

IFRS Convergence Will Enhance Shareholder Value

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Agenda for this Session

- Why global accounting standards are needed.
- How they enhance shareholder value.
- Use of IFRSs around the world.
- IASB's Current Agenda and Work Plan.
 - Including convergence of IFRSs and US GAAP.
- Convergence of Chinese GAAP and IFRSs.

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Why Global Accounting Standards Are Needed

- Investors seek investment opportunities all over the world.
- Companies seek capital at the lowest price anywhere.
- Cross-border mergers.
- Analysts cover industries across the world.
- Accounting differences can completely obscure comparisons.

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Capital Markets Are Globalised

- **NASDAQ:** 10% foreign listings.
- **NYSE:** 20% foreign (33% of market cap, 47 countries).
- **US SEC overall:** 1,200 foreign, 55 GAAPs, with reconciliation.
- **London:** 16% companies, 66% of market cap, 67 countries.
- **Euronext:** 21% foreign.
- **Switzerland:** 26% foreign.
- **Luxembourg:** 86% foreign.
- **Germany:** 14% foreign.
- **HK:** 12% foreign if you include PRC

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Enhancing Shareholder Value

- **High quality global financial reporting standards, applied consistently, will benefit investors, lenders, and other capital providers:**
 - Enhance comparability of financial information.
 - improve the efficiency of allocation and the pricing of capital.

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Enhancing Shareholder Value

- **Benefits not only capital providers but also companies that seek capital:**
 - Reduce their compliance costs.
 - Remove uncertainties that affect their cost of capital.
- **Improve consistency in audit quality.**
- **Facilitate education and training.**

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Global SME Standards Are Needed

- Even for unlisted SMEs, financial statements that are understandable across borders are needed:
 - Banks operate multi-nationally.
 - Vendors from other countries.
 - Credit rating agencies.
 - Overseas customers.
 - Foreign venture capital.
 - Outside investors, family.

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IASB's Objectives

- 1 set of global standards:
 - International Financial Reporting Standards (IFRSs).
- Convergence of both current IFRSs and US GAAP to 'global gold standard'.
- Increase number of countries using IFRSs.
- Standard for SMEs based on user needs and cost/benefit.

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Use of IFRSs Around the World

For domestic listed companies:

| | Number of Countries |
|--------------------------------|---------------------|
| IFRSs required for all | 76 |
| IFRSs required for some | 4 |
| IFRSs permitted | 23 |

Today, IFRSs are used by listed companies in over 100 countries.

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Use of IFRSs Around the World

For domestic unlisted companies:

| | Number of Countries |
|--------------------------------|---------------------|
| IFRSs required for all | 24 |
| IFRSs required for some | 14 |
| IFRSs permitted | 26 |

Today, IFRSs are used by unlisted companies in over 60 countries.

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Use of IFRSs Around the World

- **Europe:** All listed since 2005.
- **USA:**
 - Foreign issuers – reconciliation.
 - SEC roadmap to eliminating reconciliation.
 - Convergence programme.
 - Domestic issuers?
- **Canada:**
 - All listed starting 2011.

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Use of IFRSs in ASIA

- Adopted all IFRSs virtually 100% word for word: **AU, NZ, HK, PH, SG, KR (optional 2009, required 2011), IN (task force developing plan)**
- Adopted many IFRSs word for word: **ML, PK, TH, LK**
- Adopted principles from IFRSs with few changes, but not guidance: **CN**
- National GAAP different from IFRSs: **BD, ID, JP, TW, VN**
- IFRSs (rather than national GAAP) permitted or required for some domestic companies: **CN (B-shares), HK (if incorporated outside HK)**

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Use of IFRSs - Concerns

- **"IFRSs as adopted in..."**
 - Europe and elsewhere.
- **IFRS 'equivalents': Dual reporting:**
 - New Zealand and Australia.
- **"In conformity with national GAAP" even though national GAAP = IFRSs:**
 - HK, SG, PH.
 - Pain without all the gain!
- **Public assertions of substantial convergence with IFRSs.**

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Hong Kong

- **Adopts IFRSs virtually word for word as HK FRS.**
 - Several HK interpretations.
- **Audit report and basis of presentation note refer to conformity with HK FRS.**
 - Will foreign banks and capital markets know HKFRS=IFRS?
- **Separate SME standard.**

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IASB Agenda Work Plan

- **Five broad types of projects:**
 - Conceptual Framework.
 - Projects in Memorandum of Understanding (MoU) with FASB.
 - Other major projects:
 - **Active.**
 - **Research agenda.**
 - Amendments to standards.
 - Minor 'corrections'.

