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FAO Peter Godsall, Accounting Standards Board
Submitted by email to ukgaap@frc-asb.org.uk

1 February 2010

Dear Sirs

**Accounting Standards Board Consultation Paper
Policy Proposal: The future of UK GAAP**

We welcome the opportunity to respond to this important consultation.

The British Property Federation is the voice of property in the UK, representing companies owning, managing and investing in property. This includes a broad range of businesses comprising commercial property developers and owners, financial institutions including pension funds, corporate landlords, local private landlords and those professions that support the industry, including law firms, surveyors and consultants.

There are two distinct contexts in which UK GAAP can be relevant to our members (and more generally). First, many businesses are required in their entirety to report using UK GAAP. Secondly, many businesses may use UK GAAP for the solus accounts of wholly owned subsidiaries, while using IFRS at the consolidated level. The latter case is common in the property investment industry, where property groups tend to have numerous subsidiaries, and it is a particularly useful check when assessing proposals relating to the reform of UK GAAP for consistency, comparability and administrative simplicity.

We have consulted a number of our members about the proposals set out in the Board's Consultation Paper and set out our views below, focusing on our principal points in the body of this letter and setting out responses to certain of the Consultation Paper's questions in the Appendix.

Paragraph references are to numbered paragraphs in the Consultation Paper unless otherwise stated.

The following are our largest member companies or are represented on our Board or Policy Committee:

Annington Homes Ltd
Argent Group plc
Aviva Investors
AXA REIM UK Ltd
Bank of Scotland Corporate Banking
Big Yellow Group Plc
The British Land Company PLC
Brockton Capital
Cadogan Estates
Canary Wharf Group Plc
CB Richard Ellis
Credit Suisse
Crown Estate
Cushman & Wakefield
Delancey Real Estate Asset Management Ltd
Derwent London plc
Development Securities Plc
Dorrington
DTZ
Elphinstone Group Ltd
Eskmuir Properties Plc
Evans Property Group
F&C Property Asset Management plc
Frogmore Property Company Limited
Grainger plc
Great Portland Estates Plc
Grosvenor
Hammerson Plc
Helical Bar Plc
Hermes Fund Managers Limited
Hunter Advisers
Invista Real Estate Management Limited
Jones Lang LaSalle
KPMG LLP
Land Securities Group PLC
Legal & General Property Ltd
Lend Lease Corporation Ltd
Liberty International PLC
Linklaters LLP
Lovells LLP
Moorfield Group PLC
Morgan Stanley
Prudential Property Investment Managers Ltd
Quintain Estates and Development Plc
Redevco UK
Regeneration Investments Limited
Residential Land
Schroder Property Investment Management Ltd
Scottish Widows Investment Partnership Limited
SEGRO plc
St Martins Property Corporation Ltd
St Modwen Properties PLC
Standard Life Investments Ltd
Stockland
Treasury Holdings UK Ltd
Warner Estate Holdings Plc
Westfield Group
Workspace Group PLC

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Executive Summary

- We support the objectives of the Board in relation to the future of UK GAAP, as set out in para 1.
- We consider that using the IFRS for SMEs as the basis for UK GAAP is not the right way to achieve those objectives, because it
 - differs in material respects from IFRS on matters of substance (such as the way borrowing costs are treated), reducing consistency and comparability between Tier 1 and Tier 2 reporters, and
 - imposes onerous obligations (such as the need to prepare a cash flow statement) on Tier 2 reporters which are not justified by any benefit for the users of their financial statements.
- The IFRS for SMEs would be particularly inappropriate for wholly owned Tier 2 subsidiaries of Tier 1 reporters.
- We believe that many businesses (particularly those which report under IFRS at consolidated level but have wholly owned Tier 2 subsidiaries) would opt to use full IFRS across their groups rather than use the IFRS for SMEs, chiefly to avoid an increased burden associated with understanding and complying with different sets of rules.
- A better approach would be for UK GAAP for Tier 2 entities to be a simplified version of full IFRS, with carve-outs and exceptions from its more onerous substantive and presentational requirements, but avoiding the use of quite different principles such as are included within the IFRS for SMEs.

Key messages in more detail

Substantive differences between IFRS and the IFRS for SMEs

We understand that the IFRS for SMEs was conceived to provide a proportionately lighter level of reporting regulation on (broadly) unlisted entities, with the IFRS focus on relevance and reliability being moderated by taking benefit and cost into consideration. To that extent, we can see why the IFRS for SMEs is a natural candidate for UK GAAP for Tier 2 entities.

However, we believe that the objectives of the Board would be best advanced if the accounting regime to be applied to Tier 2 entities did not have significant differences of approach as regards measurement from that applicable to Tier 1 entities. While key definitions and underlying assumptions are common as between the IFRS for SMEs and full IFRS, we have identified a number of significant differences between IFRS and the IFRS for SMEs:

- (i) the treatment of transaction costs in business combinations;
- (ii) the way investments in joint ventures can be reported;
- (iii) the way borrowing costs are treated;
- (iv) reporting for non-financial assets and goodwill;
- (v) the way assets held for sale are dealt with;
- (vi) recognition of employee benefits; and

(vii) the treatment of deferred tax.

