21 April 2011

Michelle Sansom
Accounting Standards Board
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By email to asbcommentletters@frc-asb.org.uk

Dear Ms Sansom

The Future of Financial Reporting in the UK and Republic of Ireland

I am writing on behalf of AFME (the Association for Financial Markets in Europe) to respond to the IASB's October 2010 FRED: The Future of Financial Reporting in the UK and Republic of Ireland ("the FRED"). AFME is, as you know, the leading European trade association for firms active in investment banking and securities trading; it was established in November 2009 as a result of the merger of LIBA (the London Investment Banking Association) with the European Branch of SIFMA (the US-based Securities Industry and Financial Markets Association), and thus represents the shared interests of a broad range of participants in the wholesale financial markets. We welcome the opportunity to respond to the FRED, and we commend the ASB for its comprehensive consultation on this important topic.

The great majority of AFME members are large financial institutions with trading operations in a significant number of countries, both inside and outside the EU, and securities listed on one or more exchanges. Their interests therefore focus primarily on the proposed requirements for Tier 1 and Tier 1s.

Our members are generally very supportive of the ASB proposals for a differential reporting framework, particularly the "Tier 1s" proposal to provide some flexibility for subsidiary undertakings. We do however have continuing concerns with some aspects of the proposals, the more significant of which are summarised herewith:

- *Subsidiaries with public accountability*
  As set out in our 28 January 2010 response to the ASB's 2009 Consultation Paper – Policy Proposal: The Future of UK GAAP ("the 2009 CP"), the majority of our members believe that all subsidiaries should qualify for disclosure exemptions from full IFRS, even those which are themselves publicly accountable. These members therefore request that the Tier 1s proposals be expanded to include publicly accountable subsidiaries. Our detailed views on this are set out in our response to Q1 below.

- *Interaction with legal requirements*
  We understand the legal challenges the ASB faces where entities depart from full IFRS through the use of the Tier 1s exemptions and thus are required to prepare Companies Act accounts. However, the requirement to prepare Companies Act format accounts for subsidiaries, inconsistent with IFRS format accounts on consolidation, significantly reduces the benefits of the Tier 1s proposals for preparers who will still not have a consistent reporting framework across the group. This continuing Companies Act interaction will, we believe, also require an ongoing maintenance effort for the ASB to ensure that any new IFRS are consistent with the requirements for Companies Act accounts, effectively requiring a UK "endorsement process" for Tier 1s accounting.

  For these reasons we believe the legal framework needs to be challenged to ensure the Tier 1s proposal has the maximum benefit for preparers; our detailed views on this point are set out in our response to Q3 below.

- *Effective date*
  IFRS are undergoing a significant amount of change and the IASB has recently consulted on the effective dates for all of the new IFRSs. Although the outcome of that consultation is not yet known, it is our expectation that the effective dates of many, if not all, of the new IFRSs will fall within the period suggested by the ASB for implementing the changes to UK GAAP. Given this uncertainty, it is currently difficult to conclude whether the ASB proposals for transition to new UK GAAP are appropriate. As set out in our response to Q20 below, we therefore recommend that the ASB undertake a further limited round of consultation on the effective date once the IASB have provided greater clarity on their implementation timetable.

We set out below our responses to certain of the detailed questions set out on pages 18-23 of the FRED; please note that, reflecting our members' focus on Tier 1 and Tier 1s, we have only responded to Questions 1, 3, 5, 10-15, and 20.

Q1 Do you agree that a differential financial reporting framework, based on public accountability, provides a targeted approach to relevant and understandable financial information that contributes to discharging stewardship obligations?

We agree that a differential reporting framework based on public accountability provides a targeted approach to relevant and understandable financial information.

We are also pleased to note that the ASB recognises the need for additional differentiation in the case of subsidiary entities through the proposal for Tier 1s entities. However, as discussed in our response to the 2009 CP, many of

our members remain firmly of the view that this differentiation for subsidiaries should be extended to include those subsidiaries which are themselves publicly accountable, for the following reasons:

- The exemptions proposed for qualifying subsidiaries are consistent with those that have been in place for many years under UK GAAP with no call from users for additional information.

