Title: **Amendment of restrictions for companies moving between IFRS and UK GAAP**	Impact Assessment (IA)
Lead department or agency: BIS	**IA No:** BIS0304
Other departments or agencies:	**Date: 05/09/2011**
	Stage: Consultation
	Source of intervention: Domestic
	Type of measure: Secondary legislation
	Contact for enquiries: Rufus Rottenberg 02072150163 rufus.rottenberg@bis.gsi.gov.uk

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The problem is to determine the most appropriate set of rules for the flexibility of companies to move between IFRS and UK GAAP accounting rules. The rules determining the accounting framework to be used are set out in company law. Unless the law is amended, once changes proposed by the Accounting Standards Board are introduced, companies will be restricted in a way that may impose unnecessary costs or an opportunity cost (missed benefit) from reporting under an alternative accounting framework.

What are the policy objectives and the intended effects?

The Government needs to determine the appropriate regime, in order to achieve the reduction in burdens on companies, to allow companies to select the accounting framework most appropriate for them, whilst continuing to insist on reporting that allows shareholders to hold directors to account.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1: permit companies to change their accounting framework no more than once every 5 years
Option 2: add a change in the accounting standards to the list of relevant reasons for a permitted change in companies' accounting framework.
Option 3: permit companies to change their accounting framework no more than once every 3 years
Option 4: permit companies to change their accounting framework every year.
Option 5: Do nothing/status quo

The Government is currently minded to prefer Option 1 as this provides flexibility not currently available to companies and more than that provided by option 2 but may be less risky than Options 3 and 4 as it limits the opportunities for companies to misrepresent their accounts.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** Month/2016
What is the basis for this review? PIR. **If applicable, set sunset clause date:** Month/Year

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

SELECT SIGNATORY Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: Edward Davey Date: 5/9/11

Summary: Analysis and Evidence

Policy Option 1

Description: Allow companies that prepare their accounts under IFRS to move to UK GAAP no more frequently than once every 5 years.

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 18.57 High	: 22.29	Best Estimate: 20.43

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.59		Optional	**1.59**
High	1.90		Optional	**1.90**
Best Estimate	1.75			**1.75**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs of changing from preparation of accounts under IFRS to preparation of accounts under UK GAAP will be incurred by those companies choosing to switch following the implementation of the ASB proposals. On the basis of stakeholder views we have assumed a range of 75% to 90% of 5500 qualifying subsidiary companies switch in year 1 from IFRS to UK GAAP accounts incurring a transitional cost of £386 per company.

Other key non-monetised costs by 'main affected groups'

Additional transition costs of any additional companies making the switch between IFRS and UK GAAP.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		2.34	**20.16**
High	Optional		2.81	**24.19**
Best Estimate			2.58	**22.18**

Description and scale of key monetised benefits by 'main affected groups'

Benefit to company moving from IFRS to a version of UK GAAP based on IFRS, with reduced disclosures for subsidiaries will become available under changes to financial reporting standards proposed by the Accounting Standards Board. Assuming that 75% to 90% of 5500 qualifying companies choose to switch in year 1 from IFRS to UK GAAP achieving savings of £570 per company per year based on an estimated saving of 1 hour of senior management time and 2 days of middle management time from reduced accounting disclosures.

Other key non-monetised benefits by 'main affected groups'

Companies will now be able to take a commercial decision as to which framework of accounting best suits their company. Possible cost savings to companies other than those subsidiaries identified above including potential future benefits to AIM companies.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Assumption that whether accounts are prepared under IFRS or UK GAAP, they will still present a true and fair view of the company's results and financial position – as required by s393 Companies Act 2006
The new framework proposed by the ASB for UK Financial Reporting Standards will be based on IFRS. Thus the risk of arbitrage by companies between UK GAAP and IFRS is mitigated. Companies will only exercise the option if the benefits for them outweigh the costs.
Assume that the future population of companies will remain largely unchanged.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net: 2.37	Yes	OUT

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			01/01/2012		
Which organisation(s) will enforce the policy?			Companies House/FRRP		
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			Yes		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**		**Non-traded:**
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**		**Benefits:**
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	Yes	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	15
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	15
Small firms Small Firms Impact Test guidance	No	15
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 2

Description: ASB option to add a change in accounting standards to the list of relevant change in circumstances for companies switching between IFRS and UK GAAP.

