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29 January 2010

Dear Mr Godsall,

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## **Policy Proposal: The Future of UK GAAP**

We are pleased to comment on the Accounting Standards Board's (the Board's) Policy Proposal on the Future of UK GAAP.

Grant Thornton supports the Board in its move to replace UK GAAP as it currently stands with a regime based on the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). We accept that, with such a wide-ranging change to the UK accounting environment, there will inevitably be unwelcome costs, resistance by some and other difficulties to overcome. We have highlighted a number of these difficulties in the answers to the specific questions posed by the Board. In our view, however, current UK GAAP with partial convergence to IFRS is not a cohesive set of standards, and IFRS for SMEs is an appropriate standard that has been subject to the due processes of the IASB. Despite some measurement differences compared to full IFRS, the proposed changes will bring UK accounting standards into line with the concepts of IFRS, allowing better joined up accounting between constituents (above the small entity thresholds) of the UK financial reporting environment. Nevertheless, we encourage the Board to issue the standard in its own name and reserve the right to diverge UK accounting from IFRS for SMEs should it no longer suit the UK market.

We suggest that the timetable for implementation be deferred for between nine months and a year (our rationale for this can be found in our answer to question 16). We also encourage the Board to allow early adoption by entities keen to transition to an IFRS-based framework more rapidly.

Specifically with regard to public benefit entities, we support the Board's proposal to develop a public benefit entity standard. With the Board controlling this, areas of divergence from IFRS for SMEs will be minimised. We believe that public benefit entity SORPs should remain and continue to receive a statement from the Board regarding their consistency with UK GAAP.

Grant Thornton supports the continuing use of the FRSSE for smaller entities until IFRS for SMEs has become established and the European Union consideration of "micro" entities has been resolved.

**Chartered Accountants**

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We do not support the proposed additional option for subsidiaries of listed entities, allowing the use of the recognition and measurement principles of full IFRS but the disclosures of IFRS for SMEs, as this will increase the complexity of UK GAAP without a benefit for the wider market.

Finally, we encourage the Board to lobby those responsible for the introduction of XBRL to delay mandatory application until after IFRS for SME has been introduced in order to minimise duplicated effort.

If you have any questions on our response, or wish us to amplify our comments, please contact Brian Shearer (brian.r.shearer@gtuk.com or telephone 020 7728 2723) or Jake Green (jake.green@gtuk.com or telephone 020 7728 2793).

Yours sincerely

A handwritten signature in blue ink that reads "Brian Shearer". The signature is fluid and cursive, with the first name "Brian" and the last name "Shearer" clearly distinguishable.

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## **Appendix - Grant Thornton responses to specific questions raised in the policy proposal**

### **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?**

We strongly prefer the Board’s definition of public accountability. An approach based on the characteristics of an entity is much more relevant than one based on its size. Furthermore, we believe that the significant cost burden imposed by forcing all large private entities to adopt full IFRS would not be justified by the benefits to users of their accounts. We oppose full IFRS being mandated on the basis of size alone and strongly prefer the use of the publicly accountable entity definition. The use of size criteria also risks creating variability in GAAP options for an entity when it either grows or contracts.

The current legal definition does not take into account the overall financial reporting framework: only the distinction between the small companies regime and that applicable to other entities provides any meaningful reduction in complexity. The current ‘medium-sized’ category is of a minor significance for accounting, with some exemptions focused more on filing than on the accounts for members.

We believe further explanation regarding the definition of publicly accountable may be necessary to ensure that it captures all of the entities that the Board has in mind, but that it does not catch other entities that are not intended for inclusion. In order for entities to have appropriate certainty, we encourage the Board to ensure that the definition used provides clarity and minimises or eliminates judgement in applying the definition. This would ensure that all entities are certain which tier they fall into and therefore which GAAP choices they have open to them. In giving this guidance, the Board will need to be mindful that entities wishing to claim compliance with IFRS for SMEs, as well as UK GAAP, can only do so if they are not publicly accountable entities as defined in IFRS for SMEs.

