



FINANCIAL  
REPORTING  
FACULTY

# BY ALL ACCOUNTS

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## A NEW DAWN FOR IFRS AND UK GAAP REPORTING

We talk to ASB Chairman Roger Marshall about the latest plans for the future of UK GAAP  
All the latest IFRS news as the IASB's major convergence projects move closer to completion

### PLUS...

- Views from around the world on the IASB's agenda consultation
- Simpler reporting proposed for the smallest UK businesses
- The UK's Companies House delays mandatory e-filing
- News from Singapore and Hong Kong
- FTSE companies join the faculty

## FINANCIAL REPORTING FACULTY

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### FROM THE CHAIRMAN

I'm delighted to welcome you to the fifth issue of the faculty's international journal, *By All Accounts*.

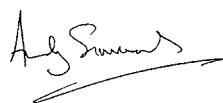
As another year draws to a close, it seems natural to look back at what has been achieved over the past 12 months. From a financial reporting perspective, 2011 was in many ways a year that promised so much but delivered so little. As we enter 2012, many long-standing questions remain unanswered. What does the future hold for UK GAAP? Will the US commit to adopting IFRS? Will the IASB ever complete its troublesome projects on leases, revenue recognition, financial instruments and insurance contracts?

We live in uncertain times. But the faculty is, as ever, here to help.

I'm pleased to report that the number of individuals taking out faculty membership has reached record levels during the year. A splendid result and one which reflects the commitment of the faculty staff to the highest standards and their innovative thinking, commercialism and grasp of the financial reporting agenda both in the UK and internationally. The Financial Reporting Faculty is a model for the rest of ICAEW and I am proud to remain associated with it as Chair.

Faculty growth has been bolstered by the launch of our brand new and highly successful corporate membership schemes for FTSE 100 and FTSE 250 companies. Our new corporate members – just like our thousands of individual members – will receive access to the full range of faculty benefits including access to eIFRS, exclusive standards trackers, an expanding range of factsheets and free access to our increasingly frequent and popular webinars. You can read more about this scheme – and meet some of our new corporate members – on page 22.

I trust you have found the Financial Reporting Faculty good value for money and will want to renew your membership in 2012. It looks like it's going to be a busy year for all of us involved in financial reporting!



### FROM THE FACULTY HEAD

This edition of the faculty journal returns to the ASB's plans for the future of UK GAAP. Their original proposals were met with a fair amount of opposition and the ASB are currently re-deliberating ahead of issuing revised proposals early in the New Year. In an exclusive interview, we talk to ASB Chairman Roger Marshall about how things are progressing.

IFRS is also very much at the forefront of our minds in this issue, as we reflect on the slew of recent new and revised standards, specifically looking at their practical implications and challenges that lie ahead. We also look forwards to the completion of the remaining projects on the IASB's current work plan and beyond that to the development of its future agenda. Whether the US decides to commit to IFRS or not, the next couple of years are likely to be very busy for IFRS reporters.

This issue also looks at many of the other current challenges facing faculty members, including a look at the proposals that may see introduction of cash accounting for the smallest UK entities and the on-going debate about narrative reporting.

I hope that you find this edition an interesting read. It carries not only contributions from authors in the UK but also from Singapore, Malaysia, Hong Kong, Australia and Dubai. As ever, your ideas for the next edition are very welcome. This will be accompanied by a special edition for our members in Cyprus.





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Recently we stumbled across a website offering an invaluable tool for accountants worldwide... introducing [www.universalsuspenseaccount.com](http://www.universalsuspenseaccount.com)

# BACK TO THE FUTURE?

When the faculty's Nigel Sleigh-Johnson and Eddy James met with the ASB's interim Chairman, Roger Marshall for *By All Accounts*, they found that the future is not what it used to be.



## THE REFORM OF UK GAAP: THE STORY SO FAR

It is now over a year since the ASB published its proposals in *The Future of Financial Reporting in the UK and the Republic of Ireland*. The plan was to replace the vast majority of existing UK GAAP with a new streamlined accounting standard known as the Financial Reporting Standard for Medium-sized Entities (FRSME).



The proposed FRSME was based on the IFRS for SMEs with very few modifications to the international standard. The guiding principle was that changes would only be made where this was necessary to comply with UK and EU law. There was, however, one notable exception to this rule: the ASB proposed replacing the whole of IFRS for SMEs' chapter on income taxes with the full text of IAS 12 *Income Taxes*.

The proposed FRSME was to apply to the vast majority of UK entities, apart from small entities that chose to continue to apply the FRSSE and those entities with public accountability, which would have to apply IFRS.

Roger Marshall recalls being appointed as the ASB's interim Chairman 'about a day after' the proposals were published. The former Chair of PwC's Global Audit Policy Board and its Global Corporate Reporting Task Force quickly discovered that the brave new world they promised was receiving – at best – a rather lukewarm reception in some areas.

## WHERE DO WE GO FROM HERE?

When we met Roger at the ASB's offices he told us that: 'The main concern for many businesses was the removal of options that currently exist under UK GAAP. Many of these options also exist under IFRS, but the urge to simplify meant that they were excluded from the IFRS for SMEs and therefore weren't included in the proposed FRSME. People were quite rightly asking why these options were being taken away.'

These concerns resulted in a major rethink at the ASB. Roger explained: 'We've changed our approach to amending the IFRS for SMEs. We will now permit accounting options that exist in current UK GAAP so long as in doing so we do nothing that conflicts with IFRS principles. So we have added various options back in. For example, we have decided to allow revaluations of fixed assets and capitalisation

of interest. We have recognised that if people do not want simplification there is little, if any, justification for removing a particular accounting treatment.'

**'We will now permit accounting options that exist in current UK GAAP so long as in doing so we do nothing that conflicts with IFRS principles.'**

The troublesome chapter on income taxes will not, after all, be replaced with the full text of IAS 12. Instead it will be replaced with what Roger describes as a 'timing difference plus' approach, which will be based on the principles of existing UK GAAP. However, some additional deferred tax will be required, for example on revaluations and business combinations. But Roger ventures that 'in 99% of cases the new UK GAAP will give you the same answer as under current IFRS'.

These are significant changes to the original proposals. In the future, UK GAAP may not be all that different to what we have today. It will be more compact and the language will be simplified to bring it broadly in line with the IFRS for SMEs... but it seems that most entities will find that they can continue to account for the vast majority of their transactions in the same way as they do today.

**'In the end we decided it wasn't our job to gold plate EU legislation by mandating IFRS for non-listed companies.'**

So what will be different in the not quite as brave as it used to be new world? Roger tells us that 'the biggest change will be in relation to financial instruments' and 'particularly hedging, where a trading company will have to recognise things on balance sheet for the first time'. He is perhaps a little coy when it comes to exactly what the new hedging rules will say, explaining that these will only be finalised 'once the IASB has completed its general hedge accounting project'. But this sounds a sensible approach as it will avoid a mismatch between the new UK GAAP and the soon to be issued IASB standard.

## **PUBLIC ACCOUNTABILITY**

Another major concern raised about the ASB's original proposals was the concept of public accountability and requirements which would have meant some unlisted UK entities – such as private banks, building societies, credit unions and insurance companies – would have had to apply IFRS even where this wasn't required under EU legislation. No longer! Roger explained: 'The definition of public accountability that we proposed was long, complex and not well understood. In the end we decided that it wasn't our job to gold plate EU legislation by mandating IFRS for non-listed companies. But, of course, if a regulator wants to require full IFRS, they can ask for it. It isn't the standard-setters job to do so!'

One implication of this decision is that some extra requirements will be added into the IFRS for SMEs. As Roger advised: 'Some companies, which under our previous proposals had public accountability, will continue to prepare their accounts in accordance with UK GAAP. But the IFRS for SMEs as issued by the IASB won't give them all the guidance they need. For example, they will want guidance on things such as earnings per share and segmental reporting, so we have references to full IFRS on these areas. And financial services companies will need to make disclosures about their financial instruments, so we have added a short chapter that is effectively a principles-based version of IFRS 7.'

## **PUBLIC BENEFIT ENTITIES**

Also included in the new UK standard will be additional guidance for public benefits entities (PBEs). The ASB had originally proposed a separate standard for such entities, but have now decided to include additional chapters within what will now be known as *The Financial Reporting Standard Applicable in the UK & Republic of Ireland*. Roger tells us that there have been some significant changes to the original proposals here too, particularly in relation to donated inventory. You can imagine the sigh of relief that will echo around charity shops up and down the country when they hear Roger explain that: 'The original proposals [which suggested all donated inventory must be valued at fair value] were not clear. We have fixed this problem now. If a valuable painting is donated to a charity then clearly it must be measured at fair value and recognised on the balance sheet. But if we are just talking about something like a box of books being handed over to a charity shop, this won't be necessary.'

Talking of PBEs, what does the future hold for the SORPs that are held in such high regard by the sector? Roger tells us that these will be retained but that: 'New SORPs will be needed as soon as the new UK GAAP becomes effective. But preliminary discussions with the SORP making bodies have

already begun. They will be preparing new SORPs by mid-2013.' He is confident that most PBEs, like most other entities, will find that their 'numbers won't change too much' when the new regime comes into effect.

**'A lot of people have been telling us that the whole process has taken long enough and that we just need to get on with it!'**

## **REDUCED DISCLOSURE FRAMEWORK**

The ASB's original exposure draft proposed introducing a reduced disclosure framework for subsidiary undertakings. Roger tells us that 'there was a lot of support' for these proposals and that they will be retained when the new exposure draft is published. Exemptions that will be available to qualifying entities include not producing a cash flow statement, reduced disclosures in relation to business combinations and reduced disclosures in relation to share-based payments. Disclosure exemptions will also be available to a parent entity which presents its accounts alongside the consolidated accounts.



## THE FUTURE ROLE OF THE ASB

Even though there will be many similarities to existing UK GAAP, Roger anticipates 'lots of questions on interpreting the new standard'. As such he sees that one of the ASB's future roles will be helping companies implement the UK standard. He talks of 'issuing practical questions and answers on commonly encountered problems' but ultimately he wants 'the 300 or so pages of the new standard to stand alone'. But interestingly, he adds that 'we won't have achieved our goal if you need a Big Six technical department to explain what the standard means.'

Of course it will be necessary to keep the new UK GAAP up to date for changes in IFRS. Roger tells us that: 'The intention is that it will be updated once every three years. The only exception will be for hedge accounting and impairment where we will incorporate the IASB's new standard before the new UK GAAP comes into force in 2014. The standards that come out of other on-going IASB projects – such as those on leasing and revenue recognition – can wait until the next update, say in 2017.'

There will also be the requirement to keep the new reduced disclosure framework up to date, as each new or updated IFRS is issued the ASB will need to consider how the IFRS requirements match up with UK Company Law and how disclosures can be reduced.

And finally, the ASB will continue to have 'an important role in influencing IFRS' in the future. They may find that they have an even bigger influence on the IFRS for SMEs. Roger explains: 'The take up of the IFRS for SMEs in the developed world is quite low. And in some countries where it has been adopted there have been significant carve outs. So in many ways what we are doing can be seen as the biggest field test yet for the IFRS for SMEs. If changes we have made work well here, they may well be taken up by the IASB in their next iteration of the IFRS for SMEs.'

## NEXT STEPS

Roger told us that: 'A new exposure draft will be published in early 2012. After a three-month comment period, the aim is to issue a new standard in the summer of 2012. The proposed effective date for the new UK GAAP is now periods beginning 1 January 2015, 18 months later than previously planned.'