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
2011	2011	10	Low: 18.57	High: 22.29	Best Estimate: 20.43

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.59	1	Optional	**1.59**
High	1.90		Optional	**1.90**
Best Estimate	1.75			**1.75**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs of changing from preparation of accounts under IFRS to preparation of accounts under UK GAAP will be incurred by those companies choosing to take up this option . On the basis of stakeholder views we have assumed a range of 75% to 90% of 5500 qualifying companies switch in year 1 from IFRS to UK GAAP accounts incurring a transitional cost of £386 per company.

Other key non-monetised costs by 'main affected groups'

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		2.34	**20.16**
High	Optional		2.81	**24.19**
Best Estimate			2.58	**22.18**

Description and scale of key monetised benefits by 'main affected groups'

Benefit to company moving from IFRS to a version of UK GAAP based on IFRS, with reduced disclosures for subsidiaries will become available under changes to financial reporting standards proposed by the Accounting Standards Board. Assuming that 75% to 90% of 5500 qualifying companies choose to switch in year 1 from IFRS to UK GAAP achieving savings of £570 per company per year based on an estimated saving of 1 hour of senior management time and 2 days of middle management time from reduced accounting disclosures.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Assumption that whether accounts are prepared under IFRS or UK GAAP, they will still present a true and fair view of the company's results and financial position – as required by s393 Companies Act 2006
The new framework proposed by the ASB for UK Financial Reporting Standards will be based on IFRS. Thus the risk of arbitrage by companies between UK GAAP and IFRS is mitigated. Companies will only exercise the option if the benefits for them outweigh the costs.
Assume that the future population of companies will remain largely unchanged.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	**Benefits:**	**Net:** 2.37	Yes	OUT

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?		United Kingdom			
From what date will the policy be implemented?		01/10/2012			
Which organisation(s) will enforce the policy?		Companies House/FRRP			
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?		Yes			
Does implementation go beyond minimum EU requirements?		Yes			
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:**		**Non-traded:**	
Does the proposal have an impact on competition?		No			
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?		**Costs:** 0		**Benefits:** 0	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	Yes	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
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Economic impacts		
Competition Competition Assessment Impact Test guidance	No	15
Small firms Small Firms Impact Test guidance	No	15
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence

Policy Option 3

Description:

Allow companies that prepare their accounts under IFRS to move to UK GAAP no more frequently than once every 3 years.

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
2011	2011	10	Low: 18.57	High: 22.29	Best Estimate: **20.43**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.59		Optional	**1.59**
High	1.90		Optional	**1.90**
Best Estimate	1.75			**1.75**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs of changing from preparation of accounts under IFRS to preparation of accounts under UK GAAP will be incurred by those companies choosing to take up this option . On the basis of stakeholder views we have assumed a range of 75% to 90% of 5500 qualifying companies switch in year 1 from IFRS to UK GAAP accounts incurring a transitional cost of £386 per company.

Other key non-monetised costs by 'main affected groups'

Possible loss of consistency over time for investors of accounts preparation under the two frameworks. Additional transition costs of any additional companies making the switch between IFRS and UK GAAP.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		2.34	**20.16**
High	Optional		2.81	**24.19**
Best Estimate			2.58	**22.18**

Description and scale of key monetised benefits by 'main affected groups'

Benefit to company moving from IFRS to a version of UK GAAP based on IFRS, but with reduced disclosures for subsidiaries will become available under changes to financial reporting standards proposed by the UK GAAP currently proposed by the Accounting Standards Board. Assuming that 75% to 90% of 5500 qualifying companies choose to switch in year 1 from IFRS to UK GAAP achieving savings of £570 per company per year based on saving 1 hour senior management time and 2 days middle management time from reduced accounting disclosures.

Other key non-monetised benefits by 'main affected groups'

Company is able to take decision as to which framework of accounting best suits their company. . Possible cost savings to companies other than those subsidiaries identified above including potential future benefits to AIM companies. Potentially greater benefit to company if it has the freedom to change every 3 years than every 5 years.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Assumption that whether accounts are prepared under IFRS or UK GAAP they will still present a true and fair view of the company's results and financial position – as required by s393 Companies Act 2006
The new framework proposed by the ASB for UK Financial Reporting Standards will be based on IFRS. Thus the risk of arbitrage by companies between UK GAAP and IFRS is mitigated. Companies will only exercise the option if the benefits for them outweigh the costs.
Assume that the future population of companies will remain constant.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	**Benefits:**	**Net:** 2.37	Yes	OUT

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	01/10/2012				
Which organisation(s) will enforce the policy?	Companies House/FRRP				
What is the annual change in enforcement cost (£m)?					
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	Yes				
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)	**Traded:**	**Non-traded:**			
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	**Costs:**	**Benefits:**			
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	Yes	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

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Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Summary: Analysis and Evidence — Policy Option 4

Description: Allow companies that prepare their accounts under IFRS to move to UK GAAP with no time restriction.