- Accounts of subsidiary companies are, in our view, largely produced only for statutory filing purposes, rather than in response to user demand. Expanding disclosure in these accounts over and above current UK GAAP only serves statutory reporting requirements, not user needs.

- Consistent with the above point, we understand there has so far been very limited response from users on the ASB proposals; we believe this supports the assertion that accounts are perceived as fulfilling a statutory requirement rather than user needs.

- Certain of the disclosures which will otherwise be required are relatively meaningless at subsidiary level. For example, treasury operations are usually managed at a consolidated level to minimise funding costs, and the cash flow statements of subsidiaries are, in these circumstances, of little value as they provide no real indication of the entity's financing activities and cash resources. Similarly, management of financial risks is normally co-ordinated across legal entities, so providing risk management disclosures at a legal entity level can provide a very distorted view. Such disclosures can even be confusing at too low a level, devaluing the information provided to users.

Accordingly preparers may incur excessive additional costs over and above the current reporting requirements to produce disclosures which add little or no useful information to users. This runs contrary to the FRC requests to "cut the clutter" in financial statements.

Q3 Appendix 1 'Note on the Legal Requirements in the United Kingdom and Republic of Ireland' to this FRED sets out a note on legal matters that are applicable to the tier system. Do you have any comments or queries on the scope or content of this Appendix?

We have concerns regarding the interaction of the UK Legal Requirements with the accounting framework proposed for Tier 1s subsidiaries. As noted in our response to Q1, we appreciate the ASB recognition of the specific challenges for subsidiaries of a Tier 1 group and the creation of the Tier 1s framework to provide a sensible and efficient approach to financial reporting at both the legal entity and consolidated group level. We also recognise the legal challenge that results in departing from full IFRS, requiring a subsidiary to prepare "Companies Act" accounts. We believe, however, that the resulting inconsistency in the format of the subsidiary primary financial statements (presented in accordance with the Companies Act requirements) versus the consolidated primary financial statements (presented in accordance with IAS 1) has some unfortunate consequences:

- Most significantly, the difference in presentation between subsidiaries and the group significantly reduces comparability of the financial statements across the group. This is particularly relevant for the financial services industry, where it is common to use the liquidity order of balance sheet presentation allowed under IAS 1, but not under the Companies Act. Moreover, given the significance of financial instruments to our industry, we currently find that the combination of financial instruments classification under FRS 26 with the prescribed line items in the Companies Act results in confusion in the presentation of the primary statements, the accounting policies and the notes to the accounts.

- A further issue with the different presentation is the need to maintain two separate charts of accounts across the group, one for subsidiary accounts and one for consolidation, which clearly limits the efficiencies that can be gained from the Tier 1s framework. This may also have consequences for XBRL filings, resulting in the need to create and maintain separate tagging for subsidiary and consolidated financial statements, as well as reducing the value of the XBRL output by limiting the comparability of tags at the subsidiary level with those at the consolidated level.

We recognise that the ASB may be constrained in this regard by the Companies Act and by the EU 4th and 7th Directives. However we are of the view that the formats prescribed by the legislation are dated and do not fully reflect the significant changes in the accounting landscape since their implementation, and that these issues could be compounded by the significant changes in IFRS due in the near future. We consider the IFRS requirements for the format of primary statements far more "fit for purpose" for current day financial reporting, and it seems incongruous that IAS 1 financial statements are required for publicly accountable entities, but are not "adequate" under the UK Legal Requirements for less significant entities.

Although the EU Directives are currently undergoing review, with the next round of consultation expected during the summer, the timeframe for implementing any legislative changes at the EU level could be extremely long. We are therefore keen to understand whether the ASB/BIS could, in the absence of any change to the EU Directives, introduce additional flexibility into UK law in the near term in order to allow primary statement formats which are consistent with the requirements of IAS 1. For example, the Overseas Companies Regulations 2009 (SI 2009/1801) provide flexibility for companies to present profit and loss accounts and balance sheets in accordance with line items required under IFRS[1]. We would also ask whether similar flexibility could be included in the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410).

