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Our ref INS/ACS

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Dear Sir

Consultation Paper: The future of UK GAAP

We write in response to the invitation to comment on the above Consultation Paper. In Appendix 1 to this letter we set out our responses to the specific questions raised by the ASB.

While we support the broad strategy the ASB is proposing to replace UK GAAP we are disappointed that after four consultations from the ASB over as many years on this topic, UK business is still facing a lengthy period of uncertainty over the future of UK GAAP.

UK GAAP has become unwieldy and confusing and entities within its scope have been faced with uncertainty over its future for too long. That period is, on the current ASB timetable, likely to continue until mid 2011 when the new rules should be issued. But on that timetable, businesses will need to change their systems from 1 January 2011 to have comparative numbers.

In our view, the ASB should take on board the lessons learnt from the transition of listed groups to full IFRS in 2005. Then, the final rules were not available until merely months before the implementation date and the affected groups had to complete their transition work in short time, often having to create short term work-arounds to produce the necessary data. The ASB is currently setting course to repeat the 2005 pain but affecting perhaps 50,000 individual companies compared to some 1,000 UK groups in 2005.

UK businesses have indicated to us a desire to move quickly to use IFRS for SMEs. This desire is driven by numerous factors, including;

1. the view that current UK GAAP is broken. The recent additions to UK GAAP of IFRS-based standards which are then subject to at least annual revisions and the use of full IFRS by some UK entities make it difficult to determine what is now UK generally accepted accounting practice;
2. companies which have “delisted” from AIM or the full market in recent times, either through choice or acquisition, may stay with full IFRS or possibly move back to UK GAAP. The latter is an unattractive option because UK GAAP has a limited shelf life and because these companies have not kept up with its changing requirements. A move now directly to IFRS for SMEs is the most attractive option;
3. companies will be required by HMRC to file financial statements in iXBRL from 2011. Under the present timetable, they will be tagging UK GAAP financial statements for one year only and then having to do another tagging exercise on their move to IFRS for SMEs;
4. the view that full IFRS’ disclosures are burdensome and complex for subsidiary companies and the IFRS for SMEs provides a more appropriate framework for such companies; and
5. more recently-qualified accountants have been trained almost exclusively in IFRS from around 2002. UK GAAP is not familiar to them and it is costly to business to train them to cope with UK GAAP financial statements. In contrast IFRS and IFRS for SMEs are more compatible.

We strongly believe that the IFRS for SMEs should be made available quickly to preparers to adopt on a voluntary basis as an alternative to current UK GAAP. This would allow entities to, if they so wished, move to the new settled regime for December 2010 year ends onwards.

We are aware that two arguments against immediate action may be advanced. The first is that it would introduce yet another accounting regime for UK companies. This argument has some validity. But if the options under existing UK GAAP and those under full IFRS are considered, the IFRS for SMEs which provides fewer options to preparers and is a settled regime for, at least, the next three years is an extremely attractive route with which users would rapidly become familiar.

The second argument is that there has to be delay to establish whether IFRS for SMEs is compatible with the EU Directives. Again, there is validity in this point. But this task may be done in a matter of days. Furthermore the test for the ASB is whether any accounting standard it introduced would be compatible with UK company law. Therefore, it does not have to await EU developments. We would hope that the ASB has already carried out this

work. We have done so ourselves and found only very minor points which can easily be coped with in surrounding guidance to the UK-introduced IFRS for SMEs.

As stated in our response to you in June 2007 on the implication of the draft IFRS for SMEs for UK and Irish entities, we believe that, to arrive at a sensible accounting framework in the UK, legal changes need to be made. Full IFRS can already be used by all entities as a standalone set of standards, i.e. bypassing most of the detailed accounting requirements set out in company law. We believe British companies would be better served if the accounting framework for those within the scope of the IFRS for SMEs could also be contained within one document as opposed to companies needing to refer to the detailed accounting requirements within Schedules 1, 2, 3 and 6 to the Accounting Regulations as well as the accounting standards. There is a need to lobby the Department for Business, Innovation and Skills (BIS) and the European Commission to allow the IFRS for SMEs to be used directly or to achieve this effect by some other route such as creating a 'one stop shop', combining the IFRS for SMEs and the Accounting Regulations into one document. The Commission is currently consulting on the IFRS for SMEs. While it would be nice to await the outcome of this, experience suggests that any changes at a European level will take many years. We strongly recommend that the ASB does not use EU developments as an excuse for delay but instead moves decisively now to assist British businesses.

