

# INSIDE TRACK 60

## In the July 2009 issue

- ASB to seek views on the Future of UK GAAP
- Changes to reporting financial instruments on the horizon
- Complexity and relevance of corporate reporting

# ASB to seek views on the Future of UK GAAP

Project Director Peter Godsall outlines the ASB's progress on its proposals for future UK reporting requirements and provides an update on the IASB's project on the IFRS for Small and Medium Sized Entities (SMEs).

The ASB will very shortly be issuing a consultation paper setting out the Board's intended Policy Proposal on 'The Future of UK GAAP'. The ASB acknowledges that this consultation has been a long time coming, but the timing has been held up until the International Accounting Standards Board (IASB) published its International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs). The IASB published the standard on 9 July 2009.

Since 2006, the ASB has been saying that it considers the IFRS for SMEs could play a significant role in the future reporting requirements for UK and Irish entities. At the time of writing this article the ASB anticipates publishing the Policy Proposal consultation paper in August 2009, with a six month consultation period running through to 1 February 2010.

## The IFRS for SMEs

The IFRS for SMEs can be accessed from the IASB's website at <http://www.iasb.org/IFRS+for+SMEs/IFRS+for+SMEs.htm>. The IFRS is a self-contained standard and has been developed for the needs of entities that publish general purpose financial statements for external users and do not have public accountability (in short, entities that do not trade debt or equity instruments in a public market and which do not hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses). Many of the principles for recognition and measurement in 'full' IFRS have been simplified, some topics omitted altogether, and the number of required disclosures has been significantly reduced. The IASB is proposing to

limited revisions to the standard to once every three years.

## The ASB's Policy Proposal

The Board's intention is to work under the IASB framework and to converge to the fullest extent possible consistent with the needs of UK entities. As a consequence of the Board's proposed approach, the separate body of literature currently referred to as UK GAAP will cease to exist. That said, the ASB is not relinquishing the right to set UK GAAP, but all existing literature would be superseded.

The Board envisages that UK GAAP under the proposals would be as follows:

Framework	Accounting Regime	Type/Nature of Entities	Implications for
IFRS	IFRS (EU Adopted)	EU listed-consolidated AIM	
UK GAAP	IFRS (EU Adopted)	Publicly accountable inc. 100% Publicly accountable subsidiaries	Investment Trust entities; Building societies; Friendly societies; Subsidiaries with listed debt
	IFRS for SMEs	Large and Medium NPAs (Non- Publicly Accountable Entities)	NPA groups NPA entities NPA subsidiaries
	FRSSE	Small	

## ASB to seek views on the Future of UK GAAP

/...continued

In summary, the Board's proposals envisage a differential reporting regime based on public accountability, broadly in line with the IASB's definition above. The Board has been working closely with the UK Department for Business Innovation and Skills (BIS) to both ensure that the proposals can be accommodated within the legal framework and that the consultation document should discuss a number of alternative approaches to what is meant by public accountability on which the ASB and the Government would welcome comments from constituents.

Under the proposals all entities will have the option (similar to the arrangements under the current law, with the exception of charitable companies) to voluntarily adopt a higher tier. For example, entities applying the Financial Reporting Standard For Smaller Entities (FRSSE) could opt to apply the IFRS for SMEs or EU-endorsed IFRS and Large and Medium Non-Publicly Accountable Entities (NPAEs) could opt to apply full IFRS. An entity may elect to do because it is part of a group that reports under IFRS or because of the nature of its business IFRS provides better information that in turn may facilitate easier access to capital markets.

These proposals are intended to apply to all entities, other than those in the public sector, in the UK and the Republic of Ireland that are required to prepare financial statements that give a 'true and fair' view.

The Board recognises the importance of ensuring these policy proposals can be implemented effectively and achieve the improvements it is seeking. The consultation paper includes a discussion of the effects of the proposals and the Board is seeking the views of constituents on this issue. The Board is planning a change date for financial years no earlier than after 1 January 2012 for the proposals in this document.

