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Our ref: 79/BLC/The Future
Application of Reporting
Requirements for UK
Companies BLC11032

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Dear Sir

Views on the future application of reporting requirements for UK companies

We thank you for the opportunity to respond to the request for further views on the above topic as set out in your press release ASB PN 289 dated 10 May 2006.

Although not explicitly stated in PN 289 we presume that the ASB's proposal that 'All UK Public Quoted and other publicly accountable companies would be required to apply full IFRS, irrespective of turnover and whether they present group accounts or not.' is to be achieved by issuing UK standards that are identical to IFRS. It is of course for the relevant market regulators to decide whether or not such companies are required to adopt EU IFRS in their individual company accounts or whether AIM or OFEX groups are required to adopt EU IFRS. Our response is made on this basis.

The extension of IFRS to more companies

Public quoted companies

We would support the extension of IFRS through UK standards to UK public quoted companies (including AIM, OFEX and investment trust companies) irrespective of whether they prepare group accounts.

However in doing so we believe there are areas in which changes to IFRS in formulating the UK equivalent could be deemed 'necessary or justifiable'. For example:

1. If the reporting entity produce both group and individual accounts on an IFRS (UK) basis there should be disclosure exemptions at the individual level - as already exist in FRS 25:3C and FRS 29:2D. Examples where additional derogation should be allowed at an entity level include cashflow statements and related party transactions.
2. As the individual accounts determine the taxable profits and distributable reserves certain measurement criteria of existing IFRS may need to be excluded or revised. For example the treatment of dividends paid from pre acquisition dividends in respect of investments in subsidiaries carried at cost.

These changes would also be applicable to UK subsidiaries required to adopt IFRS (UK), see 'Subsidiaries of groups that apply full IFRS' below.

Publicly accountable companies

We do not support the extension of IFRS (UK) to publicly accountable companies as defined. Such a definition is too wide and would lead to problems in identifying whether or not a company was publicly accountable. A more specific means of defining such companies is required. The proposed definition 'there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders depend primarily on external financial reporting as their means of obtaining financial information about the entity' would appear to encapsulate all companies that are not owner managed businesses.

We note that the IASB internet page on the 'Accounting Standards for Small and Medium-sized Entities' project (latest revision: June 2006) states:

An entity has public accountability if:

- it has filed, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or
- it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment banking entity

The proposal that medium-sized companies be allowed to use the FRSSE

The FRSSE should continue to be available for small companies pending a clear resolution of the IASB SME project.

We see that there would be advantages for those 30,000 medium sized companies¹ currently falling outside of the FRSSE scope being able to adopt the FRSSE if the criteria were extended. However we have two concerns that should be addressed before extending the scope.

1. The FRSSE (2005) reflects the requirements of Schedule 8 in addition to accounting standards and UITF abstracts. The 30,000 companies currently outside of the scope of the FRSSE would not be entitled to take advantage of the reduced Schedule 8 requirements hence there would be a need to make the FRSSE a two tier document. We are concerned that would complicate the FRSSE and make it more difficult for the 900,000 plus² small companies to use.
2. We are also concerned that the increased size of those entities entitled to use the FRSSE may lead to the FRSSE requirements becoming more onerous (i.e. less "large GAAP" omitted), than would have been the case if the FRSSE had applied solely to small companies .

In short while there may be a benefit to the 30,000 medium sized companies that would fall within the scope of the FRSSE this should not be at the expense of the 900,000 plus small companies currently entitled to use the FRSSE.

Subsidiaries of groups that apply full IFRS

We agree that UK subsidiaries of groups that apply full IFRS, but where the subsidiaries continue to report under UK GAAP, should move to IFRS (UK).

In general application of the IFRS recognition and measurement requirements to the UK subsidiaries should not be too onerous as those requirements are required to be applied for reporting at a group level.

In addition to derogations for disclosure requirements as stated in the PN certain other recognition and measurement derogations may also be necessary. For example in respect of IAS 27, also discussed above in respect of public quoted companies.

The International Accounting Standards Board's (IASB's) Small and Medium-sized Entities (SME) project

As noted above, the FRSSE should continue to be available for small companies pending a clear resolution of the IASB SME project.

Companies not included above

The discussion above addresses UK public quoted companies, publicly accountable companies (subject to clarification of the definition), subsidiaries of groups that apply full IFRS and small companies. Based on the

¹ Additional number of companies per the PN able to use the FRSSE if the limits are extend to those applicable to medium sized companies

² The DTI Report for the year ended 31 March 2005 indicates 85100 companies filed small abbreviated accounts and a further 882,500 were audit exempt in 2004/05.

figures in the press notice there 37,000 companies not addressed. The 30,000 medium sized companies and 7,000 other companies in the 'gap'.

It would seem inevitable that there will be some degree of convergence of measurement and presentation between UK GAAP and IFRS. Therefore we believe these companies should move to IFRS (UK) as proposed above. However, there should be derogations as appropriate for disclosure, recognition and measurement requirements where the cost of satisfying full IFRS exceeds the benefits for users.

Rather than omitting such IFRS requirements altogether, an approach similar to that adopted in FRS 25/ 29 and FRS 26 could be used whereby the requirements are mandatory in certain circumstances and encouraged in others.

Interaction with the Companies Act

There are certain areas in which the requirements and exemptions under the Companies Act do not obviously overlap with those in IFRS. An example is the requirement to produce consolidated accounts. The Act includes exemptions for small and medium sized groups and also for intermediate parent companies that are wider in scope than the exemptions in IAS 27. In moving to a IFRS (UK) standard based on IAS 27 amendments will be required to the exemption conditions in order to align with the Companies Act. This is just one area of difference listed as an illustration.

Timing

The PN mentions a common effective date for IFRS (UK) of periods beginning 1 January 2009. We believe this is an optimistic timetable given the need to assimilate the IFRS SME project, which is due to issue an ED in the fourth quarter 2006 with a standard currently envisaged in the second half of 2007. We would anticipate a considerable level of comment being made on the ED so that the final standard date may well move.

If there is a move to IFRS (UK) it should be to a stable platform with a subsequent moratorium on mandatory changes for an adequate period to allow IFRS (UK) to 'bed in'. The ASB should learn from the responses to the continuous changes to the IASB's 2005 stable platform and the subsequent need for the IASB's announcement that it 'will not require the application of new IFRSs under development or major amendments to existing standards before 1 January 2009.'

We hope that the above comments are of assistance. If you wish to discuss any of the points raised in our submission please contact Peter Chidgey on 020 7893 2110.

Yours faithfully

BDO Stoy Hayward LLP