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 18.57	High: 22.29	Best Estimate: 20.43

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	1.59		Optional	**1.59**
High	1.90		Optional	**1.90**
Best Estimate	1.75			**1.75**

Description and scale of key monetised costs by 'main affected groups'

Transitional costs of changing from preparation of accounts under IFRS to preparation of accounts under UK GAAP will be incurred by those companies choosing to take up this option . On the basis of stakeholder views we have assumed a range of 75% to 90% of 5500 qualifying companies switch in year 1 from IFRS to UK GAAP accounts incurring a transitional cost of £386 per company.

Other key non-monetised costs by 'main affected groups'

Under this option there is no time limit on companies switching between IFRS and UK GAAP so additional costs might include a loss of transparency to investors and other company stakeholders for those companies who switch frequently between the two standards. This switching might also allow some companies to misrepresent their accounts.
Additional companies switching or those switching repeatedly would also incur transitional costs as set out above.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Benefit to company moving from IFRS to a version of UK GAAP based on IFRS, but with reduced disclosures for subsidiaries will become available under changes to financial reporting standards proposed by the UK GAAP currently proposed by the Accounting Standards Board. Assuming that 75% to 90% of 5500 qualifying companies choose to switch in year 1 from IFRS to UK GAAP achieving savings of £570 per company per year based on saving 1 hour senior management time and 2 days middle management time from reduced accounting disclosures.

Other key non-monetised benefits by 'main affected groups'

Company is able to take decision as to which framework of accounting best suits their company. With no time limit on switching a small number of these companies may benefit from switching more than once during the ten year policy period considered.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Assumption that whether accounts are prepared under IFRS or UK GAAP they will still present a true and fair view of the company's results and financial position – as required by s393 Companies Act 2006
The new framework proposed by the ASB for UK Financial Reporting Standards will be based on IFRS. Thus the risk of arbitrage by companies between UK GAAP and IFRS is mitigated. Companies will only exercise the option if the benefits for them outweigh the costs.
Assume that the future population of companies will remain constant.

Direct impact on business (Equivalent Annual) £m):			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net: 2.37	Yes	OUT

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom			
From what date will the policy be implemented?			2012			
Which organisation(s) will enforce the policy?			Companies House/FRRP			
What is the annual change in enforcement cost (£m)?						
Does enforcement comply with Hampton principles?			Yes			
Does implementation go beyond minimum EU requirements?			Yes			
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**		**Non-traded:**	
Does the proposal have an impact on competition?			No			
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:**		**Benefits:**	
Distribution of annual cost (%) by organisation size (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**	
Are any of these organisations exempt?	Yes	Yes/No	Yes/No	Yes/No	Yes/No	

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

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Small firms Small Firms Impact Test guidance	No	15
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessments of earlier stages (e.g. Consultation, Final, Enactment) and those of the matching IN or OUTs measures.

No.	Legislation or publication
1	The Future of Financial Reporting in the UK and Republic of Ireland" , ASB (October 2010) http://www.frc.org.uk/images/uploaded/documents/Part%203%20Web%20Optimized.pdf
2	
3	
4	

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	1.75									
Annual recurring cost										
Total annual costs	1.75									
Transition benefits										
Annual recurring benefits	2.58	2.49	2.41	2.33	2.25	2.17	2.10	2.03	1..96	1.89
Total annual benefits	2.5	2.49	2.41	2.33	2.25	2.17	2.10	2.03	1.96	1.89

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

Background

UK company law provides the legal framework within which the 2.5 million entities[1] established as companies must operate and many of the accounting requirements are contained in Part 15 of the Companies Act 2006. Generally Accepted Accounting Principles in the UK (UK GAAP) broadly comprise The Companies Act 2006 and UK accounting standards developed or adopted by the UK Accounting Standards Board (ASB) over many years. International Financial Reporting Standards (IFRS) are international accounting standards (IAS) issued by the International Accounting Standards Board (IASB)[2]. According to Part 15 of the Companies Act 2006, accounts produced using UK GAAP are called "Companies Act accounts", and those produced using "IFRS as adopted in the EU" (for the purpose of this Impact Assessment abbreviated to "IFRS") are called "IAS accounts."

