Section 17: *Property, Plant and Equipment*

17.1 This section applies to accounting for **property, plant and equipment** and **investment property** whose fair value cannot be measured reliably without undue cost or effort. Section 16 *Investment Property* applies to investment property whose fair value can be measured reliably without undue cost or effort.

17.2 Property, plant and equipment are tangible assets that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

17.3 Property, plant and equipment does not include:

(a) biological assets related to agricultural activity (see Section 34 *Specialised Activities*); or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar nonregenerative resources.

Section 18: *Intangible Assets other than Goodwill*

18.1 This section applies to accounting for all intangible assets other than goodwill (see Section 19 *Business Combinations and Goodwill*) intangible assets held by an entity for sale in the ordinary course of business (see Section 13 *Inventories* and Section 23 *Revenue*).

18.2 An **intangible asset** is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:

(a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

18.3 Intangible assets do not include:

(a) **financial assets**; or

(b) mineral rights and mineral reserves, such as oil, natural gas and similar nonregenerative resources.

Section 19: ***Business Combinations and Goodwill***

19.1 This section applies to accounting for **business combinations**. It provides guidance on identifying the acquirer, measuring the cost of the business combination, and allocating that cost to the assets acquired and liabilities and contingent liabilities assumed. It also addresses accounting for goodwill both at the time of a business combination and subsequently.

19.2 This section specifies the accounting for all business combinations except:

(a) combinations of entities or **businesses** under common **control**. Common control means that all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination, and that control is not transitory.

(b) the formation of a **joint venture**.

(c) acquisition of a group of assets that do not constitute a **business.**

Section 20: ***Leases***

20.1 This section covers accounting for all **leases** other than:

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see Section 34 *Specialised Activities*);

(b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 18 *Intangible Assets other than Goodwill*);

(c) measurement of property held by lessees that is accounted for as **investment property** and measurement of investment property provided by lessors under operating leases (see Section 16 *Investment Property*);

(d) measurement of **biological assets** held by lessees under finance leases and biological assets provided by lessors under operating leases (see Section 34);

(e) leases that could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased asset, changes in foreign exchange rates, or a default by one of the counterparties (see paragraph 12.3(f); and

(f) operating leases that have become onerous.

20.2 This section applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

20.3 Some arrangements, such as outsourcing arrangements, telecommunication contracts that provide rights to capacity, and take-or-pay contracts, do not take the legal form of a lease but they convey rights to use assets in return for payments. Such arrangements are in substance leases of assets, and they should be accounted for under this section.

Section 21: ***Provisions and Contingencies***

21.1 This section applies to all **provisions (**ie liabilities of uncertain timing or amount), **contingent liabilities** and **contingent assets** except those provisions covered by other sections of this IFRS. These include provisions relating to:

(a) leases (Section 20 *Leases*). However, this section deals with operating leases that have become onerous.

(b) construction contracts (Section 23 *Revenue*).

(c) employee benefit obligations (Section 28 *Employee Benefits*).

(d) income tax (Section 29 *Income Tax*).

21.2 The requirements in this section do not apply to executory contracts unless they are **onerous contracts**. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

21.3 The word 'provision' is sometimes used in the context of such items as depreciation, impairment of assets, and uncollectable receivables. Those are adjustments of the **carrying amount**s of assets, rather than recognition of liabilities, and therefore are not covered by this section.

Section 22: ***Liabilities and Equity***

22.1 This section establishes principles for classifying financial instruments as either liabilities or equity and addresses accounting for **equity** instruments issued to individuals or other parties acting in their capacity as investors in equity instruments (ie in their capacity as **owners**). Section 26 *Share-based Payment* addresses accounting for a transaction in which the entity receives goods or services (including employee services) as consideration for its equity instruments (including shares or share options) from employees and other vendors acting in their capacity as vendors of goods and services.

22.2 This section shall be applied when classifying all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Section 9 *Consolidated and Separate Financial Statements*, Section 14 *Investments in Associates* or Section 15 *Interests in Joint Ventures*.

(b) employers' rights and obligations under employee benefit plans, to which Section 28 *Employee Benefits* applies.

(c) contracts for contingent consideration in a business combination (see Section 19 *Business Combinations and Goodwill*). This exemption applies only to the acquirer.

(d) financial instruments, contracts and obligations under share-based payment transactions to which Section 26 *Share-based Payment* applies, except that paragraphs 22.3-22.6 shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.

Section 23: ***Revenue***

23.1 This section shall be applied in accounting for **revenue** arising from the following transactions and events:

(a) the sale of goods (whether produced by the entity for the purpose of sale or purchased for resale);

(b) the rendering of services;

(c) construction contracts in which the entity is the contractor; and

(d) the use by others of entity assets yielding interest, royalties or dividends.

23.2 Revenue or other **income** arising from some transactions and events is dealt with in other sections of this IFRS:

(a) lease agreements (see Section 20 *Leases*).

(b) dividends and other income arising from investments that are accounted for using the equity method (see Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures*).

(c) changes in the **fair value** of **financial assets** and **financial liabilities** or their disposal (see Section 11 *Basic Financial* Instruments and Section 12 *Other Financial Instruments Issues*).

