THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

KS/ASC-SUB/mb

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Dear Peter

ASB Consultation Paper: Policy Proposal: THE FUTURE OF UK GAAP

The Institute of Chartered Accountants of Scotland (the Institute) is pleased to respond to the above consultation paper. The Accounting Standards Committee (ASC) has considered the response in consultation with other relevant Institute committees. The Institute also held consultation events attended by members and the ASB.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires its committees and working parties to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Our main comments on the proposals are set out below. Our responses to the specific questions are set out in Appendix A.

The Institute agrees in principle with the three-tiered approach, with entities being allowed to use the relevant GAAP for a higher tier.

We agree that publicly accountable entities should prepare their financial statements in accordance with EU adopted IFRS. We prefer a definition of public accountability entities based on that within the IFRS for SMEs, since the definition of public accountability proposed by the ASB could result in bodies such as small localised credit unions being inappropriately classed as publicly accountable. Therefore the definition should remain aligned with the original definition contained within the IFRS for SMEs with an additional exemption for entities meeting the criteria for "small".

We propose that the IFRS for SMEs should be adopted wholesale as UK GAAP with no amendments, providing the standard is found to be consistent with the EC Accounting Directives. The FRSSE should be retained until we have had two years experience of using the IFRS for SMEs in the UK.

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Further consultation will then be required to decide whether it would be more appropriate for FRSSE entities to use the IFRS for SMEs or whether a FRSSE based on international standards is required.

We would envisage that public benefit entities would report under IFRS for SMEs, with an option to use full EU adopted IFRS. A public benefit entity standard should be developed but this should only cover those issues which are not addressed by the standards. In addition, revised SORPs or equivalent guidance should be developed to replace existing public benefit entity SORPs.

We propose that for-profit industries should continue to produce industry-specific guidance where this is considered necessary, with the ASB being consulted on an informal basis on whether the guidance complies with the standards. The ASB should not formally endorse industry guidance as this would involve interpretation of international standards.

Finally, the Institute believes that the timetable proposed is unrealistic. We propose a transition date of at least two years from the date of publication of the final requirements. This will allow users, preparers and the profession sufficient time to fully understand the requirements of the IFRS for SMEs. It may also mean that the version of the standard used could be the revised version incorporating any amendments that the IASB make as part of its post-implementation review of the standard. However, once the new UK GAAP requirements are published, entities should not be precluded from adopting the requirements for an earlier date, subject to the resolution of any legal issues.

We recognise that the proposals for profit-making entities may be further advanced than those for public benefit entities. Any delays to the implementation of the proposals for public benefit entities, for example from changes to legislation, should not impede the transition for profit-making entities and in this situation we would support a two-stage process with the proposals for public benefit entities being introduced at a later date.

I hope these comments are useful to you. If you wish to discuss anything further please do not hesitate to contact me.

Yours sincerely

Karen Shaw

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APPENDIX A: Responses to Specific Questions

I am pleased to set out our responses to the specific questions below.

Question One

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 prefer a definition of public accountability based on that within the IFRS for SMEs rather than using the current legal definitions. We do not believe it is appropriate that all "large" entities, based on the current legal requirements, should be required to use EU adopted IFRS, and any attempt to introduce criteria for "very large" entities would be arbitrary.

The Institute agrees with the proposal that all entities with listed debt should be classed as publicly accountable and that those entities who have reached the stage of issuing a prospectus for listing should also be included within the definition. We are therefore satisfied with part (i) of the Board's proposal in paragraph 2.3.

With regard to part (ii) of paragraph 2.3, we note that the Board has amended the original definition from section 1.3 of the IFRS for SMEs to explicitly include "deposit-taking entities". The Institute disagrees with the rationale in paragraph 2.8 and is of the opinion that deposit-taking entities such as banks do in fact hold assets in a fiduciary capacity. It is our view that there was no need to amend the wording from the IFRS for SMEs. The addition of the "deposit-taking entity" criteria and the use of the phrase "and/or" results in confusion over whether the "broad group of outsiders" and the "primary business" criteria apply to both deposit-taking entities and those that hold assets in a fiduciary capacity. If the Board decides to retain the "deposit-taking entity" criteria within the proposed definition in paragraph 2.3 then we suggest amending part (ii) as follows to make the definition clearer:

Part (ii) should read:

The entity:

- **takes deposits from and/or**
- **holds assets in a fiduciary capacity for**

a broad group of outsiders as one of its primary businesses

This would clarify that the "broad group of outsiders" and the "primary business" criteria apply to both types of entity.

