

# IFRS News

Shedding light on the IASB's activities\*

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## Issue of the month

### SEC reconciliation announcements

**The SEC announced last month that it will issue a proposal to allow certain IFRS financial statements to be filed by foreign private issuers (FPIs) without reconciliation to US GAAP, and that it will consider the use of IFRS by US issuers.**

The SEC announced it will take a series of actions relating to the acceptance of financial reporting under IFRS in the next few months.

The SEC intends to issue a 'Proposed Release' requesting changes to SEC rules to allow the use of IFRS without reconciliation to US GAAP in financial reports filed by SEC-registered FPIs. The SEC says it is on track to remove the reconciliation requirement between IFRS and US GAAP by 2009.

The removal of this requirement is only likely to apply to those reporting under 'full IFRS' – ie, to those able to issue an 'unreserved statement of compliance'. The statement of compliance may make reference to endorsed IFRS as well as full IFRS (to comply with local requirement) provided there are no differences. The proposed rule is expected to require companies that cannot make a full statement of compliance to continue to reconcile to US GAAP. Said another way, only those FPIs filing with the SEC under IFRS as promulgated by the IASB are likely to avoid the reconciliation.

The proposal to remove the reconciliation was backed in an announcement last month by US President George W Bush, German Chancellor Angela Merkel and European Commission President José Manuel Barroso of a 'Framework for advancing transatlantic economic integration between the EU and the US'. The framework also confirmed the intentions for mutual recognition: one of its 'priority projects' is to 'promote and seek to ensure conditions for US GAAP and IFRS to be recognised in both jurisdictions without the need for reconciliation by 2009 or possibly sooner'.

The SEC also plans to issue a 'Concept Release' that will seek views on allowing US issuers to prepare their financial statements under IFRS, thus treating US domestic registrants and FPIs similarly.

A Concept Release is not a proposed rule – it simply solicits views on a matter to help the Commission. In this case they will solicit views on whether to allow US companies the option of using IFRS. There is no specified timeframe for the Commission to take further action following a concepts release. As an illustration, the SEC issued a concept release in 2000 about the acceptability of companies preparing financial statements using IFRS without reconciliation to US GAAP. This is of course still under consideration seven years later.



## Insurance DP has implications for revenue and liability/equity classification

The IASB released its Discussion Paper (DP) on insurance contracts last month. It contains the Board's preliminary decisions about a new standard on accounting for insurance contracts. It could also have significant implications for IASB and FASB discussions on revenue recognition and liability and equity classification. Insurance specialist in PwC's Global Accounting Consulting Services Francesco Nagari looks at the detail.

The Board's project to develop a standard for insurance contracts finally appears realisable. It will bring insurance contracts into the IASB Framework and provide solutions to some of the most difficult issues considered in any IASB project.

The Board's proposal for the measurement of insurance contracts is based on the concept of current exit value. This represents the amount that the insurer is prepared to pay to transfer an insurance contract to another party. The Board narrowly preferred the current exit value model's use of market inputs to a measurement model based on the customer consideration – ie, the premium a policyholder pays to buy an insurance contract. One consequence of the exit value model is the insurer's possibility to recognise day one profit if the exit value is lower than the premiums received from the policyholder.

The DP will present both models and ask views from commentators. The IASB is keen to receive comments on this crucial issue for insurance accounting because these two alternative measurements are similar to those the IASB and FASB are debating in their joint project on revenue

recognition: the fair value and the customer consideration models.

If the comments on the DP persuade the IASB that its preliminary decision to use an exit value approach can produce relevant and reliable amounts for the complexity of insurance contracts, there could be a strong precedent for them to consider when they come to make the choice for general revenue accounting principles for other less complex transactions.

The DP also has significant implications for the debate on classification of instruments as liability or equity. These implications come from the decisions on the accounting for discretionary participating rights. These are common clauses in pension/retirement contracts where the policyholders receive dividends and bonuses on their savings based on sharing the income from the assets that the insurers have purchased with the policyholders' money. The DP explores the application of the concept of constructive obligation to the classification of these dividend/bonus rights as liabilities.

The classification as equity or liability under current IFRS is based on the

identification of enforceable obligations that arise only from contractual clauses. The Board's decision to use a broader perspective could have profound implications for the notions of equity and liability when the IASB and the FASB discuss them in the context of their joint project on liability and equity classification.

There are two additional issues to be aware of:

- the IASB intends to develop an IFRS for insurance contracts that applies to policyholders as well as insurers. The DP does not cover this issue; the IASB may publish a dedicated discussion paper towards the end of 2007; and
- there is a possibility of US GAAP converging towards the new IFRS in this area. The FASB will issue the DP on insurance contracts to its constituents in the US for comment in the next few weeks to assess whether it should join the IASB in developing a US standard that will be similar to the new IFRS.

The deadline for comments is 16 November 2007. The IASB expects to publish the exposure draft towards the end of 2009, with the IFRS issued after a further consultation period in 2010.

### Illustrative condensed consolidated interim financial information – for existing IFRS preparers

2006 update of a practical guide to applying IAS 34, Interim Financial Reporting. It contains:

- illustrative set of condensed interim financial information prepared in accordance with IAS 34 for a fictional manufacturing and retail group (existing preparer)
- a disclosure checklist for condensed interim financial information and an overview of IAS 34, including solutions to practical issues.