Roger thinks this will give companies enough time to prepare for the change. He tells us: 'A lot of people have been telling us that this whole process has taken long enough and that we need to just get on with it! Our outreach activities to date suggest that most people are onside with the new version of UK GAAP. We have fixed many of their concerns. In fact, at one recent event, 96% of attendees said they agreed with our direction of travel. But ultimately we'll only find out what people think when we consult them a final time.'

## FINAL THOUGHTS

Despite the changes that have been made since the original proposals were published, the UK's new financial reporting regime will still be based primarily on the IFRS for SMEs. In Roger's words '80–90% of the content' will be drawn from the international standard. Nonetheless, reflecting on our conversation with Roger, we can't help feeling that the future is not what it used to be.

As a keen theatre goer, Roger is someone who is used to plots that take unexpected twists and turns. It is unlikely that 12 months ago that many would have predicted we'd be where we are today. It appears that many of the objections that were raised when the original exposure draft was issued have now been resolved meaning that not only will new UK GAAP look a lot more like existing UK GAAP than we'd ever expected, but all the entities that currently use it will also be able to carry on doing so. So it seems like a happy ending may be on the cards after all.

Plus ça change!



# CHARITY BEGINS AT HOME?

Bob Humphreys, Finance Director at Oxfam, shares his concerns about the ASB's proposals for public benefit entities and their potential impact on the UK charity sector.



Picture the scene. I'm in my favourite armchair, sipping a cool drink, relaxing and listening to music, when my wife instructs me to get ready to go out, as we're due to have dinner with our new neighbours. I want to be friendly, but I know it's going to be a difficult evening, as their English is poor, and we know they want to discuss with us their plans to uproot a lot of old trees at the end of their garden, which have been giving us some useful shade from the sun and wind.

What on earth has this to do with the proposed accounting changes for public benefit entities (PBE)? Well, my feelings about these latest developments are very similar to those I described above. A sincere wish to be friendly and co-operative, but my heart is not really in it; instead there is a feeling that I am being dragged unwillingly into something I don't want, or need.

The ASB has taken the view that UK GAAP should be updated to bring it more into line with IFRS. At the same time it has decided that it would be useful to address the inconsistent accounting requirements which undoubtedly exist within the various SORPs at present. Particular attention to PBE issues is necessary, as these are not addressed by the IASB in developing its standards. So far, so good. While I am very proud of, and happy with, the quality of accounting which the Charities SORP delivers, as the finance director for a major international non-governmental organisation, an internationally recognised standard for accounting by charities is high on my wish-list.

Nevertheless, I have some significant reservations on the proposals that the ASB published in March 2011 as FRED 45 *Financial Reporting Standard for Public Benefit Entities* (FRSPBE). Unfortunately:

- The proposals still do not deliver an internationally recognised standard for charity accounting (though I acknowledge that this is not the ASB's problem).
- The proposals introduce differences in measurement and recognition depending on which tier an organisation is in, which, as well as significantly increasing complexity, could reduce the credibility of the accounting profession in the eyes of the average reader of the accounts.

- The proposals are guided by a philosophical preference for 'value' rather than 'cost', for example in promoting the estimation of fair value for donated second-hand clothes.
- There has been no real attention paid to the costs of introducing these complex changes.

To expand on the penultimate point above, subjects such as valuation of donated goods and volunteer time have been thoroughly explored over several years in writing the current SORP, and sensible conclusions have been reached. Generally, if values are obtainable, and it is relevant to an understanding of the accounts, then those values should be booked, or sufficient information disclosed to assist the user. But the SORP recognises the inherent difficulties in obtaining relevant reliable valuations. The proposed FRSPBE ratchets up the pressure on preparers of accounts to measure more items at fair value – though happily it does preserve some flexibility in allowing a range of approaches to be taken to derive these values.

Our balance sheets are currently a hotchpotch – with items measured at cost, market value, outdated historical values or even at nil value where they are fully depreciated though still in use. And we are now proposing to add 'deemed value' of donated stock to that list. Oxfam's balance sheet shows no value placed on donated stock, which may amount to £3m or so, but then neither is the unrealised gain on property, which would be around £10m, in the accounts. To harmonise all these issues would require a complete re-think, and might take us back to current cost accounting and the late, much-maligned SSAP 16!

It is heartening to learn that the ASB has been re-deliberating its proposals and that a further exposure draft is proposed for early 2012, which I very much hope will address these points. In particular it is good to hear that the ASB appreciates the role and value of SORPs.

To conclude: I do appreciate the motives of the standard-setters, and applaud them for applying serious thought to the issue, but I fear that unless these issues are fully considered we shall be drawn inexorably down the road of increasing complexity and cost, with little to show for it in terms of overall usefulness and comparability of PBE accounts.



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# SIMPLER REPORTING FOR THE SMALLEST UK BUSINESSES?

Danielle Stewart, Partner at Baker Tilly, outlines the latest 'micro' entities proposals and ponders whether they really will make life simpler for the smallest UK businesses.



At the end of August 2011, the Department for Business, Innovation and Skills (BIS) released a discussion paper, jointly with the Financial Reporting Council (FRC), entitled *Simpler Reporting for the Smallest Businesses*, which proposed that there should be a review of the financial reporting regime governing the smallest ('micro') companies. The paper adopts micro company criteria proposed by the European Commission, as shown below:

**Micros are companies that do not exceed two of the following criteria:**

- net turnover of €500,000 (£440,000);
- balance sheet total of €250,000 (£220,000); and
- average number of employees of 10.

BIS estimates that some 1.3m companies would qualify under this definition. If unincorporated businesses were included then a further 3.5m enterprises would meet the same criteria. BIS gives an estimate of £250m to £400m per year of costs that could be saved in relation to the preparation of these businesses' accounts, but admits that this would be contingent on achieving similar reductions in reporting for tax purposes.

The new financial reporting regime suggested by the discussion paper would require micro companies to prepare the financial information set out below.

## TRADING STATEMENT

A simplified trading statement in place of the current profit and loss account, prepared on a cash basis, ignoring accruals, stock, changes in working capital or changes in values of fixed assets. To ensure reliability, it would be necessary to provide some guidance on how the statement would be prepared (either by legislation or by a new accounting standard).

## STATEMENT OF POSITION

A statement of position in place of the current balance sheet, which would include details of shareholders' funds, 'major assets' recorded at an unadjusted historical cost, cash, debtors, loans, and short and long-term creditors.

## ANNUAL RETURN

A simplified annual return, identifying the ultimate owners of the business and disclosing the basis on which the company asserts its entitlement to

micro company status, with the figures in the annual return being drawn from the two financial statements described above. The paper also says that micros might be required to file the annual return within 12 weeks of the end of the financial reporting period and/or that the reporting year might be standardised. No thought seems to have been given to the bottleneck this might cause for accountants; in fact, the thought that accountants would even be involved seems to have been dismissed (BIS have specifically said that there will be no requirement for independent review).

## TAX IMPLICATIONS

The Office of Tax Simplification (OTS) has also been consulting on proposals to simplify taxation for unincorporated businesses. Although the OTS paper does not consider the financial reporting requirements applicable to these businesses, the BIS discussion paper does ask for feedback on simplifying reporting requirements for unincorporated businesses, in order to feed into the OTS's work and stimulate debate about tax and reporting for small businesses generally.

## MY VIEWS...

I am not sure that BIS's proposals would actually simplify reporting for the smallest businesses at all! In order to reconcile shareholders' funds, surely companies will still need to maintain some form of accruals-based accounting records? Even if BIS passes legislation to exempt micros from the capital maintenance requirements of the Companies Act, it will be hard to run a trading business without accruals-based accounting information. Can businessmen really take good financial decisions based on cash alone, as is suggested in the discussion paper? Perhaps companies below the VAT limit can just about manage with cash-based accounts, but businesses without debtors, who wish to reclaim VAT on purchase invoices as early as possible (eg, small retail shops) may well end up keeping two sets of financial records. Surely this is not simplification?

While BIS and the FRC are to be applauded for the sentiment of wanting to deregulate reporting requirements for micros, I would suggest that they will need to look very carefully at the feedback from this consultation before proceeding further!

# DON'T LOOK BACK IN ANGER

Veronica Poole, Global Managing Director, IFRS Technical at Deloitte, and colleague Colin Fleming, look back on what has – and hasn't – been achieved in the world of IFRSs during 2011.



It is tempting to view 2011 as a rather dispiriting year in the world of IFRS. We started it with high hopes. There were anniversaries ahead: the IASB and EFRAG were both going to celebrate a decade of work. New players were taking over at the helm of the IASB: Sir David Tweedie, with a decade of achievement behind him, would pass the baton to Hans Hoogervorst at the halfway point of the year, joined by Ian Mackintosh, a technician to his fingertips, as his Vice-Chair. The IASB would have a fresh start, having signed-off on the ambitious G20 work plan and other significant projects by the end of Sir David's tenure. By the end of 2011, the US Securities and Exchange Commission (SEC) expected to be in a position to make a positive definitive statement about the role of IFRSs in reporting by US domestic issuers, cementing the status of IFRSs as a global financial reporting language. The IASB would start its second decade able to take a fresh look at its agenda, focus on quality and delivering a truly global set of standards.

**'The differences between the IASB and FASB on key financial reporting issues, such as impairment of financial assets, have proved difficult and remain unresolved in spite of an extraordinary effort on behalf of the Boards and their staff.'**

Instead the picture is far more muted. The differences between the IASB and FASB on key financial reporting issues, such as impairment of financial assets, have proved difficult and remain unresolved in spite of an extraordinary effort on behalf of the Boards and their staff. In the US, the SEC has been distracted by other issues. The Dodd-Frank Act has taken up much of the time and energy which might have been devoted to the IFRS decision. That decision is not an easy one. It is also fraught with political challenges. It is difficult to balance the needs of domestic issuers with no international operations and those of large international companies that want to move to IFRSs sooner rather than later. The idea of a sort of half-way

house – the so-called 'condorsement' approach – might yet allay the fears of many US critics of IFRSs but while this might be a plausible approach, many questions remain and many operational issues need to be worked through. The fundamental question remains: what will the SEC do?

In the meantime, the major convergence projects missed their mid-year deadline. There was just too much work to be done and not enough time. Many of the proposals will now be re-exposed. The lack of agreement on when and how to impair financial assets remains the biggest challenge and the solution remains elusive. The current incurred loss model is seen as too weak and open to divergent interpretation. What is sought is an approach that would accelerate loss recognition and would be capable of consistent application.

The remaining pieces of the financial instruments jigsaw are not easy either. Critically, the Boards still do not agree where the dividing line should be between what's to be carried at amortised cost and what's at fair value. They also failed to agree on when financial assets and financial liabilities should be offset and the proposed extensive new disclosures will only paper over the differences. The IASB hedging proposals are expected to be published early in 2012 and may prove to be very popular on this side of the Atlantic. However, FASB is less keen on them. And a macro hedging model is yet to be developed.

Even if these differences are ironed out, the benefits of a single set of high-quality global financial reporting standards can only be brought about if the interpretation, application and enforcement of IFRS are consistent with the principles in those standards. The preparers, auditors and regulators all need to own the IFRS process and be part of it. And this is where the governance of the IASB plays an important role.

The evolution of the IASB into a global standard-setting authority has led to a series of reviews of the IFRS Foundation's Constitution and the role and operations of the Foundation's Monitoring Board, which serves as the link between the IFRS Foundation and public authorities in jurisdictions requiring or permitting the use of IFRSs.

