

FINANCIAL REPORTING REVIEW PANEL

ACTIVITY REPORT

Introduction

This report covers the Panel's activity during the year from 1 April 2006 to 31 March 2007. UK groups with equity securities traded on a regulated market must now prepare their accounts under International Financial Reporting Standards (IFRS) and many of the accounts reviewed by the Panel in this period had been prepared under IFRS for the first time.

In December 2006, the Panel published a report setting out its preliminary findings following its review of IFRS implementation. The report found a good level of compliance with the international requirements but brought a number of issues to the attention of companies preparing their next IFRS annual accounts. This report completes the Panel's findings in respect of first-time implementation of IFRS, adds issues to those mentioned in its early report and comments on points previously raised with the benefit of further experience.

This report also publishes the Panel's findings from its reviews of accounts prepared under UK GAAP by standalone issuers, companies on AIM or other unregulated markets, and large private companies including those funded by private equity.

Although AIM quoted companies are not required to produce accounts under IFRS until accounting periods beginning on or after 1 January 2007 a number have already done so and some of their accounts were selected for review during the period. Directors of AIM companies may find this report helpful as they prepare their first annual accounts under IFRS.

Structure of this report

This report is set out in the following sections:

Section One	Summary
Section Two	Statistics
Section Three	Selection of accounts for review and approaches to companies
Section Four	Panel publications – press notices and focused reviews

Section Five Reviews of accounts prepared in accordance with IFRS

Section Six Reviews of banks' accounts

Section Seven Review of UK GAAP accounts

Appendices

A Tabulated statistics – Analysis of company reviews

Section One *Summary*

In 2006/07, the Panel reviewed 311 sets of accounts (2005/06: 284) and wrote letters to 135 companies (2005/06: 82) asking for further information about areas of possible non-compliance with the accounting requirements of the Companies Act 1985 or Listing Rules. The increase in the proportion of Panel enquiries when compared to last year is, in the Panel's view, due to the approach the Panel adopted in reviewing first-time IFRS accounts, rather than to any deterioration in the quality of financial reporting. The Panel took the view that it was sensible to challenge seemingly questionable accounting treatments and disclosures which appeared inadequate before they became established practice. If debates are to be had as to the appropriate application of international requirements, it is better that they be had at an early stage.

The Panel's review of IFRS accounts found a good level of compliance with the international requirements which testifies to the thoroughness of the preparatory work undertaken by preparers and auditors. This report focuses on areas where there is room for improvement but this should be seen in the context of a level of compliance which was good overall.

The Panel wrote to 45% of FTSE 350 companies whose annual accounts it reviewed compared with 57% of listed companies outside the FTSE 350.

Company responses to the Panel's letters of enquiry were generally very well considered. There was evidence of engagement by company audit committees as well as involvement of external auditors.

Four company-specific press notices were issued in the year under review, all of which related to annual accounts prepared under UK GAAP. Four Panel Groups were set up in the period, one to consider matters arising under IFRS which is now concluded and three under UK GAAP, one of which is continuing.

94 of the 135 companies who were approached by the Panel to clarify aspects of their financial reporting gave an undertaking to improve their financial reporting in at least one area in future.

Improvements and corrections agreed with companies ranged across applicable reporting standards under both reporting frameworks. Standards that gave rise to most questions about potential non-compliance fell into two categories.

- Those that deal with more complex matters where management judgement is important. These areas tend to be the same under IFRS and UK GAAP; for example, impairment testing, pensions and provisioning.
- Those international requirements that do not have a parallel under UK GAAP and which therefore presented new challenges to preparers in terms of application and disclosure; for example, IFRS 5, 'Non-Current Assets Held for Sale and Discontinued Operations'.

The Panel's review of 16 banks reporting under IFRS focused particularly on implementation of IAS 30, 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions', IAS 32, 'Financial Instruments: Disclosure and Presentation' and IAS 39, 'Financial Instruments: Recognition and Measurement'. These reviews identified a good level of compliance with these standards and with IFRS in general. Issues raised with companies indicated a need for refinement of disclosures rather than significant changes to accounting treatments.

The Panel's targeted review of pension disclosures in 30 companies' accounts showed a good degree of compliance with the detailed disclosure requirements of IAS 19 and FRS 17. The areas of disclosure that could be improved were published in a report in August 2006 which also drew attention to common disclosure omissions. A follow-up review of the same companies' 2006 IFRS pension disclosures has shown improvement in key areas - notably disclosure of mortality assumptions and of key estimates and sensitivity analysis.

SECTION TWO *Statistics*

Appendix A shows the statistics for the year in tabular form.

In the period from 1 April 2006 to 31 March 2007, the Panel reviewed 311 sets of accounts and wrote letters to 135 companies asking for explanations of possible non-compliance with the accounting requirements of the Companies Act 1985 or Listing Rules.

The Panel selected 266 sets of accounts for review in accordance with its risk-based approach. The remaining 45 accounts came to the Panel's attention through complaints, referrals from other regulators or in connection with matters raised in the financial press.

At the time of publication of this report, all but 24 cases are concluded.

Of the 135 companies approached, 94 voluntarily undertook to provide corrected or improved treatments or disclosures in their next accounts.

SECTION THREE *Selection of Accounts for Review and Approaches to Companies*

The Panel selected accounts for review broadly in accordance with its risk-based approach, where risk is a combination of the probability of a breach of accounting requirements and the impact that such a breach would have on the market and investor confidence. Companies are identified as higher risk according to a range of factors, their size and profile acting as proxy for the significance of the effect of any departure from the accounting requirements. This approach is consistent with the recommendations issued by the Committee of European Securities Regulators (CESR), which is looking to develop a harmonised approach to enforcement in EU member states.

Under this approach, the Panel focuses its attention on larger listed companies, although it selects accounts from the full range of companies within its remit, which includes large private companies.

In December 2005, the Panel announced that its monitoring activity for the year under review would focus on the automobile, pharmaceutical, retail, transport and utility sectors. These sectors were selected after discussion with the Financial Services Authority (FSA) and the Panel's Standing Advisory Group, an independent committee which comments on the Panel's proposals for priority sectors. The Panel publishes its priority sectors so that companies in those sectors are aware of the greater probability of review and may give greater consideration than usual to compliance issues in advance of publication of their accounts. Public announcements are intended to reinforce

the deterrent effect of the Panel, consistent with its objective of improving the quality of financial reporting.

Of the 72 sets of accounts selected from priority sectors, 22 led to agreement to improve at least one area of reporting in the future; 6 cases are still in progress.

A further 29 sets of accounts were selected for review based on a number of the Panel's chosen company-specific trigger factors of corporate governance, reputation, understandability, accounting issues and disclosure. In order to test the appropriateness of the company-specific selection criteria, a number of accounts were randomly selected for control purposes.

The Panel considered all accounts brought to its attention where the auditors had qualified their opinion for failure to comply with the accounting requirements of the Companies Act.

The Panel ensured that a significant proportion of the accounts of UK issuers also listed in the US were subject to review, in light of the US Securities and Exchange Commission's likely consideration of accounts prepared under IFRS and the Panel's intention to co-operate with the SEC, now confirmed in the protocol between the FRC and the SEC signed on 25 April 2007. 33 sets of accounts reviewed were selected because they were those of issuers with listings both in the UK and the US.

The Panel also reviewed a sufficient number of smaller listed entities to ensure that it had a comprehensive view of issues arising on implementation of IFRS, including the accounts of companies where access to technical resource may have been restricted.

The Panel continued to react to matters brought to its attention by investors and other users of financial information, by press comment and by referrals from other regulators. Of the 45 annual accounts considered as a result of complaint or referral, 10 gave rise to undertakings of improvements in future years; 9 cases are still in progress.

The Panel encourages investors and others to bring accounts to its attention if they think that there may be a breach of accounting requirements. In particular, the Panel welcomes referrals from professional investors as this is the section of the financial community most likely to consider and compare the accounts of companies subject to the regulatory scope of the Panel. The FSA has confirmed that, in its view, such referrals do not give rise to price-sensitive information as they do not necessarily mean that the Panel will conclude, on enquiry, that there are any areas of accounting non-compliance. The FSA Code of Market Conduct provides that disclosure of inside information by market participants does not amount to market abuse

(improper disclosure) if it is made to a regulatory body or authority, such as the Panel, in connection with the performance of its functions.

