



HM TREASURY

Financial Reporting Advisory Board Paper

Converging UK GAAP with IFRS: an update on the ASB's strategy

Issue:	Updating the Board on the ASB's proposals for convergence and alerting the Board to the potential impact on the Government's position.
Impact on guidance:	No
UK GAAP adaptation?	N/A
IAS/IFRS compliant?	N/A
IPSAS compliant?	N/A
Impact on budgetary regime?	N/A
Recommendation:	That the Board notes the update.
Timing:	N/A

DETAIL

Background

1. EC Regulation No.1606/2002 requires listed groups in the European Union to prepare their accounts following IFRS, as adopted by the Commission, with effect from 1 January 2005. Member states can require or permit other entities to apply the adopted standards, and the UK has followed a permissive regime. Europe is not alone in moving to IFRS: for example, Australia and New Zealand also adopted IFRS (and, since accounting standards in these countries are sector-neutral, this means both private and public sectors) from 1 January 2005.

2. When considering its own approach to the globalisation of accounting standards, the ASB concluded that there could be no case for maintaining differences between UK standards and IFRS, and that it should seek convergence of UK standards with IFRS. The ASB's convergence

programme was set out in its Technical Plan, published in early 2005. In brief, the plan was to converge UK standards over a period of three years or so, with batches of new UK standards based on IFRS being issued each year, leading to full convergence by about 2008 or 2009.

3. The Government Resources and Accounts Act 2000 is one of the key determinants of the Government's reporting framework. Section 5(3)(b) requires the Treasury, in issuing accounts directions, to ensure that resource accounts conform to "generally accepted accounting practice subject to such adaptations as are necessary in the context of departmental resource accounts". At the time the Act gained Royal Assent, generally accepted accounting practice was based on standards developed and issued by the ASB.

Government is following the phased approach to convergence

4. The Treasury considered the impact of Regulation No.1606/2002 on the preparation of resource accounts, and consulted the Board in March 2004 (FRAB (66)). Legal opinion was that, in conforming to generally accepted accounting practice (GAAP), the Treasury could have regard to UK or international practice. The Treasury proposed continuing to apply UK GAAP¹, following the ASB's convergence strategy for the following reasons:

- there is no single IFRS that corresponds to the ASB's standard (FRS 5) on reporting the substance on transactions. This standard is important because it deals with the accounting treatment of PFI and similar contracts;
- the International Accounting Standards Board (IASB) had embarked on an ambitious programme to improve IFRS, and the Treasury was concerned about the number of changes in accounting policies that would be required year-on-year if IFRS were to be adopted directly; and
- uncertainties about whether the Commission would adopt some of the IFRS, and whether this would then lead to gaps in accounting standards.

5. The then Chief Secretary agreed in April 2004 that, in light of these disadvantages, the Treasury should adopt the approach of following the ASB's convergence strategy. However, he asked that this be kept under review and to be informed of any significant developments.

6. The Board reluctantly accepted this decision. The Board stated in its 2003-04 report (published in June 2004) that it believed that the government should take the lead in adopting IFRS and was disappointed that the Treasury did not feel the time to be right to move to IFRS alongside the listed company sector. The Board also requested that the Treasury monitor developments in IFRS and discuss with the Board its conclusions on whether the government could adopt IFRS in advance of the completion of the ASB convergence strategy.

¹ In order to have the option of moving to international accounting standards, section 5(4)(a) of the Government Resources and Accounts Act 2000 was amended at the same time as companies legislation so that the Treasury, in issuing accounts directions now, "must have regard to any relevant guidance issued by the Accounting Standards Board Limited or any other body prescribed for the purposes of section 256 of the Companies Act 1985 (accounting standards) or to the international accounting standards within the meaning of EC Regulation No.1606/2002 of the European Parliament and of the Council of 19th July 2003 on the application of international accounting standards, adopted from time to time by the European Commission in accordance with that Regulation" (italics added).

Why do we need to review the Government's convergence strategy now?