If you have any queries on our comments, please contact Isobel Sharp (020 7007 0894) or Amanda Swaffield (020 7303 5330).

Yours faithfully

Deloitte LLP

Appendix 1

Responses to the specific questions in the Consultation Paper on the Policy Proposal: the future of UK GAAP

Question 1 – Definition of Public Accountability

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?

We support the Board's proposals to use the definition in paragraph 2.3 of the Paper, rather than using size-based definitions in the existing Act. This size test, if unchanged, would mean all large companies (referring to the size limits set out in section 465 to the 2006 Act) would fall into tier 1 as 'publicly accountable' entities. A large owner-managed business is simply not publicly accountable as defined in the IFRS for SMEs. We note that many of the largest private companies may volunteer to prepare full IFRS accounts for comparability with their peers.

The Act does not define 'public accountability' per se. However, sections 384 and 467 of the 2006 Act use similar sorts of definitions to prevent certain financial institutions from taking small or medium-sized company exemptions. In the interests of simplicity we recommend that the ASB uses similar wording to exclude those financial institutions from eligibility to use the IFRS for SMEs. This would have the advantage that the existing legal mechanisms to ensure UK Financial Services law complies with the applicable EU directives would not be broken. In addition, these definitions will continue to be relevant for other reporting issues including audit exemption and exemptions relating to the content of the directors' report. It would be unhelpful if the ASB introduced another slightly different definition.

We recognise that the ASB has amended the IASB's definition of public accountability, as included in the IFRS for SMEs, to include the additional words 'it is a deposit-taking entity'. We agree that this clarifies that banks are scoped into the definition of 'publicly accountable'. We note that the list of examples in the IFRS for SMEs includes securities broker/dealers. In the UK these entities hold client money in separate client money accounts, rather than directly in a fiduciary capacity.

The definition in paragraph 2.3, as it currently stands, is broad. We suggest that a list of the types of entity that fall in scope is prepared to help potential users of the IFRS for SMEs interpret the guiding principle set out in 2.3 of the Paper. A proposed list is included as Appendix 2. We suggest that such a listing is not enshrined within a standard but offered as guidance from the ASB.

Resolution of the definition of public accountability is a high priority and early communication on this matter would be welcomed. The current lack of clarity surrounding the definition means that many constituents are unclear how the ASB's plan for the future of UK GAAP may affect them.

Question 2 – Entities to be included in Tier 1

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

Yes. If entities are publicly accountable then by definition (see answer to Question 1) they should be included in Tier 1.

Some very small entities such as friendly societies may be categorised as Tier 1. We agree that this is appropriate as an entity being publicly accountable is not driven by the size of the entity but by its nature.

Despite the fact that the definition in 2.3 of the Paper states that banks, credit unions and mutual funds would typically be publicly accountable, it may be that some of these entities may not meet the definition if they do not hold assets for a 'broad group of outsiders'. This could be the case for a small mutual fund or credit union where membership is narrowly restricted on an on-going basis. Where a company of this nature does not meet the definition of publicly accountable it is suggested that it discloses how it supports this assertion in its financial statements.

The Paper does not set out the mechanism for requiring Tier 1 companies to prepare full IFRS accounts. An appropriate approach would be for the ASB to write a very short accounting standard which defines Tier 1 companies and forces them to elect to prepare 'IAS accounts' under the law. This is consistent with the approach taken for AIM companies under the AIM Rules.

Question 3 – application of EU adopted IFRS by wholly-owned subsidiaries that are publicly accountable

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?

Yes. We agree that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS, by definition.

