Title: Amendment of restrictions for companies moving between IFRS and UK GAAP	Impact Assessment (IA)
IA No: BIS0304	**Date: 12 June 2012**
Lead department or agency: Department for Business, Innovation and Skills	**Stage:** Final
	Source of intervention: Domestic
Other departments or agencies:	**Type of measure:** Secondary legislation
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Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option £1.75m				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£18.95m	£18.95m	-£2.08m	Yes	OUT

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 has decided on prefer Option 1 as this provides flexibility not currently available to companies and more than that provided by option 2 but is 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/2017

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** None	**Non-traded:** None	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Date: 23 August 2012

Summary: Analysis & Evidence

Policy Option 1

Description:

Allow companies that prepare their accounts under IFRS to move to UK GAAP for any reason, provided this is no more frequently than once every 5 years.

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 17.07	**High:** 20.83	**Best Estimate: 18.95**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	1.55		Optional	**1.55**
High	1.86		Optional	**1.86**
Best Estimate	1.71		0	**1.71**

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 £377 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		2.2	**18.9**
High	Optional		2.6	**22.4**
Best Estimate			2.4	**20.7**

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 qualifying entities will become available under changes to financial reporting standards proposed by the Accounting Standards Board. Assuming that 75% to 90% of 5500 qualifying subsidiary companies choose to switch in year 1 from IFRS to UK GAAP achieving savings of £533 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. Allowing a change once every 5 years is a precaution against unforeseen consequences of allowing companies to "flip-flop", which might cause investor confusion. This approach was supported by a majority of consultees.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0.2	**Benefits:** 2.3	**Net:** 2.1	Yes	OUT

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 (CA06) 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 issued by the International Accounting Standards Board (IASB)[2].

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 using "IFRS as adopted in the EU" (for the purpose of this Impact Assessment abbreviated to "IFRS". There is no similar requirement for a company's individual financial statements to be prepared under 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, both individual and consolidated, 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 7,300[4] UK companies use 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, 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.

The Government implemented some restrictions and conditions after public consultation[8] in 2004:

- once a company has prepared its financial statements under 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 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 IFRS in its consolidated financial statements.
- where the parent company prepares group accounts, companies in the same group must adopt the same accounting framework (either 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 IFRS in both its consolidated financial statements and its individual financial statements, it will not be required to ensure that all its subsidiaries use IFRS too (CA06 s407). BIS

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

has issued guidance notes on these rules, including an explanation of when there might be “good reasons”[9].

In October 2010 the ASB issued for consultation “The Future of Financial Reporting in the UK and Republic of Ireland”[10] and subsequent to the consultation, in January 2012, the ASB published “The Future of Financial Reporting in the UK and Republic of Ireland: Key Facts” [11] which outlines the revised proposals of the ASB. Amongst other measures, the proposals include allowing qualifying entities who currently file IFRS accounts 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.

Problem under consideration

As described above, both sections 395 and 403 of CA06 provide that a company or group which prepares IFRS accounts may not move to UK GAAP unless there is “relevant change in circumstance”. The ASB 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. Unless the law is amended, companies currently choosing to report under IFRS (in particular qualifying subsidiary companies) would be restricted from taking advantage of the reduced costs available for qualifying companies under the reduced disclosure regime available under the ASB’s revised proposals[13] issued in January 2012.

Responses to the ASB’s consultation were published[14] and the reduced disclosures for subsidiaries was supported by responses from the London Stock Exchange (letter 288), Institute of Chartered Accountants in England and Wales [15] (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 was specifically supported by a response from major audit firms, KPMG[16] and Ernst & Young. This would enable companies to plan how to implement the ASB’s proposals. In light of the support received, the ASB has decided to go ahead with its proposals regarding a reduced disclosure regime[17], and the reduced disclosure framework is set out in FRED 47[18]. FRED 47 proposes that the reduced disclosure regime will be available to both subsidiaries and parent entities. It is proposed that the changes will apply for accounting periods beginning on or after 1 January 2015, however early adoption will be permitted.

On 6 October 2011, the Government launched a public consultation[19], on regulating only the frequency with which a company may make the change. As a result of this, the Government has decided to significantly deregulate the process of moving from IFRS to UK GAAP by allowing companies to make this change for any reason. 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.

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

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

[11] http://www.frc.org.uk/images/uploaded/documents/The%20Key%20Facts%20January%202012.pdf

[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/images/uploaded/documents/The%20Key%20Facts%20January%202012.pdf

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

[15] “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

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

[17] http://www.frc.org.uk/images/uploaded/documents/The%20Key%20Facts%20January%202012.pdf

[18] Accounting Standards Board - Publications - Financial Reporting Exposure Drafts (FREDs)

[19] http://www.bis.gov.uk/assets/biscore/business-law/docs/c/11-1193-consultation-audit-exemptions-and-accounting-framework.pdf

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.

In 2004, the Government consulted[20] on how the IFRS regime would be incorporated into UK accounting standards. Following the consultation, the Government decided to restrict companies' ability to move from IFRS to UK GAAP in order 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 in their current form as they are an incoherent mixture both 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) – preferred option.

- Amend 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 by allowing a company to move from IFRS to UK GAAP once in any 5 year period, whilst retaining the 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.)

- Amend 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 by allowing a company to move

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

from IFRS to UK GAAP once in any period of 3 years, whilst retaining the provision for a company to move from IFRS to UK GAAP where a change of circumstances occurs.

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 proposal[21], 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.