# Changes to repo instruments on

In response to calls on standard setters to address accounting issues arising from the global financial crisis, the IASB project to replace IAS 39 is moving at an accelerated pace. This is likely to result in significant changes for preparers and users of financial statements. Project Director Deepa Raval explains.

### Developments

On 14 July 2009, the IASB issued an Exposure Draft (ED) on 'Classification and Measurement', the first of three phases of the IASB project to replace IAS 39. The overriding objective is to reduce complexity in reporting financial instruments. The project will have significant implications for UK preparers as FRS 26 has the effect of implementing the requirements of IAS 39 in the UK.

### Project Phases

The IASB project to replace IAS 39 is advancing in three phases:

- (a) Classification and Measurement – the comment period for the ED closes on 14 September 2009, this part of the standard will be available for early adoption for 2009 year ends;
- (b) Impairment – the IASB has published a Request for Information (RfI) inviting comments on the feasibility of an 'Expected Loss Model'. The ED on impairment is expected in October 2009; and
- (c) Hedge Accounting – no discussions have taken place to date on this phase of the project, however, the ED is due in December 2009.

Full replacement of IAS 39 including (b) and (c) is expected to be available during 2010. The proposed mandatory date for application of the standard is 1 January 2012. The IASB is currently in favour of retrospective application which is likely to result in significant costs for preparers.

In addition to the project to replace IAS 39, the IASB has three related projects open for comment. These are Derecognition; Fair Value Measurement; and Credit Risk in Liability Measurement.

### IASB Proposal: Classification and Measurement

The ED contains two classification and measurement methodologies – amortised cost and fair value. These will replace the fair value through profit or loss (FVTPL), loans and receivables (L&R), available for sale (AFS) and held to maturity (HTM) categories under IAS 39.

At initial recognition a reporting entity would be permitted to choose the classification method on an instrument by instrument basis depending on its business model. This will include considering whether an instrument is held for strategic or trading purposes. The ability to trade is irrelevant i.e. it does not matter whether an instrument is quoted or unquoted or whether there is an active market for the asset.

#### *Amortised cost*

Financial instruments that have 'basic loan features' and are 'managed on a contractual yield basis' qualify for the amortised cost category.

- a) An instrument has basic loan features if cash flows represent principal and interest (cash flows are determinable; and the financial instrument has no leverage).

# Reporting financial the horizon

- b) A contractual yield basis is where the purpose of holding the financial instrument is to realise value from contractual cash flows rather than gain from changes in fair value.

## *Fair Value*

All other financial instruments which do not meet the amortised cost criteria detailed above will be at fair value. Fair value changes will be presented as follows:

- a) if a financial instrument is held for trading fair value changes will be through profit and loss; and
- b) for equity investments not held for trading an entity has a free, irrevocable choice (instrument by instrument basis) on initial recognition to either present fair value changes in the profit and loss account or in other comprehensive income (statement of total recognised gains and losses under UK GAAP).

Subsequent to initial recognition no recycling, impairment or changes in presentation would be permitted. It is expected that the fair value option will be retained for accounting mismatches only.

## *Embedded Derivatives*

Embedded Derivatives in financial host contracts would no longer need to be separated under the proposals. Instead, the entire hybrid contract would be at either amortised cost or fair value as permitted under the criteria set in the amortised cost and fair value categories. However, there would be no change to the existing requirements for non-financial host contracts where the embedded derivative would need to be measured separately.

The ASB is currently considering the proposals and will be responding to the IASB within the comment deadline.

## **IASB Proposal: Impairment**

Three models for impairment are being discussed by the IASB. The incurred loss model (current method); the expected loss model; and a fair value based approach. It is likely that the expected loss model will be the one included in the forthcoming ED. During June 2009, the IASB published a Request for Input (RfI) on the feasibility of the expected loss model, with a comment deadline of 1 September.

## **IASB Proposal: Derecognition**

The IASB issued its ED on derecognition of financial instruments in March 2009. It sets out proposals to change the derecognition requirements of IAS 39. The two overriding criteria for derecognition in the ED are: (i) a transfer of economic benefits; and (ii) the practical ability to transfer test. The IASB proposes that the risks and rewards test in IAS 39 which currently acts as an indicator of control by an entity of a financial instrument that it may have transferred should be removed. When considering derecognition of a financial instrument entities the proposals in the ED would require that entities consider if they have continuing involvement in it and if so to consider the transferee's practical ability to transfer the asset onto a third party.

