Title: The Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2012 **IA No:** BIS0355	**Impact Assessment (IA)**
Lead department or agency: BIS	**Date:** 28/05/2012
Other departments or agencies:	**Stage:** Final
	Source of intervention: Domestic
	Type of measure: Secondary legislation
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Summary: Intervention and Options

RPC Opinion: AMBER

Cost of Preferred (or more likely) Option				
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**
£3.47m	£3.47m	-£1.10m	Yes	OUT

What is the problem under consideration? Why is government intervention necessary?

Companies in the UK use UK Generally Accepted Accounting Principles (GAAP) or International Accounting Standards (IAS) - to ensure consistency in reporting standards. A company choosing to relocate its headquarters to the UK may use a different system before they relocate and will generally change their accounting system to UK GAAP or IAS in time to start preparing the first set of annual accounts. There are significant costs for large and complex companies in implementing these changes within the first accounting reference period of 18 months. These regulations aim to alleviate some of these costs by providing additional time to complete the conversion.

What are the policy objectives and the intended effects?

To ensure a specified period of time (3 years) for companies, which are listed on stock exchanges in the U.S. or Japan but not in an EU Member State, to continue using their GAAP. The aim is to ensure a reasonable period for companies to make the transition in their accounting practices to either UK GAAP or IAS when redomiciling their company to the UK. The costs associated with converting accounting principles to UK GAAP or IAS will remain but the additional costs caused by ensuring conversion within the18 month deadline will be substantially reduced. Transition to UK GAAP or IAS by the end of the 3-year period will be expected as the rationale for consistency of financial statements in the UK remains.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 1 - Ensure that companies that meet specified criteria can continue to use accounting principles authorised by Japanese and US authorities, for a specificed period. (preferred option)
Option 2 - do nothing
Option 3 - Introduce a transition period for UK-incorporated companies to convert to preparing financial statements to IAS or UK GAAP from any accounting principle

Option 1 supports the need for consistency in financial accounts while recognising the equivalence of accounting principles in Japan and the US, which do not currently always allow the use of IFRS. Our preference for option 1 is based on the case study approach which determined the relative merits of the policy proposal and found that significant savings would be made by large, complex companies.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 03/2015

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**		**Non-traded:**

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 SELECT SIGNATORY: [signature] Date: 17 Sept 2012

Summary: Analysis & Evidence

Policy Option 1

Description: Introduce a transition period to convert to UK GAAP or IFRS (preferred)

FULL ECONOMIC ASSESSMENT

Price Base Year '12	PV Base Year '12	Time Period Years 3	Net Benefit (Present Value (PV)) (£m)		
			Low: 0.1	**High:** 19.83	**Best Estimate:** 3.47

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

Description and scale of key monetised costs by 'main affected groups'

There are no monetised costs associated with this policy. The preferred option reduces costs associated with switching to UK GAAP by ensuring a transition period for adoption of domestic accounting principles.

Other key non-monetised costs by 'main affected groups'

Familiarisation costs are expected to be negligible. When a company redomiciles to the UK it is required to change its accounting principles. Consideration whether to take advantage of the transition period will form part of the decision whether to convert to IAS or UK GAAP.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		0.0	**0.1**
High	Optional		6.8	**19.8**
Best Estimate			1.2	**3.5**

Description and scale of key monetised benefits by 'main affected groups'

Key monetised benefits accrue to relatively large companies redomiciling to the UK. Such benefits arise from a transitional period that ensures companies benefit from an extended period of time to convert to UK GAAP or IAS. This will ensure companies can avoid the additional costs associated with rapid adjustment to UK accounting standards, such as fees for external expertise. A case study approach was used to estimate the likely impact on a typical company.

Other key non-monetised benefits by 'main affected groups'

Other key non-monetised benefits may include the benefit to end-users of accounts from having a longer period of time in which to become accustomed to information reported under a new accounting regime.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

We have taken a cautious approach to estimating all figures for costs and benefits based on a case study and international experience. The aggregate benefits to the UK economy would be sensitive to the annual inflow of companies relocating to the UK from US and Japan.

We assume our case study is representative of a larger sample of companies who are likely to benefit from these regulations. This case is consistent with broader estimates set our later in the IA.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	**Benefits:** 1.1	**Net:** 1.1	Yes	OUT

Evidence Base (for summary sheets)

1. Note: International Accounting Standards (IAS) are set by the International Financial Reporting Council and also known as IFRS. These two terms: IAS and IFRS are interchangeable.

