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Dear Sirs

We write to offer our comments on the ASB's "Policy proposal: The future of UK GAAP", and to support the introduction of a version of the IFRS for SMEs as a new basis for UK GAAP.

Responses to the consultation paper's detailed questions are set out in an Appendix to this letter. Some more general observations are given below.

Accounting principles and requirements should be objective and understandable. Existing UK GAAP mostly meets these objectives. However, the introduction of the International Financial Reporting Standards as adopted by the European Commission (hereafter "IFRSs") for some companies and the introduction of versions of some of these standards directly into UK GAAP has complicated this picture.

For many the prospect of further convergence with IFRSs has been more of a threat than a promise. As noted in the consultation paper, although the option to follow IFRSs has been available to all companies since 2005, few, of those entities which are not obliged to, have taken this option.

For users of accounts, the two parallel accounting systems can only cause confusion. It also causes difficulties for the preparers of accounts. A particular problem is that although firms outside the big four are mostly preparing accounts under UK GAAP, pressure from the big four has ensured that the training of accountancy students is heavily focused on the requirements of IFRSs. This has the result that in most audit teams the more senior members will have little knowledge of IFRS, while the more junior members, although having experience mainly of using UK GAAP, will be basing decisions on their more detailed theoretical knowledge of a different system.

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The content of the examinations set by the professional bodies is, of course, a matter for them, nonetheless, this situation is a symptom of the problems which arise from the mixture of accounting systems. The profession can no doubt cope with these difficulties, but they also have an effect on the general usefulness and understandability of accounts to the wider community of those who rely on them.

This problem might be solved by applying IFRSs more widely. But IFRSs have been developed largely for the benefit of investors. In practice the investor catered for is the short-term external investor (a longer-term owner would not have the same perspective). For entities whose accounts are not primarily prepared for the purpose of establishing the ongoing value of the entity as a whole, this is not a particularly helpful perspective.

“Fair value” is used in UK GAAP, but its use is more prevalent under IFRS. This has been welcomed by representatives of investor groups but has been criticised elsewhere. Much of the criticism of fair value seems to miss the main point. The problem with fair value is that many assets do not have any objectively determinable fair value.

FRS 10 has the notion of a readily ascertainable market value. In practice many assets (and liabilities) will not have a readily ascertainable market value which meets the criteria set out in FRS 10. The more general definition of fair value, as a value agreed between knowledgeable willing parties in an arm’s length transaction, assumes that all willing parties are likely to offer or accept a similar price. In reality each potential party will make a different assessment based on their own economic needs. There is obviously a range of situations. Assets which are interchangeable with others will have a more readily determinable fair value than others. It may be that companies seeking a public investment will order their affairs in such a way as to ensure that the majority of the assets and liabilities they hold can be valued in this way. There is no reason for the majority of entities, whose focus is not on a share price, to order their affairs in this way. Such companies typically have a greater proportion of assets which have no clear objective value.

The point is not that such smaller entities should have exemptions from the requirements to use fair value because such values are difficult for them to determine, but that inclusion of an entirely speculative value in these cases is of little use to the readers of the accounts.

The assumption of the IASB (and often the ASB) has been that the most useful information for investors is the best estimate of fair value that can be arrived at, and that it is worth sacrificing some objectivity and reliability to achieve this. If it is accepted as at least arguable that accounts which include a



high degree of fair value are of use to investors, it is not clear that the sacrifice of objectivity and reliability is worthwhile to the users of other accounts whose interests are more concerned with the stewardship of their assets and the ability of a trading partner to meet their obligations. For them, objectivity and reliability are of greater importance, it will be useful to reflect fair values only where an objective value is readily ascertainable.

Where a fair value can be reasonably ascertained and that value is subject to major fluctuation, we would agree that the fluctuation itself does not invalidate the use of fair value in the accounts. However, where this fluctuation is combined with a large degree of uncertainty as to what the value should be at any time, we believe that an assessment of cost against benefit should conclude that the information given by the inclusion of such amounts at a speculative fair value is of limited use.

The further principle, most clearly set out in FRS 15 s43, but generally applied, that a choice must be made between including assets under a policy of current fair value or at cost, while theoretically pure, does not give the most appropriate result. It must give better information if an entity periodically, albeit erratically, reflects the long-term accumulated changes in the value of its long-term assets, than for the entity to conclude that the costs of maintaining a current valuation is prohibitive and therefore that the asset should remain at an old and now irrelevant cost.

Fair value is only one issue, there are a number of other areas where the full IFRSs introduce complications and the need for projections and subjective estimation techniques which often make little sense in the context of most entities. There will always be a need to understand how balances will be realised or settled, but this can often be done in a simpler way than is envisaged by the full IFRSs.

