######

###### Financial Reporting Committee

Michelle Sansom

Accounting Standards Board

5th Floor, Aldwych House

71-91 Aldwych

London

WC2B 4HN

20 May 2011

Dear Michelle

**Financial Reporting Exposure Draft: The Future of Financial Reporting in the UK and Republic of Ireland**

We are pleased to submit our comments on the above proposals.

**Who we are**

The Hundred Group represents the views of the finance directors of the UK’s largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of that of companies listed on the London Stock Exchange. The views expressed in this letter are not necessarily those of all of our individual members or of their respective employers.

**Summary**

We summarise our views below and set out our responses to the Board’s specific questions in the Appendix.

Most of our members are best represented by the ‘Company E’ scenario as set out on page 129 of the FRED, namely an EU listed group using IFRS in its consolidated accounts, but with subsidiaries continuing to report under UK GAAP. We have therefore responded only on the matters that we consider directly affect our members, specifically the proposals on ‘qualifying subsidiaries’ and the implications for the reporting of pension schemes.

We commented on the Board’s earlier “Policy Proposal: the Future of UK GAAP” (please refer to our letter dated 11 February 2011). For the reasons set out in that letter, we did not support the Board’s original proposal that a subsidiary of a listed company should adopt IFRS for SMEs (unless the subsidiary itself was publicly accountable, in which case it should adopt full IFRS). We therefore appreciate that the Board has reflected on its proposals and now proposes that subsidiaries of listed companies should adopt IFRS with reduced disclosure requirements.

We believe that the Board’s revised proposals go a long way towards enabling subsidiaries of listed companies to prepare their individual financial statements using the same data that they submit for inclusion in the consolidated financial statements of the group to which they belong while not imposing the disclosure burden of full IFRS. We consider that approach will deliver efficiency savings to preparers without being of any detriment to the interests of users. While the disclosures from which subsidiaries would be exempt may be relevant on consolidation, they are largely superfluous in individual financial statements. Moreover, the revised proposals align with the UK Government’s objective of reducing unnecessary regulatory burdens on UK companies.

We would, however, suggest that the Board revisits the impact of its proposals concerning the capitalisation of interest on intra-group loans. Where borrowings are made centrally and passed through to individual group entities, the capitalisation rate that will be applicable at individual entity level is likely to differ from that which will be applicable at group level. So as to minimise the number of reconciling items between the financial statements of an individual entity and the consolidated financial statements of the group to which it belongs, we would welcome an exemption for subsidiaries of listed companies from applying IAS 23 *Borrowing Costs* to intra-group loans.

We would again highlight the uncertainty that exists about the effect of adopting IFRS or IFRS for SMEs on distributable profits (in particular, in relation to the impact of adopting
IAS 39 *Financial Instruments, Recognition and Measurement* and IAS 19 *Employee Benefits*). While the ICAEW has developed guidance on the determination of distributable profits under IFRS, the fact that the guidance runs to over 120 pages indicates that the existing rules are outmoded and overly complex in the context of IFRS-based accounting standards. We suggest that the Board works closely with the UK Government with a view to simplification. We continue to support a move towards a solvency basis of determining distributable profits.

We are concerned that the Board has concluded that all pension schemes are publicly accountable and should therefore be subject to IFRS. The SORP “Financial Reports of Pension Schemes” has been developed over a number of years based on the wide cross-section of pensions expertise represented by the Pension Research Accountants Group and is tailored to address pension issues that are specific to the UK. The SORP was last updated in 2007. By comparison, IAS 26 *Accounting and Reporting by Retirement Benefit Plans* was last updated in 1994 and we are unconvinced that the wholesale application of IFRS to pension schemes will meet the needs of the users of their financial statements. We therefore recommend that the Board reconsiders whether all pension schemes are publicly accountable. Moreover, we suggest that rather than tailoring the existing SORP to IFRS, the Board should offer the SORP to the IASB as a basis for a review of accounting by pension schemes under IFRS.

We welcome the Board’s commitment to consult on future changes to exemptions as the IASB amends IFRS in the future. We believe that this is essential, given some of the issues that have arisen on actual or proposed changes to IFRS in the past which have particular implications for UK companies.

Finally, we would like to commend the Board and its staff on the considerable outreach that has been performed on the proposals.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours sincerely

****

**Chris Lucas**

*Chairman*

*The Hundred Group - Financial Reporting Committee*

 **APPENDIX**

**The Tier system**

**Question 1: Do you agree that a differential financial reporting framework, based on public accountability, provides a targeted approach to relevant and understandable financial information that contributes to discharging stewardship obligations?**

Yes. We support the approach taken by the Board to propose differentiating financial reporting frameworks which are proportionate to the specific risks and position of the company. We believe that this is an appropriate and pragmatic step by the Board.

We support an approach which considers public accountability as a primary driver of reporting requirements compared to one which is limited purely on size. In our view this approach allows a proportionate approach to financial reporting, and one which matches most closely the needs of investors and stakeholders with reporting requirements.

We would however refer you to our response to Question 15 regarding pension schemes.