If it is not possible to introduce such flexibility into UK law, we hope the ASB and BIS would support a proposal to introduce an element of flexibility into the EU Directives in order to allow recognition of formats which are compliant with IFRS.

[1] See for example Schedule 4 Part 1 paragraphs 1(a) and (b) of The Overseas Companies Regulations 2009

More broadly, coinciding with the review of the EU Directives, we would encourage a review of UK company law reporting requirements with a view to removing legacy legal accounting and disclosure requirements which have fallen out of sync with EU-adopted IFRS. A prime example is provided by the UK requirements for the disclosure of directors' emoluments, which have not kept abreast of accounting developments for share-based payments and deferred compensation schemes: the IFRS disclosures for key management personnel compensation are more up-to-date in this regard. There is little benefit in entities providing both of these disclosures, particularly when it is impossible to reconcile the two disclosures. This approach could also help to resolve some of the other legal challenges highlighted in Appendix 1 of the FRED.

We believe that removing these legal challenges will also reduce the burden on the ASB in the future in reviewing new IFRS standards and changes to existing IFRS standards for compliance with the legal requirements.

Q5 Are the definition of public accountability and the accompanying application guidance sufficiently clear to enable an entity to determine if it has public accountability? If not, why not?

We agree that the definition and the accompanying application guidance are sufficiently clear to enable an entity to determine if it has public accountability.

However, we believe the guidance is less clear for a group. Our understanding is that the determination of public accountability is determined at legal entity level so that, inter alia, a parent does not have public accountability just because it owns a publicly accountable subsidiary. In such a case we understand that either of the following reporting combinations would be acceptable:

- The parent produces FRSME standalone and consolidated accounts and the publicly accountable subsidiary produces IFRS standalone accounts and consolidated accounts (i.e. the subsidiary is not exempt from preparing consolidated accounts under IAS 27 paragraph 10 because it fails paragraph 10(d)); or

- the parent produces IFRS standalone and IFRS consolidated accounts and the publicly accountable subsidiary produces IFRS standalone accounts only (i.e. the subsidiary is exempt from preparing consolidated accounts by virtue of IAS 27 paragraph 10, assuming it does not have listed securities).

Q10 The ASB is proposing that subsidiary undertakings which apply the reduced disclosure framework should:
(a) disclose the disclosure exemptions taken;
(b) state in the notes the name of the parent undertaking in whose consolidated financial statements the subsidiary's results and relevant disclosures are included; and

(c) only be permitted to take the disclosure exemptions where the consolidated financial statements of the parent are publicly available. Are these requirements necessary and sufficient to protect users of subsidiary financial statements?

We agree that these disclosures are necessary and sufficient to protect users of subsidiary financial statements.

Q11 The ASB proposes that disclosure exemptions should be permitted for all subsidiary undertakings: do you agree, or do you consider that there should be a minimum percentage ownership requirement?

We agree that disclosure exemptions should be applicable to all subsidiary undertakings. We do not believe there should be a minimum percentage ownership requirement, as setting the level of ownership would be arbitrary. Instead, we are supportive of providing any minority shareholder the right to request full disclosures.

Q12 Do you consider that a disclosure exemption should or should not be provided for transactions between wholly-owned group undertakings? Please explain your reasoning.

We believe that a disclosure exemption should be provided for transactions between wholly-owned group undertakings. As noted in our response to Q1, the production of subsidiary financial statements is driven by statutory requirements rather than by user needs. We believe that related party disclosures, like cash flow statements and risk management disclosures, add little if any useful information at the subsidiary level, but the cost of producing such information can be excessive.

As noted in our response to Q3 there is also duplication and inconsistency resulting from the disclosure of directors' emoluments under the Companies Act and key management personnel compensation under IAS 24.