These issues cannot be readily resolved without too radical a change in accounting, but we welcome the IFRS for SMEs as setting out requirements which are, as far as possible, based on the same concepts and principles as the full IFRSs while reducing at least some of the problems set out above. The IFRS for SMEs goes a long way to reducing complexity and, while it does not eliminate the use of fair value, it does take steps to limit its use to situations where fair value is most relevant.

There must be a compromise between a fully consistent system of principles and requirements and allowing for the different needs of the users of the accounts of different types of entity. We believe that the IFRS for SMEs represents a good starting point for this compromise.



The aim should be that UK GAAP is, wherever possible, based on the same principles as full IFRS but that the differences which, for the reasons set out above, should be maintained are clearly defined. The difficulty with the current situation is not so much that there are differences, but that because there are two completely separate bodies of literature it is difficult to fully determine what the differences are. Many requirements are broadly similar but it is difficult to say conclusively that in any particular area the requirements are fully the same.

The reasons for establishing a more unified accounting system within the UK need not include international comparability at all levels. For smaller UK entities the ability to immediately compare results with entities in other jurisdictions is of limited value and the ability to do so is not a sufficient reason to accept all aspects of the IFRS for SMEs without change. It is open to the ASB, as the authority setting UK GAAP, to conclude that there are some areas where the IFRS for SMEs has reached the wrong conclusion.

As indicated in the consultation paper, one area which has caused particular concern is the treatment of deferred tax. We do not agree with the ASB's initial conclusion that they should be precluded from making changes of substance. Deferred tax is one area where improvements should be made to the usability of the standards and hence the comprehensibility of the resulting accounts.

Again, the principle should be that divergences from the international standard should be clearly defined, so that where a comparison is required the areas in which a different treatment is adopted can be readily identified. There is of course a balance to be drawn and there will be areas where, although the treatment could be improved, the improvement would not be sufficient to justify a departure from the international standard. In such cases a better conclusion would be for the ASB to lobby the IASB for a change in the IFRS for SMEs in future. Nonetheless, the principle should be that the ASB should take responsibility for ensuring that UK GAAP makes sense. Using the IFRS for SMEs is a useful starting point, changes to its text should be identified in the same way that changes from the full IFRS standards have been identified in some recent FRSs. Decisions made at the international level should not be accepted uncritically.

Just as the need for the users of the accounts of entities whose shares are not frequently publicly traded differ from those which are, so the needs of public benefit entities differ from entities which primarily trade for profit. For example where a charity holds investments as a store of value for the future, the investments can most informatively be shown at fair value. Conversely, where a charity exists to manage or use a particular heritage asset, it makes no



sense for accounts prepared on a going concern basis to reflect a value for that asset (unless it has actually been acquired through donations in which case cost would be the relevant value).

To take the Charities SORP as an example, there is quite a lot of material in the current SORP which seeks to reconcile the principles underlying charity accounting with those of regulation and accounting standards which are currently directed to profit based activities. We agree with the suggestion that, while the continued development of SORPs should remain with the various sector organisations, it would be useful for the ASB to promote a variant version of UK GAAP which recognises the different needs of these kinds of entity. Whether this could most efficiently be presented as a series of exemptions and variations from a general UK version of the IFRS for SMEs or whether it would be more straightforward to present this as a separate standalone “IFRS for public benefit entities” (and whether different types of public benefit entity may each require a separate variation) should be determined at the drafting stage and is not really a matter of principle. The principle should be that different accounting principles should apply to types of entity which have different objectives, and that these differences should be clearly defined.

This analysis of the main issues leads us to suggest changes to some of the details of the overall proposal, but, in conclusion, we believe that the IFRS for SMEs represent an opportunity to rationalise and hence improve UK GAAP.

Yours faithfully

Michael Comeau
Senior Technical Manager

APPENDIX

ANSWERS TO SPECIFIC POINTS RAISED IN THE CONSULTATION DRAFT

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 do not agree that the obligation to use full IFRSs should be extended beyond those entities whose debt or equity instruments are traded in a public market. The more complex requirements of IFRSs may be better suited to the needs of investors in those instruments, but do not necessarily give a more rigorous accountability. The interests of the public, other than investors, would be better served through the application of more straightforward and readily understandable requirements. There is an argument that to better meet the needs of the wider, non-investor, public, companies complying with the full IFRS should be required to publish a reconciliation of their full IFRS accounts to accounts prepared on the more straight forward basis of the IFRS for SMEs, with a description of the extent to which the differences rely on subjective or speculative judgements.

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

No, as above, Tier 1 should be restricted to entities whose debt or equity instruments are traded on a public market.

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?

