

iGAAP Newsletter  
Beyond the standards



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# Upfront

As 2010 draws to a close, there is no let up in the pace of change either in the UK or internationally.

Our topic of focus this month is the Accounting Standards Board (ASB)'s exposure draft on the future of UK GAAP – a document which brings us one step closer to the biggest change in UK financial reporting in a generation. We consider both the key proposals made by the ASB and also the actions companies may need to make in the shorter term to prepare for these changes.

More recently, the International Accounting Standards Board (IASB) has issued their long awaited exposure draft on hedge accounting – the last phase of their project on financial instrument accounting. Their key proposals will be covered in our next newsletter.

Important though these changes are, preparing financial statements for December year-ends may currently seem a more pressing concern for many. Our practical issue this month looks at those areas the Financial Reporting Review Panel (FRRP) have focused on which may be helpful in identifying some pitfalls to be avoided in preparing those accounts.

This quarter we interview Laurence Rivat, head of our French IFRS Centre of Excellence and member of the IFRS Interpretations Committee.

Deloitte LLP  
December 2010

# Practical issue: FRRP areas of focus

The FRRP Annual Report is available from the Financial Reporting Council website at [www.frc.org.uk/frrp/press/pub2349.html](http://www.frc.org.uk/frrp/press/pub2349.html) and the announcement of priority sectors for review at [www.frc.org.uk/frrp/press/pub2449.html](http://www.frc.org.uk/frrp/press/pub2449.html)

The recently published annual report of the Financial Reporting Review Panel ('FRRP', 'the Panel') shows no let up in the level of scrutiny applied to financial reporting in the United Kingdom, with 146 approaches made to companies compared to 112 in the previous year. This increase was primarily due to additional approaches to listed companies outside the FTSE 350 and AIM companies, a theme consistent with both the FRRP's announcement of priority sectors for 2011/12, reviews in which the Panel expressed a particular interest in companies outside the FTSE 350, and the summary section of the Annual Report which noted its concerns over the quality of reporting by some smaller listed companies and AIM companies. Taken together, this is clear evidence that – if they ever could – directors of smaller companies can no longer assume that they operate 'under the radar'.

## Priority sectors for 2011/12 reviews

The Panel has, for several years, announced in advance the industries upon which it will focus (although certainly not exclusively) in the coming years. For 2011/12, these sectors are:

- Commercial property
- Insurance
- Support services
- Travel

In addition, the Panel has stated a particular interest in companies operating in niche markets and those support service providers with a significant exposure to possible public sector spending cuts, as these are deemed to be particularly prone to risks in the current economic climate.

Receiving a letter from the Panel is rarely a welcome event. Even if no amendments to the financial statements result, a significant amount of management time may be expended in investigating and discussing the issues raised. The best defence against this is, of course, high quality financial reporting and the Panel can and will challenge any area where they suspect deficient accounting or disclosures. The Annual Report does, however, provide a useful insight into some of the areas upon which the Panel has focussed and in which it has frequently found flaws in companies' financial reporting.

## Directors' reports

In addition to its general reviews of company accounts, the Panel periodically engages in targeted reviews of particular aspects of company reporting and in its Annual Report it shares observations from the review of directors' reports.

### Principal risks and uncertainties

The Panel makes clear that it is concerned by more than the minimal compliance point of including a list of risks in the annual report, it also expresses an interest in:

- Consistency with other information in the accounts.
- Clear descriptions of risks, rather than short bullet points.
- Disclosure of risks which later events suggest must have existed, and been known, at the date of the annual report.

### Business reviews

The Panel makes clear its intention to monitor two areas in future reviews:

- Information about environmental, social and community issues and employee matters as required by the Companies Act.
- The explanation of the company's business model, as recommended by the new Corporate Governance Code.

### Other DTR requirements

It was noted that a number of smaller listed companies included no directors' responsibility statement in the annual report – a straight case of non-compliance with the Disclosure and Transparency Rules.

### Judgements, estimates and capital management

These are areas in which the Panel seeks illuminating, company specific information not boiler-plate box ticking. In particular, it stated that:

- an assertion that there are no areas of significant judgement or estimation is unlikely to be accurate and such assertions will be probed;
- companies are encouraged, where material, to indicate the impact of applying a different judgement to that taken by the directors;
- disclosures on capital management were often either absent or boiler-plate and uninformative; and
- relevant transactions or decisions (for example, a rights issue or suspension of dividend payments) should be reflected in the capital management disclosures.

### Revenue

Revenue and, in particular, the appropriateness and disclosure of revenue recognition policies has long been an area upon which the FRRP has focussed. The main issue noted in the Annual Report was superficial explanations of recognition policies, leading to the Panel enquiring as to the appropriateness of revenue recognition (particularly in industries where a high level judgement is required, such as multi-component software sales and sponsorship income of football clubs). The point is also made that revenue recognition policies are not set in stone and may need to be revisited if a company's business model changes – for example due to economic pressures.

Interestingly, the Panel also encouraged companies to consider deleting extraneous information relating to immaterial lines of business. An example, perhaps, of their desire to 'cut the clutter' in annual reports.

### Related parties

The Panel has raised concerns before over the assumption that key management personnel (whose remuneration must be disclosed in aggregate in accordance with IAS 24 *Related Party Disclosures*) are necessarily limited to the company's directors (whose emoluments are disclosed individually in accordance with the Companies Act). They reiterate this point, particularly with respect to members of executive or management committees who are not statutory directors, but might nevertheless be key management personnel.

### Impairment

Questions are raised about both the methodology of impairment reviews and the resulting disclosures, including:

- unexpected and unexplained changes in the discount rates used in value-in-use calculations;
- the same growth and discount rates being used for seemingly quite different cash generating units; and
- the need for sensitivity disclosures as required by IAS 36 *Impairment of Assets* when there is evidence of limited headroom in impairment reviews.

This last point is also highlighted in the recent Deloitte survey of financial statements, 'Drowning by Numbers', which notes that 68% of companies with goodwill included such disclosures – perhaps suggesting that they are becoming an accepted and standard part of annual reporting.

### Provisions

This was another area where inadequate disclosures were noted as a concern. In particular, some companies were asked to change their practice of including provisions within accruals or other balances, a practice which avoids the disclosure requirements for provisions.