The ASB has responded to the ED and highlighted a number of concerns with the proposals, including the intention to remove the risks and rewards test, difficulties with the practical ability to transfer test and the fact that the proposals overall fail to articulate a clear principle for derecognition. The ASB's response is available at: <http://www.frc.org.uk/asn/publications/other.cfm>.

## Complexity and relevance of corporate reporting

The discussion paper arising from the Financial Reporting Council's (FRC) project on reducing complexity in corporate reporting was published in early June 2009. The paper's title - ***Louder than Words: Principles and actions for making corporate reports less complex and more relevant*** - is intended to remind all of those involved in corporate reporting that it is what we all do in practice that affects the quality and readability of corporate reports.

The paper recommends a commonsense approach to reducing complexity based on eight guiding principles - four for better communication in reports and four for improving the quality and effectiveness of regulations. It also recognises that there is no easy solution and that change will only happen if all of those involved in corporate reporting make a concerted effort. The paper also makes five calls for action where the FRC believes further investigation may lead to opportunities for reducing complexity. These are:

1. Cash flow and net debt reporting: could this be better aligned with user needs such as by including a net debt reconciliation?
2. Wholly owned subsidiaries reporting requirements: could we find ways to reduce the reporting burden such as by reducing the filing or disclosure requirements?
3. Cut clutter: could preparers reduce immaterial information (with the support of regulators) that may be undermining the quality of reports?
4. Disclosures: could we overhaul the process for creating disclosures and provide guidance about when they can be deleted as not relevant?
5. IFRS: could we improve usability through logical organisation and clearer articulation of the desired outcomes for each standard?

A copy of the DP can be accessed at <http://www.frc.org.uk/publications/pubs.cfm?mode=list&year=2009>. Comments are requested by 30 October 2009.

# Overview of the Fair Value Measurement ED

Project Director Jennifer Guest outlines the current progress on the IASB's Exposure Draft 'Fair Value Measurement'

The IASB's ED 'Fair Value Measurement', issued in May 2009, defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. IFRS require some assets, liabilities and equity instruments to be measured at fair value. However, guidance on measuring fair value has been added to IFRS piecemeal over the years, when it was decided that fair value was an appropriate measure or fair values should be disclosure for a particular situation. As a result, guidance on measuring fair value is dispersed across many standards and it is not always consistent.

The IASB's objectives for publishing the proposed IFRS are:

- (a) to establish a single source of guidance for all fair value measurements required or permitted by IFRSs to reduce complexity and improve consistency in their application;
- (b) to clarify the definition of fair value and related guidance in order to communicate the measurement objective more clearly; and
- (c) to enhance disclosures about fair value to enable users of financial statements to assess the extent to which fair value is used and to inform them about the inputs used to derive those fair values.

The proposed IFRS does not require additional fair value measurements.

The ED defines fair value as the price that would be received to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).

A fair value measurement requires an entity to determine:

- (a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).
- (b) for an asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
- (c) the most advantageous market for the asset or liability.
- (d) the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use in pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Comments on the Exposure Draft are requested by 28 September 2009. The ASB is currently considering the proposals and will be responding to them.

## Credit Risk in Liability Measurement

On 18 June the IASB issued a discussion paper on the role of credit risk in liability measurement. Existing IFRS require profit or loss resulting from changes in own credit to be booked when debt is fair valued. This can lead to the result that a gain is recognised when there is a deterioration in own credit, a result that many find counter-intuitive. The IASB is seeking views on the issue by 1 September and the ASB has responded to make clear that credit risk should only be included on initial recognition where that is an observable market transaction. It should not be included in any subsequent measurement of liabilities.

# FRED 30 'Heritage Assets'

ASB Project Director, Alan O'Connor, explains what is in the new accounting standard on heritage assets.