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Conceptual Framework

- **Foundation for all standards.**
- **Current IASB and FASB versions need an overhaul:**
 - Clarify objectives.
 - Refine recognition and measurement concepts.
- **Being done in phases jointly IASB and FASB.**
- **Plan to finalise in phases.**

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Conceptual Framework Work Plan

| <i>Phases</i> | <i>Next step</i> | <i>Timing est.</i> |
|---|------------------------|------------------------------|
| A: Objective / qualitative characteristics | DP Done ED | July 2006 Q3 2007 |
| B: Elements / recognition | DP | 1H 2008 |
| C: Measurement | Rndtable DP | 1Q 2007 TBD |
| D: Reporting entity | DP | 2Q 2007 |
| E: Presentation and disclosure | DP | TBD |
| F: Purpose and status | DP | TBD |
| G: Not-for-profit entities | DP | TBD |
| H: Remaining issues | TBD | TBD |

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IASB-FASB Convergence Plans

- **October 2002: FASB-IASB agreement to:**
 - Remove differences.
 - Align agendas.
- **April 2005: US SEC Roadmap to eliminating the reconciliation.**
- **February 2006: Memorandum of Understanding (MoU) FASB-IASB:**
 - Milestones to meet SEC roadmap.

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MoU – Convergence Between IFRSs and US GAAP by 2008

- **What does convergence mean?**
 - Not identical standards.
 - Close alignment of principles.
 - Generally comparable trends.
 - Continued co-operation.

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MoU Project

- **Fair value measurement guidance**
 - FASB 157 issued.
 - IASB DP wrap-around was issued Nov. 2006.
 - Would define FV but would not change rules for when FV is required.
 - ED 2H 2008 or 1H 2009.
 - Final IFRS 2009 or later.

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MoU Project

▪ Business Combinations Phase II (joint IASB and FASB)

- ED issued June 2005.
- Had proposed full goodwill.
- IASB recently changed:
 - **Full goodwill will be an option.**
- FASB still supports full goodwill.
- Contingent consideration:
 - **Measured at fair value**
 - **Changes go through P&L**
- Transactions with NCI are transactions with owners, not P&L
- Final IFRS 4Q 2007.

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MoU Project

▪ Consolidation including SPEs

- Reconcile “control” and “risk and rewards” models.
- Issues to address:
 - **Control with less than a majority of the voting rights.**
 - **Investment companies.**
 - **Power to control as an agent.**
 - **SPEs.**
- DP late 2007.
- IASB alone, not joint with FASB.

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MoU Project

▪ Financial Statement Presentation

- IASB project (FASB has OCI).
- “Performance reporting”.
- Phase A – Separate statements of income and comprehensive income:
 - ED March 2006
 - Final IFRS 2007
- Phase B – One performance statement. Columns? Rows? Subtotals?
 - DP late 2007, ED 2008

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MoU Project

▪ Post-employment benefits including pensions

| | |
|--------------------------------|------------------|
| Current rules: | \$m |
| Deficit | 100 |
| Less 10% of liabilities | <u>40</u> |
| Excess | <u>60</u> |

Spread excess over 10 year working life of employees

Only \$6m of deficit hits P&L.

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MoU Project

- **Post-employment benefits including pensions continued**
 - IASB working group appointed.
 - Phase I (complete by 2010).
 - Less smoothing and deferral.
 - Presentation.
 - Settlements and curtailments.
 - Cash balance plans.
- **Everything else is in Phase Two, which would be joint with FASB**

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MoU Project

- **Revenue recognition (joint)**
 - DP expected late 2007.
 - Revenue arises from changes in assets and liabilities:
 - **Not overridden by 'earnings process' or 'realisation' notions.**
 - **Less smoothing likely.**
 - Revenue arises when performance obligations are satisfied:
 - **Amount recognised depends on measurement (FV) of remaining obligations, if any.**

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MoU Project

▪ Liabilities and Equity

- Criteria for classifying claims as liabilities or equity.
- Would amend IAS 32.
- FASB is developing a DP in mid-2007.
- IASB is likely to issue it as an invitation to comment by end of 2007.