### Business combinations

The concerns raised by the FRRP in respect of business combinations mirror those in the FRC's recent study of acquisition accounting; namely inconsistency between the possible intangible assets alluded to in narrative reporting and the actual intangibles recognised in the financial statements, the requirement to describe the factors giving rise to goodwill and inappropriate aggregation of different classes of intangible asset.

FRC Study:  
Accounting for  
acquisitions,  
available at  
[www.frc.org.uk/  
press/pub2205.html](http://www.frc.org.uk/press/pub2205.html)

### Financial instrument disclosures

The FRRP state, perhaps with a note of disappointment, that little improvement was noted in the quality of financial instrument disclosures and that the following requirements of IFRS 7 *Financial Instruments: Disclosures* continue to cause concern:

- analysis, by class of financial asset, of the age of assets that are past due but not impaired;
- maturity analysis of financial liabilities on an undiscounted cash flow basis (a number of companies were still analysing on a discounted basis); and
- analysis of sensitivities to each type of market risk exposure.

For companies not in the financial services industry and with few complex financial instruments, the deficiencies noted above might sometimes be relatively straightforward to resolve.

- Trade debtors constitute a class of financial asset and for some companies the first requirement might be satisfied by a simple ageing analysis of debtors due before the balance sheet date for which no bad debt provision has been recognised.
- Traditionally, it is expected that the notes to the accounts will tie to the balance sheet. If the maturity analysis of financial liabilities other than short term, interest free creditors does so, then it is probably wrong due to the effect of discounting on liabilities either at amortised cost or fair value.
- Market risk exposures for some companies may be limited to foreign exchange and/or interest rate risk. In these cases, the sensitivity analysis is really asking what would the effect on the financial statements have been had the rate at the year end been higher or lower.

### Operating segments

This is another area where inconsistencies between narrative and financial reporting were a stated cause for concern. In particular, where the narrative suggests a range of businesses operating in different countries but only one segment is identified or where the narrative focuses on non-GAAP measures but the segmental analysis is based purely on IFRS amounts.

### Half-yearly financial reports

It may be tempting to suppose that annual reports are under rather more scrutiny than interims, and indeed they make up the majority of the Panel's workload, but roughly 15% of reviews were of half-yearly financial reports.

The Panel makes the point that they most frequently found issues of non-compliance with the Disclosure and Transparency Rules (DTR), rather than with IAS 34. In particular, they note that a description of principal risks and uncertainties for the remainder of the year – not just a cross reference to the last annual accounts – is required. As this mirrors a point made by the FSA in their publication *List!* as far back as 2008, it is perhaps surprising that this continues to be a problem area.

## 'Appendix issues'

Letters from the Panel sometimes include an appendix detailing minor disclosure deficiencies and in their Annual Report they share some of the more common observations.

Inventory	<ul style="list-style-type: none"><li>• The cost formula (i.e. FIFO or average cost) used</li><li>• Inventory recognised as an expense, write downs and reversals</li></ul>
Construction contracts	<ul style="list-style-type: none"><li>• Methods used to determine the stage of completion of contracts</li></ul>
Income taxes	<ul style="list-style-type: none"><li>• Temporary differences and unused tax losses and credits for which no deferred tax asset or liability has been recognised</li><li>• Deferred tax balances and income or expensed for each type of temporary difference and unused tax loss and credit</li></ul>
Foreign exchange	<ul style="list-style-type: none"><li>• Foreign exchange gains and losses in the period</li></ul>
Borrowing costs	<ul style="list-style-type: none"><li>• Borrowing costs capitalised during the period and the capitalisation rate used</li></ul>
Investment property	<ul style="list-style-type: none"><li>• Analysis of direct operating costs between properties that are and are not generating rent</li></ul>
Share-based payment	<ul style="list-style-type: none"><li>• Weighted average share price at the date of exercises in the period</li><li>• Weighted average fair value of grants in the period and how that value was determined</li></ul>
Business combinations	<ul style="list-style-type: none"><li>• Acquiree's profit or loss since acquisition and revenue and profits had the acquisition taken place at the start of the year</li></ul>
Financial instruments	<ul style="list-style-type: none"><li>• Categories of financial assets and liabilities</li><li>• Impairment loss on receivables and the reconciliation of impairment allowance accounts</li><li>• For cash flow hedges, when cash flows are expected to occur and to affect profit or loss</li></ul>

The nature of many of these items suggests they may be either simple oversights or deemed to be immaterial (indeed, the Panel notes that they do not check whether 'appendix type' disclosure issues have been addressed in subsequent financial statements).

The issues raised in the Annual Report reflect the breadth of the Panel's activities and illustrate that they are likely to take an interest in any area where reporting could be improved. There are, though, some themes which can be identified.

- The scope of reviews is broader than financial statements in annual reports, with issues raised in respect of narrative reporting and half-yearly financial reports.
- Financial statements are expected to paint a coherent picture, with issues raised where, for example, narrative and financial reporting do not appear to tally.
- Statements that could be seen to result in avoiding disclosure requirements (for example, that there are no areas of judgement or that there is only one operating segment) are likely to be challenged.
- The Panel dislikes boiler-plate disclosures and expects information to be relevant and company specific.
- The significant judgement areas of revenue recognition, impairment and business combinations are likely to continue to be a point of focus.

# A coffee with ... Laurence Rivat



Laurence Rivat has been a partner in Deloitte's French practice since 1999 and since 2001 has led the French IFRS Centre of Excellence. Over her 22 years of work life, Laurence enjoyed exploring different experiences in different environments, first as an auditor (in France and in the US), then as a standard-setter (she worked for three years in London at the IASC, the IASB's predecessor) and finally as a partner in a technical department with global activities. Outside Deloitte, she has participated in various committees of the Autorité des Normes Comptables (ANC – the French standard setter). In particular, she monitored the French Advisory Group of the ANC who provided support to the IASB in developing IFRS 1 *First-Time Adoption of IFRS*.

In July 2009, Laurence was appointed to IFRIC (now the IFRS Interpretations Committee), the interpretive body of the IASC Foundation which aims to review and provide authoritative guidance on widespread issues in the application of IFRSs.

## **Do you see different approaches taken in different parts of the world either in standard setting or in the relationship between standard setters and stakeholders?**

In respect of relations with the IASB, I'm not sure I see many differences – at least within Europe. There is usually a community of users, preparers, accountants and regulators that liaise with their national standard setter and that then feeds into the IASB. That doesn't prevent some of those organisations inputting directly to the IASB as well.

