The Hundred Group
of Finance Directors

Financial Reporting Committee

Ian Mackintosh
Chairman
Accounting Standards Board
5th Floor, Aldwych House
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London WC2B 4HN

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Dear Ian

Policy Proposal: The Future of UK GAAP

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

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. Whilst this letter expresses the views of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers.

Scope of our comments

We address below only those aspects of the proposals that are relevant to our members: in particular, the implications for listed companies and their UK subsidiaries, the future of SORPs and the transitional arrangements.

Some words of caution

We support international accounting convergence, but we are mindful that the IASB's convergence project is still some way from fruition and that there are some powerful political influences at play that could yet derail the entire project. Accordingly, while we believe that it is appropriate for the Board to consider the potential options for the future, we are not convinced that now is the right time to commit to scrapping the existing body of UK GAAP.

We are concerned that the benefits to listed companies and their UK subsidiaries of moving to an IFRS-based accounting regime are not as great as the Board may think and we would be pleased to assist the Board in a cost-benefit analysis of its proposals. We suspect that unlisted companies may see little or no benefit from the transition.

It is also relevant to the Board's proposals that the European Commission has yet to decide whether IFRS for SMEs is compliant with the accounting directives.

Why do many listed companies continue to use UK GAAP?

As things stand, listed companies must prepare their consolidated financial statements in accordance with IFRS. Listed companies and their UK subsidiaries have the option of adopting IFRS in their individual financial statements, yet relatively few have taken this option and most continue to prepare their financial statements in accordance with UK GAAP. As it would usually be more efficient for a group to adopt a single set of accounting standards in all of its operations, we believe that it is important to ask why many have not chosen to do so.

We set out below what we believe are the principal reasons why UK plc has not rushed to embrace IFRS. We suggest that the Board considers each of them very carefully before taking any decision to force IFRS or IFRS for SMEs on its constituents.

Taxation

Adoption of IFRS would lead to greater volatility in reported results due to the increased use of fair value measurement. We believe that HMRC's attitude towards the taxation of fair value gains is not always clear and the possibility of increased tax payments deters many companies from adopting IFRS. We encourage the Board to discuss its proposals with HMRC.

Distributable profits

Uncertainty exists about the effect of adopting IFRS or IFRS for SMEs on distributable profits. While the ICAEW had developed guidance on the determination of distributable profits under IFRS, the fact that the guidance runs to over 120 pages indicates that the existing approach would be too complex in the context of IFRS-based accounting standards. We therefore suggest that the long-awaited review of the measurement of distributable profits is completed before there is any radical change in the UK's accounting regime. We would welcome a move towards a solvency basis of determining distributable profits and we encourage the Board to discuss its proposals with DBERR.

One size doesn't always fit all

For good reason, the UK has developed sector (or issue) specific guidance, such as SORPs, which may not be available under IFRS.

Disclosure requirements

IFRS contains voluminous disclosure requirements. Moreover, IFRSs are written in the context of consolidated financial statements and contain none of the disclosure exemptions that exist for parent companies and 90% or more owned subsidiaries that exist under UK GAAP. Companies are concerned about the cost associated with compiling, reviewing and auditing these disclosures that would be of little or no benefit to users of their financial statements.

Cost

Companies are concerned about the cost of adopting IFRS, which should not be underestimated. Both the cost of conversion in the first year and the cost of compliance in subsequent years, e.g. of measuring fair values and preparing additional disclosures, could be substantial (particularly for those companies that have several hundred UK subsidiaries).

Companies simply don't like IFRS

Many companies simply do not like many of the IFRSs that have been issued so far because they have introduced unnecessary complexity into financial statements. Moreover, IFRS is still under development with several important standards to be issued and become effective over the next two or three years. Companies are reluctant to adopt IFRS before the IASB has finalised those standards.

Listed companies and their UK subsidiaries

It is proposed that listed companies must adopt IFRS and their UK subsidiaries would normally adopt IFRS for SMEs (unless the subsidiaries are 'publicly accountable', in which case they must adopt IFRS). Non-publicly accountable subsidiaries would have the option of adopting IFRS.

We see no benefit in UK subsidiaries of listed companies adopting IFRS for SMEs because the recognition and measurement rules contained in IFRS for SMEs differ in some respects from IFRS. Consequently, on consolidation there will still be a need to adjust the financial statements of UK subsidiaries (from IFRS for SMEs to IFRS, rather than from UK GAAP to IFRS). Moreover, we are concerned that difficulties of application may arise from the fact that IFRS for SMEs is deceptively similar to IFRS and changes to IFRS for SMEs will be made at a slower pace than changes to IFRS (the IASB has proposed that changes to IFRS for SMEs will take the form of an triennial exposure draft containing all new and amended IFRSs).