The Panel writes to companies asking for additional information, explanation or clarification only if there is, or may be, a question of whether the accounts comply, in a significant aspect, with the accounting requirements of the Companies Act 1985.

More minor points of possible omissions of disclosure that come to the Panel's attention are often included in an appendix to the letter. These matters may not be applicable or sufficiently material to warrant disclosure. Alternatively, they may have been overlooked. The Panel brings such issues to management's attention so that they may be considered when the next set of accounts is prepared. Companies are not required to respond to the Panel on these issues, although many do. This approach helps to ensure that company and Panel resources are focused on issues of potential substance.

Occasionally, the Panel writes to a company where there are no points of potential substance but where a number of more minor disclosures may have been omitted. This type of letter is more often issued to smaller companies whose accounts are not likely to be reviewed again in the short term and where the letter could help raise the quality of the company's future accounts. The Panel wrote seven such letters during the year.

SECTION FOUR *Panel publications - Press Notices and Focused Reviews*

The Panel issued four company-specific press notices during the year. All related to annual accounts prepared in accordance with UK GAAP.

The first concerned the treatment of a land sale that the company had entered into after the year end but which was accounted for as if it had occurred in the year under review. The auditors had qualified their opinion in this respect. Following enquiry, the Panel concurred with the auditors' view and the matter was corrected through prior year adjustment in the company's next set of annual accounts.

The second press notice related to the valuation of shares forming part of the consideration issued by a company for an interest in an acquisition. FRS 7, 'Fair Values in Acquisition Accounting' explains that, where shares form part of the consideration and are quoted on a ready market, the market price on the date of acquisition normally provides the most reliable measure of fair value. The company however, had valued the shares at the price prevailing when the share purchase agreement was signed, some months prior to effective completion and following approval of the acquisition in general meeting. The company was not able to demonstrate that the share price at the

earlier date provided a more reliable measure of fair value. The error was corrected by way of a prior year adjustment in the company's following annual accounts.

The third press notice considered a set of accounts that had been qualified by the auditor for failure to comply with FRS 18, 'Accounting Policies'. The accounts had disclosed a number of prior year adjustments, which, on subsequent review by the directors, were found to be corrections of fundamental errors in prior year accounts and not related to policy changes as originally stated. As the policies adopted in the accounts under review were considered appropriate, there were no consequential adjustments to be made to the 2005 primary statements.

The fourth press notice related to a company which had invoked the true and fair override so as not to consolidate those of its venture capital investments that were subsidiary undertakings. The Panel did not accept the override in this case as the company was unable to demonstrate the special circumstances warranting a departure from the requirements of an accounting standard. The company consolidated the subsidiary undertakings as from its following interim accounts.

Generic Press Notices

As permitted by its Operating Procedures, the Panel sometimes publishes press notices referring to matters that have come to its attention but without identifying the companies concerned.

During the year, the Panel became aware that a number of companies in the oil and gas industry reporting under UK GAAP were adopting a narrow definition of what constitutes an operation for financial reporting purposes. This had resulted in non-compliance with disclosure requirements of FRS 3, 'Reporting Financial Performance'; specifically non-disclosure of the aggregate results of acquisitions as a component of continuing operations.

The Panel was concerned that users of these accounts would, firstly, not be able to analyse the impact that an acquisition had on results and, secondly, that they would not be able to form a proper basis for the assessment of future income.

The Panel's press notice drew attention to the issue, indicating that, in its view, the Statement of Recommended Practice (SORP) 'Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities' gives guidance on what the industry should understand by the term 'operation'. This includes, for example, the acquisition of an interest in a producing field, the share of an interest in a field already partly owned or a

farm-in licence. The Panel's view was that the SORP clarifies application of FRS 3 and that it should be considered when determining both when and how the disclosure requirements of the Standard should be applied by companies in this sector.

Specific review - Review of Pension Disclosures under IFRS and UK GAAP

In August 2006, the Panel published the results of its review into disclosures made in respect of defined benefit pension schemes.

The Panel considered the pension disclosures of 20 listed groups that prepared their December 2005 accounts under IFRS (IAS 19, 'Employee Benefits') and 10 large private companies that prepared their accounts under UK GAAP (FRS 17, 'Retirement Benefits'). The purpose of the review was to evaluate the completeness and clarity of disclosures. The report complemented work done by the Accounting Standards Board which was considering possible amendments to the UK standard based on the international requirements. The Panel did not write to the companies whose accounts were reviewed in the survey. The review reported a high level of compliance with detailed disclosure requirements of both IAS 19 and FRS 17 but set out a number of omissions and areas where the quality of pensions reporting under both frameworks could be improved.

A follow-up review of the same listed companies' pension disclosures in their December 2006 accounts shows improvement in disclosures about mortality assumptions and in the provision of sensitivity analysis. Mortality disclosures were easier to understand and there was clearer explanation of the uncertainties surrounding estimates and the impact of changes on pension liabilities as required by IAS 1, 'Presentation of financial statements'.

The Panel is encouraged by the clear improvements in these significant areas and believes this to be an example of the way in which the application of IFRS will develop.

There was, however, limited improvement in disclosures about maturity of funds and no evidence of expanded information about assets held within funds, nor about how expected returns were calculated. Where appropriate, these matters and apparent omissions of more minor disclosures will be addressed through the Panel's usual working method of writing to the companies concerned.

SECTION FIVE *Review of accounts prepared in accordance with IFRS*

First-time implementation of IFRS

First-time implementation of IFRS was a significant challenge, even to the UK's largest companies. Application of the standards will be informed by experience and shaped by peer and industry comparisons conducted at international level. Convergence of understanding of the requirements and consistency of application are matters which will continue to develop.

The increase in Panel enquiries compared with prior years reflects the Panel's approach to monitoring compliance with the requirements of the international standards. The Panel's over-riding objective is the improvement of the quality of financial reporting in the UK. The Panel took the view that it was sensible to challenge accounting treatments and disclosures which appeared doubtful before they became established as acceptable. Debates about the application of international requirements are better had at an early stage.

The Panel was impressed by the amount of detail provided in response to its queries on IFRS accounts. Responses by companies not only set out their explanations of the accounting but also reflected the dialogue that had been entered into with auditors and industry participants about the new reporting requirements.

Of the 97 IFRS preparers approached, 80 have voluntarily undertaken to provide corrected or improved treatments or disclosures in their next accounts. 8 cases remain in progress. A very high proportion of companies readily acknowledged the points raised by the Panel, indicating that they were not yet wedded to particular accounting presentations as they may have been under UK GAAP, where history, practice and expectation would have encouraged a more robust defence of their practices.

In its preliminary report on first-time implementation of IFRS published in December 2006, the Panel drew attention to areas of reporting where improvements could be made. Those areas were:-

- accounting policies
- disclosure of judgements and estimates
- new standards and interpretations
- intangible assets
- impairment testing
- related party disclosures

- presentation

The December report drew on reviews conducted in respect of 31 December 2005 consolidated accounts. This report completes the Panel's comments on first-time IFRS annual accounts prepared for periods ending up to, but not including, 31 December 2006.

The main findings of the Panel are presented under the standards to which they relate and include common disclosure issues which were included in the appendices of letters sent to companies.

IAS 1 "Presentation of Financial Statements"

The standard prescribes the basis for presentation of general purpose financial statements to ensure comparability across reporting periods and with the accounts of other entities.

Primary statements

IAS 1 does not mandate the order or format in which items are to be presented in the primary statements although it does specify minimum requirements.

Income statement and balance sheet

Many companies adopted a format for their income statement similar to that used previously under UK GAAP and there was some evidence of non-compliance with the minimum presentation requirement on the face of the income statement and balance sheet. For example, the company share of profit or loss of associates and joint ventures equity accounted for was not always disclosed as a single figure as required; deferred tax assets and deferred and current tax liabilities were not always shown on the face of the balance sheet.

In its December 2006 report, the Panel drew attention to the fact that IAS 1 permits additional line items to be disclosed or minimum items re-ordered, but only when this is necessary to explain elements of financial performance.

