

ACCOUNTANTS FOR BUSINESS

What is the future of UK GAAP?

ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies at all stages of their development. We seek to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 140,000 members and 404,000 students in 170 countries, helping them to develop successful careers in accounting and business, based on the skills required by employers. We work through a network of 83 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

ABOUT ACCOUNTANTS FOR BUSINESS

ACCA's global programme, Accountants for Business, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

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This policy paper outlines the reasons why ACCA believes that replacing UK GAAP with a system of standards based on IFRS is the right course. It outlines which entities should apply IFRS in full and which should use the IFRS for SMEs.

ACCA's aim in publishing policy papers is to explain its agreed policy positions on individual technical issues and to encourage further debate on those issues by all interested parties.

While every care has been taken in the preparation of this paper, no responsibility for loss occasioned to any person acting or refraining from acting as a result of any material in this publication can be accepted by the authors or the publisher.

BACKGROUND

In July 2009, the International Accounting Standards Board (IASB) issued its long-awaited *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*,¹ which is designed for use by non-publicly accountable entities.

Given the number of entities that fall into this bracket the *IFRS for SMEs* is a central part of the UK Accounting Standards Board's (ASB) strategy on the future of UK GAAP and its continuing convergence with IFRS. This was made clear in their consultation paper, *Policy Proposal: The Future of UK GAAP*,² which was issued in August 2009, following the release of the IASB's standard.

EXISTING POSITION OF FINANCIAL REPORTING STANDARDS IN THE UK

Listed companies use International Financial Reporting Standards (IFRS) as the basis of their consolidated accounts. All other companies (for single company and consolidated accounts) are allowed to use IFRS, but few companies have chosen to do this. These companies use UK accounting standards (that is FRS and the older SSAPs), which were developed largely before the take up of IFRS from 2005.

Companies deemed 'small' under the Companies Act (meeting any two of the following three criteria – less than £6.5 million turnover, less than £3.2 million of assets, and fewer than 50 employees) are allowed to use the FRSE (Financial Reporting Standard for Smaller Entities). FRSE is essentially a distillation of UK standards with fewer disclosure requirements and some exemptions such as consolidated accounts and cashflow statements.

REPLACING UK GAAP

As a global body, ACCA fully supports the drive towards global high-quality accounting standards and has therefore continuously encouraged the long-term convergence of UK GAAP with IFRS, ultimately resulting in all companies in the UK and Ireland reporting under a single set of accounting principles.

There are a number of reasons why replacing UK GAAP with a system of standards based on IFRS is the right course.

- There would be comparability between the reports of listed and unlisted companies in the UK and Ireland and also with companies in the many jurisdictions around the world that have adopted IFRS. Users of accounts in the UK and Ireland would be sure that the information they are presented with had been prepared in a fundamentally similar way.
- There would also be comparability between reports of companies across jurisdictions and this would inevitably benefit cross-border trade.
- The preparation of accounting information on a single consistent basis would help simplify internal reporting and so reduce costs for companies.
- Accountants preparing or auditing the financial statements would have to be familiar with that one system. Although there might be significant disclosure differences for different types of entity, there should be less scope for confusion and complexity.
- The costs and time involved in maintaining a separate system of UK GAAP could be avoided and more efficiently used in influencing the development of IFRS.
- The training and education of accountants and users could be simplified by being similarly based on a single system of financial reporting.

1. International Accounting Standards Board, *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*, 2009. Available from <http://www.iasb.org/IFRS+for+SMEs/IFRS+for+SMEs.htm>

2. UK Accounting Standards Board, *Policy Proposal: The Future of UK GAAP*, 2009. Available from <http://www.frc.org.uk/asb/press/pub2054.html>

POSITIVE IMPACT ON EDUCATION AND TRAINING

We believe there would be considerable cost reductions for all stakeholders in this respect. The costs of currently meeting training needs (for qualifications and for CPD, etc) in both UK GAAP and IFRS would be reduced for all parties, be they students, professionals, employers or tuition providers.

We do not consider that there will be significant continuing extra costs of IFRS for SMEs in terms of preparing accounts. There will be one-off costs of transition, but the potential benefits will recover these over a short period.

