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30 April 2012

Dear Mrs Carter

Exposure Draft 46 "Application of Financial Reporting Requirements (draft FRS 100)", Exposure Draft 47 "Reduced Disclosure Framework (draft FRS 101)" and Exposure Draft 48 "The Financial Reporting Standard applicable in the UK and Republic of Ireland (draft FRS 102) ("the Exposure Drafts")

We thank the Accounting Standards Board ("ASB") for the opportunity to comment on the above Exposure Drafts setting out revised proposals for the future of financial reporting in the UK and Republic of Ireland.

We also thank the Board for the considerable efforts expended in its research and outreach activities and for paying careful attention to the feedback to its previous proposals and as a consequence, making several welcome changes.

We are particularly pleased that the revised proposals do not take a metaphorical backward step in financial reporting for UK entities and that accounting options permitted under current UK standards that are already consistent with EU-adopted IFRS have been introduced. This, along with the retention of the fair value accounting provisions for certain financial instruments, results in a much improved set of financial reporting principles, most of which will already be understandable to the compilers and users of the accounts.

The proposed effective date

Whilst we understand the reasons for the proposed effective date and the option to adopt early, we believe that there are further considerations that need to be taken into account to promote an orderly and consistent transition process.

The eventual implementation of the proposed new European Accounting Directive will mean that the FRSSE will require extensive revision and we do not believe that this would be worthwhile. Consequently small entities may have to suffer two major changes in close succession or avoid doing so by adopting FRS 102 before larger companies are compelled to do so, which in our view is not appropriate. In addition, some entities will need to wait for the relevant SORP to be updated before FRS 102 can be applied and existing IFRS adopters will not be able to reap the benefits of the reduced disclosure framework until current legislation has been amended.

These factors increase the complexity of the transition process and we therefore suggest that, where possible, there should be a mandatory effective date that aligns with these other changes. We would also ask for the removal of the option for early adoption. We believe that, if possible, one mandatory date for all changes will reduce confusion and promote clarity and consistency for preparers and users of accounts alike.

The basis of preparation

Given the imminent legislative changes noted above, we suggest amending paragraph 7 'Basis of Preparation of Financial Statements' in draft FRS 100 to allow small eligible entities to apply the recognition and measurement requirements only in draft FRS 102, without having to comply with the disclosure requirements.

Removal of the tiered system

We had initially supported the proposed financial reporting framework based on public accountability. However, in view of the changes the Board proposes, we now consider draft FRS 102 to be a more robust and refined financial reporting framework, suitable for a broader group of entities and their users.

Proposals for agricultural activities

We understand that there has been much debate as to the practical ability of entities to reliably estimate fair value, particularly with regards to those agricultural activities involving biological transformation. However, under BEN 19, most UK farmers currently use 'market value' as the starting point for estimating the deemed cost of arable stocks and livestock for tax purposes. It is therefore difficult to claim that the proposals are unduly arduous unless the activities are carried out in jurisdictions where market information is not available.

However, it cannot be ignored that such proposals will accelerate taxable profits which may impose cash flow difficulties on an already struggling industry. When specific industries have been affected by changes in accounting standards in the past, HMRC has allowed a spreading provision to ensure the effects of the changes have not been crippling in their impact. We believe similar treatment would be appropriate in this case. We therefore ask that if these proposals are accepted the ASB seeks confirmation from HMRC that biological assets are held as trading stock and that the change from realisation to fair value will fall within s185 and s186 Corporation Taxes Act 2009 and the equivalent rules contained in s236 and s237 Income Tax (Trading and Other Income) Act 2005.

Proposals in respect of Income Taxes

As set out in our response to the Board's previous proposals, we were supportive of tax accounting principles based on IAS 12, with some straightforward simplifications. We do however acknowledge that whilst many are supportive of the temporary difference approach of IAS 12, it is often criticised for its complexity and the difficulties associated with its practical application. Furthermore, there is currently significant debate and a lack of global consensus about accounting in this area and any change to UK accounting should be a step towards some future possible alignment, rather than a step into uncertainty.