The Institute's key concern with the proposal in paragraph 2.3 is that the definition could result in bodies such as small localised credit unions, with a membership limited to a restricted group, being classed as publicly accountable. These bodies will currently be preparing financial statements under UK GAAP and requiring them to prepare financial statements under full IFRS, with all its additional disclosures, would be disproportionate and the benefit to stakeholders minimal. The Institute fundamentally disagrees that these bodies are "publicly accountable". It is possible that these bodies would be exempt by virtue of their services not being for a "broad group of outsiders" but we are concerned that this definition leaves much to the exercise of judgement.

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We therefore propose a further exemption based on the Company Law concept of size. We would not propose introducing any of the ineligibility criteria from the Companies Act, only the thresholds.

The Institute proposes an addition to part (ii):

and does not meet two of the following three criteria:

Turnover	**Not more than £6.5m**
Balance Sheet Total	**Not more than £3.26m**
Number of Employees	**Not more than 50**

In conclusion, the Institute is proposing to endorse the definition of public accountability from the IFRS for SMEs with a further exemption for companies meeting the size criteria contained within the Companies Act 2006. If the Board continues with the proposal in paragraph 2.3 the wording should be amended as above to make it clearer. Whatever route is taken, it should be clear which category an entity falls under and, if an entity falls under more than one category, what "GAAP" is to be applied.

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

The Institute believes that all entities classed as publicly accountable under the definition proposed in our answer to Question One should be included in Tier 1 and should be required to prepare financial statements in accordance with full EU adopted IFRS.

Question Three
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?

The Institute agrees that wholly-owned subsidiaries meeting the definition of public accountability should apply EU adopted IFRS.

Question Four
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.

The Institute does not agree that publicly accountable wholly-owned subsidiaries should be allowed reduced disclosures. If an entity meets the definition of public accountability it should be required to produce full IFRS financial statements. Reduced disclosures can cause problems when a wholly-owned subsidiary is divested and limited information is available to potential investors. In addition, the burden on the Board of identifying and making the reduced disclosures and then maintaining this regime is likely to outweigh any benefit for such entities.

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

We agree that the IFRS for SMEs should be used by "Tier 2" entities.

Question Six
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 you think should be made, as well as the reason for recommending these amendments.

The IFRS for SMEs should be adopted wholesale as UK GAAP and should not be amended. However, it is noted that the ASB will need to ensure that the standard is compliant with the EC Accounting Directives. The IASB has proposed a three year cycle for amendment of the Standard and the Board should use this process to lobby for any amendments it considers desirable.

Question Seven
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.

The Institute agrees with the Board's proposal that any Non-Publicly Accountable Entities should be permitted to adopt the IFRS for SMEs. As indicated in our response to Question One, we do not believe it is appropriate that all "large" entities based on the current legal requirements should be required to use EU adopted IFRS, and any attempt to introduce criteria for "very large" entities would be arbitrary.

We believe that some large entities will opt to voluntarily adopt EU adopted IFRS in order to allow comparability with their sector competitors. Indeed some large non-listed companies in the UK already report using EU adopted IFRS. However, this should be a choice for those companies which do not meet the definition of public accountability proposed in the response to Question One.

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

We agree that the FRSSE should remain in force but only for a limited time. The Institute is concerned that, if the FRSSE continues for too long it will become out of date without a body of UK GAAP to support any revisions. We believe that some experience is needed of using the IFRS for SMEs before it is possible to determine whether it would be suitable for FRSSE companies. Therefore the Institute proposes that the future of the FRSSE should be formally revisited after we have had two years experience of using the IFRS for SMEs in the UK.

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Question Nine
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?

As explained in the response to Question Eight, the Institute believes that the UK FRSSE cannot continue indefinitely. However, we believe that there will continue to be a need for a simplified regime for small entities. We would propose that practical experience of the use of IFRS for SMEs and more extensive field testing for small entities is necessary to make an informed decision on what is appropriate for those entities currently using the FRSSE.

We also note that the outcome of the EU proposal to exempt micro entities from the requirement to produce financial statements could significantly impact on the number of bodies using the FRSSE. If this proposal were to be enacted, maintenance of a FRSSE may not be justified on cost grounds as the number of bodies using the FRSSE would dramatically decrease. It should be noted that ICAS does not believe that micro entities should be exempted from the requirement for financial reporting – accountability through financial reporting is a necessary quid pro quo for an entity being granted limited liability.

The Institute suggests that the future use of the FRSSE should be limited to two years beyond the transition to IFRS for SMEs, with a presumption that those bodies currently using the FRSSE will then adopt the IFRS for SMEs. If field testing and practical experience suggests that this would be unduly burdensome then the Board should consider whether it is possible to produce a FRSSE based on international standards.

