PKF

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Peter Godsall
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27 January 2010

Dear Mr Godsall

Future of UK GAAP

We are pleased to respond to your request for comments on *Policy Proposal: The Future of UK GAAP.*

In principle, we welcome the proposal to adopt the IFRS for SMEs in place of current UK GAAP. Our responses to the specific questions raised in the Policy Proposal are given in the appendix to this letter.

Whilst the views expressed in our responses are our own, they were, in part shaped, by the results of a e-questionnaire we distributed to clients, professional intermediaries and other contacts.

Please contact me or my colleague Anthony Appleton, Technical Director, should you wish to discuss any of the points raised.

Yours sincerely

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Appendix 1

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?

Our preference is for the Board's proposal, rather than one based on size or reference to more specific activities as set out in company legislation.

We do not consider that large private companies should be forced to apply EU adopted IFRS through regulation; if it is beneficial to the company or its stakeholders to comply with EU adopted IFRS the availability of the option to adopt such standards will suffice to meet the needs of users. In our view, the market should decide.

However, we would note that the majority of respondents to a survey we carried out of clients, professional intermediaries and other contacts considered that large private companies (with turnover of more than £500m in the question we posed) should fall within the definition of publicly accountable entities.

We would urge the Board to provide clear guidance on the application of the definition to avoid confusion as we consider that, as currently drafted, it raises a number of questions.

What is meant by a deposit-taking entity? Presumably it does not include usual retailing activities where deposits are taken in advance of delivery of goods, but this is not made explicit.

How "broad" must the "group of outsiders" be before an entity's fiduciary activities make it publicly accountable? Would a Limited Partnership with a small number of knowledgeable investors be publicly accountable? When does a "small number" become a "broad group"?

Or does "broad" imply a qualitative characteristic, as opposed to specialist knowledgeable investors? Would an investment manager, managing assets on behalf of a limited class of knowledgeable investors, as opposed to the general public, be publicly accountable?

Furthermore, is the definition intended to capture entities, perhaps certain fund managers, acting as agents for their clients that might take and invest monies without the assets ever being recognised on the entities' own balance sheet? If the investors' assets are ring-fenced and secure whilst under the stewardship of the entity, will the entity be publicly accountable?

These issues and others should be clarified to ensure consistent application of the definitions.

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

Subject to clarification of the definition as discussed above, we agree that all publicly accountable entities should be included in Tier 1.

Question 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 agree that subsidiaries which, when viewed in isolation, are publicly accountable should apply EU adopted IFRS. We agree with the board that it is not practicable to identify individual disclosure, measurement or recognition requirements from which such subsidiaries should be exempt.

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.

As noted above we do not consider that such subsidiaries should be subject to reduced disclosure requirements, except where mandated by EU adopted IFRS (e.g. an unquoted subsidiary would not be required to provide earnings per share disclosures).

Question 5 – Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?
Subject to our considerations in response to question 6 below we agree with the proposal that "Tier 2" entities should apply the IFRS for SMEs. We welcome the proposal to reduce the regulatory burden on preparers of financial statements for non-publicly accountable entities.

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.

We recognise that introducing significant changes to the IFRS for SMEs for adoption in UK and Ireland would require a costly system of review and maintenance in future years.

However, we do consider that careful consideration is given to isolated changes to the standard if:

- the changes result in information relevant to users of the financial statements;
- the benefits to users exceed the costs of compliance; and
- the resulting costs to the Board in reviewing and maintaining the amendments are limited.

In finalising the IFRS for SMEs, the IASB has taken certain decisions purely on the grounds of their own cost-benefit analyses, or partly on such grounds along with considerations of comparability. These include:

- disallowing the capitalisation of development expenditure
- disallowing the capitalisation of interest costs
- disallowing the revaluation of tangible fixed assets, despite requiring the use of fair values in respect of other assets
- requiring entities to amortise intangible assets over 10 years
- not including the recognition and measurement of assets held for sale in the standard

In the UK these have been areas where individual entities have, in effect, been able to make their own cost-benefit analyses in choosing their accounting policies. Given entities do, for example, choose to capitalise development expenditure would suggest that such information is seen to be sufficiently useful to users to outweigh any costs incurred in collating the information.

In our view, consideration should be given to amending the IFRS for SMEs in these areas and that the final decision should be based on research into the requirements of users in the UK, rather than relying on the expedient decisions of the IASB.

Question 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.

