

iGAAP Newsletter

Beyond the standards



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IFRSs set down requirements for the measurement and recognition of profits, but if a UK company wishes to pay dividends out of those profits its directors must consider whether those profits are distributable. Our practical issue this quarter considers the concept of distributable profits in the context of some of the more complex areas of IFRS accounting.

An item that can significantly affect a company's distributable profits is a defined benefit pension scheme. This quarter's topic of focus deals with a recent exposure draft (ED) produced by the International Accounting Standards Board (IASB) which proposes a number of amendments to the required accounting for such schemes.

The IASB and US Financial Accounting Standards Board (FASB) have recently announced a modified strategy for the convergence of IFRS and US GAAP, focusing on projects viewed as a priority. Subsequent to this, a modified work programme for IFRSs was released and is reflected in the ASB and IASB timetables section of this publication. Significantly, the project to replace all aspects of IAS 39 on financial instruments is now expected to be completed in the second quarter of 2011 and the project on derecognition is to proceed with a more limited scope.

One person who will not be involved in these future developments, but has been central to the development of financial reporting both in the UK and around the world, is Ken Wild – the recently retired head of Deloitte's Global IFRS Leadership Team and our interviewee this quarter.

Deloitte LLP
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Practical issue: Distributable profits

It goes without saying that a company's primary aim is to make profits. However, in the UK there is another consideration if a company wishes to transfer benefits to its shareholders – are those profits distributable?

The determination of distributable profits is a complex area, operating at the interface between accounting and company law and demanding an appreciation of both. This article aims to summarise briefly the key considerations for directors and their application to IFRS accounting.

Key considerations

As distributions are made by companies, a group's consolidated reserves position is irrelevant to its ability to pay dividends.

UK law dictates that a limited company may make a distribution only out of profits available for that purpose. Those are the accumulated realised profits less accumulated realised losses shown in the company's relevant accounts. Distributions by public companies are further restricted as such companies cannot make a distribution if by so doing its net assets would fall below the aggregate of its called-up share capital and undistributable reserves.

For the purposes of the law on distributions, a public company is any company designated as a plc whether or not its shares are traded on a market.

These terms are discussed below.

Distributions

The most obvious form of distribution is a company's annual dividend paid in cash. However, the term applies much more widely, encompassing any distribution of a company's assets to its members. This wider definition might often be significant to transactions within a group of companies, such as:

- the waiver of a liability due from a parent to its subsidiary;
- the transfer of tax losses for no consideration; or
- the transfer of a property for below its market value.

It is therefore important that directors are mindful of their distributable profits position whenever they are contemplating a transaction which could constitute a transfer of value from a subsidiary to its parent.

Realised profits

Profits are treated as realised when they arise in the form of cash or another form of 'qualifying consideration'.

Qualifying consideration comprises:

- (a) cash; or
- (b) an asset that is readily convertible to cash; or
- (c) the release, or the settlement or assumption by another party, of all or part of a liability of the company, unless:
 - (i) the liability arose from the purchase of an asset that does not meet the definition of qualifying consideration and has not been disposed of for qualifying consideration; and
 - (ii) the purchase and release are part of a group or series of transactions or arrangements that fall within paragraph 3.5 of this guidance; or
- (d) an amount receivable in any of the above forms of consideration where:
 - (i) the debtor is capable of settling the receivable within a reasonable period of time; and
 - (ii) there is a reasonable certainty that the debtor will be capable of settling when called upon to do so; and
 - (iii) there is an expectation that the receivable will be settled.

Tech 01/09 Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006.

Again, transactions within a group might often need careful consideration. For example, when a transaction results in recognition of a receivable from another group company it is necessary to consider whether the other company is capable of settling the balance and intends to do so.

Realised losses

The concept of qualifying consideration does not apply to losses. Losses are treated as realised unless the law, accounting standards or relevant technical guidance provide otherwise. This apparent discrepancy is an intentional result of the company law principle of providing protection for a company's creditors.

Relevant accounts

A company is required to determine whether it has sufficient distributable profits to make a distribution based on its relevant accounts. A company's last set of statutory accounts may be used for this purpose, but if they do not show sufficient distributable profits interim accounts must be prepared. Interim accounts for these purposes do not have to be in the same format as statutory accounts, indeed management accounts may be used provided they deal with all relevant matters (for example, a company's tax balances may need more consideration than would be the case for a normal set of monthly management accounts).

Again, public companies are subject to more stringent requirements. Their interim accounts for the purposes of determining the legality of a distribution must be filed with Companies House prior to the distribution and must be drawn up broadly in accordance with the requirements for annual accounts.

Application of IFRS accounting

When the requirements on distributions were enshrined in the Companies Act 1985, the use of historical cost accounting and the overriding principle of prudence meant that profits recognised in a company's accounts were most probably realised. The advent of IFRSs, with their increased focus on fair values, has meant that this is no longer the case.

In response to this, the Institute of Chartered Accountants in England and Wales (ICAEW) and Institute of Chartered Accountants of Scotland (ICAS) have issued guidance in this area, most recently Tech 01/09 *Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006* and Tech 03/09 *Proposed additional guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006*. Some of the more common areas which can cause difficulties are discussed below.

Share-based payment expenses

IFRS 2 *Share-based payments* requires an expense to be recognised in profit or loss in respect of equity-settled share based payment transactions, with a corresponding credit in equity. The expense is a realised loss. However the credit to equity is frequently considered distributable, meaning there is no net reduction in distributable profits. This is the case so long as:

- the goods or services reflected in the IFRS 2 expense do not, as a matter of law, constitute consideration for the issue of shares; and
- the expense is included in profit or loss (i.e. it has not been capitalised as part of a tangible or intangible asset).