Expenses may be analysed on the face of the income statement or in the notes, either by nature or by function, depending on which presentation provides users with the most useful information. Additional information is required when the functional presentation is adopted. A number of companies provided a mixed presentation or did not analyse expenses in full, making it difficult to appreciate how expenses vary, directly or indirectly, with a change in the level of sales.

IAS 1 does not require disclosure of operating profit or loss, although this may be presented as a sub-total when relevant to an understanding of the entity's financial performance. As under UK GAAP, the Panel questioned disclosure of the sub-total "Operating Profit or Loss" if the number seemed not to take account of items that would ordinarily be considered operating in nature.

Unlike UK GAAP, where there is a specific exemption from providing comparative information in respect of intangible assets and plant, property and equipment (PPE), there is no such exemption under IFRS. A number of companies did not provide the comparative information in respect of amounts reported in the period. Additionally, others did not provide the prior period figures in respect of discontinued activities and exceptional items.

The Panel also queried the basis on which some companies distinguished current from non-current assets and liabilities. Where appropriate, for example where a company had failed to disclose the current portion of a non-current receivable, or a revolving credit facility was incorrectly categorised as current, the Panel agreed that presentation could be put right going forward.

Statement of changes in equity

Under IFRS, the statement of total recognised gains and losses (STRGL) required by UK GAAP is replaced by a statement of changes in equity (SOCIE) that may be split into two parts – a statement of recognised income and expense (SORIE) presented as a primary statement with a separate statement in the notes that shows transactions with equity holders acting in that capacity.

In its review of interim reports prepared under IFRS measurement and valuation criteria, the Panel noted some confusion in the placing of items within the sections of the statement, particularly in relation to items recognised for the first time as a result of new accounting policies.

Examples of issues raised with companies in connection with the presentation of the statements of changes in equity in annual accounts included the following;

- Impact on each component of equity of changes in policy on implementation of IAS 32 and 39 not disclosed
- Movements on cash flow hedges not included
- Dividends included in the SORIE, rather than the SOCIE
- Revaluation surpluses incorrectly excluded
- Reversal of IFRS 2 charge incorrectly included in SORIE, rather than in the SOCIE.

In addition, movements in reserves and changes in equity were, on occasion, presented as a note rather than in a primary statement when no SORIE was presented. Movements in minority interests were also not always included in the statement of changes in equity as required.

Accounting Policies

Under IAS 1, companies are required to disclose, in a summary of accounting policies, the measurement bases used in preparing the accounts and other policies used that are relevant to an understanding of the financial statements.

The transition to IFRS prompted companies to make significant changes to their accounting policies. Following such changes of policy, some companies' policy descriptions retained UK GAAP terminology. Where enquiry revealed the underlying accounting to be appropriate, the Panel agreed that these matters could be addressed through redrafting of the policies for inclusion in the next year's accounts.

The Panel noted a tendency to include 'boiler-plate' descriptions of policies where wording appeared to have been copied from standards or audit firm templates with little indication of company-specific application. Sometimes all relevant options available under a standard had been copied without deletion of the superfluous alternatives, or policies were included even though there were no material transactions falling within their scope in the current or previous year.

This type of disclosure does not provide users with useful information. Statements of accounting policy are helpful when they identify issues that are relevant to a company's individual circumstances. Companies should also consider the policies that users would expect to see disclosed for that type of entity; policies may be significant because of the nature of the company's operations even if amounts for both current and prior year are not material.

The Panel considered, on a case by case basis, whether disclosure of policies would be needed by users to understand how transactions and events were reflected in financial performance. Queries included the lack of a stated policy for claims and contract variations in a construction company; a financial asset impairment policy applied by an investment bank; royalty income when it was clear from other reported information that this represented a significant income stream; and a policy for revaluations when other disclosures indicated that assets were carried at revalued amounts.

Disclosures of Judgements and Estimates

In its preliminary report the Panel referred to a new and significant area of disclosure related to the application of accounting policies. The requirements cover two specific areas.

In the absence of industry guidance or established practice, IFRS implementation requires extensive judgement about the selection of accounting treatments. IAS 1 requires disclosure of the judgements that management has made in applying the entity's accounting policies that have the most significant effect on the amounts recognised in the accounts.

Management is also required to disclose key assumptions about the future that have a significant risk of causing a material adjustment to the carrying amounts of assets or liabilities in the following year. These estimates present management with their most difficult, subjective or complex judgements. IAS 1 gives examples of areas that may be covered and of the types of disclosures that can be made in order to help users understand these judgements, including 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.

These two requirements are not paralleled in UK GAAP and they attracted more Panel questions and comment than any other aspect of IFRS or, indeed, any other standard.

The requirements apply to all areas of accounting estimates and assumptions. The standard specifically refers to long-term employee benefit liabilities such as pensions obligations as demonstrating that the determination of the carrying value of some assets and liabilities involves estimating the effects of uncertain future events. Standards that deal with more specific areas of accounting, for example, IAS 19 'Employee Benefits' or IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets', do not explicitly extend to the disclosure of the effect of uncertainty on the carrying amounts of related assets and liabilities.

Companies are obliged to comply with relevant requirements of IAS 1 even where such disclosures are not required by the more specific standards. Companies should apply the requirements of the latter and then consider whether further disclosure is required under IAS 1 if it is probable that assumptions have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

The reviews also indicated some variation 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 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 audit opinion.

Materiality

Material items of income and expense should be disclosed separately either on the face of the income statement or in the notes. The list of circumstances given by the standard that would give rise to separate disclosure include a number of items which, under UK GAAP, may have been considered exceptional non-operating items. These items were sometimes disclosed on the face of the IFRS income statement where the information provided was not material. Other items that were clearly material by virtue of amount – including, for example, reversal of provisions, substantial tax adjustments, bid costs – were not disclosed separately as required by IFRS.

Management needs to balance the provisions of the standards with the relevance of the information they require to present IFRS-compliant accounts that are understandable and at an appropriate level of aggregation. Line items that are not individually material may be aggregated with other items on the face of the income statement or in the notes. Separate presentation in a note may be more appropriate in some circumstances.

IAS 1, paragraph 31, is clear that specific disclosures required by IFRS or IFRIC interpretations need not be made if the information is not material.

Departure from the Standards

In extremely rare circumstances, management may conclude that compliance with a requirement of a standard or IFRIC Interpretation would be so misleading that it would conflict with the objective of financial statements set out in the IASB's Framework (IAS 1, paragraph 17). In such circumstances, the company must depart from that requirement, providing national law permits, as it does in the UK. Full disclosure is required to support such departure.

The Panel considered one such departure in the interim accounts of a UK listed company in the previous reporting period when it accepted the company's treatment. The Panel will, however, consider all such departures from the requirements of IFRS drawn to its attention to ensure that companies are only departing from IFRS in extremely rare circumstances where the relevant criteria are met and where the necessary supporting disclosure is provided.

Points raised by the Panel

- Assets and liabilities, income and expenses should not be offset unless required or permitted by another Standard or an Interpretation (IAS 1. 32).
- Assets and liabilities for current tax and deferred tax assets and liabilities should be disclosed on the face of the balance sheet (IAS 1. 68).
- Each reserve within equity should be supported by a description of its nature and purpose (IAS 1. 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 (IAS 11. 96(d)).

IAS 2 “Inventories”

The standard establishes the accounting for inventories including how cost and subsequent expense is to be determined, including any write-down to net realisable value. The Panel’s enquiries relating to this standard focused on apparent omissions of disclosure for which there is no equivalent under UK GAAP.

A small number of companies did not disclose the cost formulas adopted in measuring inventories. A more significant number of companies failed to provide all the details required to enable users to understand the types of inventory held and the extent of any changes in them.

Points raised by the Panel:

- The amount of inventory recognised as an expense in the period is required to be disclosed (IAS 2. 36(d)).
- The amount of any write down to net realisable value or reversal of write-down should both be disclosed (IAS 2. 36(e) and (f)).

IAS 7 “Cash Flow Statements”

The range of questions raised by the Panel in relation to cash flow statements reflects the number of significant differences between this standard and its UK equivalent, FRS 1, both in terms of the definitions that apply and the formats required.

