

FINANCIAL REPORTING REVIEW PANEL

PRELIMINARY REPORT

IFRS IMPLEMENTATION

Introduction

1. This report sets out the Panel's preliminary findings following its review of IFRS implementation by UK listed companies in their annual accounts. In February 2006 the Panel published its report on a review of 2005 interim accounts prepared under IFRS (Press Notice 91). The Panel's review of annual accounts is continuing but it has identified a number of recurring issues which are highlighted in this report in order to draw them to the attention of companies planning the preparation of their next IFRS annual accounts.
2. The accounts selected for review were drawn from FTSE 350 companies and smaller listed companies. The points raised in this report are potentially relevant for all companies reporting under IFRS. This report does not include any direct references to IAS 19, 'Employee Benefits', as this was the subject of a separate review published in August this year (Press Notice 96).

Summary

3. The Panel's review of annual accounts identified a good level of compliance with IFRS. The Panel appreciates and applauds the hard work that has gone into the production of these accounts and it is against this background that this report, which inevitably focuses on areas for improvement, should be read.
4. The Panel found a tendency to use "boiler-plate" descriptions for disclosure of accounting policies, irrespective of whether those policies had been applied in the accounts. IFRS accounts have been said to be too long and too complicated. More focused and thoughtful approaches to these areas might reduce their length and increase understanding of the complexities which are inevitable in sophisticated commercial operations.
5. Disclosures relating to subjective or complex judgements made by management were sometimes bland and uninformative.
6. Other issues identified in the Panel's review relate to disclosure requirements under IFRS which are not required under UK GAAP, in particular in relation

to intangible assets and impairment testing. The Panel has also raised points, in a number of cases, relating to the presentation of accounts, notably the Income Statement. The Panel is also taking this opportunity to remind preparers about the need to explain the factors that give rise to goodwill and the potential requirement for additional information to be disclosed under IFRS in respect of key managers.

7. When the Panel writes to a company asking for clarification of matters of potential substance in its accounts it often notes a number of more minor points in an appendix. The Panel does not ask companies to comment on these matters but brings them to a company's attention so that, if relevant, they may be considered for the next year's accounts. The Appendix to this preliminary report contains examples of such points.
8. When approached to give information or explanations companies have provided the Panel with full and well considered responses. Suggestions that the Panel has made for improvement have been well received. On no occasion to date has the Panel found it necessary to announce the correction of a significant breach of the requirements of the international standards.

Accounting Policies

9. In its report on interim accounts, the Panel noted that the move to IFRS had prompted companies to make significant changes to their accounting policies. Occasionally, some UK GAAP terminology had been retained but, on enquiry, it was found that it was the description rather than the underlying accounting that was inappropriate. This was still the case in a number of annual accounts of companies. There was also a tendency for companies to include "boiler-plate" descriptions of accounting policies. In some cases, it appeared that the wording of accounting policies had been copied from the relevant standards with no indication of company specific application.
10. Standardised disclosures have limited use especially where the policy is prescribed by IFRS. Descriptions of accounting policies are more useful when they identify issues relevant to a company's individual circumstances. For example, revenue recognition policies may need to describe the methods applied to determine the stage of completion of transactions involving the rendering of services (IAS 18, 'Revenue'). As the methods used will vary according to the nature of the circumstances it is helpful if the policy includes specific relevant details.
11. In other cases, there was also evidence of "boiler-plating" in the accounting policies selected for disclosure. For example, accounting policy descriptions

were given which, on enquiry, were found to be irrelevant since there were no underlying accounting transactions falling within their scope. This issue arose, in particular, in relation to the descriptions of accounting policies for hedging instruments which appeared to have been copied from IAS 39, 'Financial Instruments: Recognition and Measurement', whether or not such hedges were used in practice.

12. The requirements regarding disclosure of accounting policies are set out in IAS 1, 'Presentation of Financial Statements'. **The Panel encourages companies to describe the accounting policies applied in practice including information specific to their particular circumstances.**

Disclosure of Judgements and Estimates

13. IFRS introduces a new and significant area of disclosure related to the application of accounting policies. The requirements are set out in IAS 1 and cover two specific areas.
14. First, there is a requirement to disclose the judgements that management has made in applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the accounts (paragraph 113). IAS 1 gives examples of areas that may need to be covered.
15. Second, IAS 1 requires disclosure of the key assumptions concerning the future that have a significant risk of causing a material adjustment to the carrying amounts of assets or liabilities in the following year (paragraph 116). These are the estimates that require management's most difficult, subjective or complex judgements. IAS 1, again, gives examples of areas that may fall to be covered and of the types of disclosures that can be made in order to help users understand these judgements. These include quantification of the effect of the uncertainty (paragraph 120). The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances.
16. Disclosures in relation to these new requirements showed significant variation. Some companies set out clearly the key judgements and main areas of estimation uncertainty with details relevant to their particular circumstances. Other companies did not appear to have made any specific disclosures in accordance with IAS 1 although they may have made similar disclosures on the same areas as required by the provisions of more specific standards, for example, IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets'.