Employee share schemes will often meet these conditions but share-based payment transactions with other suppliers may not.

The position for cash-settled share-based payment transactions is straightforward, as the expense recognised represents an accrual for cash payment and is therefore a realised loss.

Defined benefit retirement benefit schemes

A defined benefit balance results from a number of gains and losses (service costs, interest cost, actuarial gains and losses etc) and cash transactions (contributions paid by the company and benefits paid to members). Only the gains and losses are relevant to a company's distributable profits position.

The impact on distributable profits is determined by the cumulative net gain or loss recognised in reserves in respect of a scheme (including the gain or loss recognised in profit or loss and any gain or loss in other comprehensive income).

In summary:

- if a net debit to reserves has been recognised, this is a realised loss and there is no difference between the accounting balance and realised profits; and
- if a net credit has been recognised, this is realised only to the extent that it has been agreed by the scheme's trustees that a refund will be paid in qualifying consideration.

This is an example of the principle that losses are assumed to be realised whilst profits are not. A company's realised profits position with respect to a defined benefit scheme cannot be better than its accounting position, but it can be worse.

Fair value measurement

IFRSs require or allow various items to be measured at fair value. As a general principle, fair value gains are realised where they are readily convertible into cash, and as a result:

- profits on remeasurement of a financial asset traded in an active market would be expected to be realised; and
- revaluation gains on investment properties would not be realised.

The status of other fair value gains might be less clear and will require consideration on a case by case basis.

As is often the case, fair value losses are more likely to be considered realised than profits. In fact, such losses are only unrealised where:

- profits on remeasurement of the same asset and liability would be unrealised; and
- the losses would not have been recorded if fair value accounting not been applied.

Thus, to consider a fair value loss on an asset to be unrealised, it is necessary to demonstrate both that the asset is not readily convertible to cash and that if the asset were measured at cost it would not be impaired.

Hedge accounting

From a distributable profits point of view, it is necessary to consider the combined effect of both sides of a hedge relationship to determine whether there is a realised profit or loss.

The application of this to hedging under IAS 39 *Financial Instruments: Recognition and Measurement* is summarised below:

| Fair value hedge | Cash flow hedge | Net investment hedge |
|--|--|--|
| Where the net of the remeasurement of the hedging instrument and the hedged item is a loss, that loss is realised. Where it is a profit, that profit is only realised if the gain on whichever of the hedging instrument and hedged item gives rise to a gain would, if considered in isolation, be a realised profit. | Any gain or loss deferred in equity is unrealised and becomes realised only when the gain or loss is recycled to profit or loss. | In the rare circumstance where net investment hedging is relevant to individual company accounts, the gains and losses arising are considered equivalent to those arising from cash flow hedging for distributable profits purposes. |

Business combinations

Where a business combination is completed by the purchase of a subsidiary, the accounting required by IFRS 3 *Business Combinations* will most likely have no impact on distributable profits as the accounting will exist only at a consolidated level. Where trade and assets are acquired, the accounting may impact individual company accounts.

IFRS 3(2008) requires a gain to be recognised on acquisition in a number of circumstances (for example, on a bargain purchase or on settlement of a pre-existing relationship between the acquirer and the acquired entity). Careful consideration will be needed before concluding that any such profit is realised as it is unlikely that qualifying consideration will be received upon completion of a business combination.

Reduction of capital by solvency statement

One means of improving a company's distributable profits position is by reducing its capital (effectively converting share capital into distributable reserves). Under Companies Act 1985, such a reduction required court approval but since October 2008 a simpler method has been available.

A reduction of capital may now be affected by special members' resolution supported by a solvency statement signed by each of the company's directors. The solvency statement and special resolution must then be filed with the Registrar of Companies together with a statement of capital setting out the details of the reduced share capital of the company and a statement by the directors confirming that the solvency statement was made not more than 15 days before the passing of the special resolution.

The resolution to reduce the company's share capital then takes effect on registration by the Registrar.

The above is, of course, only an indication of the many issues which may need to be considered in determining whether a company has sufficient distributable reserves to make a distribution. Companies should consult with their advisers if they are in any doubt about this matter.

Further guidance on distributable profits can be found in the Deloitte publication *iGAAP 2010: IFRS Reporting in the UK*.

A coffee with ... Ken Wild



Ken Wild was a partner at Deloitte for 26 years until his retirement in 2010, for much of that time he led the firm's UK technical department and, more recently, the Global IFRS Leadership Team. Ken was also a member of the ASB from 1994 to 2003 and IFRIC from 2003 to 2009.

What do you see as the opportunities and risks facing standard setters in the coming years?

The opportunity is to achieve genuinely global standards and thus a common language of accounting. A common language does not mean complete uniformity because even a common language will have different accents, I think you will always be able to recognise a French, a German or an American set of accounts because they will look slightly different. What we have got to avoid is dialects. Dialects being, in accounting standard terms, words having different meanings for different people.

So I think that the opportunity is we will move to a common global set of standards. The risk is that it is such a vast task and when you consider bringing in, say, the Americans the difficulties become clear. The Americans have a really difficult task going from a very detailed set of rules to a less detailed set of rules, so there is real difficulty as we bring some people in.

I think the other main risk is politics and politicians interfering, trying to use accounting standards for regulatory, or tax reasons or whatever and interfering with the thing. Politicians will add layers which will potentially add complexity or may actually distort what we see as real numbers.

An example is the debate around impairment of loans where you ought to be telling the market where you have got to, what's happened with the loans you have made. What you shouldn't do is provide for loans you haven't even yet made on the basis that the economic cycle will turn down and when it does you'll make a load of losses. If you make a load of losses in the future, you make a load of losses in the future, you should not start distorting the accounting, telling people that you've made losses now for smoothing reasons or whatever and that I think is the big danger. The politicians may be acting either for straight political reasons or what they see as good reasons, but reasons that are actually distorting the purpose of accounting which is communicating what has happened to the company.