In respect of France, the community mentioned above participates to debates organised by the French standard-setter. The organisation has been created and is funded by the Ministry of the Economy and Finance. The Board of the ANC is composed of 16 members. Seven of them (including the Chairman) are civil servants (some from the various courts and regulators), eight of them have been selected for their economy and accounting expertise and one is a representative of employees' unions.

One thing I would say is that sometimes I find that investors and users of accounts are not sufficiently involved in the process and we can only be regretful of that.

## **Is that something that the IASB could facilitate better or is that just the fact of life that some users and investors are not as engaged as might be desired?**

The reality is that if you want to be involved in standard-setting you need to have the personnel and the resources to do it and not all organisations have that. This is why you always find the bigger organisations are more involved because they are better able to be involved. It is extremely difficult for smaller organisations to be involved in standard-setting.

## **You are a member of the IFRS Interpretations Committee (IFRIC). How do you see the role of that group developing in the future?**

I think that IFRIC can do more. IFRIC members are on the ground and see the implementation issues. With the IASB being so busy on their core projects, IFRIC could prepare some work for the IASB on some of the other projects aiming at fixing the malfunctioning of some current standards – one of the examples of this is the work that IFRIC will be doing on put options over non-controlling interests. I think that's a good thing that IFRIC tries to progress on these implementation issues. It may go beyond a simple interpretation or annual improvement, but if the IASB want to outsource some work to IFRIC, I think that's good.

Currently, it seems to me that IFRIC too often rejects digging into issues due to the limitation that if the outcome requires changes to standards beyond annual improvements, it is only the IASB that can do that type of project. So we do not necessarily spend time looking at how those issues could be fixed.



**In terms of your input into IFRIC, what do you enjoy about that role and what do you find challenging?**

What I enjoy most is when we provide something that is helpful for constituents, as well as the interaction with people from various professional and geographical backgrounds.

What I find most challenging is being constrained on the extent to which we can provide help.

**We are now seeing IFRS being adopted, or potentially adopted, much more widely in Asia and in North and South America, how do you see that affecting the future direction of the IASB?**

I think that the IASB will learn a lot about the priorities and issues in those jurisdictions, from the consultation process on their future agenda that will take in place in 2011.

At IFRIC, we are already seeing implementation issues coming out of adoption of IFRS in new jurisdictions. One example is in Asia, where banking documentation is often written in a different way than in Europe with significant effects on whether bank loans are classified as current or as non-current liabilities.

As the IASB becomes aware of these differences in environment, there is a question of whether IFRSs will adapt to take account of local practices or whether those practices will change to adapt to IFRSs. It's going to be both ways in my view.

**There have been recent changes in the constitution of the French standard-setter (the ANC was founded in 2009, replacing the Conseil National de le Comptabilité and the Comité de le Réglementation Comptable). Has that changed the way that France interacts with standard setters in different countries?**

Not really, but the organisation has been simplified. The French standard-setter has always looked to interact with other standard-setters.

As far back as the 1980s, the French standard-setter has always been very involved with international standard-setting. Of course, the French have their own views on how transactions should be reflected in financial statements, but the standard-setter has always been willing to co-operate internationally and on a European basis. The French standard-setter worked alongside the IASB in developing IFRS 1 *First-time adoption of IFRSs* and they are currently doing research for the IASB on ways of improving IFRS 2 *Share-based payments*. There is also a lot of work going on with EFRAG (the European Financial Reporting Advisory Group).

**In our last newsletter, Ian Mackintosh mentioned the French standard-setter becoming more involved in research. Do you see that as a positive thing and do you see the same level of engagement from the UK?**

Yes. When I used to work at the IASB, I was desperate to find research other than that produced in the US. As I mentioned earlier, it has always been the wish in France to contribute to thinking and we know that the earlier in the process you get involved the more effective it is.

The UK standard-setter, along with in particular their German and Italian counterparts, have always been very involved at a European level. I want to acknowledge particularly the UK efforts in accounting research and thinking, which to me, was always impressive. However, as I said earlier, it is also a question of resources devoted to it.

**Thinking about IFRS more generally, do you see areas where IFRS needs more guidance or where the current standards need to change?**

I do believe that when developing IFRS 3 *Business combinations* and revising IAS 27 *Consolidated and Separate Financial Statements*, the IASB made a big mistake in requiring that when you gain control of an entity in which you already have a stake (for example, an associate becoming a subsidiary) you fair value the existing stake and recognise a gain. Similarly, when you dispose of a subsidiary but retain an interest, you recognise a gain on the whole investment. I do not believe that users or CEOs understand or are convinced by the economic representation that this accounting provides!

One area that is not well addressed is transactions under common control. Should these give rise to gains and losses in profit or loss, or only to equity entries? Should you use fair values or previous book amounts? These are quite common transactions, particularly at times of companies' demergers and reorganisations, and I think they should be higher on the IASB's agenda.

## The good, the bad and the ugly

<b>IFRIC agenda setting</b>	Sometimes good, sometimes bad
<b>The IASB's proposals on lease accounting</b>	Bad
<b>The IASB's outreach activities</b>	They are good. IFRIC should do the same (adapted).
<b>French food</b>	Good, of course!
<b>British food</b>	It depends! I've had good food in Britain, but I'm definitely not keen on sandwiches for lunch. Still, the Deloitte London office's cookies are just excellent (with Smarties preferably)!

# Topic of focus: the future of financial reporting in the United Kingdom

Further discussion on the differences between UK GAAP and the IFRS for SMEs is included in our December 2009 iGAAP newsletter and in the Deloitte publication IFRS for SMEs in your pocket – UK edition. Both are available at [www.deloitte.co.uk/auditpublications](http://www.deloitte.co.uk/auditpublications)

The FRED is available from the ASB's website at [www.frc.org.uk/asb/press/pub2414.html](http://www.frc.org.uk/asb/press/pub2414.html)

The project to replace current UK financial reporting standards with a new model based on the requirements of IFRSs has taken another step forward with the publication by the Accounting Standards Board (ASB) of a Financial Reporting Exposure Draft entitled *The Future of Financial Reporting in the UK and Republic of Ireland ('the FRED')*.

