

By email: [ukgaap@frc-asb.org.uk](mailto:ukgaap@frc-asb.org.uk)

22 January 2010

Peter Godsall  
ACCOUNTING STANDARDS BOARD  
5<sup>th</sup> Floor, Aldwych House  
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London WC2B 4HN

Dear Peter

### **The Future of UK GAAP**

The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around £3 trillion of assets, which are invested on behalf of clients globally. These include UK-authorized investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

In particular, our Members represent £463bn<sup>1</sup> of funds under management in more than 2,400 UK Authorised Funds (i.e. unit trusts and open-ended investment companies) and are the investment managers for a range of other pooled vehicles including offshore funds, an estimated 4,000 of which are registered with the FSA for marketing to UK investors. When compared to £1,528bn aggregate market capitalisation of the companies in the FTSE All share index it is clear that authorised funds represent significant investments in capital markets.

We welcome the Board's proposals and the invitation to comment on the future of UK GAAP. We support the Board's objective to converge to the fullest extent possible, consistent with the needs of UK entities. In particular, we agree with the Board's intention to retain responsibility for the accounting framework that is UK GAAP. It is essential that the Board balances the desire for convergence with the needs of users and costs to preparers. We are interested in how, in practice, the Board will exercise this responsibility. It is essential that UK GAAP continues to be sensitive to the needs of its many constituents, especially where they are small or have special needs.

However, we strongly disagree with the proposal in paragraph 2.36 that "the SORP should be withdrawn for authorised funds and IFRS applied". For authorised funds and a wide range of other open-ended funds, the SORP is an essential part of the existing UK GAAP framework and nothing in IFRS changes that. The withdrawal of

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<sup>1</sup> September 2009

the ASB's endorsement of the SORP would force both HM Treasury and the FSA to create new legislation, which would cause severe disruption and ambiguity in an important part of the UK financial services sector. There is an ongoing need for a form industry-specific ASB-endorsed guidance.

To a large extent SORP are maintained by the SORP-making bodies and the costs are absorbed the industries they serve. The Financial Services and Other Specialised Industries Committee brings expertise and contributes positively to the endorsement process. This endorsement gives great comfort to investors, regulators and fiscal authorities. We believe the benefits will continue to justify the cost of maintaining this Committee and the SORP in the ASB's future UK GAAP framework, regardless of whether the individual standard setter is the IASB or the ASB.

For authorised funds and certain other open-ended funds the need for the SORP arises due to the unique interaction between accounting standards and FSA regulations. It could be argued that the regulator should incorporate the requirements of the SORP into their regulations. However, such an argument is flawed because the regulator does not deal with accounting standards and is not experienced in applying accounting principles. Moreover, the cost of rewriting and maintaining the four sets of regulations that specifically refer to the SORP would be far greater than the existing SORP-making process and would carry the risk of creating regulatory conflict, causing confusion and uncertainty.

It is suggested that IFRIC is the body to provide authoritative interpretations of IFRS. We agree. It is not in the interests of common global standards to allow multiple national interpretations to develop. However, the absence of authoritative guidance at a national level poses the risk that divergent practices will develop at a local level. We assert that the SORP for Authorised Funds fills a gap by applying accounting principles to circumstances that IFRS do not address. In this instance the issue is peculiar to the UK and a national solution would not compromise the global integrity of IFRS. Moreover, experience shows that IFRIC cannot and will not opine on national issues.

We would welcome the opportunity to discuss these matters with you as you progress the development of your proposals. Please find attached our responses to the specific questions in the consultation paper.

Yours sincerely

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

Mark Sherwin  
Senior Adviser, Financial Reporting

**Question 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?**

The Board's proposal has the effect of placing in Tier 1 all listed entities (other than those required or opting to apply EU-adopted IFRS directly) and other entities holding assets in a fiduciary capacity for a broad group of outsiders. According to this definition authorised funds will fall into Tier 1.

