

Accounting Standards Board October 2010



The Future of Financial Reporting

in the United Kingdom
and Republic of Ireland

The Key Facts



Accounting Standards in the UK: an Overview

Introduction

This booklet summarises the Accounting Standards Board's proposals for the future of financial reporting in the UK and Republic of Ireland. The Exposure Draft provides a framework targeted to meet the needs of those who prepare and use accounts. Its aims include:

- to explain to companies and other entities which set of accounting standards will apply to them; and
- to simplify UK standards into a concise, coherent and updated form.

In view of the significance of the changes, the ASB is open to fundamental comments on the Draft, not just points of detail. The ASB is aware that there are differing views, and one of its members has provided an alternative proposal reflecting some of the comments made in earlier consultations.

What do we propose?

At present, entities fall into one of three categories. Quoted groups are obliged to report to their shareholders using International Financial Reporting Standards (IFRS), as adopted by the EU. Other companies use UK standards (UK FRS) unless they are small, in which case they may use a simplified standard, the FRSSE.

The proposed framework also has three tiers.

The ASB proposes no change for quoted groups or those eligible to use the FRSSE. For unquoted companies and others that currently apply UK FRS, the ASB is proposing a new standard based on the international standard for small and medium-sized entities (IFRS for SMEs). The draft standard, called the FRSME, runs to less than 400 pages. It has been adapted to comply with UK and EU law and in response to feedback on tax requirements.

An important part of the simplification process is the proposed reduced disclosure regime for most group subsidiaries, which would cut the reporting burden and allow significant cost savings.

A small proportion of unquoted entities, notably in the financial services sector, would now be required to apply IFRS. This is because their role as stewards of other people's money makes them publicly accountable – an important element of the definition for Tier 1. The exact definitions proposed for each tier are set out below.

As part of the revision of UK accounting standards, some sector-specific Statements of Recommended Practice (SORPs) will be phased out. But where there is a clear need, for investment trusts for example, they will be retained.

The changes will affect charities and other "public benefit entities" that use UK FRS. In response to requests from this sector for a tailored standard, the ASB is developing one. It is due to be issued as an Exposure Draft in 2011.

Why are we proposing change?

The ASB has developed these proposals because of the increasing complexity of UK accounting standards and the need to update them. UK standards have been developed over decades to reflect changing economic circumstances and corporate activity. They have also been adapted to include changes in international accounting standards. This has created an unwieldy book of 2,000 pages, which lacks a coherent framework.

UK FRS, in particular, is in need of updating because certain increasingly common transactions, involving financial instruments for example, are not recognised.

The ASB believes that the logical approach for a country whose standards have much in common with IFRS, and which continues to influence them, is to extend the IFRS-based framework. While full IFRS would place a disproportionate burden on the vast majority of companies, the advent of the IFRS for SMEs has presented an opportunity to adopt a simplified version. The development of, and consultation on, this plan dates back to 2004.

Whilst any change has transition expenses, the ASB believes that its proposals would cut the cost of reporting for many companies and reduce the cost of capital more broadly, quickly enabling upfront costs to be recouped.

