



## Article topic: Financial Reporting

# An Unwelcome Future for UK GAAP

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As professional accountants are aware, there are some fundamental changes proposed for the [future of UK GAAP](#) with a proposal on the table for the International Financial Reporting Standard for Smaller Entities (IFRS for SMEs) to replace current UK GAAP.

I recently presented a lecture to a large group of qualified accountants on the proposals and the general feeling was that the proposals were certainly unwelcome, with one delegate in the group even refusing to implement IFRS for SMEs when it is introduced in the UK! The purpose of this article is to “flag up” the general feelings of practitioners who deal with clients in the SME sector.

During such lectures, I am often asked questions such as:

- “Are the standard-setters remotely aware of what goes on in real life professional practice?”
- “Why introduce an International-based framework when the current framework works adequately well?” and
- “Are the standard-setters going to meet the additional cost? In the current economic climate we cannot pass on any disproportionate fee increases?”

These questions are asked all over the country. As a partner in practice myself I can fully empathise with practitioners who are not looking forward to the change – particularly sole practitioners who are struggling with the sheer weight of regulation and legislation. One sole practitioner told me she would be forced into early retirement once IFRS for SMEs is implemented simply because she cannot afford to absorb the costs of the switch and because of exasperation with all the regulation the profession is currently facing.

### The proposals

[Previous articles](#) have covered the proposed change within IFRS for SMEs. To recap, the new standard will fit into a three-tier financial reporting structure as follows:

|        | Nature of Entity                          | Financial Reporting Framework |
|--------|---|-------------------------------|
| Tier 1 | Entities who are publicly accountable     | EU-adopted IFRS               |
| Tier 2 | Entities who are not publicly accountable | UK-adopted IFRS for SMEs      |
| Tier 3 | Small entities                            | FRSSE                         |

### The standard-setters versus professional practice

One of the most common questions raised is whether the standard-setters are “in touch” with the profession – do they understand the issues practitioners face and do these issues get taken into account when such fundamental changes are proposed?

The answer is, yes they do. The proposed IFRS for SMEs was issued in July 2009 and was open for comment for a six-month period. The ASB received around 150 comments. Considering that over 90% of UK companies are “small-medium entities” at which the IFRS for SMEs is targeted, this was a staggeringly low number.

The ASB also published a questionnaire for practitioners that was open until 20 August 2010. This survey was designed to gauge the concerns of practitioners who will be implementing the proposed GAAP switch. When it publishes its Exposure Draft on the future of UK GAAP in November, the standard-setters will take into account the feedback received from the profession.

### The need for an International framework

The international framework reflects the ASB’s recognition of the need to increase the quality of financial reporting on a worldwide level. UK GAAP is, more or less, aligned with IFRS anyway, although some aspects of UK GAAP are not covered by IFRS for SMEs, and vice-versa. To accommodate these issues the ASB will need to tweak IFRS for SMEs to suit the UK and our legislative requirements in a similar fashion to our current auditing standards. International Standards on Auditing (ISAs) were introduced in the UK in 2005 and were adapted in such a way to be UK and Ireland specific. Thus we have ISAs (UK and Ireland)) that are also referred to as “ISA pluses”.

In publishing the proposed IFRS for SMEs, the ASB said it was a response to the growing complexity of existing GAAP. I am not entirely sure that practitioners agree with this statement. There are some burdensome areas in current GAAP, but the same can be said for IFRS for SMEs (deferred tax, for example). As many lecture delegates remind me on this point, “*The standard-setters make the standards!*”

### Reservations

The majority of practising accountants seem to be against the proposed IFRS for SMEs, mainly for the imbalance between cost and benefits. Is a cash flow statement *really* needed for a small, owner-managed joinery business turning over £100,000 a year? I don’t think it is and it would be far too time-consuming to have to sit down with the client and explain why he or she has to have such a statement, and then interpret it.

However, full International Financial Reporting Standards (IFRS) do make the cash flow statement a mandatory primary statement. So many practitioners may be further disheartened at the prospect of having to prepare one – particularly those who do not have reliable accounts production software.

Another problem child will be deferred tax provisions under the new regime. IFRS for SMEs takes a “temporary” difference approach rather than a “timing” difference approach so we will be seeing more deferred tax provisions – a concept which is viewed by many in the profession as meaningless. Meaningless it may be to some, but there are whole accounting standards on the subject!

Talking to practitioners, it is clear that FRSSE should be retained. But if it is retained, I would argue the ASB should bite the bullet and align it immediately with IFRS for SMEs. In its current form FRSSE is based on a financial reporting framework that is soon going to be redundant. If the ASB’s proposals are implemented as they currently stand, keeping FRSSE in its current form and implementing IFRS for SMEs and then later aligning FRSSE to IFRS for SMEs will mean more change and disruption for practitioners who deal with Tier 2 and Tier 3 clients.

### **Recommendations**

The ASB should take on board the lessons when PLCs switched to IFRS in 2005 and AIM-listed entities followed in 2007. The planned implementation date of 1 January 2012 is impractical. I would suggest the ASB give at least three years’ notice of the GAAP switch. This delay would allow practitioners to undertake the required planning, particularly around restating prior year comparatives and the transitional requirements for first-time adoption. Practitioners need time to notify and educate clients about the new GAAP and the switch will throw up some important taxation issues. The tax impact is a major factor why companies in the UK will not voluntarily adopt IFRS.

Practitioners need to ensure they plan adequately planned for the GAAP switch. In particular, those accountants who do not have reputable accounts production software will be hugely affected. Merely looking at the terminology illustrates the scale of the challenge:

| <b>UK GAAP Terminology</b> | <b>IFRS for SMEs Terminology</b>                      |
|----------------------------|---|
| Fixed assets               | Non-current assets                                    |
| Stock                      | Inventory   |
| Balance sheet              | Statement of financial position                       |
| Profit and loss account    | Income statement or statement of comprehensive income |
| Debtors                    | Receivables   |
| Creditors                  | Payables  |

|                     |                           |
|---------------------|---------------------------|
| Minority interests  | Non-controlling interests |
| Reserves            | Retained earnings         |
| Cash flow statement | Statement of cash flows   |

### Conclusion

We are currently awaiting the ASB's Exposure Draft setting out its intentions for the future of UK GAAP. When this draft is issued, I shall be publishing articles highlighting the new changes and what practitioners need to do in order to plan for the GAAP switch.

The ASB do listen to practitioners, but the board needs to ensure it has learnt lessons from the difficulties faced by listed companies when they adopted IFRS. The difficulties experienced when the UK switched from UK domestic auditing standards to International standards should also be taken on board. The accounting profession is constantly changing and the ASB have made no secret of its intention to switch to an international-based framework. Practitioners are not welcoming IFRS for SMEs, but the ASB appears deaf to their cries of "if it is not broke, don't fix it!". If the ASB thinks current GAAP is over-complicated, then why not simplify it?

In spite of this common sense professional advice, the harsh reality is that the ASB will introduce an international-based framework and practising firms will have to accept the change.

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