A scenario that we believe requires consideration by the ASB is that where a non publicly accountable entity has a subsidiary with listed debt. Under current law and accounting standards, the subsidiary entity can adopt UK GAAP (including FRS 26) and the parent company (including its consolidated accounts) and other members within the group may continue to apply 'old' UK GAAP (i.e. not adopting FRS 26 and related standards). Under

the proposed regime, should the parent company in this group and the other group entities within the group prepare full IFRS individual accounts even if they are not publicly accountable?

UK law (s407) requires that a UK parent company and any subsidiary undertakings preparing accounts in accordance with the Act must be prepared using the same framework unless there are good reasons. The Guidance Notes issued by the DTI (now BIS) in October 2004 cite this example as a 'good reason' for the non-listed subsidiaries and parent company remaining on 'old' UK GAAP. However, under the new regime, can a justification be made for any group accounts being prepared by the parent company being prepared under IFRS for SMEs? If a group includes a publicly accountable entity it may not seem intuitive that the group accounts are produced using an accounting framework not designed for publicly accountable entities. It is recommended that the ASB addresses this.

A further question is whether wholly-owned subsidiaries of a publicly accountable entity, which are not publicly accountable themselves, will have to prepare full IFRS accounts. By virtue of s407 they will not, as inconsistency is permitted where a UK parent prepares IAS individual and consolidated accounts.

Question 4 – Should wholly-owned subsidiaries that are publicly accountable be allowed reduced disclosures?

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 disclosures.

No. We do not think that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures. The current disclosure requirements in the IFRS for SMEs are not compatible with full IFRS as the recognition and measurement requirements of the two regimes differ. Therefore a separate document specifying the reduced disclosures for this category of company would need to be produced. Given the majority of the information will have been produced for group reporting purposes, the incremental cost of reproducing such information in the subsidiary accounts should be minimal.

We are aware of the suggestion that non-publicly accountable subsidiaries should be allowed to use full IFRS for recognition and measurement and then the IFRS for SMEs or another set of rules for disclosures. We understand why this idea is appealing. However the mis-match point above is also relevant here. The ASB would have to create a new tier of rules for such entities. It would be contrary to the UK's position of supporting international convergence. As yet and given that the IFRS for SMEs allows entities to use IAS39, we have not identified major issues in using the IFRS for SMEs for subsidiaries. Furthermore, entities under such a regime would have to comply with the Directives as the accounts would not comply with IFRS as adopted by the EU.

In some cases where there are differences e.g. the default useful life of 10 years for the amortisation of intangibles, the IFRS for SMEs accounting is attractive for tax purposes.

However we agree that should major issues be identified, which cannot readily be handled by consolidation adjustments, the ASB should lobby IASB on these.

In our response of 2 November 2009 to the FRC on its discussion paper 'Louder than words', we welcomed the FRC's suggested action to ensure requirements for wholly-owned subsidiaries' reporting are targeted and proportionate and that using the exemption in the Seventh Directive is explored further. We ask the ASB to pursue this.

Question 5 – Should IFRS for SMEs be used by 'Tier 2' entities?

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

Yes. We agree that the IFRS for SMEs should be used by 'Tier 2' entities.

Question 6 – Should IFRS for SMEs be adopted wholesale and not amended?

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.

Yes. We agree with the Board's proposal. Adopting the Standard wholesale is in line with the argument that transitioning to the IFRS for SMEs enhances international comparability. It also simplifies the maintenance of the Standard. The ASB would retain responsibility for accounting standards used by UK entities to comply with the legal requirement to prepare accounts contained in company law. As such they should retain the right to amend the IFRS for SMEs if deemed necessary in the future.

The IASB intends to revise the IFRS for SMEs every two to three years. It is likely that the IASB will be starting consultation on changes to the IFRS for SMEs at the same time that the ASB mandates the UK transition to the IFRS for SMEs although an amended standard is unlikely to be available until 2014. The Paper does not set out the ASB's policy on adopting revised versions of the IFRS for SMEs. Would a revised standard be adopted immediately to allow entities to use a better standard straight away or with a time lag? We recommend that the ASB keeps the version of the IFRS for SMEs used in the UK aligned with the one issued by the IASB. It is vital that entities are provided with a stable platform prior to transition.