**Question 2: Do you have any further comments on the proposed application of the tier system?**

We would ask the Board to provide additional clarity over the application of the proposals for qualifying subsidiaries. In particular, we consider that the FRED does not make it clear how qualifying subsidiaries will adopt section 395 and section 396 of the Companies Act. In addition, it appears that, for dormant subsidiaries, the exemption under paragraph 35.10(m) would not be applicable as this relates only to adopters of the FRSME. In our view paragraph 35.10(m) should be applicable for all dormant UK companies.

**Question 3: Appendix 1 ‘Note on the Legal Requirements in the United Kingdom and Republic of Ireland’ to this FRED sets out a note on legal matters that are applicable to the tier system. Do you have any comments or queries on the scope or content of this Appendix?**

We consider that the Board should confirm that it will take the lead in ensuring that the UK Government gives effect to the consequential amendments to the legal requirements occasioned by the proposed changes.

We are concerned about the impact of the proposals on the distributable profits of UK companies. We strongly believe that the current distributable reserves requirements, which are outmoded and complex, should be reassessed and replaced by a simpler solvency based test for UK entities. We are of the opinion that the Board is well positioned to drive such a change in consultation with the UK Government.

**Entities with public accountability (Tier 1)**

We have no comments on Question 4.

**Question 5: Are the definition of public accountability and the accompanying application guidance sufficiently clear to enable an entity to determine if it has public accountability? If not, why not?**

Yes, subject to our response to Question 15 regarding pension schemes.

**Entities without public accountability (Tier 2)**

We have no comments on Questions 6 to 8.

**Small entities (Tier 3)**

We have no comments on Question 9.

**Reduced disclosures for subsidiaries**

**Question 10: The ASB is proposing that subsidiary undertakings which apply the reduced disclosure framework should:**

1. **disclose the disclosure exemptions taken;**
2. **state in the notes the name of the parent undertaking in whose consolidated financial statements the subsidiary’s results and relevant disclosures are included; and**
3. **only be permitted to take the disclosure exemptions where the consolidated financial statements of the parent are publicly available.**

**Are these requirements necessary and sufficient to protect users of subsidiary financial statements?**

Yes.

As we understand it, the Board’s intention is that subsidiaries may refer to parent consolidated financial statements and have exemption from disclosure, even in areas where the individual disclosures relating directly to the subsidiary may not be visible within these financial statements. For example, a UK subsidiary of an international group may be exempt from, say, defined benefit pension scheme disclosures even if the parent group does not disclose information on the particular pension scheme of the subsidiary on the basis of materiality. We would however ask the Board to clarify its position on ‘equivalent disclosures’.

**Question 11: The ASB proposes that disclosure exemptions should be permitted for all subsidiary undertakings: do you agree, or do you consider that there should be a**

**minimum percentage ownership requirement?**

We support disclosure exemptions for all subsidiaries where, as proposed by the Board, there is no objection from any shareholders. In our view this is a sensible approach and will provide information that is considered relevant by shareholders.

**Question 12: Do you consider that a disclosure exemption should or should not be provided for transactions between wholly-owned group undertakings? Please explain your reasoning.**

We believe that the primary purpose of financial statements is to report to shareholders on the management’s stewardship. Where a subsidiary is wholly-owned, its shareholders can be assumed to be aware of transactions with other group companies. Disclosure of such transactions would lead to increased volume of data with little or no information value to shareholders.

We recognise, however, that there are other users of financial statements who may not otherwise be aware of transactions between wholly-owned group companies and for whom such disclosure may be decision useful, e.g. lenders, tax authorities and employees. The Board cites the Rover case as an example where knowledge of such transactions may have been relevant to stakeholders.

While we would prefer the current exemption that exists within UK GAAP to be maintained, we would not object strongly to its removal provided that it was made clear that disclosure need be made only of transactions that are material to the reporting entity and therefore may be decision useful to stakeholders. We would emphasise that we do not believe that the significance of the transaction to the related party should be a consideration in determining whether it should be disclosed in the reporting entity’s financial statements.

**Question 13: The reduced disclosure framework was developed in response to the feedback on the ASB’s policy proposal issued in August 2009. Qualifying subsidiaries applying the reduced disclosure framework look to EU-adopted IFRS and the Appendix to the draft Application FRS to prepare their financial statements. Does this proposal adequately address preparers’ needs?**

Yes.

**Question 14: Do you have any further suggestions for disclosure exemptions for qualifying subsidiaries? If so, please explain why you consider the disclosure is not required in the subsidiary financial statements.**

We suggest that the Board considers further disclosure exemptions in the following areas:

* **Sensitivity disclosures under IFRS 7 *Financial Instruments: Disclosures*:** In our experience, sensitivity disclosures can be excessively voluminous, and for individual statutory entities, not especially relevant or helpful. We would encourage the Board to revisit this exemption.
* **Comparative information:** We suggest that the exemptions from disclosing comparative information could be extended: for example, to cover further exemptions in IFRS 2 *Share Based Payments* (paragraph 45(b)) and IFRS3 *Business Combinations* (paragraph B67d), as well as aspects of IAS12 *Taxation.*

**SORPs for profit-seeking entities**

**Question 15: Do you agree with the detail of the ASB’s proposal to streamline the number of SORPs for profit-seeking entities? If not, why not?**

Yes.