17. In some cases, as with the disclosure of accounting policies, the IAS 1 disclosure requirements were addressed but only by superficial comments which were bland and uninformative with little or no information relevant to the particular circumstances. **The Panel encourages companies to avoid “boiler-plate” descriptions and to include specific information relevant to understanding key sources of estimation uncertainty.**
18. The reviews undertaken also indicated some variability in the positioning of these disclosures.. IAS 1 requires that they be made within the accounting policies section or within the notes to the accounts where they form part of the audited financial statements. Where companies include the relevant information in the Operating and Financial Review or other narrative report, there should be clear cross-referencing to bring them within the scope of the audited accounts.

New Standards and Interpretations

19. There is a requirement in IAS 8, ‘Accounting Policies’, to disclose details of new standards and interpretations that have been issued but which are not yet effective. The disclosure should include a discussion of the impact that initial application of the standard is likely to have. If the impact is not known or reasonably estimable then this should be stated. Not all companies complied with this requirement.
20. **Companies should consider the possible impact on their financial statements of published Standards and Interpretations not yet effective at their reporting date and give appropriate disclosure.**

Intangible Assets

21. The application of IFRS has led to a greater variety of intangible assets being recognised in the financial statements than under UK GAAP. This difference is due to changes in accounting for business acquisitions under IFRS and the fact that IAS 38, ‘Intangible Assets’, is less restrictive than the UK standard, FRS 10, in terms of recognition criteria .
22. Application of IFRS 3, ‘Business Combinations’, can result in the recognition of less goodwill but more intangible assets than under UK GAAP. Where goodwill does arise on an acquisition, IFRS 3 requires that there should be an explanation of the factors giving rise to that goodwill including a description of any intangible assets that were not recognised and why their value could not be reliably measured (paragraph 67(h)).

23. **The Panel reminds preparers of this new disclosure requirement which in some cases was not met, and in others, was addressed by a bland statement with little specific information content.**
24. The Appendix includes details of other specific requirements in relation to disclosure of business acquisitions which have sometimes been omitted.

Impairment Testing

25. A key difference between UK GAAP and IFRS is that goodwill is no longer amortised but tested annually for impairment. Under IFRS, intangible assets with indefinite lives are also subjected to annual impairment tests. IAS 36, 'Impairment of Assets', prescribes the procedures to be applied to ensure that assets are carried at no more than their recoverable amount. The standard also prescribes the disclosures which should be made about the impairment testing.
26. The degree of compliance with the standard was variable as with the disclosure of judgements and estimates discussed above. Some companies provided detailed explanations of their impairment testing including the specific information required by IAS 36.
27. In other cases, specific points of disclosure required by the standard and considered appropriate by the Panel in the particular circumstances of the company were omitted. This was true, in particular, for disclosures in relation to estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives (paragraph 134 of IAS 36).
28. **Preparers are advised to review the sufficiency of their disclosure to support their impairment testing of goodwill and intangible assets with indefinite useful lives.**

Related Party Disclosures

29. Under UK GAAP, FRS 8, 'Related party disclosures', key management of the reporting entity (or of its parent) are presumed to be related parties unless it can be demonstrated that neither party has influenced the financial and operating policies of the other in such a way as to inhibit the pursuit of separate interests. By contrast, IAS 24 'Related party disclosures' states that key management personnel of the entity (or of its parent) are related parties of the entity. The effect of this difference is that under IAS 24 certain additional disclosures such as details of remuneration should be provided for

key managers irrespective of whether they are directors (paragraph 16). **Where narrative reports refer to key managers by name, companies should consider whether their remuneration and other details fall to be included within the IAS 24 disclosures.**