The current legal definition of a publicly accountable entity provides for exceptions that override the size thresholds for the small and medium-sized companies' regimes. Authorised funds have no employees, no turnover in a conventional sense and do not fall into the exceptions provided by sections 384 and 467. Therefore, using the legal definition, it could be argued that authorised funds will fall into Tier 3.

The discrepancy in these two outcomes illustrates the problem of finding a single definition that works in every situation. On balance we find the Board's proposal to be more appropriate for authorised funds. However, the nature of an entity's public accountability is also an important factor and the two parts of the proposed definition reflect this. Our answer to question 2 considers how Tier 1 might accommodate the distinct needs of both the users of the accounts of listed entities and users of the accounts of entities that hold clients' assets in a fiduciary capacity.

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

We agree that, in general terms, public accountability provides a reasonable cut off point below which EU-adopted IFRS is not required. However, within Tier 1 we advocate a reduced disclosure regime, such as 'full' IFRS for recognition and measurement, to cater for special situations.

The Board's proposal is that the constituents of Tier 1 are defined by public accountability: this is a definition with two strands. Individual listed entities raise capital in public markets, so would appear to be similar in their accountability to consolidated listed entities and we believe the same requirements should apply. However, in this response we focus on the implications of the definition for unlisted entities.

The second strand of the definition deals with a diverse collection of entities that have in common a position of trust, from which they manage their clients' assets. The information needs of these clients are different to the needs of shareholders in listed companies. The ongoing reporting requirements should reflect the nature of an entity's public accountability.

An open-ended fund is an arrangement in which contributions from a number of clients are pooled and managed on their behalf in accordance with a defined investment policy for the collective benefit of those clients. The arrangement entitles clients to require redemption of their proportional interest calculated by reference to

the value of the pool of investments. Progress reporting takes the form of annual and half-yearly reports, focusing on the effectiveness of the fund manager in delivering increased value by implementing the investment policy.

To achieve this there needs to be a reduced disclosure option available to unlisted entities with public accountability. We recognise that this approach risks creating an ongoing care and maintenance obligation on the ASB. However, we believe this burden can be mitigated by co-opting the expertise of regulators and/or SORP-making bodies. For example, the ASB might approve a disclosure exemption recommended by a SORP-making body and sanctioned by the regulator on the basis that it does not compromise the true and fair presentation of an entity's results. Alternative disclosure might then be prescribed in regulations and/or the relevant SORP.

**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.**

We believe that this question reinforces our assertion in our answer to question 2 that there are certain special situations within Tier 1 that warrant a reduced disclosure regime.

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

We do not agree. We find the recommendation that the SORP for Authorised Funds ("AF SORP") should be withdrawn to be inconsistent with the views expressed by the Board in the consultation paper. In our opinion this SORP passes the Board's test that "SORPs should only remain where there is a clear and demonstrable need arising from sector specific issues not covered by guidance in accounting standards." The AF SORP is supplemental to existing UK GAAP and there is nothing in IFRS that changes the need for it.

Authorised Funds are unlisted and open-ended, which means a fund manager issues shares to new investors and buys back shares from investors who wish to redeem. It is essential therefore to calculate a fair and accurate share price daily. Moreover investors are entitled to receive distributions of the net revenue portion of the investment return. The investment return therefore needs to be classified as revenue or capital with reasonable certainty on a daily basis. Ultimately this classification is confirmed by the approval of the annual accounts, so it is essential for the accurate calculation of the share price that there are clear and consistent principles for determining the correct split. It is this need for a consistent application of accounting principles to the classification of revenue that gives rise to the need for the AF SORP.

FSA Regulations require the financial statements of Authorised Funds to give a true and fair view of the net revenue and the net capital gains or losses for the annual accounting period in question and the financial position as at the end of that period. UK GAAP provides the standards required to give a true and fair view of the profit

and loss. The AF SORP provides the additional guidance to split the profit and loss in order to give a true and fair view of the net revenue and the net capital gains or losses components, in accordance with accounting principles.