## The ASB's proposals

The policy proposal issued by the ASB in August 2009 suggested a three-tiered structure, with publicly accountable entities applying IFRSs as adopted by the European Union ('full IFRS'), smaller entities continuing to use the Financial Reporting Standard for Smaller Entities ('FRSSE') and other entities reporting under the IFRS for SMEs.

The FRED retains this basic model, but makes two important modifications:

- adding an option for subsidiary entities to use the same measurement and recognition framework as used in their group's financial statements, but with reduced disclosure requirements; and
- making certain amendments to the IFRS for SMEs for use in the UK and Ireland, creating the Financial Reporting Standard for Medium-sized Entities ('FRSME').

Tier 1	Publicly accountable entities	Full IFRSs as adopted by the European Union
Tier 1s	Qualifying subsidiaries	Full IFRSs with reduced disclosure requirements
Tier 2	Non-publicly accountable entities	FRSME
Tier 2s	Qualifying Tier 2 subsidiaries	FRSME with reduced disclosure requirements
Tier 3	Entities currently able to use the FRSSE	FRSSE

It is important to note that only Tier 1 constitutes 'IAS Accounts' as defined in the Companies Act 2006, all other tiers will be 'Companies Act Accounts' and hence subject to the EU's 4th and 7th Directives as enacted in UK law.

## Public accountability

An entity has public accountability if:

- as at the reporting date, its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
- as one of its primary businesses, it holds assets in a fiduciary capacity for a broad group of outsiders and/or it is a deposit taking entity for a broad group of outsiders. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds or investment banks.

The FRED retains the definition of public accountability suggested in the August 2009 proposals, but attempts to add clarity by providing a list of types of entity deemed to be publicly accountable, being:

- quoted companies;
- banks, building societies, credit unions and friendly societies;
- entities that undertake the business of effecting or carrying out contracts of insurance, including general and life assurance entities;
- pension schemes and employee benefit trusts; and
- investment trusts, investment companies, venture capital trusts, mutual funds, exchange traded funds, unit trusts, open-ended investment companies, custodian banks and stockbrokers.

In addition, it is made clear that entities holding assets in a fiduciary capacity for reasons incidental to their primary business are not publicly accountable. The following examples of such entities are given:

- travel or real estate agents;
- schools and charitable organisations;
- co-operative enterprises requiring a nominal membership deposit;
- sellers receiving payment in advance of delivery of goods or services; and
- solicitors, accountants and chartered surveyors holding client monies.

The guidance in the FRED is intended only to assist entities in determining whether they have public accountability, not to provide exhaustive lists and therefore other entities will need to consider whether their activities may bring them into the ASB's definition of public accountability.

#### **Small, prudentially regulated publicly accountable entities**

Concerns have been raised over the cost of applying full IFRSs for small financial institutions with a limited membership (for example, small local credit unions). In response to this, the FRED proposes that the FRSME be made available to publicly accountable entities meeting two strict criteria:

- that they be 'prudentially regulated' (that is, be an authorised insurance company, banking company, e-money issuer, MiFID investment firm, UCITS management company, person with permission to carry on a regulated activity under Part 4 of the Financial Services and Markets Act 2000 or a person carrying on an insurance market activity); and
- that they satisfy all three of the size conditions of a small company or small group under Companies Act 2006 (this means that the total value of assets held cannot exceed £3.26 million).

#### **Reduced disclosures for subsidiaries**

The option for reduced disclosures for subsidiaries was added as a result of responses to the August 2009 policy proposal – particularly from listed groups wishing to reduce the differences between group and subsidiary figures without the burden of full IFRS disclosures in every set of financial statements.

The reduced disclosure option would be available to all 'qualifying subsidiaries' on condition that they are not required to prepare consolidated financial statements and that their shareholders have been informed about, and do not object to, the use of the disclosure exemptions.

### Qualifying subsidiary

A qualifying subsidiary undertaking is an undertaking that does not have public accountability, and whose parent undertaking prepares publicly available financial statements in which that subsidiary is included.

The reduced disclosures section of the FRED consists of financial reporting standards, or paragraphs of standards, which a qualifying subsidiary need not apply and have been selected based on current UK GAAP exemptions and areas which are typically managed on a group basis.

#### Exemptions available for subsidiaries applying full IFRS

Presentation of a cash flow statement

Financial instrument disclosures under IFRS 7

Detailed disclosures on the valuation and effect of share-based payment schemes

Detailed disclosures on defined benefit schemes

Detailed disclosures on business combinations (other than the fair value of consideration paid and assets and liabilities acquired)

Analysis of net income or expense from discontinued operations

Comparative information on movements in property, plant and equipment, intangible asset and investment property balances

Disclosures on management of the company's capital

IFRSs issued but not yet effective

Detailed disclosures in respect of associates

Some assumptions and sensitivities significant for an impairment review

The exemptions from presentation of a cash flow statement and from disclosing information on financial instruments, share-based payments and defined benefit schemes would also be available to subsidiaries using FRSME. The other disclosures would not be required for any entities using the FRSME and hence additional exemptions are not necessary.

Exemption from disclosures on share-based payments, defined benefit schemes, financial instruments, business combinations, discontinued operations, associates and impairment reviews would only be available where equivalent disclosures are included in the financial statements. There is, however, no requirement for those consolidated financial statements to be prepared under IFRS or under FRSME. Accordingly, many of these exemptions may be available for subsidiaries of companies producing consolidated financial statements under, for example, US GAAP.

### Modifications to the IFRS for SMEs

The most significant proposed difference between the IFRS for SMEs and FRSME is in accounting for income taxes. The tax section of the IFRS for SMEs is based upon an exposure draft issued by the IASB in March 2009 as a potential replacement for IAS 12 *Income taxes*. This exposure draft was widely criticised and as a result the IASB is now pursuing a narrower project on income taxes.