Unlike UK GAAP, there is no provision under IAS 7 exempting certain companies from preparing a cash flow statement. In a number of cases, no cash flow statement was prepared for the IFRS parent company accounts published with the consolidated accounts.

Whereas FRS 1 focuses on movements in cash, IAS 7 requires a cash flow statement showing the movements in cash and cash equivalents held for meeting short-term commitments rather than for investment. Cash equivalents are defined as short-term highly liquid investments readily convertible to known amounts of cash and which are not subject to significant risk of changes in value less, in certain circumstances, bank overdrafts. Although cash equivalents are normally determined by their purpose, investments qualify when they have a maturity of three months or less from the date of acquisition. Companies which did not specify the original maturity in their policy statements were challenged to explain the application of the definitions to their circumstances; others classified cash equivalents by reference to the maturity length at the balance sheet date leading to some correction of amounts to be included in future.

Some companies were questioned about their classification of cash flows – for example, proceeds from the exercise of options on own shares were disclosed as an investing rather than a financing cash flow. Others did not disclose the full information required to support the cash flow effects of acquisitions and disposals of subsidiaries and business units.

Points raised by the Panel:

- There is no exemption for parent companies from preparing a cash flow statement.
- The acquisition of assets under finance leases does not involve movements in cash or cash equivalents that are investing or financing transactions in a cash flow statement (IAS 7. 44).

IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”

The Panel’s preliminary report drew attention to a disclosure requirement in IAS 8 relating to the impact of new standards and interpretations issued before the date of issue of the accounts but that are not yet effective. There is no similar requirement under UK GAAP. Disclosure should include information relevant to assessing the possible impact that application of the standard or interpretation will have on the company. IAS 8 suggests the type of disclosure that might satisfy the requirement.

More than 20 companies failed to provide the relevant information, with others failing to extend their disclosure to include IFRIC interpretations. Other instances of non-compliance with IAS 8 were isolated but included accounting for a change in estimate retrospectively by restating prior year figures while the standard requires prospective application.

Point raised by the Panel:

- The impact of standards and interpretations issued but not yet effective and the guidance provided should be considered (IAS 8. 30-31).

IAS 11 “Construction Contracts”

This standard sets out the accounting treatment of revenue and costs relating to construction contracts. As these generally continue over more than one accounting period, a key issue is the basis on which contract revenue and costs are recognised.

Companies which did not provide sufficient disclosure to enable an understanding of the method used to determine the contract revenue in the period or the determination of the stage of completion of contracts in progress as required by the standard were challenged to provide the information. The detail required to support significant balances relating to contracts in progress at the balance sheet date was also not always provided in full.

Points raised by the Panel:

- The methods used to determine contract revenue and stage-of-completion of contracts should be disclosed (IAS 11. 39).
- The aggregate costs and recognised profits to date for contracts in progress at the year end should be disclosed (IAS 11. 40).

IAS 12 “Income Taxes”

Application of IAS 12 presented few points of substance in the accounts reviewed in the period. The majority of questions raised by the Panel were apparent omissions of disclosure or unclear or inconsistent information. In most cases, these points were raised as “appendix” type issues.

Under IFRS, a deferred tax asset is recognised for the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that they will be absorbed by taxable future profits. The existence of unused tax losses, however, is strong evidence that future taxable profit may not be available. In such cases, the standard requires a company to have convincing evidence that enough taxable profit will be generated and requires the nature of this evidence to be disclosed. A number of companies were challenged for failure to disclose the nature of their evidence. They satisfied the Panel on the robustness of their evidence and agreed to include appropriate disclosure in their next accounts.

Clarification was also sought of numerical reconciliations provided to explain the relationship between tax expense or income and accounting profit.

Points raised by the Panel:

- Deferred tax is required to be provided in respect of revaluations of non-monetary assets (IAS 12.26(d)).
- Reconciliations are required in respect of total, rather than current, tax (IAS 12. 81(c)).
- The amount of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised on the balance sheet should be disclosed (IAS 12. 81(f)).
- Temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures for which deferred tax liabilities have not been recognised should be disclosed (IAS 12. 81(fl)).

IAS 14 “Segment Reporting”

IAS 14 sets out the principles for reporting segmental information to improve a user’s understanding of past performance, assess the company’s risks and returns and make more informed judgements about the entity as a whole.

The standard is more prescriptive than the UK equivalent in terms of how a segment is identified leaving less to the judgement of directors and leading to increased disclosure by many companies.

Most issues raised by the Panel were connected with the reconciliation required between the information for reportable segments and aggregated information. The most common point drawn to companies’ attention was that segment assets and liabilities do not include income tax assets and liabilities. Other points related to the completeness or accuracy of the presentation of required reconciliations. These often disclosed a significant amount identified as “unallocated” or “other” and which would have benefited from further analysis to help users understand the nature of the items they comprised.

The Panel also challenged companies where, from other disclosures provided both in the accounts and the narrative surround, it appeared that there were additional reportable segments in respect of which further disclosure might be expected. The Panel, however, accepted the companies’ arguments supporting their disclosures.

Points raised by the Panel:

- Additional geographical information is required when the primary form of segmental reporting is business segments (IAS 14.69).
- Segment assets and segment liabilities do not include tax assets and liabilities (IAS 14.16).

IAS 16 “Property, Plant and Equipment” (PPE)

Application of this standard by UK companies raised few points of substance. The Panel drew companies’ attention to the fact that, under IFRS, the residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset after certain deductions and if it was already of the age and condition expected at the end of its useful life. Under UK GAAP, residual value is based on prices ruling at the date of acquisition. This change was overlooked by some reporting entities.

Assets that are similar in nature and use are grouped together to form classes under IAS 16. A class that includes operational structures, fixed plant, vehicles and computers is unlikely to meet that definition. Companies challenged to justify their classification agreed to amend their allocation of PPE so that arguably dissimilar items are not carried as a class going forwards.

Several companies were reminded that, on acquisition, the cost to the company of PPE is the net of the cost and depreciation, not the gross figures.

There is no exemption in the current IAS 16 from the general requirement to show comparatives on PPE disclosures. Omission of comparative information was raised with a number of companies.

Point raised by the Panel:

- Detailed disclosures, including measurement bases and depreciation methods used, are required in respect of each class of PPE (IAS 16.73).

IAS 17 “Leases”

IAS 17 prescribes the appropriate accounting policies and disclosure relating to leases both for lessees and lessors.

It was not always clear whether interest on finance leases had been allocated to the lease to produce a constant periodic rate of return on the liability although this always proved to be a drafting issue only. The net carrying amount of leased assets at the balance sheet date was not always disclosed

and, occasionally, no reconciliation provided between the total of future minimum lease payments at the balance sheet date and their present value.

A more common matter was the failure to disclose the total of the future minimum lease payments at the balance sheet date and their present value for the relevant periods required by the Standard. A significant number of companies disclosed the lease commitments for the next year only, as required by UK GAAP, rather than the total commitments as required by IAS 17.

Some companies chose to recognise lease payments as an expense on a basis other than straight line over the lease term. This is permitted by the Standard for an operating lease where the other basis is more representative of the time pattern of the benefit. The reason for the alternative option however was not always clear.

Points raised by the Panel:

- The total of future minimum lease payments under non-cancellable operating leases analysed for the ranges of years required should be disclosed, not just the annual commitment as for UK GAAP (IAS 17. 35(a), 56).
- Reconciliation required of the total of future minimum lease payments under finance leases at the balance sheet date and their present value (IAS 17. 31(b)).
- Descriptions are required of significant leasing arrangements for lessees and lessors, to include the information specified in the Standard (IAS 17. 31(e), 35(d)).

IAS 18 “Revenue”

IAS 18 sets out the criteria for revenue recognition arising from certain types of transactions and events.

Questions about IAS 18 focused on the adequacy of the stated accounting policy to describe properly how revenue is recognised in respect of significant income streams.

The accounting policy note often referred to the sale of goods and supply of services, but gave no detail of the way in which revenue from those services was recognised by reference to the stage of completion. Disclosure of the significant categories of revenue amounts was not always provided as required. Questions were also raised about contracts that combine a supply of goods with the provision of services and about how contract amounts were allocated and recognised. Clarification of the treatment adopted in respect of discount and customer loyalty arrangements, performance fees, membership

income and royalties was sought in a number of cases. Where diversity of treatment is permitted by a Standard, it is particularly important to disclose the policy adopted.