Will standards be simpler or more complex in ten years time?

I would like to think things can get simpler, but the world tends to make things more complex until you get to a point where they are so complex, somebody says too much and you do a complete rejig. I think that is further away than ten years.

What do you see as the IASB's greatest strength and its biggest weakness?

I think its greatest strength is the strength of will behind making it happen. I think they have some really good people involved and there is a genuine desire to do the job well.

The strength of all these different people from different cultures being involved is also its biggest weakness. The difficulty comes because people from different cultures have a different view of how to write standards. A group of British people will write a standard in a British way. If you put American, French, German, Japanese and British people together writing in different ways, they are tearing in different directions. The danger is that you say, let's just stop and go back to the theory and you forget about communication and start basing it too much on theory. This actually gets in the way of good communication, and accounting is all about good communication.

For example, we seem to be moving towards using exit values much more, whether for assets or for liabilities. Exit value makes enormous sense for some things. A lot of financial instruments, for example, are held for their resale value. But consider office or computer equipment; its exit value may be minimal, nobody wants the second hand equipment, but it's very valuable to you and would cost a lot if you had to replace it. You may want to put a fair value on those things, but exit value would be pretty meaningless.

Or take the example of properties. If you've owned a property for sixty years, its original cost may be pretty meaningless, so you want to revalue it. But why are you revaluing it? Is it because of what you could sell it for or what it would cost you to replace it? So I would say exit value is a good theory, but it may not work for everything.

Are there any major areas where we have no accounting standard yet, but we might in the future, or areas where we might see big changes?

I can think of quite a few I would like to do away with. Deferred tax, get rid of that one, earnings per share, get rid of that one. Unless we get into industry specific standards, I can't honestly think of anywhere we really want to have another standard. Perhaps we ought to have a standard on liabilities because we haven't actually got one, we have standards covering particular types of liability. We're messing around with IAS 37 and getting it very wrong, but we ought to have an actual liability standard.

What I was saying earlier about exit value equally applies to liabilities because that's essentially what they've sought to do with IAS 37. If I wanted somehow to remove completely this liability, what would I have to pay now? For something like litigation, the money you would have to pay now may be a million miles from what you actually intend to do.

What we are doing with things like associates and hedge accounting still needs quite a lot of work. The standards are there but it's a case of harmonising and improving.

What has been the most rewarding and the most challenging experience of your career?

The most rewarding is easy. I've come across so many people that are so good at what they do and so many people that I have really liked and enjoyed working with and have been intellectually stimulating.

Within a firm and a department like ours, we have a fantastic team of people and the banter that goes on is really enjoyable and rewarding. Outside the firm, some of the groups, such as working on the old accounting standards board were very much like that. It's interesting that the proceedings of those groups were not on public record. Whether it alters things when you put them on public record I don't know, but I have always thought the old ASB did a fantastically good job and was a very enjoyable thing to be involved in. I got a lot out of my involvement in public sector accounting because it was sort of nowhere, basically cash accounting and so archaic, and we've now moved to a decent form of accounting.

The issues in the public sector are fascinating. We all know what impairment of an asset is, it's when you are not going to get your money back. But when a government buys an aircraft carrier it doesn't actually get very much money back from it – so impairment must mean something different. You are trying to get to the same basic concept, you have got something you wish you hadn't paid that much for and it's not worth that much to you. There is no money that you are going to get back for it so you have to find another way.

Were there any turning points which changed the course of your career?

When I was at university, I always said there were three things I would never do: be an actuary because it was boring, be a teacher because I didn't have any patience for it and be an accountant because it was even more boring. I wanted to be an academic at university but I hadn't found the post, I needed a job in York and KPMG happened to have a York office and were advertising for people. I thought I would stick with it for a year until I found a proper job – literally that was how I got into accountancy. I then found I enjoyed it.

The next pivotal point was when I was six months qualified and the Accounting Standards Committee advertised for staff members. They were looking for people who were three years qualified and I thought, "that sounds interesting, but maybe in another few years" and my wife said to me: "well you're not going to lose anything by applying." I applied and I got the job and had a couple of years there. I was intending to stay longer but Deloitte advertised for people for a technical post. It was so unusual to see adverts for the technical department that I thought I might as well talk to them as I hadn't done an interview for a couple of years and it's always good to keep your hand in; so I came to Deloitte.

At the time Deloitte was thought of as a bit American and a bit brash; it was the smallest of the firms. I wasn't sure it was where I wanted to be but I found the people really friendly. When I was made a partner, I was just amazed how you were welcomed in; you became part of something that was very important to the individuals involved.

There are lots of other points when I was at the ASB, which became very significant to me. There are various things I suppose that were issues that I took very much for my own. For example, I thought we were getting to a stage that accounting standards were catering for large companies. The average small practitioner was producing a set of accounts for a small company that their bank manager wouldn't be able to understand and the practitioner would say to the company: "don't bother about these, we have got to produce them, got to sign them, got to file them, but you won't recognise your business in them."

I said we ought to do something for small companies and did a lot of campaigning, eventually convincing David Tweedie so he agreed to let me chair a working party. That was the origin of the FRSSE. Equally there was a working party some years later that I was asked to chair. I was chairing the technical committee at the industry and they asked if I would chair a committee on window dressing, which had become a bit of a cause célèbre. I said I would but I thought that the up and coming issue was off balance sheet finance. This then absolutely blew up. We produced a technical paper from the institute which eventually lead into FRS 5.