Problem under consideration

2. Companies that are incorporated in the UK prepare their financial statements using UK Generally Accepted Accounting Principles (UK GAAP) set by the Financial Reporting Council Ltd or International Accounting Standards (IAS) which are set by the International Financial Reporting Standards Foundation (IFRS). The aim is to ensure consistency in the presentation of accounts so that users (particularly shareholders) can analyse and compare information.

3. Companies may use other accounting systems before relocating their headquarters to the UK and change their accounting system to UK GAAP or IFRS. There are significant costs (see Table 1 on page 9) incurred when changing from a third-country GAAP to UK GAAP or IAS regardless of the time frame for conversion and these costs will not be reduced by this regulation.

4. When a parent company relocates and incorporates in the UK, it will aim to file its first set of financial accounts at Companies House in UK-GAAP or IFRS within 18 months. A complex company operating in a complex sector that operates in a high number of countries will find converting its accounts costly in such a short timeframe. This regulation aims to reduce these costs by allowing an additional period of time to undertake this exercise.

5. Additional costs will arise if the company converts to UK accounting principles in an accelerated time frame. These include the premium associated with hiring external accounting resource and/or costs associated with hiring and training additional internal resource. These would not have otherwise been incurred under a more lenient conversion period.

Rationale for intervention

6. These regulations support the UK Government's policy of encouraging inward assessment which brings productivity, competition and innovation benefits to the UK economy (see wider benefits section at end of IA for more information). It also supports the UK Government's commitment to reducing regulation as a way to promote growth, innovation and social action.

7. The regulations ensure an explicit transition period allowing a company incorporating in the UK that is listed in a Japanese or US stock exchange but not listed in a European member state to continue preparing its group financial statements using US or Japanese GAAP for a period of three years following incorporation.

8. These regulations should provide cost savings for companies moving to the UK from the US or Japan and potentially reduces an obstacle to relocating a company to the UK.

Policy objective

9. These regulations are directed towards companies moving their head office to the UK; their effect is to ensure an explicit transition period to move their accounting principles to IAS or UK GAAP, in specified circumstances. The aim is to ensure additional time to convert accounts to IFRS or UK GAAP and reduce the costs involved with an 18-month transition which would require additional expensive external contracting.

10. The UK Government remains committed to ensuring consistency in the preparation of financial statements by UK-incorporated companies as consistency is important to the users of audited accounts.

11. Companies taking advantage of the transition to UK GAAP or IAS will be required to ensure their financial statements meet the UK's legal requirement to give a "true and fair view".

12. These regulations apply to group accounts for financial years ending on or before 31 December 2014.

13. Options considered

1. Introduce an explicit transition period for UK-incorporated companies that meet specified criteria to convert financial statements to IAS or UK GAAP from Japan and US (those countries whose accounting practices are deemed 'equivalent' to IFRS by the European Commission but whose practical differences would make an accelerated transition very costly).
2. Do nothing.
3. Introduce a transition period for UK-incorporated companies to convert to preparing financial statements to IAS or UK GAAP from any accounting principle.

Option 1 – Introducing a transition period.

14. Ensure that companies:

- incorporated in the UK;
- not listed on a EEA stock exchange;
- with securities registered in the United States of America or admitted to trading on Japanese stock exchanges
- who prepare their accounts approved by the following prescribed bodies:
  - US GAAP: Financial Accounting Standards Board - FASB (this is the US Board)
  - Japanese GAAP, which includes the Accounting Standards Board of Japan

can use the accounting principles authorised by the bodies prescribed in the Regulations for a specified period (three years) for their group accounts. The accounts must meet the UK and European statutory requirement to present a "true and fair" view of the company's accounts.

15. These Regulations create two prescribed bodies in addition to the Financial Reporting Council Ltd. These newly prescribed bodies have been given responsibility for the creation and maintenance of the Generally Accepted Accounting Principles by the relevant authorities in the US and Japan.

16. The US and Japan are two countries where the accounting standards have been deemed 'equivalent' to European requirements for the purposes of the Prospectus Directive and in which it is not necessarily open for parent companies to use IAS/IFRS. (China has been omitted from the scope of the Regulations, while it is not fully converged with IFRS, it is deemed extremely close). Adjustments may be required to the relevant third party GAAP accounts to ensure that those accounts give a 'true and fair' view as required by UK law.

Equivalence of Accounting Principles – An Explanation

17. A significant proportion of the UK's accounting rules are based on European requirements which are set out in the Accounting Directives. Accounting standards are key in a range of associated areas including the Transparency and Prospectus Directives. The European Commission has considered equivalence in accounting standards for the purposes of the latter two Directives.

