



**Simon Witney**

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## Introduction

This is my first Bulletin since taking over the Chairmanship of the BVCA Legal & Technical Committee, and I would like to extend my sincere thanks, and those of the Committee and the BVCA, to my predecessor, Sue Woodman, who acted as Chair of the Committee for five years. Sue did a sterling job and the British private equity and venture capital industry owes her a debt of gratitude.

A great deal has happened in the last year to keep the Committee fully occupied, and in this Bulletin we review some of the key legal developments which have been on our agenda.

First, Mark Soundy considers the potential impact of important proposals to amend the UK Takeover Code which are currently under consideration. A draft of the Takeover Panel's proposed new rules is expected imminently, and the working group that we have formed – which Mark is leading – will co-ordinate the BVCA's response to that consultation. >>>

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No responsibility can be accepted by the BVCA, the Legal & Technical Committee or contributors for action taken or not taken as a result of information contained in this Bulletin. Specific advice should always be taken in each situation.

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Graeme Stening  
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The BVCA worked with the EVCA and other associations in Europe to prepare a combined response to the SEC's draft rules mandated by the Dodd Frank Act. Many US-based private equity and venture capital houses will have to register with the SEC for the first time in July, and some non-US firms will also have to do so. As Stephanie Biggs explains in her article, the likely outcome for non-US firms is not as bad as feared - and many (although not all) will probably be able to benefit from an exemption from full registration (although the final form of the rules is still awaited).

A joint working group with the BVCA Regulatory Committee has considered the impact of the UK's Bribery Act on the sector, and has made representations to the Ministry of Justice on its proposed guidance. Although there has been a slight delay to the Act's implementation, and further guidance is expected imminently, Alison Hampton's article explains where we are in the process, and what private equity firms should be doing to prepare for the Act when it does come into force.

As many of you will know we have been concerned by the impact of the Carbon Reduction Commitment Regulations on private equity firms, particularly because of the uncertainty in determining the extent of a "group" when a private equity fund owns a number of separate businesses. The government has announced important changes to the system, and a delay to the implementation of the second phase of the scheme, and is now discussing ways that it might simplify the scheme. Roger Fink is leading the Committee's efforts to explain the particular issues that arise in a private equity context and his article sets out the latest position. Roger and Blair Thompson have also contributed an article on a recent case involving Babcock and Brown which provides important lessons on preserving privilege in a funds context, Roger then looks at the impact on private equity firms of the impending abolition of the default retirement age in the UK.

Graham Phillips and Blair Thompson review the Accounting Standards Board's proposals for the future of financial reporting in the UK and Republic of Ireland that will, if adopted, fundamentally change corporate reporting for UK entities which are not currently applying EU-adopted IFRS. Finally, I have included a short piece summarising the likely change to accounting rules for limited partnerships this year, which will affect many private equity fund structures, and will require many to prepare and file statutory accounts for their fund partnerships for the first time.

I hope that you find these articles to be helpful. In an effort to communicate more effectively with our members, we have also started to publish our meeting agendas and minutes on the BVCA website and we are exploring other ways to keep you informed about our work, so watch this space! If, in the meantime, you have feedback or suggestions, please do not hesitate to get in touch.

We have had some changes to the Committee recently. I want to welcome four new members: Christopher Bown from Freshfields, Godfrey Davis from CDC, John Heard of Abingworth and Philip Price from Candover - and to thank those who have recently stood down: Elizabeth Ward from Linklaters, Gavin Brown from Slaughter & May and Martin Williams from SPARK Ventures. They, and the other members of the Committee, have given many hours of their time and worked very hard to support the BVCA at a time when our industry faces a continuing and unprecedented onslaught of new regulation. 

## Proposed changes to the UK Takeover code

The UK Takeover Panel is currently considering changes to the Takeover Code, which could have a significant impact on private equity activity. This update provides information on the activity currently being undertaken by the BVCA and the impact the Panel's proposals could have on the industry.

On 21 October 2010, the Takeover Panel published a statement in response to its wide-ranging consultation following the Kraft takeover of Cadbury. In its statement, the Panel rejected some of the more controversial options outlined in its consultation paper, but also proposed further changes which did not form part of its original consultation. A number of the Panel's proposals could have a significant impact on private equity bids; in particular:

- All potential bidders should be named in the first announcement which identifies that a takeover approach has been made. At present, bidders are rarely identified in such announcements.
- After being publicly identified, a potential bidder will be allowed only four weeks to make an announcement of a firm intention to make an offer, or to make a binding announcement that it does not intend to make an offer. This will not apply, however, to situations where the target has initiated a formal process for its sale by means of a public auction. The four week period may be extended by the Panel following a joint application by the bidder and the target.
- Except where the target has initiated a formal process for its sale by means of a public auction, inducement (break) fees and all deal protection measures (such as non-solicitation of other bidders) will be prohibited.
- Each bidder and the target will be required to disclose the aggregate amount of its offer-related fees, and the fees of advisers (including financial advisers, corporate brokers, accountants, lawyers and public relations advisers) must be disclosed separately by category of adviser.


- Greater details of the bidder's financial position and of its financing of the offer will need to be disclosed than at present.

The Panel is expected shortly to publish one or more public consultation papers setting out its proposed amendments in full.