Under the IAS Regulation (EC 1606/2002), since financial years beginning on or after 1 January 2005, all listed companies in the EU must prepare their consolidated financial statements as IAS accounts (that is, under EU-adopted International Financial Reporting Standards (IFRS)). Following a public consultation in 2002[3], the Government decided that unlisted UK companies would be permitted to choose whether to switch to IFRS or continue to prepare their accounts in accordance with UK GAAP. Thus in the UK most companies have a free choice as to whether they prepare their individual financial statements under UK GAAP or under IFRS . Around 7,400[4] UK companies use EU-adopted IFRS, 50,000 UK companies use full UK GAAP[5]and the remaining 1,959,000 use the Financial Reporting Standards for Smaller Entities (FRSSE)[6].

Broadly UK GAAP and IFRS have different requirements[7] for: types of financial statements; slight differences in expense recognition; accounting for employee defined benefit plans; accounting for income tax; accounting for non-financial assets; business combinations (e.g. mergers); investments in associates and joint ventures. In deciding whether or not to move from UK GAAP to IFRS, private companies will have considered whether costs (including preparation and training costs) exceed the benefits. Benefits would include: international comparability for suppliers, customers and partners (useful if the company is seeking to expand globally) or banks (useful if the company may seek an internationally syndicated loan); whether the company intends to list in the near future; whether the tax or accounting treatment of particular issues are favourable for the business.

UK companies whose securities are not listed[8] may prepare their consolidated financial statements under EU-adopted IFRS or under UK GAAP. However, the Government has implemented some restrictions and conditions after public consultation[9] launched in 2004:

- once a company has prepared its financial statements under EU-adopted IFRS, it cannot revert to UK GAAP in a later financial year unless there is "a relevant change in circumstances". A relevant change in circumstances occurs if the company becomes a subsidiary of an undertaking that is not preparing its individual financial statements under EU-adopted IFRS; if the company ceases to be a subsidiary undertaking; or if the company (or its parent) ceases to have its securities admitted to trading on a regulated market in an EEA state. (CA06 s395(3)(4).
- a parent company may elect to prepare its individual financial statements under UK GAAP even if it elects to use EU-adopted IFRS in its consolidated financial statements.

1 http://www.companieshouse.gov.uk/about/busRegArchive/businessRegisterStatisticsMay2011.pdf

2 Accounting standards inherited by the IASB from its predecessor body are called IAS. Completely new standards issued by the IASB are called International Financial Reporting Standards (IFRS).

3 International Accounting Standards , 30 August 2002, URN 02/1158, Department for Trade and Industry.

4 Source: FAME database at 12 July 2011

5 Choosing your GAAP Planning for the proposed removal of UK GAAP, Deloitte LLP 2009 http://www.iasplus.com/uk/0908ukgaap.pdf

6 FRSSE sets out accounting requirements and disclosures for smaller entities under UK GAAP, as modified and simplified from other accounting standards contained in "full" UK GAAP. Source of number of companies in UK: Companies Register Activities 2009-10, Companies House, Table F2 http://www.companieshouse.gov.uk/about/pdf/companiesRegActivities2009_2010.pdf

7 https://pwcinform.pwc.com/inform2/show?action=applyInformContentTerritory&id=1109172003171894#

8 In this context, listed companies means any companies that have securities traded on a regulated market of any EU member state. Regulated markets in the UK are the following: London Stock Exchange; London Metal Exchange; ICE Futures Europe; SWX Europe Ltd; LIFFE; EDX and PLUS-listed Market.

9 "Modernisation of accounting directive/IAS infrastructure" March 2004, URN 04/733 Department for Trade and Industry and HM Treasury

- where the parent company prepares group accounts, companies in the same group must adopt the same accounting framework (either EU-adopted IFRS or UK GAAP) as each other, unless in the opinion of the directors there are “good reasons” not to do so. That is, the parent must ensure that all UK companies in the group use either EU-adopted IFRS or UK GAAP. There is an exception to this requirement: where a parent adopts EU-adopted IFRS in both its consolidated financial statements and its individual financial statements, it will not be required to ensure that all its subsidiaries use EU-adopted IFRS too (CA06 s407). BIS has issued guidance notes on these rules, including an explanation of when there might be “good reasons”[10].

In October 2010 the ASB issued for consultation “The Future of Financial Reporting in the UK and Republic of Ireland.[11] Amongst other measures, this proposes that subsidiaries who currently file IFRS accounts should be able to switch to filing accounts under a new version of UK GAAP and make savings from reduced disclosures that the ASB is introducing. The parent company, if listed on the Main Market or on AIM would continue to file its group accounts with normal disclosures of the group’s activities under IFRS. Of those companies filing IFRS accounts, the vast majority are subsidiary companies and/or holding companies – these may be listed (AIM/main market), public or private companies of any size.

