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**CHARTERED
ACCOUNTANTS**

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ACCOUNTING STANDARDS BOARD

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Our Ref: NNS/MPC

Dear Sirs

THE FUTURE OF FINANCIAL REPORTING

We write to offer our comments on the ASB's latest proposals for the Future of Financial Reporting in the UK and Republic of Ireland (FREDs 46, 47 and 48).

Responses to the FREDs' detailed questions are set out in an Appendix. Our general comments are set out below.

Support for the proposals

We support these proposals as offering a balance between a system which is based on the IFRS for SMEs (and as such is based on the international standards) but which departs from it in some areas in order to better meet users' information needs.

This approach recognises that, while a consistent framework is desirable where this can be achieved, the accounting requirements of most entities differ from those of the listed entities which have always been the focus of the international standards. The development principles of the IFRS for SMEs included a move away from the "investor perspective" which IFRSs apply to listed companies. As we argued in our letter of comment (dated 27 April 2011) on the previous proposals, the detailed requirements and perspectives of the full IFRSs are not necessarily "better" accounting. On the contrary we believe that, for unlisted entities, following the requirements of the proposed FRS 102 will produce accounts which are more comprehensible to the user and better meet the overall requirement to give a true and fair view.

Areas for further improvement

There remain some areas where improvements could be made.

As an example, as argued in our previous letter of comment, the current requirements for share-based payment charges (which we accept are not a change from existing requirements) derive from an assumption that the shares in the company which are to be received by the third party are akin to cash. This assumption does not apply to unlisted entities, many of which nonetheless make such awards to their employees. Their shares do not have a readily ascertainable market value, and cannot in fact be readily sold. For such entities a more appropriate accounting approach is to reflect the potential change in shareholding as a narrative note without any accounting entry (the substance over form argument that underlies the accounting charge does not apply to unlisted entities.)

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Nonetheless, we support proceeding with the current proposals to rationalise the UK accounting requirements, on the basis that such issues can be considered for amendment in future editions of FRS 102.

Public Benefit Entities

The accounting objectives of Public Benefit Entities are significantly different from that of trading companies and we supported the previous proposal for a separate Financial Reporting Standard on the basis that this could allow for some differences in measurement basis for these entities.

The previously proposed FRED 45 was, however, not a separate standard, but worked as an addition to the proposed FRSME. The decision to incorporate this material within the proposed FRS 102 should not in itself cause difficulties so long as the principle is maintained that some different accounting requirements are required.

The basis for the inclusion of the additional PBE paragraphs is that some of the transactions undertaken by Public Benefit Entities, and the resulting assets and liabilities, may differ from those undertaken by trading entities and that catering for these transactions separately is sufficient to meet the different accounting objectives of these entities. The mechanism whereby some provisions which present alternative treatments are only to be followed by PBEs implies an acceptance that some differences should apply when dealing with a different entity type.

We can see the merits of the proposed approach. But if all such requirements are to be met within a single standard it will be important to consult with the various SORP making bodies to ensure that there are no further areas where the proposed standard would cause difficulties for such entities. Although this consultation need not await the finalisation of the relevant SORPs, it will be important to establish with those bodies that there are no other issues which should be amended in the proposed FRS 102 before it is finalised.

In the particular context of charities, there are concerns that the new proposals in FRS 102 (in particular the definition of “restrictions”) could make significant changes to charity accounting. The Charity SORP has established a framework which is well understood and meets the information needs of the users of charity accounts. Care should be taken that any changes made by the proposed FRS 102 do not disturb this, unless a reasoned case is made for doing so.

The Charities SORP requires the use of a SOFA in place of a profit and loss account, but charitable companies are also required to meet the requirements of the profit and loss account which derive from the Companies Act formats. Although this can usually be achieved within a single statement, the differences between the two sets of requirements are a complication for charitable companies which unincorporated charities can avoid without detriment. While we generally support the decision to require non-corporate entities to follow the Companies Act formats, it would be better to exempt entities which are following a recognised SORP from this requirement. This could be achieved by extending the exception in section 5.1 of FRED 48 that disapplies the requirements where “these requirements are not permitted by any statutory framework under which such entities report” to include a situation where departure is permitted by a SORP that the entity has adopted (a similar change should also be made to section 4.1 of FRED 48).

FRSSE

We agree that the European Commission proposals on small-company reporting, and their further proposals for Micro-entities, necessitate a delay in finalising the proposals for small companies.

Much of what is proposed for the revised Directive is unhelpful (in particular the proposal to outlaw the accounting formats which are most commonly used in this country, and which give a clearer picture of the financial position of the entity, and the proposal to limit the detailed accounting requirements which can be mandated at national level). It is to be hoped that lobbying to amend these proposals will be successful.

In the absence of these considerations we would continue to argue that in the long-term there should not be a separate FRSSE, although some form of separate FRSSE may be useful in the short term as a transitional measure. As far as possible the FRSSE should be based on proposed FRS 102 while allowing for further disclosure exemptions. In the long term we would have favoured moving the exemptions into a future version of FRS 102 and dispensing with the separate document.

We accept the suggestion of paragraph 5.8 of the explanatory material to your proposals that, assuming that the EC proposals go ahead, users of the EC regime for small entities would benefit from an accounting standard setting out how to apply the accounting requirements of the proposed Directive. However, one possible outcome is that the EC directive will be finalised in a form which would make the adoption of this regime undesirable to many of the companies entitled to use them. On the assumption that such companies are still entitled to opt to follow the requirements applying to larger entities (and so could opt, under draft FRS 100 s7 b), to apply proposed FRS 102) such companies could still usefully be offered disclosure exemptions which are equivalent to those which they have been entitled to under the existing FRSSE.

