

## The story so far

In many parts of the world 2005 was the first year in which listed companies (and in some parts of the world a wider range of companies) were required to prepare their accounts in accordance with International Financial Reporting Standards (IFRS). With the financial statements for many of those companies having now been made public we are finally seeing the real effects of applying IFRS.

### The impact on earnings

As was widely predicted, the standard that is probably making the biggest difference to reported earnings is IFRS 3 'Business combinations', because of its requirement that goodwill should not be amortised but subject to annual impairment review. However, while the effect of IFRS 3 may be the most significant in terms of size, analysts and other users of financial statements frequently disregarded the old amortisation charges when assessing business performance. As a consequence it is some of the other standards, where the apparent effects are smaller, that are causing more interest.

IFRS 2 'Share based payments' requires the inclusion of the fair value of share options granted to employees in the income statement. On first-time adoption of IFRS, companies are showing a reduction in earnings as a consequence of the recognition of share-based payments. Although there is a provision in IFRS 2 which allows companies to only account for options granted after 7 November 2002, a number of companies have chosen to apply the standard fully-retrospectively.

For many companies first time adoption of IFRS has also meant first time inclusion of derivative financial instruments within their financial statements. Where these derivatives do not meet the strict criteria for hedge accounting under IAS 39 'Financial instruments: recognition and measurement' they are accounted for 'at fair value through profit and loss' resulting in changes in their value being reflected directly in the income statement whilst the derivatives themselves are included on the balance sheet. Over the longer term, where a company has any significant level of derivatives, the use of fair values will increase volatility of reported earnings.

### The impact on net assets

Goodwill is frozen at its book value at the date of transition to IFRS (subject to a first time application impairment review). As a consequence the amortisation charged from that date is reversed and any company with goodwill on their balance sheet has shown an increase in net assets at transition.

However, any increase in assets as a consequence of a different policy with respect to goodwill has been more than tempered by the effect of accounting for retirement benefit schemes. With many defined benefit pension schemes currently in deficit, the inclusion of retirement benefit schemes in the accounts of many companies for the first time has seen significant reductions in net assets for many. With much of the decrease in net assets being recorded in equity, companies are also showing a substantially reduced level of retained profits.

Many financial assets are now required to be accounted for at fair value (market value) for the first time, resulting in increases in net assets as previously many 'available for sale' financial assets were held at their historical cost. As the gains and losses on revaluation of this class of assets are taken straight to equity there is no impact on the income statement.



## Increased disclosure

Whilst dealing with the interpretation and application of standards was one significant challenge facing the preparers of IFRS accounts, anyone looking at their published accounts will also appreciate the amount of work required to produce the large volumes of additional disclosure information. With the financial statements for the first year of adoption having to include the reconciliation requirements of IFRS 1 'First time adoption of international financial reporting standards', the size of accounts has increased by as much as a third.

## And the future?

The International Accounting Standards Board's (IASB) recently issued work programme provides a good indication of the new and revised standards we can expect to see issued in the remainder of 2006. The work programme now very clearly differentiates those projects which are part of the Memorandum of Understanding (MOU) with the US standard setter FASB and those which are ongoing IASB projects outside of the MOU.

The only revised standard this year is likely to be a replacement for IAS 14 'Segment reporting'. The revised standard will achieve convergence with the equivalent US standard. Before the end of 2006 exposure drafts will also be issued of revisions to IAS 31 'Interests in joint ventures' and IAS 12 'Income taxes'. In addition an exposure draft of the long-awaited proposals for the use of IFRS by small and medium-sized entities is due before the year is out.

The IASB have also announced that they intend to undertake research projects into accounting for both leases and for post-retirement benefits. It is widely anticipated that the leasing project will result in a fundamental change to the way in which leases are accounted for, but this is unlikely to be before 2010.

## And finally ..... a small piece of good news

The IASB have recently announced that any new standards or revisions to existing standards will not have an application date before 2009, in addition new standards will not have application dates earlier than 12 months from their date of issue. While assisting those who have yet to apply IFRS by providing a 'stable platform', the move is also seen as a major contributing factor to achieving greater world-wide convergence.



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