The treatment of borrowing costs is particularly relevant for the property development and investment industry, which is highly capital intensive and typically uses debt to finance large development projects (either relying on existing facilities or borrowing specifically for the project). When a development project is initially appraised, the borrowing costs are estimated and included in the calculation of the internal rate of return, so capitalising them in the accounts – in line with full IFRS – makes sense. Treating borrowing costs as an expense at the (Tier 2) entity level – as required by the IFRS for SMEs – would deliver no benefit to the preparer or the users of that entity's accounts and, where it is a wholly owned subsidiary of an IFRS reporter, an adjustment would be needed on consolidation to eliminate the very different asset measurement bases and profit or loss resulting from the application of the IFRS for SMEs.

In other words, applying the IFRS for SMEs to Tier 2 entities would:

- miss an opportunity to enhance the consistency and comparability of financial statements produced by Tier 1 and Tier 2 entities; and
- place groups which report under IFRS at the consolidated level but have wholly owned Tier 2 subsidiaries in the position where – if they opt to use the IFRS for SMEs for their Tier 2 entities – they must report on very different bases at the entity and consolidated level, with the differences needing to be tracked and adjusted for on consolidation.

Our recommendation would be for the Board to identify specific carve-outs from full IFRS which would be appropriate for Tier 2 entities, reducing complexity and the burden of reporting requirements without disadvantaging the users of their financial statements. That would be in line with the way FRSE modified UK GAAP pre-IFRS, and would enhance the consistency and comparability of financial statements both between Tier 1 and Tier 2 entities generally, and between solus and consolidated accounts in groups consisting of Tier 1 and Tier 2 entities.

Presentational differences under the IFRS for SMEs

While we consider that the IFRS for SMEs departs unhelpfully from full IFRS on a number of substantive points, we are concerned that it is too close to full IFRS in terms of its presentational requirements.

The components of financial statements under IFRS for SMEs (statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flows, and notes) are similar to those under full IFRS. In our view, it would not be consistent with the principles of better regulation to impose the requirement for all those components on Tier 2 entities. The users of financial statements for unlisted companies (particularly wholly owned subsidiaries, where the primary user is the parent company) do not need all the information that analysts and institutional investors, the primary end users of listed company financial statements, want.

The requirement for a cash flow statement for every Tier 2 entity, prepared in the same manner as under full IFRS, would be particularly unwelcome. It would increase the administrative burden for wholly owned subsidiaries as compared to the position under existing UK GAAP without any discernible benefit for the users of their financial statements – contrary to the principles of better regulation.

If, contrary to our submissions, the Board moves forward with the IFRS for SMEs for Tier 2 entities, we believe that at the very least there should be an exception from the obligation to prepare a cash flow statement for Tier 2 entities which are wholly owned subsidiaries. This is a particular concern for the property industry, because REITs and other IFRS reporting groups commonly have large numbers of subsidiaries.

The 'Publicly Accountable' definition

The meaning of this term is very important, because it is key to determining whether an entity falls into Tier 1 (and IFRS reporting) or Tier 2 (and UK GAAP reporting, whether under the IFRS for SMEs as proposed or otherwise). However, we are concerned that it is not sufficiently clear. We would welcome greater clarity over the meaning of the term 'Publicly Accountable', including specific guidance on the following points:

- in the context of the phrase '*it is a deposit-taking entity and / or holds assets in a fiduciary capacity*', would investment property be regarded as 'assets'?
- is the reference to '*a broad group of outsiders*' limited to investors in retail investment vehicles, or would it also include investors in an investment vehicle (such as an unauthorised unit trust) designed for institutional investors? Whatever the answer to that question about the quality of the outsiders, guidance would also be helpful on whether the term envisages any particular quantity of outsiders.

These questions are important to the property industry because this sector uses a wide range of investment vehicles, including REITs (which must be listed on a recognised stock exchange), private corporate groups, unauthorised unit trusts and limited partnerships. While REITs clearly have public accountability, uncertainty surrounds the status of other entities, including limited partnerships and unit trusts – which may have institutional, sophisticated or private investors, numbering anything from two upwards. It would be helpful to understand how one should determine which entities must apply full IFRS.

Conclusions

We strongly support the Board's intention to pursue convergence between UK GAAP and IFRS (*para 1.1*), and we endorse the Board's recognition that the approach adopted should respect the principles of better regulation (*para 1.6*). We too would like to see UK GAAP develop in a way which simplifies reporting (*para 1.8(i)*); provides a consistent basis for financial reporting and reduces the burden associated with understanding and complying with different sets of rules (*para 1.8(ii)*); improves comparability and understandability (*para 1.8(iii)*); and enables the Board to devote more of its resources to seeking to influence the development of IFRS (*para 1.8(iv)*).