Of course, the obvious solution to these problems is that UK subsidiaries would have the option of adopting IFRS. While this would align the results, cash flows, assets and liabilities of UK subsidiaries at entity-level and on consolidation, it would also introduce into the financial statements of the UK subsidiaries the disclosures required by IFRS (which are written in the context of consolidated financial statements).

We therefore suggest that, if the UK is to adopt IFRS-based accounting standards, parent companies and their UK subsidiaries should be permitted to adopt IFRS with exemptions from those disclosure requirements that may be relevant on consolidation but are superfluous in individual financial statements.

Suggested exemptions from disclosures required by IFRS

We have on many occasions expressed our concerns about the IASB's increasing reliance on extensive disclosure requirements. We have not conducted a detailed review of disclosures required under IFRS that may be superfluous in the individual financial statements of parent companies and their UK subsidiaries, but we suggest below some obvious candidates for exemption.

IFRS2 'Share-based Payment'
At subsidiary level, share-based payments typically involve the shares of the parent company and the cost of the awards is in some way recharged by the parent to the subsidiary. Accordingly, we do not believe that the disclosures relating to the terms of the schemes and the awards issued during the year and outstanding at the end of the year are of much relevance to users of the subsidiary's financial statements.

IFRS7 'Financial Instruments: Disclosures'
Financial risk is typically managed on a group-wide basis and therefore risk management disclosures at parent company and subsidiary level are likely to give an incomplete picture that will be of limited use, and potentially misleading, to users of the individual financial statements.

We believe that the Board recognised this by exempting parent companies and 90% or more owned subsidiaries from the equivalent UK standard, FRS29 'Financial Instruments: Disclosures'. We encourage the Board to introduce a similar exemption from IFRS7.

IAS7 ‘Statement of Cash Flows’
Cash flows are typically managed on a group-wide basis and therefore cash flow statements prepared at parent company or subsidiary level are likely to be of limited use to users of the individual financial statements.

We believe that the Board recognised this by exempting parent companies and 90% or more owned subsidiaries from the equivalent UK standard, FRS1 ‘Cash Flow Statements’. We encourage the Board to introduce a similar exemption from IAS7.

IAS24 ‘Related Party Disclosures’
Parent companies and their subsidiaries by definition have related party relationships with each other and typically have significant transactions with each other. If IAS24 was to be mandated in the financial statements of parent companies and their UK subsidiaries this would require very lengthy disclosures that would be of limited use to users of their financial statements.

We believe that the Board recognised this by exempting parent companies and 90% or more owned subsidiaries from the equivalent UK standard, FRS8 ‘Related Party Transactions’. We encourage the Board to introduce a similar exemption from IAS24.

Furthermore, the disclosure of the remuneration of key management personnel required by IAS24 would exceed, duplicate or be inconsistent with the disclosures required under the Companies Act 2006. We therefore encourage the Board to exempt ***all*** UK companies from this aspect of IAS24.

The future of SORPs

SORPs have been developed in a number of sectors where there isn’t yet a robust international accounting standard and there is unlikely to be one for some years to come, e.g. for insurance, oil and gas and pension schemes.

We therefore believe that there is a continuing need for SORPs at least in the medium term and we suggest that the Board engages with the relevant SORP-making bodies and regulators to discuss how they will interact with IFRS and IFRS for SMEs.

Proposed adoption date

The Board has proposed that the new regime should come into effect for financial years beginning on or after 1 January 2012. We are anxious that companies are not forced to adopt IFRS or IFRS for SMEs before the significant amendments to those standards that will result from the IASB’s response to the financial crisis and its dash for convergence with US GAAP become mandatory. Otherwise, UK companies are likely to be faced with two major transitions within a couple of years.

We are mindful that IFRS9 ‘Financial Instruments’ is mandatory only for accounting periods beginning on or after 1 January 2013, and we expect that the standards that will emerge between now and mid-2011 will have similar adoption dates.

We therefore suggest that any new UK accounting regime should come into effect no earlier than financial years beginning on or after 1 January 2013.

The future of the ASB

Whatever the outcome of the current debate, we believe that the Board will have an important role to play in the future. As the UK remains one of the world's major economies and London one of the leading financial centres, the Board will have an important role to play in seeking to influence the future direction of international accounting standards on behalf of its constituents.

We expect that the Board will retain the responsibility for the maintenance and appropriateness of UK accounting standards, whether they are IFRS-based or an independent body of standards.

Feedback

We meet regularly with representatives of the FRC and ASB and would be happy to participate in a debate on any of the issues raised in this letter or the direction of the project as a whole. Alternatively, please feel free to contact me direct if you would like to discuss our comments.

Yours sincerely

Chairman
The Hundred Group - Financial Reporting Committee