We acknowledge that convergence with IFRS will inevitably result in UK standard setting losing its ability to remain firmly in the UK context and tradition. We also appreciate that there will be challenges and transitional costs for all involved in the process. Be they preparers, auditors or users any change is a cost, whether it be education and training for understanding the new standards or implementation costs to switching accounts and other financial information systems. However these costs are essentially one-off costs of transition, and we believe that the potential benefits will recover these over a short period.

Therefore, on balance, ACCA considers convergence should take place, though to an appropriate timetable and recognising the need for this to be fully explained and justified to all involved.

Education and training

While initially there would be transition costs relating to the education and training of accountants, in the long run, we believe that the impact of a move to a single basis of accounting on teaching and education services at all levels would be positive.

Accountants would not have to be familiar with two accounting regimes, and therefore qualifications and training programmes would be simplified. In parallel, accounting skills would be more readily transferable both between markets and between employers.

Two-tier framework for UK GAAP

ACCA believes there is little justification for maintaining the three main tiers of accounting standards that we currently have – IFRS, full UK and Ireland standards and the FRSSE. Instead, there should in future be two main tiers (albeit based on the same principles and having much in common):

- tier 1: full IFRS
- tier 2: IFRS for SMEs, constituting UK accounting standards and including exemptions for small companies.

WHICH ENTITIES SHOULD APPLY FULL IFRS?

We believe that all publicly accountable entities should be included in tier 1, and apply full IFRS. As noted above, listed companies in the UK and Ireland are already required to use full IFRS when preparing their consolidated financial statements. However, we believe that there is public interest in extending the compulsory application of full IFRS.

All quoted companies

ACCA supports the idea that all quoted companies should be required to use full IFRS. This would extend IFRS to individual accounts of listed companies, any remaining companies quoted on other than official exchanges and those that do not need to prepare consolidated accounts. We consider that this was the spirit of the European legislation and that it was a quirk of the EU Regulation that they have not been obliged to do so up to now.

Institutions with fiduciary responsibilities

The IASB's definition of public accountability seems likely to include financial fiduciaries such as banks and insurance companies. While, in principle, ACCA supports the extension of full IFRS to deposit-taking entities in the UK and Ireland that hold assets in a fiduciary capacity as their primary business, we understand the concerns as to whether it would be appropriate for very small deposit-taking entities such as the smaller credit unions to have to apply IFRS in full. We believe that it is important for the ASB to assess the cost/benefits of such smaller financial fiduciaries having to apply full IFRS, before deciding whether they should be kept within the definition of a publicly accountable entity.

Large private entities

ACCA considers that very large companies, which are likely to have a degree of public interest, should also be required to apply IFRS. We do, however, believe that clear criteria need to be established for the extension of IFRS to such companies which would include appropriate threshold on size. As the current legal definition within the Companies Act 2006 could potentially result in companies below the size we envisage being publicly accountable, the threshold could be based on a similar premise as that in SSAP 25, at ten times the statutory definition of a medium-sized entity.³

Extended use of full IFRS

ACCA would like to see the compulsory use of full IFRS extended to:

- all other quoted companies – those that do not need to prepare consolidated financial accounts and those quoted on other markets
- deposit-taking entities that hold assets in a fiduciary capacity as their primary business
- very large entities – subject to review of the appropriate threshold, but perhaps based on the SSAP 25 stipulation of ten times the statutory definition of a medium-sized entity.

ACCA believes that the ASB should explain why certain other entities that could be deemed publicly accountable, such as large high-profile charities and some QUANGOs (outside of the government's accounting boundary), have been excluded from their definition of public accountability.

3. A qualifying medium-sized entity has to satisfy two of the following conditions: turnover of not more than £22.8m; balance sheet total more than £11.4m; and number of employees no more than 250 (schedule 465, Companies Act 2006).

REPLACING UK ACCOUNTING STANDARDS WITH THE IFRS FOR SMES

ACCA firmly believes that the use of the IFRS for SMEs by non-publicly accountable entities would complement and reinforce the use of full IFRS by publicly accountable entities in the UK, and that tier-2 entities should use UK GAAP based on the IFRS for SMEs.