These became big issues that I was heavily involved in.

What will you miss most about Deloitte, and least?

100% I'll miss the people most. Deloitte has good people, not only in my department – who I obviously know best – but spread across the firm. I also think what I do makes a contribution, both to the firm and more widely. I enjoy it and I think it is interesting, so I will miss the work as well; but it's the people I will miss most.

I am really looking forward to being in control of my own time. I have always felt it is in the nature of what I do that I have to be available 24 hours a day. I never mind when people phone me up in the middle of the night because they are in the office working and I am at least at home, but it will be quite nice not to be subject to that, not to feel responsible.

| The good, the bad and the ugly | |
|---|--|
| Public sector accounting in the UK | Good, certainly compared to other jurisdictions. I can't say we lead the world as New Zealand, for example, has a very well established system, but pretty good. |
| Fair value measurement | Good bits, bad bits and ugly bits. |
| IFRS for SMEs | Good. Probably the best possible, but could have been better if those that were enthusiastic about it had been allowed to proceed without compromises from those that weren't so sure. |
| Political influence on accounting standards | Bad and ugly. |
| Retirement | Good. |
| Beards | Handsome. |

Topic of focus: Proposed amendments to accounting for defined benefit plans

Accounting for defined benefit plans has long been recognised as one of the more complex and controversial areas of financial reporting. It is also an area in which IFRSs include an unusual amount of optionality, both in the timing of recognition of gains and losses relating to such plans and in their presentation in the statement of comprehensive income.

The IASB's recent exposure draft (ED) *Defined Benefit Plans – Proposed amendments to IAS 19* seeks to address the following perceived deficiencies in the current standard:

- companies do not have to account for changes in their defined benefit plan immediately, with the so called 'corridor approach' allowing deferral of some actuarial gains and losses;
- there is little comparability in presentation of amounts relating to defined benefit plans, with actuarial gains and losses recognised either in profit or loss or in other comprehensive income (OCI), but with limited guidance on the presentation of other items within the income statement; and
- there are voluminous disclosure requirements in this area, but these may not always highlight the risks arising from defined benefit plans.

The IASB seeks to address these issues through the ED by standardising the recognition and presentation of gains and losses relating to defined benefit schemes and by introducing new disclosures focussing on risks.

The ED does not address the measurement of defined benefit plans (i.e. the projected unit credit method and the actuarial assumptions inherent in its use) or the accounting for defined contribution schemes. The IASB will consider after 2011 whether to address these topics.

Recognition of actuarial gains and losses

The so called 'corridor method' of deferring a portion of actuarial gains and losses falling outside a specific range (being the greater of 10% of the defined benefit obligation and 10% of the fair value of plan assets) has long been something of an anomaly in IFRSs in allowing some gains and losses not to be recognised at the point they arise. Certain gains and losses (for example, the effective portion of cash flow hedges and revaluation gains on items of property, plant and equipment) are recognised outside profit or loss, but the corridor method of disclosing gains and losses in full but spreading their recognition over a number of years is unique to defined benefit plan accounting.

The ED's proposal to remove this option is intended both to make it easier to understand defined benefit balances and to improve comparability between companies.

Comparison with current UK practice under IAS 19

The corridor approach is employed only by a minority of UK companies in accounting for defined benefit plans. Therefore, this element of the ED (while it is very significant for those entities using the corridor approach) might have less impact on financial reporting in the UK than in other territories where use of the corridor is more widespread.

Presentation of gains and losses

The current version of IAS 19 also offers a choice in the presentation of actuarial gains and losses, meaning that some companies present these, often significant, movements within profit or loss while others present these as items of other comprehensive income.

In addition, IAS 19 does not prescribe the presentation of the various other gains and losses recognised within profit or loss (current service cost, interest cost, expected return on plan assets, curtailment gains etc), which leads to additional variation in practice and lack of comparability between different sets of financial statements.

The ED proposes a simpler, but much more prescriptive approach, classifying all gains and losses into one of three categories and prescribing the presentation of each:

| Category | Comprises | Recognised in |
|-------------------------------|---|------------------------------------|
| Service cost | Current and past service costs and curtailment gains and losses. | Employment costs (profit or loss). |
| Net interest income (expense) | The expected change in net surplus or deficit due to the time value of money. | Finance costs (profit or loss). |
| Remeasurement | <ul style="list-style-type: none">• Actuarial gains and losses.• Return on plan assets.• Gains and losses on non-routine settlements.• Change in the limitation in recognition of net plan assets. | Other comprehensive income (OCI). |

Comparison with current UK practice under IAS 19

The approach suggested by the ED is, on the face of it, similar to that prescribed by FRS 17 (with actuarial gains and losses recognised outside profit or loss and a split between operating and finance elements of costs within profit or loss) and applied by many UK companies in their IFRS reporting.

There are, however, significant differences in the apportionment of gains and losses between the three categories, most notably:

- finance costs in profit or loss are a function of only the net plan surplus or deficit and the time value of money, the concept of expected returns on plan assets is eliminated, actual returns go into OCI;
- settlement gains and losses will be recognised in OCI, not as part of the employee expense in profit or loss; and
- all changes arising from the limitation on recognition of assets for plans in surplus will be recognised in OCI, rather than following actuarial gains and losses to either OCI or profit or loss.

Thus, the ED proposes a split which is superficially similar to the approach currently employed by many UK companies but there may be significant differences in calculated the three items.

Disclosure

In the ED, the IASB attempts to respond to criticism that the requirements of IAS 19 result in disclosures which are of excessive length but which neither aid an understanding of the affect of defined benefit plans on the financial statements as a whole, nor highlight information about the risks arising from such plans.