We particularly agree with the propositions (set out in *para 1.11*) that the "widespread adoption and recognition of IFRS around the world make them the most obvious basis for UK GAAP", but that "the full suite of IFRS may not be the most appropriate basis for preparing financial statements for all entities in the UK".

However, **we consider that using the IFRS for SMEs as the basis for UK GAAP is not the right way to achieve the above objectives.** The principal reason for that view is that the IFRS for SMEs, far from being a simplified, less onerous version of full IFRS, effectively amounts to an alternative set of accounting principles which differ from IFRS while in certain respects increasing the administrative burden for preparers as compared to the position under existing UK GAAP.

Feedback from our members suggests that many businesses – particularly those using IFRS at the consolidated level, but even some wholly subject to UK GAAP – would opt to use full IFRS in preference over the IFRS for SMEs for Tier 2 entities in their groups. It is felt that the IFRS for SMEs would add to the burden associated with understanding and complying with different sets of rules, and it would reduce comparability with financial statements prepared under IFRS. It would be particularly unattractive for wholly owned Tier 2 subsidiaries in groups which report under IFRS at the consolidated level.

A better approach would be for UK GAAP for Tier 2 entities to be a simplified version of full IFRS, with carve-outs and exceptions from its more onerous substantive and presentational

requirements, but avoiding the use of quite different principles such as are included within the IFRS for SMEs.

We would welcome the opportunity to participate in more detailed discussions with you about how this project might best be taken forward. Please do not hesitate to contact me in the first instance if you have any queries.

Yours faithfully

A handwritten signature in black ink, appearing to read 'P Cosmetatos', written in a cursive style.

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Appendix: Responses to specific questions

Question 1

Which definition of Public Accountability do you prefer: the Board's proposal or the current legal definitions? 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 agree with the Board's proposal that the accounting regime should be determined by the nature of that entity rather than being determined by the size of the entity. We concur with the Board's preference that the financial reporting requirement be applied best suited to discharging the entities' stewardship and accountability obligations. We would like further guidance to be issued as to which assets are included in the second paragraph of the definition of public accountability as well as to whom a broad group of outsiders refers?

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.

Yes. We agree with the Board that wholly owned subsidiaries that are publicly accountable should be allowed reduced disclosures – with full IFRS, rather than the IFRS for SMEs, as the starting point, as explained in the main part of this response. We are concerned that the accounting regime proposed for Tier 2 entities is particularly inappropriate for wholly owned subsidiaries, imposing a regulatory burden that is not justified by any benefit for the users of their financial statements.

Question 5

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

No, for the reasons set out in the main part of our response.

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.

No, we do not agree with the Board's proposal that the IFRS for SMEs be adopted wholesale. For the reasons set out in the main part of this response, we consider that Tier 2 entities should be required to report under a modified version of full IFRS (with appropriate amendments and carve-outs) and not under the IFRS for SMEs.

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?

No. In principle, we support the proposition that Tier 3 entities should (after an appropriate transition period) report on the basis of the regime applicable to Tier 2 entities, subject to appropriate modifications. Using the Tier 2 reporting regime as the starting point for Tier 3 reporting would further enhance the consistency and comparability of financial statements

produced by different entities. Doing so subject to appropriate simplifications, carve-outs and exceptions would ensure that the compliance burden for Tier 3 entities remained modest. However, for the reasons set out in the main part of this response, we do not consider the IFRS for SMEs to be the right reporting framework for Tier 2 entities, so it follows that it would not be the right reporting framework for entities currently using FRSE.

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?

Members who are Tier 1 reporters at the group level but with subsidiary Tier 2 companies currently reporting under UK GAAP gave the following feedback:

The new IFRS for SMEs would not substantially reduce the burden of disclosure, nor would it remove differences in accounting treatment between the solus accounts of subsidiaries and the consolidated accounts. As a result, we would choose to adopt full IFRS for our subsidiary Tier 2 companies if the alternative under UK GAAP were to apply the IFRS for SMEs. While applying full IFRS group wide would increase aspects of the compliance burden, it would at least reduce the number of consolidation adjustments required at the group level and remove any ambiguity regarding how items should be accounted for across the group.

As compared to current UK GAAP, the IFRS for SMEs would give rise to significant extra cost in the preparation of cash flow statements at the subsidiary level, with the one off transition costs (preparing two sets of cash flows in the first year) being a particular burden. Disclosure of related party transactions between group entities would also become a problem, as the exclusion from the scope of FRS 8 under para 3(c) does not seem to be reflected under the IFRS for SMEs. The need to track information about transactions and balances in complex groups would add an additional administrative burden, potentially requiring changes to accounting systems. As the user of the solus accounts of our Tier 2 subsidiaries, we regard the requirements of the IFRS for SMEs in these respects as wholly unnecessary.