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Dear Mr Godsall

## The future of UK GAAP

### INTRODUCTION

1. Ernst & Young LLP welcomes the opportunity to comment on The Future of UK GAAP ("the Consultation") issued by the Accounting Standards Board ("the Board").

### GENERAL OBSERVATIONS

2. We agree with the Board's strategy to work under the IASB framework, and consider the Board's proposal to be a positive step towards achieving this. In our view, the proposal will bring greater consistency, comparability and relevance in reporting across companies which are publicly accountable.
3. We broadly support the use of the IFRS for SMEs for 'Tier 2' entities, with the possible exception of wholly-owned subsidiaries of IFRS reporters. We also support the Board's proposal that public accountability should not be based solely on an entity's size. However, some aspects of the definition of public accountability are ambiguous in our opinion, so we encourage the Board to give entities absolute clarity as to the types of entities that will fall within the scope of this definition.
4. Whilst we support the proposed timetable for change - because it will ensure that UK GAAP is replaced in the near future - the Board might wish to reconsider the potential impact of the timetable on businesses affected by the proposals. That said, it is important that it reaches a final decision as quickly as possible, to bring more clarity and certainty for these businesses. But if this is not possible, we suggest that the Board considers delaying the transition date by one year to give businesses more time to prepare.



## RESPONSE TO QUESTIONS

**Q1. 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 prefer the definition of public accountability proposed by the Board (paragraph 2.3). The Board's proposal defines public accountability based on the nature of an entity's accountability, whereas the current legal definition deems accountability based solely on an entity's size. We do not consider that an entity's size should be the predominant factor in determining public accountability. We say this because we consider accountability to arise from the nature of an entity and its stakeholders, not necessarily the size of its operations.

One definition of a publicly accountable entity (based on the original definition in the IFRS for SMEs), includes an entity which is a deposit taking entity (added by the Board) and/or holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

In our view, both elements of this definition are ambiguous and should be clarified. For example, it is unclear whether it should apply to law firms (which typically hold client monies in a fiduciary capacity) or small entities such as credit unions (with narrowly defined membership criteria). To this end we encourage the Board to define what it means by "deposit-taking" and "in a fiduciary capacity for a broad group of outsiders", and state clearly the type of entities that will fall within the scope of this definition.

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

We agree. All publicly accountable entities should be included in 'Tier 1'. We consider this to be the case because it is appropriate that the financial statements and extent of disclosure made by all publicly accountable companies should be aligned to those of listed companies. However, as stated in our reply to Q1, the Board should clarify its definition of public accountability and provide clear guidance as to the type of entities to which this definition should apply. We also suggest that the Board ensures it has considered the potential impact on distributable reserves, for those companies that will be required to convert from UK GAAP to either IFRS or the IFRS for SMEs, as a result of the Board's proposal.

**Q3. 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?**

We agree. Wholly-owned publicly accountable subsidiaries should apply EU-adopted IFRS, to meet the objective of decision-useful information for users and to preserve comparable, relevant and reliable information across all publicly accountable entities.

**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 wholly-owned publicly accountable subsidiaries should be allowed to make reduced disclosures. We do not consider the ownership of a publicly accountable entity to alter the obligation on that entity, to provide the same level of disclosure as that required by other publicly accountable entities.

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

We recognise that over a number of years the Board has pursued a strategy to converge UK GAAP with IFRS, and that the Board's proposal represents a major change in the UK reporting framework. As this will bring significant change to many businesses in the UK, we concur with the Board that regulation should be proportionate, accountable, consistent, transparent and targeted.

We support the convergence of UK GAAP with IFRS to provide a consistent basis for financial reporting, and to reduce the burden of maintaining a dual accounting framework.

We consider the IFRS for SMEs to be appropriate for 'Tier 2' entities on the basis that:

- It represents a form of IFRS, which is more relevant to entities that are not publicly accountable.
- It provides a stable platform for reporting, as the intention of the IASB is to update the standard approximately once every three years (however note our response to question six regarding the frequency of review for consistency with IFRS).
- The disclosure requirements are proportionate to the nature of the entities and the level of stakeholder interest.

However, whilst the IFRS for SMEs is appropriate for 'Tier 2' entities, we are of the opinion that the Board should consider whether wholly-owned subsidiaries of IFRS reporters should be required to adopt IFRS for recognition and measurement, in line with the policy of the parent company. Feedback from many of our clients, particularly listed companies with high numbers of UK subsidiaries, is that they would prefer wholly-owned subsidiaries to adopt accounting policies consistent with the parent company.

We suggest that it may be possible, depending on feedback from investors and preparers, for the Board to carve-out certain disclosures for subsidiaries of IFRS reporters, to reduce the burden on preparers and achieve the objective of decision-useful information. In our view the groups affected the most by this are best placed to identify

unnecessary disclosures. We suggest that certain IFRS 7 disclosures on financial instruments may fall into this category.

We believe that this approach will balance the objective of consistent reporting for 'Tier 2' entities across jurisdictions under the IFRS for SMEs, whilst providing a pragmatic solution for subsidiaries of IFRS reporters.

**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.**

In principle we agree with the ASB's position that the IFRS for SMEs should be adopted wholesale. However, we are aware of two specific issues which we believe the Board will need to consider.