To make progress with the current proposals, we agree that the current drafts should be further developed for publication on the assumption that in the short term there will continue to be a FRSSE. That FRSSE would initially be adapted from the current version along the lines proposed. This may need to be replaced by a new FRSSE which would provide guidance on accounting within the proposed EC small-company regime (and also potentially that for Micro-entities), but we would suggest that the new FRSSE should also allow that a company which is entitled to follow those requirements may choose not to do so but may instead apply FRS 102 with some specified exemptions. (This effectively mirrors the reduced disclosure regime, such entities would be opting to follow the FRSSE without opting to follow the EC small-company regime.) Such complications would best be avoided but may, depending on the wording of the final EC Directive, be unavoidable.

Drafting points

While we have not carried out a detailed analysis of the wording in these drafts, one particular point arose from our more general review. Paragraph 7 of proposed FRS 100 is a crucial paragraph which sets out the basis on which entities should account. Although we think that the intended meaning is clear, the suggestion in the current draft is that it is only consolidated financial statements which may already be required to follow full EU-adopted IFRS. Although the IAS Regulation only applies to consolidated financial statements, paragraph 7 also refers to the requirements of “other legislation or regulation” which may oblige entities to follow full IFRSs in their own single entity accounts. This is already a requirement for AIM companies and it is possible that other regulators may apply similar requirements in future. The introductory section of paragraph 7 could usefully be clarified simply by removing the first appearance of the word “consolidated”, or by rephrasing the opening words to be: “An entity that is required by the IAS Regulation to prepare consolidated financial statements in accordance with EU-adopted IFRS, or is required by other legislation or regulation to prepare financial statements on this basis, must do so”. (Consequential changes would be required to paragraph 6 of the Summary of FRED 46 and elsewhere.

**Conclusion**

Although some difficulties remain, we support the introduction of the proposed FRSs 100 - 102 by the proposed implementation date, with early adoption allowed once these documents are available.

Yours faithfully

Michael Comeau
Technical Principal

ANSWERS TO SPECIFIC POINTS RAISED

Q1 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?

As discussed above, subject to the points raised in this letter, we agree that the proposals meet the stated objective and that this is an appropriate objective.

We would suggest a small change of emphasis in the stated objective. The reference to “understandable reporting proportionate to the size and complexity of the entity” might be taken to suggest that the differences from full IFRSs are only justified on cost benefit analysis and that in some way the full IFRSs give “better” accounting. We do not believe this to be the case and, as argued in our main letter, believe that different accounting principles are more appropriate for different entity types and give a more useful result. This might be reflected by amending the above phrase to “understandable reporting appropriate to the type of entity and proportionate to its size and complexity”.

Q2 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?

The disclosure requirements of IFRS 7 and IFRS 13 are extensive and in many cases excessive. We support the second option whereby the required disclosures are only those which are consistent with FRED 48.

Q3 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 proposals set out in 1.3, 1.4 and 1.5 of FRED 48 to apply the relevant IFRS requirements where an entity is obliged to, or otherwise chooses to, make the disclosures listed. The wording could usefully be amended to avoid any potential circumstances where such additional disclosures are directly required by the accounting standard if it is not already required.

We agree with the proposal in 1.6 of FRED 48 to apply IFRS 4 in the circumstances described.



Q4 Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

Although we have no detailed comments to make, the imposition of the additional requirements or Credit Unions (many of which are very small entities) would seem to be disproportionate.

Q5 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?

Other respondents are likely to have greater experience in accounting for agriculture and service concession arrangements. However, we would note that in the former case agricultural assets are unlikely to have an objectively observable value which can be demonstrated with reference to transactions in equivalent amounts such as to form a homogeneous population in which financial transactions occur, in practice agricultural assets will differ one from another significantly and it is hard to see what real information would be by applying generalised valuation techniques to them. A cost basis would give a much clearer view of this economic activity (especially given that most agricultural assets will be realised within a relatively short time frame).

Q6 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 have no particular comments to make under this heading.

Q7 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 agree with the decision to exempt transactions between wholly owned subsidiaries in section 33 of FRED 48.

The identification and auditing of related party transactions continues to be a difficult area for most entities and their auditors. It is difficult to see how a clear but less onerous requirement could be drafted, and, obviously, the ASB has to work within the legal requirements, but we would suggest that the value of such disclosure has been overemphasised and that in the future some method of limiting the disclosure requirements to those transactions which are genuinely of relevance to the user of the accounts should be sought.

Q8 Do you agree with the effective date? If not, what alternative date would you prefer and why?

We agree with the proposed effective date.

As noted in our main letter there are some areas which we believe could usefully be developed further in due course. However, we think that it is important that progress be made with these proposals (we agree with the reasons for this identified in paragraph 1.9 of the explanation of your proposals). We agree that early implementation should be permitted once the final standards are available, and that entities following a SORP should also have to wait for the publication of the appropriate SORP. While this latter policy would mean that early publication of the final documents would be desirable, it is important that, while there would be no need to await the final publication



of each SORP it is important that the ASB reaches agreement with the SORP making bodies that there is nothing in these proposals which would have an effect on accounting for such bodies which cannot be justified as better accounting, before finalising the standards..

Early adoption could be allowed for accounts prepared after the date of publication of the new standards, rather than only for accounting periods commencing after that date (this would benefit those who are late in preparing accounts for a transitional period.)

Q9 Do you support the alternative view, or any individual aspect of it?

The alternative view cannot entirely be dismissed. As set out under “Areas for further improvement” in our main letter above, we believe that there are areas where the accounting could better reflect the needs of users of unlisted entity accounts. Nonetheless, the proposals set out in the current drafts already substantially meet these needs and will be a considerable improvement on the current situation. We do not agree with the alternative view that the progress of this proposal should be delayed to allow for a major reconsideration of the information needs of users.