18. To be considered "equivalent", the Commission has concluded that the Generally Accepted Accounting Principles of a third country may be considered equivalent to IAS/IFRS. The financial statements drawn up in accordance with their GAAP principles must allow investors to make decisions about:

- Liabilities;
- financial position;
- profit and losses; and
- prospects of the issuer

19. Those GAAP principles must allow investors to make decisions about the acquisition, retention or disposal of securities of an issuer.

20. As of 1 January 2012, the accounting principles of 5 countries (Canada, China, Japan, South Korea and the U.S.) are equivalent for the Transparency and Prospectus Directive purposes. However, Canada and South Korea allow companies to use IAS and Chinese GAAP is considered to be extremely close to IAS. As companies from these countries are already allowed to use IAS (or in the case of China, the accounting principles are extremely close to IAS), they should not have to change their accounting practices to meet UK requirements to create accounts using UK GAAP or IAS, when they redomicile in the UK. Therefore, we do not envisage benefits in extending the Regulations to bodies responsible for issuing accounting standards in these three countries.

<u>Option 2 – Do nothing.</u>

21. Companies that incorporate in the UK from other countries will continue to change their accounting practices to UK GAAP or IAS from their first accounting period following incorporation in the UK.

22. When a company incorporates in the UK it files its accounts using UK GAAP or IAS. In the best-case scenario, the company will have 18 months to begin preparing its accounts. A company newly incorporated in the UK would normally have up to 18-month financial year for their first filing (instead of the usual 12-month period) as well as an additional 6 months to submit its first accounts. In practice, companies with listings on the Japanese and US stock exchanges would have a commitment to continue to file accounts annually. Therefore, they would not be able to take advantage of the additional 6 – month period provided for new registrations in the UK.

<u>Option 3 – Ensure a transition period for UK-incorporated companies to convert to preparing financial statements to IAS or UK GAAP from any accounting principle</u>

23. The UK government has accepted that there are benefits to companies if they are relocating to the UK from outside the EU, in being granted a specified period of time to change their accounting principles to UK GAAP or IAS. Therefore, it was necessary to consider whether this concession should be extended to all third country GAAPs. Those countries not deemed "equivalent" by the EU have not reached a specified standard which will cause difficulties to the users of accounts.

24. The purpose of having consistency in accounting standards is so shareholders and investor groups are able to analyse and compare the financial statements of companies that they have invested in or may invest in the future. A consistent approach in accounting principles allows analysis and comparison. It is necessary to minimise the need for users of audited accounts to be conversant in multiple accounting principles. Therefore, ensuring that a wide variety of accounting principles can be used by UK-registered companies during their transition period would not be in the public interest.

25. Therefore BIS concluded that the measure should not be extended wider that the GAAP principles of those countries deemed equivalent to IAS by the European Commission. This ensures an appropriate standard of financial reporting and reflects the needs of the users of accounts to compare and analyse financial information.

Estimating the number of companies to benefit from our preferred option - regulations set out in option 1

26. We have been unable to estimate the number of companies that would benefit from these regulations. Ernst and Young European Investment Monitor data lists 1320 US companies and 164 Japanese companies that have located a business operation in the UK during the period 2007 to 2011. However, this does not provide sufficient information to show which of these companies incorporated their <u>headquarters</u> in the UK nor is sufficient information available to determine whether they met the requirements set out in the regulations, i.e. not listed in a European Member State but registered in the U.S. or listed on a Japanese stock exchange. Of those, fewer would consider the savings to be sufficiently significant to consider adopting the transition period.

27. This is further complicated by the probability that only large, complex companies would opt in to take advantage of these regulations. In addition, considering the commercial sensitivity surrounding a

decision to redomicile to a third country, we do not have access to this information. We considered whether further research could be done to drill down the 1484 companies that relocated to the UK, but the level of detail required to determine whether these companies had met the various conditions within the regulations would be disproportionate.

28. Our stakeholder consultation indicated that while few companies would benefit from these regulations, those that did would be economically significant. The commercial sensitivity associated with the decision to relocate headquarters means we are unlikely to be able to gain a reliable indication of which companies are planning to relocate to the UK. In addition, these companies may not currently have a significant operation in the UK, which increases the difficulty in gaining sound information. We deem this process to be too speculative.

29. Given the difficulty in predicting take up of the regulation by companies for the reasons outlined above, it was decided to take a case study approach. This was deemed the most appropriate approach because it would enable us to gain reliable data from a company that had responded to our consultation and provided detailed information.

30. We approached two companies with relevant experience of moving to the UK from the US to assist in calculating the costs and benefits of this policy. The first company has recently moved its head quarters from the US to the UK and has made the change from US GAAP to IAS. The second company has recently decided to make the same move and may be in the position to benefit from the regulations.