The ED's revisions to disclosure requirements are thus intended to satisfy the following objectives:

- explanation of the characteristics of an entity's defined benefit plans;
- identification and explanation of the amounts in the financial statements resulting from those plans; and
- description of how future cash flows may be affected by defined benefit plans.

The removal of the option of the 'corridor method' naturally leads to a reduction in the number of disclosure requirements, as this is an option that currently requires a high level of disclosure.

The ED proposals also include requirements to disclose:

- further quantitative information on actuarial assumptions, including:
 - separate disclosure of actuarial gains and losses arising from changes in demographic and financial assumptions;
 - sensitivity analyses about actuarial assumptions; and
 - the present value of the defined benefit obligation adjusted to exclude the effect of projected growth in salaries;
- further narrative information on risks associated with defined benefit plans and the investment strategy for plan assets, including factors that could cause contributions over the next five years to differ from current service costs.

Comparison with current UK practice under IAS 19

Many UK companies have taken note of the ASB's voluntary reporting statement *Retirement Benefits – Disclosures* and make disclosures in excess of the minimum requirements of IAS 19. In particular, disclosing an analysis of the sensitivity of the defined benefit obligations balance to changes in actuarial assumptions.

However, the proposed disclosures, for example, disaggregation of actuarial gains and losses and adjustment for the effect of projected growth in salaries, go beyond the suggestions of the ASB statement.

Other proposed changes

The ED includes other proposed changes, intended to add clarity in a number of areas.

Classification of employee benefits

The ED proposes the removal of the distinction between 'post employment benefits' and 'other long-term employee benefits', meaning that all long-term defined benefit arrangements would be recognised, measured and disclosed in a consistent manner as described above. Thus, for benefits such as long-term profit sharing or bonus arrangements and long-term disability benefits some elements of actuarial gains and losses are proposed to be taken to OCI.

Administrative costs

The ED specifies that only costs relating to the management of plan assets would be presented as a reduction in the return on plan assets (and, therefore, within the 'remeasurement' category in OCI). Future administration costs relating to the administration of benefits would be included in the measurement of the defined benefit obligation.

The next steps

Comments are invited on the ED by 6 September 2010 and following consideration of comments received the IASB expects to finalise amendments to IAS 19 by June 2011 with an effective date no earlier than 1 January 2013.

As noted above, several of the proposals might be expected to have less impact in the UK than in some other territories, but they will still have significant implications for the presentation and disclosure of defined benefit plans, and perhaps other long-term employee benefits, some of which may require additional involvement of a scheme's actuaries.

Activities of the IASB

The following amendments can be downloaded from the IASB's website at www.iasb.org

Deloitte (Global) has issued an IFRS in Focus Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1006convergence.pdf>

IASB and FASB modify convergence strategy

The International Accounting Standards Board (IASB) and U.S. Financial Accounting Standards Board (FASB) (collectively "the Boards") have announced a modified strategy for the convergence of IFRS and US GAAP. This comes at a time of unprecedented standard-setting activity. The Boards first entered into a Memorandum of Understanding (MoU) in 2006, which was updated in 2008. The MoU's objective is to improve and converge many of the Boards' respective accounting standards. A work plan was established that contemplated the completion of the MoU projects by June 2011. In addition, the IASB added many non-MoU projects to its agenda as part of its overall work plan.

In 2009, the G20 Leaders called on the Boards "to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011." The Boards responded to the G20 by reaffirming their commitment to improving their standards and intensifying their convergence efforts by meeting jointly and at least on a monthly basis. This increased level of activity would have resulted in issue of a significant number of proposals for comment in a very short period of time.

Constituents have since expressed concern about their ability to provide meaningful input on these proposals given their number, significance and, in some cases, complexity. Concerns have also been voiced about the vast resources that would be necessary to implement such a large number of new standards in a short period of time.

In response to these concerns, the Boards have released a joint press release announcing modifications to their convergence strategy as follows:

- major MoU projects will be rescheduled to prioritise those that will provide significant improvement and convergence between IFRS and US GAAP;
- no more than four significant or complex Exposure Drafts will be issued in any one quarter to allow for full stakeholder participation in due process; and
- a separate document will be issued requesting constituent input on the proposed effective date and transition methods for the projects covered under the new work plan.

Following this announcement, the IASB issued a revised work plan for those MOU and non-MOU projects affected by the Boards' modified convergence strategy, confirming its goal of completion of several of these by June 2011 while extending the timeline for others considered non-urgent.

The joint projects on financial instruments, revenue recognition and leases are to be given priority. The projects on derecognition, financial instruments with characteristics of equity and the main project on financial statement presentation are significantly delayed.

Specifically, the objective of the derecognition project has changed from convergence before 2012 to enhancement, in the near term, of the disclosure requirements regarding an entity's exposure to the risks of transferred assets under the Boards' existing derecognition models. Additional research and analysis will be carried out prior to the assessment of the nature and direction of any further convergence efforts.

Additionally, in response to stakeholders' concerns (including those of the Basel Committee on Banking Supervision and the Financial Stability Board), a new project on Balance Sheet Netting of Derivatives and Other Financial Instruments has been introduced.

IASB issues exposure draft on revenue

The IASB and FASB have jointly published for public comment an exposure draft (ED) on Revenue from Contracts with Customers. If adopted, the proposals would supersede IAS 11 *Construction Contracts* and IAS 18 *Revenue* and related interpretations. The core principle proposed in the ED would require an entity to recognise revenue to depict the transfer of goods or services to customers at an amount that reflects the consideration that it expects to receive in exchange for those goods or services.