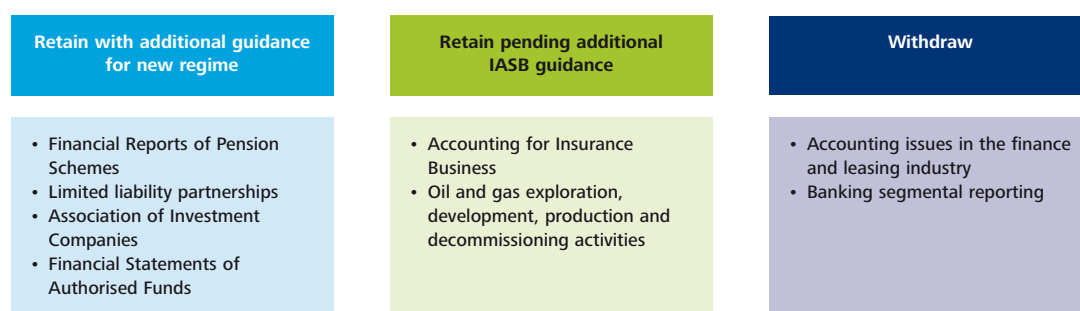
The tax section of the IFRS for SMEs was also criticised for being unclear and potentially unworkable in practice. For this reason, the ASB proposes to replace this section with the full, current text of IAS 12.

As noted above, all tiers other than Tier 1 (full IFRSs with full disclosures) constitute 'Companies Act Accounts' under UK law and hence must comply with the EU's 4<sup>th</sup> and 7<sup>th</sup> directives. In order to achieve this, a number of amendments are proposed to the IFRS for SMEs, for Tiers 2 and 2s and to IFRSs for Tier 1s. Many of these are minor or likely to be rare in practice, but of note are the following:

- requiring the preparation of consolidated financial statements only when so required by law;
- requiring equity accounting to be applied for associates and joint ventures in consolidated financial statements;
- requiring the recognition of negative goodwill on the balance sheet, to be amortised over the life of non-monetary assets acquired; and
- prohibiting offset of assets and liabilities and income and expense in respect of government grants, provisions and employee benefits.

### The role of SORPs

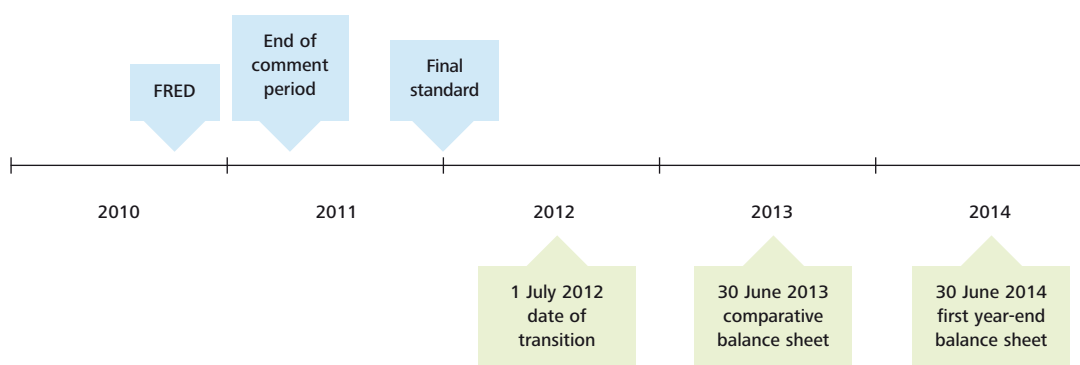
Statements of Recommended Practice (SORPs) currently provide valuable interpretative guidance under UK GAAP for entities in particular industries, the FRED proposes their retention only where there is a 'clear and demonstrable need' for such guidance.



### The timetable for change

The comment period for the FRED ends on 30 April 2011, with the ASB intending to develop a final standard by the end of 2011. This will be followed by an 18 month transition period, meaning the earliest possible date for mandatory adoption of the new regime is likely to be periods beginning on or after 1 July 2013.

This would give the following timeline for a June year-end company:



It may be tempting to look at this timeline and conclude that no action is needed until 2013 or 2014. It should be noted, however, that the date of transition may be only two years away and that any instruments or arrangements in place at that date would need to be accounted for under the new regime. Accordingly, companies may need to act before that date to avoid any unwanted implications for, for example, tax planning, distributable profits or loan covenants.

Companies may wish to undertake a high level impact analysis during 2011, in order to:

- determine which options are available to them and which of these may be preferable; and
- to highlight any significant business implications of the proposed changes.

A more detailed analysis could then follow in 2012 to ensure that the company is prepared ahead of its date of transition.

# Activities of the IASB

## **IASB issues additions to IFRS 9 for financial liability accounting**

The IASB has issued requirements on the accounting for financial liabilities. These requirements will be added to IFRS 9 *Financial Instruments* and complete the classification and measurement phase of the IASB's project to replace IAS 39.

The new requirements address the problem of volatility in profit or loss arising from an issuer choosing to measure its own debt at fair value. This is often referred to as the 'own credit' problem. Under the new requirements, an entity choosing to measure a liability at fair value will present the portion of the change in its fair value due to changes in the entity's own credit risk in other comprehensive income (OCI), rather than within profit or loss.

IFRS 9 applies to financial statements for annual periods beginning on or after 1 January 2013, but will not be considered for endorsement by the European Union until the remaining elements of the project (covering impairment and hedge accounting) have been completed.

## **IASB finalises enhanced derecognition disclosure requirements for transfer transactions of financial assets**

The IASB has issued amendments to IFRS 7 *Financial Instruments: Disclosures* as part of its comprehensive review of off balance sheet activities.

The amendments will allow users of financial statements to improve their understanding of transfer transactions of financial assets (for example, securitisations), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period.

The amendments are effective for annual periods beginning on or after 1 July 2011. In the first year of application, comparative information is not required.

## **IASB publishes exposure draft on hedge accounting**

The IASB has published for public comment an exposure draft (ED) on the accounting for hedging activities. The proposed model is principle based, and is designed to more closely align hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures.

The proposals of the ED include:

- a new hedge accounting model which combines a management view that aims to use information produced internally for risk management purposes and an accounting view that seeks to address risk management in the timing of recognition of gains and losses;
- considering whether a risk component can be identified and measured, as opposed to determining by type of item (financial or non-financial) what can be hedged;
- extending the use of hedge accounting to net positions (to improve the link to risk management); and
- a comprehensive set of new disclosures that focus on the risks being hedged, how those risks are being managed and the effect of hedging those risks upon the primary financial statements.

Comments on the ED are requested by 9 March 2011. The IASB intends to finalise and issue the proposals during the first half of 2011.