Presentation

30. IFRS is more permissive than UK GAAP in terms of presentation of the primary statements, in particular, of the Income Statement. IAS 1, 'Presentation of Financial Statements', details some line items and an ordering whilst providing the flexibility in certain circumstances to add additional lines to those specified or to reorder the lines.
31. Many companies used a layout for the Income Statement similar to that used previously under UK GAAP. Items such as impairment charges, amortisation of intangibles acquired as a result of a business combination and fair value adjustments on derivatives were often shown separately in the IFRS financial statements. Additionally, some companies presented items in a different order to that in IAS 1.
32. **Under IAS 1 additional line items may be included or items reordered *when this is necessary* to explain elements of financial performance (paragraph 84). Changes to the minimum presentation should be justifiable.**
33. Within the narrative review sections of their reports, some companies referred to measures of profit which were not consistent with the presentation adopted for the Income Statement. Non-GAAP performance measures should be defined and reconciled to GAAP measures. Similarly, alternative measures for Earnings per Share (EPS) should be identified and reconciled to EPS figures derived from IAS 33, 'Earnings per Share'. Undue prominence should not be given to any non-GAAP measures.

IFRS 2 'Share-based Payment'

For share options exercised during the year, the weighted average share price at the date of exercise should be disclosed. If options were exercised on a regular basis throughout the period, the weighted average share price during the period may be given instead (paragraph 45(c) of IFRS 2).

For share options outstanding at the end of the period, the range of exercise prices and weighted average remaining contractual life should be stated. If the range of exercise prices is wide, the outstanding options should be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received on their exercise (paragraph 45(d)).

For share options granted during the period, there should be disclosure of the weighted average fair value of those options at the measurement date and information about how that fair value was measured, including the specified requirements set out in paragraph 47, in particular, details related to the option pricing model used.

IFRS 3 'Business Combinations'

The amount of the acquiree's profit or loss since acquisition date included in the acquirer's profit or loss for the period should be given (paragraph 67(i)). The revenue and the profit or loss for the combined entity for the period should also be disclosed as if all business combinations effected during the period had been entered into on the first day of the financial year (paragraph 70).

If it is impracticable to provide either of these disclosures, that fact should be stated with an explanation of why that is the case.

IAS 1 'Presentation of Financial Statements'

Assets and liabilities for current taxes should be shown separately on the face of the balance sheet (paragraph 68 (m)) of IAS 1).

A description of the nature and purpose of each reserve within equity should be given (paragraph 76 (b)).

For each component of equity, the effects of changes in accounting policies should be shown separately on the face of the Statement of Changes in Equity (paragraph 96(d)).

IAS 2 'Inventories'

Disclosure of the amount of inventories recognised as an expense during the period is required (paragraph 36(d) of IAS 2).

IAS 7 'Cash flow Statements'

Paragraph 40 of IAS 7 sets out specific disclosures that are required, in aggregate, in respect of both acquisitions and disposals of subsidiaries or other business units during the period.

IAS 12 'Income Taxes'

Separate disclosure is required of:

- the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet (paragraph 81(e));
- the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interest in joint ventures for which deferred tax liabilities have not been recognised (paragraph 81(f)); and
- the amount of deferred tax assets and liabilities recognised in the balance sheet and the amount of the deferred tax income or expense recognised in the income statement if this is not apparent from the changes in the amounts recognised in the balance sheet, in respect of each type of timing difference and in respect of unused tax losses and unused tax credits (paragraph 81(g)).

IAS 14 'Segment Reporting'

Paragraph 67 requires a reconciliation between the information disclosed for reportable segments and the aggregated information in the financial statements. The reconciliation should cover revenue, results from continuing and discontinued activities and segment assets and segment liabilities.

IAS 21 'The Effects of Changes in Foreign Exchange Rates'

Paragraph 52 requires disclosure of the amount of exchange differences recognised in the profit and loss account except for those arising on financial instruments measured at fair value through the profit or loss in accordance with IAS 39. Net exchange differences classified in a separate component of equity are also required with a reconciliation of such exchange differences at the beginning and end of the period.

IAS 32 Financial Instruments: Disclosure and Presentation

Treasury shares are to be deducted from equity and the amount held disclosed separately either on the face of the balance sheet or in the notes (paragraphs 33 and 34).

Paragraph 58 (relocated to IFRS 7 in August 2005) sets out the detailed information that is required to be disclosed separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation. Paragraph 59 (similarly relocated) stipulates the disclosures required when a gain or loss on a cash flow hedge has been recognised directly in equity or removed from equity in the period.

The nature and amount of any impairment loss recognised in profit or loss for a financial asset should be disclosed separately for each significant class of financial asset (paragraph 94 (i), also relocated to IFRS 7).

IAS 38 Intangible Assets

Paragraph 118 sets out the general disclosure requirements in relation to intangible assets including accounting policy, amortisation rates, movements from beginning to end of the period and these disclosures are required for each class of intangible assets distinguishing between internally generated and other intangible assets.