To apply that principle, an entity would:

- Identify the contract(s) with a customer. Normally each revenue transaction is a single contract, but sometimes the elements of a multiple-element contract must be accounted for separately or, less commonly, two contracts be combined.
- Identify the separate performance obligations in the contract. If an entity promises to provide more than one good or service, it would account for each promised good or service as a separate performance obligation only if the good or service is distinct – that is, it is or could be sold separately.
- Determine the transaction price. Transaction price is the probability-weighted amount of consideration that an entity expects to receive. This would take into account collectability, the time value of money, the fair value of non-cash consideration and consideration payable to a customer.
- Allocate the transaction price to the separate performance obligations in proportion to the standalone selling prices of the goods or services underlying each performance obligation.
- Recognise revenue when the entity satisfies each performance obligation by transferring the promised good or service to the customer. A contract for the development of an asset (for example, construction, manufacturing, and customised software) would result in continuous revenue recognition only if the customer controls the asset as it is developed.

The ED also specifies the accounting for contract costs. Costs of obtaining a contract are charged to expense when incurred. If the costs incurred in fulfilling a contract are not eligible for capitalisation in accordance with other standards (for example, IAS 2 *Inventories*), an entity would recognise an asset only if those costs:

- relate directly to a contract (or a specific contract under negotiation);
- generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- are expected to be recovered.

Comments on the ED are requested by 22 October 2010.

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1006/revenue.pdf>

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1005improvements.pdf>

IASB issues improvements to seven IFRSs

The IASB has issued amendments to the following seven IFRSs as part of its programme of annual improvements to its standards. These amendments had been proposed in exposure drafts issued in August 2008 and August 2009.

| IFRS | Subject of amendment |
|---|--|
| IFRS 1 First-time Adoption of IFRSs | <ul style="list-style-type: none"> Accounting policy changes in the year of adoption; Revaluation basis as deemed cost; and Use of deemed cost for operations subject to rate regulation. |
| IFRS 3 Business Combinations | <ul style="list-style-type: none"> Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS; Measurement of non-controlling interests; and Un-replaced and voluntarily replaced share-based payment awards. |
| IFRS 7 Financial Instruments: Disclosures | Clarification of disclosures. |
| IAS 1 Presentation of Financial Statements | Clarification of items to be included of the face of the statement of changes in equity. |
| IAS 27 Consolidated and Separate Financial Statements | Transition requirements for amendments arising as a result of IAS 27. |
| IAS 34 Interim Financial Reporting | Disclosure of significant events and transaction. |
| IFRIC 13 Customer Loyalty Programmes | Fair value of award credits. |

Most of the amendments are effective for annual periods beginning on or after 1 January 2011, although entities are generally permitted to adopt them earlier.

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1005fvoliabilities.pdf>

IASB issue exposure draft on measurement of financial liabilities

Many investors and others have said that volatility in profit or loss resulting from changes in an entity's own credit risk is counter-intuitive and does not provide useful information – except for value changes relating to derivatives and liabilities held for trading (such as short sales).

In response to these concerns, the IASB has published for public comment an exposure draft (ED) proposing that all gains and losses resulting from changes in 'own credit' for those financial liabilities that an entity chooses to measure at fair value should be recognised as a component of 'other comprehensive income', not in profit or loss.

The ED does not propose any other changes for financial liabilities and consequently the proposals will affect only those entities that elect to apply the fair value option to their financial liabilities.

Comments on the ED are requested by 16 July 2010.

IASB issues exposure draft on statement of comprehensive income

The IASB has published for public comment an exposure draft (ED) proposing to require that all entities present profit or loss and other comprehensive income (OCI) in separate sections of a single continuous statement. This would amend IAS 1 *Presentation of Financial Statements*, which currently allows entities a choice of presenting results of operations either in a single, continuous statement similar to the proposal in the ED or in two separate statements. Other proposals in the ED include:

- that items of OCI should be grouped on the basis of whether they will eventually be 'recycled' (reclassified) into the profit or loss section of the statement of comprehensive income; and
- that income tax on items presented in OCI would be allocated between items that might be subsequently 'recycled' and those that will not be 'recycled', if the items in OCI are presented before tax (which is an option).

The title of the statement of comprehensive income would be changed to 'Statement of profit or loss and other comprehensive income' when referred to in IFRSs, though entities could use another title in their financial statements.

Comments on the ED are requested by 30 September 2010.

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1006comprehensiveincome.pdf> and Deloitte in the UK has issued an iGAAP Alert, which is available at www.deloitte.co.uk/auditpublications

IASB proposes to amend IAS 19 for defined benefit plans

The International Accounting Standards Board (IASB) has published for public comment an exposure draft (ED) of proposed amendments to IAS 19 Employee Benefits. The ED proposes improvements to the recognition, presentation, and disclosure of defined benefit plans but does not address measurement of defined benefit plans or the accounting for contribution-based benefit promises.

Among the amendments proposed to IAS 19 are:

- Immediate recognition of all estimated changes in the cost of providing defined benefits and all changes in the value of plan assets. This would eliminate the various methods currently in IAS 19, including the 'corridor' methods, which allow deferral of some of those gains or losses.
- A new presentation approach that would clearly distinguish between different types of gains and losses arising from defined benefit plans. Specifically, the ED proposes that the following changes in benefit costs should be presented separately:
 - service cost – in profit or loss;
 - net interest on the net defined benefit liability – as part of finance costs in profit or loss;
 - remeasurement (i.e. actuarial gains and losses) – in other comprehensive income.
- Improved disclosures about matters such as the characteristics of the company's defined benefit plans, the amounts recognised in the financial statements, risks arising from defined benefit plans and participation in multi-employer plans.

Comments on the ED are requested by 6 September 2010.