The primary focus of the IFRS Foundation's Trustees' review has been to strengthen the internal



governance procedures of the organisation – how it exercises its oversight responsibilities for the IASB – and ensuring a stable, transparent and politically neutral funding platform. In particular, the Trustees’ Due Process Oversight Committee has fundamentally altered its approach to oversight of the IASB itself such that its oversight will be embedded throughout the standard-setting process.

The Monitoring Board is still relatively new and is undertaking a review of its role and how it interacts with the IFRS Foundation Trustees. A solid, transparent and respected structure is needed, in which the IASB can be a standard-setter with the required independence to set high-quality standards. The Trustees must provide clear, authoritative and transparent oversight. And the Monitoring Board should provide unquestionable political legitimacy, while ensuring that the Trustees have done their job effectively. This implies a membership for the Monitoring Board that is broader and more reflective of the G20 and IFRS jurisdictions than the current five-member panel. An expanded Monitoring Board, as representatives of capital markets authorities, should be instrumental in promoting a single set of high-quality global financial reporting standards. It should work with the International Organization of Securities Commissions (IOSCO) and other capital market authorities to promote actions that support the interpretation and application of IFRSs consistent with the principles in those standards on a global basis. And the Monitoring Board needs to be seen as the IFRS Foundation’s advocate at the highest political levels.

The continued evolution and strengthening of the IASB’s due process is a vital component of

ensuring that IFRSs are accepted worldwide. As discussed on page 20 of this journal, in July 2011 the IASB launched their first agenda consultation – a welcomed enhancement of their due process. This consultation and future consultations by the IASB on its agenda should contribute to further respect for and acceptance of the due process of the IASB and for IFRSs themselves, by involving constituents throughout the standard-setting process.

Although 2011 might be reflected upon as a year of many hopes but much frustration, the fundamental optimism that the IFRS project will succeed remains. Speaking in Boston in October 2011, Hans Hoogervorst reiterated his belief that ‘the case for global accounting standards, and with it the case for US adoption of IFRSs, remains compelling’. Harvey Goldschmid, an IFRS Foundation Trustee speaking at the same conference, was equally upbeat, saying that the incorporation of IFRSs into US financial reporting was a ‘national imperative’.

As we approach the end of 2011, much of the current uncertainty should be clarified. In recent public speeches, senior members of the SEC staff have said that they are working toward providing enough information to the Commission so that they are in a position to make a decision by the end of 2011. By then progress on resolving some of the thorny issues facing the IASB should have been made. The final pieces of the IASB’s governance are expected early in 2012, putting in place the final components to enable the IASB to act as a truly global standard-setter – as envisaged by the G20 leaders. So, while 2011 might in many ways be seen as disappointing, ultimately the prognosis remains very positive.

# GETTING TO GRIPS WITH THE IASB'S NEW CONSOLIDATIONS STANDARDS

Andy Simmonds, Chairman of the Financial Reporting Faculty and Partner in Deloitte LLP, looks at some of the practical implications of the IASB's 'package of five' new and revised standards. The views expressed are very much his own.



<b>IFRS 10</b>	<i>Consolidated Financial Statements</i>	<ul style="list-style-type: none"> <li>Replaces SIC-12 and most of IAS 27.</li> </ul>	<ul style="list-style-type: none"> <li>Includes all material on consolidation.</li> </ul>
<b>IAS 27</b>	<i>Separate Financial Statements</i>	<ul style="list-style-type: none"> <li>Residual guidance on single entities.</li> </ul>	<ul style="list-style-type: none"> <li>Cost or fair value choice.</li> </ul>
<b>IFRS 11</b>	<i>Joint Arrangements</i>	<ul style="list-style-type: none"> <li>Differentiates 'joint ventures' from 'joint operations'.</li> </ul>	<ul style="list-style-type: none"> <li>Accounting for joint operations.</li> </ul>
<b>IAS 28</b>	<i>Investments in Associates and Joint Ventures</i>	<ul style="list-style-type: none"> <li>'How to do' equity accounting.</li> </ul>	<ul style="list-style-type: none"> <li>Applies to associates and joint ventures.</li> </ul>
<b>IFRS 12</b>	<i>Disclosure of Interests in Other Entities</i>	<ul style="list-style-type: none"> <li>All the disclosure requirements bundled together...plus some new ones!</li> </ul>	

On 12 May 2011, the IASB issued a package of three new and two revised standards dealing with consolidations, joint arrangements and disclosure. The package takes effect for 2013 year-ends, assuming that EU endorsement runs smoothly – which presently looks a reasonable assumption.

## WHAT WAS THE PROBLEM?

The completeness of consolidated accounts was an issue raised by the G20 following the credit crisis. The key question was: do consolidation rules capture all intended 'subsidiaries' within the boundary of what is consolidated? In addition, the IASB identified two areas where it thought there might be divergence in practice. The first area was the apparent difference in the way that subsidiaries are defined in IAS 27 using a 'control' definition, compared to the way that controlled special purpose entities are defined in SIC-12 using a 'risks and rewards' approach. The second area was the choice of accounting method for jointly controlled entities, where investors had a free choice between equity accounting and proportional consolidation.

## WHAT HAS CHANGED – CONSOLIDATIONS?

The IASB has replaced the definitions of IAS 27 and SIC-12 with a single new basis of consolidation in IFRS 10. This is still based on the notion of control, but has three elements which must all be present:

- **power** over an investee from existing rights;
- exposure or right to **variable returns** of the investee; and
- a **link** between power and variable returns that gives the investor the ability to affect the returns it receives.

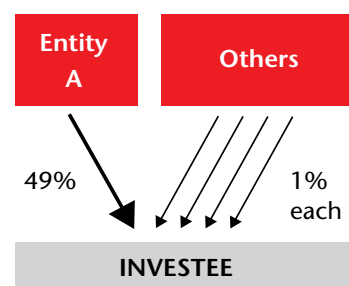
IFRS 10 includes extensive guidance on how to identify 'power'.

If we were to sum up the intended meaning in one test, it would be that IFRS 10 aims to consolidate any investee where the investor has the practical ability to act unilaterally.

Where an investor holds a majority of voting shares in an investee, there will be no change. However, IFRS 10 identifies two circumstances, which it terms de facto control, where consolidation may be required although there is no majority shareholding.

The first de facto control example concerns a significant minority shareholding, with other shareholdings being widely dispersed (see figure 1 below).

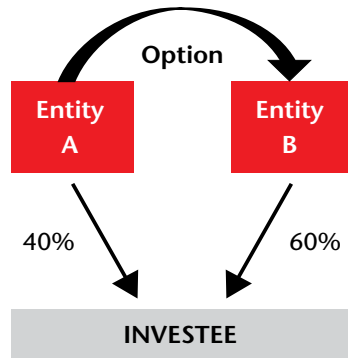
Figure 1



The key issue is whether the 'others' are organised to take action collectively, or whether Entity A can act without real challenge. Under IFRS 10, Entity A controls the investee when it has the practical ability to direct the relevant activities of the investee unilaterally.

The second de facto control example concerns potential voting rights, for example, arising from an option that is exercisable in the future (see figure 2 below).

Figure 2



Under IAS 27, only options which were currently exercisable were taken into account. Under IFRS 10, the terms of the option are examined including how far into the future exercise may occur, whether the price is fixed or variable, and whether the current market value of the voting rights means the option is more or less likely to be exercised. Consolidation by Entity A is required where the terms of the option give Entity A the practical ability to direct the relevant activities of Entity B. This may occur before the option exercise date where all parties accept that exercise will occur, and start to act on that assumption.

For investment management situations, IFRS 10 requires an analysis based on whether an interested party, such as the investment manager, is a principal acting for its own benefit, or an agent of others, acting purely for a management fee. Four areas are examined: the objectives of each party, the rights of other parties such as rights to remove the investment manager, whether the remuneration of the investment manager represents a market fee for services, and the level of variable return the manager receives from any equity investment or provision of 'first loss' cover. IFRS 10 includes a number of examples which assist in applying the agent/principal analysis.

### WHAT HAS CHANGED – JOINT ARRANGEMENTS?

The existing standard, IAS 31, is regarded as 'form

driven,' in that the accounting treatment depends on whether the form of the investee is an entity or not. Where an investee is a jointly controlled entity, it is classified as a joint venture, which may be accounted for either under the equity method or by proportional consolidation.

IFRS 11 adds an economic test to assist in identifying circumstances, called a 'joint operation', where different investors in an entity have different interests in specific assets, liabilities, revenues or expenses. This is the notion found in UK GAAP termed a 'joint arrangement not an entity' or 'JANE'. Where a legal entity can be so analysed, then an investor is able to account separately for its interest in assets, liabilities, revenues and expenses in a joint operation. Where an investor's interest is a share of net assets or net profits, then the joint arrangement is classified as a 'joint venture', and the investor's interest is accounted for under the equity method only. Figure 3 below illustrates the difference between a joint operation and a joint venture.

### WHAT HAS CHANGED – DISCLOSURE?

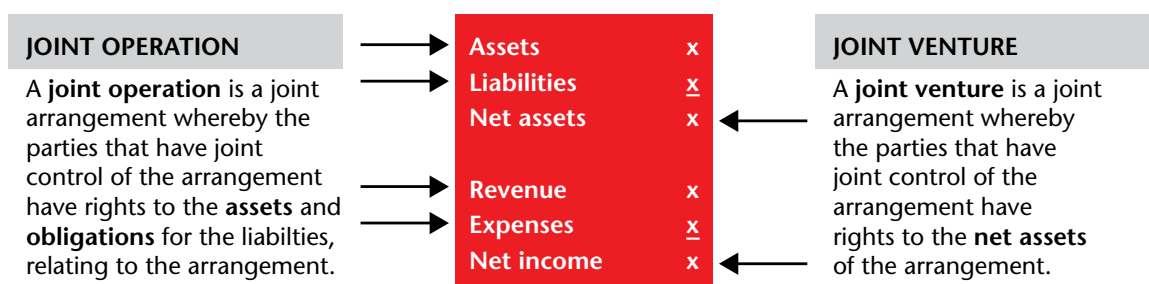
All disclosure requirements relating to subsidiaries, joint arrangements, associates and unconsolidated structured entities have been drawn together in IFRS 12.

There are two significant new disclosures. The first is a narrative disclosure about significant judgements and assumptions an investor has made in deciding whether it has control, joint control or significant influence, for example, explaining how control is judged to exist where an investor holds less than 50% of voting shares. The second relates to interests in unconsolidated structured entities. IFRS 12 requires extensive disclosures to help users understand the nature and extent of an entity's interests and the associated risks including any support provided to an unconsolidated structured entity when there is no contractual obligation to do so.

### CONCLUSIONS

While many straightforward groups will be unaffected by these changes, others will need to dedicate considerable time to determine how their consolidated accounts will change. I'd recommend starting work on assessing the impact of the 'package of five' on your business as soon as possible.

Figure 3



# FAIR VALUE: SIX IMPOSSIBLE THINGS

The IASB recently issued a new standard on fair value. Brian Singleton-Green, Faculty Manager, draws attention to some of its more curious features.



*Through the Looking Glass* fans will recall a scene where the White Queen exclaims, 'Why, sometimes I've believed as many as six impossible things before breakfast'. This is a valuable skill and will come in handy for users of IFRS 13 *Fair Value Measurement*.

## ABOUT IFRS 13

In May 2011, the IASB issued IFRS 13 *Fair Value Measurement*. IFRS 13 provides for the first time a single definition of fair value and a consistent framework for measuring it. In doing so it replaces the often inconsistent guidance that was previously dispersed across many different standards.