The ASB has issued a new Financial Reporting Standard that will improve the reporting of heritage assets held by museums and art galleries. FRS 30 'Heritage Assets' introduces significant new disclosure requirements for reporting the content and value of collections. The new standard should be applied in respect of accounting periods beginning on or after 1 April 2010, although earlier application is encouraged.

The standard covers heritage assets that are kept principally for their contribution to knowledge and culture, regardless of whether these assets are reported in the balance sheet. New disclosures will provide information about an entity's total holding of heritage assets and its stewardship of these assets. Illustrative examples of the disclosures are provided to help with implementation.

FRS 30 retains the recognition and measurement requirements of FRS 15 'Tangible Fixed Assets', which require heritage assets to be reported in the balance sheet where information is available on cost or value. The ASB retains the view that heritage assets are assets and that the best financial reporting is secured when they are reported in the balance sheet. To encourage a valuation approach, the FRS allows entities to use internal valuations without the need for a full valuation every five years.

The publication of FRS 30 marks the culmination of the ASB's project on heritage assets which was launched in January 2006 with publication of the Discussion Paper 'Heritage Assets – Can accounting do better?'

# European Developments

## European Commission

As reported in Inside Track 59, the European Commission is currently undertaking a review of the 4th and 7th Company Law Directives (usually referred to as the Accounting Directives). Following a consultation exercise earlier in the year, the Commission hosted a stakeholder meeting in June, at which the ASB was represented, to discuss the responses and likely next steps, which will – the ASB understands – include an examination of the IFRS for SMEs and its potential applicability for use across the EU.

## EU Endorsement of IFRS

Any new or revised IFRS or IFRIC Interpretation has first to be endorsed for use in the EU before it can be applied by EU-listed companies in their consolidated financial statements under a process first set out in Regulation 1606/2002, and as amended in Regulation 297/2008.

During July, the European Financial Reporting Advisory Group (EFRAG) issued its latest report showing the status of endorsement for application in the EU of each IFRS and IFRIC Interpretation. The report can be downloaded from the EFRAG website at: <http://www.efrag.org/news/detail.asp?id=385>. Following the recent endorsement of IFRS 3 'Business Combinations (2008)' and IAS 27 'Consolidated and Separate Financial Statements (2008)', there are currently 10 IASB pronouncements yet to be endorsed for use in Europe.

## EFRAG Issues

EFRAG has recently announced the membership of its new Supervisory Board (SB), which is now chaired by Pedro Solbes Mira, a former European Commissioner and Minister of Economy and Finance in Spain.

The ASB continues to work with EFRAG and other major European standard-setters on proactive issues, as part of the Pro-active Accounting issues in Europe (PAAinE) initiative.

## PAAinE Pensions Project

The PAAinE Discussion Paper (DP) 'The Financial Reporting of Pensions', issued in January 2008, attracted over 100 responses. The ASB will shortly conclude its redeliberations on the DP and the responses to it. Following consultation with the PAAinE partners who issued the DP, the ASB plans to publish a report which sets out its recommendations and provides feedback on its redeliberations of the responses to the consultation in the autumn of this year.

Over the past year the ASB has carefully considered its responses to the DP and has developed its thinking taking into consideration of the views of respondents.

## Survey of users' information needs

As part of the PAAinE work on the conceptual framework, EFRAG and the French national standard-setter (the CNC) on 29 May issued a report summarising and analysing the results of a recent survey carried out of users of financial statements. Amongst the messages highlighted by the survey are that users would like to see:

- more stability in reporting standards,
- improved comparability,
- simpler presentations that highlight key data and key disclosures,
- better disclosure of risk management information,

A copy of the survey report can be accessed from the ASB website at <http://www.frc.org.uk/asb/technical/projects/project0061.html>.

## PAAinE project on Common Control Transactions

The Organismo Italiano di Contabilità (OIC), has agreed to undertake a project to develop proposals for the financial reporting of business combinations for entities under common control. The Co-ordinators Committee of the Proactive Accounting Activities in Europe ('PAAinE') have agreed that the project will form part of the PAAinE initiative and that there should be pan-European input to inform the project.