Points raised by the Panel:

- Accounting policies should disclose the methods adopted for determining the stage of completion of transactions involving the provision of services (IAS 18. 35(a)).
- The amount of each significant category of revenue recognised during the period should be disclosed including separate disclosure of the revenue arising from the sale of goods and the rendering of services (IAS 18. 35(b)).

IAS 19 “Employee Benefits”

The Panel conducted a focused review of pension disclosures under IFRS and UK GAAP and published its findings in August 2006. No additional detail is provided here, except to confirm key disclosure points identified in that report.

Points raised by the Panel:

- Companies that recognise actuarial gains and losses in the period in which they occur in the SORIE should disclose the cumulative amount so recognised (IAS 19. 120A(i)).
- A narrative description is required of the basis used to determine the overall expected rate of return on plan assets including the effect of the major categories of plan assets (IAS 19. 120A(l)).
- The actual return on plan assets should be disclosed (IAS 19. 120A(m)).

IAS 21 “The Effects of Changes in Foreign Exchange Rates”

Few points were raised in respect of this standard although they were included in a significant number of letters to companies as appendix issues.

Points raised by the Panel:

- The amount of foreign exchange gains and losses charged/credited to profit and loss (other than those arising on financial instruments measured at fair value through profit and loss) should be disclosed (IAS 21. 52(a)).
- The net exchange differences classified in a separate component of equity should be disclosed and a reconciliation of the amounts at the beginning and end of the period should be provided (IAS 21. 52(b)).

IAS 24 “Related Party Disclosures”

The Panel’s preliminary report on IFRS implementation drew attention to a key difference in the reporting requirements of related party disclosures under IFRS and UK GAAP. Under FRS 8, there is a rebuttable presumption that key management personnel of the company (or its parent) are related parties of the company but IAS 24 goes further and requires that such key management personnel are considered as related parties.

The Panel raised this issue with companies where it seemed likely from other information disclosed that non-executive directors had been excluded from the definition of related party or where there was reference to ‘senior management’ who had not been included and who might qualify as key management personnel. The extent to which senior management meet the standard’s definition is a matter for directors’ judgement. The definition of related parties however is not restricted to directors.

The Panel also reminded a number of companies that, unlike under UK GAAP, there is no provision exempting 90% owned subsidiaries from disclosing transactions and outstanding balances with other group companies and with investees of the group qualifying as related parties.

A common point raised with companies was the apparent failure to disclose aspects of key management personnel compensation as required. The most common omission was the amount of compensation given by way of share-based payment.

Additional information required to support the transactions and outstanding balances between related parties, including terms, conditions and any guarantees, for example, was overlooked by a smaller number of companies – particularly balances with associates and joint ventures.

Points raised by the Panel:

- Key management personnel of a company (or its parent) are related parties of the entity (IAS 24. 9(d)).
- There is no exemption from disclosure for 90% owned subsidiaries as there is, under certain conditions, under UK GAAP.
- The name of the entity’s parent should be disclosed and, if different, the ultimate controlling party (IAS 24. 12).

IAS 27 “Consolidated and Separate Financial Statements”

Both UK and international standards base consolidation on the concept of control – when an investor controls another entity, that entity is its subsidiary and should be consolidated. Slight differences between the standards

however mean that, in practice, the entities identified as subsidiaries may not be the same under the two regimes. While FRS 2 is based on the existence of control in practice, IAS 27 is not wholly clear as to whether control is to be based on rights or operation in practice.

The Panel asked companies to clarify their accounting policy where it appeared that not all companies falling to be accounted for as subsidiaries were consolidated – in particular, the exceptional circumstances rebutting the presumption that a company controls another a company when it owns, directly or indirectly, more than 50% of the voting power. In these circumstances, the Panel encouraged increased disclosure explaining the restrictions to the company's ability to set the operating and financial policies of investee companies.

Points raised by the Panel:

- The nature of the relationship between the parent and subsidiary when the parent does not own, directly or indirectly, more than half of the voting power should be disclosed (IAS 27. 40(c)).
- Where ownership of more than half of the voting or potential voting power does not constitute control, the reasons must be stated (IAS 27. 40(d)).

IAS 31 “Interests in Joint ventures”

The definition of ‘joint venture’ is more restrictive under UK GAAP than its international counterpart which recognises three different type of joint ventures.

Several companies were asked to clarify the nature of the joint ventures in which they had an interest and to ensure that the relevant disclosures had been given.

Points raised by the Panel:

- Aggregate disclosure is required of any contingent liabilities that a company has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities that have been incurred jointly with other ventures. These should be separate from disclosure of other contingent liabilities (IAS 31. 54 (a)).
- A company recognising its interests in jointly controlled entities using the line-by-line format or the equity method should distinguish between current assets and long-term assets, current liabilities and long-term liabilities when disclosing aggregate amounts (IAS 31.56).

IAS 32 “Financial Instruments: Disclosure and Presentation”

The standard aims to improve users’ understanding of the significance of financial instruments on a company’s financial position, performance and cash flows and, together with IAS 39 “Financial Instruments: Recognition and Measurement”, has particular significance for banks. The Panel summarises the findings of these reviews in Section Six below. This section restricts itself to comments relating to application of IAS 32 by other corporates.

Questions were raised with several companies regarding the consideration of non-derivative financial instruments to determine whether there were liability and equity components which should be separately classified. These resulted in a refinement of policy statements to clarify that the equity component was assigned the residual amount, after deducting the amount for the liability component from the fair value.

IAS 32 sets out strict criteria for the offsetting of financial assets and liabilities which were not met by some companies which netted overdrafts against cash balances. Others did not provide sufficient information to explain their financial risk management objectives, specifically their hedging policies for each type of forecast transaction. Disclosures required to support an understanding of designated fair value hedges and hedges of a net investment in a foreign operation were also incomplete in a smaller number of instances.

More broadly, the information required about the extent and nature of financial instruments was sometimes not sufficient. Omissions included a lack of detail in the accounting policy note of the recognition criteria adopted or the measurement basis applied, including non-disclosure of significant terms and conditions of loans.

IAS 32 requires companies to disclose the nature and amount of any impairment loss recognised in profit or loss for a class of financial asset. Many companies failed to publish the impairment loss recognised in respect of trade receivables where such a bad debt charge might have been expected, given the nature of the activities.

Points raised by the Panel:

- Information is required about exposure to interest rate risk in respect of each class of financial assets and financial liabilities (IAS 32. 67).
- Impairment loss recognised in respect of trade receivables should be disclosed (IAS 32.94(i)).

IAS 33 “Earnings per Share”

IAS 33 prescribes the principles for determining earnings per share to improve consistency across accounting periods and companies. The standard focuses on how to determine the number of shares to be applied in the calculation. The requirements are the same, in effect, as under UK GAAP and gave rise to few points of substance. However, there were a number of common disclosure issues.

Points raised by the Panel:

- If basic and diluted EPS are the same, that fact should be made clear from the disclosure provided in the income statement (IAS 33. 66).
- If an adjusted EPS is disclosed, a diluted adjusted EPS should also be given (IAS 33. 73).
- If a discontinued operation is reported, a basic and diluted EPS for that operation should be disclosed either on the face of the statement, or in a note (IAS 33. 68).
- Potential ordinary shares are dilutive only when their conversion to ordinary shares would decrease/increase earnings/loss per share from continuing operations only (IAS 33. 41).

IAS 36 “Impairment of Assets”

IAS 36 prescribes the procedures to be applied to a company to ensure that assets are carried at no more than their recoverable amount. The robustness of the IFRS impairment test is an important issue as, in a change from UK GAAP, goodwill is always tested annually for impairment rather than amortised over its estimated useful life. Intangible assets with indefinite lives are also tested annually for impairment.

The standard requires sufficient disclosure about the procedures applied by management for users to understand the basis on which the decision was made to write down an asset. As this decision is based on estimates, disclosure can be extensive to ensure that there is fair presentation of the bases and assumptions on which those estimates were made.

Detailed disclosure is required, in particular, where the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to a cash generating unit is significant compared to the company’s total carrying amount irrespective of whether an impairment charge has arisen.