Problem under consideration

As described above, both sections 395 and 403 of Companies Act 2006 provide that a company or group which prepares IAS accounts may not move to preparing Companies Act Accounts unless there is “relevant change in circumstance”. The ASB has therefore asked[12] the Government to consult on amending the Act so that the definition of a relevant change in circumstance includes the implementation of the ASB’s proposals. Once the changes proposed by the ASB are introduced, unless the law is amended, companies currently choosing to report under IFRS (in particular qualifying subsidiary companies) will be restricted from taking advantage of the reduced costs available for subsidiary companies under the reduced disclosure regime available under the ASB’s proposals.

Responses to the ASB’s consultation have now been published[13]. The reduced disclosures for subsidiaries are supported by responses from the London Stock Exchange (letter 288), Institute of Chartered Accountants in England and Wales [14] (letter 273), Confederation of British Industry (letter 282) “because it will provide simplification and reduce companies’ costs” and Ernst & Young (letter 101). A change in the Act made prior to the effective date of the proposed new accounting framework regime is specifically supported by a response from major audit firms, KPMG[15] and Ernst & Young. This will enable companies to plan how to implement the ASB’s proposals.

Instead of simply amending the Companies Act to include in the “change of circumstances” the introduction of a change in UK accounting standards, the Government is minded to significantly deregulate the process of moving from IFRS to UK GAAP by allowing companies to make this change for any reason, but the Government proposes to consult on regulating the frequency with which a company may make the change. It would then be a commercial decision on the basis of the costs and benefits for eligible companies to determine whether they should move from IFRS to UK GAAP.

Rationale for intervention

Government intervenes in the area of accounting to ensure that users of company accounts, primarily investors, but also creditors, employees, regulators and tax authorities, are presented with a true and fair view of the company’s performance and financial position.

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[10] http://www.bis.gov.uk/files/file46791.pdf

[11] http://www.frc.org.uk/asb/technical/projects/project0072.html

[12] Appendices to “The Future of Financial Reporting in the UK and Republic of Ireland” , ASB (October 2010) paragraph A1.15 http://www.frc.org.uk/images/uploaded/documents/Part%203%20Web%20Optimized.pdf

[13] http://www.frc.org.uk/asb/technical/projects/responses_fred_UK_IRE.cfm

[14] “Listed groups in the UK have, until now, largely opted not to move their subsidiary accounts on to EU-adopted IFRS due mainly to the onerous disclosures that this would necessitate. This has produced and perpetuated a situation where a series of consolidation adjustments have been required to move from local to group accounts. The proposed reduced disclosure regime would make it practicable for subsidiaries to apply EU-adopted IFRS in their own published accounts…” para 16 response from ICAEW 52/11 12 May 2011

[15] KPMG Response 93, page 16; Ernst & Young response 101, page 5 http://www.frc.org.uk/asb/technical/projects/responses_fred_UK_IRE.cfm

Before the IFRS regime was introduced, the reason given in 2004[16] by the Government for restricting companies' ability to move from IFRS to UK GAAP was to prevent companies from "misrepresenting their position by switching regimes depending on which shows their performance in a better light". The reasons for intervening now are that:

- the Government is committed to reducing the burden of unnecessary regulation;
- the use of IFRS in the UK is well established; and
- the new framework proposed by the ASB for UK Financial Reporting Standards will be based on IFRS. This significantly reduces any benefits of arbitrage between the UK GAAP and IFRS (arbitrage would occur if companies could artificially flatter their performance by choosing a particular accounting framework) . In this context, therefore the Government now considers that law in this area is unduly restrictive.

The ASB believes that UK Financial Reporting standards are not tenable in the longer term as they are an incoherent mixture of standards developed in the UK over a long period of time and standards that have been converged with IFRS.

Policy objectives

The Government needs to determine the appropriate accounting regime, in order to achieve the reduction in burdens on companies, to allow companies to select the accounting framework most appropriate for them, whilst continuing to insist on reporting that allows shareholders to hold directors to account.

Description of options considered (including do nothing)

The options set out below range from the original ASB proposal (the least deregulatory) to complete deregulation allowing companies to change their accounting framework every year if they wish.

Option 1 (Allow companies that prepare their accounts under IFRS to move to UK GAAP for any other reason than a relevant change in circumstances no more frequently than once every 5 years ASB option) – preferred option.

- Remove the requirement in sections 395 and 403 of Companies Act 2006 for a change in circumstances before a company can move from IFRS to UK GAAP.
- Replace it with a prohibition against moving from IFRS to UK GAAP more frequently than once every 5 years alongside provision for a company to move from IFRS to UK GAAP where a change of circumstances occurs.