If the IFRS for SMEs is to be adopted as a replacement to current UK GAAP rather than being recognised as part of the IAS Regulation, entities will be required to apply the accounting requirements set out in the Accounting Regulations. A note on legal requirements would need to be issued to demonstrate that the ASB is content that the IFRS for SMEs is consistent with UK law. Alternatively, the IFRS for SMEs could be incorporated into the Accounting Regulations, either in full or via a cross reference. All requirements of the Accounting Regulations which are duplicated in the IFRS for SMEs

could be deleted. This would have the benefit of making the replacement for UK GAAP a 'one stop shop', rather like the FRSSE.

In addition, the note on legal requirements should clarify that the exemptions in s400 and 401 of the 2006 Act (preparation of group accounts exemption) will be available to IFRS for SME adopters, despite the fact that the IFRS for SMEs does not contain an equivalent exemption. This would be consistent with the current view of the Commission in respect of EU endorsed IFRS preparers.

Furthermore, under current UK law, an entity which opts to prepare IAS accounts is unable to switch back to preparing Companies Act accounts unless there is a 'relevant change in circumstance'. On the assumption that the IFRS for SMEs becomes UK GAAP and that the IFRS for SMEs is closer to full IFRS than current UK GAAP, the restriction on moving between accounting frameworks (s395 and 403) unless there is a 'relevant change in circumstance' should be removed so that entities which volunteered to apply full IFRS could switch from full IFRS to IFRS for SMEs.

Question 7 – Should IFRS for SMEs be used by large non-publicly accountable entities?

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.

We agree with the Board's proposal. See answer to Question 1. In some areas the IFRS for SMEs is tougher than UK GAAP e.g. financial instruments. We see no merit in basing public accountability on size of entity. If size were the prominent criterion then entities may fall in and out of scope year on year depending on their financials with no underlying change in the nature of the business.

There are other mechanisms outside of the ASB which could push an entity up to tier 1 e.g. market demand or regulators as proven a few years ago when the AIM rules were amended to require AIM companies to apply EU endorsed IFRSs.

Question 8 – Should the FRSSE remain?

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

Yes. The FRSSE works well for those entities within its scope and there are no cost/benefit grounds to change the regime for this category of entity.

Question 9 – Should the FRSSE be replaced in time?

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?

This question should be revisited no earlier than 2014, once the proposed regime is embedded into UK reporting and we have experience of how it is working. The needs of preparers and users of small company financial statements should also be borne in mind. There is a case for aligning the preparation of financial statements with the requirements for tax purposes to help ease the burden on small companies.

Furthermore, the outcome of EC's consultation on exempting 'micro' entities from the EU Accounting Directives may result in the number of entities within scope of the FRSSE being reduced drastically, raising the question of whether a third tier would be necessary. In the meantime pressing for deregulation of small companies at the EU level should be a priority.

Question 10 – The future role of SORPs

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

We believe that SORPs have a transitional role but no long-term future. We agree that the future of some of the SORPs e.g. insurance and oil and gas are dependent on the progress of IASB initiatives. Once Standards are issued in these areas there should be no need for a SORP. Where additional guidance is deemed necessary for an issue specific to UK reporters, it should continue to be the responsibility of the specific industry bodies to develop and maintain such guidance. There is no need for the ASB to be involved in franking such guidance.

We are unclear as to why the LLP SORP may be built into the FRSSE. If further guidance is needed for LLPs, surely this would apply to larger LLPs as well?

Question 11 – Should a public benefit entity standard be developed?

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?

No. We do not agree that the ASB should develop a separate framework for public benefit entities. At present, many public benefit entities are also UK incorporated limited companies and are required to prepare accounts under UK GAAP and UK company law. Applying a different framework for public benefit entities that are not companies would mean there was not a level playing field. Removing public benefit entities from the scope of company law could require complex legislation.