In contrast, users and preparers in the UK and the Republic of Ireland are familiar with the timing difference approach of FRS 19 which in many circumstances, produces an equivalent deferred tax result to that given by the temporary difference approach of IAS 12.

We therefore see the 'timing difference plus' approach as an attractive practical solution at a time when there is such a fundamental lack of agreement globally on this area. We are, however, concerned that there may be a lack of consistent application of the timing difference plus approach on matters that are treated differently under UK GAAP and IFRS, for which draft FRS 102 provides no guidance, for example equity settled share-based payment transactions and intra-group transactions. We therefore ask the Board to include additional guidance in respect of such transactions.

As progress is made towards a new global standard, we would ask the Board to commit to reconsidering the draft FRS 102 requirements and re-exposing this section if necessary in order to achieve greater global consistency.

Draft FRS 101: Reduced Disclosure Framework

We agree with the Board's proposals to extend the reduced disclosure framework to parent companies that are not themselves subsidiaries, given the major focus of users on the consolidated financial statements and on the basis that the parent company financial statements are usually presented with the consolidated financial statements.

We believe that a further cost saving and benefit could be obtained by removing the requirement to disclose each paragraph exemption that has been applied. A requirement to disclose the application of the Reduced Disclosure Framework and a brief reference to the accounting topics these relate to would, in our opinion, be sufficient information for the readers and would also align with the Financial Reporting Council's objective for cutting clutter in annual reports.

The Alternative View

In our experience smaller entities are more sophisticated than the alternative view suggests. Given the computerisation of records many small entities now prepare regular management accounts and management want to fully understand the financial implications of their decisions. We see a very important feature of draft FRS 102 as promoting good decision making. Simplifying complex areas can lull preparers into a false sense of security when they should be considering very carefully whether or not they should be taking on specific financial instruments or share based payment transactions. In our view the simplification of complex areas as suggested will lead to financial information that does not reflect the commercial reality of such transactions and, as a consequence, preparers and users of the accounts alike will not have sufficient information when companies enter into such transactions to assess the commercial, risk or financial implications.

Like the alternative view, we are in favour of cutting clutter in the accounts. However we believe that the suggested approach of dealing with certain transactions predominantly or exclusively by disclosure is not compatible with this objective. Furthermore we feel this will dilute information that we believe to be important thus hampering effective decision making by management, suppliers, providers of finance and other classes of user.

ASB questions and detailed comments

Our responses to the specific questions posed by the ASB in the Exposure Drafts are given in the attached Appendix 1. Additional requests for clarity have been included in Appendix 2.

Summary

We appreciate that many different interests need to be considered before the adoption of a new approach to financial reporting in the UK. However, given the overwhelming support for change evidenced in the previous consultation, we hope that the final version of the new UK GAAP can be agreed upon very soon. This will enable preparers of accounts, users and auditors to make appropriate plans for training and transition in good time for the changes.

If you would like to discuss any of the points raised in this response, please contact Nicky Warburton (nicky.warburton@bakertilly.co.uk).

Yours sincerely

Nicky Warburton.

Nicky Warburton
Technical Associate Director
Baker Tilly UK Audit LLP

Appendix 1

Question 1

The ASB is setting out the proposals in this revised FRED following a prolonged period of consultation. The ASB considers that the proposals in FREDs 46 to FRED 48 achieve its project objective 'To enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.'
Do you agree?

We are very supportive of the Board's revised proposals for the future of financial reporting in the UK and Republic of Ireland as set out in FREDs 46 to 48 and believe that significant improvement has been made. The inclusion of accounting options that align UK GAAP with EU adopted IFRS will assist in the transition for entities that are seeking capital market growth.

