

IFRS News

Shedding light on the IASB's activities*

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Issue of the month

Proposed amendments to IAS 24, Related Party Disclosures

The Board proposed amendments to IAS 24, Related Party Disclosures last month. They arise from the convergence project between Chinese Accounting Standards and IFRS.

Many businesses in China are controlled by the state. It can be difficult and onerous for state-controlled companies to identify and to aggregate transactions with other businesses under state control. For example, how would a state-controlled railway company be able to capture and record which passengers were travelling on business while working for other state-controlled companies? Would this information be relevant if the charges paid by state-controlled entities were no different from amounts paid by the general public? Expand this example to an economy where many major enterprises remain under government ownership, including post, banks, petrol companies and others.

The proposals aim to give relief from the detailed disclosure of such retail transactions between state-controlled entities. However, knowledge of the existence of related-party transactions remains important information for investors. Clear disclosures are still required, particularly where transactions might not be on an arm's-length basis.

The main proposal affects only state-controlled companies. However, the Board has also proposed some small changes to the definitions. For example, associates of controlling parties will be considered related parties. This change may be minor for some companies but could mean onerous disclosure requirements for others. Management should be aware of the other changes before concluding that the proposals are not relevant.

Status of IFRS 8, IFRIC 10 and IFRIC 11

The Accounting Regulatory Committee (ARC) has recommended adoption for use in Europe of IFRS 8, Operating Segments; IFRIC 10, Interim Financial Reporting and Impairment, and IFRIC 11, IFRS 2 – Group and Treasury Share Transactions.

Such recommendations from the ARC in the past have led to the standards and interpretations being adopted. However, the

European Parliament is reviewing the process and its involvement in adopting IFRS standards and interpretations. It seems to want a greater role and more time for its consideration. The timing of the adoption of this standard and these interpretations for use in Europe is therefore uncertain.

The ARC has not so far considered IFRIC 12, Service Concession Arrangements, in its discussions.



IFRS for small and medium-sized entities

Simon Wray, chief accountant in the Netherlands, and Hugo van den Ende from PwC's middle market practice in the Netherlands, look at the scope of the Board's ED on IFRS for SMEs.



The Board published the exposure draft of 'International Financial Reporting Standards for Small and Medium-sized Entities' (IFRS for SMEs) last month. The document is brief relative to full IFRS – 254 pages compared with over 2,400 – but it is still a considerable work. The Basis for Conclusions is an additional 48 pages, and the Implementation Guidance, 80 pages (including a disclosure checklist and illustrative financial statements).

The IASB's starting point for the SME standard is the Conceptual Framework's recognition and measurement principles. The ED contains only a limited number of departures from full IFRS, such as:

- simplifications in relation to financial instruments (classification, derecognition, hedge accounting);
- goodwill impairment (mandatory calculation of the recoverable amount only if impairment is indicated, and not on an annual basis);
- R&D costs (option to treat all R&D costs as expenses); and
- employee benefits (alternative recognition of actuarial gains and losses).

The ED does not cover topics less relevant to most SMEs/non-listed companies such as hyperinflation, interim financial reporting and earnings per share. Non-listed companies are permitted to use the same accounting policy options as those under full IFRS, but the ED assumes that they will apply the simpler options – for example, the cost method for PPE.

Meeting users' and preparers' needs?

The users of non-listed companies' financial statements differ from those of listed companies. Stakeholders of non-listed companies are likely to be banks and family members, not investors and analysts. Does the proposed standard address their needs? The user group as a whole will benefit from harmonised and simplified standards. Credit must be given in particular for the effective use of plain English, making these standards more accessible to a wider audience. The range of potential users of IFRS for SMEs makes it inevitable that some users will want the simplification to go further.

As for preparers, do the simplifications go far enough – for example in areas such as impairment, acquisitions, use of fair market value and pension accounting? The latter requires actuarial calculations and estimations of future developments. IFRS for SMEs may also involve complexity for tax reporting in some countries. In cases where reporting entities may have the option but are not required to use IFRS for SMEs, this decision will be influenced by the cost benefit considerations. Further simplification of the standard would lead to a positive influence on the take-up rate and acceptance of IFRS for SMEs.

The comment deadline is 1 October 2007.

Current financial reporting practice in Europe

Financial reporting among SMEs varies from country to country. There is diversity in practice in Europe alone. For example:

- EU Member States apply local reporting rules based on the 4th and 7th European Directives;
- Some have adjusted the Directives to fit their own situation;
- Some base their requirements on tax reporting – for example, Germany and Belgium.
- Some have developed local standards based on IFRS – for example, the Netherlands and UK.