Compliance with detailed disclosure requirements was variable, although this standard raised more questions than most regarding the adequacy of disclosures, particularly those required where the recoverable amount was based on value in use.

Points raised by the Panel:

- Key assumptions on which management bases its cash flow projections should be described (IAS 36. 134(d)(i)).
- The period over which cash flows are projected by management should be disclosed with an explanation if a period of more than 5 years is used (IAS 36. 134 (d)(iii)).
- The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts should be disclosed and any growth rate that exceeds the relevant long term average growth rate should be justified (IAS 36.134(d)(iv)).
- Additional sensitivity disclosures are required if a reasonably possible change in a key assumption causes the carrying amount to exceed its recoverable amount (IAS 36.134 (f)).

IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”

The standard sets out the recognition criteria and measurement bases to apply to provisions, contingent liabilities and contingent assets so that users can understand their nature, timing and amount. There are no differences of substance between IAS 37 and its UK equivalent, FRS 12.

The Panel raised questions relating to recognition where companies referred only to ‘possible’, rather than ‘probable’ outflows of economic benefits where outflows are required to be regarded as more likely than not if a provision is to be recognised. It sought explanation where provisions appeared not to have been recognised when circumstances seemed likely to give rise to an outflow of benefits, or where there was a doubt that the amount provided may not have been the best estimate of the expenditure required to settle the present obligation at the year end.

Most of the Panel’s queries focused on disclosures where the requirement is to show the movements in classes of provisions during the year; in particular, the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate. The disclosure of movements in the period should show separately unused amounts that have been reversed.

A common question was the aggregation of apparently dissimilar provisions with insufficient narrative to explain what the class comprised. A class identified as “Other” was, on occasion, as significant an amount as the individually identified classes of provision. This presentation is not helpful to users in understanding the nature, timing or amount of provisions. Although the description supporting each class of provision is intended to be brief it should be sufficient to allow users to understand the nature of the obligation

and the resulting outflows. Few companies indicated uncertainties about the amount or timing of outflows, and there was little information to explain the major assumptions about future events. Similar disclosures required to support contingent liabilities also fell short on occasion.

Similar comments were made in relation to disclosures provided under the UK Standard, FRS 12.

Points raised by the Panel:

- A brief description is required of the nature of the obligation and the expected timing of any resulting outflows of economic benefits (IAS 37 (85(a))).
- For each class of provision, the uncertainties about the amount or timing of probable outflows should be indicated and disclosure of major assumptions concerning future events should be considered (IAS 37. 85(b)).
- The unwinding of any discounts on provisions should be disclosed (IAS 37. 84(e)).

IAS 38 “Intangible Assets”

The standard establishes the criteria for recognising and measuring intangible assets that are not specifically covered by other standards.

Although broadly similar, the provisions of IAS 38 are less restrictive in terms of recognition than UK GAAP, and the changes in accounting for business combinations mean that adoption of IFRS has led to a wider variety of intangible assets in company balance sheets. Specifically, the fair value of an intangible asset acquired in a business combination is expected normally to be capable of measurement with sufficient reliability for it to be recognised separately from goodwill. Where the asset has a finite life, there is a rebuttable presumption that its fair value can be reliably measured.

The Panel challenged companies to explain their approach when, from the information provided, it appeared that identifiable intangible assets acquired on a business combination were treated as part of residual goodwill rather than being separately identified as intangibles. The Panel also queried whether certain intangibles met the necessary qualifying criteria for recognition as intangible assets, for example, certain types of commission. A number of companies carried forward internally generated assets relating to development costs. Internally generated intangible assets can only be recognised where there is an identifiable asset that will generate expected future benefits and whose cost can be determined reliably. The Panel also raised a question where it appeared that companies may have capitalised advertising costs and which is clearly prohibited by IAS 38.

Disclosures required to support classes of intangibles varied in the detail and comprehensiveness provided. More common omissions were whether useful lives were finite or indefinite, and, if finite, the useful lives or amortisation rates used.

In some cases, companies had to be reminded that, where an asset is considered to have an indefinite useful life, the reasons for that view and the factors that played a significant role in coming to that conclusion must be stated.

Points raised by the Panel:

- The aggregate amount of research and development charged as an expense in the year should be disclosed (IAS 38. 126).
- Internally generated intangible assets and others should be distinguished when providing key disclosures for each class of assets (IAS 38. 118).

IAS 39 “Financial Instruments: Recognition and Measurement”

This standard, which establishes the principles for recognising and measuring financial assets, liabilities and certain contracts to buy or sell non-financial items, has particular significance for banks. The results of the Panel’s reviews of banks’ accounts is summarised below. This section refers only to findings relating to other corporates.

The Panel questioned the initial measurement of financial assets and liabilities where it was not clear

- how transaction costs had been accounted for
- how deferred consideration was determined
- whether financial assets/liabilities were carried at fair value.

It was not always clear how companies had concluded that they had embedded derivatives that needed to be accounted for separately from the host contract; particularly when the need for there to be no close relationship between the economic characteristics and risks of the contract and the embedded derivative was taken into account. Some companies classified financial assets in such a way that it was not possible to tell if IAS 39 had been applied, as there was no analysis of financial instruments as required by the standard.

Points raised by the Panel:

- Transaction costs directly attributable to the acquisition or issue of financial assets and liabilities should be added to/deducted from their fair value if those assets and liabilities are not recognised initially at fair value through profit or loss (IAS 39.43).

IFRS 1 “First-Time Adoption of IFRS”

As the Panel’s focus is on improving the quality of future financial reporting, it raised few questions on IFRS 1, reserving enquiries for potentially material mis-statements or where there was a significant degree of doubt as to how the standard had been applied which would have an impact for the future.

The standard requires companies to explain how the transition from previous GAAP to IFRS affected their reported financial position, performance and cash flows. Reconciliations were not always disclosed in sufficient detail to explain the effect of the transition to the new framework. In particular, material adjustments to the cash flow statement prepared under UK GAAP were sometimes omitted.

Companies that chose to present comparative information that did not comply with IAS 32, IAS 39 and IFRS 4 in the year of transition did not all disclose the nature of the main adjustments that would make the information comply with those standards.

Points raised by the Panel:

- IFRS 1 prohibits retrospective application of some aspects of other IFRS, for example, relating to estimates at the date of transition. Estimates should be consistent with those made for the same date under previous GAAP after adjustment reflecting policy changes (IFRS 1. 31).
- There is no need to separate out the liability and equity components of a compound financial instrument if, at the date of transition, the liability component is no longer outstanding (IFRS 1. 23).
- The carrying amount for goodwill in the opening balance sheet should be the same as the carrying amount under previous GAAP at the date of transition to IFRS, after three permitted adjustments (IFRS 1. Appendix B B2(g)).

IFRS 2 “Share-based payment”

IFRS 2 requires companies to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses.

The Panel challenged one company where, from the description provided, there was a question whether the arrangement might be more appropriately classified as cash rather than equity-settled although the company did enhance its disclosures going forwards. This enquiry did not result in a change of accounting treatment. In another case the share option charge had been incorrectly added back in the calculation of earnings per share, which the standard clearly prohibits.

A small number of companies transferred amounts to shareholder equity in respect of share-based payments that did not match the income statement charge. The amounts were not material and the comparatives are to be corrected next year.

IFRS 2 requires disclosure of information to enable users to understand the nature and extent of share-based payment arrangements during the period; how the fair value of the goods or services received, or fair value of equity instruments granted, was determined and the effect of share-based payment transactions on profit or loss for the period.

The standard prescribes minimum disclosures to satisfy these requirements. Common omissions are set out below.

Points raised by the Panel:

- For share options exercised during the period, the weighted average share price at the date of exercise should be disclosed (IFRS 2. 45(c)).
- For share options outstanding at the end of the period, the range of exercise prices should be disclosed, divided into ranges where necessary, and the weighted average remaining contractual life (IFRS 2. 45(d)).
- For share options granted during the period, information on how the fair value was measured should be provided, specifically, the option pricing model used and inputs to that model and the supporting detail as specified (IFRS 2. 47(a)(i)).