31. We are not able to estimate the number of companies that will choose to move from the US or Japan to incorporate to the UK that will (1) fit the criteria set out in the regulations and (2) be large and complex enough to consider the transitional period to be beneficial. Until a company announces that it is going to move its HQ to the UK, this information is treated as commercially sensitive.

32. When determining costs and benefits, it is important to note that these regulations are enabling and there is no compulsion for companies to take advantage of the concessions. Companies will self-select to use these provisions only if they believe the benefits are significant.

Costs and benefits

Option 1 -Introduce a transition period where specified third country GAAPs can be used

Costs

33. Costs in familiarisation of the law will be minimal. Companies will need to consider the following issues when considering whether a company is eligible:

1. Is the company incorporated in the UK?
2. Is the company listed in an EEA state? If it is, it will not be able to take advantage of this concession.
3. Are the company's securities registered in the US or admitted to trading on Japanese stock exchanges?
4. Is the third country GAAP under consideration implemented by a prescribed body listed in the Accounting Standards (Prescribed Bodies) (United States and Japan) Regulations 2012? It will only be able to take advantage of the transition period if it is.
5. Will significant savings be made by taking advantage of the transition period to use UK GAAP or IAS for its group accounts?

34. There are a limited number of companies that will meet the conditions set out at 2 and 3 above. In our view, this regulation will only provide financial benefits to companies intending to redomicile to the UK from the US or Japan, who require additional time to convert their accounting practices to IAS or UK GAAP.

35. It is clear that these are short, simple regulations that will be of interest to a small number of companies, we concluded the costs would not be material. This is particularly the case as consideration whether to take advantage of these regulations would form part of the wider, more complex exercise of deciding whether to convert accounts to IAS or UK-GAAP. These regulations merely provide an additional option to consider during the exercise. Therefore, we have not monetised costs for familiarisation.

36. Consideration was given to whether there would be new costs for investor organisations that would have to analyse accounts that use alternative accounting principles to UK GAAP or IAS. In effect, a company that takes advantage of the transition period will continue to prepare their accounts using US or Japanese GAAP, which they did before incorporation in the UK. As the UK-based investor groups would have received previous accounts in US or Japanese GAAP, there will not be any new costs in receiving them in this same form for an additional three years.

37. We recognise that UK investor companies would prefer to receive accounts in UK GAAP or IFRS because they would be simpler to analyse and we recognise their will be a loss of benefit due to inconsistency. We consider that the small number of companies that are expected to opt in to benefit from these regulations, make this cost immaterial. This conclusion is supported by the absence of concern raised by the investor groups that were directly contacted during the consultation.

<u>Option 2 - Do nothing</u>.

38. This will introduce no new costs or benefits to companies. The costs occurred in accelerated conversion to IAS or UK GAAP for companies relocating to the UK will remain – this is expected to currently range somewhere between £3m and $8.5m for the types of large, complex multinationals that are anticipated to benefit the most from the policy proposal.

<u>Option 3. Ensure a transition period for UK-incorporated companies to convert to preparing financial statements to IAS or UK GAAP from any accounting principle</u>

39. As we have concluded the policy reasons for not implementing this option are strong, we consider it disproportionate to determine the costs and benefits of this.

Benefits

40. As mentioned above (see section on estimating number of companies) it is unreasonable for us to estimate the population of companies that will take advantage of this proposal, though there is a limited population that would be able to benefit (given the criteria set out in above). We are aware of one company that is in the process of relocating its headquarters to the UK and would be able to benefit from the reduced costs associated with the proposal under option 1. Whilst this is a minimum population of beneficiary companies, we need to make an assumption about the degree of future take up.

41. The Republic of Ireland introduced similar legislation in December 2009 and since then, 2 large complex companies, Accenture and Willis, have redomiciled to Ireland and taken advantage of Irish legislation to prepare accounts under GAAP. However, it would be prudent to estimate that take-up would be low given that the policy is a net benefit as a whole. We assume as a best estimate the same take-up rate of one company per year despite the fact the UK's larger economy may attract a larger inflow. Adjusting for the larger size of the UK economy produces our high-end estimate. Our calculations are explained in detail below.

42. Case study - model Company: We have taken a company within a complex sector with a $10bn turnover on its consolidated accounts, which operates in 120 countries as a model to calculate the benefits. This reflects one of the companies that provided us with information regarding costs and benefits of these regulations. This company has recently decided to move to the UK and has indicated its intent to take advantage of these regulations. Therefore, we consider this to be an extremely strong example when calculating costs and benefits.

<u>43. All the estimates for costs were sourced from the company moving to the UK</u>. We consider the estimates to be a reasonable reflection of the costs incurred by the model company but would not consider it to reflect smaller, less complex companies which we would not expect to be significantly affected by the policy proposal.

