

Accounting Standards Board
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN**Tel** 020 7147 3449**Fax** 020 7147 0433**Email** Matt.Blake@hmrc.gsi.gov.uk**Date** 29 January 2010www.hmrc.gov.uk

Dear Sirs

Policy Proposal: The future of UK GAAP

Thank you for the opportunity to comment on this policy proposal. I would be happy to discuss any of the points raised in this letter if you so wish.

Our perspective

1. HM Revenue & Customs (HMRC) administers and collects tax in the United Kingdom. In doing so, we use the financial statements of most businesses in the UK, and a number of overseas businesses. The managers and owners of those businesses directly use the numbers reported in financial statements as the basis of their corporate or personal tax liabilities. We check those numbers and the tax liabilities based on them, and we use many of the disclosures in financial statements to help us to check those and other tax liabilities.
2. In the UK, it has long been the case that the starting point for most businesses for calculating a business's corporate or income tax liability is its commercial profit, and it is enshrined in UK tax law that tax is based on 'profit prepared in accordance with Generally Accepted Accounting Practice' (GAAP), and this includes profit prepared in accordance with UK GAAP, should a company prepare its statutory financial statements in accordance with UK GAAP.

3. HMRC's direct interest is with a reliable measure of commercial profit, or profit before tax, which businesses can use to measure their liability to corporate or income tax. HMRC also uses the information in financial statements to check entities' returned tax liabilities.

General comments

4. We welcome the Policy Proposal and support many of its detailed proposals.
5. In the UK at the moment, businesses prepare their financial statements on one of a number of regimes, the main ones (for "for profit" businesses) being:
 - IFRS as adopted by the EU;
 - Full UK GAAP (having adopted FRS23 and FRS26)
 - Full UK GAAP (without adopting FRS23 and FRS26) ("old UK GAAP")
 - The Financial Reporting Statement for Smaller Entities ("FRSSE")
6. There are differences between most of these regimes. Businesses, accountants, users and auditors are faced with a lack of comparability and understandability. Accountants, users and auditors also have to be familiar with all the regimes in place, this creates a burden in keeping up-to-date with each regime as it separately develops.
7. We support the overall objective of the proposal in producing a single and clear basis for all GAAP in the UK. We note that there will still be differences between the regimes proposed, but other than for disclosures, these should be minimised. In particular, we see major benefits for businesses (singly and as an economy) of the proposals:
 - Comparability – results will be more easily comparable;
 - The scope of what accountants, users and auditors need to learn and apply will be reduced, leading to greater reliability, less cost or both;
 - An end to the situation where most businesses account in old UK GAAP but the professional bodies' training is almost entirely IFRS-based;
 - Moving between regimes, for example because of an intended listing or as a result of a takeover, will be more straightforward and less costly;
 - An end to some businesses calculating which regime produces the best results (for example for its lenders or for its tax liability); and
 - A reduction in consolidation adjustments required for a parent of subsidiaries reporting using UK GAAP in order to prepare its IFRS group accounts.

8. HMRC's has two major concerns that we hope you will address in the next stage of the development of this proposal. These are around the timing and method of introducing the new UK GAAP, and the impact on small businesses.

Timing and method of introducing the new UK GAAP

9. The government has legislated¹ that all companies shall submit tax returns to HMRC electronically, including financial statements in the in-line XBRL format, for all tax returns for accounting periods ending on or after 31 March 2010 submitted on or after 31 March 2011. We anticipate that this is likely to lead to some companies needing to spend some resource to come to terms with the process, although we have done substantial work to publicise the requirement and mitigate the impact on companies. Whilst companies can already file tax returns and accompanying financial statements in this format, companies with a December year end will have a filing deadline for their 2010 return (including their financial statements for the year ended 31 December 2010) of 31 December 2011.
10. In your consultation paper, you propose a "change" date for financial years beginning on or after 1 January 2012, which if mandatory from that date would involve many companies planning for the change in late 2011, if not earlier. We suggest that it would be helpful to companies if the "change" date was, say, a year later so that preparations for the first mandatory iXBRL filing and the change to the future UK GAAP did not coincide.
11. A period when entities are able to adopt the future UK GAAP "early" before it becomes mandatory might be seen by some as beneficial. However, we see this as adding complexity and cost, as businesses work out whether they are better off staying on with their existing regime (or switching to another existing regime), or moving early to the future UK GAAP. For this reason, we see a "big bang" approach as the better one, much like the introduction of IFRS for listed companies in 2005. It would also mean that there would be no need for the ASB, BIS or HMRC to devise rules to cope with businesses that may move to the future UK GAAP and then wish to switch back to an old UK GAAP prior to the future UK GAAP becoming mandatory.

¹ SI2009/3218 The Income and Corporation Taxes (Electronic Communications) (Amendment) Regulations 2009.