The BVCA's Legal & Technical Committee set up a working group to co-ordinate the BVCA's response to the proposals. This working group includes private equity professionals and legal advisers and, among other things, has:

- Published a briefing note to BVCA members explaining the proposed amendments.
- Prepared a template letter to aid individual member firms in making their own views known to the Panel.
- Commissioned a survey of BVCA members of their views on the proposed changes. A summary of the results can be viewed [http://admin.bvca.co.uk/library/documents/RN8\\_-\\_Takeover\\_Code\\_changes.pdf](http://admin.bvca.co.uk/library/documents/RN8_-_Takeover_Code_changes.pdf).
- Engaged with the Takeover Panel to highlight the particular concerns of BVCA members in relation to certain of these proposals.

The working group will also take the lead in drafting the BVCA's formal response to the Panel's final proposals, once published.

If you have any questions or comments for the working group in this regard, please do not hesitate to contact its chairman: Mark Soundy at [mark.soundy@weil.com](mailto:mark.soundy@weil.com) or +44 20 7903 1377. 



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## SEC Registration Update

The implementation of the U.S. Dodd-Frank Act has been something of a roller coaster ride for non-U.S. private equity firms. When the Dodd-Frank Act was passed in July 2010, it seemed that any non-U.S. firm with total commitments of US\$25 million or more from U.S. investors would be required to register with the SEC by 21 July 2011. Then, in November 2010, the SEC published draft rules indicating that it will interpret the “mid-sized private fund advisers” exemption in a way favourable to non-U.S. firms, exempting all firms with no U.S. office from full registration.

The position will become certain only when the SEC publishes its final rules. These are expected no earlier than April, which leaves relatively little preparation time for any firm unexpectedly required to register, as reflected in the timeline below.

At present, it seems that non-U.S. firms will likely fall into one of four broad categories under the proposed rules:

### Firms exempt under the foreign private advisers exemption

These firms have no place of business in the U.S., fewer than 15 U.S. investors (and other U.S. clients, if any) and less than US\$25m of commitments in aggregate attributable to U.S. investors (and other U.S. clients, if any).

Firms that are able to rely on the Foreign Private Advisers Exemption would not be required to register with the SEC and would have no other filing or compliance obligations.

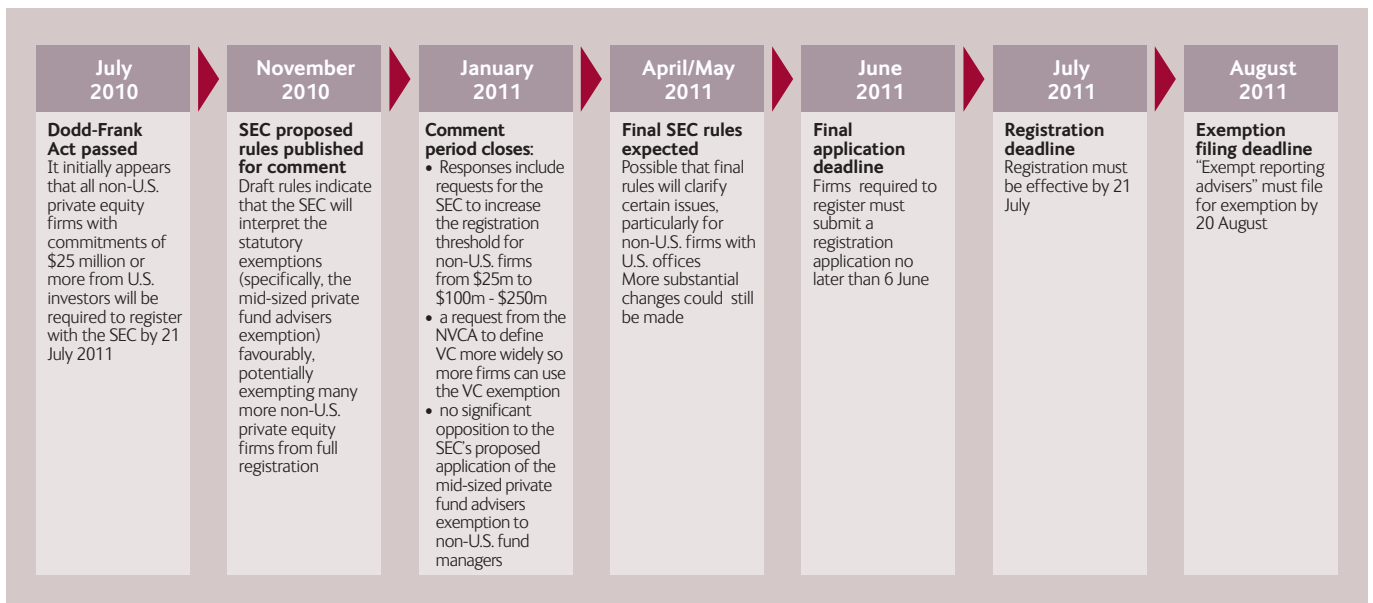
A number of consultation respondents asked the SEC to exercise its discretion to increase the US\$25

million threshold to between US\$100 million and US\$250 million. There is no indication at present that the SEC intends to do so. However, firms with less than US\$100 million of commitments from U.S. investors may want to wait and see whether the SEC’s final rules increase the scope of this exemption before preparing to file for the mid-sized private fund advisers exemption or, if necessary, full registration.

### Firms exempt under the mid-sized private fund advisers exemption

These firms advise only private funds (broadly meaning funds that have been offered to U.S. investors on a private placement basis) and have fund assets under management (AUM) in the U.S. of less than US\$150 million.