(d) changes in the fair value of **investment property** (see Section 16 *Investment Property*.

(e) initial **recognition** and changes in the fair value of **biological assets** related to agricultural activity (see Section 34 *Specialised Activities*).

(f) initial recognition of **agricultural produce** (see Section 34).

Section 24: ***Government Grants***

24.1 This section specifies the accounting for all government grants. A **government grant** is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity.

24.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.

24.3 This section does not cover government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates. Section 28 *Income Tax* covers accounting for taxes based on income.

Section 25: ***Borrowing Costs***

This section specifies the accounting for **borrowing costs**. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs include:

(a) interest expense calculated using the effective interest method as described in Section 11 *Basic Financial Instruments*.

(b) finance charges in respect of finance leases recognised in accordance with Section 20 *Leases*.

(c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Section 26: ***Share-Based Payment***

26.1 This section specifies the accounting for all **share-based payment transactions** including:

(a) **equity-settled share-based payment** transactions, in which the entity acquires goods or services as consideration for **equity** instruments of the entity (including shares or share options);

(b) **cash-settled share-based payment** transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and

(c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

26.2 Cash-settled share-based payment transactions include share appreciation rights. For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. Or an entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (eg upon cessation of employment) or at the employee's option.

Section 27: ***Impairment of Assets***

An **impairment loss** occurs when the **carrying amount** of an asset exceeds its **recoverable amount**. This section shall be applied in accounting for the impairment of all assets other than the following, for which other sections of this IFRS establish impairment requirements:

(a) **deferred tax assets** (see Section 29 *Income Tax*).

(b) assets arising from **employee benefits** (see Section 28 *Employee Benefits*).

(c) **financial assets** within the scope of Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instruments Issues*.

(d) **investment property** measured at **fair value** (see Section 16 *Investment Property*).

(e) **biological assets** related to agricultural activity measured at fair value less estimated costs to sell (see Section 34 *Specialised Activities*).

Section 28: ***Employee Benefits***

28.1 **Employee benefits** are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to all employee benefits, except for share-based payment transactions, which are covered by Section 26 *Share-based Payment*. Employee benefits covered by this section will be one of the following four types:

(a) short-term employee benefits, which are employee benefits (other than **termination benefits**) that are wholly due within twelve months after the end of the period in which the employees render the related service.

(b) **post-employment benefits**, which are employee benefits (other than termination benefits) that are payable after the completion of employment.

(c) other long-term employee benefits, which are employee benefits (other than post-employment benefits and termination benefits) that are not wholly due within twelve months after the end of the period in which the employees render the related service.

(d) termination benefits, which are employee benefits payable as a result of either:

(i) an entity's decision to terminate an employee's employment before the normal retirement date; or

(ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.

28.2 Employee benefits also include **share-based payment transactions** by which employees receive equity instruments (such as shares or share options) or cash or other assets of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity. An entity shall apply Section 26 in accounting for share-based payment transactions.

Section 29: ***Income Tax***

29.1 For the purpose of this IFRS, **income tax** includes all domestic and foreign taxes that are based on **taxable profits**. Income tax also includes taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

29.2 This section covers accounting for income tax. It requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the financial statements. These recognised tax amounts comprise **current tax** and **deferred tax**. Current tax is tax due on taxable profit for the current and past periods. Deferred tax is tax payable or recoverable in future periods, generally as a result of the entity recovering or settling its **assets** and **liabilities** for their current carrying amount, and the tax effect of the carryforward of currently unused tax losses and tax credits.

Section 30: ***Foreign Currency Translation***

An entity can conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a **presentation currency**. Accounting for **financial instruments** denominated in a foreign currency and hedge accounting of foreign currency items are dealt with in Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*.

Section 31: ***Hyperinflation***

This section applies to an entity whose **functional currency** is the currency of a hyperinflationary economy. It requires such an entity to prepare **financial statements** that have been adjusted for the effects of hyperinflation.

Section 32: ***Events after the End of the Reporting Period***

This section defines events after the end of the **reporting period** and sets out principles for recognising, measuring and disclosing those events.

Section 33: ***Related Party Disclosures***

This section requires an entity to include in its financial statements the disclosures necessary to draw attention to the possibility that its **financial position** and profit or loss have been affected by the existence of **related parties** and by transactions and outstanding balances with such parties.

Section 34: ***Specialised Activities***

This section provides guidance on financial reporting by SMEs involved in three types of specialised activities – agriculture, extractive activities and service concessions.

Section 35: ***Transition to the IFRS for SMEs***

35.1 This section applies to a **first-time adopter of the *IFRS for Small and Medium-sized Entities***, regardless of whether its previous accounting framework was full **International Financial Reporting Standards (IFRSs)** or another set of generally accepted accounting principles (GAAP) such as its national accounting standards, or another framework such as the local income tax basis.

35.2 An entity can be a first-time adopter of the *IFRS for Small and Medium-sized Entities* only once. If an entity using the *IFRS for Small and Medium-sized Entities* stops using it for one or more **reporting periods** and then is required, or chooses, to adopt it again later, the special exemptions, simplifications and other requirements in this section do not apply to the re-adoption.

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