Option 2 (ASB option)

- Change the definition of a relevant change in circumstances for companies moving from IFRS to UK GAAP in sections 395 and 403 of Companies Act 2006 to include a change in the accounting standards such as that currently proposed by the ASB.

Option 3 (Allow companies that prepare their accounts under IFRS to move to UK GAAP for any other reason than a relevant change in circumstances no more frequently than once every 3 years.)

- Remove the requirement in sections 395 and 403 of Companies Act 2006 for a change in circumstances before a company can move from IFRS to UK GAAP.
- Replace it with a prohibition against moving from IFRS to UK GAAP more frequently than once every 3 years alongside provision for a company to move from IFRS to UK GAAP where a change of circumstances occurs.

[16] "Modernisation of accounting directive/IAS infrastructure" March 2004, URN 04/733 Department for Trade and Industry and HM Treasury

Option 4 (Allow companies that prepare their accounts under IFRS to move to UK GAAP with no restrictions)

- Remove the requirement in sections 395 and 403 of Companies Act 2006 for a change in circumstances before a company can move from IFRS to UK GAAP.
- Allow a company to move from IFRS to UK GAAP in any year for any reason.

Option 5 (Do nothing)

- Do nothing.

A non-regulatory option is not possible as legislation dictates the current position.

Costs and benefits of each option (including administrative burden)

There are costs and benefits arising from the ASB's October 2010 proposal[17], (which is of course subject to change) and these are set out in the impact assessment in that proposal. Only some of those benefits and costs depend on the Government's proposal to permit companies' increased flexibility in moving from IFRS to UK GAAP. It should be noted that these costs and savings in this IA may change to reflect further developments in ASB policy.

The only monetised costs and benefits are those relating to the initial ASB proposal where a well defined set of beneficiaries has been identified (subsidiary companies currently using IFRS). As the analysis below and the summary table sets out there may well be other companies now and in the future who would benefit from deregulation in this area but this will be specific to their own commercial situation and it is therefore difficult to monetise any likely costs and benefits arising.

Option 1 (Allow companies that prepare their accounts under IFRS to move to UK GAAP no more frequently than once every 5 years)

Benefits

The simplified reporting and disclosure regime proposed by the ASB for subsidiary companies currently reporting under IFRS and taking this opportunity to move to UK GAAP will provide simplification and reduce companies' costs by reducing the hours spent by companies preparing certain disclosures in their financial statements.

Of the 7,300 UK companies preparing their accounts under EU IFRS, around 1,700 are group accounts of listed companies, which would be obliged to continue to produce accounts under IFRS[18]. This leaves 5,600 companies who would be free to change to UK GAAP of which around 5,500 are subsidiaries who are likely to benefit most from switching to UK GAAP. We have estimated, having consulted informally with stakeholders, that 75% (4125) to 90% (4950) of those companies would take up this option, in order to take advantage of the reduced disclosures proposed by the ASB. We will test this assumption further through the consultation.

It is estimated by BIS, having informally consulted with stakeholders, that this will save 1 hour of senior management time and 2 days of middle management time per year in accounts preparation. We will test these assumptions further through the consultation.

Hourly pay of senior management time (directors of major organisations[19]) £48.85 per hour. Including a 24% uplift for over head costs, 1 hour of time costs £60.57.

Hourly pay of financial managers and chartered secretaries £27.37 per hour. Including a 24% uplift for overhead costs, 2 days (of 7.5 hours each) of middle management time costs £509.

Annual saving per company is therefore £61 plus £509 equal to £570.

Total annual saving for the 4125 to 4950 companies taking up the option is therefore £2.34m to £2.81m.

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[17] http://www.frc.org.uk/asb/technical/projects/project0072.html

[18] Source: FAME database 6 July 2011

[19] http://www.statistics.gov.uk/downloads/theme_labour/ashe-2010/2010-occ4.pdf

These savings arise jointly from ASB and BIS changes.

This option will also provide additional flexibility and possible cost savings to other companies moving between IFRS and UK GAAP. Companies may have perfectly valid business reasons – not necessarily foreseeable at the time of the initial election for wishing to revert to UK GAAP. For example, a subsidiary which elects to apply IFRS to prevent measurement differences with other group companies would be unable to return to UK GAAP when those differences had been eliminated and would therefore be unable at that time to take advantage of any disclosure exemptions retained in UK GAAP.

