

ACCOUNTING STANDARDS BOARD

THE FUTURE OF UK GAAP

CBI RESPONSE

FEBRUARY 2010

1 INTRODUCTION AND SUMMARY OF CBI POSITION

1. The Confederation of British Industry (CBI) is pleased to respond to the Board's consultation.

2. We welcome the Board's decision to consult on the future of UK GAAP.

The trend of harmonisation between IFRS guidance and US GAAP is commendable, as is the ASB's continuing alignment with IFRS. However, whilst in principle we understand the Board's direction in aligning UK GAAP with IFRS (and towards a single or consistent body of accounting standards for UK companies, subject to the FRSSSE for small companies), we are not convinced that IFRS, and in turn the IFRS for SMEs, is substantially fit for purpose in its present state.

3. IFRS is still under development with several important standards to be issued and become effective over the next two or three years. Companies are reluctant to adopt IFRS before the IASB has finalised those standards. We are also mindful that the IASB's convergence project is still some way from fruition and that there are some powerful political influences at play that could yet derail the entire project.

4. In framing our response, we have notionally segregated UK companies into the following groupings:

- Listed and publicly accountable companies
- Subsidiaries of listed companies
- Other companies
- Companies applying the FRSSSE

5. We do not have details of the respective numbers of UK companies within each grouping but we believe it would be important for the Board to establish this information to determine accurately the pool of entities potentially affected by these proposals. This would seem to be an essential component in undertaking a cost benefit analysis of any final proposals. However, for the purposes of this response, we believe the split is workable and provides insights into both the impact of the proposals and the current state of IFRS as a whole. Our remarks specifically consider the second two groupings – subsidiaries of listed companies and other companies.

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6. We have also identified certain factors that we believe the Board should consider in its work:
- The non-availability of exemptions for even wholly-owned subsidiaries, contrasting with the concessions of UK GAAP for 90% owned subsidiaries.
 - The introduction of XBRL
 - The state of evolution of IFRS for SMEs

Subsidiaries of listed companies

7. The debate on subsidiaries of listed companies has been well rehearsed. At this point, we should note that we do not support an option of adopting individual IFRSs within the overall context of the IFRS for SMEs since this would have the potential of creating multiple versions of IFRS. However, it is worth examining at this point why, when listed companies and their UK subsidiaries already have the option of adopting IFRS in their individual financial statements (a seemingly attractive option, allowing for the efficiency of a single set of accounting standards across all such entities), relatively few have taken this option and most continue to prepare their financial statements in accordance with UK GAAP.

8. There are several contributory factors including the following:

- Taxation - Adoption of IFRS would lead to greater volatility in reported results due to the increased use of fair value measurement. We believe that HMRC's attitude towards the taxation of fair value gains is not always clear and the possibility of increased tax payments deters many companies from adopting IFRS.
- Distributable profits - Although now rectified under the new guidance, the original approach to the carrying value of investments in subsidiaries (and recognition of dividend income) in IAS327 presented a practical bookkeeping obstacle to transition to IFRS. However, uncertainty still exists about the effect of adopting IFRS or IFRS for SMEs on distributable profits. Whilst the ICAEW had developed guidance on the determination of distributable profits under IFRS, this guidance runs to over 120 pages. We support a simpler regime with a move towards a solvency basis for determining distributable profits, but in any event, priority with regard to the impact on distributable profits should be a prerequisite.
- SORPs - Companies welcome that the UK has developed sector specific guidance, such as SORPs, which may not be available under IFRS.
- Disclosure requirements - IFRS contains voluminous disclosure requirements. Moreover, IFRSs are written in the context of consolidated financial statements and contain none of the disclosure exemptions that exist for parent companies and 90% or more owned subsidiaries that exist under UK GAAP. Companies are concerned about the cost associated with compiling, reviewing and auditing these disclosures that would be of little or no benefit to users of their financial statements. We discuss this further below.