Impact on small businesses

12. Small businesses, accountants preparing accounts of small businesses, and users of those accounts, whether managers, banks, HMRC or others, make up a sizeable proportion of the UK accounting community. We believe that, given the size of the constituent base, and the potential longer-term impact of your proposals, more consideration and explanation needs to be given to the impact of the proposals on the accounting needs of small businesses, their accountants and users.
13. Currently, small businesses account using the full (old) UK GAAP, or the condensed Financial Reporting Standard for Smaller Entities. A significant number, if not a majority, of the small business community (and thereby most UK businesses and their users) use the FRSSE.
14. Assuming that your proposal that the FRSSE can remain unchanged for a period is practical, all the benefits of your main proposals (see paragraph 7) will not be available for small businesses, their accountants and users unless they adopt the full future UK GAAP. Indeed, the effect of the proposal will be to create a larger divide than currently exists between FRSSE small business accounts and non-FRSSE small business accounts, and between the knowledge requirements of accountants preparing, using and auditing FRSSE accounts and those preparing, using and auditing non-FRSSE accounts.
15. This is the case because, at the moment, except in a very limited number of specific instances, recognition and measurement practice in the FRSSE is the same as with full (old) UK GAAP. By proposing that full future UK GAAP is the IFRS for SMEs and the FRSSE to stay as it is, you are, in effect, proposing to introduce a wide range of differences between FRSSE and full future UK GAAP. We do not think that you have set out the implications clearly. For example, a small farming business that chooses to adopt new UK GAAP based on the IFRS for SMEs will have markedly different accounting for its livestock and crop (biological asset) inventories than a small farming business that chooses to adopt the FRSSE, if the FRSSE is unchanged. At the moment, there is no recognition and measurement difference in this regard between the two businesses as the FRSSE and UK GAAP are the same.

16. We also believe that the way that the FRSSE interacts with full UK GAAP will cause difficulties, if the FRSSE is unchanged. This is because the FRSSE is a subset of full UK GAAP, and as a result does not (and does not need to) include many situations covered by full (old) UK GAAP. As a result, the FRSSE contains the statement:
- “Financial statements will generally be prepared using accepted practice and, accordingly, for transactions or events not dealt with in the FRSSE, smaller entities should have regard to other accounting standards and UITF Abstracts, not as mandatory documents, but as a means of establishing current practice.”²
17. We believe that in the context of the full future UK GAAP being the IFRS for SMEs, and not current accounting standards and UITF Abstracts, there will be at least confusion as to the accounting that small businesses should follow where the FRSSE is silent on a matter. Common areas where small businesses might currently look to other standards and UITF Abstracts are accounting for onerous lease provisions and accounting for employee benefit trusts.
18. We see this as creating another problem where small businesses' accounting is not covered by the FRSSE, but is derived not from accounting standards, but from a more general perception of accepted practice or from the accounting regulations made under the Companies Act 2006. In particular, we note that currently, most FRSSE businesses will account for any derivatives (such as the forward purchase of foreign currency) at the lower of purchase price and net realisable value, and take any net cash flows to the profit and loss account as they arise. At the moment, that this is an acceptable accounting treatment is clear, because that treatment is accepted practice for entities accounting using full (old) UK GAAP and the accounting regulations made under the Companies Act 2006. Under your proposals, full future UK GAAP will require derivatives to be recognised at fair value and movements in that fair value to be reported in the profit and loss account and company law permits this. The FRSSE, if unamended, will contain no requirement or guidance to do otherwise.
19. We suggest that you could resolve this in one of a number of ways including:
- (a) Amend the FRSSE so that, like the IFRS for SMEs, it will be substantially comprehensive, that is, it will cover substantially all topics – whether covered by an accounting standard now, or not - rather than asking the preparer to refer to other accounting standards and UITF Abstracts. In particular, it could set out the FRSSE treatment for all items covered in the IFRS for SMEs, rather than be based on the

² FRSSE, Status of the FRSSE, paragraph 4.

corpus and layout of existing UK GAAP. It will then be a complete, standalone, UK GAAP for smaller entities;

- (b) As suggested in your consultation paper, discontinue the FRSSE. However, we believe that the FRSSE has value for many companies, and if you do discontinue the FRSSE, we believe you will be pressed to produce a similar set of exemptions and simplifications from full future UK GAAP for small entities.

Comparison of UK GAAP to IFRS for SMEs

20. We note your comparison of UK GAAP to IFRS for SMEs at Appendix B. We assume that your intention, in producing this comparison, was to demonstrate how businesses' accounting might change as a result of adopting new UK GAAP being the IFRS for SMEs. We did not find this analysis as helpful as it could have been.
21. UK GAAP, as set out in the ASB's Financial Reporting Standards and its predecessor's Statements of Standard Accounting Practice is not comprehensive in the way that the IFRS for SMEs is. Many current practices, that are not set out in accounting standards, will change as result of your proposal, and you do not mention those; for example, entities who have not adopted FRS23 and FRS26 might be preparing financial statements in accordance with UK GAAP, but will see dramatic differences on adopting a future UK GAAP based on the IFRS for SMEs.
22. We also think that in some common areas the differences are wider than you set out, for example in the significant areas of revaluation of tangible fixed assets or plant, property and equipment (company law and FRS15 permits, IFRS for SMEs does not) and revenue recognition (which is similar but has several key differences of detail). In addition, where you say that "specialised activities" are not addressed in UK GAAP, they are, but they are not given special treatment in UK GAAP. For example, the stock (inventory) and fixed assets (property, plant and equipment) of agricultural businesses *are* addressed in UK GAAP, because they are not treated differently from non-specialised activities. So, for an agricultural business, the difference will be between SSAP9 and FRS15 and the treatment set out in Section 34 of the IFRS for SMEs, which will in many cases be a material difference to an agricultural business. Your proposals, as they develop, should ensure that businesses that might adopt the new UK GAAP would be aware of the impact of your proposal in these areas, as well as those you set out in Appendix B, and some of these will, for some businesses be material and/ or controversial.