Here are six impossible things that it will be helpful for an IFRS 13 user to believe:

**1. We can know what assumptions other market participants will make.** Paragraph 22 of the standard requires us to measure fair value 'using the assumptions that market participants would use'. The managers of a business know what their own assumptions are, but they do not know what assumptions other market participants will make. No doubt they can make a guess, but they are likely in practice to assume that managers in other businesses make much the same assumptions as they do.

**2. All market participants make the same assumptions.** The various participants in any given market have different information and make different assumptions. This is one reason why market prices are unpredictable. So, when we go through the imaginative exercise of working out what assumptions other market participants would make, there will be a very wide range of potential assumptions, many of them conflicting, that would meet the requirement.

**3. There is one fair value for each asset and each liability in any given market.** The standard does not say this explicitly, but I think it's implicit in every line. What makes me say this is mainly the constant use of 'the fair value' rather than 'a fair value'. There are many circumstances where if we want to buy or sell something the price will depend on who is doing the buying and selling. This is why people bother to spend time comparing prices or negotiating a price. There is a potentially wide range of values for many

items that could be their fair value. It is not typically a single, determinate amount.

**4. Liabilities are transferable.** Transferring a liability is the logical equivalent of selling an asset. In practice most liabilities are virtually untransferable. When they are transferred they usually involve special legal arrangements. For a liability, the practical equivalent of selling an asset is not transfer but settlement.

**5. Transport costs are not transaction costs.** This notable proposition is in paragraph 26 of the standard. To be fair, this says that 'transaction costs do not include transport costs'. Again there is a kind of impeccable logic at work here, as the transport costs referred to are those involved in taking the asset to market, not the transport costs incurred in the sale itself, which the standard does count as transaction costs.

**6. Sufficient data are always available to measure fair value.** Paragraph 61 of the standard requires the use of valuation techniques 'that are appropriate in the circumstances and for which sufficient data are available'. In many cases the data available will only be sufficient to make a very subjective assessment of fair value. This will often be true of Level 3 measurements. In these circumstances the word 'sufficient' really has no force at all. What the standard wants us to do, I think, is to get hold of any relevant information that we can find ('maximising the use of relevant observable inputs') and just do our best.

The main problems in the standard are inherent in the task of 'measuring' market prices in situations where there is no market. There is a second layer of problems that comes from having to coordinate the IASB standard with what FASB had already decided in FAS 157 (which is now contained in section 820-10 of the FASB's Accounting Standards Codification). This does not mean that fair value, as measured under the standard, will fail to provide useful information. But we need to be aware of its limitations.

For more information on how to apply the standard in practice, I recommend that you consult the faculty's *IFRS 13 Fair Value Measurement* factsheet.

# LEASES, FINANCIAL INSTRUMENTS AND INSURANCE: THE SLOW ROAD TO CONVERGENCE

The IASB's major projects on leases, financial instruments and insurance contracts have been furthered delayed, with final standards now not expected until later in 2012 at the earliest. The chairs of the relevant ICAEW working parties provide faculty members with an update on the latest position.



## LEASES

By Peter Hogarth, Partner, PwC

Since my previous article about the leases project, the IASB and FASB have focused their attention largely on lessor accounting, but have also made an important decision regarding next steps.

You might recall that when the Boards issued their 2009 discussion paper on leases, lessor accounting was dealt with only briefly. The exposure draft published in August 2010 moved the debate forward and proposed a 'dual model' whereby lessors would account differently depending on their exposure to risks and rewards. This approach proved unpopular, with most comment letters favouring either a form of accounting that has some similarity with today's finance lease accounting or preserving the status quo. The Boards have now decided that they will propose only one form of lessor accounting, which will be another evolution of what I will continue to call finance lease accounting for convenience (although it is different in some respects).

The Boards announced in July that a revised exposure draft would be issued before progressing to a final standard. This exposure draft is expected early in 2012. What does that mean for the effective date? The Boards will have to work hard to get a final standard out in 2012, which is likely to push the effective date back further. I think we can be safe in the assumption that effective date will not be before 2015, but whether it will be then or later is anyone's guess!

## FINANCIAL INSTRUMENTS

By Sondra Tarshis, Senior Manager – Accounting Developments, HSBC Holdings plc

### Effective date

The IASB is considering comments received in response to its proposal to delay the mandatory effective date of IFRS 9 until 31 December 2015.

### Impairment

The Supplementary Document published in January 2011 – which set out an approach to impairment that both the IASB and FASB supported – was not well received. Therefore the Boards are now working on a new model, building on feedback received and recognising the need for an approach which is operational. A further due process document is expected soon.

## Hedge accounting

The final standard on general hedge accounting is expected early in 2012. However, there are still issues to consider on the accounting treatment of risk management strategies for open portfolios, so a further exposure draft on macro hedge accounting will be published soon.

## Asset and liability off-setting

The IASB and FASB were unable to reach agreement on a common approach to off-setting. As a result there will be no fundamental change to IAS 32 or US GAAP. Both Boards have agreed to develop disclosures to provide comparable information on a gross and net basis and the IASB will issue additional guidance to improve the consistency of application of IAS 32. The revised standard was due to be issued late in 2011 with application on a retrospective basis from 1 January 2013.

## INSURANCE CONTRACTS

By James Dean, Global Insurance IFRS Leader, Ernst & Young

More than a year has now passed since the IASB published its exposure draft on insurance contracts. The proposals attracted a wave of responses from around the globe. Top of the list of concerns is the potential for significant artificial volatility in earnings. Other major issues include the presentation format for the income statement, limited acquisition cost recognition and transition arrangements.

Earlier this year, the IASB and FASB started their re-deliberations. Progress is being made, including tentative decisions to widen the definition of acquisition costs and to recognise contracts when coverage periods begin unless contracts are onerous. Also, additional guidance on how to calculate the discount rate has been provided as a means of addressing the volatility issue.

Although the IASB is showing continuing effort and commitment to finalise the project, critical hurdles need to be jumped and a number of key issues still need to be resolved. The outcome is difficult to predict. The project time table has also proven to be unpredictable, with a possible re-exposure early in 2012. The publication date of the final IASB standard has yet to be determined.

# REVENUE RECOGNITION: ONE STEP FURTHER TOWARDS A CONVERGED STANDARD

Phil Barden, a Partner in Deloitte's UK technical department, looks at the IASB's latest proposals on revenue recognition.



On 14 November 2011, the IASB and FASB jointly published a new exposure draft (ED) *Revenue from Contracts with Customers*, which builds on the previous ED published in June 2010. The core principle of the new ED is essentially the same as the previous ED, and broadly consistent with the thinking behind the current standards, IAS 11 and IAS 18 – in effect, an entity recognises revenue as it delivers goods and services to a customer. But although the new ED retains the same overall 'five step' approach outlined in the previous ED, much of the detail has changed, so all IFRS reporters should consider its impact on them.

**'Although the new ED retains the same overall "five step" approach outlined in the previous ED, much of the detail has changed.'**

Many entities will probably find that the proposals in the new ED will not fundamentally change the profile of revenue recognition. Nevertheless, the existing guidance (particularly IAS 18) is often very light on detail, whereas the new ED contains much detailed guidance. Therefore, all entities may be affected to some extent, even if the overall effect of changes is not huge. For some entities, the profile of revenue recognition may alter significantly – but this seems unlikely to be the norm.

One of the main criticisms of the previous ED was that the guidance on services was inadequate. In particular, it was not clear how entities such as professional services firms should apply the 'control' concept. The new ED contains considerably more guidance, including a focus on whether any work in progress has 'alternative use' to the entity. Work in progress has 'alternative use' if, both contractually and practically, it is capable of being supplied to a different customer. Often, the work in progress of professional services firms does not have alternative use, in which case revenue will be recognised as work is performed, provided that one of three conditions specified in the ED is met. For example, if the customer cannot cancel the contract without paying an amount that at least compensates the seller for work performed to date, revenue will be recognised as work is performed – but if the

customer can cancel without paying for the work performed to date, it is possible that revenue will be recognised only on completion.

This focus on alternative use will also affect the accounting for some construction-type activity. Under current standards the construction of a property that is not to a customer-specific design is typically accounted for as a sale of goods. Under the new ED, if the customer cannot cancel the contract and the seller is contractually restricted from selling the property to a different customer, revenue may instead be recognised as construction takes place.

Another significant criticism of the previous ED related to arrangements containing multiple elements (sometimes called 'unbundling'). The proposals reflected in the new ED include an overall restriction that elements should not be accounted for separately where:

- they are highly interrelated;
- transferring them to the customer requires the entity to provide a significant service of integrating them into the combined item(s) for which the customer has contracted; and
- they are significantly modified or customised to fulfil the contract.

This overall restriction is a new concept, and may have a significant impact eg, for some entities that supply a core software product together with associated services such as customisation and integration.

The IASB is asking specific questions on certain aspects of the new ED that are different from the previous ED. Beyond that, the main question asked is whether the proposed requirements are clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers. This is, arguably, the key issue for IFRS reporters at this stage: can you see how to apply these proposals to your business, and will they result in a profile of revenue recognition that makes sense to users of your financial statements?

The comment deadline is 13 March 2012. The new standard will not apply before accounting periods starting on or after 1 January 2015 at the earliest.

# FUNDAMENTAL CHANGES TO IFRS PENSION ACCOUNTING

Lynn Percy, KPMG's Global IFRS Employee Benefits Standards Leader, explains the potential impact of changes to the way we account for defined benefit pension plans.



In June 2011 the IASB issued a revised IAS 19 *Employee Benefits*, effective for financial years starting on or after 1 January 2013. While the amendments are not as far-reaching as originally envisaged, they nonetheless introduce some fundamental changes, particularly for entities with defined benefit pension plans. This article considers three of the key changes.

## ABOLITION OF THE 'CORRIDOR' APPROACH

Under existing IAS 19, entities have a choice of how to account for actuarial gains and losses arising in their defined benefit plans. They can:

- defer their recognition for so long as they remain within a 'corridor' calculated by reference to the plan assets and liabilities, recognising any excess amount gradually through profit or loss;
- recognise them in profit or loss on any faster basis, including immediately; or
- recognise the full amount immediately in other comprehensive income (OCI).

The revised standard mandates the last of these approaches, bringing the full amount of the plan deficit or surplus (subject to any asset ceiling) onto the balance sheet and increasing the comparability and consistency of financial statements.

Worldwide, deferral under the corridor method is common and its abolition will have a widespread effect. However, it will not be so significant in the UK since immediate recognition in OCI was the treatment required by FRS 17 and many simply continued with this approach when adopting IFRS.

### Implications

The recognition of previously deferred gains and losses may result in a higher net defined benefit liability and, going forward, will make the balance sheet more volatile. Those currently using the 'corridor' may need to discuss with their lenders revising any relevant covenants in loan agreements.

## CALCULATION OF EXPECTED RETURN ON PLAN ASSETS

At present, the expected return on plan assets reported in profit or loss is based on the long-term rate of return expected on the actual assets held. In another significant change, under the amended standard it will be based on the rate used to discount the plan liabilities – generally, the yield on

high-quality corporate bonds. This is the result of the standard now requiring the net interest figure in profit or loss to be calculated by applying the liability discount rate to the net defined benefit asset or liability reported in the balance sheet.

This will not change the total return on plan assets for the period (although this might be affected by other amendments re administration costs and taxes). However, it will change the split of how much of this return is reported in profit or loss, and how much in OCI.

