



National Audit Office

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Helping the nation spend wisely

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Dear Mr Godsall

POLICY PROPOSAL: THE FUTURE OF UK GAAP

The National Audit Office (NAO) is pleased to comment on the above consultation paper published by the Accounting Standards Board (the Board).

The NAO, on behalf of the Comptroller and Auditor General, carries out the external audit of all UK central government departments and a wide range of other UK and international public bodies, including a number of charities.

We agree with the general direction of the policy proposals. We are particularly supportive of the suggestion that the Board should develop a standard for the public benefit sector, where both full IFRS and the IFRS for SMEs do not address a number of issues common to entities in that sector. But we also believe that the Board should retain a wider role in UK standard setting that acknowledges a potential requirement for interpreting or supplementing IFRS for SMEs to reflect the needs of UK preparers and users in the for-profit sector, whether arising from law or from industry or regulator requirements set out in SORPs.

We welcome the publication by the IASB of the IFRS for SMEs which is well-written and concise and should be generally well suited to the reporting requirements of the 'Tier 2' companies. Whilst some small entities may consider retention of the FRSSE, with which they are familiar, to be desirable, we do not believe that expense and complexity of maintaining a separate third tier of GAAP, with the associated need for specialists therein, will be efficient beyond the short term.

Our responses to the Questions for Consultation are set out in the attached annex.

I hope these observations are useful to you.

Yours sincerely



ANDREW BAIGENT

Director General, Financial Audit

Annex

Policy Proposal: The Future of UK GAAP

NAO response to consultation questions

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

We prefer the Board's proposal. This accords better with the IASB's intentions regarding the applicability of IFRS to bodies based on the public interest rather than just size. Some further precision with regard to the terms "deposit-taking entity" and "holds assets in a fiduciary capacity" might be desirable as a number of very small entities for which full IFRS would not seem to be necessary might be considered to act in those capacities on occasion.

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

Subject to our comments above regarding tightening up of the definition (which might also include a limited size exemption), we agree that all publicly accountable entities should be included in Tier 1.

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

We agree with the Board's proposal that subsidiaries that are themselves publicly accountable should apply EU adopted IFRS.

Q4: Do you still consider that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures? If so, it would be helpful if you could highlight such disclosure reductions as well as explaining the rationale for these reductions.

We do not consider that that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures. If groups choose to establish or retain structures that include publicly accountable subsidiaries then the burden of full disclosure at that level should be expected.

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

Yes, we believe that the IFRS for SMEs in its present form is well suited to the reporting requirements of the 'Tier 2' companies and will provide advantages over the current use of UK GAAP in terms of its conciseness and better comparability with financial statements based on full EU adopted IFRS (which may be helpful for

larger companies within Tier 2 or those that may wish to enter the 'publicly accountable' regime).

Q6: Do you agree with the Board's proposal that the IFRS for SMEs should be adopted wholesale and not amended? If not, why not? It would be helpful if you could provide specific examples of any amendments that should be made, as well as the reason for recommending these amendments.

We consider that the current version of IFRS for SMEs is fit to be adopted wholesale subject to consideration of any particular UK or EU legal requirements or exemptions. It would be generally desirable not to amend the standard for UK application, although the Board should be prepared to do so if the IASB were to change the standard in a way that was not seen to be desirable or which conflicted with legal or regulatory requirements.

Q7: Do you agree with the Board's proposals 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. Market forces or particular industry regulators may persuade or require some larger entities to move to EU adopted IFRS but we see no argument that size by itself should require its use.

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

Whilst we believe that the FRSSE should remain available for the time being, we do not believe that the cost and complexity of maintaining a third tier of GAAP indefinitely is warranted when there is a concise and practical alternative. There may be benefits if the Board were to develop guidance additional to the IFRS for SMEs that in conjunction with it would provide a comprehensive body of reporting guidance for small entities. Such guidance might be viewed in the same light as a SORP that covers regulatory and legal requirements in addition to accounting practice.

Q9: Do you agree that the FRSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?

Yes, but possibly supported by some practice guidance as described in the answer to Q8 above.

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

The SORPs have been of great benefit in promoting good quality, consistent and comparable accounting across the relevant industry sectors and we see a continuing need for this type of practice guidance where there are gaps in standards or a particular need for comparability and consistency in an industry or

public benefit sector that is not met by the standards alone. We are in broad agreement with the Paper's proposed approach for each SORP in the short term, but believe that the Board should be prepared to continue to provide some form of assurance over SORPs that may be prepared or amended to converge with EU adopted IFRS or IFRS for SMEs. We do not believe that this should be seen as 'interpreting' IFRS and it might be appropriate to rename SORPs to indicate that they should be seen as application guidance rather than as standards or interpretations of standards.

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

We support the Board's proposal to develop a public benefit standard, to cover those issues common to the sector which are not addressed in EU adopted IFRS or IFRS for SMEs. Such a standard would assist in providing a greater level of consistency across the sector and reduce the need for such issues to be addressed separately in a number of different SORPs (although we would not suggest that a public benefit entity standard will necessarily remove the need for some extra practice guidance for particular types of public benefit entities).

Q12: If you do agree with the proposal to develop a public benefit entity standard, should the standard cover all the requirements for preparing true and fair 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.

On balance we consider that the second approach, to supplement IFRS or IFRS for SMEs, would be best. Such an approach recognises that IFRS/IFRS for SMEs should remain as the core source of accounting standards for both the profit and not-for-profit sectors and that much of IFRS should apply without adaptation or interpretation. This is similar to the approach adopted for central government public sector financial reporting guidance where the Government Financial Reporting Manual provides appropriate supplementary guidance based on the general applicability of IFRS to the sector. This approach will enable a relatively 'lean' standard, which should not require constant revisiting as IFRS/IFRS for SMEs evolves.

It may be necessary to supplement a public benefit standard with additional application guidance for the different types of public benefit entities (such as charities, housing, and higher education), but the need for fully comprehensive SORP style guidance should be reduced. Whilst the individual sub-sectors might prefer separate comprehensive standards as 'one-stop shops' we consider that this is unlikely to be practicable or desirable. Maintenance of separate standards would be resource-intensive, and there would a risk of individual standards becoming out of date or leading to inconsistent practices across the wider public benefit sector.

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

We agree that the issues in the table at paragraph 3.15 are distinctive for the sector and should be covered in a public benefit entity standard. The list is a fairly comprehensive starting point, although there could perhaps be separate reference to donated property, plant and equipment, and donated time/services.

Q14: The Board accepts there may be a continuing need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. Where this is the case, do you think the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?

Yes, we consider that such guidance should have such an assurance statement.

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

The proposals will not affect the basis for the preparation of our own financial statements, but we do audit the financial statements of a number of public sector charities and companies. Whilst there will be one-off costs in any move to an IFRS based regime we believe that the wider benefits of a consistent IFRS based approach across the public sector will outweigh this.

Q16: What are your views on the proposed adoption dates?

We consider that a 1 January 2012 date for the for-profit sector should be achievable as the relevant EU adopted IFRS and IFRS for SMEs guidance is already in place. But this may depend on the duration of any further consultation process and the resolution of any outstanding legal issues.

With regard to the public benefit entity sector, the challenges of developing a public benefit entity standard as proposed by the Board should not be underestimated and a target of 1 January 2012 may be challenging. While it would be desirable for the public benefit sector to move to an IFRS basis on a similar timetable to the for-profit sector any delays in the implementation of changes for public benefit entities should not be allowed to delay change for the for-profit sector.