We believe that quality could be further enhanced in respect of the accounting for goodwill and changes in stake and accounting for grants, as set out below:

Goodwill and changes in stake

Paragraph 14. 8i provides guidance in respect of a change in stake when an associate or joint venture becomes a subsidiary. It requires the previously held equity interest to be re-measured to fair value with a resultant gain or loss being recognised in the income statement. This is consistent with the draft FRS 102 requirements that deal with other changes in stake. Paragraph 19.14 of draft FRS 102 requires the cost of the business combination to be allocated to the acquiree's identifiable assets and liabilities, where the cost of the combination is defined as the 'fair values of consideration at the acquisition date'. The section does not however explain how to treat the previously held equity interest in the goodwill calculation nor how the difference between the fair value of the previously held equity interest and the fair value of the identifiable assets and liabilities represented by that previously held equity interest should be treated.

We therefore ask the Board to amend the calculation of goodwill as set out in section 19.14 to include the fair value of the previously held equity interest, thus aligning section 19 with the calculation set out in IFRS 3 (revised 2008) paragraph 32.

Section 24 Grants

Currently there is an accounting policy choice. However it is unclear whether an entity must select one policy and apply it to all grants or whether an entity can select the most appropriate policy on a grant by grant basis. We would welcome further guidance in respect of this particular issue.

Requests for further clarification have been set out in Appendix 2.

Question 2

The ASB has decided to seek views on whether:

- As proposed in FRED 47- A qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements in either IFRS 7 or IFRS 13; or
- Alternatively- A qualifying entity that is a financial institution should be exempt in its individual accounts from all of IFRS 7 except for paragraphs 6, 7, 9(b), 16, 27A, 31, 33, 36, 37, 38, 39, 40 and 41 and from paragraphs 92-99 of IFRS 13 (all disclosure requirements except the disclosure objectives).

Which alternative do you prefer and why?

We agree with proposed FRED 47 that a qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements of IFRS 7 and IFRS 13.

Question 3

Do you agree with the proposed scope for the areas cross-referenced to EU-adopted IFRS as set out in section 1 of FRED 48? If not, please state what changes you prefer and why.

We agree with the additional requirements in respect of Operating Segments. However we foresee problems with the application of IAS 34 Interim Financial Reporting and IAS 33 Earnings Per Share.

Certain publicly traded markets such as the Alternative Investment Market do not mandate the application of IAS 34 for interim reporting. As such the proposal means that individual companies with shares traded on such markets applying the draft FRS 102 would need to comply with IAS 34, whereas parent companies with shares traded on the same market, that prepare their consolidated accounts in accordance with EU adopted IFRS, would not be required to comply with IAS 34. The proposals therefore place more onerous requirements on individual entities that are not parent undertakings. We can only suppose that this is an unintended effect and would ask the Board to refer to this requirement on a voluntary basis only.

In addition, the proposals require all entities to comply with IAS 33. However, parent companies are permitted under by the Companies Act to take exemption from producing a profit and loss account if their financial statements are presented with the group financial statements. We therefore ask the Board to reconsider its proposals and exempt parent companies from the requirement to comply with IAS 33.

Question 4

Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

The definition of a financial institution includes venture capital and investment trusts but excludes entities that operate a similar business model within a different legal structure. Therefore these ‘other’ similar entities are treated as having a different risk profile to venture capital and investment trusts. By contrast, they are treated similarly in section 9 when determining whether such entities need to consolidate their investments. We cannot see any reason for treating them differently for disclosure purposes and therefore we ask the Board to consider including these ‘other’ entities within the definition of a financial institution.

Question 5

In relation to the proposals for specialist activities, the ASB would welcome views on:

a) **Whether and, if so, why the proposals for agriculture activities are considered unduly arduous? What alternatives should be proposed?**
b) **Whether the proposals for service concession arrangements are sufficient to meet the needs of preparers?**

Agriculture

Please see our comments in our covering letter.

Service concessions

The proposals for service concessions arrangements will amend current accounting practice in the private sector and will ensure consistency with the public sector, avoiding the current situation where an asset may not appear on the balance sheet of either party to the arrangement.