Where a firm has no U.S. office or place of business, the SEC’s proposed rules indicate that the firm will be treated as having no assets under management in the U.S. Therefore, the firm will be exempt from registration. However, the position will not become certain until the final SEC rules are published.



If the firm has a U.S. office, the availability of the exemption will depend on the extent to which (if at all) the firm's AUM will be treated as managed "in the U.S.," and it is recommended that firms seek individual advice on this point.

Firms relying on this exemption will be "Exempt Reporting Advisers" (ERAs). Although exempt from SEC registration, ERAs are required to claim exemption from registration by filing a Form ADV Part 1 with the SEC by 20 August 2011. This filing must be updated annually and whenever a material change occurs, and is publicly available on the SEC website.

**Firms exempt under the venture capital fund advisers exemption**

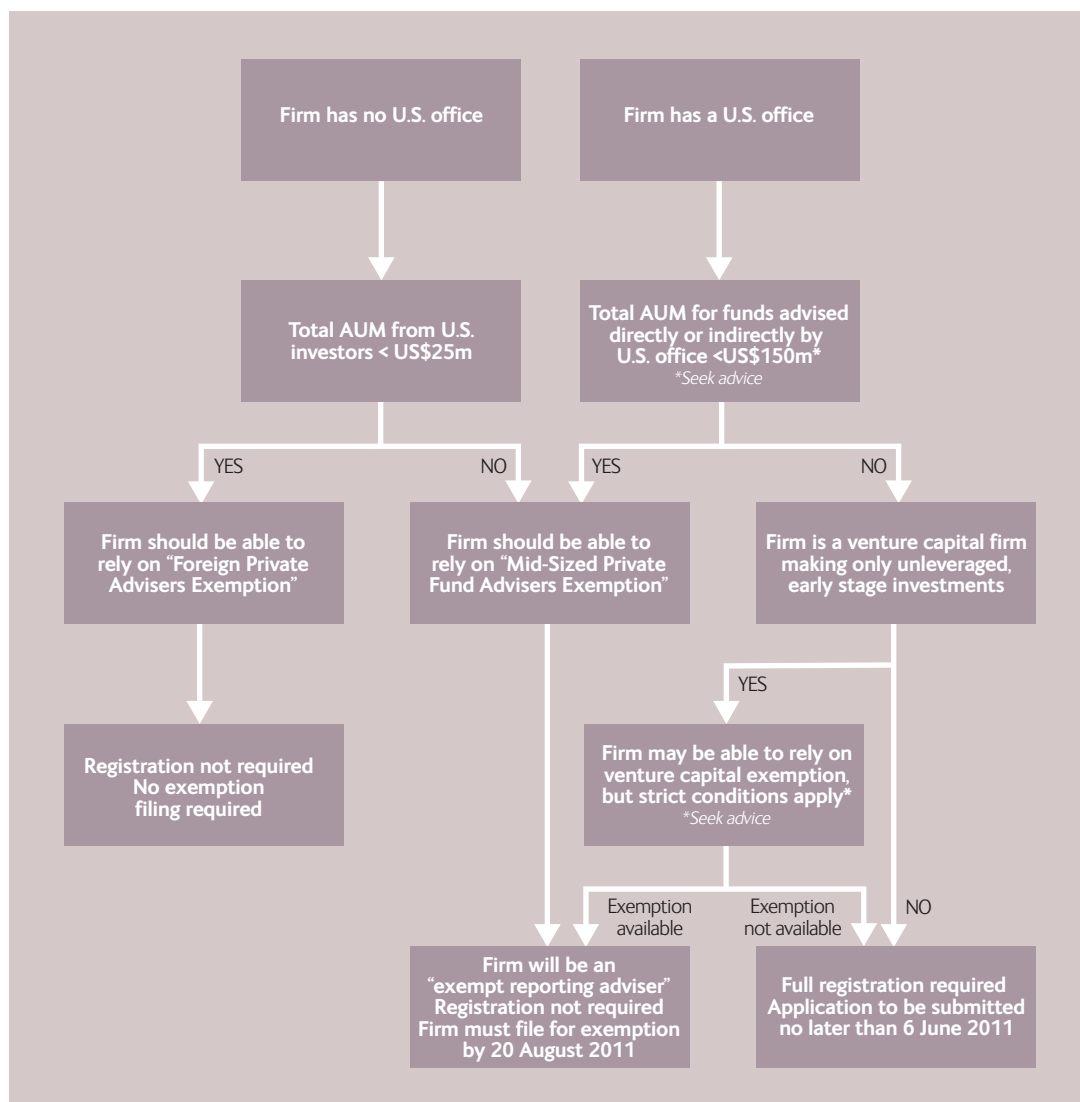
If a firm is not eligible for the mid-sized private fund advisers exemption but makes only early stage, unleveraged investments, it may be possible for the firm to rely on the venture capital fund advisers exemption.

The SEC's proposed definition of 'venture capital fund' is narrow, so even firms that would ordinarily be considered as 'venture firms' may well struggle to satisfy all the necessary conditions. However, it is possible that the final definition may be more favourable. Firms relying on this exemption will also be ERAs and so will also need to claim exemption by filing Form ADV Part 1 with the SEC.

**Firms required to register with the SEC**

A number of firms will not be eligible for any exemption and will be required to register with the SEC. Any such firm should start preparing now, as the application must be filed no later than 6 June 2011 (and ideally by mid-May) and the firm must have a full SEC compliance programme in place at the time registration becomes effective.