## **IASB and FASB consult on effective dates for convergence accounting standards**

The IASB has issued a request for views (RV) on when any final standards resulting from their current projects (significantly on leases, revenue, insurance contracts and financial instruments) should become effective.

Deloitte (Global) has issued an IFRS in Focus Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1011ifrs9.pdf> and Deloitte in the UK has issued an iGAAP Alert which is available at [www.deloitte.co.uk/auditpublications](http://www.deloitte.co.uk/auditpublications)

Deloitte (Global) has issued an IFRS in Focus Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1010transfers.pdf>

Feedback from the RV will inform the IASB as they and FASB jointly develop an implementation plan for those new standards that helps stakeholders to manage both the pace and cost of change.

Comments on the RV are requested by 31 January 2011.

### **IASB publishes IFRS Practice Statement on Management Commentary**

The IASB has published an IFRS Practice Statement Management Commentary, a broad, non-binding framework for the presentation of narrative reporting to accompany financial statements prepared in accordance with IFRSs.

The Practice Statement is not an IFRS. Consequently, entities applying IFRSs are not required to comply with the Practice Statement, unless specifically required by their jurisdiction.

### **IFRS trustees appoint Hans Hoogervorst to succeed Sir David Tweedie**

The Trustees of the IFRS Foundation, the oversight body of the IASB have announced the appointment of Hans Hoogervorst as chairman and Ian Mackintosh as vice-chairman of the IASB.

Hans Hoogervorst will succeed Sir David Tweedie on his retirement as chairman of the IASB at the end of June 2011. He is currently chairman of the Netherlands Authority for the Financial Markets (AFM), the Dutch securities and market regulator, chairman of the Technical Committee of the International Organization of Securities Commissions (IOSCO) and co-chair of the Financial Crisis Advisory Group (FCAG), an independent body of senior leaders formed to advise accounting standard-setters on their response to the global financial crisis. He will step down from all his present positions in order to join the IASB.

Ian Mackintosh, a former chief accountant of the Australian Securities and Investment Commission, has more than 30 years experience of national and international accounting standard-setting. He is currently chairman of the UK Accounting Standards Board and chairman of the group of national accounting standard-setters, a body in which more than 20 national and regional accounting standard-setting organisations participate.

### **Updated convergence report and IASB work plan**

The IASB and the US Financial Accounting Standards Board (FASB) have published an updated progress report on their convergence efforts.

The report confirms a target completion date of June 2011 or earlier for the joint priority projects on financial instruments, revenue recognition, leases, the presentation of other comprehensive income, and fair value measurement and for the IASB only projects on consolidation and insurance contracts.

In order to meet the June 2011 deadline, consideration of a number of other projects has been deferred until after June 2011.

### **IASB amends accounting for deferred tax**

The IASB has issued amendments to IAS 12 *Income Taxes*. IAS 12 requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 *Investment Property*. The amendment provides a practical solution to the problem by introducing a presumption that recovery of the carrying amount will, normally be, be through sale.

The amendment is consistent with an exposure draft published in September and is effective for periods beginning on or after 1 January 2012 with earlier adoption permitted.

### **IASB issues narrow amendments to IFRS 1**

The IASB has issued two narrow amendments to IFRS 1 *First-time Adoption of IFRSs*.

The first amendment replaces references to a fixed date of '1 January 2004' with 'the date of transition to IFRSs', thus eliminating the need for companies adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation.

The amendments are consistent with exposure drafts published in August and September and are effective for periods beginning on or after 1 July 2011 with earlier adoption permitted.



# UK GAAP Round Up

## ASB publishes proposals on the future of UK financial reporting

The Accounting Standards Board (ASB) has published a Financial Reporting Exposure Draft ('the FRED'), detailing its proposals for the future of financial reporting in the UK and Republic of Ireland.

The FRED proposes a three-tier approach, which has been developed and consulted on over the past six years:

- Tier 1 – Companies with quoted debt or equity instruments will report under IFRSs as endorsed by the European Union in both consolidated and company only financial statements. They would be joined in Tier 1 by other companies that are deemed to be 'publicly accountable' because they hold assets in a fiduciary capacity or are deposit taking entities.
- Tier 2 – All other UK entities, except those that apply the Financial Reporting Standard for Smaller Entities (FRSSE), would report under the Financial Reporting Standard for Medium-sized Entities (FRSME) – a standard based on the IFRS for SMEs, modified to comply with UK and EU law and by replacing the tax section of the IFRS for SMEs with IAS 12 *Income Taxes*.
- Tier 3 – The smallest companies will continue to use the simplified version of UK standards, the FRSSE.

The FRED proposes that entities be allowed to use a higher tier and that subsidiaries be able to comply with reduced disclosure requirements.

The consultation period on the FRED will run until 30 April 2011 and it is proposed that the new framework would be effective from 1 July 2013.

## ASB finalises amendments to FRS 8, FRS 29 and SSAP 25

The ASB has issued a Financial Reporting Standard (FRS) 'Improvements to Financial Reporting Standards 2010' amending FRS 8 *Related party disclosures*, FRS 29 (IFRS 7) *Financial Instruments: Disclosures and SSAP 25 Segmental Reporting*.

The changes are:

- revision of the definition of a related party in FRS 8 to conform with the current version of IAS 24 and with company law;
- to reflect the clarifications made to IFRS 7 in May 2010 as part of the IASB's Annual Improvements programme in FRS 29; and
- to update the references in company law in SSAP 25 to refer to Companies Act 2006.

The amendments are effective for periods beginning on or after 1 January 2011, with earlier application permitted.

## Further guidance on the determination of realised profits and losses

The Institute of Chartered Accountants in England and Wales (ICAEW) and Institute of Chartered Accountants of Scotland (ICAS) have jointly published TECH 02/10 *Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006*.

TECH 02/10 consolidates and builds upon previous guidance on the topic and offers additional guidance on a number of situations, including the application of the 'linkage' principle (requiring a group or series of linked or circular transactions to be viewed as a whole), 'cash box' structures used to raise equity finance and the application of section 846 of Companies Act 2006 to distributions in kind.