Given this change, in our view the proposals on the application of the draft FRS 102 principles should be clearly established. Although we understand that the thrust of draft FRS 102 is to be concise, the requirements at present do not stand alone and knowledge of IFRIC 12 is considered necessary for the principles to be applied.

We therefore ask the Board to incorporate the provisions of paragraphs 11-27 along with the illustrative flowchart in information note 1 of IFRIC 12 into section 34. This would keep the requirements concise but provide sufficient guidance to aid in their application when preparing draft FRS 102 financial statements.

Question 6

The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:

a) **Do you consider that the proposals provide sufficient guidance?**
b) **Do you agree with the proposed disclosures about the liability to pay pension benefits?**

We consider that the guidance provided in the proposals for pension schemes is reasonable and we look forward to a revised SORP that provides more specific disclosure guidance and direction in respect of financial instruments so as to avoid the adoption of boiler plate disclosures.

We are content with the status quo in that the liability to pay pension benefits remains disclosure only. We also do not anticipate any practical difficulties in the application of the valuation hierarchy to asset valuations.

We also agree with approach adopted by draft FRS 102 to allow actuarial information to be included in a separate report alongside the financial statements or in the notes to the financial statements and we agree with the liability disclosure objectives in paragraph 34.43. We would however, ask the Board to consider how the requirements of paragraph 34.43 could be achieved by utilising the information already required to be disclosed to members by UK defined benefit retirement plans under the regulatory requirements to produce Summary Funding Statements.

Question 7

Do you consider that the related party disclosure requirements in section 33 of FRED 48 are sufficient to meet the needs of preparers and users?

We are generally in agreement with the requirements and exemptions in respect of related parties. However the difference in wording between IAS 24 and draft FRS 102 leads to a different interpretation and we therefore suggest that the wording is aligned.

Question 8

Do you agree with the effective date? If not, what alternative date would you prefer and why?

As set out in our covering letter we understand the reasons for the proposed effective date. However, we believe that current and proposed legal requirements should be taken into account when determining an appropriate transition date as set out below.

The interaction of current legal requirements with the reduced disclosure framework

Companies that apply EU adopted IFRS (IFRS) will not be able to benefit from the reduced disclosure framework until the current legal requirements are amended (ie section 403(4) of the Companies Act 2006). If this change does not occur until after the effective date of these proposals, entities that currently apply UK GAAP will be able to apply the reduced disclosure framework earlier than those entities that currently apply IFRS. Although we appreciate that this may be outside the Board's control or influence, we would support the Board in encouraging the UK Department for Business, Innovation and Skills (BIS) to make such a change in a timeframe that will permit all qualifying entities to adopt the reduced disclosure framework at the same time.

The effect of the European Directive on the future of the FRSSE

The interaction between the Legislative Proposal for a new European Directive, "*Annual financial statements, consolidated financial statements and related reports of certain types of undertakings*" and the FRSSE should in our view be considered when setting the effective adoption date.

If the Legislative proposal receives assent from the European Parliament in September 2012, and is enacted in the UK as soon as possible thereafter, taking full advantage of all of its deregulatory provisions, (which is likely, given the attitude of the Government to deregulation), there will be an immediate consequential effect on the FRSSE and the companies which use it. The FRSSE will either need to be withdrawn or extensively revised to remove most of its disclosure requirements. It would surely be inappropriate to devote sufficient resources to make the scale of changes to the FRSSE that would be required.

Therefore under the current proposals, small entities which are currently using the FRSSE will either have to apply full current UK GAAP before they adopt FRS 102, or choose to adopt the FRS 102 early. As the former option will mean two major changes in close succession, the effect will be that any small companies currently using the FRSSE will have to adopt FRS 102 before larger companies are compelled to do so. We do not believe that this is appropriate.

In summary

To reduce complexity, avoid confusion and promote clarity and consistency for preparers and users of accounts we propose a mandatory effective date that aligns with the effective date of these proposed legislative changes where possible and the option for early adoption should be removed.

Question 9

Do you support the alternative view, or any individual aspect of it?