44. It has been suggested that only large companies with high levels of complexity would gain substantial benefits from these regulations and, as they apply to the group accounts, the expectation is that companies that would be interested in gaining these benefits would operate in a significant number of countries. Therefore, we consider our model company to be representative of the type of company that would take advantage of these regulations.

45. There are three elements in calculating the benefits of these regulations, these are:

- The costs associated with converting accounts to IAS to a normal timetable

- The additional costs associated with converting accounts to IAS to an accelerated timetable; and
- The adjustments to the accounts required to provide the statutory requirement for accounts to give a true and fair view.

Costs of converting accounts to IAS

46. There are two sources that estimate the costs conversion from US GAAP to IAS. The Securities Exchange Committee (SEC) in the US and the Institute of Chartered Accountants of England and Wales (ICAEW).

47. For a number of years, the SEC has been considering whether to allow the use of IAS for US-listed companies. In 2008, it examined the costs of converting from US GAAP to IAS and issued guidance ((p117 of http://www.sec.gov/rules/proposed/2008/33-8982.pdf.). This guidance estimated the cost of IAS implementation to be between 0.125% and 0.13% of a company's revenue. Therefore, if we apply these percentages to our model US company, with a consolidated revenue of $10 billion, the SEC would estimate convergence to IAS to cost between $12.5million to $13 million.

48. The Chartered Accountants in England and Wales estimated that the cost of IAS implementation to be 0.05% for companies with more than €5 billion of revenue. Applying this test to the same model would result in costs of $5 million. Taking the SEC's and ICAEW's estimations, we expect implementation of IFRS for our model company to cost between $5 million and $13 million, should the company not have to to convert to UK accounting principles within 18 months. The assumption is that the $5 million to $13 million range refers to conversion to IAS under a 3-year timetable.

49. The SEC made its estimation a part of its on-going consideration whether it should allow the use of IAS in the US. The ICAEW was also estimating for the purposes of calculating possible US sign-up to IFRS. Should the US decide to mandate IFRS, it is likely to allow a number of years to converge (certainly more than 3 years). Therefore, our example of considering a 3-year period to converge does not necessarily reflect the ICAEW or SEC timetable but instead reflects the period that has been suggested by stakeholders to be a reasonable period of time to make the transition from US GAAP to IAS.

50. These costs will be accrued by any company that redomiciles to the UK from a third country and will not be reduced by these regulations. The purpose of estimating the costs of convergence by the SEC and ICAEW was to determine the costs that US business would be exposed to, should the US require listed companies to use IAS. It is a reasonable assumption that the US authorities would give US business a significant period to make that conversion should they introduce IAS.

51. Regardless of the time period allowed for transition to UK accounting principles, it is recognised that companies will nevertheless have to undergo a costly adjustment process. However, additional costs would be accrued should it prove necessary to accelerate convergence to IAS within 18 months. For example, a shorter period for adjustment renders the process more costly due to the potential need to hire relatively expensive external accounting capacity to enable the company to convert within the prescribed time period. While this represents a cost to the business which would have otherwise not been incurred under a more lenient time frame for adjustment, it needs to be offset against the reduction in internal effort that would have had to be expended at a later date if the time frame for adjustment were longer. The cost calculations which follow below adopt this methodology in order to arrive at a "net cost" figure for the additional cost of an accelerated time frame.

52. Cost savings from allowing an extended period of adjustment are therefore generated by reduced reliance on costly external accounting resource. However, as an alternative to hiring external resource, the company could also expand its internal capacity. This would also involve fixed costs of recruitment and training, thereby raising the costs of conversion under an accelerated time table. In order to produce a range of estimates, the calculations below also account for this option.

Table 1

53. We have been informed that the steps in Table 1 would apply if convergence needs to be accelerated from 2 to 3 years to 15 to 18 months. This 18 month deadline corresponds with the current situation; a company who moves to the UK should begin preparing annual accounts using IAS or UK GAAP from its first statutory filing date. If the company moved on to the UK on the first day of its new financial year will have that 12-month period that the accounts will cover plus the 6 month period allowed for statutory filing to convert to IFRS or UK GAAP.

54. The information in the table is displayed as follows. The left column of the table shows the steps involved assuming an adjustment period of 2-3 years, which is the proposed policy. The right column shows how the process changes when the conversion period is 18 months.