As discussed above, we do not believe that the application of the IFRS for SMEs should be limited by size. There is a qualitative difference between publicly accountable and non-publicly accountable entities which merits the application of more detailed and complex financial reporting standards. No similar distinction can be made between those entities above and below any given arbitrary size criteria.

If the needs of investors or other stakeholders in any particular large entity demand greater information the company may voluntarily apply IFRS as adopted by the EU in response to these demands. With this option available we do not believe it is appropriate to place a more onerous regulatory burden on *all* "large" non-publicly accountable entities (however defined).

Question 8 – Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?

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?

We do not consider that it would be tenable to retain the FRSSE into the medium term once the IFRS for SMEs has become mandatory for "Tier 2" entities that do not voluntarily apply IFRS as adopted by the EU, because:

- it is "derived" from financial reporting standards that will no longer exist; and
- unless amendments are made to the IFRS for SMEs, as considered above, or to the FRSSE small entities will have the option to apply accounting policies no longer available to "Tier 2" entities. For example, a small company would be able to revalue tangible fixed assets whilst a "Tier 2" company could only do this if it adopted full IFRS.

We also consider that the costs of transition to the IFRS for SMEs for small companies will be relatively low due to the relative simplicity of their operations. They are less likely to be engaged in transactions or to hold assets or liabilities requiring significantly different accounting treatments under the IFRS for SMEs. This has been borne out by the field tests performed under the direction of the Association of Chartered Certified Accountants.

If the FRSSE is to be retained at all then the Board should set out a clear timetable for its withdrawal and that the date of withdrawal be limited to no more than two years after the introduction of the IFRS for SMEs.

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

It is not entirely clear what the Board's views are on the future role of SORPs. Paragraph 2.34 of the policy proposals implies that SORPs should be retained if they continue to provide benefits, whilst paragraph 2.35 and the table at 2.36 implies that some SORPs should be withdrawn on adoption of IFRS and others once certain IASB initiatives are complete. Why should they be withdrawn, rather than amended to reflect IFRS if such amendments would result in beneficial guidance?

Taking the Association of Investments Companies SORP as an example, it will clearly not be relevant in its current form if one assumes that such companies will fall within the definition of publicly accountable entities and will be required to apply IFRS. However, this would not negate the benefits of having authoritative guidance which ensures consistency and comparability in the presentation of the financial statements and the provision of additional disclosures not mandated by IFRS. For example, the SORP requires that capital and revenue returns be presented in a columnar format on the income statement, reflecting key distinctions in legal and tax implications of such returns. In effect, IFRS only applies to the total column of such statements.

In our view, such SORPs will continue to be of benefit as they address issues which are unlikely to ever be the subject of IFRIC Interpretations as they arise from highly specific industry, regulatory and legislative issues. The Board or the Financial Reporting Council as a whole should investigate possible mechanisms for the continuing approval of IFRS based SORPs, as only such approval will provide the assurance that the guidance is appropriate.

Question 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?

Question 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?

Question 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?

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?

At present there is no separate public benefit standard; public benefit entities apply UK GAAP as interpreted in SORPs. As the Board notes (and considers further in question 14), even if a public benefit standard was introduced there is likely to remain a need for sector specific guidance for charities, housing and education.

Therefore, we do not accept there is a need for a separate public benefit standard. Key principles will be set out in the IFRS for SMEs, but their interpretation would be better addressed via revised and updated SORP guidance with a negative assurance statement by the Board.

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?

As a firm of accountants and business providers, we prepare, audit and use financial statements of many companies and other entities.

Whilst there are likely to be significant costs in the year of transition (e.g. training, updating of systems, revisions to databases etc), we believe these will be outweighed by the longer term benefits from the removal of extant UK financial reporting standards.

The impact on our clients will vary considerably and will be a function of their size and complexity. We would anticipate that smaller entities will, generally, not face significant difficulties in transitioning to IFRS for SMEs from current UK GAAP, as their relatively simple activities will be accounted for in fundamentally similar ways. However, it should be noted that the proportionate impact of each pound spent will be greater on such smaller entities.

We do expect some entities to face additional costs of compliance where the IFRS for SMEs requires relatively more complex accounting. For example, the measurement of certain financial instruments at their fair value may necessitate additional expert valuations.

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

Whilst adoption in 2012 may be ambitious, we believe it is achievable if the Board clarifies and finalises its proposals as soon as is practicable.

If the adoption date is pushed back, such delays should be kept to a minimum and we would hope that adoption would be for the 2013 calendar year at the latest.