According to the consultation paper, the ASB recognises the need to fill in gaps where there is no IFRS. The IFRS Framework defines income as increases in economic benefits and encompasses both revenue and gains. Gains are no different in nature from revenue; hence the Framework does not regard them as constituting a separate element.<sup>2</sup> However, to give a true and fair view of the results of Authorised Funds it is essential to be able to allocate income to revenue or capital gains in accordance with accounting principles. Therefore, there is a gap in the guidance provided by accounting standards that has hitherto been filled by the AF SORP.

The ASB takes the view that IFRIC is the body that should provide authoritative interpretations of IFRS. In our opinion the role of IFRIC is too broad to accommodate the expertise in Authorised Funds and UK regulations that is required. The need for special expertise at the UK level is demonstrated by the ASB's Financial Services and Other Special Industries Committee (FSOSIC). This Committee has made significant and positive contributions to the development of the AF SORP.

Moreover, experience shows that IFRIC cannot and will not opine on national market practice issues. In February 2006, IMA submitted to IFRIC a request to provide an interpretation of IAS 18 in relation to revenue recognition in respect of initial fees received by a fund manager. It was noted that a wide range of business models exists in different national markets and that the recognition of revenue depends on the facts and circumstances relevant to each model. In January 2007 IFRIC concluded that it could not reach a consensus and removed the subject from its agenda. This underlines the need for some form of endorsed guidance to continue to be provided in relation to national issues.

The meeting of National Standard-Setters (NSS) in September discussed the need to avoid NSS/ National Interpretation Groups issuing national interpretations of IFRS. We agree it is desirable to avoid diversities in practice that could result from plethora of interpretations at a national level. However, the absence of guidance at a national level poses the risk of diversity in practice at a local level. The need to allocate income to revenue or capital gains in accordance with accounting principles requires an understanding of the interplay between accounting standards and FSA Regulations; as such it is an issue truly specific to the UK. We believe that the continued existence of a committee such as FSOSIC and of the SORP would provide an ongoing benefit in terms of the quality and consistency of financial reporting by authorised funds.

An alternative title, such as "Practice Statement" might more accurately reflect the role of the SORP in defining additional disclosures and as a source of guidance to deal with items not considered by IFRS. There is an ongoing need for a form of industry-specific ASB-endorsed guidance.

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<sup>2</sup> The ASB's Statement of Principles is based on the IASB Framework and, notwithstanding some differences that are essentially concerned with nomenclature rather than principle, the two documents adopt the same approach to identifying the elements of financial statements.

**Question 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?**

Charities are required to report under the Charities Act. Charities Regulations set out the reporting requirements for different types of charity, as follows:

- the Regulations require common investment funds<sup>3</sup> to apply the methods and principles of the SORP for Authorised Funds;
- according to the charities SORP, special case charities should adhere to the SORPs applicable to Registered Social Landlords and to Further and Higher Education institutions; and
- the Regulations require other charities to apply the methods and principles of the Charities SORP.

As is the case with the SORP for Authorised Funds, in order that the Charities Regulations can continue to make such reference to SORPs, it is essential that the ASB continues to provide an endorsement.

**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?**

For Authorised Funds the withdrawal of the SORP would be by far the most significant effect of the Board's proposals. Our answer to question 10 explains how this SORP is an essential part of the true and fair presentation of the results of an Authorised Fund. In addition, it should be understood that the SORP for Authorised Funds ("AF SORP") is embedded deeply in the UK regulatory regime governing the operation of open-ended funds and the treatment of investors in those funds:

- In the 2009 Budget the Government announced the conclusion of an extensive package of measures to enhance the competitiveness of the UK as a key international centre for asset management. The regulatory requirement to distribute the amount of accounting net revenue as determined by the AF SORP provides for a level of certainty that forms a cornerstone for these reforms.
- FSA Regulations<sup>4</sup> require that the accounts must be prepared in accordance with the requirements of the AF SORP. These Regulations impose an obligation to distribute to investors an amount based on the net revenue after taxation determined in accordance with the requirements of the AF SORP. There are over

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<sup>3</sup> Common investment funds are charities established under the Charities Act and that operate in a similar manner to authorised funds. They are available for investment only by UK registered charities.