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 additional 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 qualifying 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[22]. 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 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. There are two reasons why we believe that between 10% to 25% of certain corporates who are eligible to switch may continue to use IFRS. The first is that they may have a particular group structure which will not enable them to achieve the savings proposed by the FRC. The second is that there will be some unlisted companies who wish to remain comparable to listed entities in similar industries, or who wish to prepare for a listing at some point in the future.

It was also 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. Following consultation, we believe these estimates of the take up rate and the level of savings to be still valid.

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[21] http://www.frc.org.uk/images/uploaded/documents/The%20Key%20Facts%20January%202012.pdf

[22] Source: FAME database 6 July 2011

Hourly pay of senior management time (directors of major organisations[23]) £48.85 per hour. Including a 16% uplift for over head costs, 1 hour of time costs £56.67.

Hourly pay of financial managers and chartered secretaries £27.37 per hour. Including a 16% uplift for overhead costs, 2 days (of 7.5 hours each) of middle management time costs £476.

Annual saving per company is therefore £57 plus £476 equal to £533.

Total annual saving for the 4125 to 4950 companies taking up the option is therefore £2.2m to £2.6m.

These savings arise jointly from ASB and BIS changes.

This option will also provide additional flexibility and possible cost savings to companies, other than the subsidiaries accounted for above, moving between IFRS and UK GAAP and so there may be additional non-monetised benefits of this option. 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, under the existing regime a qualifying entity 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 timescale of allowing a change once every 5 year period was the preferred timescale of the majority of respondents (44%). 34% of respondents believed no time restriction should be in place, 16% believed a change should not be allowed for reasons other than a relevant change in circumstances, 3% preferred a timescale of 3 years, and 3% were unsure. A timescale of 5 years was thought necessary by many respondents to maintain consistency and comparability with respect to the preparation and filing of accounts, while providing companies with a sufficient level of flexibility.

- The London Stock Exchange[24] 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, under the IAS Regulation, 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[25].

There are two particular 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 897[26] 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>[27]

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 £127 including a 16% uplift for overhead costs.

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

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

[24] 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

[25] 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

[26] http://www.londonstockexchange.com/statistics/historic/aim/february-2012.pdf

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

Thus total one-off cost in year of movement from IFRS to UK GAAP for each company is £127 plus £250 equal to £377. When multiplied by the 4125 to 4950 companies estimated to make the change the one-off cost amounts to £1.55m to £1.86m. The majority of respondents to the consultation were unsure about the likely costs involved in moving from IFRS to UK GAAP, with several accounting firms commenting that the cost would depend on the size and complexity of the company in question. 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[28] 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.

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 companies switching from IFRS to UK GAAP following the ASB proposed change in the accounting standard. Our view, which was supported by respondents to the consultation, is that companies will not opt to change their accounting framework on a frequent basis, and so the allowed frequency of switching is unlikely to affect the decision to switch. We are therefore estimating a take up rate of 75%-90% for all options under consideration. Under Option 2, 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, however as indicated above, this option does not provide as much flexibility to companies in selecting the most appropriate accounting framework as in available under options 1,3 and 4.

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 owing to the costs involved in a change of accounting framework.

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

Benefits

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

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 once within a 3 or 5 year period 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. The majority of respondents to the consultation (55%) believed that allowing a company to change from IFRS to UK GAAP every 5 years would not increase the risk of financial irregularities, primarily owing to the similarities between the frameworks. 24% of respondents believed the risk of financial irregularities would increase as a result of the proposed changes, while 21% of respondents were unsure.

The timescale of allowing a change once every 5 year period was the preferred timescale of the majority of respondents (44%). 34% of respondents believed no time restriction should be in place, 16% believed a change should not be allowed for reasons other than a relevant change in circumstances, 3% preferred a timescale of 3 years, and 3% were unsure. A timescale of 5 years was thought necessary by many respondents to maintain consistency and comparability with respect to the preparation and filing of accounts, while providing companies with a sufficient level of flexibility.

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). This view was also supported by respondents to the consultation.

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 (present value) of implementing Option 1 is £18.95million over the ten year period. This represents an equivalent net annual saving to business of £ 2.08million and is therefore a One Out.

Summary and preferred option with description of implementation plan

As all of the deregulatory options considered concern allow qualifying companies currently choosing to report under IFRS more flexibility to change from IFRS to UK GAAP, the monetised costs and benefits of these four options are identical. However, as there are different levels of flexibility and risks attached to each option, there are significant differences in the non-monetised impacts of each option. The Government has therefore decided 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) as 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. Furthermore, as mentioned above, Option 1 was the preferred option of the majority of respondents to the consultation. Option 2 further restricts future flexibility by not allowing companies to select their accounting framework based on their commercial position. Options 1, 3 and 4 provide this flexibility. Option 1, however, will retain increased comparability of accounts over Options 3 and 4 and limit the risk of tax arbitrage and companies switching to represent their accounts in a better light (a particular concern of consultation respondees) particularly in relation to Option 4, and is therefore the preferred option.

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.

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: [The basis of the review could be statutory (forming part of the legislation), i.e. a sunset clause or a duty to review , or there could be a political commitment to review (PIR)]; Post implementation review
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] To ascertain the uptake of the new flexibility in accounting regime and any impact on users of accounts.
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] Monitoring data of uptake and stakeholder discussions on actual impacts.
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] Impact assessment sets out the baseline – current use of IFRS accounts.
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] Uptake of new flexibility to move from IFRS to UK GAAP accounting regimes
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] Data from FAME database on use of IFRS accounts by subsidiaries.
Reasons for not planning a review: [If there is no plan to do a PIR please provide reasons here]