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

The Institute believes that industry-specific guidance for profit-making entities is necessary for certain industries but its development should be the responsibility of the specific industry and the Board should only be consulted on an informal basis. Any formal approval of industry guidance by the Board would result in interpretation of international standards and this would risk re-creating a body of UK GAAP separate from international standards. Where industry-specific guidance is required in an international capacity this should be referred to the IASB or IFRIC. It is our view that the guidance will be self-regulating with its implementation subject to additional scrutiny by auditors and the FRRP.

Question Eleven
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 issues?

The Institute recognises that there are certain issues affecting public benefit entities which are not addressed by EU adopted IFRS or IFRS for SMEs. IFRS was developed to address the needs of global capital markets with the IFRS for SMEs effectively a simplified version of full IFRS. The specific needs of the public benefit entity sector were not considered in the development of the standards. Therefore we agree with the Board's proposal to develop a public benefit entity standard.

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Question Twelve
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?

As we have already stated in our response to Question Ten, we believe that it is not appropriate for the ASB to interpret EU adopted IFRS or IFRS for SMEs. Therefore we would propose that any public benefit entity standard should only cover those issues where supplementary guidance is required and the standards are silent.

The proposals in Section 3 of the consultation document do not clarify whether the Board is proposing that public benefit entities should all apply the IFRS for SMEs or whether some entities such as the very large charities should be reporting under full EU adopted IFRS. Assuming that some entities will apply full IFRS it will be necessary for the new standard to deal with those areas where the treatment and/or disclosures differ between full IFRS and IFRS for SMEs.

The Institute believes that the FRSSE can be ignored for the public benefit entity sector on the grounds that we believe it should have a limited shelf-life unless experience of using IFRS for SMEs suggests otherwise. Any benefit derived from the use of FRSSE for a small public benefit entity could be marginal given the level of additional disclosure required by the regulators of such bodies.

Question Thirteen
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?

We agree that those issues contained within the table in paragraph 3.15 are distinctive for the public benefit entity sector and should be covered by a public benefit entity standard. In addition, the following issues might also be included in a proposed standard:

- Accounting for heritage assets
- Treatment of donated assets and services
- Impairment of assets not purchased to generate cash flows
- Programmes of social investment

Question Fourteen
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?

The Institute takes the view that there will be a need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. The legislative and regulatory requirements applicable to these sectors add to the complexities of financial reporting and many organisations have limited access to accountancy expertise. Comprehensive guidance is a necessity for these organisations.

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We have stated in our response to Question Ten that we would not support the continuation of SORPs for the profit making sector. However, we recognise that both EU adopted IFRS and IFRS for SMEs were intended for use by profit making entities and therefore SORPs or equivalent guidance is necessary for the public benefit entity sector.

We believe that it would be appropriate for the Board to provide a Statement confirming that the SORPs are consistent with UK GAAP. The legal requirements for public benefit entities vary greatly between jurisdictions and therefore we recognise that it would not be possible to develop common accounting rules at the IASB level for public benefit entities.

Question Fifteen
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?

This question is not applicable to the Institute.

Question Sixteen
What are your views on the proposed adoption dates?

We believe that the proposed timetable is unrealistic. Entities adopting either EU adopted IFRS or the IFRS for SMEs will need to prepare a full set of comparative figures and narrative disclosures for the financial year prior to the year of adoption. Under the current timetable this would mean the need to restate financial statements for 2011 – when the final decision on these proposals is unlikely to be made before December 2010. There is likely to be a need for legislative amendments to the Companies Act 2006 and legislation containing accounts requirements for public benefit entities which will also take a significant period of time. In addition, industry-specific guidance and SORPs will need to be re-written under EU-adopted IFRS and IFRS for SMEs.

The Institute proposes that the date of transition should be 1 January at least two years from the date of publication of the final requirements. We also note that the IASB expects to undertake a post-implementation review of the IFRS for SMEs, following which a revised version would be issued. Although it is unclear when this might happen, it might be that the IFRS for SMEs could be updated.

However, once the new UK GAAP requirements are published, entities should not be precluded from adopting the requirements for an earlier date, subject to the resolution of any legal issues.

We recognise that the proposals for profit-making entities may be further advanced than those for public benefit entities. Any delays to the implementation of the proposals for public benefit entities, for examples from changes to legislation, should not impede the transition for profit-making entities and in this situation we would support a two-stage process with the proposals for public benefit entities being introduced at a later date.

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