Below we provide some examples of entities that may have difficulty in applying the current definition of public accountability:

- 1 Deposit-taking entity: We believe that building societies should also meet this set of criteria and recommend that the Board include them in their list. However, estate agents or rental companies (deposits from tenants), travel agents (deposits on holidays), motor retailers (deposits on cars), and solicitors (deposits from house buyers) could all be caught by the current definition. A very strict interpretation of the rules could imply any builder, manufacturer or developer that takes an up-front payment as a deposit could be caught (particularly if the “for a broad group of outsiders as one of its primary businesses” is construed only to apply to “fiduciary capacity”).
- 2 Fiduciary capacity: Solicitors (holding clients’ money), insurance brokers (holding premiums in a client bank account under trust until paid to the insurer), execution-only ISA managers (holding clients’ securities in a nominee name and clients’ money in a client money account in accordance with FSA rules), and fund brokers (who again can hold clients’ money in a client money account in accordance with FSA rules) could also all be caught.
- 3 Pension schemes: These are not currently explicitly scoped in or out of “public accountability” by the Board.

- 4 Public benefit entities: A number of public benefit entities believe that by the nature of their activities, they are accountable to the public. The definition should provide clarity for such entities.

We would additionally suggest that, with the potential increase in the number of entities that may wish to choose full IFRS, the Board could also consider whether or not to recommend company law changes that would facilitate the move from IFRS to IFRS for SMEs. Under the current law, Companies Act 2006 section 395, only upon a “relevant change in circumstances” can a company change from IFRS to UK GAAP. As a result a move from IFRS to UK GAAP is available to companies ceasing to be traded on an EU regulated market. A similar option does not currently exist for AIM companies. This leads to the unusual position where an AIM company on de-listing must remain on full IFRS whereas a company de-listed from the full list can convert back to UK GAAP. Without revision to company law in this area, further unhelpful prohibitions will arise. We recommend that the legal requirement be changed such that it mirrors the Board’s proposed wording. This would allow a company to change from IFRS to IFRS for SMEs upon ceasing to be publicly accountable. We encourage the Board to seek a change in the law in this regard.

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

Yes. We believe that, subject to appropriate clarification of the definition as noted above in our response to question 1, that all entities that are publicly accountable 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?**

Yes. An entity that in its own right is publicly accountable should not be permitted to apply IFRS for SMEs. IFRS for SMEs has not been designed to meet the needs of the users of the financial statements of such entities.

**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.**

No. As for question 3, we believe that the benefit to these entities of reduced disclosures is outweighed by their obligations as publicly accountable bodies.

In answer to a related, but unasked, question of “Should wholly owned subsidiaries of publicly accountable entities be allowed reduced disclosures?” we believe that they should either follow full IFRS or follow IFRS for SMEs. We do not believe that there would be significant benefits to the wider market of having an additional tier of “recognition and measurement of IFRS but disclosures of IFRS for SMEs”. Whilst there are some obvious advantages to the preparer, the added complexity of an additional tier would, in our opinion, outweigh that advantage. We believe that whilst subsidiaries continue to be required to prepare general purpose financial statements, a cohesive set of standards and disclosures should be used and a further tier based on reducing IFRS disclosures would not meet this principle. We note that the FRC’s Discussion Paper, ‘Louder than words’ explores this area and we believe a wider consultation is required before any decision is made about the general purpose financial statements of subsidiaries.

If the Board receives a large number of responses calling for such a tier, and the Board becomes minded to agree, we believe that it should be available for all entities of a lower tier and not restricted solely to subsidiaries of publicly accountable entities. We are aware of entities that currently revalue property or have large internally-generated development costs that would welcome this option.

**Question 5 – Do you agree with the Board’s proposal that the IFRS for SMEs should be used by ‘Tier 2’ entities?**

Yes. The developments in the international arena on convergence between accounting standards and better cross-border comparability mean that IFRS for SMEs will be an important part of the future of international accounting, and we believe that the UK will benefit from adopting it.

We acknowledge the concerns regarding the cost of the change, the lack of direct benefit, and the inconvenience for accountants who may have trained some time ago. These are particularly pertinent to private entities for whom international comparability is not a benefit. Such entities state a preference for retaining existing UK GAAP. However, UK GAAP in its current state of part-convergence with IFRS is not, in our view, easy to work with, or even fit for purpose as a fully articulated accounting framework for continuing use in the future.

Therefore, taking into account the ongoing advantages of an IFRS-based UK GAAP in terms of comparability, the knowledge base of accountants trained more recently or in the future, the support given by software packages and advisers, and the benefits of a cohesive accounting framework across all UK entities, we believe that the adoption of IFRS for SMEs as UK GAAP for Tier 2 entities represents the best way forward.

**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.**

In the main, yes.