9. Adoption of IFRS for SMEs by such subsidiaries would clearly not address these issues.

10. In addition, there are two serious weaknesses with the current proposals:

- First, in simplifying and reducing the choice of accounting treatments under IFRS for SMEs, (for instance the capitalisation of borrowing costs), there is the possibility of IFRS GAAP differences between subsidiary companies and the consolidated group.
- Secondly, given that the intention of the Board is to update IFRS for SMEs in the first instance after three years and thereafter every two years, this will result in a divergence of accounting treatment within listed groups as new EU adopted IFRS standards will be issued and adopted at a consolidated level far more frequently.

11. We believe there are means of overcoming these practical problems available to the Board. This would be achieved by allowing subsidiaries to adopt the same accounting treatment as the group through the adoption of the full recognition and measurement principles of IFRS with reduced disclosure requirements. This could be accomplished by a simple addition of a chapter to the issued UK GAAP IFRS for SMEs setting out the appropriate disclosure exemptions. We do not believe this should cause issues with the relevant company legislation – after all, the IFRS for SMEs includes a read across to the full IAS39. Whilst the latter may involve more work for the UK standard setter, this needs to be balanced with the reduction in work and costs for UK companies. It is also capable of simple updating when a new IFRS is issued.

Other companies

12. In the case of other companies, we do think that the adoption of IFRS for SMEs has merits. There is no doubt that the process the Board has been undertaking to align UK GAAP with IFRS has resulted in a body of accounting guidance that is not easy to follow, particularly in determining which standards affect whom, and when. However, the Board should consider the consequences of introducing a completely new, albeit simpler, body of GAAP on a significant number of entities. This is particularly significant when considering proposed adoption date of 1 January 2012 which allows companies very little time to prepare for the transition. This date means that companies will have to provide comparative information for 2011. In order to be in a position to gather such information, companies must have substantially completed their analysis of the differences between current and future GAAP and have identified the data required. Such analysis, which could also involve changes to internal systems and processes, will require at least a year.

13. In addition there are also developments in XBRL reporting, which is being introduced by HMRC in 2011. Companies will effectively end up doubling up on the XBRL reporting – once under UK GAAP and thereafter from 2013 under IFRS for SMEs or full IFRS as applicable. Whilst we accept XBRL is a disclosure tagging initiative and, as such, would be less affected by a change in GAAP (after all, sales are sales), its introduction does impose extensive resource requirements on companies' resources which would then face the competing pressures of transition to a new body of GAAP. As part of the regulatory environment in the UK, we would like to see the Board working with other bodies to co-ordinate introductions of new requirements.

Cost

14. Companies are concerned about the cost of adopting any new body of GAAP. Both the cost of conversion in the first year and the cost of compliance in subsequent years, e.g. of measuring fair values and preparing additional disclosures, could be substantial (particularly for companies with many UK subsidiaries). The ASB should conduct a comprehensive cost benefit analysis of any draft proposals.

The state of evolution of IFRS for SMEs

15. We have concerns about the state of evolution of the IFRS for SMEs. In particular, the section on taxation introduces new concepts which have, at best, been deferred (and possibly rejected) for full IFRS. However, we see no reason why the Board cannot amend the IFRS for SMEs where clear failings or anomalies are identified.

FRSSE

16. We strongly support retention of the FRSSE for continued use by small companies over the medium to long term, and indeed for the foreseeable future. Notwithstanding any future updates to reflect accounting developments, there will always be a need to keep the accounting and reporting requirements for small companies as simple and practical as possible. Particularly now, small companies want the minimum disruptions to their business, as they continue to grapple with the recession and the consequences of the financial crisis on the availability of credit, and the difficulties faced by themselves, their customers and suppliers.

Legal and regulatory issues

17. We would expect detailed legal and regulatory issues to be addressed at the exposure draft stage of this consultation. We are aware that the European Commission is looking at the extent to which the IFRS for SMEs is compliant with the Accounting Directives and obviously the interaction of the standard with the law will be important.