Our comments on reducing complexity are set out in our covering letter. In addition to these comments, we disagree with the proposed project objective. It suggests that the project objective should focus on the information needs of the users subject only to cost/benefit constraints and that the Board's objective sub-ordinates these needs to the requirement for high-quality and understandable financial reporting. In our view, the ASB has been able to make an informed view of the user's needs as a direct consequence of its extensive outreach programme to which we have already made reference to in our covering letter. Furthermore, whilst we accept that financial reporting requirements should take into account cost / benefit considerations, we consider that different users will view the benefits of financial information in different ways. Adding such a requirement to the project objective in our view introduces subjectivity rather than simplicity and nor are we persuaded that such an objective, even if desirable, is met by the alternative view's other proposals. Therefore we do not support the proposed objective but instead support the ASB's project objective because in our view, high-quality and understandable financial information will meet the users' needs and is essential to promote effective decision making and stewardship.

Appendix 2 Requests for clarity

Investments in subsidiaries, associates and joint ventures measured at fair value through profit and loss

Draft FRS 101 and section 9 of draft FRS 102 permit investments in subsidiaries, associates and joint ventures to be recognised at fair value through profit and loss in the separate financial statements of parent entities. SI 2008/410 section D Fair Value Accounting paragraph 36(3c) only permits investments in subsidiaries, associates and joint ventures to be measured at fair value if permitted by International Accounting Standards and provided that the disclosures required by such international accounting standards are made. Section 11.48A was inserted so that certain financial assets and liabilities could be measured at fair value and achieve compliance with Company Law. However section 9 does not include the requirement to apply the financial instrument disclosures set out in section 11 to such investments should an entity wish to adopt this measurement policy. We would ask Board to amend 9.26(c) to include this requirement.

We also ask the Board to reconsider the completeness of section 11.48A and whether it incorporates all the requirements of IFRS 7 with regards to financial assets (including investments in subsidiaries, associates and joint ventures) and financial liabilities that may be measured at fair value under SI 2008/410 section D. We have concerns that section 11.48A does not enable compliance with Company Law and particularly the relevance of IFRS 7 paragraphs 27, 28, 31, 36, 40 and 41.

In the summary to the reduced disclosure framework, paragraph 4 suggests that where a qualifying entity has financial liabilities held at fair value which are neither held as part of a trading portfolio nor are derivatives, it must apply certain specific requirements of IFRS 7. There are, however other circumstances in which these disclosures are required in order to achieve compliance with the Regulations for example investments in subsidiaries, associates and joint ventures measured at fair value through profit and loss. We therefore ask the Board to make further reference to this circumstance in FRS 101 paragraph 4. In addition we ask the Board to update Appendix 1 of FRS 101 paragraph A1.6 to include subsection 3 of paragraph 36 of Schedule 1 to the Regulations.

Liabilities and Equity

Draft FRS 102 section 22.4(a)(iv) restricts a puttable financial instrument from being classified as equity if it will or may be settled in the entity's own equity instruments. This means that any convertible instrument will not meet the definition of equity. In contrast IAS 32 paragraph 16A(d) only restricts instruments that are convertible into a variable number of the entity's own equity instruments. To avoid this inconsistency we ask the Board to clarify that the restriction in 22.4(a)(iv) relates to instruments that will or may be settled in a *variable number* of the entity's own equity instruments.

Defined Benefit Pension Schemes

Draft FRS 102 28.38 requires that where there is a contractual agreement or stated policy for charging the cost of a defined benefit plan as a whole measured in accordance with this draft FRS to individual group entities, the entity shall, in its individual accounts, recognise the cost of a defined benefit plan so charged. It is unclear how this should be applied. We therefore ask the Board to consider amending the wording to bring in line with IAS 19 paragraph 34A.

Discontinued operations

FRS 102 5.7C requires discontinued operations re-presented for the comparative period, to be disclosed on the face of the profit and loss account as shown by the appendix illustration. This is currently not a requirement in UK GAAP which permits such disclosure to be made in the notes in order to meet the legal requirements. In our view this requirement could add unnecessary clutter and we request that disclosure of comparative information in the year the operation is discontinued is permitted in the notes to the accounts.