The chart below is a high level summary of the exemptions, their availability, and certain related timing requirements.



There may be changes to the final position following comments made to the SEC during the consultation process. In particular, changes may arise for certain non US-based firms concerning the SEC's Jurisdiction outside the US.



**Alison Hampton**  
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## The UK Bribery Act 2010 – Practical points for private equity houses

“An Act to make provisions about offences relating to bribery; and for connected purposes” – the UK Bribery Act 2010 has the distinction of being the last passed by the outgoing Labour administration. It was intended to provide a codification of the existing laws on bribery, and to introduce two new offences.

The Act was originally due to come into force in April 2011, but its implementation has been delayed. As can be seen from the summary of the provisions in the box overleaf, the new offence created by the Act, which makes commercial organisations liable for any bribery committed on their behalf by their “associated persons”, has a defence where the organisation has “adequate procedures” in place. The Act required the Ministry of Justice to publish guidance on what constituted “adequate procedures” – quite properly identifying the need to give companies of all sizes a clear steer on what they need to do to comply with a potentially far-ranging piece of legislation. Draft guidance for consultation was published in November 2010, which gives a high level overview of the sorts of steps which organisations should take, but which lacked detailed or specific guidance on a number of knotty issues raised by the legislation. Final guidance was expected in January following a number of responses to the consultation (including one from the BVCA). Due to the number of issues raised by the consultation process, the publication of the revised guidance has been significantly delayed, and the Government has announced that the Act will not be brought into force until three months after the publication of the final guidance, in order to allow organisations sufficient time to digest it and to implement policies in the light of it.

### What are the implications for private equity houses?

As commercial organisations (regardless of their structure as LLPs, companies, or partnerships), private equity managers, advisers and funds will need to ensure that in relation to their own business, they have adequate policies and procedures in place to prevent bribery taking place by any entity which performs services on their behalf.

Unless a portfolio company actually provides services on behalf of the fund, the general partner, or the manager (for example, as a placement agent, or a consultancy in which an investment has been made), the mere fact of the investment relationship, whether or not a majority holding, will not make the fund, general partner, manager or adviser liable for the acts of the portfolio company. However, houses should be considering what policies portfolio companies should adopt, given that there may

be representatives appointed to their boards. In addition, any failure by the portfolio company itself to have adequate procedures in place may lead to its being liable under the Act, with a consequential loss in value of the investment, and may further cause reputational damage for itself and the private equity house.

### Guidance from the Ministry of Justice

The draft guidance from the Ministry of Justice suggests six principles to be followed by all organisations in developing their policies – principles intended to be non-prescriptive and flexible allowing organisations the ability to tailor their approach in proportion to the different challenges each organisation faces. The six principles are:

#### 1. Clear, practical and proportionate procedures

The different elements of the policy (risk, diligence, training and so forth) should be expressed clearly and practically, and be proportionate to the risks faced by each organisation.

#### 2. Top level commitment

A commitment to preventing bribery should come from the top level within an organisation, who should foster a culture in which bribery is never acceptable.

#### 3. Risk assessment

Organisations should periodically assess the potential bribery risks by persons associated with it, in a manner which is informed and documented.

#### 4. Due diligence

Due diligence is both part of the risk assessment procedure and a mitigating tool. It should be conducted in a proportionate manner, using a risk-based approach.

#### 5. Communication (including training)

Bribery prevention policies should be embedded and understood throughout the organisation with appropriate training.

#### 6. Monitoring and review

Bribery prevention procedures should be monitored and reviewed periodically.

## So what should private equity houses be doing in practice?

In putting together a policy for bribery prevention private equity houses should consider the following:

- Identify **an individual** who will be responsible for considering and developing an anti-corruption policy. This should be someone with sufficient seniority who will report in to the topmost governance committee.
- Identify **all relevant existing relationships** where there is a potential risk of bribery, and consider appropriate preventative actions – such as explicit statements in engagement letters that there is no authority to make such payments on behalf of the company, reviews of the third party's own anti-corruption policy and compliance with it, considering in particular the jurisdictions and sectors in which such third parties operate and any increased risk of corruption which these indicate (Transparency International's "Corruption Perception Index" may be helpful here).
- Review the **adequacy of existing portfolio companies' anti-corruption policies**.
- Ensure that **corruption risks are assessed as part of the investment process**, with enhanced due diligence taking place where jurisdictions or sectors indicate an increased risk of corruption, or where there are concerns about third parties involved in the deal or with the target.
- Consider whether to **require all portfolio companies to adopt robust bribery prevention policies**, and the extent to which these should be reviewed by the private equity house on a regular basis. A portfolio company policy should cover the same areas as a private equity house policy, although tailored to the particular risks faced by that company given its sector and the countries in which it operates.
- **Review staff policies on gifts, entertainment and political and charitable donations** to ensure there are clear guidelines on what is acceptable and what is not permitted. Although there has been much publicity over the "death of corporate hospitality", the Act does not outlaw it. Instead, hospitality should not be lavish or excessive. The Guidance provides examples of what is and is not acceptable. For example, flights and accommodation to permit a foreign official to meet with an organisation to review its safety standards, together with some reasonable hospitality, would be unlikely to raise concerns – if it included a partner, that partner should pay for their own travel. A five star holiday for the same official with his partner, unconnected to a demonstration of the organisation's services, is far more likely to raise an inference of bribery.