Subsidiaries should only be required to follow the full IFRSs if they meet the general criterion above. A wholly-owned subsidiary may still have publicly traded debt. Where this is not the case subsidiaries may well choose to follow the full IFRSs in order to use consistent recognition and measurement principles within a consolidation, but this should remain an option. The possibility should be allowed that the accounts of smaller subsidiaries prepared under the IFRS for SMEs may, from the group’s point of view, be materially equivalent to accounts prepared under full IFRSs, and therefore that the costs of those subsidiaries preparing full IFRS accounts can be avoided.

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.

Such entities could usefully be allowed reduced disclosures, in particular in areas where disclosure made on an accumulated basis in the group account gives the most useful information. At least the areas listed in 2.15 of the consultation paper should be the subject of exemptions but the possibility of further exemptions should be considered when the UK version of the IFRS for SMEs is at the Exposure Draft stage.

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



Yes, we agree that the IFRS for SMEs should be used by Tier 2 entities, although as set out in the next point we do not agree that the IFRS for SMEs should be used in the UK without change.

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.

No, we do not agree that the ASB should adopt the IFRS for SMEs without change so long as there remain requirements in the international standards which, to most UK users, do not make sense. There are clear advantages to minimising the changes, but so long as any departures from the international standard are clearly defined and justified, the chance to improve UK GAAP should not be missed. This will necessitate ongoing ‘care and maintenance’ by the ASB. More detailed changes can be considered at the Exposure Draft stage.

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 do not believe that the size of an entity is a relevant factor, or that the investor perspective embodied in full IFRSs would necessarily result in better accounting. The important point is that the accounting regime reflects the needs of the users of the relevant accounts. A large unlisted entity would only need to present information for an investors’ perspective if they were seeking future investment through the market. In such a case the full IFRSs can be used on a voluntary basis.

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

Although the continued use of the FRSSE will cause complications, we accept that it may be expedient to allow its continued use for a time. However, the ultimate aim must be to eliminate the use of this as a parallel accounting system. There is a suggestion that the FRSSE should be adapted to be more in line with IFRSs, but we believe that the result would be fairly similar to the existing IFRS for SMEs. The issue which does arise concerns the exemptions which are available within the FRSSE, the solution would seem to be to consider including such exemptions within the IFRS for SMEs rather than to maintain a parallel standard.

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?

Yes.

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

Of the SORPs listed in this table, the only one on which we wish to comment is the SORP for LLPs. There are a number of specific issues that arise for LLPs on which the existing SORP presents useful guidance. It is not clear why the ASB suggests that it is only LLPs following the FRSSE that would in future require this guidance. It may be that there are no specific areas of actual conflict with the IFRS for SMEs, but the guidance given in the current SORP should not



be lost.

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, a separate standard will give an opportunity to recognise the different needs of the users of public benefit entity accounts.

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?

The requirements applying to public benefit entities should differ from those devised for profit-based entities in some areas, but this should apply only where necessary. Where possible the requirement should be identical. It would not be helpful to draft a parallel standard which had numerous differences in emphasis and drafting. (One of the problems with the existing FRSSE is that it is often difficult to tell whether it has a simplified requirement or whether the same requirement is simply being described in a simplified way.) In the development of the public benefit standard (or standards) the ASB should focus on those areas which need to be supplemented or adapted for public benefit entities. Whether or not the results are presented in the form of a complete variant standard (or standards), or in the form of variations from the main standard, is less important so long as the differences are minimised and can be clearly identified.

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?

We agree that the issues listed should be covered in a separate standard. At this stage we have no particular suggestions of additional issues requiring separate treatment but anticipate that other issues will arise at the Exposure Draft stage.

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 it would be useful for the ASB to continue to confirm, or otherwise, that such guidance is consistent with UK 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?

Although the costs of conversion identified in the consultation paper seem to be rather underestimated, adoption of a standard based on the IFRS for SMEs would be expected to cost



much less than a conversion to full IFRSs, and the latter should be required only where the investor perspective is needed. For the reasons already given, there is no reason for entities to be obliged to follow full IFRSs only because they hold client monies or deposits.

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

The proposed adoption date for the UK version of the IFRS for SMEs appears reasonable, however this is primarily a practical issue. We believe that:

- a) As soon as the UK version of the IFRS for SMEs is available, early adoption should be allowed. We do not see particular advantages in imposing a single conversion date so long as the standard being followed is clear in each set of accounts.
- b) Depending on the timing of the remainder of this project, there may be advantages to delaying the implementation date, generally or for particular types of entity (for example public benefit entities where the relevant guidance may only be available at a later stage).

There is already a mixture of accounting standards and the aim should be to move to a unified position with as little disruption as possible. While the possibility that conversion is postponed indefinitely must be avoided, a single conversion date is more likely to hinder than to help the conversion process. The difficulties of having different companies converting at different dates should not be any greater than the current difficulties of having different companies using different standards.