In principle, we would like to see the IFRS for SMEs adopted wholesale as the basis of UK GAAP. However, ACCA recognises that some amendments may need to be considered for small companies and wholly-owned subsidiaries.

Wholly-owned subsidiaries of publicly accountable entities

For many subsidiaries that are already preparing IFRS accounting information for consolidation purposes, a requirement to extend IFRS may not represent a significant burden. However, as IFRS is not designed for the individual accounts of companies in groups, ACCA believes there is a case for some reduction of disclosure requirements. We believe that the existing exemptions under UK GAAP, which include cash flow statements, related party disclosures, segmental reporting and financial instruments, are appropriate and proportionate for wholly-owned subsidiaries.

As well as potentially creating an additional layer of reporting, however, there are also possible legal difficulties in implementing the disclosure reductions while complying with either EU-endorsed IFRS or with the Accounting Directives. Furthermore, we are unclear that there is sufficient public support for insisting that these companies apply IFRS. Therefore, we propose that wholly-owned subsidiaries of publicly accountable entities that are not themselves publicly accountable should apply the IFRS for SMEs.

We still see merit in the disclosure reductions noted above, although we believe that this is a matter that should be systematically assessed by the IASB and amended according to its due process. Where it is felt that changes are required, the ASB should urge the IASB to make the relevant amendments.

Application of IFRS for SMEs should be facilitated by the European Commission

ACCA believes that EU member states, such as the UK, should be able to adopt IFRS for SMEs for some or all of their companies. While this could be by way of an explicit member state option (MSO) in the Accounting Directives, we do not believe that this is necessary. ACCA believes that it would be more appropriate to remove any obstacles or incompatibilities between the IFRS for SMEs and the Directives, thereby allowing any member state to adopt it. In other words the Directives could stay silent on IFRS for SMEs, but implicitly allow it.

This would also allow individual member states such as the UK to make any necessary amendments to the IFRS for SMEs for their own purposes.

The case for small companies

While the IFRS for SMEs will certainly not be a burden for companies in the UK who are currently using full UK GAAP, ACCA believes that the IFRS for SMEs could also be used by small companies who are currently using the Financial Reporting Standard for Small Entities (FRSSE). However, we believe that there should be some additional derogations for small companies.

Ideally, as with wholly-owned subsidiaries we would prefer the IASB to make appropriate amendments to IFRS for SMEs for small companies on the next revision, with UK and Irish constituents pressing for the relevant changes through the IASB's due process. However, we do recognise the possibility that these amendments may not immediately be considered by the IASB. We therefore believe that the ASB should make the more pressing transitional derogations for small companies part of its adoption of the IFRS for SMEs into UK GAAP.

We recognise that some of these amendments would mean that some UK and Irish companies would not be able to claim compliance with the IFRS for SMEs, but would need to refer to the UK standard or standards, which could in turn be noted as being largely based on the IFRS for SMEs.

IFRS for SMEs (with exemptions) is a suitable replacement for the FRSSE

The ASB consultation paper notes the results of field testing the IFRS for SMEs Exposure Draft conducted by ACCA.⁴ The majority of companies sampled (23 out of 25) were applying the FRSSE. From the testing it was evident that there were very few issues noted in terms of translating from the FRSSE to the IFRS for SMEs. The overall consensus being that preparers of accounts of smaller entities would have few problems in applying the IFRS for SMEs, largely because they were unlikely to encounter the more complex accounting issues.

4. A detailed analysis of the results of the field testing is available from http://www.accaglobal.com/general/activities/library/financial_reporting/other

WHAT ABOUT THE FRSSE?

ACCA acknowledges that the FRSSE is both widely used and well understood by preparers of small company financial statements. We also note that some of the benefits of IFRS for SMEs will not be relevant to many smaller companies, for example international comparability, and that the transition costs will tend to weigh disproportionately more on these companies.

Moving to the two-tier system that ACCA envisages would inevitably mean the phasing out of the FRSSE. We strongly believe the retention of the FRSSE based on the principles of existing UK GAAP, following the adoption of the IFRS for SMEs as future UK GAAP, will add unnecessary complexity to the structure of UK financial reporting.

