aic

By email: audconsult@bis.gsi.gov.uk

Mr Rufus Rottenberg
Audit & Accounting Team
Department of Business, Innovation and Skills
Spur 2, 3rd Floor,
1 Victoria Street
London SW1H 0ET

The Association of Investment Companies
9th Floor 24 Chiswell Street
London EC1Y 4YY
Telephone 020 7282 5555
Fax 020 7282 5556
enquiries@theaic.co.uk
www.theaic.co.uk

22 December 2011

Dear Mr Rottenberg

Consultation on Audit Exemptions and Change of Accounting Framework

The Association of Investment Companies ('AIC') is the trade body representing some 340 investment companies, managing assets of approximately £77bn. 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. The balance will, of course, produce their consolidated accounts in accordance with IFRS and we understand that, in order to avoid undue complication, many of these companies will also have opted to produce their individual accounts in accordance with IFRS.

The AIC is pleased to have the opportunity to comment on the proposals set out in the Consultation on Audit Exemptions and Change of Accounting Framework. However, due to its relative lack of relevance to investment companies, this response has nothing to say with regard to the audit exemptions and focuses on the proposals relating to the change of accounting framework.

Change of Accounting Framework

Because of the circumstances as described above, any changes to the accounting framework could be very significant for the investment company sector.

You will be aware that in addition to the ASB's changes to UK GAAP, which it appears to us are still very much in a state of flux, the IASB has recently consulted on Investment Entities (ED/2011/4) which, broadly, proposes that investment entities, which is likely to include most if not all investment companies, will not have to consolidate their controlled entities. If so, many of those investment companies currently producing consolidated accounts will no longer have to do so, meaning that they could produce their individual company accounts in accordance with UK GAAP providing they have not previously opted for IFRS.

It follows that the proposed changes to the accounting framework could be very important to these companies in as much as they will permit them to prepare their accounts in accordance with UK GAAP even though they had previously opted for IFRS for the reasons set out above.

As an aside, if the IASB's proposals re investment entities find their way into an international accounting standard, we would expect the ASB to reflect similar provisions within UK GAAP (and the commensurate changes made to UK Company Law). Otherwise, we could end up in the absurd position of UK GAAP requiring consolidation, and hence IFRS having to be applied to the consolidated accounts, with IFRS itself not requiring (or even permitting) consolidation.

You might also be aware that the AIC produces a SORP (Statement of Recommended Practice: Financial Statements of Investment Trust Companies and Venture Capital Trusts). This, basically, provides guidance and makes recommendations with regard to the financial statements of our UK Members; but only for those that prepare their accounts in accordance with UK GAAP – SORPS have no role or status with regard to international financial accounting standards. The SORP is a valuable tool in promoting harmonisation within the industry by identifying and setting out best practice across a wide range of issues. It is very likely to have an even more significant role following the ASB's proposed changes to UK GAAP and some investment companies may wish to be brought within its scope by moving from IFRS to UK GAAP.

Proposals

The AIC is not quite clear on the general proposal. For example, option (a) set out in paragraph 79 proposes to 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 five years. As a company that moves to UK GAAP will never be in a position to move to UK GAAP again unless in the meantime it has moved back to IFRS, we are assuming that the option to move to IFRS will be available without restriction.

Consultation Questions

Q22 Do you agree that the government should impose restrictions on companies' ability to move from IFRS to UK GAAP?

The AIC does not believe that its Members, or indeed other companies, will lightly switch between IFRS to UK GAAP (or vice versa). The reasons set out in paragraph 78 of the consultation are persuasive and therefore the AIC **recommends** that option d be adopted.

There may be commercial or other reasons to switch from UK GAAP to IFRS (or vice versa) and the AIC believes it should be left for the company to decide and that the accounting framework should provide the company with the flexibility so to do.

Q23 How frequently should a company be able to move from IFRS to UK GAAP, unless there is a relevant change in circumstances? Every year, every 3 years, every 5 years, or never?

As stated above, the AIC does not believe that companies will lightly switch from IFRS to UK GAAP (or vice versa) because of the reasons set out in paragraph 78 and also because switching is onerous and shareholders, analysts and other stakeholders will need to be persuaded that switching frequently is in the company's best interest. In addition, comparative figures will probably be required which will further complicate matters and reinforces our view that switching will be a major challenge for a company.

Consequently, the AIC believes that, in order to give a company maximum flexibility to meet changing circumstances, the legislation should permit a company to move from IFRS to UK GAAP every year (i.e. whenever it wishes to do so). Obviously, in practice a company cannot move from IFRS to UK GAAP every year, so the legislation should probably state without restriction or similar wording.

Q24A Do you agree with the Government's estimate that 90% of eligible subsidiary companies will take up the option?

B Do you agree that the saving for each company will be £569?

The AIC has no comment on Q24.

Q25 Do you agree that the one-off cost per company will be £390?

We do not know what the one-off cost is likely to be for our Members, but the important point is that what is proposed is optional rather than compulsory. It follows that it is for a company considering such a change to identify the cost and then make a commercial decision whether the cost is acceptable or not.

Q26 Do the proposed changes in any way increase the risk of financial irregularities? If so, what would you estimate the potential impact to be on investors?

As stated above, our general position is that companies will not switch accounting frameworks without a very good reason to do so. Consequently, we do not see the proposed changes increasing the risk of financial irregularities.

Q27 What is the risk that investors will be misled or confused by a company switching between accounting frameworks?

The AIC believes that there is a strong possibility that investors and other stakeholders will be confused by a company switching accounting frameworks, which is one of the reasons why we believe that frequent switching will not occur.

On those rare occasions when a company decides to switch, we would expect it to fully engage with investors and provide a detailed explanation of the rationale behind the decision and its consequences.

Q28 Do you agree with the Governments assessment of the risks of this proposal?

Yes.

Q29 Do you agree that the proposals should apply to entities for financial years ending on or after 1 October 2012?

As you can see from the points made above, the AIC generally supports maximum flexibility with regard to the proposals. However, with regard to the start date we struggle to see how a company with, for example, a 31October year end could switch its accounting framework for its 31 October 2012 year given that the year has already started. In addition, the situation regarding the future of UK GAAP is far from certain.

We would suggest that the proposals are either effective from financial year beginning on or after 1 October 2012 or immediately after the legislation is brought into force (whether that is earlier or later than October 2012).

For further information on any issues raised in this paper please contact:

John Stevens **email: john.stevens@theaic.co.uk** **tel: 020 7282 5605**