Firstly, we are aware that there is now an unintended inconsistency between the IFRS for SMEs and IAS 12, in relation to the accounting for deferred tax. This has arisen because of the IASB's decision not to press ahead with its full amendment to IAS 12, having previously reflected its thinking in the IFRS for SMEs. Ideally, we believe the best way to resolve this is by the IASB amending the IFRS for SMEs. To this end we hope the ASB will encourage the IASB to do this, but if the IASB is unwilling we believe the ASB should consider amending the IFRS for SMEs as it applies in the UK.

Secondly, it would appear that any company applying the IFRS for SMEs will only be exempt from preparing group accounts, if it satisfies the criteria in 9.3 of the standard. Whereas, under both current UK GAAP (FRS 2) and IFRS - as endorsed in the EU (although not of course "full" IFRS) - an entity can avoid preparing group accounts if it satisfies the conditions of the Companies Act 2006, s400 or s401. We believe this inconsistency is inappropriate and recommend that the ASB amend the standard accordingly. In our view the Board should extend to entities applying the IFRS for SMEs the same option in relation to the preparation of group accounts, which they would have if they opted to apply IFRS as endorsed in the EU.

These are the only issues we are aware of at the moment, but we believe it is important that the ASB continues to review the practical application of IFRS for SMEs as it is implemented, and be willing to address issues similar to those we have identified if they arise.

To mitigate the risk of issues arising on an ongoing basis, we would urge the Board to encourage the IASB to review the IFRS for SMEs on a more regular basis. Whilst a triennial review will ensure a stable platform of reporting, we are of the view that this could lead to a substantial and unintended misalignment between IFRS and the IFRS for SMEs.

**Q7. 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.**

Yes, we agree. Large non-publicly accountable entities should be permitted to adopt IFRS for SMEs. As stated in our response to Question 1, we do not consider that an entity's size should be the predominant factor in determining public accountability, and consequently it should not preclude an entity from adopting the IFRS for SMEs if the Board determines that to be the appropriate reporting framework for 'Tier 2' entities.

**Q8. Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?**

Yes, we agree. The FRSSE should remain in force for the foreseeable future. We see no benefit in changing the requirements for entities that currently report under the FRSSE, until the experience of 'Tier 2' entities transitioning from current UK GAAP can be assessed and the conclusions of the EU review of the accounting directives is known.

**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?**

We agree. The FRSSE could be replaced by IFRS for SMEs at some future date, depending on the experience of other entities transitioning from current UK GAAP and the conclusions of the EU review of the accounting directives. However, it is important that the cost and timing of this change is carefully considered for these entities.

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

We broadly agree with the Board's current views on the future role of SORPs. However, before it makes any final decisions, it should discuss the potential impact with the entities and regulators most likely to be affected. This is because the withdrawal of some SORPs could leave gaps in reporting currently required by UK regulatory bodies, so care should be taken when deciding which SORPs to remove.

**Q11. 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 entity issues?**

We agree that the Board must provide clarity and certainty on how IFRS-based standards should be applied by these entities. After considering the four options proposed by the Board, the development of a public benefit entity standard, whilst potentially more onerous for the Board, is preferable to the other options. It will give clarity and one source of reporting requirements for public benefit entities. We therefore consider that any public benefit entity standard should be standalone and cover all accounting areas. In our view, it is important that the Board uses the IFRS for SMEs as the starting point for this

standard, with amendments being made to reflect only requirements that are absolutely necessary for the public benefit entity sector.

**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 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?**

Based on our response to Question 11, we consider that any public benefit entity standard should be standalone and cover all accounting areas. This will provide absolute clarity to public benefit entities.

**Q13. 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?**

We agree. The issues listed are distinctive for the public benefit entity sector and therefore appropriate to be covered in a public benefit entity standard. One other issue that might be proposed is accounting for donated 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?**

We agree. In the interests of clarity the Board should provide a statement confirming that the guidance is consistent with UK GAAP, including the public benefit entity standard.

**Q15. 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?**

Not applicable.

**Q16. What are your views on the proposed adoption dates?**

It is imperative in our view that a final standard is issued in advance of the proposed transition date (i.e., prior to 1 January 2011 in relation to the current proposals). Any Exposure Draft should be open for consultation for a reasonable period, given the significance of this change for the majority of entities in the UK.

Therefore, we encourage the Board to run with the current timetable, but only if it believes it can meet this deadline. Alternatively, if there are any concerns about this, the Board should consider delaying the transition date by one year. We encourage the Board

to take into consideration the views of the preparers of financial statements, and any concerns they have with the proposed timetable, before it is finalised.

## CONCLUSION

We welcome the Board's intention to converge UK GAAP with IFRS to the fullest extent possible. We agree that this should provide a consistent basis for financial reporting and reduce the requirements of maintaining a dual accounting framework.

However, recognising the importance of this proposal to the majority of UK businesses, we are of the view that further clarification is needed from the Board. This is in regards to the definition of public accountability as it relates to deposit-taking entities, and those entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

It is important that the UK has a converged financial reporting framework that balances the needs of users with regulatory objectives. In our view the lowest level of reporting for 'Tier 2' entities should be IFRS for SMEs. However, in our opinion the Board should consider whether wholly-owned subsidiaries of IFRS reporters should be required to adopt IFRS for recognition and measurement. In this regard, it might also consider disclosure carve-outs for these entities.

We are grateful to the Board for publishing this consultation and we hope you have found our comments helpful. If you would find it useful, colleagues in our firm are available to discuss further any of the points we have raised.

We wish you every success with the rest of the consultation process and encourage you to publish all non-confidential responses shortly after the closing date. We look forward to reading the results.

Yours sincerely



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