IFRS 3 “Business Combinations”

IFRS 3 prohibits merger accounting and requires that all business combinations are accounted for by the purchase method, under which identifiable assets and liabilities acquired are recognised at their fair values at the date of acquisition with the balance taken as goodwill. Goodwill arising is subsequently tested annually for impairment.

Unlike UK GAAP, which is more tolerant of intangible assets being subsumed in goodwill, under IFRS, an intangible asset is recognised if it is separable or

arises from contractual or other legal rights and if its fair value can be measured reliably. If an intangible asset is acquired in a business combination, the condition that future economic benefits are probable is always met. Intangible assets that are not recognised separately from goodwill are to be described and there should be an explanation supporting why their fair value cannot be measured reliably. The Panel queried with some companies whether all relevant customer relationships had been identified and recognised at fair value.

In terms of disclosure, a significant number of companies did not provide a description of the factors contributing to the recognition of goodwill. Factors were either not disclosed or provided in identical terms and at a high level across several acquisitions.

Whereas under UK GAAP adjustments to provisional fair values are accounted for in the period in which adjustments are made, IFRS 3 requires that comparative figures should be restated as if the initial accounting had been completed at the acquisition date; a change that was overlooked by a small number of companies who undertook to correct in future.

Companies did not always disclose the revenue and profit or loss of the combined entity for the period as though all business combinations had been effected at the beginning of the period, a disclosure that has no equivalent under UK GAAP. Others stated that their initial accounting for an acquisition was provisional, but did not explain why.

Points raised by the Panel:

- The factors that contributed to a cost that results in the recognition of goodwill and each intangible asset not recognised separately from goodwill should be described, with an explanation why it could not be measured reliably (IFRS 3. 67(h)).
- The revenue and profit or loss of the combined entity should be disclosed as though all business combinations during the period had been entered into on the first day of the period (IFRS 3. 70(a)(b)).

IFRS 5 “Non-Current Assets Held for Sale and Discontinued Operations”

The standard specifies the requirements relating to the classification, measurement and presentation of non-current assets held for sale. There is no UK equivalent to this standard, although it replaces the UK GAAP distinction between continuing and discontinued operations established in FRS 3.

As headline operating figures are improved by identifying loss-making operations as discontinued, the international criteria for defining an operation as discontinued are very restricted.

Where, from the information available, it appeared questionable whether discontinued operations met the required criteria, the Panel challenged companies to explain their evidence to demonstrate that the sale was highly probable; that management was committed to a plan to sell the asset and that an active programme to locate a buyer had been initiated. This was provided in all cases when raised by the Panel. Where the company had not yet completed its sale, the Panel reminded companies of the requirement that the unit should be actively marketed in order to meet the criteria and that they should continue to consider carefully the application of the “highly probable” criterion in identifying items as held for sale.

Point raised by the Panel:

- A single amount is required on the face of the income statement. It should be further analysed as required either on the face of the income statement or in a note (IFRS 5. 33(b)).

SECTION SIX REVIEWS OF BANKS' ACCOUNTS

During the year the Panel reviewed the accounts of 16 banks reporting under IFRS, including retail and investment banks and finance subsidiaries of overseas banks and large UK retail companies.

The Panel considered compliance with all applicable standards but focused on the implementation of IAS 30, ‘Disclosures in the Financial Statements of Banks and Similar Financial Institutions’, IAS 32 and IAS 39, of which the latter two are complex standards with particular significance for banks. The review identified a good level of compliance with these standards and with IFRS in general. The following summary of the Panel’s key findings in relation to banks’ compliance with IAS 32 and IAS 39 should be read in that context.

Points identified by the Panel indicated a need for refinement of some disclosures in certain cases rather than for significant changes. The issues raised varied between banks and there was no evidence of any systemic reporting weaknesses.

All the banks whose accounts were reviewed adopted IAS 32 and IAS 39 for the first time and took advantage of the option not to restate their comparatives to comply with the standards.

Classification

The classification of financial instruments under IAS 39 is different to the asset categories required by schedule 9 Companies Act 1985, which led to considerable change in the reporting of financial assets for most banks. As with other companies, the new accounting policies gave rise to a number of questions which were largely resolved by the banks concerned volunteering improvements to the descriptions of their policies, notably amending the wording or including specific detail relevant to the company rather than reiterating the requirements of the standard.

One investment bank retained its UK GAAP formats for both the balance sheet and notes in terms of the classification of financial assets but provided narrative information in footnotes analysing the assets in accordance with IAS 39. The Panel challenged the resulting lack of clarity and the company has given an undertaking to address this in its next financial statements by reclassifying its financial assets on the face of the balance sheet and in the notes.

Accounting Policies

IAS 39 also prescribes how different classes of financial instruments should be measured both on initial recognition and in subsequent periods. These changes in classification and measurement prompted the need for substantially revised accounting policies. As with other companies, the new policies gave rise to a number of queries which were largely resolved by the banks concerned volunteering changes to a policy wording or by the inclusion of specific details about the application of a policy.

Under IAS 32, detailed information is required of each class of financial instrument, including significant terms and conditions and the basis of measurement applied. The Panel identified a number of instances where the disclosures fell short of these requirements as follows.

Lack of appropriate detail in accounting policies was seen in relation to the use of the fair value option. IAS 39 permits companies to designate financial instruments at fair value through the profit or loss. This designation may only be used for instruments held for trading, certain contracts containing an embedded derivative or when doing so results in more relevant information. Where the fair value option is applied to specific financial instruments, these should be identified. This information was not given by all the banks reviewed.

Other occasions where policies lacked sufficient detail related to measurement bases. One bank did not state whether transaction costs were included in the cost recognised for available-for-sale investments, which is the

prescribed treatment, although it did specify the treatment of such costs in relation to a different category of investment. Another did not state whether its financial liabilities were recognised at amortised cost using the effective interest rate method as specified for most liabilities by IAS 39.

Hedging

IAS 39 identifies three types of hedging relationships and specifies the conditions that must be met in order for a hedging relationship to qualify for hedge accounting. Some banks disclosed the existence of economic hedges that failed to meet the IAS 39 requirements for hedge accounting. One bank, however, did not provide a description of its hedging strategy as required by IAS 32.

Certain of the IAS 39 hedging rules were “carved out” of the standard when adopted by the EU to allow banks greater flexibility in two areas. One allows fair value hedge accounting to be applied to interest rate risk in customer accounts repayable on demand (such as current accounts) which are often referred to as “core deposits”; the other allows ineffectiveness resulting from under-hedging a portfolio of interest rate risk not to be recognised. None of the UK banks reviewed by the Panel adopted the carved-out version of IAS 39.

Financial Assets - Loans and Advances

IAS 39 contains detailed loan impairment rules. The change from UK GAAP to IFRS generally resulted in slightly increased loan impairment allowances. This is likely to be because, under IFRS, an impairment loss is measured as the difference between an asset’s carrying amount and the present value of estimated future cash flows; the discounting has the effect of increasing the allowances required. The Panel wrote to one bank where there was a significant reduction in the allowance, the reason for which was not clear. This case is continuing.

IAS 32: Other Disclosure Issues

IAS 32 requires disclosure of the best estimate of the maximum credit exposure. This includes, but is not limited to, lending exposure; other financial assets carrying credit risk, for example, should be included. One bank referred to financial instruments carrying credit risk other than exposure to lending in its narrative disclosure but excluded those items from its quantitative disclosures.

Under UK GAAP retail banks largely achieved netting of customer balances through the use of master netting agreements. In some cases, these were not effective under the rules for offset in IAS 32. A financial asset and liability may be offset only where there is a legally enforceable right of offset and an

intention to settle net or to realise the asset and settle the liability simultaneously. Disclosure is required of the effect, if significant, of master netting agreements that do not qualify for offset and which one retail bank failed to provide.

Seven *Review of UK GAAP Accounts*

The Panel reviewed 97 sets of accounts prepared under UK GAAP. The number and range of substantive and more minor points raised with companies were substantially less than those accounts prepared under IFRS.

Compliance with requirements was generally good with some areas of accounting attracting more comment than others as follows.