Some areas to consider in particular for a gifts and entertainment policy:


- a. The appropriate limits for both disclosure and approval of gifts and entertainment – perhaps to capture all gifts, and all entertainment above what is considered to be a normal threshold.
- b. Due to the extra sensitivity around public officials, perhaps include a tighter approval process for any gifts or donations, or provisions of hospitality, to a public official.
- c. Consider a review of the frequency of entertaining individuals from a particular organisation.
- d. Whether all hospitality should be accompanied by someone from the host organisation, rather than being a gift.
- e. Whether it would be appropriate to prohibit accepting or giving flights and accommodation costs where hospitality is offered.

This is an area where careful thought should be given both to what is normal and acceptable for the relevant industry, and what can be framed in a clear way for staff to understand and implement.

- Include **specific guidance on facilitation payments** (small bribes paid to facilitate routine Government action). Houses should note that, unlike the US foreign bribery law, there is no exemption for such payments. This is deliberate, and in line with the OECD Anti-Bribery Recommendation which asks adhering countries to discourage companies from making such payments. However, it is recognised that such payments are endemic in some parts of the world, and that organisations on their own cannot change local culture. The Guidance makes clear that any payments made to avoid physical injury, loss of life or liberty are not intended to be criminalised by the Act. Furthermore, prosecutors will consider the public interest before taking action against individuals or organisations who have made facilitation payments. Accordingly, bribery prevention policies should require individuals to strive to avoid facilitation payments, but in circumstances where they are unavoidable, provide a reporting mechanism so that the organisation can monitor the size and scale of the issue as it relates to its business and raise it with representative bodies or other appropriate organisations.
- **Communicate** the new policy across the organisation and to identified "associated persons". Consider what sort of training may be required to ensure that all staff, particularly those whose role makes them more likely to be exposed to bribery risk, understand the policy.

- **Provide a means to measure the effectiveness of the policy**, and what form of report should be made on a regular basis to the top governance level.
- **Set out the actions to be taken if an incidence of bribery is suspected.**
- The **whistle blowing policy** should expressly cover reports relating to suspected bribery.

### When does this need to happen?

At the time of writing, the final guidance has not yet been published, and the Government has said that the Act will come into force three months from the date of publication. The Bribery Act is not retrospective – only actions committed after the date it comes into force will be caught. However, houses and portfolio companies should be considering the impact of it upon their business now, and taking the steps outlined above in order to be ready. 

## Summary of the Bribery Act 2010

Under the Act, offences are committed if:

- a person offers, promises or gives a financial or other advantage to another person, with the intention of inducing any person to perform a relevant function or activity improperly, or to reward the improper performance of a relevant function or activity;
- a person offers, promises or gives a financial or other advantage to another person and knows or believes that the acceptance of the advantage would constitute the improper performance of a relevant function or activity.

In both cases above offences are committed by the person doing the offering or promising, and the person receiving the financial or other advantage. “Relevant function or activity” means any function “of a public nature”, or any activity connected with a business, in the course of a person’s employment, or performed on behalf of a body of persons; in each case where the activity is expected to be performed in good faith, or impartially, or where the person is in a position of trust.

The Act expressly makes it clear that the function or activity is covered even if it is performed outside the UK and has no connection with the UK – if either of the persons involved are connected with the UK, the offence will have been committed. In relation to actions outside the UK, when considering whether there has been a breach, the Act requires that local customs and practices are disregarded unless expressly permitted or required by applicable written law.

The new offences introduced by the Act are:

- bribing a foreign public official with the intention of influencing them in order to obtain or retain a business advantage. “Foreign public official” is widely defined so that it captures those in international organisations, and any individual in a legislative or administrative position who exercises a public function for any country, public agency or public enterprise.
- for commercial organisations only, an offence is committed where a person “associated with” a company bribes another person, intending to obtain or retain a business advantage. For this offence only, it is a defence if a company can show that it has adequate procedures in place designed to prevent such conduct. “Persons associated with” a company is also broadly defined as any person who performs services for or on behalf of a company. This means that it may capture employees, agents, subsidiaries, distributors, joint venture partners – to be determined by the relevant circumstances of the services which are performed and not simply by reference to the relationship (although there is a presumption that employees will be performing services).

The penalty for breach of the Bribery Act is: for individuals, imprisonment for a term up to ten years, and / or an unlimited fine; and for companies, an unlimited fine.

## Update on CRC Energy Efficiency Scheme

There have been three recent developments on the CRC Energy Efficiency Scheme:

1. In the Coalition Spending Review in October, it was announced that revenue from the sale of allowances (which according to the Government will total £1 billion by 2014/15) will not be recycled. In effect, the requirement to buy allowances will operate as a carbon tax. It was also announced that the first sale of allowances (for 2011/12 emissions) will now take place in 2012 rather than 2011.
2. The Department of Energy & Climate Change ("DECC") then published a consultation on proposals to:
  - extend the introductory phase of the Scheme by 12 months to March 2014;
  - postpone the requirement to register for the second phase from 2011 to 2013; and
  - remove the requirement for organisations not required to register under the scheme to make information disclosures.In responding to the proposals, the BVCA also made a number of recommendations to simplify the Scheme and a link to the BVCA's response follows [http://admin.bvca.co.uk/library/documents/BVCA\\_Response\\_to\\_CRC\\_Consultation.pdf](http://admin.bvca.co.uk/library/documents/BVCA_Response_to_CRC_Consultation.pdf).
3. In January DECC published a series of discussion papers which, DECC made clear, were not a

statement of Government policy but aimed to "stimulate an informal dialogue between Government and participants about the simplification of the ... Scheme". Of particular interest to BVCA members is the paper which considers various options for simplifying the organisational rules. These options are:

- any group member to have the right to disaggregate (possibly subject to minimum use of electricity);
- look at each group company individually to assess qualification for the Scheme but allow for it to be grouped together with other companies if it wishes;
- determine who belongs to a group in accordance with accounting rules;
- specifically address assets held in a fiduciary capacity;
- remove the requirement for organisations to group together with their overseas parent and allow a UK based group member to be nominated as the highest parent;
- simplify the whole area of significant group undertakings.