- The London Stock Exchange[20] is the operator of the UK's largest public equity markets, the Main Market and AIM (the Alternative Investment Market). An appropriate accounting framework for companies that join its market enable investor confidence to be maintained and allows companies to raise capital at a reasonable cost over the long term, and preserves the flexible regime which has contributed to the attractiveness of London as a major global financial centre. The Main Market is an EU Regulated Market and therefore companies on the Main Market already have to comply with IAS, under the IAS Regulation, i.e. to prepare IFRS accounts. Currently the AIM rules for companies require that companies incorporated in an EEA country must prepare their financial statement in accordance with IFRS[21].

There are two other reasons why the amendment in the law sought will assist AIM companies:

- if a company delists from AIM, under the current law, it would not be able to move to UK GAAP, since it is not covered by s395(4)(b) (which allows moving to UK GAAP if a company ceases to be admitted to trading on a regulated market) as AIM is not a regulated market;

The London Stock Exchange believes that the AIM IFRS requirement may be relaxed at some point in the future to help SMEs access a wider range of funding sources. If this occurred it would be likely for many existing AIM companies to wish to move to UK GAAP, which the current law precludes, but the proposed change would permit. This would potentially benefit 934[22] companies who are UK registered and are quoted on AIM. However this is not yet a proposal from the Stock Exchange and is therefore too remote to be quantified.

Costs

Additional one-off costs of implementation <u>of each company moving from IFRS to UK GAAP</u>[23]

Based on stakeholder views we assume internal staff costs of 4 hours per company (as above hourly pay of financial managers and chartered secretaries £27.37 per hour) equals £136 including a 24% uplift for overhead costs.

Auditor cost per company of £250 (estimate agreed with industry experts) due to the additional audit work necessary in the first year that the company moves from IFRS to UK GAAP.

These estimates will also be tested with stakeholders as part of the consultation.

Thus total one-off cost in year of movement from IFRS to UK GAAP for each company is £136 plus £250 equal to £386. When multiplied by the 4125 to 4950 companies estimated to make the change the one-off cost amounts to £1.59m to £1.9m. These transitional costs will rise proportionately to reflect the cost to any additional companies that choose to take up the increased flexibility to move between IFRS and UK GAAP.

The ASB believes that[24] the disclosure exemptions for companies proposed will not impede the quality of financial reporting. This was agreed by almost all respondents to the ASB's consultation.

See above section on Rationale for Intervention for reasons why the costs foreseen in 2004 when the Government introduced the rule restricting companies' ability to move from IFRS to UK GAAP do not apply.

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[20] Source of information letter 288 from London Stock Exchange in response to ASB consultation on the Future of Financial Reporting: http://www.frc.org.uk/asb/technical/projects/responses_fred_UK_IRE.cfm

[21] If a company is a single entity and does not produce consolidated financial statements it may choose UK GAAP (<2% of AIM companies still use UK GAAP

[22] http://www.londonstockexchange.com/statistics/historic/aim/may-2011.pdf

[23] The Future of Financial Reporting , Volume 1, ASB assumption p158

[24] ASB "The Future of Financial Reporting" Part 1, p39 October 2010

The costs of lack of comparability over time when companies change accounting frameworks are minimised by transitional arrangements in the accounting standards.

The costs of loss of comparability between two companies adopting different accounting frameworks already exist, but these costs will be reduced after the ASB's proposals are implemented, as the new framework proposed by the ASB for UK Financial Reporting Standards will be based on IFRS.

Option 2 (ASB option to add a change in accounting standards to the list of relevant change in circumstances in sections 395 and 403 of the Companies Act 2006)

Benefits

The monetised benefits of this option are the same as those under option 1 above in terms of cost savings for subsidiary companies switching from IFRS to UK GAAP following the ASB proposed change in the accounting standard. There are not however the benefits of increased flexibility now or in the future for other companies who might want to switch from IFRS to UK GAAP on the basis of their commercial position.

Costs

The monetised costs of this option are the same as those for option 1.

Option 3 (Allow companies that prepare their accounts under IFRS to move to UK GAAP no more frequently than once every 3 years.)

Benefits

Same as Option 1, but the company has greater flexibility because they can take the commercial decision as to which framework of accounting best suits their company every 3 years, rather than every 5 years.

Costs

As above for Option 1, but there may be less comparability of accounts over time if the company changes its accounting framework every 3 years as opposed to every 5 years. However, it is expected that companies will not make these changes frequently.

Option 4 (Allow companies that prepare their accounts under IFRS to move to UK GAAP with no restrictions)

Benefits

Same as Options 1 and 3 above but the company has greater flexibility than in the other options because they can take the commercial decision as to which framework of accounting best suits their company every year unrestricted by the need for a change in circumstances.