We believe that the IFRS for SMEs is not sufficiently different from UK GAAP that any of the accounting answers it produces would lead to counterintuitive answers for public

benefit entities. Whilst the IFRS for SMEs may not provide specific guidance, it does not contradict current practice to any significant extent. In certain overseas jurisdictions public benefit entities already apply full IFRS and it is commonly used by global charities. Whilst we appreciate that some public benefit entities may have had concerns about the cost of transition to full IFRS, the short length of the IFRS for SMEs and their often relatively simple operations should not make the transition overly burdensome. Indeed, the simplified nature of the standard and reduced frequency of change should be welcomed by many such entities. Concerns have been expressed about areas of perceived complexity such as financial instruments. However, the IFRS for SMEs is no more complicated than current UK GAAP when read together with applicable SORPs. For example, UK charities are already required to hold their investments at market value.

We accept that the existing not-for-profit SORPs provide some useful consistency of application within their sectors, but we note that there are currently significant differences between some of them. We recommend instead that the relevant regulators and representative bodies work together to produce guidance to assist their sectors in applying the IFRS for SMEs. Concerns that such guidance could be ignored by a particular entity could be dealt with by requiring compliance with the applicable code by regulation as is currently the case for English and Scottish charities.

Question 12 – What should a public benefit entity standard cover?

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?

See Question 11.

Question 13 – What issues should be included in a public benefit entity standard?

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?

As above, we do not believe a public benefit standard is required. There are existing SORPs in the three areas mentioned in the Paper although it is recognised that these SORPs conflict in places. It is suggested that the bodies which produce the sector specific SORPs revisit the SORPs in light of the IFRS for SMEs and work to reduce inconsistencies.

Question 14 – Consistency of UK GAAP and a public benefit entity standard

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?

This should not be needed as the requirements should be based on the IFRS for SMEs.

Question 15 – Costs vs benefits

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 and creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?

To help entities transition smoothly, at minimal cost, a stable regime is needed. The ASB should consider more widely all reporting requirements facing entities to reduce the burden on reporters. The current timeline sees XBRL being introduced by HMRC shortly before the ASB implements the new accounting regime. This means that entities will need to map their accounts against two different XBRL taxonomies, once from UK GAAP and again from IFRS for SMEs. Every effort should be made to harmonise these changes to minimise the burden on reporters.

Question 16 – Views on proposed adoption date

What are your views on the proposed adoption dates?

Under the ASB's current proposals, the timeline of 2012 is ambitious if the final rules are not to be issued until mid 2011. A stable platform required in the lead up to transition. To avoid repeating the mistakes of 2005, the final standard would need to be available by the middle of 2010 given that the date of transition for an entity with a year end of 31 December 2012 would be 1 January 2011. With responses to the Consultation Paper not due until 1 February 2010 this means that there is little or no time for an exposure draft of the Standard. It is questionable whether an exposure draft of a Standard which has already been published by the IASB and previously consulted on by the ASB is required. If published as an exposure draft, only a short consultation period, say two months, would be needed given the IFRS for SMEs as issued by the IASB is final. The final decision must be made as soon as possible after the consultation period.

Rather than face this period of uncertainty, we strongly believe that preparers should be allowed to adopt the IFRS for SMEs immediately on a voluntary basis as an alternative to current UK GAAP. Due process may call for an Exposure Draft but this could be a few pages, inviting comments on making the IFRS for SMEs available for use early in 2010. The ASB could then make the IFRS for SMEs available immediately, say no later than 30 June 2010 and allow entities to adopt the regime voluntarily from December 2010 year ends. This has the benefit of allowing preparers which would be in scope of the IFRS for SMEs under the proposed regime to transition at a time of their choosing.

Appendix 2

Scope – some initial ideas

Within the scope of publicly accountable

Entities with debt or equity securities traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets [list markets])

Banks (retail and investment)

Insurance companies

e-money issuers

Friendly societies

Building societies

Credit unions

MiFID investment firms

UCITS management company and UCITS funds

Outwith the scope of publicly accountable

Travel agents

Estate agents

Solicitors

Insurance brokers

Mortgage and insurance intermediaries

Non-MiFID investment firms (broadly those that do not hold assets on behalf of the public)

Sellers that receive payment in advance of delivery of goods or services

Non-UCITS investment funds

We note that the list of examples in the IFRS for SMEs includes broker

/dealers. However, in the UK these entities hold client money in separate client money accounts, rather than directly in a fiduciary capacity.