23. We think that this could be easily addressed in future comparisons by starting your analysis from the IFRS for SMEs and setting against it the UK GAAP treatment, whether or not set out in a standard, rather than working from the standards to the more comprehensive IFRS for SMEs.

Answers to specific questions

Question 5

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

24. We do not have a view that the future UK GAAP must be the IFRS for SMEs. We do, however, strongly support the proposal because it provides a clear way forward to overcome what we see as a burdensome and unsatisfactory situation of having parallel but different regimes in place. We would also support a proposal for an alternative future UK GAAP that was robust and practical to apply. However, it is our view that the IFRS for SMEs does provide a robust and practical accounting framework, and that it would take significant initial and ongoing work for the ASB, stakeholders, preparers, users and auditors to develop and maintain an alternative future UK GAAP that was as robust and practical, and that was significantly different to the IFRS for SMEs.

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.

25. Yes, IFRS for SMEs should be adopted wholesale and not amended. Most of the benefits would disappear if the ASB maintained a UK GAAP that was different in material respects from the IFRS for SMEs.

Question 8

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

26. We believe that small entities (which form a sizeable majority of UK businesses) benefit from being able to use the FRSSE, and, should continue to be able to access those benefits. However, we would like to see the accounting needs of small businesses, preparers of small business accounts (both those who prepare only small, and those who prepare both small and medium), users and auditors of small business accounts

addressed more fully and explicitly in the next stage of the development of the future UK GAAP.

27. I have set out our concerns around the accounting for small businesses in detail in paragraphs 12 to 19 above.

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?

28. If you do discontinue the FRSSE, we believe that you will come under pressure to produce an equivalent set of exemptions or simplifications, to that in the FRSSE, for small entities.
29. A clear opportunity to withdraw the FRSSE would arise if the EU were to allow a member state option, and the UK were to take up that option, to exempt "micro" companies from the 4th and 7th directives, and if a "micro" accounting regime had been developed in the UK. In such a scenario, we foresee that the population of entities entitled to, and wishing to use the FRSSE would be such that the costs of maintaining it (and learning old UK GAAP that underlies it) would be outweighed by the benefit of retaining it for the then smaller number of businesses that would wish to, and be able to, use it.

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?

30. There will be transitional costs to businesses, preparers, users and auditors. In our view, these will be outweighed by the clear way forward, comparability, ease of keeping up-to-date (for preparers, users, auditors) and easier transition between regimes.
31. We believe that without action as regards the FRSSE, FRSSE preparers, users and auditors will suffer as a minimum uncertainty, and possibly unexpected change. It will be more difficult and costly for FRSSE businesses to grow to the next tier. It may be that accountants who serve both small businesses and other businesses, or indeed small businesses with a mixture of FRSSE and non-FRSSE adopters, bear an additional burden of learning and keeping up-to-date with two very different regimes.

Question 16

What are your views on the proposed adoption dates?

32. The government has legislated³ that all companies shall submit tax returns to HMRC electronically, including financial statements in the in-line XBRL format, for all tax returns for accounting periods ending on or after 31 March 2010 submitted on or after 31 March 2011. We anticipate that this is likely to lead to some companies needing to spend some resource to come to terms with the process, although we have done substantial work to publicise the requirement and mitigate the impact on companies. Whilst companies can already file tax returns and accompanying financial statements in this format, companies with a December year end will have a filing deadline for their 2010 return (including their financial statements for the year ended 31 December 2010) of 31 December 2011.
33. I have set out some detailed comments on this matter in paragraphs 9 to 11 above.
34. In addition, we also note that the IFRS for SMEs will be revised in the future, and that the IASB has said that it may work on a 3-year cycle, which would imply a revised IFRS for SMEs in 2012. We request that the "change" date be tied into the IASB's revision of the IFRS for SMEs so that businesses are not compelled to adopt a revised new UK GAAP (based on a revised IFRS for SMEs) immediately after adopting the new UK GAAP for the first time.
35. I hope you have found these comments useful. I would be happy to discuss these in more detail with you if you so wished.

Yours faithfully



Matt Blake, FCA
Commissioners' Advisory Accountant

³ SI2009/3218 The Income and Corporation Taxes (Electronic Communications) (Amendment) Regulations 2009.