### Implications

Entities with plans holding riskier assets (eg, equities) will generally have been expecting the return on these assets to exceed the discount rate and this change will therefore reduce their reported profits. Initial indications are that this reduction could be material in many cases. Conversely, those entities whose plans hold a high proportion of less risky assets (eg, government bonds) might see reported profits rise. This change will mean that the nature of the assets held in the plan's portfolio will have no impact on profit or loss. As a result, there may be some rebalancing of portfolios.

Entities may again need to consider the impact on loan covenants and, potentially, on the design of profit-based remuneration.

## ENHANCED DISCLOSURES

The IASB has reviewed the disclosure requirements in IAS 19, changing some and adding others. The driver for the changes was to enable users to understand better the exposure to risk arising from operating a defined benefit plan.

### Implications

Entities with a number of plans will need to consider carefully the extent and level of aggregation of their disclosures.

## CONCLUSIONS

These, and other, changes to IAS 19 are likely to have a significant impact on many entities. Planning ahead will be essential to ensure a smooth transition.

For more information on how to apply for the revised standard in practice, consult the faculty's *IAS 19 Employee Benefits – Revised* factsheet.

# SLIPPING UNDER THE IFRS RADAR?

Faculty Manager, Eddy James, provides a roundup of other recent IFRS developments that you may have missed.



In recent months, a number of major projects have been completed and, quite rightly, it is these new and revised standards that have been getting a lot of the headlines. Much coverage has also been given to the on-going projects on revenue recognition, leasing, financial instruments and insurance contracts. In this article I highlight one amendment and a couple of recent proposals that you may have missed.

## AMENDMENT TO IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

The IASB has issued an amendment to IAS 1 *Presentation of Financial Statements*. The amendment aims to improve the transparency of items reported in other comprehensive income and is effective for financial years beginning on or after 1 July 2012.

Entities must now distinguish between items in other comprehensive income that:

- will never be recycled to profit or loss (eg, remeasurements under the recently revised version of IAS 19); and
- those that will be, if certain conditions are met (eg, foreign currency translation adjustments on foreign subsidiaries).

Income taxes on items presented in other comprehensive income must now also be allocated between these two categories, if those items are presented before tax.

You may recall that the exposure draft that preceded this amendment had suggested removing the option of presenting separate statements of profit and loss and other comprehensive income and instead mandating a single performance statement. Many respondents objected to these proposals, arguing that a single continuous statement undermines the importance of profit or loss by making it a subtotal and fearing that it may be the first step on a road that could ultimately lead to the elimination of the notion of profit or loss altogether. Therefore a collective sigh of relief was heard when the IASB announced that it was retaining the option to produce two separate statements.

## EXPOSURE DRAFT – INVESTMENT ENTITIES

The IASB has published an exposure draft of proposals to define investment entities as a separate type of entity that would be exempt from the requirements in IFRS 10 *Consolidated Financial Statements*.

Investment entities are commonly understood to be entities that pool investments from a wide range of investors for investment purposes only. They include venture capital organisations, mutual funds, unit trusts and similar entities. IFRS 10 requires consolidation if an investment entity controls an entity it is investing in. However, many investors feel that this does not provide them with the information they need to assess the value of their investments.

The exposure draft proposes six qualifying criteria that would have to be met by an entity in order to qualify as an investment entity. Entities that meet these criteria would be exempt from the consolidation requirements of IFRS 10 and instead would be required to account for all their investments at fair value through profit or loss. The exposure draft also includes disclosure requirements about the nature and type of these investments.

A final standard is expected in the second half of 2012.

## EXPOSURE DRAFT – ANNUAL IMPROVEMENTS

The IASB has published an exposure draft containing proposed minor amendments to the following five standards:

IFRS	Subject of amendment
IFRS 1 <i>First-time Adoption of IFRSs</i>	Repeated application of IFRS 1. Borrowing costs relating to qualifying assets for which the commencement date for capitalisation is before the date of transition to IFRSs.
IAS 1 <i>Presentation of Financial Statements</i>	Clarification of the requirements for comparative information. Consistency with the updated <i>Conceptual Framework</i> .
IAS 16 <i>Property, Plant and Equipment</i>	Classification of serving equipment.
IAS 32 <i>Financial Instruments: Presentation</i>	Income tax consequences of distributions to holders of an equity instrument and of transaction costs of an equity transaction.
IAS 34 <i>Interim Financial Reporting</i>	Interim financial reporting and segment information.

The proposed effective date for the amendments is for annual periods beginning on or after 1 January 2013, although entities will be permitted to adopt them earlier. The final amendments are expected to be published in March 2012.

# HOPES AND FEARS

Nigel Sleigh-Johnson reports from the IASB's recent US conference, and speculates about the forthcoming SEC decision on the stateside use of IFRS.



While in Boston last October, I took the opportunity to attend the major IASB conference on *The North American Perspective*, which was held jointly with the AICPA. The conference provided some insights into the hopes and fears of those with an interest in how far and how fast the US travels along the road to IFRS reporting.

**'The message delivered to the SEC by US companies present was loud and clear: it is time to end the uncertainty.'**

Not surprisingly, much of the debate centred on convergence between IFRS and US GAAP and on 'condorsement' – the 5–7 year strategy proposed by the SEC staff that is a heady mix of convergence and endorsement. IASB and FASB staff trumpeted the very real success stories, such as the revenue recognition project, where the two boards had made identical decisions. However, Renee Bomchill – a Partner in the Financial Accounting and Reporting Services group of Deloitte – pointed out that many significant differences remain between IFRS and US GAAP, not only in the shape of unconverted standards like IASs 36, 37 and 38, but in recently-converged standards such as IFRS 3.

Some of the remarks by Leslie Seidman, Chair of the FASB, were not too encouraging on this point either. Ms Seidman noted that the short-term convergence projects had been viewed as 'low-hanging fruit', but even these had led to less than 100% convergence. Ms Seidman also warned that the failure to agree on a common approach to the key issue of offsetting of financial assets and financial liabilities could furnish a 'good test' for a new US endorsement mechanism ie, if US investors were happy with the US approach and did not see the IASB requirements as an improvement then that might form the basis for an ongoing difference between the two sets of standards. But it was accounting for rate regulated activities that she held up as 'Exhibit A' in the file of concerns about a wholesale switch to IFRS reporting as this is an

example of where there is a specific US standard to deal with unique US regulatory arrangements which she anticipated US constituents would wish to retain.

Perhaps with these sorts of issue in mind, the message delivered to the SEC by US companies present was loud and clear: it's time to end the damaging uncertainty. That uncertainty had led many to shift preparations for IFRS reporting onto the back burner. Most speakers dismissed 'condorsement' as likely to prove disruptive – thousands of pages of US GAAP changing every year, as one put it – and demanded at the least an option to use IFRS, and from a date certain. The well-rehearsed benefits of IFRS adoption were repeated: reduced costs of cross-border finance; improved comparability between sectors; and, interestingly, a better internal control environment, as a less fragmented reporting processes meant that the incidence of human error was likely to fall. Two shows of hands at the end of a packed session for preparers summed up the prevailing sentiment: almost unanimous results rejecting 'condorsement' and supporting an option to apply IFRS.

So, given the discussions in and around the conference, what is the prognosis for a positive SEC decision? Some idle speculation, bearing in mind that by the time this article is published, the SEC is likely to have made its announcement: a December statement looks likely, with some warm words about global standards and progress made in the convergence programme; a commitment to further research, reports, monitoring and consultation; support for continued convergence efforts; and – especially in an election year in the US – no certainty about timing or much else of significance.

A couple of things do seem certain, whatever the decision: 'US GAAP', in some shape or form, is here to stay, if a less potent force around the world, and FASB will not be downing tools any time soon. That leaves open the question of how the IASB manages its relationship with FASB in the next few years, but there will certainly be substantial pressure on the IASB to turn its primary focus away from US convergence and towards jurisdictions already applying IFRS or fully committed to joining the worldwide IFRS community.

# THE IASB'S FUTURE AGENDA: LESS IS MORE?

Kathryn Cearns, Consultant Accountant at Herbert Smith LLP, and three constituents from around the world give their personal views on the IASB's agenda consultation.



In June 2011 the IASB launched a major public consultation on the strategic direction and overall balance of its future work programme. It is a welcome development that we now have our first opportunity formally to comment on proposals for the Board's future agenda. The undertaking to consult every three years should help over time to build a picture of both current and longer lasting concerns of constituents.



The major projects that were completed in 2011 (consolidation, joint arrangements, fair value measurement) plus those that hopefully will be completed fairly soon (financial instruments, leasing, revenue recognition, insurance) will result in a significant amount of work for all IFRS reporters. The significance of each of the changes will vary according to industry sector, but the range of standards and the pervasive nature of several of them mean that all businesses will be affected to some extent.



So there is likely to be a heartfelt cry from just about everyone for a 'period of calm' after the implementation dates of these standards. How long should that be? I suspect most companies would look for at least two years free of major accounting changes. Many users will feel the same as they bed in the new information metrics. Final decisions on implementation dates and transition will have a direct bearing on this point.



This would give the Board breathing space to do two things: clear up problems in existing standards through its annual improvements process and 'finish' the conceptual framework (which, as a dynamic document, must continue to evolve as new business practices and standards develop).

What about the long list of possible projects? Before decisions can be made on precedence, I suggest some form of categorisation, such as:

- **Just say no!** The IASB should 'stick to its knitting' and leave to others those projects outside its core remit. Country-by-country reporting is driven by different public policy drivers; and Islamic finance institutions could apply IFRS as they stand now.
- **If it ain't broke...** Don't spend time on things that aren't broken when there are lots of other things to do. IAS 37 on liabilities, while not

perfect, is operating reasonably well. We put up with differential treatment for acquired and non-acquired intangibles, so don't change just to match the IFRS 3 treatment.

- **Kill two birds...** Some issues are pervasive problems for standard-setters and ought to be tackled, but it may be feasible to wrap them up, at least at this stage, with the conceptual framework project. The issues of other comprehensive income and the recycling of gains and losses really needs sorting, for example, but it could be looked at afresh here in the broader context of what performance means. Others might include debt/equity, discounting and, most importantly, a presentation and disclosure framework.
- **Reward patience!** Some of those with the least capacity to demand attention have been waiting patiently for help. IAS 41 on agriculture may be the classic case, where some of its complexities mean that it does not serve the wide range of entities around the world that wish or need to follow it.

A few things are not on the list as published. For example, the IFRS for SMEs would benefit from a post-implementation review, particularly in relation to how questions from constituents are being dealt with.

And there are a few dangers hinted at in the paper. Convergence with the US, after the current round of projects, must be subordinated to improving things for current IFRS users. Helping anyone get on board the IFRS train is fine, but not if we have to change the tracks and the engine to do it! The IASB should also be careful about intervening in the audit and regulatory realm in its (rightful) concern about consistent application; the regulatory system surrounding financial reporting may not be perfect, but the IASB's primary responsibility in relation to this question is to produce clear, well drafted and practical standards.

And finally, this consultation cannot simply be an exercise in 'votes cast'; judgement will need to be applied by the Board when deciding the way forwards, and while it would be wrong to constrain that judgement, the IASB could help itself by starting to develop some broad rules of the road.

## A MALAYSIAN VIEW



Mohammad Faiz Azmi, Senior Partner at PricewaterhouseCoopers and Chairman of the Malaysian Accounting Standards Board.