We do believe, however, that some additional guidance material may be necessary, outside the text of IFRS for SMEs, for example to explain its interaction with the UK legal framework, and as noted in our response to question 1 to enhance the interpretation of “publicly accountable” to provide clarity to UK entities.

Currently, IFRS for SMEs includes an exemption from consolidation where group accounts are prepared for a larger group in accordance with full IFRS or with IFRS for SMEs. It would appear appropriate to extend this exemption to allow the use of a GAAP other than IFRS. Section 400 and section 401 of the Companies Act 2006 allow exemption from the preparation of group financial statements when a parent company is a subsidiary of a larger group, subject to certain criteria. In our opinion, the ASB should amend IFRS for SMEs to allow a similar exemption from the preparation of group financial statements for intermediate parent entities.

We understand that the IASB are minded not to pursue the changes to deferred tax proposed in their recent exposure draft on the topic. If the IASB do not go ahead, the accounting for deferred tax in IFRS for SMEs will remain out of line with IFRS. We believe the Board should draw this to the IASB’s attention and encourage the IASB to amend IFRS for SMEs appropriately.

Further, we believe that the Board should continue to be responsible for setting UK GAAP as highlighted in paragraph 1.1 of the consultation paper, and should therefore explicitly state an intention to amend IFRS for SMEs for UK purposes in the future should it not be suitable, or to decline to bring into UK GAAP future amendments to the standard.

Finally, we recommend that the Board provides appropriate guidance to entities on any areas where IFRS for SMEs as adopted into UK GAAP is incompatible with the European Union Fourth and Seventh Directives.

**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.**

We agree with the Board’s proposal. Full IFRS is intended largely for entities with widely dispersed ownership, and frequent changes in ownership, in particular quoted entities, including those entities quoted on a non-regulated market. Many large private entities do not have wide ownership and the users of their accounts will not generally be interested in the additional or different information provided by full IFRS. If investors desire full IFRS for a non-publicly accountable entity, they can encourage management of the entity to provide the information they require.

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

Yes. However we believe that the Board should consider aligning gradually the FRSSSE’s principles with those of IFRS for SMEs. When the Board again considers the future of the FRSSSE, we advocate retaining the exemption from preparing group accounts and the simplified share-based payment aspects of the FRSSSE. The FRSSSE could also retain its simpler approach to financial instruments, but experience of IFRS for SMEs in practice may indicate that it is suitable for small entities.

**Question 9 – Do you agree that the FRSSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?**

Yes. We agree that it could, but we would welcome seeing IFRS for SMEs in use for a few years first, alongside the FRSSSE. The ongoing consideration of “micros” in the European Union may significantly affect the population of entities that are required to prepare FRSSSE accounts. If “micros” are exempted from following the relevant European Directives and the UK legal requirements mirror this, then it will become more logical to replace FRSSSE with IFRS for SMEs for those remaining entities where accounts under the Directives are still required.

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

Clearly, the existing SORPs cannot continue as written if UK GAAP moves to IFRS for SMEs. However, Grant Thornton recognises that the SORPs have played an important role in raising the quality of the financial statements in their industries. We therefore see a beneficial role for SORPs in the new IFRS for SMEs environment, provided that they are carefully crafted such that they do not interpret IFRS for SMEs. Instead they could contain additional disclosure requirements, particularly if required in the financial statements by the relevant regulator, and guidance to deal with accounting for items not considered by IFRS for SMEs. Any additional guidance would need to apply the framework outlined in paragraph 10.5 of IFRS for SMEs. We note that some entities that will apply full IFRS under the

proposed framework currently benefit from SORPs and recognise that in those industries the SORP could provide additional guidance and disclosures.

In the table below we comment on each of the Board's recommendations for the SORPs, omitting HEFE, Registered Social Landlords, Charities and Local Authorities. Our views on the relevant accounting framework for public benefit entities are set out in our answers to questions 11-14.