18. Other practical issues include the movement of companies between the different tiers. We would not support a restrictive regime in this respect. Under the current reporting framework, restrictions within the existing Companies Act to stop companies switching back to UK GAAP from IFRS seem to reflect unwarranted fears - the cost of switching means that companies cannot easily do it. Accordingly, companies should thus be permitted to move to follow the GAAP that suits their circumstances within the rules of the tiered approach put in place.

Consultation questions

19. We respond overleaf to the specific consultation questions.

Conclusion

20. We remain supportive of the Board's continuing important role within the global standard setting environment. The Board's composition and procedures often provide it with insights denied to or rejected by other standard setters leading to better developed and more widely accepted guidance. Therefore, whilst we cannot support the proposals as currently drafted within the timetable suggested, we believe that there is an approach using the IFRS for SMEs as a starting point from which the Board can build a practical, well regarded body of UK GAAP whilst taking a leadership role in co-ordinating the regulatory environment in the UK. Such an approach would be consistent with the stated aims and objectives of the Board and we look forward to supporting the Board in this work.

II RESPONSES TO CONSULTATION QUESTIONS

Q.1 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 support the Board's proposal in Paragraph 2.3.
The definition is practical and relatively easy to understand.

Q.2 Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

Subject to our comments in response to Q.3, we agree.

Q. 3 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 recognise that the size criterion is an important consideration in determining whether an entity falls within a Tier 1 (EU adopted IFRS) category.
However, we believe that there are further considerations which should be taken into account when determining whether or not an entity falls within the Tier 1 category.
For example, in the case of a subsidiary, which has debt or equity trading in a public market but held by another group company, then in this instance we believe that it would be inappropriate for such an entity to be deemed to be a publicly accountable entity.
Consideration should therefore be given to as to who the debt and equity holders are and what the information needs of those users are, in determining whether the entity is genuinely a publicly accountable entity. Where the debt or equity is held by other group companies they should not be considered to be included in Tier 1.

Subject to the above comments, we support the Board's proposals that entities which have traded debt or equity instruments are publicly accountable and should therefore apply EU adopted IFRS.

Q. 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.

As discussed above, there is a strong wish for reduced disclosure requirements for subsidiaries of listed companies that are not publicly accountable.

However in instances where a subsidiary is itself publicly accountable, some CBI members consider that such subsidiaries should provide the disclosure requirements of full IFRS, so that there is transparency and comparability of financial information provided by all publicly accountable entities. However see also our comments in response to Q.3 in determining public accountability.

Q.5 Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?

Yes in principle, subject to our comments in respect of subsidiaries.

We also have the following additional comments.

Related Party Transactions

Another issue is the treatment of Related Party transactions.

Under full IFRS as it stands currently, it will no longer be possible to claim any exemptions for related party transactions with other wholly owned subsidiaries in the Group, thus creating a substantial issue of data collection and presentation, especially burdensome for UK companies operating globally. This includes intra-group transactions on a daily basis in a variety of manners (e.g. intra-group funding arrangements, provision of specialist services/personnel or purchasing/selling products prior to their reaching the market). Whilst the amounts of these transactions are captured for the purpose of elimination within the group consolidation using an appropriate level of materiality, if there was a requirement to quantify these for an individual subsidiary at an appropriate level of materiality and to provide the full set of disclosures required by IAS 24 would take an inordinate amount of time, cost and effort for very limited benefit to shareholders and other users of accounts.

Cash flow statements / Financial Instruments

The requirement for individual cash flow statements and the increased requirements around financial instruments are other areas of note that would provide additional burden with only limited benefit.

Taxation issues

CBI members are also concerned that some of the more contentious aspects of the recent IASB ED for Income Taxes have been adopted in the IFRS for SMEs in advance of the full EU adopted IFRS.

For example, we note the following:

- **Definition and measurement of tax basis**

We disagree with the proposal to define the tax basis of an asset or liability as being assessed based on sale or settlement at the reporting date.

This is an example of a very detailed rules based approach which will introduce significant incremental work in the analysis of the tax consequences. In reality such sales or settlements are highly unlikely to occur and the resulting deferred tax balances recognised on this basis will not be useful to users of the accounts given that, in the vast majority of cases, the value of most non-current assets will actually be realised through use.