Q13 The reduced disclosure framework was developed in response to the feedback on the ASB's policy proposal issued in August 2009. Qualifying subsidiaries applying the reduced disclosure framework look to EU-adopted IFRS and the Appendix to the draft Application FRS to prepare their financial statements. Does this proposal adequately address preparers' needs?

As noted in our response to Q1, while welcoming the reduced disclosure framework for qualifying subsidiaries, which does substantially address preparers' needs, many of our members believe that this framework should also be available to subsidiaries which are publicly accountable. We also reiterate our concerns over the interaction with the UK Legal Requirements in our response to Q3, which reduces the overall benefit for both preparers' and users.

Q14 Do you have any further suggestions for disclosure exemptions for qualifying subsidiaries? If so, please explain why you consider the disclosure is not required in the subsidiary financial statements.

While we have no further suggestions for disclosure exemptions, we would like clarification regarding certain exemptions for qualifying subsidiaries:

- *Paragraph 14(d): IFRS 7 exemption*
  Under current UK GAAP, a 90% owned non banking/insurance subsidiary is generally exempt from the disclosure requirements of FRS 29. However, if such a subsidiary designates financial instruments listed under paragraphs 36(2) or 36(3) at fair value using the fair value option, under paragraph 36(4) of Schedule 1 to the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations ("the Regulations"), we understand that the subsidiary is required to provide disclosures in accordance with paragraphs 9, 10 and 11 of FRS 29/IFRS 7. We do not believe that paragraph 36(4) of the Regulations requires the subsidiary to apply FRS 29/IFRS 7 in full.

  The exemption from providing IFRS 7 disclosures set out in paragraph 14(d) of the Draft Financial Reporting Standard: Application of Financial Reporting Requirements, as drafted, appears to deny the exemption from IFRS 7 disclosures if the subsidiary designates liabilities at fair value under the fair value option. We believe that this restriction in the use of the exemption goes beyond the current disclosure requirements in UK GAAP and we are uncertain whether this is intended.

- *Paragraph 16: Equivalence of disclosures in consolidated financial statements*
  We note that the ASB intends to retain UITF Abstract 43 "The interpretation of equivalence for the purposes of section 228A of the Companies Act 1985" as set out in paragraph A2.5 of Appendix 2. It would therefore be helpful if the ASB could clarify that the language regarding equivalence in paragraph 16 of the Draft Financial Reporting Standard is not intended to require any additional equivalence assessment over and above that set out in UITF Abstract 43.

Q15 Do you agree with the detail of the ASB's proposal to streamline the number of SORPs for profit-seeking entities? If not, why not?

We agree that SORPs should be retained only where there is a clear and demonstrable need.

Q20 The ASB is proposing an effective date of July 2013, with early adoption permitted, which assumes an 18 month transition period. The ASB's rationale for this date is set out in paragraphs 11.121 to 11.126. Early adoption will permit entities to secure benefits as soon as possible, however other entities may wish to defer the effective date to permit businesses more time to prepare for transition. Do you agree with the proposed effective date and early adoption? If not, what would be your preferred date, and why?

We agree that an 18 month transition period would be appropriate in normal circumstances. However, given the major changes currently being proposed for IFRS, particularly those which may have significant operational impacts such as impairment of financial assets and leases, we are concerned that the proposed timeframe may not be realistic. Further, given that the IASB has not yet concluded on the effective dates for all of its new standards, it is difficult to determine, operationally, how the ASB's proposed date will impact implementation efforts.

We therefore recommend that the ASB undertake a further limited round of consultation on the effective date once the IASB have provided greater clarity on their implementation timetable.

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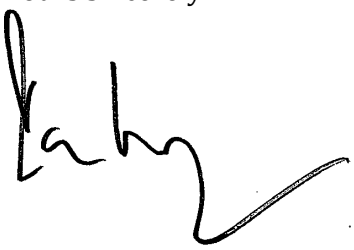
I hope the above comments are helpful. We would of course be pleased to discuss any points which you may find unclear, or where you believe AFME members might be able to assist in other ways.

Yours sincerely



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