IASB issues extractive industries discussion paper

The IASB has published a Discussion Paper (DP) 'Extractive Activities' setting out the results of an international research project on a possible future Standard for extractive activities. Extractive activities are the activities undertaken by entities when searching for, and ultimately extracting, minerals, oil or natural gas. The activities involve the following four phases:

- exploration: the search for deposits of minerals or oil and gas;
- evaluation: assessing the quantity, quality and viability of the deposits found and the economic viability of their extraction;
- development: undertaking works to access the deposit and to construct the infrastructure necessary to extract the minerals or oil and gas; and
- production: the extraction of the minerals or oil and gas from those deposits.

The area of extractive industries poses some very specific challenges resulting from the uncertainties that are faced by entities pursuing extractive activities. A research team comprising members of the Australian, Canadian, Norwegian and South African accounting standard-setters analysed and discussed accounting for extractive activities with a wide range of stakeholders to identify a possible approach for an IFRS. The DP contains the views of the project team (it does not represent the views of the Board) and addresses the following four questions:

- how to estimate and classify the quantities of minerals or oil and gas discovered;
- how to account for minerals or oil and gas properties;
- how minerals or oil and gas properties should be measured; and
- what information about extractive activities should be disclosed.

After considering the responses received on the DP, the Board will decide whether to add the project to its active agenda. Comments are requested by 30 July 2010.

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1005employeebenefits.pdf> and Deloitte in the UK has issued an iGAAP Alert which is available at www.deloitte.co.uk/auditpublications

Deloitte in the UK has issued two newsletters with observations on the draft discussion paper entitled 'Your judgement. Reserved.' (addressing the mining industry) and 'Reserved revisions or seismic shift?' (addressing the oil and gas industries), both of which are available at www.deloitte.com/view/en_GB/uk/industries/eiu/index

UK GAAP round up

ASB proposes Amendments to FRS 8, FRS 29 and SSAP 25

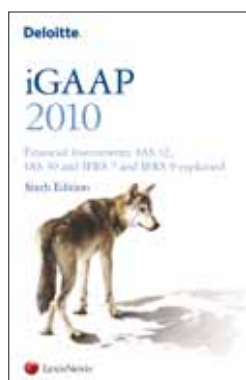
The Accounting Standards Board (ASB) has published a Financial Reporting Exposure Draft (FRED) proposing amendments to FRS 8 *Related Party Disclosures*, FRS 29 (IFRS 7) *Financial Instruments: Disclosures* and SSAP 25 *Segmental Reporting*.

The changes proposed are:

- to revise the definition of a related party in FRS 8 to conform with the revised version of IAS 24 issued by the IASB in November 2009;
- 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 to company law in SSAP 25 to refer to Companies Act 2006.

The proposed amendments are proposed to be effective for periods beginning on or after 1 January 2011 and the comment period for the FRED closes on 30 August 2010.

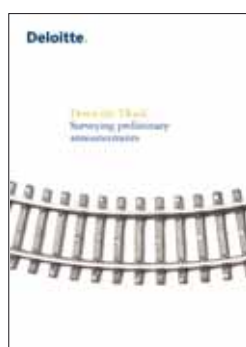
Publications



iGAAP 2010 Financial Instruments: IAS 32, IAS 39, IFRS 7 and IFRS 9 Explained (Sixth Edition)

iGAAP 2010 Financial Instruments: IAS 32, IAS 39, IFRS 7 and IFRS 9 Explained (Sixth Edition) is the authoritative guide for financial instruments accounting under IFRSs. The 2010 edition expands last year's edition with further interpretations, examples, discussions from the IASB and the IFRIC, updates on comparisons of IFRSs with US GAAP for financial instruments, as well as including guidance on the IASB's new standard on financial assets, IFRS 9. It also includes extracts from 2009 annual reports illustrating the application of IFRS 7.

iGAAP 2010 Financial Instruments: IAS 32, IAS 39, IFRS 7 and IFRS 9 Explained (Sixth Edition) is available from LexisNexis at: www.lexisnexis.co.uk/deloitte



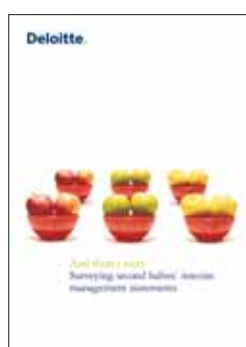
Down the TRack – Surveying preliminary announcements

"Down the TRack" analyses the announcements of annual results made by 130 listed companies, reviewing:

- what form companies' announcements of their annual results took;
- compliance with the dissemination requirements of the Disclosure and Transparency Rules (DTR); and
- what information companies chose to include in the financial highlights section of preliminary announcements.

Of particular interest was how practice in announcing annual results had developed in the second year under the requirements of the DTR.

Down the TRack is available at: www.deloitte.co.uk/auditpublications



And there's more – Surveying second halves' interim management statements

"And there's more" is the latest in Deloitte's corporate reporting series and considers how UK listed companies have met the requirements for an interim management statement (IMS) in the second year of compliance with the Disclosure and Transparency Rules (DTR). It differs from previous reports such as "In Many Styles" as this 2010 survey focuses on the IMSs issued in the second half of the accounting periods.