Deloitte in the UK has issued a ukGAAP alert covering this topic in more detail, which is available at [www.deloitte.co.uk/auditpublications](http://www.deloitte.co.uk/auditpublications)

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### **ASB issues study on the quality of capital management disclosures**

The ASB has issued a study of the quality of capital management disclosures in the annual report and accounts of 65 companies, examining the disclosures required by the Companies Act and IAS 1 *Presentation of Financial Statements* and those recommended by the ASB's Reporting Statement on the Operating and Financial Review.

This study concludes that there is good practice in places. But too often there is excessive boilerplate text and too many companies have missed essential elements of the required disclosures. The ASB has stated its intention to continue to monitor the quality of capital disclosures.

### **UITF issues Abstract 48 on replacement of RPI with CPI for retirement benefits**

The Urgent Issues Task Force (UITF) has issued Abstract 48 *Accounting implications of the replacement of the retail prices index with the consumer prices index for retirement benefits*. This issue arose as a result of an announcement of the government's intention to move to using CPI rather than RPI as the inflation measure for determining the minimum pension increases to be applied to statutory index-linked features of retirement benefits. In general, CPI increases have been lower than annual RPI increases and therefore the change has the potential to reduce pension scheme liabilities.

The Abstract considers three matters:

- whether there is a reduction in scheme liabilities;
- how the effect of a reduction in scheme liabilities should be presented; and
- when the effect of a reduction in scheme liabilities should be recognised.

The UITF reached a consensus that:

- whether there is a reduction in liabilities depends on facts and circumstances;
- where the scheme has an obligation to pay benefit increases based on RPI, the change in liabilities is a change in benefit and gives rise to a past service cost to be recognised in profit or loss in the accounting period when any necessary consultations have been concluded or employees' valid expectations have been changed; and
- where the scheme has no obligation to pay benefit increases based on RPI, a change to CPI is a change in the financial assumption about inflation used to measure scheme liabilities and represents an actuarial gain or loss to be recognised in the statement of total recognised gains and losses in the period when market expectations change.

The UITF also reached a consensus that disclosures explaining the effect of any changes to scheme liabilities arising from the replacement of RPI with CPI should be provided.

The accounting treatment required by UITF Abstract 48 should be adopted with immediate effect.

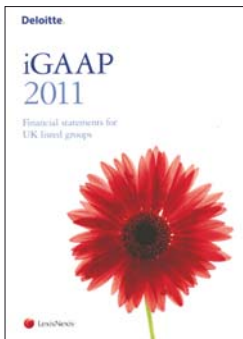
# Publications



## **iGAAP 2011 – IFRS Reporting in the UK**

The fourth edition of this guide (now in two volumes) sets out comprehensive guidance for UK companies reporting under IFRSs. It has been updated not only to deal with new or amended requirements but also to reflect increased practical experience of dealing with IFRS issues. It states the differences between the requirements of IFRSs and UK GAAP and also identifies UK specific requirements that apply to companies reporting under IFRSs.

*iGAAP 2011 – IFRS Reporting in the UK* may be ordered from LexisNexis at: [www.lexisnexis.co.uk/deloitte](http://www.lexisnexis.co.uk/deloitte)

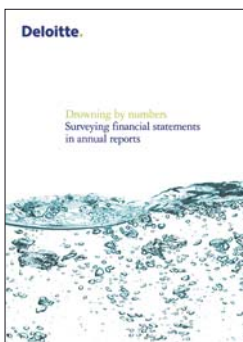


## **iGAAP 2011 – Financial statements for UK listed groups**

*iGAAP 2011 – Financial statements for UK listed groups* offers far reaching guidance on the presentation and disclosure requirements for financial statements for UK listed groups.

Beginning with a comprehensive explanation of the UK regulatory framework that forms the foundation of financial statements, this guide goes on to provide practical model financial statements. These in turn are complemented by a full and detailed commentary – highlighting the various disclosure requirements.

*iGAAP 2011 – Financial statements for UK listed groups* may be ordered from LexisNexis at: [www.lexisnexis.co.uk/deloitte](http://www.lexisnexis.co.uk/deloitte)



## **Drowning by numbers – Surveying financial statements in annual reports**

*Drowning by numbers* analyses the financial statements of 130 listed companies, split into two categories, being investment trusts and other companies. It includes a review of:

- the variety in presentation of the primary statements in listed companies' financial statements;
- which critical judgements and key estimations directors consider to be the most significant when preparing their financial statements; and
- how compliance with disclosure requirements and the accounting policy choices made under IFRSs varied.

*Drowning by numbers* is available at: [www.deloitte.co.uk/auditpublications](http://www.deloitte.co.uk/auditpublications)

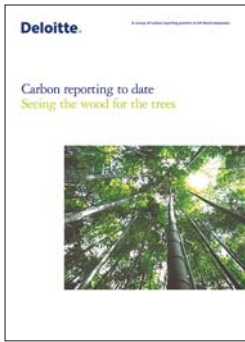


## **Swimming in words – Surveying narrative reporting in annual reports**

*Swimming in words* follows on from *A telling performance*, the 2009 survey on narrative reporting. The survey analyses the narrative reporting of 130 listed companies and includes a review of:

- how compliance with the disclosure requirements of the Companies Act 2006, the Listing Rules, the Disclosure and Transparency Rules and the Combined Code varied;
- the extent to which companies have adopted the FRC's revised guidance on going concern and liquidity; and
- the use of the ASB's Reporting Statement: Operating and Financial Review.

*Swimming in words* is available at: [www.deloitte.co.uk/auditpublications](http://www.deloitte.co.uk/auditpublications)



**Carbon reporting to date – Seeing the wood for the trees**

*Seeing the wood for the trees* is a report by Deloitte examining how a sample of 100 UK listed companies in 2009 publicly reported their greenhouse gas emissions or their ‘corporate carbon footprint’. It considers what information listed companies are reporting and to what extent they already comply with Defra’s guidance on the subject (which may become mandatory from 2012).

The survey highlights a number of ‘best practice’ disclosures and includes a reporting checklist and illustrative carbon disclosures for an annual report, drawing on our findings to provide a practical guide to assist preparers with their carbon reporting.