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MoU Project

▪ Financial Instruments – Comprehensive (joint with FASB):

- Working group appointed.
- Likely: Fair value principle with exceptions only if no quoted market price.
 - **DP expected late 2007.**
- Derecognition separate project:
 - **Research expected late 2007.**

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MoU Project

▪ Leases

- Global Leasing Volume \$579bn
 - N America - 41%
 - Europe - 40%
 - Asia - 14%
 - Much off balance sheet!
- Joint project just beginning.
- DP late 2008.
- Likely: Put property rights and obligations on balance sheet.

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MoU Short-term Convergence

- **Income taxes (joint with FASB):**
 - Temporary difference approach, fewer exceptions. Only remaining exceptions:
 - Initial recognition of goodwill.
 - Unremitted earnings of foreign subsidiaries and JVs.
 - Tax uncertainties: FIN 48 vs IAS 37?
 - ED late 2007.
 - Final IFRS 2008.

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MoU Short-term Convergence

- **Joint ventures:**
 - Probably will eliminate proportionate consolidation.
 - Clarify definition of JV.
 - More extensive guidance.
 - Joint ED mid-2007.
 - Final IFRS 1H 2008.

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MoU Short-term Convergence

- **Impairment (joint with FASB)**
 - Staff research has started.
- **Government Grants**
 - Work deferred pending liabilities project.
- **Discontinued operations**
 - Amend IFRS 5 definition.
 - Converge with FASB.

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Other Major IASB Projects

▪ IFRS for SMEs

- Exposure Draft (ED) issued.
- Final IFRS 4Q 2008.
- For entities without public accountability (not listed, not financial institution).
- Stand alone document.
- Based on IFRSs but simplified and aimed at SME users.

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Other Major IASB Projects

▪ Insurance contracts – comprehensive project

- DP with preliminary views was issued 3 May 2007.
- ED late 2008.
- Would mean substantial changes to insurance accounting.
- FASB will issue wrap-around invitation to comment on IASB DP.

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Other Major IASB Projects

▪ Liabilities

- Covers all liabilities not covered by another standard.
- Eliminate 'contingent' liabilities.
- Liability = present obligation:
 - Recognise if reliably measurable.
 - Measure at expected value.
- Liability ≠ possible obligation arising from business risks.
- ED issued June 2005.
- Final IFRS 2H 2008.

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IASB Research Agenda

- Intangible assets
- Management commentary
- Extractive industries
- Emission trading schemes

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Amendments (1)

- **Related party disclosures**
 - ED issued Feb. 2007 relating to state owned entities.
 - **Disclosure not required if it is clear that related entities are not influencing each other.**
 - Also some changes to definition of related party.
 - Final IFRS 2008.

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Amendments (2)

- **Puttable instruments and obligations arising on liquidation**
 - Liability vs equity.
 - Big issue in Europe.
 - ED June 2006.
 - Final IFRS late 2007.
 - Responses to ED identified other issues:
 - **These will be dealt with in second phase of this project.**

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Amendments (3)

- **IFRS 2 Share based payment:**
 - Vesting conditions and cancellations
 - IFRS 2Q 2007.
- **IAS 33 Earnings per share:**
 - Treasury stock method.
 - ED 2Q 2007, IFRS 2H 2008.
- **IFRS 1 First-time adoption:**
 - Cost of investment in subsidiary
 - IFRS 4Q 2007.

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Convergence - PRC GAAP and IFRSs

- **February 2006 - 38 new CASs**
 - Substantially same principles as IFRSs.
 - Cover nearly all topics of IFRSs.
 - Effective 2007 for listed companies, allowed for others.
- **Nov. 2006 – 263 pages of implementation guidance**
- **April 2007 – 622 pages of additional guidance**
- **Plus two sets of Q&As**

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Examples of PRC Changes (1)

- FV of stock options = expense.
- Purchase accounting for business combinations.
- Goodwill not amortised.
- Minority interests part of equity.
- Capitalisation of development costs.
- Reversals of impairment losses.
- All derivatives recognised, FV through P&L.

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Examples of PRC Changes (2)

- Hedge accounting same as IAS 39.
- Investment property may be measured at FV through P&L.
- Non-monetary transactions measured at fair value.
- Temporary difference method for deferred taxes.
- Split accounting for compound instruments.

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The Future

2007 IFRS — 100 Countries + US Convergence programme.

2011 IFRS — 150 Countries + US Converged:

- No reconciliation required in US for foreign IFRS filers.
- Maybe even US companies allowed to use IFRSs.

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Thank you.

**Questions?
Comments?**



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