<sup>4</sup> New Collective Investment Schemes Sourcebook Instrument 2004 (FSA 2004/33)

2,400 Authorised Funds operating in the UK, which represent over £450 billion of investors' assets.

- Charities Regulations<sup>5</sup> require the methods and principles set out in the AF SORP to be followed by common investment funds<sup>2</sup>. There are approximately 50 such charitable funds operating in the UK.
- Tax Regulations<sup>6</sup> grant exemption from tax to the capital elements of the investment return of Authorised Funds, as shown in the Statement of Total Return in accordance with the AF SORP.
- Offshore Funds Regulations<sup>7</sup> require income to be reported in accordance with the AF SORP in order for a fund to qualify for tax treatment equivalent to UK Authorised Funds. We estimate there are in the region of 4,000 offshore funds that will report under this regime and the numbers are expected to rise given the recent liberalisation of the regime: from 1 December 2009 funds may report, but no longer need to distribute, income to investors.

If ASB endorsement of the AF SORP were withdrawn, all these regulations would presumably need to be rewritten to incorporate its substance. That would be a major undertaking, and would require different regulations to be updated in tandem, with the real risk that they would get out of kilter over time, creating confusion and uncertainty. Without this it is difficult to see how these Regulations could work in the absence of the SORP. Moreover, financial regulators do not claim to be accounting experts, and do not generally have the in-house expertise to perform this role.

We understand that there will be a benefit to the ASB in no longer maintaining the structures necessary to endorse the AF SORP. However, we believe the cost to Government of initiating and maintaining the legislative expansion required to fill the gap that would be left by withdrawing this SORP is considerably higher.

In addition the preparers and auditors of financial statements will need to become accustomed to working under detailed legislative rules that would replace accounting principles. We believe the cost of this cultural and knowledge shift alone would be greater than the cost of implementing EU-adopted IFRS in all other respects.

Apart from the consequences of the change for the AF SORP, we have identified the main changes required to move Authorised Funds to EU-adopted IFRS. There will be additional presentation and disclosure obligations (cash flow statements, reconciliation of the number of each class of share and numerical risk disclosures) and for a small, but significant number of funds it will be necessary to incur systems development costs to facilitate a change to the functional currency. However, the UK GAAP standards of most relevance for Authorised Funds, those dealing with financial instruments, are already converged with IFRS. Managers of Authorised Funds have already implemented the requirements of IAS 39 and, in particular, have incurred significant systems development costs in order to apply the effective yield method.

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<sup>5</sup> The Charities (Accounts and Reports) Regulations 2008 (SI 2008/629)

<sup>6</sup> The Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964)

<sup>7</sup> The Offshore Funds (Tax) Regulations 2009 (SI 2009/3001)

***Question 16 – What are your views on the proposed adoption dates?***

We are concerned that the proposed “change” date is so soon. Application for financial years beginning on or after 1 January 2012 means that the “date of transition to IFRSs” according to IFRS 1 is 1 January 2011: this being the date of the opening balance sheet to be presented in the IFRS financial statements. Moreover, the IASB has an extensive list of standards, especially the financial instruments standards, which affect Authorised Funds and which are in the process of being changed. These new standards will then require EU adoption before they become relevant to future UK GAAP. This uncertainty makes it more difficult either to assess the impact of convergence or to plan for adoption of the new accounting framework.

We would prefer an adoption date to be established to give certainty to the planning process. However, this should be later than that proposed, in order that practitioners can have a clear understanding of the new UK GAAP standards they will be implementing. An option for early adoption should be available.