The deadline for comments on the papers is 11 March and the BVCA will be sending a further submission essentially repeating the views expressed in January. A link to DECC's papers follows: [http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/lc\\_uk/crc/crc.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/crc/crc.aspx) 



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## Legal Professional Privilege – the Babcock & Brown Global Partners Fund case


This case (2010 EWHC 2176 Ch) shows the difficulties of establishing legal professional privilege is so far as it relates to advice provided to a limited partnership fund.

The facts in brief are:

1. A fund was set up by Babcock & Brown (“B&B”) with a B&B subsidiary as the general partner (“B&B GP”). The limited partners included external investors as well as some further B&B entities. The fund was principally established to co-invest alongside B&B in certain opportunities identified by B&B.
2. In 2008 disputes arose between B&B and the fund about how to deal with some of their joint investments. These disputes were unable to be settled and, as part of wider actions between the limited partners and B&B, in late 2009 the limited partners removed B&B GP as the general partner of the fund and appointed a new (non B&B) general partner.
3. As part of the process of removing the B&B GP and handing over the books and records of the fund to the new general partner, the issue arose as to (i) whether or not certain legal advice which had been provided prior to the removal was confidential and/or privileged, and therefore (ii) whether or not it could be handed over to the new general partner and disclosed to other members of B&B.

The Court held that:

- although the solicitors had received their instructions from B&B GP, B&B GP were acting in their capacity as general partner of the fund and as such the clients of the solicitors included each of the partners in the fund (including the limited partners). There could therefore be no legal professional privilege in the advice as against any of the partners, even those limited partners with whom B&B were in dispute;
- under general principles, a direct shareholder of a company is entitled to see all documents obtained by the company in the course of the administration of its affairs B&B; therefore the advice could be provided to B&B GP’s direct shareholder. However these general principles did not extend further up the B&B group and therefore the advice could not be disclosed to indirect B&B shareholders.

The case highlights the care which needs to be taken in ensuring that the appropriate engagement letters are in place making it clear exactly to whom external advisers are providing advice. When advice is being provided to the general partner or manager of a fund in their capacity as general partner or manager then the limited partners in that fund will have the right to be provided with a copy of such advice, notwithstanding that their views may not always be aligned with those of the general partner or manager. 

## Abolition of the Default Retirement Age in the UK

New legislation abolishing the Default Retirement Age of 65 (“DRA”) will come into effect on 1 October this year. This means that it will no longer be a fair dismissal reason to require an employee to retire at this age. It will also be discriminatory (unless there is justification) not to continue to employ someone, or not to recruit someone, because they are 65.

Employers will have the option of either:

- not having a Compulsory Retirement Age (“CRA”), in which case a dismissal would have to fall within one of the existing five potentially fair reasons (capability, conduct, illegality, redundancy or some other substantial reason) to be fair; or
- retaining a CRA (or different CRAs for different roles) but the relevant CRA would have to be justified on a number of grounds specified in the legislation. In practice, the justification of a CRA is likely to be difficult.

Employers will need to check their CRA rules. They will also need to check their documentation such as bonus schemes, share option schemes and investment documents for “Good Leaver/Bad Leaver” provisions. Generally speaking:

- if someone is classified as a Good Leaver by reference to “the employer’s normal retirement age” (or something similarly generic) no change will need to be made following the abolition of the DRA;
- however, if someone is classified as a Good Leaver by reference to reaching the age of 65 then there will be a problem because compulsory retirement at that age will be unlawful.

Draft regulations have recently been published setting out the transitional arrangements. These are:

- the DRA is being phased out over a 12 month transitional period (not 6 as previously understood)

running to 5 April 2012 (not 30 September this year as previously understood);

- the key change under the Regulations is that employers will be able to give a minimum of 6 up to a maximum of 12 months notice of retirement, with the last date for issuing the full 12 months notice being 5 April this year;
- during the transitional period, notifications of retirement can be given, and retirements that have already begun can continue to completion if:
  - a notification (whether full length or short notice) of impending retirement was issued by the employer prior to 5 April;
  - the employee has reached the age of 65 by 30 September this year;
  - the date of retirement falls on or before 5 April 2012 unless the employee exercises the right to request not to retire which, if agreed to, could extend the retirement date to 5 October 2012; and
  - the DRA statutory retirement procedure is followed correctly.

The new goal post is that a person must have reached 65 (or have reached the normal retirement age if higher) by 30 September this year if they are to be retired under the DRA.