*Seeing the wood for the trees* is available at: [www.deloitte.co.uk/carbonreporting](http://www.deloitte.co.uk/carbonreporting)

# IFRS issued but not yet effective or endorsed by the EU

Title	Subject	Mandatory for accounting periods beginning on or after	Endorsed* or when endorsement expected (EFRAG 13 October 2010)
<b>IAS/IFRS standards</b>			
IFRS 9 (November 2009)	Financial Instruments: Classification and Measurement	1 January 2013	To be confirmed
Improvements to IFRSs (May 2010)	Improvements to IFRSs 2010	1 July 2010 or 1 January 2011 (varies by standard)	Q4 2010
Amendments to IFRS 7 (October 2010)	Transfers of financial assets	1 July 2011	Q2 2011

\* The critical date when considering endorsement is the date of approval of the financial statements

# ASB and IASB timetables

## ASB Current Projects

The Future of UK GAAP	<ul style="list-style-type: none"> <li>In October 2010, the ASB issued a Financial Reporting Exposure Draft ('the FRED') on the future of UK GAAP. Under these proposals, publicly accountable entities would use full IFRSs as endorsed by the European Union, entities currently able to use the FRSE would continue to do so and other entities would use the Financial Reporting Standard for Medium-sized Entities ('the FRSME') – a modified version of the IASB's IFRS for SMEs.</li> <li>The FRED proposes that entities be able to voluntarily 'move up' to a higher tier of reporting and that subsidiaries benefit from reduced disclosure requirements.</li> <li>Comments on the FRED are due by 30 April 2011.</li> </ul>
Convergence	<ul style="list-style-type: none"> <li>The ASB and the UITF continually consider what consequential amendments will be needed to UK GAAP once the IASB and IFRIC finalise standards, amendments and interpretations.</li> <li><i>Improvements to Financial Reporting Standards 2010</i> issued November 2010.</li> </ul>

## IASB Project Timeline – Active Projects

Annual Improvements to IFRSs – 2009-2011	<ul style="list-style-type: none"> <li>Final IFRS issued May 2010.</li> <li>Further ED expected first half of 2011.</li> </ul>
Conceptual Framework Eight phases in all	<ul style="list-style-type: none"> <li>ED on objectives and qualitative characteristics was issued in May 2008. Final chapter issued September 2010.</li> <li>ED on reporting entity was issued in March 2010, deliberations not expected to continue until after June 2011.</li> <li>Consideration of remaining phases not expected until after June 2011.</li> </ul>
Consolidation, including SPEs*	<ul style="list-style-type: none"> <li>ED issued in December 2008.</li> <li>Round tables held in June 2009.</li> <li>Final IFRS replacing IAS 27 and detailed disclosures on unconsolidated entities expected first half of 2011.</li> <li>ED on proposed changes for investment companies expected first half of 2011.</li> </ul>
Derecognition – disclosure*	<ul style="list-style-type: none"> <li>ED issued March 2009.</li> <li>Round tables held June 2009.</li> <li>Final IFRS on disclosure requirements for derecognitions issued October 2010.</li> </ul>
Discontinued operations amendment	<ul style="list-style-type: none"> <li>ED issued September 2008.</li> <li>Further ED expected first half of 2011 as part of annual improvements project.</li> </ul>
Fair Value Measurement Guidance	<ul style="list-style-type: none"> <li>ED issued May 2009.</li> <li>ED on measurement uncertainty analysis disclosures issued June 2010.</li> <li>Final IFRS expected first half of 2011.</li> </ul>
Financial Instruments (replacement of existing standards)*	<ul style="list-style-type: none"> <li>Classification and measurement of financial assets, Final IFRS issued November 2009.</li> <li>Classification and measurement of financial liabilities ED issued May 2010, Final IFRS issued October 2010.</li> <li>Impairment ED issued November 2009, Hedging ED issued December 2010, additional Impairment ED and Final IFRSs expected first half of 2011.</li> <li>ED and Final IFRS on asset and liability offsetting expected first half of 2011.</li> </ul>
Financial Statement Presentation* Phase B: Statement of information in the financial statements	<ul style="list-style-type: none"> <li>DP issued October 2008.</li> <li>ED on presentation of items of other comprehensive income issued May 2010, final IFRS expected first half of 2011.</li> </ul>
Income Taxes – limited scope project	<ul style="list-style-type: none"> <li>ED on recovery of underlying assets issued September 2010.</li> <li>Final IFRS issued December 2010.</li> </ul>

Insurance Contracts – Phase II	<ul style="list-style-type: none"> <li>• ED issued July 2010.</li> <li>• Round tables December 2010.</li> <li>• Final IFRS expected first half of 2011.</li> </ul>
Joint Arrangements	<ul style="list-style-type: none"> <li>• ED issued September 2007.</li> <li>• Final IFRS expected first half of 2011.</li> </ul>
Leases*	<ul style="list-style-type: none"> <li>• ED issued August 2010.</li> <li>• Round tables December 2010 and January 2011.</li> <li>• Final IFRS expected first half of 2011.</li> </ul>
Management Commentary	<ul style="list-style-type: none"> <li>• Output is best practice guidance, not an IFRS.</li> <li>• ED issued June 2009.</li> <li>• Final guidance issued December 2010.</li> </ul>
Post-employment Benefits (including Pensions)*	<ul style="list-style-type: none"> <li>• DP issued March 2008.</li> <li>• ED on defined benefit plans issued April 2010. Final IFRS expected first half of 2011.</li> <li>• Final IFRS on termination benefits expected first half of 2011.</li> </ul>
Revenue Recognition*	<ul style="list-style-type: none"> <li>• DP issued December 2008.</li> <li>• ED Issue June 2010, followed by round tables November 2010.</li> <li>• Final IFRS expected first half of 2011.</li> </ul>

Work on the projects on common control transactions, earnings per share, emissions trading schemes, financial instruments with characteristics of equity, financial statements presentation (replacement of IAS 1 and IAS 7), liabilities (IAS 37 amendments) and rate-regulated activities has been deferred. The Board expects to resume discussions on some or all of these topics in the second half of 2011.

\* IASB projects with milestones agreed in the February 2006 IASB-FASB Memorandum of Understanding on convergence – download the MoU at [www.iasplus.com/pressrel/0602roadmapmou.pdf](http://www.iasplus.com/pressrel/0602roadmapmou.pdf)

This timetable is derived from the IASB's published timetable supplemented by decisions and comments made at recent meetings of the Board. You will find details on each project, including decision summaries from each Board meeting, at [www.iasplus.com/agenda/agenda.htm](http://www.iasplus.com/agenda/agenda.htm)



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