I am pleased to see that the IASB's agenda consultation includes a potential project to amend IAS 41 *Agriculture*. This reflects proposals made by the Malaysian Accounting Standards Board (MASB) and supported by the Asian Oceanian Standard-Setters Group (AOSSG).

IAS 41 generally requires biological assets and agricultural produce to be measured at fair value less cost to sell, with changes in the fair value included in profit or loss. But many people are uneasy with this accounting treatment when applied to what are known as bearer biological assets.

Such assets include mature dairy cows, mature grape vines and mature olive trees. It takes many years to cultivate these assets to maturity. Once mature, they are then held for use in the production of agricultural produce for sale; they are not agricultural produce themselves and are not for sale. Such assets are more akin to manufacturing plant used for the production of goods for sale. Therefore, the view is that the cost basis should be allowed as the measurement model for mature bearer biological assets. If entities wish to use the revaluation model, changes in fair value should be included in other comprehensive income rather than profit or loss. In other words we are recommending an approach consistent with IAS 16 *Property, Plant and Equipment*; such an approach would reflect the true nature of bearer biological assets and eliminate artificial earnings volatility.

We hope that feedback supports this proposed amendment.

## AN AUSTRALIAN VIEW



Colin Parker, FCA, Head of the GAAP Consulting Network ([www.gaap.com.au](http://www.gaap.com.au)) and a former member of the Australian Accounting Standards Board.

The existing IAS 38 *Intangible Assets* fails to provide relevant information for economic decision-making by users. It requires only the smallest portion of cost to be recognised as an asset in the current year, there is no reinstatement of previous efforts to fair value, and revaluations are limited to where there is an active market. Some intangible assets such as brands are not permitted to be revalued at all. Inconsistencies abound between the recognition and measurement requirements of tangible and intangible assets. There are also no meaningful intangible asset qualitative disclosures. In short, IAS 38 is a legacy standard from the IASC which needs a fundamental review to ensure we have an accounting standard that meets user needs, rather than one that misleads.

As to other important agenda items:

- IFRS 6 *Exploration for and Evaluation of Mineral Resources* needs to be developed into a comprehensive standard;
- IAS 12 *Income Taxes* needs a fundamental review for scope, measurement (discounting) and whether some deferred tax liabilities actually meet the definition of a liability;
- IFRS for SMEs needs to be revisited to apply the same recognition and measurement requirements as full IFRS, perhaps applying the Australian/New Zealand Reduced Disclosure Regime; and
- standards need to be developed in a manner that does not impede their use by private sector not-for-profit entities. We hope that feedback supports this proposed amendment.

## A UNITED ARAB EMIRATES VIEW



Yusuf Hassan, Head of KPMG Middle East and South Asia.

With the current packed agenda of the IASB, perhaps we do not always make enough of a fuss about old standards such as IAS 20 *Government Grants*. However, in the Middle East many complex issues arise out of transactions with government entities.

The issue primarily arises when the government is a significant shareholder in a corporate entity and it transfers resources to that entity. The question that vexes us is whether the government is acting in its capacity as a shareholder or acting as a government and providing a government grant. Depending on your conclusions, the outcome could be to treat the transaction as a capital contribution or as a grant to be recognised in profit and loss. We expect this question to take on relevance beyond the Middle East as government ownership in entities has become more prevalent since the onset of the global economic crisis.

In our experience, the substance of the arrangement is not always clear and the basis of the grant is often not documented adequately. In practice, it appears that once government has a more than an insignificant shareholding in an entity it is difficult to challenge a presumption that government is acting in any capacity other than as a shareholder.

As such transactions are widespread and have a significant impact on the financial statements, it is imperative to converge on a common set of principles. The current guidance in IFRS unfortunately does not result in consistency in our region.

# FACULTY LAUNCHES NEW FTSE SCHEMES

Over the summer the Financial Reporting Faculty launched two new corporate schemes for members of the FTSE 100 and 250 respectively. Named employees at member companies benefit from access to the faculty's exclusive range of products including copies of this journal.

The faculty has, since inception, been popular among members in business, with many finding that resources such as eIFRS are invaluable when preparing their financial statements. With the launch of the FTSE schemes the faculty is moving to further engage with, and listen to, the needs of members in business.

Aviva, Pearson and Shell are only some of the many FTSE companies that have joined us and we look forward to welcoming many others over the coming months.

**If you're interested in exploring the possibility of corporate membership, please get in touch with our Relationship Manager, Thomas Stewart (thomas.stewart@icaew.com or 020 7920 8659)**

## AVIVA plc



Aviva is the world's sixth-largest insurance group and provides more than 53 million customers in 28 countries with insurance, savings and investment products. It is the UK's largest insurer and one of Europe's leading providers of life and general insurance. Aviva combines strong life and general insurance and asset management businesses under a single strong brand, focused on providing customers with prosperity and peace of mind. Aviva's premium income and investment sales were £47.1bn in 2010.

'From Aviva's perspective the faculty's corporate membership represents excellent value for money. It enables our regional reporting teams in the UK and around the world to access the excellent technical content and stay up to date with changes in IFRS. This aligns with our objective of staying at the forefront of best practice in financial reporting.'

**Jo Clube, Head of Group Technical Accounting, Aviva plc**

## PEARSON plc



Pearson is the world's leading learning company, providing educational materials and services, business information through the Financial Times Group, and consumer publishing through the Penguin brand. Pearson serves learners of all ages around the globe, employing 36,000 people in more than 70 countries, and is listed on the London and New York stock exchanges.

'The Financial Reporting Faculty provides a one stop resource for our finance teams whether they are researching detailed technical questions or just want to keep up to date on the current financial reporting agenda. We are facing a period of significant change in both IFRS and UK GAAP and we hope to be able to draw on the faculty for help in understanding these changes and sharing experiences.'

**Robin Freestone, Chief Financial Officer, Pearson plc**

## ROYAL DUTCH SHELL plc



Shell is a global group of energy and petrochemical companies. Its aim is to meet the energy needs of society, in ways that are economically, socially and environmentally viable, now and in the future.

'Shell's membership to the ICAEW Financial Reporting Faculty provides us with an excellent up-to-date information resource across a wide spectrum of financial reporting matters which is of tremendous value to our finance organisation.'

**Simon Constant-Glemas, VP Corporate & UK Country Controller, Royal Dutch Shell plc**

# FACULTY RESOURCES: ONWARDS AND UPWARDS

Marianne Mau, Faculty Manager, explains how the Financial Reporting Faculty is continuing to expand its activities.



As the Financial Reporting Faculty moves into its fourth year, we continue to build on our success, while never resting on our laurels. To date we have published 28 factsheets, launched this journal and developed an iPhone and iPad App which has been downloaded more than 9,000 times. We have also started to broadcast webinars regularly, hosted numerous events around the UK, and maintained the other on-going services such as eIFRS, the standards trackers, and the e-bulletin. All of these resources are monitored to ensure they remain up to date and relevant to members.

## FACTSHEETS

Our recent factsheets include the following:

- *IAS 19 Employee Benefits – Revised* outlines the changes made to the accounting treatment of defined benefit pension plans, termination benefits, and the distinction between short-term and long-term benefits.
- *IFRS 13 Fair Value Measurement* introduces the new measurement and disclosure requirements for items accounted for, or disclosed at, fair value in the financial statements.
- *UK Distributable Profits* provides guidance on the determination of distributable profits and has been updated for the latest technical release, TECH 02/10.
- *IAS 1 (Revised)* has been updated for the amendments made to IAS 1 *Presentation of Financial Statements* which introduces new disclosure requirements for items of other comprehensive income.

We expect to publish a factsheet on the 'group of five' standards (including IFRSs 10, 11 and 12) which deal with the accounting and disclosure of subsidiaries, joint arrangements, associates and other interests, early in 2012. Further factsheets will be developed as new requirements are published by the UK's ASB, the IASB or other regulatory bodies.

## WEBINARS

A major success in 2011 has been our increasingly extensive range of webinars, including practical updates, available free of charge exclusively to faculty members; and policy events, which are free to all. The feedback makes it clear that this new resource is highly valued by the membership.

In 2011 we hosted two IFRS updates, a webinar on financial instruments, as well as several policy events on the future of UK GAAP and simpler reporting for the smallest UK entities. Those attending the webinars have the opportunity to ask questions to the expert presenters. If you are unable to attend, or you want to revisit what was said, the slides and recordings are available for you to download at your convenience.

In 2012 we will continue to host regular updates for faculty members throughout the year and expect to host further policy webinars on the future of UK GAAP and other areas.

## FACULTY EVENTS

In 2011 our expanded roadshow travelled far and wide; the half-day events had either a UK or IFRS focus, reflecting the interests of our membership. In December we hosted our first all-day IFRS conference, with an impressive range of key-note speakers from business, practice and regulatory bodies. In 2012 we will continue to build on the feedback to ensure that the content of the roadshows, conferences and policy events are targeted to areas of significant interest.

## FACULTY FOCUS FOR 2012

Our focus will continue to be to provide high-quality, timely resources which are practical and easily accessible, which has been our mission since our launch. Your ideas for further improvements are always welcome.



We recently joined the Financial Reporting Faculty as corporate members because we wanted to bring the benefits of the faculty to a wider audience in the firm.

UK GAAP is facing a wholesale change in the near future and there are many changes on the horizon for IFRS – we are looking forward to the support for our teams the faculty can deliver in meeting the challenges these will bring.

**Donna Caira**  
Partner, Saffery Champness

**Saffery Champness**  
CHARTERED ACCOUNTANTS

# FINANCIAL CRISIS: THE ROW RUMBLES ON

Some people still blame IFRS for the financial crisis. Brian Singleton-Green, Faculty Manager, revisits the arguments.



There is already enough written on the financial crisis to fill a small library. Most of the serious studies agree on what caused it: badly-judged property-based lending and investments based on it.

But some have an alternative explanation. Accounting did it. Or at least, accounting made the crisis a lot worse than it had to be. Allegations to this effect continue to surface from time to time, and it seems safe to assume that this alternative explanation will now be with us forever.

It crops up in odd places. In March 2011 the House of Lords Select Committee on Economic Affairs published a report on *Auditors: Market Concentration and Their Role*. This inquiry into auditors got side-tracked into considering the impact of IFRS. Its report quoted evidence that IFRS was less prudent than UK GAAP as IFRS allowed banks to pay dividends and bonuses out of unrealised profits and failed to make provision for expected losses on banks' lending. It was suggested that this may have contributed to the financial crisis – or indeed have caused it. The peers feared that IFRS had squeezed prudence out of accounting.

Also in March, Steve Baker MP presented a Private Member's Bill in the House of Commons. The Bill was designed to make financial services firms prepare 'parallel' accounts that would measure derivatives at the lower of historical cost and mark to market. It would have required these parallel accounts to be known as 'the prudent accounts of true capital and true profits'. Mr Baker explained that his proposals addressed 'one of the most damaging... weaknesses of the... British banking system'. The Bill has not got any further since March, but could be revived.

In some of the criticisms of IFRS it is perhaps possible to detect a note of accounting patriotism. IFRS, it is implied, is an essentially foreign system foisted on us by Brussels. Good old UK GAAP was much better and would not have provoked a banking crisis. They feel the same, of course, in France, except that they think IFRS was foisted on them by the Anglo-Saxons. And across the Atlantic they no doubt see IFRS as a subtle plot by the Europeans to rob ordinary Americans of good old US GAAP.