However, we are concerned about the Board’s proposals with regard to accounting by pension schemes. The Board has concluded that all pension schemes are publicly accountable and should therefore be subject to IFRS. We believe that the users of pension scheme accounts have different needs compared with the users of corporate financial statements.

Pension scheme accounts are directed towards their members whose principal interest is in the management of the assets of the scheme by the trustees and the funding of the scheme. We believe that their information needs differ from those of the stakeholders in publicly-accountable corporate entities. Moreover, pension scheme accounting in the UK should reflect not only the distinction between the trustee and the sponsoring employer (which does not exist in some jurisdictions) and the basis on which the liabilities of the scheme are calculated for funding purposes under the rules of the Pensions Regulator (which differs from that prescribed by IAS 19 *Employee Benefits.*

The SORP “Financial Reports of Pension Schemes” has been developed over a number of years based on the wide cross-section of pensions expertise represented by the Pension Research Accountants Group and is tailored to address pension issues that are specific to the UK. The SORP was last updated in 2007. By comparison, IAS 26 *Accounting and Reporting by Retirement Benefit Plans* was last updated in 1994.

We recommend that the Board reconsiders whether all pension schemes are publicly accountable. Moreover, we suggest that rather than tailoring the existing SORP to IFRS, the Board should offer the SORP to the IASB as a basis for a review of accounting by pension schemes under IFRS.

**Draft impact assessment**

**Question 16: Do you agree with the benefits that have been identified as arising after adoption of the proposed Financial Reporting Framework? If not, why not?**

**Please provide examples, including quantification where possible, of any benefits you believe have not been taken into account.**

For our members, the principal benefit of the proposals will come from enabling their subsidiaries to prepare their individual financial statements using the same data that they submit for inclusion in the consolidated financial statements of the group to which they belong while not imposing the disclosure burden of full IFRS.

**Question 17: In relation to the case study scenarios identifying the likely costs of transition for certain entities, do you agree with the nature and range of costs identified? If not, please provide details of any alternatives you would propose, including any comments on the assumptions underlying the calculation of the costs.**

We agree that the Board has identified the major areas of cost but we consider that it has underestimated the implementation costs.

Most of our members are best represented by the ‘Company E’ scenario for which the Board projects a cost of £1,100 for subsidiaries currently reporting under UK GAAP and £270 for those currently reporting under IFRS.

We are concerned that these estimates appear very slight and represent a significant underestimate of the true amount of time and cost – both internal and external – that would be incurred. In particular, the costs of compliance for any change in accounting standards require for preparers to study the proposals in detail and to identify the impact on each legal entity. Restating comparative amounts also requires additional work, even if in the majority of cases the restated amounts have already been quantified in the context of the group’s financial statements.

In particular, we believe that the estimated incremental audit costs to companies are unrealistically low. At around £200 to £300 per subsidiary, this equates to approximately 1.5 days at the Board’s assumed rate of £130 per day. In our opinion, not only is the transition likely to require more than 1.5 days of auditor time, but the rate of £130 per day is significantly below the fees that are charged by auditors (particularly, by the “Big 4” accounting firms which are engaged by most of our members).

While we consider the cost projections by the Board to be materially understated, we expect that the benefits to our members are likely to outweigh even a more realistic estimate of the likely costs.

**Question 18: The [draft] Impact Assessment also gives an indication of the impact on the ‘main affected groups’. Do you agree with this analysis? If not, why not?**

As the list of ‘main affected groups’ predominantly excludes our members, we have no comments on Question 18.

**Question 19: The benefits are hard to quantify; do you agree that they outweigh the costs of transition and any ongoing incremental costs? Do you have any comments on the estimates used?**

As set out in our response to Question 17, we believe that the benefits for our members are likely to outweigh the costs of implementation.

**Question 20: The ASB is proposing an effective date of July 2013, with early adoption permitted, which assumes an 18 month transition period. The ASB’s rationale for this date is set out in paragraphs 11.121 to 11.126. Early adoption will permit entities to secure benefits as soon as possible, however other entities may wish to defer the effective date to permit businesses more time to prepare for transition. Do you agree with the proposed effective date and early adoption? If not, what would be your preferred date, and why?**

As you will be aware, the IASB recently consulted on the effective date for a number of international accounting standards that are currently under development (including important standards on revenue recognition, leases and financial instruments). In our response to the IASB, we set out our preference for a “Big Bang” approach with an effective date of
1 January 2015.

We believe that most of our members would prefer to transition from UK GAAP to IFRS at the same time as these new or revised accounting standards become mandatory under IFRS in order to avoid two significant changes in accounting within as many years. We therefore suggest that before finalising the effective date of its proposals, the Board awaits the IASB’s decision on effective dates

**Question 21: Please provide any other comments you may have on the [draft] Impact Assessment.**

We have no comments on Question 21.

**Alternative view**

**Boundary between Tier 1 and Tier 2**

We have no comments on Questions 22 to 25.

**Boundary between Tier 2 and Tier 3**

We have no comments on Questions 26 or 27.