A standard for non-listed companies means companies with cross-border activities will not need to prepare consolidated annual accounts based on figures drawn up under different regimes.

It is up to local regulators to decide which companies will be permitted, or required, to apply the IFRS for SMEs. Harmonisation of SME reporting may remain an elusive goal if countries' requirements vary.

IFRS 7 – potential impact of market risk

IFRS News has published a supplement this month illustrating how market risks under IFRS 7 can be calculated. The article uses case studies of a manufacturing company and a

multinational group with different functional currencies to illustrate the guidance. By Sandra Thompson and Peter Hogarth.

New EC Standards Advice Review Group

A Standards Advice Review Group has been set up to advise the European Commission on the standards and interpretations endorsement process. It will assess the objectivity of the European Financial Reporting Advisory Group's opinions on endorsement.

Members of the SARG are:

- **Josef Jílek**, a professor at the University of Economics in Prague and chief expert at the Czech National Bank;
- **Carlos Soria Sendra**, co-author of *Fundamentals in auditing*;
- **Hervé Stolowy**, a professor at HEC School of Management, department of Accounting and Management Control, in Paris;
- **Enrico Laghi**, Extraordinary Professor of Business Management at La Sapienza University in Rome, lecturer on Financial Analysis at the LUISS-Guido Carli University, and consultant on valuations issues, financial reporting and judicial proceedings;
- **Jan Klaassen**, former professor of financial accounting at the Vrije Universiteit Amsterdam;
- **Geoffrey Mitchell**, Director of Financial Projects at Barclays Bank; former Chief Accountant of Barclays Bank; former Technical Director at the Institute of Chartered Accountants in England and Wales (ICAEW); former Secretary-General of the International Accounting Standards Committee; member of the British Bankers' Association Financial Reporting Advisory Panel, the European Banking Federation Technical Committee and the 100 Group Technical Committee; Chairman of the Technical Strategy Board at the ICAEW; member of the Federation des Experts Europeens – Extended Banks Working Party and Capital Markets Advisory Group
- **Elisabeth Knorr**, Secretary-General of the Accounting Standards Committee of Germany, and lecturer at Potsdam University.

'Measuring Assets and Liabilities – Investment Professionals' Views'

A global PwC team interviewed more than 50 professional investors in late 2006 about their use of the balance sheet in their analysis of companies' performance. The survey results contribute to a deeper understanding of attitudes and practices in the investment community.



The findings have already influenced our own understanding of the role of the balance sheet and informed our submissions as a firm to the IASB and FASB's Roundtable discussions on measurement.

Key findings include:

- **Current value has its place.** There is consensus that current value concerning liquid financial assets is useful. However, this does not indicate a desire for the wholesale adoption of current values.
- **The income statement should be considered in conjunction with proposed changes to the measurement of assets and liabilities.** Many investors point out the fallacy of analysing the balance

sheet in isolation. Measurement decisions in the balance sheet have a direct impact on amounts reported in the income statement, and there is concern that an increase in the use of current values might make it more difficult to understand the underlying operating performance.

- **Additional disclosure in the notes can add value.** A 'one-size-fits-all' model will struggle to meet the diverse needs of the investment community. If 'current value', for example, means different things to

"This research is an important contribution to the fair value debate and will be examined with interest by the IASB"

Sir David Tweedie, IASB chairman

different people, a suite of disclosures in the notes rather than recognition of a single number in the balance sheet could be more useful.

- **Valuation is as much art as science.** Investors' core competency is valuing businesses. They need reliable and relevant information that provides insight into the quality and sustainability of performance. If a current value measure is adopted for illiquid assets or liabilities, investors would like to see management's inputs into the valuation model so that they have the option of independently assessing the resulting amount.

Download the survey findings from www.pwc.com/ifrs (see under 'Publications'); or order hard copies from samantha.mckevitt@uk.pwc.com

IASB agenda – impact for entities in 2009

This table highlights the potential impact on the preparation of 2009 financial statements of standards and interpretations from IASB. Please note: the IASB agenda is subject to change, and the potential impacts outlined below may change accordingly.