Employers may want to act promptly to identify who they might wish to retire using that procedure, or instead simply disregard retirement age as a reason for dismissal, recruitment or different treatment. **■**



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## ASB proposals will fundamentally change UK GAAP

On 29th October 2010 the ASB issued its proposals for the future of financial reporting in the UK and Republic of Ireland that will, if adopted, fundamentally change corporate reporting for UK entities which are not currently applying EU-adopted IFRS.

The proposals result from several years of consultation by the ASB in order to develop an IFRS-based framework for UK GAAP. The proposals include two draft financial reporting standards:

- Application of Financial Reporting Requirements (setting out the tier system and application guidance on the definition of public accountability); and
- The Financial Reporting Standard for Medium-sized Entities (based on the IASB's IFRS for SMEs, and applicable to entities which are not small and not publicly accountable).

If the proposed financial reporting standards are adopted, thereby replacing current UK GAAP, they will impact far more businesses in the UK than that experienced following the introduction of IFRS in 2005.

### The proposals

The ASB proposes a three-tier reporting framework based on public accountability rather than the size of entity. The proposals include reduced disclosure concessions for qualifying subsidiaries and also allow an entity to "trade up" so a subsidiary of a listed group can apply Tier 1 S if it wishes.

#### TIER 1

This will include quoted groups who will continue to report under IFRS as adopted by the EU. It will also include other companies that are publicly accountable. Broadly, "publicly accountable" applies to entities where their debt is traded on public markets or if they hold deposits or manage other people's money; certain small financial institutions would be exempt (eg credit unions).

#### TIER 2

Tier 2 entities are those that will report under a new standard "FRS for medium-sized entities" (FRSME), based on IFRS for SME's, which would include all entities without public accountability and some small publicly accountable entities that are prudentially regulated.

#### TIER 3

This tier includes all the small entities without public accountability and the accounting regime will be the "FRS for smaller entities" (FRSSE). The FRSSE will, as now, be used by small companies with 50 or fewer staff, turnover of less than £6.5 million and assets of less than £3.26 million.

There is a reduced disclosure framework for qualified subsidiary entities giving exemptions from certain disclosure requirements to those subsidiaries that prepare financial statements either in accordance with EU-adopted IFRS or the FRSME.

### Scope and effect

Any entity reporting under UK GAAP will be affected and will have to decide which of the new Tiers to apply. In addition, subsidiary entities will need to consider whether they wish to take advantage of the reduced disclosure options in Tier 1 and Tier 2.

When deciding which Tier to apply, an entity's management should not only consider the accounting issues when thinking about whether to apply IFRS or FRSME but also other consequences, e.g. tax, ability to pay dividends, data and systems requirements and their corporate structures.

- Tax – there may be tax advantages for entities that move to full IFRS or adopt the standards early rather than waiting until 2013. Early adoption may either

<p><b>TIER 1</b> Publicly accountable entities Apply EU-adopted IFRS</p>	<p><b>TIER 2</b> All other entities Apply UK-adopted IFRS for SME</p>	<p><b>TIER 3</b> Small entities eligible to apply FRSSE Apply FRSSE</p>
<p>Subsidiaries <b>(Tier 1S)</b> Reduced disclosures</p>	<p>Subsidiaries <b>(Tier 2S)</b> Reduced disclosures</p>	

slow down the rate at which income is recognised or speed up the recognition of cost, thereby deferring cash tax payments. However, there may be an opposite effect where cash tax payments are accelerated. This will need to be factored in to the business planning around adoption.

- Distributable reserves – changing the accounting framework may reduce distributable reserves, e.g. from the allocation of pension deficits to individual subsidiaries or recording derivatives at fair value.
- Systems requirements – new information requirements for measurement and disclosure will be more onerous under both core IFRS and FRSME.
- Group structure – significant manager groups with many subsidiaries may wish to take the opportunity to simplify their structure prior to transition in order to reduce the time and cost of converting to IFRS; it might also cut the costs associated with tagging other accounts for iXBRL purposes.

### Managers

Managers that are part of a larger Group will need to discuss with their parent the most appropriate form of accounts; many should be able to take advantage of the reduced disclosure regime as a qualifying subsidiary and may wish to use their Group accounting framework (e.g. full IFRS) so as to only report one set of numbers internally and externally, with reduced disclosures. Many stand alone manager entities are formed as limited liability partnerships and prepare their accounts in accordance with the Statement of Recommended Practice – Accounting by Limited Liability Partnerships. The proposals confirm that the SORP will be retained and such entities will probably prepare their accounts under Tier 2.

### Funds

Many Funds prepare their limited partnership accounts on a modified GAAP basis as set out in the Limited Partnership Agreement. This might not be so easy in the future with the advent of the Alternative Investment Fund Managers Directive (AIFMD); once the AIFMD level two process is complete, there may be a requirement to produce fund accounts in accordance with a recognised financial reporting framework. For most European funds this is likely to be either IFRS or US GAAP or the adapted equivalent of IFRS. Assuming such Funds are not considered publically accountable (see below), then for UK limited partnerships, FRSME would seem to be appropriate. With a fair wind, the proposals before the IASB for a “carve out” for investment entities from the current provisions in the exposure draft of the new IFRS consolidation standard (ED 10) will have been implemented by the time any provisions of the AIFMD

come into effect. The potential modifications to ED 10 would allow investment entities to account for their investee entities on a “one line” fair value basis rather than consider consolidation or equity accounting. Assuming the investment entity accounting amendments are incorporated into the IFRS for SMEs and hence into the FRSME, Funds would be able to comply with the IFRS framework which would give a similar presentation to the use of the investment company rules within US GAAP.