FRS 1 “Cash Flow Statements”

The issues raised in connection with FRS 1 were not dissimilar to those in relation to IAS 7 although there are significant differences in the requirements of the standards. Questions were asked of a number of companies about the following:

- Non-cash movements incorrectly included in cash flow
- Loans omitted from definition of net debt
- Inappropriate offsetting of assets and liabilities
- Inconsistencies between the cash flow statement and other notes to the accounts
- Lack of disclosure of major non-cash transactions.

FRS 3 “Reporting Financial Performance”

The standard adopts a layered format for the profit and loss account to highlight a number of important components of financial performance.

A number of companies did not present separately the aggregate results of each of continuing operations, acquisitions (as a component of continuing operations) and discontinued operations, as required by the standard. At a minimum, turnover and operating profit should be analysed down to the operating profit level on the face of the profit and loss account in respect of continuing operations, acquisitions and discontinued operations. Similar analysis of the statutory format lines of cost of sales, gross profit, administrative expenses and distribution costs was not always provided either on the face of the profit and loss account or in a note as required. A few companies provided a less than adequate description of exceptional items such that their nature was not clearly understandable.

FRS 7 “Fair Values in Acquisition Accounting”

FRS 7 sets out the principles of accounting for a business combination under the acquisition method of accounting. It requires identification of the assets and liabilities of the acquired entity and determines how these and the cost of acquisition should be valued. A number of companies were asked to provide further clarification of their accounting treatments including calculation and treatment of deferred consideration. Others were queried about the fair value of their shares issued as part consideration for an acquisition, one of which led to corrective action and a press notice.

FRS 9 “Associates and Joint Ventures”

Disclosure issues raised with companies included the point that goodwill amortisation on joint ventures should be shown (and disclosed separately) as part of joint venture profits or losses in the profit and loss account, and not included in group amortisation above the group operating profit line. Share of an associate’s operating profit or loss should be shown directly after group operating profit or loss. In considering whether or not a joint venture is material to a company, consideration should be given to the gross assets and gross liabilities in addition to the net position. Additional disclosures are required for joint ventures and associates if certain thresholds are exceeded.

FRS 10 “Goodwill and Intangible Assets”

FRS 10 sets out the principles of accounting for goodwill and intangible assets to ensure that purchased goodwill and intangible assets are charged to the profit and loss account in the periods in which they are depleted. Companies were asked to explain whether they had reviewed goodwill at the end of the first full financial year following a business combination to determine whether there is an impairment and whether that impairment reflected overpayment, the effects of a subsequent event or depletion over time.

The accounts should disclose the methods and periods of amortisation of goodwill and intangible assets and the reasons for choosing those periods. A number of companies did not provide details as required.

Where purchased goodwill or an intangible asset is amortised over a period that exceeds 20 years or is not amortised, the company must give the grounds for rebutting the 20 year presumption. This should be based on the specific factors contributing to the durability of the acquired business or intangible asset. Companies were challenged on this point where disclosures appeared weak; they agreed to improve their disclosure going forward, ensuring that they would provide a reasoned explanation as required by the standard.

FRS 11 “Impairment of Fixed Assets and Goodwill”

In a number of cases, impairment of goodwill was found not to have been taken into account in the calculation of operating profit or was not included within an appropriate heading on the income statement. If considered an operating exceptional item, this could have been disclosed as an exceptional amount within a statutory format line on the face of the profit and loss account.

Other companies were asked to explain whether impairment losses recognised in respect of tangible or other assets had triggered an impairment review of goodwill and which was not always clear from the accounts. Companies were reminded that the reasons for any reversal of impairment losses, including changes in the underlying assumptions, must be disclosed. Where, in the measurement of value in use, the period before a steady or declining long-term growth rate has been assumed is in excess of five years or where the long term growth rate exceeds the long term average growth rate for the country in which the company operates, those facts should be stated.

FRS 12 “Provisions, Contingent Liabilities and Assets”

Unusually, one company did not disclose information in relation to litigation provisions on the basis that to do so would be seriously prejudicial. Following investigation, the Panel supported the company’s view given the nature of the litigation and its impact on the company, its operations and its employees and did not pursue the matter further.

The standard requires, for each class of provision, a set of disclosures showing specific movements in the period. Similar to questions raised on IAS 37, companies were asked to provide details to cover the specific requirements of the standard and to provide better indication of the uncertainties about the amounts or timing of the expected transfers of economic benefits.

Companies were also asked to provide an analysis of the component parts of classes of provision classified as ‘Other’ which were sometimes greater than those provisions individually highlighted and disclosed.

FRS 17 “Retirement Benefits”

Detailed points arising from the Panel’s focused review of pension disclosures were published in its report in August 2006. In addition to the accounts reviewed in the survey sample, companies were reminded that their analysis of reserves should state how much is attributable to the defined benefit asset or liability net of the related deferred tax.

Other companies were asked to clarify whether their schemes were defined contribution or defined benefit and, where defined contribution, to disclose the cost of the period separately as required by the standard.

FRS 18 “Accounting Policies”

Clarification was sought from a number of companies in connection with their stated accounting policies. Most issues arose in connection with revenue recognition where it was unclear whether significant revenue streams were accounted for in accordance with the underlying principles of Application Note G of FRS 5. Specific questions were raised in connection with the accounting treatment of advanced royalties, installation costs, research and development, and licence fees.

Companies operating in the retail sector were asked to explain their policy in respect of concession sales and to disclose these separately where they were material. In a number of instances, the revenue recognition policy was not adequate to reflect the different elements of contractual obligation.

Companies were asked to explain why they believed their new accounting policies to be more appropriate than those which they replaced if this explanation was not provided. Companies approached satisfied the Panel that their policies complied with the requirements and undertook to expand their disclosure in future accounting periods so that users might have a better understanding of the basis on which revenue is accounted. Two companies were asked to provide additional information to support the directors’ statement that the companies were going concerns.

FRS 19 “Deferred Tax”

Companies were reminded that where a deferred tax asset is not recognised on the grounds that there is insufficient evidence to support its recoverability, the amount that has not been recognised and the circumstances in which the asset would be recovered should be disclosed. Companies were also asked to provide additional justification for the carrying forward of the deferred tax asset in relation to tax losses. The standard requires disclosure of the amount of deferred tax assets and the nature of the supporting evidence where recoverability is dependent on future taxable profits in excess of those arising from the reversal of deferred tax liabilities and the reporting entity has suffered losses in the current or preceding period.

FRS 22 “Earnings per Share”

A small number of Aim quoted companies showed some evidence of potential non-compliance with the requirements of FRS 22. A few companies had not calculated the effect of dilutive options correctly but the impact on

diluted eps was not so significant as to change the result. Other matters raised in connection with application of this standard included a reminder that diluted and basic eps are to be presented with equal prominence for all periods on the face of the income statement.

FRS 25 (IAS 32) “Financial Instruments: Disclosure and Presentation”

A few companies had to be reminded that their accounting policies for convertible debt needed to be updated in order to comply with FRS 25. Two others had issued convertible loan notes but had not separately accounted for the debt and equity elements. One company offset amounts due to and from subsidiaries on the face of the parent company balance sheet when it was not clear that the offset criteria had been met, i.e. that an entity had a legally enforceable right to set off the recognised amount and intended either to settle on a net basis or to realise the asset and settle the liability simultaneously. The company agreed to amend its presentation going forwards.

APPENDIX A

Analysis of Company Reviews

	FTSE 100	FTSE 250	Other listed	AiM	Third Country	Unlisted public and private	TOTAL
<i>Accounts reviewed</i>							
Annual	52	41	81	49	15	36	274
Interim	6	25	3	3	-	n/a	37
<i>Selected by the FRRP</i>							
Annual	46	33	74	42	14	21	230
Interim	5	25	2	4	-	n/a	36
<i>Complaints/referrals</i>							
Annual	6	8	7	6	1	15	43
Interim	1	-	1	-	-	n/a	2
<i>Approaches to companies</i>							
Annual	18	24	46	24	4	12	128
Interim	1	4	1	1	-	n/a	7
<i>Groups established</i>							
Annual	1	-	1	1	-	1	4
Interim	-	-	-	-	-	-	-
<i>Improvements</i>							
Annual	14	21	34	13	2	5	89
Interim	-	4	1	-	-	n/a	5
<i>Continuing</i>							
Annual	1	1	5	10	2	5	24
Interim	-	-	-	-	-	-	-