Table 1: Conversion Process under Proposed and Current Regimes

Steps	Proposed Regime	Current Regime
1	Exercise to determine differences in policy between 3rd country GAAP and IAS (3-5 months) 50% external accounting resource 50% internal accounting	Exercise to determine differences in policy between 3rd country GAAP and IAS. Then determine most appropriate choice of approach – where IAS allows a choice. (This is step 1 & 2 of the normal timetable). 80% external resource and 20% internal resource. Figures at end of table only include additional costs.
2	Determine most appropriate choice of approach – there are a number of IAS requirements which requires a choice of approach to be made (3-5 months)	
3	Implement new policies and complete relevant reporting across the Group. Each subsidiary will be required to produce IAS accounts. (9-12 months) 100% internal resource	Rollout of IAS policies including training and process documentation. 100% external resources – seen by companies as majority of additional costs.
4	Complete consolidation exercise for the corporate accounts – this may involve procurement of new software etc. (3 months)	Systems change and additional costs to third party providers to comply with IFRS.
5	Complete consolidated corporate audit (3 months).	

Table 1

Cost workings

55. The following estimates are the additional costs associated with the conversion of accounting principles to IAS within the 18-month period as provided by our model company and form part of the same case study.

56. In order to convert within the accelerated (18 month) time frame, the company would require 800 hours of external accounting resource in step 3 for each of the 20 largest countries within the Group (by revenue). At an average bill rate of $400 per hour[1], this would result in a total cost of $6.4 million. However, the employment of external accounting resource reduces the amount of internal resource that would have otherwise been needed to complete the transition process. Assuming the same level of efficiency for internal and external resource, and an average cost of internal resource equal to $100 per

[1] As estimated by the model company in its communications with BIS.

hour, the net cost of accelerated conversion for the 20 largest countries in which the Group operates is therefore ($400 - $100) x 800 x 20 = $4.8m.

57. Similar reasoning applies for the remaining 100 smaller countries of the Group. 200 hours of external accounting resource would be incurred in step 3 for each of the remaining 100 countries. At an average bill rate of $400 per hour, this would result in a total cost of $8 million. Offsetting this against the 200 hours at a cost of $100 per hour of internal resource that would not need to be employed for the purpose of conversion gives a net cost of accelerated conversion equal to $6m in total for the 100 countries.

58. The additional time cost for all 120 countries for the remaining steps is estimated by our model company at $1million, which breaks down into 2500 hours at $400 an hour. This therefore represents a net cost increase of ($400 - $100) x 2500 = $0.75m.

59. Therefore, based on information provided to BIS by industry, it is estimated that converting accounts to IAS within 18 months will cost an additional **$11.55 million,** It then follows that this would be the amount saved were the government's proposals to be implemented. Our case study company have informed us that their preferred option is to contract the necessary external accounting expertise so they consider this figure to be a reasonable estimation.

60. Implementation could be carried out in a number of ways and so a range of benefits is provided. We requested that the model company provide information to calculate the costs of the 18-month timetable using internal staff to undertake the convergence. The model company advised that should time permit to hire and train internal resources rather than use more costly external resources, the number of additional hours set out in the 18-month timetable above would need to increase by approximately 30%. The average cost of these employees would be $100 per hour, which assumes a level of knowledge and efficiency that would be provided by using external accountants.

61. In step 3, for the largest 20 countries of the Group, the additional time cost of hiring labour is 800 hours x 30% = 240 hours. Assuming an average bill of $100 an hour, this would result in a total cost of $0.48 million.

62. For each of the remaining 100 countries within the Group, the additional time requirement is 0.3 x 200 = 60 hours of internal accounting resource. Assuming an average bill of $100 an hour, this would result in a total cost of $0.6 million

63. Taking the additional time for the remaining steps, which was estimated by the model company in the earlier calculations to cost $1million, before dividing by $400 to calculate the hours estimated to be 2500 hours. As suggested by the model company, taking 30% of those hours and multiplying by the average wage of $100/hour gives an additional cost of $75,000.

64. Therefore, the lower end of the scale of costs accrued under the 18-month timetable using 100% internal resources is **$1.155 million**.

Explanation of "true and fair" and requirement to make adjustments to accounts

65. The concession of a transition period is granted on the condition that the accounts a true and fair view of the state of affairs at the end of the financial year. This means an adjustment to the accounts may be required in order to make the company eligible to continue to use their 3rd country GAAP.

66. The relationship between the legal requirement to provide a true and fair view and accounting standards has been considered in detail in various opinions. The most recent view was provided by Michael Moore QC in 2008. One of his key conclusions was that the preparation of accounts is not a mechanical process where compliance with accounting standards will automatically ensure that those statements show a true and fair view.