<b>SORP</b>	<b>Board Recommendation</b>	<b>Grant Thornton comment</b>
Financial Reports of Pension Schemes	The SORP should continue until an appropriate alternative is available. The SORP is currently the only guidance available for Pension Schemes.	We concur, although we note that the current SORP will require a re-write to align its principles with IFRS or IFRS for SMEs as appropriate.
Accounting for Insurance Business	The Board's view is to leave the issue of the future of the insurance SORP on the ASB's work programme. As long as the insurance SORP was the only guidance available, the Board should retain its oversight. The SORP should continue until the publication of the new IFRS.	We agree. We note that FRS 27 Life Assurance will cease to exist, unless it remains extant for Insurance Business. If other aspects of insurance accounting are transitioned to IFRS, building any additional requirements into the SORP would be appropriate. It is also not clear how entities undertaking insurance business that are permitted to apply IFRS for SMEs will apply any new IFRS.
Accounting for Oil and Gas Exploration Leases	The SORP should continue until the publication of the new IFRS.	We concur, subject to appropriate implementation within IFRS for SMEs.
Accounting by LLPs	The SORP should continue until the publication of the new IFRS.	We agree, subject to appropriate implementation within IFRS for SMEs.
	The Board noted that the CCAB wanted to continue with the SORP for LLP's (to provide guidance to those LLP's using the FRSSE). This could be achieved by having a very short SORP or by building it into the FRSSE. The latter approach is being considered.	We partially agree. Whilst the current SORP is not necessary for IFRS accounts, there may be matters particular to partnerships, principally around partnership agreements and debt/equity, that may not be adequately dealt with by IFRS for SMEs. A SORP could provide guidance in this area. We agree that LLPs applying the FRSSE would benefit from additional material that could be embedded into the FRSSE itself.

<b>SORP</b>	<b>Board Recommendation</b>	<b>Grant Thornton comment</b>
Association of Investment Companies	The SORP should be withdrawn and investment companies should apply IFRS (leaving the question of whether additional guidance was needed as a matter entirely for the AIC).	Although investment companies are subject to UK law and accounting standards, whether IFRS or UK GAAP, there are certain key differences which make the reporting of their financial performance not directly comparable with other companies. Investment companies are fundamentally different with respect to their primary business; they do not provide goods or services and have no customers other than their shareholders. Rather, they function as investment vehicles for their investors. In addition, certain tax legislation, for example in relation to loan relationships and derivatives, is dependent on the requirements which currently lie within the SORP. Overall, we believe that where additional guidance is required, it would be most appropriate to continue to have that specific guidance included within a SORP.
Financial Statements of Authorised Funds	The SORP should be withdrawn for authorised funds and IFRS applied.	<p>We believe that it may prove difficult to withdraw this SORP immediately. There are three key reasons for this:</p> <ol style="list-style-type: none"> <li>1 HMRC places reliance on the SORP in respect of the correct measurement and distribution of revenue</li> <li>2 The accounting requirements for authorised funds, whether a unit trust or open-ended investment company, are prescribed by the FSA in its Collective Investment Schemes sourcebook, which states in rule 4.5.7 that “An annual long report... must contain... the full accounts...prepared in accordance with the requirements of the IMA SORP”</li> <li>3 It is not immediately clear that all authorised funds will meet the “public accountability” definition. This is because an authorised fund may not be marketed, and thus invisible to investors, being used for one or a small number of investors. As such they may be permitted to apply IFRS for SMEs, where further guidance would continue to be helpful.</li> </ol>



SORP	Board Recommendation	Grant Thornton comment
Banks - segments	The SORP should be withdrawn.	We concur.

In summary, we believe that SORPs should be retained when there is a good reason to do so. A good reason might include the lack of appropriate guidance in IFRS or IFRS for SMEs for specific transactions relevant to a particular industry or where there are compelling regulatory reasons for ensuring that certain disclosure requirements or guidance are available. Those disclosure requirements or guidance must be structured in such a way that they do not interpret IFRS or IFRS for SMEs and we believe that the Board is best suited to provide that assurance.

**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?**

Yes. This is an important issue in the UK, where many public benefit entities, including very major charities, have to issue true and fair accounts. IFRS was not written with such entities in mind, and neither is IFRS for SMEs. Any public benefit entity standard has to build on something and in our opinion that should be IFRS for SMEs, on the assumption that the Board proceeds to replace current UK GAAP. The regulators of these various sectors also have a keen interest in the financial statements of these entities, which are based on the differing objectives of the various types of public benefit entities.

The development of a public benefit entity standard will need to address the differing needs of these entities, for example:

- charities seek to maximise funds so that they can do the maximum good
- education establishments aim to maximise the quality of the education delivered with restricted sources of income
- registered social landlords use Private Finance Initiative schemes and growth in assets, for the purposes of reinvestment.