7. In March 2005, the ASB issued an Exposure Draft of a policy statement about its future role in relation to accounting standard-setting in the changing environment. Although not a specific question in the Exposure Draft, respondents raised questions about the existing convergence strategy. While one or two respondents wondered whether UK GAAP should converge at all, most accepted that the ASB was right to aim for convergence, but questioned the way in which that should be achieved.

8. ASB members generally shared respondents' concerns. A public meeting was held on 19 January 2006 to consider the ASB's proposals developed in the context of the responses to the Exposure Draft. The ASB key proposals were to:

- stop the convergence programme as currently set out in its Technical Plan;
- require listed companies that do not have subsidiaries, other companies accessing public markets, parent entities that use IFRS, and certain large unlisted entities to apply EU-adopted IFRS directly (size criteria and mechanism yet to be decided, but could for example apply to those with a turnover in excess of £250m); and
- await the outcome of the IASB's review of accounting by small and medium-sized entities (SME) before deciding exactly what standards should be used for companies (other than those applying the Financial Reporting Standard for Smaller Entities (FRSSE)) not required to follow IFRS (or EU-adopted IFRS). (The ASB anticipates that convergence to IFRS for these other companies will take place from 2009 at the earliest).

9. No clear consensus about the options in paragraph 8 emerged from the meeting. However, the fact that it was these options that formed the focus of discussion suggests that the proposed halt to the current ASB convergence strategy is supported. The ASB will issue shortly another consultation document² that states that, since the public meeting, the ASB has confirmed that it will move to a 'big bang' convergence strategy and that this will not be effective before 1 January 2009.

10. Under the proposals, all entities of a comparable size to Government Departments would prepare their accounts under EU-adopted IFRS. This is a 'significant development' that needs to be considered in the light of the interest expressed by both CST and the Board.

What are the options?

11. Although we do not know exactly what the ASB will decide in the light of the discussions at the public meeting, the Treasury is likely to have the same two options it had in 2004:

- following the ASB's new convergence strategy; or
- applying EU-adopted IFRS.

Following the ASB's new convergence strategy

12. Although the arguments for following the ASB's new convergence strategy essentially remain the same as in 2004 (see paragraph 5), the risks of adopting this strategy are now greater. If the

² This consultation seeks constituents' views on the costs and benefits of extending the application of full IFRS to all entities with public accountability; the costs and benefits of moving the FRSSE to medium-sized entities; and the costs and benefits of developing IFRS-based UK accounting standards in addition to full IFRS and the FRSSE.

Treasury were to advocate a continuing adherence to the ASB's convergence strategy for the entities covered by the Board, it could be interpreted as signalling an unwillingness to move to IFRS (although this is not the Treasury position) because the ASB's preferred outcome appears to be either:

- to wait until 2009 at the earliest; or
- to allow entities not applying IFRS to use some form of simplified reporting.

Applying EU-adopted IFRS

13. Application of EU-adopted IFRS would have the general advantage of reinforcing the Government's world class position in the adoption of accruals accounting and budgeting. Although the disadvantages in paragraph 5 still exist to some extent, the IASB has made progress with its standards programme, and guidance on accounting for PFI-type contracts is likely to be issued soon. Although this may only initially apply to PFI providers, rather than the bodies letting such contracts, it is now clear that in the medium term (under any convergence strategy), most PFI schemes are likely to come on the public sector balance sheet under IFRS. The timetable for developing international public sector accounting guidance remains uncertain, but the International Public Sector Accounting Standards Board is currently planning to issue a standard in 2007. Given ONS's intention to bring leases into the measurement of Public Sector Net Debt (PSND) as soon as information of sufficient quality becomes available, any review of the fiscal rules for the next economic cycle will need to take this development into account.

The Treasury is actively considering its position

14. The Treasury is actively monitoring the developments in the ASB's thinking about convergence and considering what proposals for change it might make in the light of the ASB's changing strategy, and IASB developments and in the light of the Comprehensive Spending Review.

Summary and recommendation

15. The Board is invited to note that the Treasury is actively considering how it should adopt IFRS in the light of the ASB's decision to abandon the phased convergence. The Treasury will revert to the Board in May with firm proposals for the way forward.

HM Treasury
20 March 2006