Costs

As above for Options 1 and 3, but there will be less comparability of accounts over time for investors if companies change their accounting framework more frequently than every 3 years. Companies might also switch between accounting frameworks to take advantage of tax arbitrage benefits (see discussion in risks section below) at a cost to the exchequer.

Option 5 (Do nothing)

There are no costs and benefits from the Do Nothing option.

Risks and assumptions

There is a risk that giving a company power to change from IFRS to UK GAAP every 3 or 5 years might result in companies being able to misrepresent their position by switching between accounting regimes depending on which shows their performance in a better light. The cost of misrepresentation will in the long term result in a reduction in shareholder value. However (a) the new accounting framework proposed by the ASB for UK Financial Reporting Standards will be based, not on "old UK GAAP" but on IFRS. Thus, since the accounting differences between the two are now less significant, the risk of arbitrage between the two sets of financial statements is mitigated; (b) whether accounts are prepared under IFRS or UK GAAP, s393 Companies Act 2006 still requires that the directors of a company must not approve the accounts of a company unless that they are satisfied that they give a true and fair view of the company's results and financial position (c) there are transitional rules in accounting standards which means that the risk of lack of comparability of accounts between periods when the company changes between accounting framework is minimised.

It is assumed that companies will only exercise the option to change from IFRS to UK GAAP if the benefits for them outweigh the costs and that this will not happen very frequently, indeed the analysis above assumes that companies will only move once (from IFRS to UK GAAP).

There may be scope for tax arbitrage, but these will be addressed by application of the powers of the tax authorities, rather than by keeping restrictions in company law. HMRC have legislation that is designed to ensure that where entities switch from IFRS to UK GAAP or vice versa, amounts are taxed once and once only and expenses are relieved once and once only. Further, HMRC has legislation that deals, in a group situation only, with some arbitrage advantages where group companies use different GAAPs. HMRC do not from a general point of principle, have an issue with companies switching back to UK GAAP, although they recognise there is uncertainty over the extent to which companies may switch for tax arbitrage reasons once the rules are relaxed .

Direct costs and benefits to business calculations (following OIOO methodology)

Under the "One In, One Out" rule, whereby a measure that has a net cost to business must have a measure or measures of equivalent cost removed in order to be implemented, the net benefit of implementing Option 1 is £20.4million over the ten year period. This represents a saving to business and is therefore a One Out.

Summary and preferred option with description of implementation plan

Although the monetised costs and benefits of the four deregulatory options set out above are identical, there are different levels of flexibility and risks attached to each option. The Government is therefore currently minded to amend sections 395 and 403 of CA06 to remove the requirement for a "relevant change of circumstances" and allow individual companies or groups who prepare their accounts using IFRS and who are not otherwise obliged to prepare IAS accounts (e.g. by the IAS Regulation) to move freely to UK GAAP, but no more frequently than once every 5 years (Option 1). This will provide significantly more flexibility for companies and groups than both the current position and the ASB proposal (option 2). It will permit them to take advantage of the cost and burden saving changes to UK GAAP proposed by the ASB, as well as possible future flexibility, whilst retaining increased comparability of accounts over Options 3 and 4 and limiting the risk of tax arbitrage particularly in relation to Option 4.

Statutory equality duties

The proposed changes are not expected to have any impact given that they are designed to impact on companies rather than individuals.

Economic impacts

Competition effects

The proposed changes are not expected to have any impact

Small firms impact test

The proposed changes are not expected to have any impact as they are likely to impact on mainly larger companies currently reporting under IFRS.

Environmental impacts

The proposed changes are not expected to have any impact.

Social impacts

The proposed changes are not expected to have any impact.

Sustainable development

The proposed changes are not expected to have any impact.

Inserting text for this section:

Replace the notes on this page with the text for the evidence base.

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Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. If the policy is subject to a sunset clause, the review should be carried out sufficiently early that any renewal or amendment to legislation can be enacted before the expiry date. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: Post implementation review
Review objective: To ascertain the uptake of the new flexibility in accounting regime and any impact on users of accounts.
Review approach and rationale: Monitoring data of uptake and stakeholder discussions on actual impacts.
Baseline: Impact assessment sets out the baseline – current use of IFRS accounts.
Success criteria: Uptake of new flexibility to move between IFRS and UK GAAP accounting regimes
Monitoring information arrangements: Data from FAME database on use of IFRS accounts by subsidiaries.
Reasons for not planning a review:

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