

By email: ukgaap@frc-asb.org.uk

1 February 2010

Peter Godsall
Accounting Standards Board
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

Dear Peter

The Future of UK GAAP

The Association of Investment Companies ('AIC') is the trade body representing some 350 investment companies, managing assets of approximately £70bn. Our Members are closed-ended investment companies whose business is to invest in a diversified portfolio of shares and securities, property and other assets to provide returns for their shareholders. Investment companies are one of the main forms of collective investment vehicle available to UK investors, along with unit trusts and OEICs.

Our Members are domiciled both in the UK (investment trusts, Venture Capital Trusts) and offshore (predominantly in the Channel Islands); with the vast majority listed on the London Stock Exchange.

In our experience, because the vast majority of investment companies do not produce consolidated accounts (simply because they have no subsidiary companies), and notwithstanding that they have the option to produce their company accounts in accordance with IFRS, most of our Members (we estimate around 70%) produce their accounts in accordance with UK GAAP. It follows that any changes to UK GAAP will be hugely significant to the investment company sector.

The AIC is pleased to have the opportunity to comment on the future of UK GAAP. We support the ASB's decision not to relinquish the right to set UK GAAP but do not understand what is meant by your statement:

'The intention is to work under the IASB framework and to converge to the fullest extent possible consistent with the needs of UK entities.'

Does this mean that we will end up with UK adopted IFRS?

If so, this could be a welcome outcome as the AIC is not persuaded that the introduction and general adoption of IFRS has been a positive change for our Members. Given their specialist nature, most accounting standards do not fit well with the requirements of investment companies. It seems to us that the IASB is preoccupied with its task of converging IFRS and US GAAP and its mission to prevent accounting abuse. This results in the production of very prescriptive accounting standards which do not cater well for specialist sectors such as investment companies.

Issuing and investing in financial instruments characterises the investment company sector and it follows that their accounts are hugely impacted by the financial instrument standards. As an example of accounting difficulties caused by IFRS, and as the ASB is well aware, investment companies have had extreme difficulty in determining whether some of their share classes should be classified as equity or a liability. Dealing with this represents unproductive use of time and resources, with the only outcome that shareholders and other

users of the accounts are becoming more confused and the accounts themselves merely glanced at.

The IASB is spreading itself over such a large area that it is unable to listen to even the most compelling of arguments that contradict its proposed solutions or course of action. For example, with respect to their investing activity, we know that shareholders and other users of the accounts do not want to see investment companies consolidate the results of their investee companies. We note that the IASB is considering widening the definition of control for consolidation purposes which will exacerbate the problem. The IASB seems to be adamant that consolidation is the best solution and the one preferred by users. We have asked them for the evidence supporting this view but have had no response.

It follows that the ASB retaining the right to set UK GAAP taking into account the needs of UK entities is the right stance. Although this could, of course, mean that there might be yet another version of IFRS, on balance we believe it is the most appropriate approach.

Having said all this, we note that in the consultation document reference is made to EU adopted IFRS rather than UK adopted IFRS; we therefore assume that changing EU adopted IFRS for UK purposes is expected to be an extremely rare event.

As listed companies, our Members will fall within the definition of publically accountable entities and the majority that report in accordance with UK accounting standards will have to change to IFRS if it is made compulsory. This is yet another burden for our Members and we would ask that if the change is made a considerable amount of thought is given to making the transition as straightforward as possible thereby keeping costs down. We believe that a cost/benefit analysis of the ASB's proposals will struggle to show a material net benefit, and we do not support the change. However, for a variety of reasons we recognise that the change is likely to happen and we will do our utmost to support our Members through the process.

Turning to the ASB's role in this new regime, we would recommend that you act as the UK conduit for IFRS, meaning that you co-ordinate the UK's response to, for example, IFRS consultations. You could then represent any UK based special situations (such as investment companies) rather than the UK entities (or their trade body) attempting to deal directly with the IASB – although direct representation might still be undertaken in special circumstances. This is analogous to the position on EU directives, where the UK government will consult with interested parties before negotiating with Brussels.

SORPs

A major concern with regard to the future of UK GAAP is the ASB's proposal in paragraph 2.36 that our SORP should be withdrawn ("leaving the question of whether additional guidance was needed as a matter entirely for the AIC").

We strongly disagree with this proposal and wish to highlight the major harmonising impact that the AIC's SORPs have had over the last 14 years or so. It was the ASB that encouraged the AIC to issue its first SORP (published in 1995) because of inconsistent accounting treatments being adopted by investment companies.

Our most recent SORP was issued in January 2009 when its scope was widened to include Venture Capital Trusts. The vast majority of preparers, users and directors view the SORP as an essential part of UK GAAP and welcome the best practice set out therein. The withdrawal of the SORP would be viewed as a very negative step which would lead to a divergence of accounting practices and, ultimately, less useful financial statements to the possible detriment of users.

As we are sure you agree, the ASB's oversight and assurance of the SORPs development together with the requirements set out in FRS 18 give the SORP a status that guidance could never attain. We believe that to abandon SORPs will put in jeopardy the high level of financial reporting which shareholders and other stakeholders benefit from today.