In our view, it would be preferable to cover the accounting for these various entities within one public benefit standard, provided that the regulators for the various entities are satisfied with any accounting changes that may result. In our opinion, it would be disadvantageous if requirements of regulators led to onerous additional “primary statements” or unjustifiably extensive disclosures. A public benefit standard written by the Board and limited additional disclosures required by regulators or considered important by the SORP committees, built into a SORP, appears to be the most appropriate future for public benefit accounting.

**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?**

We favour a standard that would sit alongside IFRS for SMEs and both supplement it and address issues of how to apply IFRS for SMEs to public benefit entities. This should minimise the volume of material that entities would be required to consult, and reduce effort needed to update “UK GAAP” by the Board. We comment further on the prospect of a one-stop shop for public benefit entities in our response to question 14.

**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?**

Yes. We agree that the areas listed are distinctive. In addition, we note that the use of “cost” for donated assets, principally in Charities, could be another area where explanation is required, ie the deemed cost of the asset is the value of the gift, being the day one fair value of the asset received. Also in the Housing arena, property is often held at valuation: this would only continue to be acceptable under IFRS for SMEs where the property meets the definition of investment property, which may prove difficult in some social care situations.

**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?**

Yes. We believe that each of the public benefit entity sectors mentioned above will continue to desire specific guidance through SORPs. Where such guidance is produced, we believe that it should be confirmed to be “consistent with UK GAAP” by an appropriate body. The Board would appear to be that body.

Once the Board has produced the public benefit entity standard, the necessity for additional accounting requirements within the SORPs should be eliminated. This will then allow the SORPs to be used for two things. Firstly, they can give application guidance, such as examples of how to value a property for the purposes of impairment testing in a manner appropriate to that particular public benefit entity. Secondly, they can require additional disclosures of items desired by the regulators or considered important by the sector.

We accept that a large proportion of the public benefit entity sectors appreciate the one-stop-shop aspects of the current SORPs. We believe that the SORPs will continue to play an important role for these entities in particular. As such they may need to be written from the perspective of those users, minimising the amount of cross reference back to IFRS for SMEs or public benefit entity standard. The SORP-making body could be responsible for integrating the contents of IFRS for SMEs, the ASB’s public benefit entity standard and the application guidance and additional disclosures required by the sector, in such a way as to make it accessible to preparers without losing the essential recognisable correspondence between the SORP and the core UK GAAP regime. We believe that the Board should continue to ensure that these SORPs do not conflict with the underlying GAAP.

**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?**

No comment.

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

We agree that the Board is right to actively pursue the adoption of IFRS for SMEs as soon as is reasonably practicable.

Under the proposed dates mentioned by the Board, the first IFRS for SMEs accounts, excepting any early adopters or short periods, would be for 31 December 2012. These would need to be filed at Companies House by 30 September 2013. This does not appear at first glance too onerous. However, we note that for those accounts IFRS for SMEs comparatives will be necessary. Hence a balance sheet as at 1 January 2011 must be drawn up. It will also be necessary to have a system capable of producing IFRS for SMEs and UK GAAP numbers for the accounting year then beginning (or at least capable of converting between the two). That date is merely 11 months after the end of the consultation period for this paper. From the conversion of full list and AIM clients onto full IFRS, we note that the deadline for adoption was upon many of our clients before they were fully prepared.

It is also not yet clear how IFRS for SMEs will interact with the UK tax system. When IFRS was implemented, the interaction between the tax computation and the accounting was complex and involved the need to choose between a number of additional tax elections. It would be helpful to all entities to have further time to assess how their tax affairs will be impacted by the conversion to IFRS for SMEs, or potentially full IFRS.

We note that in setting the adoption date the Board might also choose to take into account not-for-profit entities. Writing an additional public benefit standard, with appropriate due process, and layering onto that SORPs or regulatory requirements is likely to take longer than the time available for the proposed withdrawal of UK GAAP. For example, any charitable entity with a trading subsidiary may be faced with needing to prepare accounts under two distinct GAAPs, if the date of transition for public benefit entities is later. It could also be beneficial to transition profit making entities first, exempting those which are wholly owned by public benefit entities and to use the knowledge acquired through that process to better help the public benefit entities with their transition to IFRS for SME based accounting.

On balance we believe that it would be appropriate for the Board to delay by an additional nine to twelve months in order to allow entities slightly longer to prepare and understand the impact on their accounts and business practices, with the option of early adoption. This would have the added benefit of allowing the public benefit entities to transition at a comparable time to the “profit-seeking” entities, thereby minimising the different GAAPs in operation.