67. In November 2011, the Financial Reporting Council issued a circular concerning the approach to true and fair view, which says that:

(a) the professional judgement applied to ensure that the accounts give a true and fair view is all important;

(b) true and fair is not something that is merely a separate add on to accounting standards; and

(c) the FRC expects preparers, those charged with governance and auditors to always stand back and ensure that the accounts as a whole give a true and fair view.

68. This means, regardless of the accounting principles used to prepare accounts, there is an additional step required to ensure that a "true and fair view" is provided. It is reasonable to conclude that accountants will be more familiar in reconciling accounts using IFRS or UK GAAP to the "true and fair" requirement than they would be using other accounting principles. Therefore the financial benefits associated with allowing the transition period should be reduced to allow for the reconciliation to take place.

69. We consulted the company that is in the process of moving to the UK for estimates of the costs of adjustment required to achieve the "true and fair" level of assurance required under UK law. We were informed that it should not be a significant amount and estimate it to be between $250,000 to $500,000.

70. Any company using US or Japanese GAAP will also incur additional costs to ensure that Companies House and other UK disclosure requirements are met. These costs are expected to be approximately $500,000.

Bringing it together to calculate benefits

71. To calculate the scale of savings to be made:

	Top end of scale	Lower end of scale
Additional costs for conversion to accelerated timetable	$11,550,000	$1,155,000
- adjustment for true and fair	(-$250,000)	(-$500,000)
- adjustment for Companies House and other regulatory requirements	(-$500,000)	(-$500,000)
Total	$10.8 million **£6.84million**	$.0.155 million **£0.1million**

Table 2

72. Based on information provided by the company, we estimate savings of $10.8m to $0.155million **(£6.84million to £0.1million**)

73. Therefore, the benefits that these regulations provide are the costs that a company will save by not having to follow the accelerated timetable for conversion of accounts to IFRS. These savings are estimated to be on a scale between £0.1 million and £6.84 million.

Sensitivity Analysis of Net Benefits of Policy

74. The figures determined in the previous section pertain to one company. The justification for adopting our case study approach was the uncertainty regarding the likely population of companies that would be affected by the policy proposals. In this section we characterise a plausible range for the benefits of the policy proposal based on assumptions regarding likely take-up rates. A cautious approach is adopted in order to avoid overstating the impact of the policy given that it is considered to be a net benefit to business.

75. Three scenarios are considered to obtain a low, high and best estimate of the net benefits of the policy. The details for each are as follows.

(i). *Low estimate.* For the lower end estimate, it is assumed that only one company will be affected over the entire life of the policy, which is assumed to be three years given the sunset clause mentioned above. To establish a conservative lower bound, it is assumed that the lower end of the range of cost savings presented in the previous section applies, so that the total net present value of the policy is £0.1m.

(ii). *High estimate.* For the purposes of the upper end of the range, an inflow of one company per year is assumed, which is based on the similar experience of Ireland. Clearly, there are substantial differences between the UK and Ireland which could lead to different policy impacts in

each country. One immediate difference is the relative size of the two economies; according to Eurostat data, the UK economy was roughly 10 times larger than Ireland's in 2011. However, there are various other factors which affect a company's decision to redomicile that would need consideration, such as differences in tax structures, which would make such an analysis complicated.

In order to maintain a conservative approach to quantifying the policy's impact, it is assumed that only one company per year benefits from the policy, which is comparable to the Irish experience and therefore is likely to understate the impact in the UK. In terms of cost savings per company, the high end of the range of estimates from the previous section is taken.

Under these assumptions, the net benefit to the UK over the life of the policy would be;

1 company per year x 3 years x £6.84m cost savings

which gives a net present value of £19.83m.

(iii). *Best estimate.*

The best estimate of the policy impact strikes a middle ground between (i) and (ii). In particular, it is assumed that one company benefits from the policy over the entire 3 year period. This reflects the lower end assumption in (i) in order to remain conservative. However, it is assumed that the cost saving accruing to the company is £3.47m, which is the average of the range established by our case study (£0.1m to £6.84m). This gives a business net present value of £3.47m over the life of the policy.

Option 3. Introduce a transition period for UK-incorporated companies to convert to preparing financial statements to IAS or UK GAAP from any accounting principle

76. The costs and benefits for this option have not been included due to the strong policy reasons for not implementing this option.