The Financial Reporting Council (FRC) was evidently concerned by the Lords report and in July issued what is in substance a reply to some of the points made in it. The FRC statement, *True and Fair*, reaffirms the fundamental importance of the true and fair view requirement in both UK GAAP and IFRS (something else the Lords committee was worried about). It also states that 'in practice the concept of prudence continues to underlie the preparation of accounts under both UK GAAP and IFRS'. I think the words 'in practice' are important here, as standard-setters do not seem to be terribly comfortable with prudence in theory.

What are the facts? The huge unrealised profits that banks are alleged to have made before the crisis are, as far as I can tell, mythical. Fair valuing derivatives and other financial instruments is as likely to show a loss as a profit. And most fair valued items are relatively short-term anyway, so any unrealised gains are usually realised (or turned into losses) fairly quickly.

**'The huge unrealised profits that banks are alleged to have made before the crisis are, as far as I can tell, mythical.'**

As for prudence, Professor John O'Hanlon of Lancaster University has investigated whether the UK's transition from UK GAAP to IFRS made loan-loss provisioning by UK banks less timely. His paper (available at [www.ssrn.com](http://www.ssrn.com)) concludes that it did not.

Like other sources of business and economic information, accounting reports good news in the good times and bad news in the bad times. It is plausible to speculate that all these sources of information may well have some kind of amplifying effect on economic crises. But there is still no evidence that accounting played a significant role in the most recent one.

# FINANCIAL REPORTING IN THE PUBLIC SECTOR

Karen Sanderson, Deputy Director, Financial Management & Reporting at HM Treasury, explains the challenges behind producing the UK's first Whole of Government Accounts and the benefits such such reporting can bring not only to the UK but to governments around the world.



The Whole of Government Accounts (WGA) is a consolidation of around 1,500 bodies across the UK public sector, including central government, devolved administrations, the health service, local government and public corporations. It is prepared using EU-adopted IFRS as adapted and interpreted for the public sector. The UK holds a leading position in public sector financial reporting, and is the first country to publish such information for the whole public sector. Internationally, consolidated financial statements are produced, but these fall short of the ambitious scope of WGA.

There are many challenges in producing these highly complex accounts. These include:

- defining the coverage of WGA and therefore which bodies to include;
- the diversity of bodies, which have a number of different statutory bases and, as a consequence, different accounting frameworks, as well as accounting policies within those frameworks;
- the elimination of thousands of transactions and balances that exist between different parts of the public sector; and
- the scale of the data collection exercise.

WGA has been an on-going project for several years, with dry runs used to develop and test processes and procedures, with important input from the National Audit Office. Changes in coverage and accounting policies extended this important build up, prompting questions about whether WGA would ever see the light of day. The reality is, however, that producing WGA is challenging, and the dry runs have allowed continuous improvement to be made, so that the resulting accounts are meaningful.

With so many challenges, I am consistently asked about the benefits. This is particularly so in the face of ever more constrained resources in finance functions. The original scoping document identified a number of benefits to producing WGA, and these benefits still hold true today. Many may be of interest to governments outside the UK. WGA:

- improves **transparency** of the public sector finances. It has the look and feel of commercial accounts, making them more accessible. It differs from government's conventional presentations of public sector finances, where fiscal indicators used to manage the UK's finances are prepared using national accounts data;

- improves **accountability** through the independent audit of the accounts by the Comptroller and Auditor General. This supports effective scrutiny by Parliament;
- provides **complementary information** that can inform the sustainability of the public finances. A more complete and reliable balance sheet, with a full accruals view of income and expenditure, can support long-term fiscal analysis and decision making;
- increases the **completeness** of financial information as it includes data on provisions (including public service pension liabilities), private finance initiative (PFI) projects, future contract expenditure and contingent liabilities that are not included in other data sources. This brings greater clarity to these liabilities; and
- provides **consistent data** which can be used to strengthen fiscal discipline. The convergence of accounting policies across the public sector allows comparison of the use of resources across the public sector.

In July 2011 we published an unaudited summary of the 2009–10 WGA. This was the first ever publication of WGA data and perhaps somewhat unconventional, but we wanted to get this important data into the public domain. By doing so, the Office for Budget Responsibility (OBR) was able to obtain a picture of the UK's financial position as defined by accounting standards, and consider how this information might affect its analysis of the UK's long-term finances.

Moody's have expressed the view that WGA, together with the OBR's report bolster the UK's already strong fiscal planning process. I believe that the public sector finances benefit from an accounting view, and the greater levels of transparency add to the richness of the data available to inform fiscal decision making. I look forward to discussing the accounts with others in the UK and overseas who are interested, and to sharing with fellow faculty members the developing picture when we publish the 2010–11 WGA next year.

# FINANCIAL REPORTING IN SINGAPORE

Grace Chua, a Manager in ICPAS's Technical Division, provides an update for our members in Singapore.



## THE SPIRIT OF CONVERGENCE

Singapore positions itself as an international business and financial hub therefore

converging its own financial reporting standards with IFRS makes a lot of sense. Doing so not only eliminates financial reporting costs for companies operating beyond Singapore but also allows for smoother access into international capital markets.

Today, most companies in Singapore are substantially 'IFRS-ready' and 'IFRS-compliant'. The Accounting Standards Council (ASC) is working fervently towards full convergence with the IFRS for companies listed on the Singapore Exchange.

Many new and amended standards were issued by the ASC during 2011, primarily reflecting equivalent changes to IFRS and therefore maintaining the existing level of convergence. The gap between Singapore Financial Reporting Standards (SFRS) and IFRS is smaller than ever.

At the moment, key differences that remain include:

- **IAS 27 *Separate and Consolidated Financial Statements***: under IAS 27 paragraph 10(d), a parent need not present consolidated financial statements if their ultimate or any intermediate parent produces consolidated financial statements available for public use which comply with IFRS. SFRSs removes the requirement for the parent to be compliant with IFRS, meaning more intermediate parents can benefit from this exemption than is the case under IFRS.
- **IFRS 9 *Financial Instruments***: Singapore has not adopted the first phase of IFRS 9, which introduces new requirements for classifying and measuring financial assets. This standard will not be adopted until all three phases are completed.
- **IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments***: this interpretation has not been adopted in Singapore as there are practical difficulties in implementing it due to conflicts with local laws and jurisdictions.
- **IFRIC 15 *Agreements for the Construction of Real Estate***: an accompanying note to INT FRS 115 (the local equivalent of IFRIC 15) takes into account the legal framework in Singapore that is relevant when applying the interpretation to standard residential property sales. The note deals with the issue of whether significant risk and rewards of ownership

of uncompleted units are transferred progressively and therefore if revenue should be recognised by reference to the stage of completion using the percentage of completion method.

## FRESH FROM THE OVEN – CHARITIES ACCOUNTING STANDARD

In 2008, the ASC had commissioned a study into the development of a simpler financial reporting framework that is tailored to the needs of the charities sector. After public consultation in 2009, the ASC issued the Charities Accounting Standard (CAS) in 2011. This new standard was developed based on the requirements of FRSs. The CAS provides guidance in areas specific to Singapore charities such as the accounting for 'Preservation of Monuments' assets. The CAS is an alternative to SFRS and is designed make it easier for charities to comply with financial reporting requirements.

## REGULATORS DRIVE IMPROVEMENTS TO THE FINANCIAL REPORTING FRAMEWORK

Singapore regulators remain vigilant to improving and enhancing the financial reporting framework. On 20 June 2011, the Report of the Steering Committee for the Review of the Companies Act issued a consultation paper containing 217 recommendations, of which Chapter 4 related to accounts and audit. Some of the proposals, which align financial reporting requirements with the legislation, include:

- financial year-end of a parent company and its subsidiaries should be determined by SFRSs, rather than specified in the Companies Act;
- determination of whether a company should prepare consolidated accounts should be set out only by SFRSs and not the Companies Act; and
- components of what comprises a full set of accounts in the Companies Act should be referred to SFRSs so that amendments to SFRSs will not warrant amendments to the Companies Act.

Further details on the Report of the Steering Committee for the Review of the Companies Act can be found in the August 2011 issue of CPA Singapore, which can be viewed at [www.icpas.org.sg/mediacentre/CPA\\_Singapore.aspx](http://www.icpas.org.sg/mediacentre/CPA_Singapore.aspx)

# FINANCIAL REPORTING IN HONG KONG

Nigel Dealy, Director in Accounting Consulting Services of PricewaterhouseCoopers in Hong Kong, provides our members in the region with his personal views on recent developments and their implications for both Hong Kong and mainland China companies.



## IAS 12 – DEFERRED TAX AND ‘CORPORATE WRAPPERS’

There is a saying: ‘Be careful what you wish for!’

In my update in the July 2011 edition of *By All Accounts*, I suggested that the application of IAS 12 to corporate wrapper structures might be suitable for referral to the IFRS Interpretations Committee (IFRSIC). The question is: should the provision for deferred tax be made at the rate applicable to the sale of the wrapper’s shares or at the rate for the disposal of the asset it holds?

It is common for the asset held by the wrapper to be realised by selling its shares rather than by selling the asset it holds. It seems my wish was answered, as in September 2011 the IFRSIC reached a tentative decision – deferred tax should be provided at the rate applicable to the disposal of the asset – that will not be liked by many. If the decision is affirmed, those companies using corporate wrappers to hold investment properties in mainland China at fair value will see a significantly smaller reduction of their deferred tax liabilities when the amendment to IAS 12 on recovery of underlying assets is applied from 1 January 2012.

## FINANCIAL REPORTING COUNCIL (FRC) SHARPENS ITS TEETH

To reinforce Hong Kong’s reputation as a reliable capital market, from January 2011 the FRC started its proactive risk-based reviews of listed entities’ financial statements.

This marks a step change from when it only investigated complaints on possible auditing irregularities or non-compliance with an accounting requirement. The initial programme of over 70 financial statements (around 5% of listed companies) covers those newly listed (including those using Chinese Accounting Standards for Business Enterprises (CAS)), those with a change of auditors and pharmaceutical companies (2011’s industry theme).

The FRC allocates each set of financial statements to a large accounting firm and an academic from one of Hong Kong’s universities. They conduct their reviews independently. Only the FRC knows the totality of the review comments and the degree of overlap between those of the accounting firm and the academic.

Mainland China companies listed in Hong Kong and their auditors are not immune, as the FRC can challenge any identified deficiencies in their CAS (or HKFRS) financial statements with the co-operation of China’s Ministry of Finance and the China Securities Regulatory Commission, which would determine what actions might be taken against directors, their companies or their auditors. For other companies found deficient, the FRC has the power to ask for voluntary rectification of non-compliance with accounting requirements, or to seek a court order. The FRC also refers unrectified cases for follow-up action by authorities, including the Securities and Futures Commission, the Stock Exchange of Hong Kong and the HKICPA. We await the results of the 2011 reviews.

## HKICPA ACCOUNTING BULLETIN 4 (AB 4) – DISTRIBUTABLE PROFITS

Application of the 2010 guidance in AB 4 has caused some headaches, as directors, lawyers and auditors grapple with the, by no means new, Hong Kong Companies Ordinance’s (HKCO) requirements for distributions. It has highlighted:

- the need to ensure sufficient dividends from subsidiaries are paid up to cover a parent company’s distributions before they are proposed;
- the requirement for listed HK companies to file interim accounts with the Registrar of Companies (there is no filing requirement for annual accounts) showing sufficient realised profits to cover the proposed distribution, where the amount shown by the previous annual accounts is insufficient;
- the implications of dividend re-investment schemes (as these can be an ‘in-substance’ capitalisation of a subsidiary’s retained earnings), which are common in mainland China, that mean the parent should treat the dividend re-invested in the relevant subsidiary as unrealised; and
- changes in the principles of realisation as applied to reserves arising under the merger and group relief provisions of the HKCO, which are treated as unrealised and thus not available for distribution as had previously been thought.