The publication covers disclosures required by IFRS standards and interpretations issued up to 30 June 2007. Contact your local PwC office for copies.

# China prepares for 2007

China announced in February last year its decision to require its 1,400 listed companies to report under IFRS-aligned Chinese Accounting Standards (CAS) from January 2007. Yvonne Kam, PwC director in China, talks about preparations for the change.

## What are the biggest technical issues facing PRC-listed companies?

One of the main issues is valuations, in the context of business combinations, financial instruments and share-based payments. We have limited benchmarks for these valuations in China due to our lack of deep and liquid markets.

Companies are using valuers from outside China to help. In addition, the audit firms are using in-house valuers to assess the valuations done by external valuers. Corporate finance valuations can differ from those carried out by external valuers. The assumptions used would need to be carefully reviewed, and this could take longer than expected. Management should consider this issue now.

The treatment of impaired loans is another challenge. Large impaired loans are accounted for individually using a discounted cash flow approach. As the size of the loans gets smaller, a more 'collective assessment' of the amount of impairment is needed. National banking regulations require lenders to make general reserves to cover the expected losses for an entire portfolio and specific reserves to offset the deterioration of large loans.

Under new CAS, the suggested size of the reserves flowing from the new accounting regime will significantly decrease the size of the general reserves. Only impairment that exists at the balance sheet date can be accounted for.

Another issue is the collection of detailed disclosure data, such as fee

income and expenses, and the maturity of assets and liabilities. Some companies in more modern industries such as telecoms may be equipped to aggregate this information; others need to assess whether they need to send people out to all of their branches to collect information manually. Management should think about developing new systems to cope with the requirements.

Finally the identification of unrecognised transactions not accounted for under current GAAP will be a challenge. Many financial instruments such as options and financial guarantee contracts are not accounted for until exercised. Preparers may not be aware when implementing new CAS that they must account for a transaction when they become a party to a contract, as opposed to cash exchanging hands or using accruals-based accounting. This arises a lot in the context of financial instruments and share-based payments.

Companies should therefore do an inventory of their transactions and formulate a strategy. This requirement will be mandatory in 2007.

## How has the exposure draft on IAS 24, Related Party Disclosures, been received in China?

I'm participating in drafting the firm's response. We strongly support the relief provided by IAS 24 to state-owned enterprises (SOEs). However, we believe the proposals relating to indicators need some fine-tuning.

An SOE that meets one of the indicators is not exempt from the IAS 24 requirements to account for related-

party transactions. Such indicators include a transaction conducted by two SOEs at non-market rates – this would be subject to disclosure. Parties that share common resources or are engaged in 'economically significant' transactions are also exempt from relief. We are hoping for amendments in this area.

## How is knowledge of new CAS developing in China?

The Ministry of Finance and the China Securities and Regulatory Commission are rolling out massive training initiatives. Around 300 people may attend each course, which are typically five-day classroom training sessions on new CAS principles. Many listed companies will send employees on a number of these over the course of the 18-month build-up to December 2007.

Regulators, the government, the firms and the Chinese Institute of Certified Public Accountants are organising roadshows; CPAs and financial advisers are running company-specific training sessions.

Of course, some companies already have IFRS (or HKFRS) experience – those with listings outside of China. But they represent only around 10% of China's companies. Some 1,300 companies will be new to new CAS and have the steepest learning curve.

## Will preparers be fully up to speed by 2007?

Companies will make the change to new CAS in two phases, much as has happened in Europe since 2005. Phase 1 in 2007 will be a question of getting

the numbers right. Audit adjustments may be unavoidable. Phase 2 will involve improving disclosures and embedding the changes and systems.

In 2005 we implemented Hong Kong

FRS, which is almost identical to IFRS. In 2007, we will implement IFRS-aligned CAS. 2009 will be the next IFRS big bang, when the next wave of IFRSs, standards and interpretations, will be effective.

*A comparison of the similarities and differences between IFRS and new IFRS-aligned CAS is available in Chinese. Visit [http://www.pwccn.com/home/eng/cas2006\\_chi.html](http://www.pwccn.com/home/eng/cas2006_chi.html) to download the PDF.*

## Shanghai secondee gets a global perspective

**Tracy Chen was seconded from PwC's Shanghai Accounting Consulting Services team to the Global ACS Central team in London in October 2006, eight months after China announced its move to IFRS.**

### **What was your motivation to do a secondment to the Global ACS Central team?**

I was strongly encouraged by the ACS leader for Hong Kong/China, Addison Everett. I also recognised that a secondment would not only benefit PwC's ACS group in China; it would also benefit me and my future development. I was seconded to the financial instruments team in the Central team. The financial instruments market in China is growing very fast, and everything I learn on my secondment will be of great relevance when I return home.

### **Has the reality matched your expectations?**

I quickly found that in the Central team, you learn the subject by

'doing the job' – you hit the ground running. And it has been a steep learning curve. Projects I have been involved in include preparing training materials and writing the illustrative financial statements for banks, so I have certainly broadened my horizons.

### **How will you be able to add value to ACS in Shanghai when you return?**

My more specialist knowledge of financial instruments will be valuable. I also now have a more global perspective of accounting issues and experience gained by working with, for example, European companies' financial statements. This will be very useful if similar issues arise in China.

## **For further help, please contact:**

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