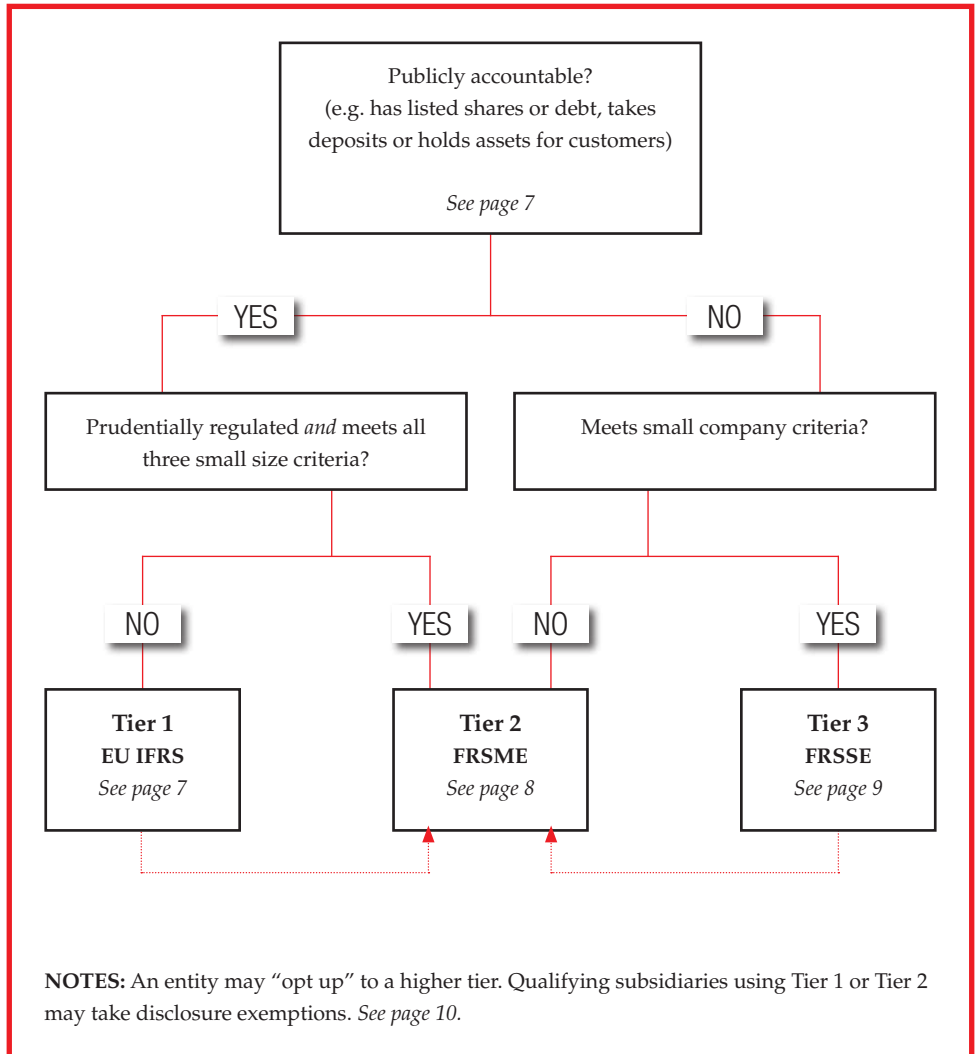
The ASB also believes that the costs of training accountants would be reduced as, in future, reporting and audit work for all but the smallest entities would be based on a single international framework. This consistent model would also make interpretation of accounts easier for users.

The ASB welcomes the views of both preparers and the accounting profession on the potential cost reductions and whether the proposals will deliver such savings. Costs, estimated at less than £80m, are contained in a draft Impact Assessment in the Exposure Draft.

International accounting standards are becoming genuinely global and their use is being promoted by the G20 leaders. They have been adopted across the EU and in about 120 other countries. They are being introduced in Canada, Brazil and China, with decisions on adoption due soon in the US and Japan. The ASB believes it is beneficial to UK entities operating in world markets to be able to present their accounts to investors, suppliers and other partners in a form that will be immediately recognisable. The Board welcomes views on these points and whether the modifications made to the IFRS for SMEs (e.g. on tax) are necessary and appropriate.

The consultation period for this Financial Reporting Exposure Draft (FRED) will run until 30 April 2011. It is proposed that the changes will apply to accounting periods beginning on or after 1 July 2013. Early adoption would be permitted.

The Proposed Reporting Framework



The Proposed Reporting Framework

- The proposals set out a **three-tier framework**. Preparers and others responding to the Exposure Draft should look at the detailed definitions it contains to check which reporting category they would fall into.

Tier	Accounting Regime	Nature of entity	Reduced disclosures for:
1	EU-adopted IFRS	Publicly accountable	Qualifying subsidiaries
2	FRSME	Entities without public accountability	Qualifying subsidiaries
3	FRSSE	Smaller entities without public accountability	

- The middle tier includes all businesses falling between these categories. These entities would apply IFRS for SMEs, modified as necessary.
- The new framework would be effective for accounting periods beginning on or after **1 July 2013**, with earlier adoption permitted.

- The proposals apply to all entities required to prepare financial statements that give a **'true and fair' view**.
- IFRS will primarily apply to quoted groups, as now, although some additional entities will now be classified as publicly accountable and therefore required to use Tier 1. The smallest financial services businesses (e.g. small credit unions) would be permitted to apply the proposed FRSME.
- The FRSSE will, as now, be used by small companies with 50 or fewer staff, turnover of less than £6.5 million and assets of less £3.26 million.