- **Elimination of initial recognition exemption**

There is little in way of guidance as to how these temporary differences should be accounted for and whether there will be a move to the contentious "entity-specific tax effects" as detailed by the recent Exposure Draft. We would prefer to see the continuation of the current IAS 12 exemption, which is straightforward to apply and easily understood until a more principles based approach is developed.

- **Investment in subsidiaries, joint ventures and associates.**

We can see no reasonable basis for the proposed exemption from deferred tax being recognised only in respect of investments in foreign subsidiaries and joint ventures, if certain conditions are met. This appears to be another example of an unnecessarily rules-based approach.

- **Uncertain tax provisions**

We do not agree with the proposals on uncertain tax provisions in the measurement of current and deferred tax for a number of reasons. They will result in all uncertain tax positions needing to be reviewed and measured using a probability weighted average amount of all possible outcomes for all its uncertain tax positions. The proposal does not define how, or at what level of detail, or what unit of accounts, a tax position is to be analysed which will leave disclosure open to differing interpretations and therefore inconsistent reporting.

Q. 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 as Set out and explained in our response to Q.5.

Q. 7 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.

We support the first proposal.

Q. 8 Do you agree with the Board that the FRSE should remain in force for the foreseeable future?

Yes, see our comments above.

Small companies currently have their hands very full grappling the recession, and the consequences of the financial crisis, and do not want further disruption to their business.

Q. 9 Do you agree that the FRSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?

We strongly support retention of the FRSE for continued use by small companies over the medium to long term, and indeed for the foreseeable future. Notwithstanding any future updates to reflect accounting developments, there will always be a need to keep the accounting and reporting requirements for small companies as simple and practical as possible, so there would seem always to be a need for a FRSE.

Q. 10 Do you agree with the Board's current views on the future role of SORPs. If not, why not?

We support the view the Board's view that the majority of SORPS are dependent on IASB initiatives and that therefore there is a need for "transitional" arrangements to be in place, to the extent that full IFRSs or the IFRS for SMEs do not address specific issues.

We consider that accounting rules should be consistently applied for those industry sectors, such as telecommunications, where businesses typically operate in many different jurisdictions. The Board's proposals should help towards seeking standardised and consistently applied global financial reporting, to the extent that the rules are permissible in individual countries.

Q. 11 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?

Q. 12 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?

Q.13 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?

Q. 14 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 are not in a position to comment in detail on these Questions, but we support the Board's objectives in principle.

Q.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?

The potential major benefit for a UK listed company currently using UK GAAP for its UK subsidiary companies' accounting is the practical ability to prepare all the UK financial statements on the same basis as the group. However, this would not be possible under the existing IFRS for SMEs and the absence of disclosure exemptions would result in unnecessary costs .

For other companies, there are potential advantages from a simpler "one-stop shop" body of accounting but the anomalies and failings within the existing guidance probably negates these benefits.

The ASB should also consider with HMRC the taxation impact of its proposals and the interaction with the introduction of XBRL, and reach agreement with HMRC on avoiding any adverse or unintended consequences.

Q.16 What are your views on the proposed adoption dates?

CBI members are concerned that the proposed adoption date of 1 January 2012 allows very little time to prepare for the transition.

This date means that companies will have to provide comparative information for 2011. In order to be in a position to gather such information, companies must have substantially completed their analysis of the differences between current and future GAAP and have identified the data required. Such analysis, which could also involve changes to internal systems and processes, will require at least a year.

There are also developments in XBRL reporting, which is being introduced in 2011.

Companies will effectively end up doubling up on the XBRL reporting – once under UK GAAP and thereafter in 2013 under IFRS for SMEs or full IFRS as applicable.

These dual changes will place additional burden on both the profit and not for profit sectors within a very short period of time.

Therefore we believe that companies should be allowed to defer adoption of IFRS for SMEs for at least a period of 12 months, with voluntary earlier adoption permitted if agreement on co-ordination with the HMRC cannot be achieved.