As the results of field testing commissioned by ACCA on the IFRS for SMEs Exposure Draft testify, there would not be significant accounting challenges for FRSSE users in applying the IFRS for SMEs. Indeed, ACCA also understands that entities in Ireland within the scope of the FRSSE are rarely applying it, and are applying full UK GAAP instead. As applying the IFRS for SMEs should be less complex than using full UK GAAP, this further suggests that it could be used by all companies currently applying the FRSSE.

We are of the view, however, that exemptions will be appropriate for current FRSSE users (ie small entities) from certain requirements of the IFRS for SMEs. These would include, in certain cases:

- no obligation for consolidated accounts to be prepared
- no requirement for a cashflow statement
- share-based payments being dealt with by note disclosure, and the cost not requiring to be recognised.

Along with other disclosure reductions that are likely to be less relevant to small companies, these derogations would in a great measure reflect the current position of the FRSSE and therefore negate the need for a distinct third tier of accounting.

Adoption date for IFRS for SMEs into UK GAAP

In its consultation paper, the ASB suggested an adoption date of 2012. With the availability of the appropriate software packages, the transition process should be relatively smooth. However, we acknowledge that sufficient time is needed for training and education, and for companies with more sophisticated information systems and more complex accounting issues.

While the proposed adoption date could fit into such a time frame, ACCA believes it is important that this allows enough time for further detailed analysis and consultation, to resolve issues around:

- compatibility with legal requirements
- the threshold for very large publicly accountable entities and
- derogations to the IFRS for SMEs for the UK and Irish context, especially in relation to small companies.

While we do not support the retention of the FRSSE indefinitely, should the ASB decide to continue with it as it proposes, we strongly believe that this should be for as short a time as possible.

While we are comfortable with the 2012 adoption date, if further time is needed to resolve these issues, we believe it is important for the ASB to make its intentions clear, thereby allowing all interested parties to plan accordingly.

STANDARD SETTING FOR PUBLIC BENEFIT ENTITIES

In its consultation paper, the ASB proposed that it would consider developing a new standard for all public benefit entities. ACCA does not believe it is feasible for the ASB to adequately cover all issues faced by the wide range of not-for-profit entities within a single standard. We believe that the current use of specialised Statements of Recognised Practice (SORPs) works well, and that these should be further developed to ensure they are in line with the proposed changes to UK GAAP (ie the IFRS for SMEs). We do not think that there would be insurmountable difficulties with this approach.

We believe it is important that this development process be on similar lines to the current development of SORPs, with input from a representative selection of interested parties from the sector itself. This will help to ensure that any new guidance for the sector retains the user-friendly approach and style of the existing SORPs, which we believe are particularly beneficial for the many non-accountants who have to apply them in the voluntary sector.

FURTHER READING

- *Policy Proposal: The Future of UK GAAP*, Accounting Standards Board, August 2009. Available from <http://www.frc.org.uk/asb/press/pub2054.html>
- ACCA's response to *The Future of UK GAAP*, consultation paper is available as online text at http://www.accaglobal.com/general/activities/policy_papers/archive/financial/cdr894
- Paragraph 2.26 of the ASB consultation paper refers to field testing undertaken by ACCA. An analysis of the testing has been published as *IFRS for SMEs: ACCA's Field Testing Result*, ACCA September 2009. Available as http://www.accaglobal.com/pubs/general/activities/library/financial_reporting/other/tech-tp-sftmain.pdf
- ACCA held a public meeting to discuss the future of UK GAAP on 18 November 2009. A brief summary of the event and a link to the podcast is available from <http://uk.accaglobal.com/uk/members/technical/gaap/ukgaap>
- During the public meeting, electronic voting was used to gauge audience views on key questions on the future of UK GAAP. The results of these, together with those of an online survey of UK and Irish members, is available as http://www.accaglobal.com/pubs/general/activities/library/financial_reporting/other/tech-ms-fug.pdf
- In May 2010, ACCA issued a report assessing the potential impact on reported and taxable profits of UK companies, were UK GAAP to be replaced by the IFRS for SMEs. The report, *The New UK GAAP – How Would the Numbers Look?* is available as http://www.accaglobal.com/pubs/general/activities/library/financial_reporting/other/tech-afb-nug.pdf

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