

# Future of financial reporting in the UK and Ireland

Summary of ACCA Member Surveys  
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## BACKGROUND

UK and Irish accounting standards remained static for a number of years while the UK Accounting Standards Board (ASB) awaited the conclusion of the International Accounting Standards Board (IASB) project on producing an international standard for non-publicly accountable entities. In July 2009, the IASB finally issued its *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*, and the ASB were quick to seek comments from UK and Irish constituents on ways to incorporate this standard into the future framework of UK GAAP. This would be a critical step in strengthening the ASB's long-standing objective of converging UK GAAP with IFRS.

In October 2010, having absorbed the feedback from its original high-level proposals, the ASB issued two extensive exposure drafts (FREDs): *FRED 43: The Application of Financial Reporting Standards* and *FRED 44: Financial Reporting Standard for Medium-sized Entities (FRSME)*.

In order to assist ACCA form its response to the ASB consultations, ACCA conducted a survey of its members on the key issues related to convergence of UK GAAP with IFRS. This paper summarises the results of the survey, which more than 650 ACCA members at networks events and online between January and March 2011 took part in.

## **CURRENT POSITION OF ACCOUNTING STANDARDS IN THE UK**

Listed companies use 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, £3.2 million of assets and 50 employees) are allowed to use the FRSSE (Financial Reporting Standard for Smaller Entities) which is essentially a distillation of UK standards with fewer disclosure requirements and some exemptions such as consolidated accounts and cashflow statements.

## **PROPOSALS IN OUTLINE**

The proposals set out a three tier framework for financial reporting in the UK, retaining EU-adopted IFRS and the FRSSE in the extremes, while replacing the current body of accounting standards for the UK and Ireland in the middle with a modified version of the IFRS for SMEs. In addition, 'qualifying subsidiaries' within Tiers 1 & 2, will benefit from certain disclosure requirements.

### **TIER 1: International financial reporting standards (IFRS)**

Listed companies in the UK and Ireland use IFRS as the basis of their consolidated accounts. Under the proposals the current use of IFRS will be extended to all entities deemed to have public accountability. Thus any entity that has equity or debt instruments traded on a public market or holds assets in a fiduciary capacity as its primary business will be required to use IFRS for the preparation of their financial statements. While there will be an exemption for small companies that are prudentially regulated (who will be required to use the FRSME), the likely result will be more entities in the UK and Ireland having to apply IFRS.

### **TIER 2: UK GAAP - FRSME**

Entities falling within this bracket will be impacted the most by the ASB proposals. While some will move vertically into Tier 1 by virtue of being publicly accountable, the overwhelming majority will now be required to apply the simpler, single FRSME, rather than full UK accounting standards. The FRSME

is essentially the IFRS for SMEs with amendments made to neutralise conflicts with applicable legislation. As the IFRS for SMEs is based on the same principles as full IFRS, this will clearly be a significant move towards convergence for UK financial reporting, as well as aligning the principles for reporting of listed companies with other non-publicly accountable entities in the UK and Ireland.

### **TIER 3: FRSSSE**

The vast majority of entities in the UK are deemed 'small' under the Companies Act<sup>1</sup>. These will continue to be allowed to use the FRSSSE (Financial Reporting Standard for Smaller Entities). However, the FRSSSE is essentially a distillation of existing UK standards with fewer disclosure requirements and some exemptions such as for consolidated accounts and cashflow statements. Therefore the principle of current UK GAAP will remain alongside those of IFRS within the UK financial reporting framework for the foreseeable future.

### **Public benefit entities**

The specifics regarding the accounting regime for the whole range of public benefit entities is still unclear, although it is the intention to develop a tailored standard for such entities, with the draft standard having been issued for comment in March 2011. However, the likelihood is that the popular Statements of Recognised Practice (SORPs) for *Charities*, *Registered Social Landlords* and *Further & higher Education* will be retained by updating them on the basis of the FRSSSE and the public sector standard.

## **ACCA CONSULTATION PROCESS ON THE FUTURE OF FINANCIAL REPORTING IN THE UK AND IRELAND**

Understanding the potential impact on UK and Irish business and the accounting profession, ACCA have looked to raise awareness of the proposals from the ASB, and engage with members on how they envisage the future of UK GAAP.

ACCA have consulted members through various forums since the ASB issued their proposals. To aid the formal response to the ASB, ACCA also surveyed their UK members and held a high-level debate on the roadmap for UK GAAP.

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<sup>1</sup> The Companies Act provides three criteria – less than £6.5 million turnover, less than £3.26 million of assets, and fewer than 50 employees – of which a company has to fulfil two of the three, to be deemed a 'small' company.

The event took place on Tuesday, 8 March 2011, and proved to be a resounding success, with over 200 members and accounting professionals in attendance. Expert panelists included:

- Roger Marshall, chairman, UK Accounting Standards Board (ASB)
- Matt Blake, commissioners' advisory accountant, HMRC
- Nigel Davies, deputy head of accountancy policy, Charities Commission
- Geoffrey Britton, president, EFAA and
- Richard Martin, head of financial reporting, ACCA

At the end of the event members were asked to vote on a number of questions, based on the ASB proposals. The results of these and the on-line members survey are outlined below.

## **FINDINGS FROM MEMBER CONSULTATIONS**

On average, 370 members responded to the online survey. The increasing importance and imminence of the issues raised in the ASB proposals clearly evident, given an earlier survey on higher level proposals from the ASB in November 2009, yielded on average just over 100 responses.

The five questions<sup>2</sup> members voted on at the meeting were the same as on the online survey and those completed by Members at a number of technical updates held by ACCA during 2010 and 2011. On average about 190 members voted on these questions during the meeting and a further 90 on average from the technical updates<sup>3</sup>.