Topic	Current status	Industry/business impact	Potential impact on training, systems, investor communications, etc	Expected 2009 requirement
Fair value measurement – convergence with FAS 157 approach, amending fair value guidance in many standards	Discussion Paper released Dec 2006; comment deadline 2 April 2007. Roundtable ‘measurement’ discussions Q2 2007.	All industries, but greater impact in financial services and businesses with recent acquisitions.	Higher	
Presentation of income statement – IAS 1 amendment	Phase 1 standard expected Q2 2007; DP for phase 2 expected Q2 2007; ED late 2008.	All entities.	Lower	Re-presentation of income statement with statement of other recognised gains and losses.
Business combinations – full goodwill amendment to IFRS 3	ED released June 2005. IFRS expected Q3 2007.	All industries, but greater impact on businesses with history of making acquisitions.	Moderate	Applicable to new business combinations. Potential additional implications for impairments.
Income tax – IAS 12 amendment – extend model to include differences arising on initial recognition	ED expected Q2 2007; IFRS late 2008.	All industries, but more significant in industries with substantial tangible assets.	Higher	Restatement of all deferred tax numbers and detailed exercise to capture tax base of many assets and liabilities.
Provisions (non-financial liabilities) – IAS 37 amendment	ED released June 2005. IFRS expected Q1-2 2008.	All entities, but particularly those with environmental obligations or litigation exposures.	Higher	Extensive reworking of measurement to balance sheet date settlement cost.
Deemed cost of investments in subsidiaries – IAS 27 and IFRS 1 amendments	ED released January 2007. IFRS expected Q4 2007.	Parent not group financial statements.	Moderate	Impact in financial statements of carrying value of investment. Likely to trigger some groups to move more subsidiaries to IFRS.
Net investment hedging – IFRIC revisions to IAS 21	IFRIC staff agreed to IAS 21 revision November 2006. No timing publicly proposed.	All entities.	Moderate	Could impact many net investment hedging strategies, requiring relocation of current borrowings – borrowing in different currency from their functional currency.
Share-based payment vesting conditions – IFRS 2 amendment	IFRS expected Q2 2007.	Entities with SBPs that include conditions that will no longer satisfy the definition of vesting conditions.	Moderate	Restatement of past employee costs/earnings. Expected to be applied in 2008 but may also have impact on 2009.

Topic	Current status	Industry/business impact	Potential impact on training, systems, investor communications, etc	Expected 2009 requirement
Borrowing costs – require capitalisation borrowing cost under IAS 23	IFRS expected Q1 or Q2 2007.	Large self-constructed tangible and intangible assets.	Moderate	Borrowing costs on new self-constructed assets must be capitalised.
Joint ventures – new standard replacing IAS 31 prohibiting proportional consolidation	ED expected Q2 2007; IFRS Q1-2 2008.	Principally extractive industries.	Lower	New analysis of direct vs. indirect interests model – more work needed in relation to OFR/MDA and market management.
EPS relating to convertibles – IAS 33 amendment	ED expected Q2-3 Q3 2007. IFRS Q1-2 2008.	Entities with contingently convertible share capital.	Lower	Restatement of EPS numbers
Derivatives linked to EBIT and other financial measures – IAS 39 amendment	Tentative agenda decision published July 2006.	Entities with derivatives dependent on financial statement line items including royalties.	Moderate	Restatement of balance sheet and past performance.
Puttable financial instruments – IAS 39 amendment	ED released June 2007; comment deadline Oct 2006. IFRS 6 expected Q2 2007.	Entities with redeemable share capital	Lower	Restatement of certain liabilities as equity.
Insurance contracts – new IFRS	DP expected late Q1 2007; ED late 2008.	Insurance companies	High for insurance companies	
Small and medium sized entities	ED released February 2007; IFRS expected Q2 2007.	Fundamental new simplified standards, but not affecting listed companies.	Moderate	
Related-party disclosures – IAS 24 amendment	ED released February 2007; IFRS Q1 2008.	Relief for disclosures of transactions with governments.	Lower	Lower data collection costs for some emerging markets with highly managed economies.
Service concessions (IFRIC 12 quasi standard)	IFRIC 12 released November 2006.	Toll road and similar concession operators	Higher	Fundamental revision to balance sheet and income statement models – effective from 2008 with retrospective application.
Agriculture: biological transformation – IAS 41 amendments (IFRIC)	IFRIC agreed to IAS 41 amendment November 2006. No timing publicly proposed.	All industries with biological assets.	Lower	Restatement of balance sheets and past performance for these industries.
Improvements project to existing standards	Annual improvement.	All entities.	Lower	Could impact many line items but should confirm existing interpretations rather than create changes.



For further help, please contact:

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