Investments in associates and joint ventures held by an entity that is not a parent

Where an entity is not a parent under section 14 and 15 of draft FRS 102, investments in associates cannot be measured at fair value through profit and loss. In contrast, parent companies may recognise investments in associates at fair value through profit and loss. Is this what the Board intended?

Disclosures cross referenced to other group members accounts

Draft FRS 102 28.41 refers to disclosures being cross referred to another group members accounts if they are prepared on the same 'terms'. It would be useful if the ASB clarified what it mean by the same terms through the use of examples.

Impairment of assets held for their service potential

Extending the application to all entities

In the context of public benefit entities, calculating impairment losses using a value in use measurement, based on the present value of future service potential was easy to understand. Extending its application to all entities through its incorporation into draft FRS 102, may however, lead to individual assets that are not individually held for their cash generating potential but are part of a cash generating unit that generates a commercial return (for example, corporate assets) being measured inappropriately based on its service potential. We therefore ask the Board to provide examples of the type of assets that might be held by profit-seeking entities for their service potential rather than generating a commercial return or consider a definition of 'service potential' that incorporates the nature of the asset that may be held. This, in our view would assist profit seeking entities in applying the appropriate value in use measurement to assets held for their service potential and assets that should be allocated to a cash generating unit.

We agree that a cash flow driven valuation such as value in use in not an appropriate measure of impairment for assets that are held for their service potential. We also agree that the alternative measure as set out in draft FRS 102 is an appropriate measurement but should be referred to as an alternative measure for assets held for their service potential rather than 'value in use (in respect of assets held for their service potential)'. This is because value in use is specifically defined in the glossary as the present value of <u>cash flows</u>, whereas 'value in use' for assets held for their service potential is determined using a <u>non-cash flow</u> driven model.

We ask the Board to consider amending paragraph 27.11 as follows: "The recoverable amount of an asset or a cash generating unit, other than an asset held for its service potential (i.e. one that is not held for the primary purpose of generating a commercial return either individually or in conjunction with other assets), is the higher of its **fair value less costs to sell** and **its value in use.** If it is not possible to estimate the recoverable amount of an individual asset, references in paragraphs 27.12-27.20 to an asset should be read as references to an asset's cash-generating unit. For an asset held for its service potential a cash flow driven valuation may not be appropriate and in such circumstances its recoverable amount is the higher of its fair value less costs to sell and the present value of the asset's remaining **service potential."** In addition we ask that paragraph 27.14B be clearly presented as an alternative measure with its own separate heading "Service potential", rather than being included under the heading "fair value less costs to sell" as it is at present, and reworded to "For assets held for their **service potential**, the present value of the asset's remaining service potential should be determined. In many cases this may be taken to be the costs avoided by possession of the asset. Therefore, **depreciated replacement cost** may be a suitable method measurement model but other approaches may be used where more appropriate."

Definitions of 'Service Potential', 'Depreciated Replacement Cost' and 'Recoverable Amount'

Draft FRS 102 defines depreciated replacement cost as 'The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date' and defines service potential as 'the economic utility of an asset, based on the total benefit expected to be derived by the entity from use (and/or through sale) of the asset.' This definition takes into account a future cash inflow from the assets ultimate sale whilst the Development of the Financial Reporting Exposure Draft (Part 3) paragraph 10.18 makes reference to the fact that depreciated replacement reflects the *outflows* that are saved from the ownership of the asset.

The inclusion of disposal proceeds is therefore inconsistent with the depreciated replacement cost concept being the cash flows that are saved through continued ownership of the asset. We therefore suggest that the definitions of service potential be amended to "The economic utility of an asset based on the total benefit expected to be derived by the entity from its continued use", depreciated replacement cost aligned with the definition set out in paragraph 10.18 of Part 3 and the recoverable amount include the alternative measure as set out above.