Consultation

77. Considering the specialist nature of this issue, the decision was taken to undertake a targeted consultation with interested parties. Letters were sent to:

- Law Society (Company Law Committee);
- Law Society of Scotland (Company Law and Insolvency Committee);
- City of London Law Society (Company Law Committee);
- Bar Council;
- Consultancy Committee of Accounting Bodies (CCAB);
- Association of British Insurers (ABI);
- National Association of Pension funds (NAPF);
- Confederation of British Industry (CBI);
- Institute of Chartered Secretaries and Administrators (ICSA);
- Financial Services Authority (FSA);
- UK Listing Authority (UKLA);
- Investment Management Association (IMA);
- HM Treasury; and
- Financial Reporting Council

78. Seven responses were received. A general theme that ran through the majority of responses was that while few companies would benefit from these regulations, those companies that did would be economically significant. The regulations would ameliorate a potential barrier to relocating a company to the UK and despite the temporary nature of a transition period; it would lead to benefits to the wider economy.

79. The CCAB distributed the consultation letter to its members, which includes accounting firms and the accounting bodies. One of those accounting bodies, the Institute of Chartered Accountants in England and Wales (ICAEW) were not supportive of this measure pointing out that UK companies already have a choice of accounting principles – UK GAAP and IFRS. However, they explicitly recognised that the regulations aim to support a specific economic objective that would have a wider economic benefit and accepted that a "limited scope, temporary measure may be acceptable as a practical expedient".

80. The ICAEW made the case that the transition should be limited to group accounts only and not be extended to individual accounts (ie the accounts of the parent company of the group). Extension of the scheme would result in tax, capital maintenance problems and there is a risk that a number of UK subsidiaries to overseas groups would stop using UK GAAP or IAS. This would make it difficult for users of audited accounts to undertake the necessary comparison of companies and analysis. We have taken the ICAEW's concerns on board and restricted the regulations to group accounts only.

81. There was some disagreement among respondents as to the time length that the transition period should last. The timescales suggested ranged from 2 years to 5. Taking on board, the additional costs caused by following an 18 month timetable provided by our model company (outlined earlier in this document), the regulations will allow a transition period of 3 years for a company to convert to IAS or UK GAAP and a sunset clause applies to the regulation so that it cannot be used beyond 2015 This should provide an opportunity for more countries to sign up to IAS removing the need for these regulations.

Risks and assumptions;

82. We have taken a cautious approach to estimating all figures for costs and benefits. Specifically, we have only explicitly monetised benefits for 1 case study rather than calculating an aggregate figure for the UK economy. As described earlier, this is because of the specific nature of the policy, which makes the estimation of take-up rates costly and speculative.

83. It would be difficult to estimate the annual flow of companies into the UK that would benefit from the policy proposal. Nevertheless, based on stakeholder consultation, we would expect large and complex companies to be the typical beneficiaries of the proposal as opposed to smaller companies for whom conversion costs are less onerous. Therefore, even though our case study focuses on a specific company, we consider it to be representative of the typical beneficiary.

Direct costs and benefits to business calculations (following OIOO methodology);

84. These regulations will provide benefits to certain companies who may opt to take advantage of the transition period and there are minimal costs involved. There will be an impact on business so the regulations fall under One In One Out. Using the OIOO methodology, we estimate an annual net benefit to business (i.e. "out") of £1.1 million . This figure represents the equivalent annual net benefit to business which is computed in accordance with OIOO methodology based on an estimated business net present value of £3.47m.

Wider impacts

85. The UK supports the development of International Accounting Standards and is aware of the need to minimise actions that would undermine the US and Japan reaching full convergence with these. Therefore the transitional period is limited to three years

86. The UK government supports inward investment as it introduces:

- Positive direct and indirect productivity effects on UK firms – through exposure to new ideas and technologies; organisational skills and knowledge spillovers.

- Competition effects – as foreign firms compete with domestic ones, for resources such as labour; as well as in markets for products and services.
- Innovation effects – expanding markets provide additional incentives for firms to innovate. In addition, multinationals tend to have the highest research and development intensity, but only in their home country.

87. The UK government is committed to reducing regulation as a way to promote growth, innovation and social action.

88. While, we do not consider that the introduction of these regulations alone would attract companies to redomicile in the UK, it is reasonable to assume that these regulations would be perceived as an additional benefit within the wider mix of benefits that companies consider when choosing to redomicile.

Summary and preferred option with description of implementation plan.

89. The Accounting Standards (Prescribed Bodies) (United States of America and Japan) Regulations 2012 ensure a transition period for UK-incorporated companies that meet specified criteria. By providing that certain US and Japanese bodies are prescribed bodies for a period of 3 years, the use of accounting standards issued by those bodies (US and Japanese GAAP) in Companies Act group accounts for certain companies will be accepted. Companies will be effectively granted a three-year transition period to convert their financial statements to IAS or UK GAAP from Japanese or US GAAP. During this three year period, these companies will be able to file accounts using Japanese or US GAAP at Companies House.

90. A post-implementation review will be undertaken by 31 December 2014.