

In this first edition of IFRS Link of 2006 we look at some of the most recent developments in International Financial Reporting Standards (IFRS) and what they may mean for those responsible for the preparation of IFRS compliant financial statements. Whilst the number of new standards may have been relatively low, there have been exposure drafts of potential new standards which could result in some very significant changes to financial reporting.

Financial instruments disclosure - more change

IFRS 7 'Financial instruments: disclosures' will apply for periods beginning on or after 1 January 2007 and will replace the presentation part of IAS 32: 'Financial instruments: disclosure and presentation'. The standard will also replace IAS 30 'Disclosures in the financial statements of banks and other financial institutions'. Earlier application will be permitted and could be advantageous for any company recently required to use IFRS for the first time as it will save them from having to apply two different standards in a relatively short period of time.

The IFRS applies to all risks from all financial instruments and to all entities even where they have few financial instruments. For example a manufacturer whose only financial instruments are accounts receivable and accounts payable will still have to comply with the standard. The extent of the disclosure however will depend on the extent of use of financial instruments and the risks the entity faces.

As with the previous standard there are two aspects to the disclosure requirements:

- the overall significance of financial instruments; and
- qualitative and quantitative information about exposure to risks arising from financial instruments.

The standard includes specified minimum disclosures about credit risk, liquidity risk and market risk.

Whilst many of the requirements remain the same as those in IAS 32, there have been some simplifications, particularly the removal of requirements that result in duplication of information. However, some further disclosure will also be required. The most significant changes include:

- Disclosure of the carrying amounts of financial instruments under each of the classifications in IAS 39 'Financial instruments: recognition and measurement'.
- The need to provide further information about assets and liabilities designated as at fair value through profit and loss.
- An analysis of the age of financial assets that are past due and an estimate of the fair value of collaterals held by the reporting entity.
- Separate disclosure of the amount of ineffectiveness recognised in income on cash flow hedges and hedges of net investments in foreign operations.
- Additional requirements with respect to sensitivity analysis of market risks and how changes in those risks affect the profit and loss account and equity in the period.
- Disclosures with respect to the management of capital.

Determining the scope of IFRS 2 'Share-based payment'

IFRS 2 'Share-based payment' deals with the accounting treatment where a company receives goods or services in return for an equity instrument in itself. In some cases however it can be difficult to demonstrate that goods or services have been received. Other than share-based payments involving employees (for example share options) there is a rebuttable presumption that the fair value of the goods or services received can be estimated reliably and the transaction should be measured at that fair value. There is therefore an underlying presumption that the entity will be able to identify the goods or services received.

In certain circumstances it might appear that the consideration received is less than

the fair value of the instrument granted.

The International Financial Reporting Interpretations Committee has issued an extract (IFRIC 8) dealing with this issue and have concluded that such circumstances are indicative of the fact that other goods and services must have been received. The value of the unidentified goods and services should be measured as the difference between the fair value of the instrument and the fair value of any identifiable goods and services.

Business combinations - re-writing the rules

When IFRS 3 'Business combinations' was first issued in March 2004 it was on the basis that it was only the initial guidance in this important area. Finance directors of companies adopting IFRS were just about getting to grips with its requirements when the International Accounting Standards Board (IASB) issued an exposure draft setting out significant proposed revisions. The exposure draft 'Proposed amendments to IFRS 3 Business combinations', reflects the end of phase II and the culmination of a joint project between the IASB and the US Financial Accounting Standards Board (FASB).

The exposure draft which was issued by both the IASB and FASB has provoked considerable controversy and attracted nearly 300 letters of comment. Some of the proposed changes will affect all business combinations whilst others are set to significantly change the accounting in circumstances where control over an entity is less than 100%.

Currently costs associated with making an acquisition (for example professional fees) are considered to be part of the cost of acquisition and are included within the cost of investment. The costs are therefore taken into account when calculating goodwill and are effectively capitalised onto the balance sheet. The IASB however argue that such costs are not part of the consideration and should not be included as part of the cost of

acquisition, as a consequence they would need to be expensed to the income statement as incurred.

The IASB are also looking to re-write some established rules of accounting by suggesting a different model for reporting business combinations, the impact of which will be significant where control of less than 100% is acquired. Current accounting reflects the cost of the acquisition and, to the extent that exceeds the identifiable assets and liabilities acquired, goodwill is included as an asset on the balance sheet. The proposed new approach however requires the total fair value of the acquired business to be measured and reflected in the accounts even in circumstances where less than 100% is acquired. As a consequence, 100% of the calculated goodwill will be on balance sheet even where there is control over less than 100% of the entity.

Whilst under both the existing and proposed practices the assets and liabilities are consolidated in full even where there is not full ownership, any outside interest in the acquired business will be viewed differently. The term minority interest will be replaced by 'non-controlling interest' and because the group will now be viewed as a single entity any changes in those non-controlling interests will not be reflected in the income statement, but as movements within equity.

Other features of the exposure draft include:

- A definition of what constitutes 'a business' and guidance on factors to consider when determining whether a group of assets and liabilities constitute a business.
- Recognition of all assets and liabilities even where the economic benefits or liabilities associated with those assets or liabilities are contingent on the outcome of a future event.

With the period for comment now closed, the IASB have indicated that it could take them a year to redeliberate the principles addressed in the exposure draft.

The end of provisions, contingent assets and contingent liabilities?

An exposure draft of amendments to IAS 37 'Provisions, contingent liabilities and contingent assets' has been issued as part of the short-term convergence project between US GAAP and IFRS. Changes to IAS 37 in respect of constructive obligations, onerous contracts and restructuring provisions, as well as amendments to IAS 19 'Employee benefits' in respect of termination benefits, result from the IASB's consideration of FASB statement 146 'Accounting for costs associated with exit or disposal activities'.

The business combinations project discussed above has included reconsidering the way in which contingencies are accounted for in a business combination. As a consequence it is proposed that the terms contingent asset and contingent liability will be eliminated and that these items should be analysed in a different way. The IASB consider that these changes will also bring IFRS closer to US GAAP.

The exposure draft does not use the term provision and proposes instead use of the term 'non-financial liability'. Contingency will be used to refer to the extent of uncertainty associated with the amount required to settle the liability rather than uncertainty as to its existence. The effect of this is that the extent of the uncertainty is built into the measurement of the non-financial liability which will need to include the likelihood of the relevant event occurring.

ED 8 'Operating segments'

ED 8 is further output from the short-term convergence project between the IASB and FASB. The IASB have compared FASB Statement 131 'Disclosures about segments of an enterprise and related information' with IAS 14 'Segment reporting' and proposed that the wording of a new IFRS reflect the wording of SFAS 131. A consequential amendment to IAS 34 'Interim financial reporting' will also require selected segmental information to be reported in interim statements.

The proposed new standard requires reporting that is based on the information about components of the entity which are the same as those used by management.

Operating segments will therefore be identified by reference to those internal reports which are regularly reviewed by management. Unlike IAS 14, reportable segments will not be limited to those that earn a majority of their revenue from external sales, therefore components that principally service other operating segments could be included.

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