And there's more is available at: www.deloitte.co.uk/auditpublications

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 1 July 2010) |
|------------------------------------|---|--|--|
| IAS/IFRS standards | | | |
| IAS 24 (revised November 2009) | Related Party Disclosures | 1 January 2011 | Q3 2010 |
| IFRS 9 (November 2009) | Financial Instruments: Classification and Measurement | 1 January 2013 | To be confirmed |
| Amendments to IFRS 1 (July 2009) | Additional Exemptions for First-time adopters | 1 January 2010 | 23 June 2010 |
| Amendment to IFRS 1 (January 2010) | Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters | 1 July 2010 | 30 June 2010 |
| Improvements to IFRSs (May 2010) | Improvements to IFRSs 2010 | 1 July 2010 or 1 January 2011 (varies by standard) | Q4 2010 |
| Interpretations | | | |
| IFRIC 19 | Extinguishing Financial Liabilities with Equity Instruments | 1 July 2010 | Q3 2010 |
| Amendment to IFRIC 14 | Prepayments of a Minimum Funding Requirement | 1 January 2011 | Q3 2010 |

* 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"> The ASB issued on 11 August 2009 a consultation paper 'Policy Proposal: the future of UK GAAP', which sets out its proposals for the future reporting requirements for UK and Irish entities. The Board's proposals envisage a differential reporting regime based on public accountability, with publicly accountable entities applying IFRS as adopted by the EU, small entities continuing to apply the FRSSE and all other entities applying the IFRS for SMEs. Following the closure of the consultation paper's comment period on 1 February 2010, the ASB is considering the responses received and plans to consult further before publishing an exposure draft outlining the Board's recommendations which is expected in the third quarter of 2010. |
| Convergence | <ul style="list-style-type: none"> The ASB and the IASB continually consider what consequential amendments will be needed to UK GAAP once the IASB and IFRIC finalise standards, amendments and interpretations. |

IASB Project Timeline – Active Projects

| | |
|---|---|
| Annual Improvements to IFRSs – 2009-2011 | <ul style="list-style-type: none"> Final IFRS issued May 2010. Further ED expected second half of 2010. Further Final IFRS expected first half of 2011. |
| Common Control Transactions | <ul style="list-style-type: none"> Added to agenda December 2007. Timing not yet determined. |
| Conceptual Framework Eight phases in all | <ul style="list-style-type: none"> ED on objectives and qualitative characteristics was issued in May 2008. Final chapter expected second half of 2010. ED on reporting entity was issued in March 2010, final chapter expected second half of 2010. DP on measurement expected second half of 2010 or first half of 2011. Timing not yet determined on elements and recognition. |
| Consolidation, including SPEs* | <ul style="list-style-type: none"> ED issued in December 2008. Round tables held in June 2009. Final IFRS replacing IAS 27 expected second half of 2010. ED on proposed changes for investment companies expected second half of 2010, Final IFRS expected first half of 2011. |
| Derecognition* | <ul style="list-style-type: none"> ED issued March 2009. Round tables held June 2009. Final IFRS on disclosure requirements for derecognitions expected second half of 2010. Comprehensive standard on derecognition to be considered at a future date. |
| Discontinued operations amendment | <ul style="list-style-type: none"> ED issued September 2008. Further ED expected first half of 2011 and Final IFRS second half of 2011. |
| Earnings per share amendment | <ul style="list-style-type: none"> Exposure draft issued August 2008. Further discussion expected second half of 2010. |
| Emissions Trading Schemes | <ul style="list-style-type: none"> ED expected second half of 2011. Final IFRS expected 2012. |

| | |
|--|--|
| Fair Value Measurement Guidance | <ul style="list-style-type: none"> • ED issued May 2009. • ED on measurement uncertainty analysis disclosures expected first half of 2010. • Final IFRS expected first half of 2011. |
| Financial Instruments with the Characteristics of Equity* | <ul style="list-style-type: none"> • DP issued February 2008. • ED expected first half of 2011 and Final IFRS second half of 2011. |
| Financial Instruments (replacement of existing standards) * | <ul style="list-style-type: none"> • Classification and measurement of financial assets, Final IFRS issued November 2009. • Classification and measurement of financial liabilities ED issued May 2010, Final IFRS expected first half of 2011. • Impairment ED issued November 2009, Hedging ED expected second half of 2010, Final IFRSs expected first half of 2011. • ED on asset and liability offsetting expected second half of 2010, Final IFRS expected first half of 2011. |
| Financial Statement Presentation* Phase B: Statement of information in the financial statements | <ul style="list-style-type: none"> • DP issued October 2008. • ED on presentation of items of other comprehensive income issued May 2010, Final IFRS expected second half of 2010. • ED on replacement of IAS 1 and IAS 7 expected first half of 2011, Final IFRS second half of 2011. |
| Income Taxes – limited scope project | <ul style="list-style-type: none"> • ED expected second half of 2010. • Final IFRS expected first half of 2011. |
| Insurance Contracts – Phase II | <ul style="list-style-type: none"> • DP issued May 2007. • ED expected second half of 2010. • Final IFRS expected first half of 2011. |
| Joint Arrangements | <ul style="list-style-type: none"> • ED issued September 2007. • Final IFRS expected second half of 2010. |
| Leases* | <ul style="list-style-type: none"> • DP issued March 2009. • ED expected second half of 2010. • Final IFRS expected first half of 2011. |
| Liabilities (IAS 37 amendments) | <ul style="list-style-type: none"> • ED issued June 2005 and certain elements re-exposed in January 2010. • Final IFRS expected first half of 2011. |
| Management Commentary | <ul style="list-style-type: none"> • Output will be best practice guidance, not an IFRS. • ED issued June 2009. • Final guidance expected second half of 2010. |
| Post-employment Benefits (including Pensions)* | <ul style="list-style-type: none"> • DP issued March 2008. • ED on defined benefit plans issued April 2010. Final IFRS expected first half of 2011. • Final IFRS on termination benefits expected second half of 2010. |
| Rate-regulated Activities | <ul style="list-style-type: none"> • ED published July 2009. • Final IFRS expected first half of 2011. |
| Revenue Recognition* | <ul style="list-style-type: none"> • DP issued December 2008. • ED Issue June 2010, to be followed by round tables second half of 2010. • Final IFRS expected first 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

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

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