We do not agree with the IASB's view that SORPs have no place within the accounting framework. SORPs cannot override accounting standards but, particularly for specialised sectors, they can set out best practice where alternative treatments exist or deal with situations that accounting standards do not address. For example, the separation of capital and revenue is of fundamental importance to investment companies but is not covered by accounting standards. The AIC's SORP caters for this by stating that investment companies should provide a revenue column and a capital column as supplementary information – no accounting standard is ever likely to deal with this.

In addition, other bodies such as HMRC make use of the SORP and refer to it in legislation and their guidance manuals. It is unlikely that this will continue if the SORP loses its ASB-given status. This would create uncertainty and could lead to industry-wide standard interpretations being withdrawn as new solutions are sought.

We recommend that the ASB retains SORPs and as far as possible maintains their current status.

Please find attached our responses to the specific questions set out in the consultation paper which are particularly relevant for investment companies.

We would welcome the opportunity to discuss the above matters further with you as you start to firm up on your proposals. However, if you wish to discuss any aspect at an earlier stage please do not hesitate to contact me on my direct line 020 7282 5605 (email: john.stevens@theaic.co.uk).

Yours sincerely

John Stevens
Finance Director

Question 1 – Which definition of Public Accountability do you prefer: the Board’s proposal (paragraph 2.3) or the current legal definitions (paragraph 2.5)? Please state the reasons for your preference. If you do not agree with either definition, please explain why not and what your proposed alternative would be?

The AIC is neutral on this as it believes that investment companies, as listed companies, will fall within the definition of Public Accountability on either basis.

Question 2 – Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

The AIC agrees that listed entities should be included in Tier 1.

Question 10 – Do you agree with the Board’s current views on the future role of SORPs. If not, why not?

We do not agree.

As also set out in our covering letter and the subject of recent face-to-face discussions with the ASB, the AIC believes that its SORP, which was first issued in December 1995, has been a major factor in harmonising financial reporting across the investment company sector. Within the last year or so the scope of the SORP has actually been widened to include Venture Capital Trusts.

Investment companies, alongside other investing entities, are unique with regard to their financial reporting requirements; for example the need to report separately capital and revenue returns. No accounting standard is ever likely to deal with these matters, and the AIC believes that this requirement fits within the ASB’s stated principle that SORPs should only remain where there is a clear and demonstrable need arising from sector specific issues not covered by guidance in accounting standards.

There is no question that the AIC’s SORP provides benefits in terms of contributing to the ASB’s aim of improving financial reporting. Any industry guidance that the AIC might issue cannot have the same status as a SORP which has been developed in accordance with the ASB’s oversight and assurance process. The AIC is not in a position to require its Members to comply with its guidance and accordingly different presentations are almost certain to evolve over time and put in jeopardy the high level of financial reporting which shareholders and other stakeholders benefit from today.

We do not agree with the IASB’s position that SORPs have no place within an accounting framework, although we understand why they would take such a stance being responsible for a world-wide accounting regime. But the fact of the matter is that SORPs cannot override accounting standards whereas they can deal with situations where accounting standards permit alternative treatments or where they do not deal with specific issues. Thus the position of the IASB is not threatened by SORPs. In addition, we do not believe that IFRIC is able to replace the role of a SORP because, as stated above, SORP deal with situations where accounting standards permit alternative treatments or where they do not deal with specific issues. As the ASB states in paragraph 2.33, there is a need for someone to fill in gaps where there is no IFRS.

With regard to the last point, we are not clear on the distinction the ASB is obviously drawing in paragraph 2.33 between the insurance and extractive industries sectors and the investment company sector where, with regard to the first two, you are recognising a gap in IFRS that, presumably, you do not believe exists for investment companies. As stated above, the AIC believes that IFRS does not cater for investment companies.

Finally, other bodies such as HMRC make use of the SORP. It is possible that if ASB endorsement is withdrawn HMRC will withdraw its references to the AIC's SORP to the detriment of the sector.

Question 15 – If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as appropriate. If you are a user of financial statements (such as an investor or creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?

For our Members, withdrawal of the SORP would be by far the most significant effect of the ASB's proposals

However, there would be other effects and we would urge the ASB to consider, for example, the first time adoption rules so that any impact (and the associated costs) is minimised.

For users, considering that investment companies are already within the scope of the UK's financial instrument standards, we would not expect there to be fundamental changes. However, we are aware that there are still some differences between current UK accounting standards and IFRS which could give rise to some disclosure changes.

One consequence of implementing the proposals which has been mentioned at our committees is the requirement, in respect of share issues requiring the publication of a prospectus, for three years of accounts to be disclosed. We understand that this will mean that, once the proposals apply, it will initially be necessary for relevant companies to have to restate their previous years' accounts which will involve considerable time and effort (and no doubt cost).

Question 16 – What are your views on the proposed adoption dates?

The AIC believes that a 'change' date for financial years beginning on or after 1 January 2012 is ambitious. This means that entities will have to apply the new regime to their 2012 interims with the requirement to restate the comparative figures. In addition, if the AIC SORP is to be withdrawn and the AIC is to issue guidance this will take time to produce. We would support a delay in the adoption date of at least 12 months.