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<sup>2</sup> Question 3, on proposed amendments in the FRSME from the IFRS for SMEs, was not included, in the interests of time.

<sup>3</sup> On some of the questions on the online survey and from the technical updates, respondents were able to choose more than one of the available options.

<b>1. The current mix of financial reporting in the UK, including IFRS, UK FRS, IFRS-converged standards and FRSSE lacks cohesiveness. Do you support the overall convergence process to align UK GAAP with IFRS?</b>		
Yes	93%	622
No	7%	44
	<b>100%</b>	<b>666</b>

There remains overwhelming support from ACCA Members for the convergence of UK GAAP with IFRS.

Given the number of companies that qualify as small companies in the UK and Ireland, the question over the replacement of the FRSSE remains a significant factor in the overall convergence plans.

<b>2. Do you believe that the FRSSE (as currently based on UK GAAP) should be replaced?</b>		
Yes, with the IFRS for SME	18%	120
Yes, with the IFRS for SME (with additional exemptions)	29%	199
Yes, following a review of implementation of IFRS for SME in the UK	37%	253
No, not in the foreseeable future	16%	110
	<b>100%</b>	<b>682</b>

The ASB proposals are for UK GAAP to be replaced by IFRS for small and medium sized enterprises with some extension of full IFRS, but retaining the FRSSE for the foreseeable future. The FRSSE, which is designed to enable small businesses report their financial activities is based on UK GAAP. The survey shows a sizeable majority wanting the FRSSE to be replaced in line with general views on convergence. Some members calling for additional exemptions in IFRS and others wanting it after a review of how the rest of the convergence has fared.

<b>3. The ASB is proposing to make a number of amendments to the IFRS for SME for application in the UK &amp; Ireland. Do you agree that the amendments listed below should be made?</b>		
<b>Amendment</b>		<b>Should be made</b>
a. Negative goodwill (No longer have immediate write off)	50%	224
b. Extraordinary items (permitted)	68%	309
c. Remove options to fair value associated and JVs	58%	252
d. Reference to Companies Act for requirement to prepare consolidated accounts	76%	340
e. Replace section on income taxes with IAS12	79%	338
f. Reduced disclosure for subsidiaries	79%	361

Members were reasonably satisfied with the amendments proposed to the IFRS for SMEs for application in the UK and Ireland, although the treatments for negative goodwill and the removal of the fair value option, based on conflicts with EU Directives were less popular.

<b>4. The ASB have proposed that the new UK GAAP standard will be applicable from 1 July 2013, and is likely to be available from early 2012. Do you agree with the following:</b>		
		<b>Yes</b>
The effective date is appropriate to allow for implementation	60%	402
The effective date should be extended to 1 July 2014, to allow for a longer implementation period	40%	258
Early adoption should be permitted	84%	502

A majority of Members appear to be largely comfortable with the proposed effective date of 1 July 2013, although a sizeable number preferred an extension. Most Members were clearly in favour of early adoption being permitted.

**5. The ASB outlines types of costs that are likely to be incurred for companies that will transition from existing UK GAAP. For each type of cost listed below, please identify how significant it will be for your company/clients, where 4 is very significant and 1 is minimal.**

	Weighted average	Number
Initial training	2.52	632
Software	2.20	624
Internal preparation costs	2.37	619
External advice on preparation	2.74	626
Audit of transition	2.65	616
Need for more complex calculations due to use of fair value	2.50	625
Will not be affected by current proposals		5

There was no cost that was an overwhelming concern for Members, although external costs for experts related to consultancy and audit were visibly an issue. Certainly for smaller organisation with limited financial reporting specialists, the initial transition would be assisted by experts who may have had experience of the full IFRS transition.

The need to invest in training in the new standards as well as the potential for requiring more complex calculations from those standards were also likely to increase costs for many.

**6. To what extent will the following help you achieve a smooth transition (where 4 is very much and 1 is little)?**

Cost	Weighted average	Number
Training courses	3.15	641
Software	2.37	636
External advice on preparation	2.93	638
Guidance material	3.33	639
Model accounts and disclosure checklists	3.53	646

Respondents believed that the practical guidance from model accounts and disclosure checklists would be the most helpful tool when applying the new accounting standard. This is likely to reflect the importance of such guides in the preparation of financial statements in general. However, reflecting the views on costs of transition, respondents again placed value on external advice on preparing for the initial implementation as well as the need to train internally.

## FURTHER READING

The full ASB consultation paper, *The Future of financial reporting in UK and Ireland*, can be accessed by visiting

<http://www.frc.org.uk/asb/press/pub2414.html>

ACCA's response to the consultation paper can be accessed by visiting

[http://www.accaglobal.com/general/activities/policy\\_papers/archive/financial/](http://www.accaglobal.com/general/activities/policy_papers/archive/financial/)

The ASB consultation paper refers to field testing undertaken by ACCA. An analysis of the testing can be viewed by visiting

[http://www.accaglobal.com/general/activities/library/financial\\_reporting/other](http://www.accaglobal.com/general/activities/library/financial_reporting/other)

For a broad overview of the ACCA roundtable meeting held on 18th November 2009, including a link to the podcast, please visit

<http://uk.accaglobal.com/uk/members/technical/gaap/ukgaap>

A detailed review of the differences between the IFRS for SME and UK GAAP is included in an ACCA report entitled, *The New UK GAAP – How Would the Numbers Look*, available at

[http://www.accaglobal.com/pubs/general/activities/library/financial\\_reporting/other/tech-afb-nug.pdf](http://www.accaglobal.com/pubs/general/activities/library/financial_reporting/other/tech-afb-nug.pdf)