Entities with Public Accountability

- **Public accountability** is the proposed differentiator, determining which entities are in Tier 1.
- Draft **application guidance** is provided on the definition of public accountability.
- An **exemption** is provided for entities subject to **prudential regulation** that meet all three **small size criteria**: staff of fewer than 50, turnover below £6.5 million and assets of less than £3.26 million (e.g. small credit unions).

An entity has public accountability if:

- as at the reporting date, its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
- as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit taking entity for a broad group of outsiders. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds or investment banks.

Entities without Public Accountability but which are not small

- Under the proposals, entities that do not have public accountability and are not small fall into Tier 2 and would apply the **FRSME**.
- The FRSME is based on the **IFRS** for **SMEs**, amended for application in the UK and Republic of Ireland.

Amendment	Reason
Conflicts with EU Directives, for example: <ul style="list-style-type: none"> • Negative goodwill • Extraordinary items • Treatment of associates and joint ventures 	Ensure compliance with legal requirements
Refer to company law for requirement to prepare consolidated accounts Exemption from parent company and subsidiary cash flow statement	Avoidance of gold plating legal requirements
Replace Section 29 Income Tax with IAS 12	IFRS for SMEs reflects abandoned proposal for IFRS

Small Entities

- The objective is **no change** for small entities, which fall into Tier 3, although there are some consequential amendments proposed to the FRSSE.
- Small entities may continue to use their **current accounting policies**.
- The ASB will **consult on future options** for the FRSSE at a later date.
- Future developments will be informed by the ongoing **EU and FRC work on micro entities**.
- For transactions that are not covered by the FRSSE, and for which an entity does not have an accounting policy, entities will **look to the FRSME**.

Subsidiaries

- Reduced disclosures will apply to '**qualifying subsidiaries**'.
- A qualifying subsidiary is:
 - **not publicly accountable;**
 - **included in consolidated accounts** of a parent whose financial statements are **publicly available; and**
 - not subject to any **objection from shareholders.**
- Subsidiaries applying **EU-adopted IFRS** may use disclosure exemptions in the following areas:

<i>Based on current UK FRS</i>	<i>Areas managed on a group basis</i>	<i>Other exemptions</i>
Cash flow statement	Share-based Payments	Comparative reconciliations
Financial instruments	Trade and assets acquisitions	Management of capital
	Discounted operations	Standards in issue not yet effective
	Employee benefits	Associates
		Impairment of assets

- Subsidiary entities applying the **FRSME** are also offered disclosure exemptions

Public Benefit Entities

- For public benefit entities a **tailored PBE standard** will be developed. It will address areas not covered by the FRSME.
- The PBE standard is being **drafted by CAPE** (the Committee for Accounting for Public Benefit Entities).
- An exposure draft of the PBE standard is **expected in 2011**.
- The standard will be designed to be applied to PBEs in **Tier 2** (FRSME) and should be followed by **Tier 1** PBEs to the extent that it does not conflict with EU-adopted IFRS.
- The three **not-for-profit SORPs** (Charities, Registered Social Landlords and Further and Higher Education) will be retained and updated based on the FRSME and PBE standard.

Statements of Recommended Practice

- SORPs will be retained, where there is a clear and demonstrable need.
- The following are the ASB's proposals for current SORPs withdrawn or phased out as below:

Retain/update	Pension schemes Limited Liability Partnerships Investment Companies Authorised Funds Further and Higher Education Accounting and Reporting by Charities Registered Social Landlords
Withdraw/phase out	Insurance Business Oil and Gas Exploration Leases Banks — segments

Impact Assessment

The ASB believes that:

- The **current mix** of UK FRS and IFRS-converged standards lacks cohesiveness and is not sustainable.
- The IFRS for SMEs, modified as little as is feasible, is the **best option** to replace UK FRS.
- The **costs and benefits will vary** considerably between companies but the **net effect** will be beneficial to the UK economy.
- The cost has been estimated at £78.9 million.

Costs	Benefits of ASB proposals
Initial training Software Internal preparation costs External advice on preparation Audit of transition Need for more complex calculations due to use of fair value	Tiered system provides targeted response to reporting requirements Reduced volume of literature Simplified accounting Increased stability Increased comparability with quoted international entities Improved access to capital markets and other finance sources Reduced burden for subsidiaries Streamlined continuing training based on one framework

Request for Comments

- The ASB **welcomes comments** on any aspect of the proposals, including the alternative view.
- A full explanation of the proposals and a number of **specific questions** are set out in the FRED.
- Comment letters should be received by **30 April 2011**.
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