### Publicly Accountable

The proposals need refinement to the definition of publicly accountable. The definition of publicly accountable includes entities whose primary business is to “hold assets in a fiduciary capacity for a broad group of outsiders”. Investment entities such as pension funds, mutual funds or investment companies would seem to fit the definition of publicly accountable. Generally, such investment entities would recognise the assets they hold on their balance sheets.

However, the manager of such an investment entity does not typically recognise “assets held in a fiduciary capacity” on its balance sheet. There is potential for confusion here because the FSA regulatory rules permit asset managers to “hold” client assets as client money or custody assets. Private equity managers would not typically hold client money but some hold title to a Fund’s assets in a custody capacity.

Similarly, most private equity funds do not have a requirement to prepare statutory accounts; the preparation of accounts is determined by the Limited Partnership Agreement which is a private agreement between the general partner and the limited partner investors. The limited partner investors are considered sophisticated investors rather than a “broad group of outsiders”. Whilst such funds maybe of public interest, it does not appear that they should be publicly accountable.

In its response to the ASB, the BVCA will emphasise that it does not consider either private equity manager entities or the fund entities they manage fit the definition of publicly accountable.

### Implementation date

It is not certain that the exposure draft proposals will be implemented: there is a dissenting view from one of the members of the ASB and there is concern from some that the costs outweigh the benefits arising from the changes. However, at present the ASB hope to issue final standards in Q3 2011. The proposal is that the standards are expected to be effective for periods starting on or after 1st July 2013, although early adoption will be permitted.

The comment period ends on 30th April 2011. 



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## Accounting rules set to change for UK Limited Partnerships ...

The Government has re-confirmed its intention to amend the Partnerships (Accounts) Regulations 2008 (the “2008 Regulations”) governing the preparation and publication of accounts for UK partnerships.

Draft amendments to the 2008 Regulations were circulated by the Department for Business, Innovation & Skills (BIS) in a letter to stakeholders in April 2010. The proposed amendments are designed to remedy what the Government says is a technical defect in the UK legislation implementing the European Council Directive 90/605/EEC, and may require certain UK limited partnerships to prepare accounts and make these available to the public. The government’s present intention is to apply the amended regulations to financial years beginning on or after 6 April 2011 although that date has not yet been confirmed, and the commencement date could easily slip to October. Funds that are structured as UK limited partnerships should therefore review their structures and consider the impact of the proposed amendments to the 2008 Regulations.

If the 2008 Regulations are amended as intended it will be clear that a UK limited partnership whose sole general partner is a limited company (or a Scottish partnership, each of whose members is itself a limited company) will be a “qualifying partnership” for the purposes of the Regulations. Funds structured as UK limited partnerships (or managers that use such a partnership in their structure) will need to determine whether those partnerships are “qualifying partnerships” (“QPs”) under the revised rules.

QPs may be subject to three separate obligations as described below, but not all QPs are subject to each of these three obligations. QPs will therefore have to be examined individually to ascertain which obligations they will need to comply with.

The first obligation applies to all QPs, and requires the general partner of a QP to prepare annual accounts and a directors’ report for the QP and cause to be prepared an auditors’ report in respect of the QP, as if it were a company, in accordance with UK GAAP and the Companies Act 2006.

The second obligation applies only to a QP where none of the QP’s general partners are UK limited companies but the QP’s “head office” is in the UK, and its general partner is a limited company, unlimited company, partnership or comparable undertaking incorporated outside the UK (and not in another EU member state where the general partner is under a duty to file the accounts of the QP). Pursuant to this obligation, the general partner of a QP will have to make the accounts available at the partnership’s


“head office” for inspection. Note that Guernsey and Jersey (a common choice for the jurisdiction of a general partner) are not members of the EU. In deciding whether this obligation applies, it is necessary to determine where the partnership’s head office is located.

The third obligation only falls on QPs with a general partner that is a UK limited company. The general partner of such QP will have to file the accounts of the QP at Companies House in the UK, and the accounts then become available for inspection by the public.

There is an important exemption from these obligations for QPs whose accounts are “dealt with on a consolidated basis in group accounts” prepared by a partner (or its parent) which is established in the EU. “Dealt with on a consolidated basis” for this purpose means that accounts are prepared using full or proportional accounting, or the “equity method of accounting”.

Fund managers are advised to review their structures and where appropriate seek professional advice. Managers may particularly want to consider with their auditors whether the new rules would require them to produce consolidated accounts which include controlled portfolio companies. In some cases, it will be possible to make structural changes to mitigate the impact of the amended Regulations, but managers should also consider the revised rules in light of obligations that may apply following introduction of the Alternative Investment Fund Managers Directive in 2013.

### ... while more helpful reforms are put on hold

Meanwhile, BIS has shelved its plans to continue with a more general reform of UK limited partnership law, citing resource constraints. BIS (at the time known as BERR) had decided to proceed with a modular, staged approach to implementing various proposed reforms, after many years of lobbying by the BVCA, and the first step in this process was the implementation of the Legislative Reform (Limited Partnerships) Order 2009. This LRO dealt with, amongst other things, the conclusiveness of registration for limited partnerships, and was intended to be the first in a series of Legislative Reform Orders (“LROs”). Unfortunately, BIS has now announced that it will not continue the reform process for cost reasons. The BVCA will continue to press them to revive their proposals, which we believe would be helpful to UK based fund managers. 

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