These examples perhaps explain why Hong Kong’s Government had concerns about the previous lack of clarity over the meaning of ‘realised profits’ and called for the HKICPA to issue guidance which is now AB 4.

# TOWARDS A PAPERLESS OFFICE?

Faculty Manager, John Boulton, gives a personal view on proposals to bring UK narrative reporting into the twenty-first century.



Health and safety legislation has been blamed for many things, but in the world of financial reporting it made headlines when the UK Royal Mail reportedly limited the numbers of HSBC 2006 annual reports its postal workers were allowed to carry after the 454-page tome weighed in at around 1.5kg (3lb) – which is more than the average phone book. This example raises a very obvious question: is the ever increasing size of annual reports really of benefit to users?

**‘The financial crisis focused minds on risk reporting and a slew of consultations have been issued in recent months looking at options for the future.’**

With relevance, one of the guiding principles of IFRS, the length and complexity of company reports are important considerations; too little information and shareholders risk being inadequately informed, too much and relevance could be reduced. Yet this is a difficult balancing act, particularly where an increasing number of initiatives are pressing for incremental disclosure to be made.

The back part of the accounts is the remit of the IASB and we will leave the hard numbers to one side for now. In contrast, whether you call it the front end of the accounts, narrative reporting or management commentary, this is a section characterised by more qualitative, descriptive information; it is a place where future predictions can be aired or risk factors discussed. It’s also an area that has undergone significant evolution over the years, but the gradual accretion of requirements means an overhaul is overdue.

The financial crisis focused minds on risk and business model reporting and a slew of consultations have been released in recent months looking at options for the future. Narrative reporting and the reporting of risk are firmly on the agenda.

The world is rapidly changing and the ways in which we receive and digest information are continually evolving. In this context, it is clear that the days of the paper-based annual report are limited; for many, those days are already over. But while we may no longer print annual reports, much electronic access is via the familiar medium of the

pdf – a document that in look and feel is merely a replica of the paper version. Even where published in more interactive form, a linear, continuous document may still be favoured by many users.

It is the ability to break-down, to re-arrange and to inter-link information promised by electronic formats that could be one of the most exciting opportunities for financial reporting over the coming years. It’s an opportunity that has been recognised by the Department of Business, Innovation and Skills (BIS). As their consultations on the future of narrative reporting rumbles on, the latest paper, *Consulting on a New Reporting Framework*, sets out a new framework for narrative reporting. The proposed implementation is for accounting periods beginning on or after 1 October 2012.

The paper raises the prospect of a revised approach towards clutter. Clutter can be a problem where it starts to obscure other, more relevant information, something recently recognised by the FRC through their campaign to cut it. But while clutter cutting may be attractive, it is not always practical or desirable, as much of what falls into the clutter category was introduced to satisfy particular regulatory considerations. BIS have started from the premise that electronic publication has the potential to change the way we look at and use information. Rather than one continuous document, an electronic report could be broken down in new ways; different elements could fulfil alternative needs.

So the proposal is to split narrative reporting into two distinct parts, encompassing the current legal requirements for content of the directors’ report and business review, with some additional disclosure.

## THE STRATEGIC REPORT

This will be a place for key information about the company and will provide details on its key risks. It is expected that this report will show how a company goes about generating long-term sustainable value and it will provide a link between historical financial performance and future strategy and the business model. But the government is also more specific in places, suggesting companies would need to provide, where necessary, key social and environmental information, with required disclosure of key points on corporate governance and remuneration.

### THE ANNUAL DIRECTORS' STATEMENT

This will be a repository for detailed, specific information on performance or governance. It would include the director's remuneration report, corporate governance statement, the audit committee report and social or environmental matters. Those disclosures that are always required, regardless of materiality, would be included here and the statement would follow a prescribed format under standard headings. The intention is that this information will be published online.

Of course you could just stick the two parts together into a traditional annual report document and this is presumably how they will normally be presented, at least in the immediate future. But conceptually this separation could offer a fresh way of reporting in the digital world. As we move away from the traditional linear document, the strategic report could benefit from increased prominence

as a discrete information source. Freed from the prescriptive requirements of regulatory compliance contained in the annual directors' statement, it could foster greater company specificity in the articulation of risk and business models. It is unfortunate, therefore, that the government proposes a level of prescription over the content of the strategic report which many may consider a barrier to innovative reporting. BIS has also included some new disclosure requirements, for example on human rights issues and, most controversially, executive remuneration, which may distract from the potential benefits of the rest of the proposals.

Ultimately, electronic publication gives new opportunities to highlight information of particular relevance and to give sufficient prominence to key information about risk and business models, while still allowing more detailed, regulatory material to be included. How much it will influence the way in which we use corporate information remains to be seen.



# DIGITAL BY DEFAULT

Jack Mansfield, Head of E-Accounts Transition at the UK's Companies House, provides an update for faculty members on moves towards electronic filing.



## BACKGROUND

Companies House announced in November 2010 the intention to mandate electronic delivery of most of our filing services by March 2013. However, in March 2011 the Government announced a moratorium on new regulations that affect small businesses which overrode the planned regulations to remove paper filing. So mandating electronic delivery to Companies House is off the agenda for now, although this decision may be reviewed once the moratorium is lifted.

The UK Government remains committed to using digital technology to drive better services and lower costs. Quality online services should be the default solution for people needing to use government services. Not only are such services more convenient and cheaper, but they can be better and more personalised. Indeed, Companies House has achieved considerable success in recent years in persuading customers to submit documents electronically. The volume of submissions received through our electronic services has increased from around 30% in 2007 to nearly 70% now. This includes over 96% of incorporations, 96% of annual returns and nearly 40% of accounts. Over 99.9% of all searches for company information are carried out electronically through our web services. We are continuing to invest in making our electronic services simpler and easier to use for all customers. We recognise that this is the key to making services 'digital by default'.

**'We are continuing to invest in making our electronic services simpler and easier to use for all customers.'**

## FILING ACCOUNTS ELECTRONICALLY

The benefits to customers of filing accounts electronically are clear. It is safe and secure, saves time and postage and customers receive automatic confirmation when the accounts have been received and accepted. Over the last year the volume of accounts we are receiving electronically has increased by over 45%. Companies House first created an accounts filing service in 2006. This allows those companies which are allowed to do so under the Companies Act 2006 to file abbreviated

accounts. To this service has been added a simple balance sheet template for those needing to file accounts for dormant companies which have not traded. In October 2010, in collaboration with HMRC, we launched a 'joint filing' accounts template for small companies. This allows for accounts data to be input once, saved locally, and then used to separately file the accounts data required by Companies House and HMRC.

More information on all our web filing electronic services can be found at [www.companieshouse.gov.uk](http://www.companieshouse.gov.uk). Overall these services provide an option for over 75% of all companies to file accounts electronically if they wish.

In addition to creating our own accounts electronic filing services, we have worked with many accounts software package providers to enable electronic filing of accounts data directly from their products. The growing range of e-enabled accounts production packages, which are used by the majority of accountancy firms, can be viewed at [www.companieshouse.gov.uk/accounts](http://www.companieshouse.gov.uk/accounts). Nearly all of these packages have already been enabled for iXBRL filing of accounts to HMRC to comply with their requirement to submit corporation tax returns and accounts electronically from April 2010. We are encouraging the companies concerned to extend their software to feature electronic filing of accounts to Companies House as well. We are committed to using the iXBRL format for collecting accounts data, which is the same approach adopted by HMRC.

The growth in e-filing of accounts from software is encouraging and we have already received a number of full audited accounts in iXBRL.

## THE FUTURE

We are looking to create and support solutions for larger companies whose accounts are too complex to be filed using our existing electronic services. Soon we will be working with the providers of tagging software tools to enable their products for e-filing of iXBRL accounts with the public record. In due course Companies House will be developing products that will make accounts data available in an XBRL format to support the accounts information market.

Companies House would welcome any feedback on these developments from faculty members, and we will keep you informed as our electronic services evolve.

# AND FINALLY...

Recently we stumbled across a website offering an invaluable tool for accountants worldwide ... introducing [www.universalsuspenseaccount.com](http://www.universalsuspenseaccount.com)

A common problem for accountants is that balance sheets don't balance; there are differences on 'trial balances'; there are differences between what Company A thinks it owes Company B and what Company B thinks Company A owes it. Differences are also common in the banking world: it's easy to mistake £1m for £10m, thus giving rise to a difference of £9m.

Until the invention of the Universal Suspense Account (or USA as it is sometimes called), these differences either had to be found (but that often meant working late into the evening), or recorded in a 'suspense account' in the accounting records of the company in question. A suspense account in the accounts of an individual company is a meaningless fudge. But the USA recognises and uses the fact that 'if there is a difference in one account, there must be an equal and opposite difference in another account somewhere in the universe'. In other words the universe's accounting is in equilibrium. It balances.

## FREQUENTLY ASKED QUESTIONS

### Does the USA apply worldwide?

More than that, it applies to the universe! Not satisfied with sorting out the Middle East conflict, the USA seeks to reconcile the whole universe. We've all encountered accounting practices which we think are either 'out of this world' or perhaps, more accurately, 'unearthly' – the USA is set up to deal with such differences.

### How much does it cost to use the USA?

It costs nothing to use [universalsuspenseaccount.com](http://universalsuspenseaccount.com) to record differences, but there is a trading system – see below.

### Can I trade my surplus debits or credits?

Yes, a system modelled on trading in emissions allowances has been developed. If you have surplus debits, you can trade them with another party who has surplus credits (and vice-versa). Simply contact a party with surplus credits and negotiate a price. The website does not regulate trading in surpluses but asks that you post the price agreed so that other market participants can use these prices as a guide.

### Are there any accounting rules relating to the use of the USA?

The only rules developed for the USA are in the USA. Emerging Issues Task Force pronouncement 2009/34 *Difference holders' accounting for transactions in surplus debits and credits using the Universal Suspense Account* (127pp, \$19.95, hardback) is available from the FASB, Amazon and Tesco.

### Does the USA have applications in other unmatched areas?

As all men, and many women, know, there is a problem with unmatched socks. Men put a pair of socks into the washing basket, and only one returns (but sometimes three). Technically, the one-sock situation is known as 'going short in socks'; the three-sock situation is known as 'going long in socks'. Applying the general principles of the USA, an unmatched sock in one man's wardrobe must be matched by a surplus sock in another's.

[Universalsuspenseaccount.com](http://Universalsuspenseaccount.com) can also be used to record unmatched socks, thus allowing men short in socks to contact and trade with men who are long in socks, and thus for equilibrium to be restored.

### Does the USA have any other uses?

Few have been identified to date, though research continues. Using the USA to facilitate the matching of biro tops with biro barrels is a key area which is attracting the attention of the greatest academic minds in this area.

### Customer testimonials

'I'm an accountant in business and was at my wits end when my brand spanking new system, implemented by the finest minds in the IT world, and clearly programmed by monkeys, left me with an unexplained difference. Thanks to the USA, I've traded my debit, pulled the wool over the eyes of my boss and am retiring early on a massive bonus. Thank you USA!'

'I am an underemployed banker in the city and have already used the USA to develop a new security based on parceling up universal suspense account balances of various risk profiles which I've sold on to a 9-year old boy who found his Dad's credit card next to the PC. The USA is a fabulous idea.'



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