Business combinations between entities under common control ('BCUCC') are currently not covered by any standard issued by the IASB. As a consequence of the lack of applicable standards for BCUCC differences regarding the selection of accounting policies to be applied might generate diversity in practice.

The project aims to identify, analyse and discuss financial reporting practices to account for business combinations under common control in consolidated and separate financial statements.

It is hoped that this project will both encourage and a debate in Europe on this important issue and help the IASB progress in its currently inactive project on the topic.

# Update on Current Projects

## IASB Project on Post-Employment Benefits

The IASB is currently undertaking a project that will give rise to two separate exposure drafts based as follows:

- Part 1: *Recognition and presentation* of changes in the defined benefit obligation and in plan assets, disclosures, and other issues raised in the comment letters to its March 2008 discussion paper (see Inside Track 55) that can be addressed expeditiously.
- Part 2: *Contribution-based promises*, potentially as part of a comprehensive review of pension accounting.

If there are no unexpected delays, it is estimated that the redeliberations on Part 1 will be shortly be completed and an ED of the IASB's proposals will be published in the fourth quarter of 2009.

In view of the potential changes to the disclosure requirements in IAS 19 the ASB will be considering whether to amend FRS 17, which contains the same disclosure requirements of the current version of IAS 19.

## Liabilities

The IASB is continuing its redeliberations of the exposure draft issued in 2005. More recent discussions have considered the measurement objective for IAS 37. In September 2009 it is anticipated that the IASB will conclude its discussions and determine whether re-exposure is required.

## Annual improvements

The ASB recently completed its annual review of UK GAAP which assesses the implications of the IASB's Annual Improvement programme for UK accounting standards along with other issues arising from constituents in the UK and the Republic of Ireland. The ASB issued Financial Reporting

Exposure Draft (FRED) 'Improvements to Financial Reporting Standards 2009' for comment in June. The FRED includes a proposal to strengthen the disclosures requirements in FRS 11 'Impairments of Fixed Assets' by requiring relevant assumptions to be disclosed where estimates are used to measure an impairment loss. A similar amendment was made by the IASB to International Accounting Standard 36 (IAS 36) 'Impairment of Assets'.

The FRED also proposes amendments to converged standards FRS 20 (IFRS 2) 'Share-based Payments', FRS 26 (IAS 39) 'Financial Instruments: Recognition and Measurement' and to UITF Abstract 42 (IFRIC 9) 'Reassessment of Embedded Derivatives' and UITF Abstract 46 (IFRIC 16) 'Hedges of a Net Investment in a Foreign Operation'. These proposals mirror the amendments the IASB made to IFRS as result of its 2008 Annual Improvements programme.

The comment period on the FRED closes on 30 September.

## Tax Project

The ASB and the German Accounting Standard Board are continuing to work on their joint project of accounting for corporate income tax from first principles.

The project is supported by an advisory panel of tax and financial reporting experts. The Panel met again in June and discussed approaches to the measurement of deferred tax liabilities. The discussion included the application of the measurement approach in the proposed revisions to International Accounting Standard IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. The IAS 37 approach was considered because it includes the latest thinking by the IASB on the measurement of liabilities with uncertainty in the timing and amount of cash outflows.

## Group Cash-settled Share-based Payment transactions

In June 2009 the IASB amended IFRS 2 to clarify its scope and the accounting for cash-settled share-based transactions in the separate or individual financial statements of the entity receiving the goods or services when that entity has no obligation to settle the share-based payment transactions. The amendments also incorporate the guidance contained in the following interpretations: IFRIC 8 & 11; as a result the IASB withdrew IFRIC 8 & 11. As FRS 20 is a converged standard with IFRS 2 the Board has agreed that FRS 20 should be amended to incorporate the IASB's amendments to IFRS 2. The ASB plans to publish its amendment to FRS 20 in August 2009.

## Leases

As discussed in detail in Inside Track 59, the IASB and FASB recently published a discussion paper (DP) outlining preliminary views on a new lease accounting model, with comments due by 17 July 2009. The DP focuses primarily on lessee accounting using a right-of-use model. The ASB has submitted a response welcoming the proposals overall, on the basis that they will correct a major flaw in the requirements for lease accounting by recording operating lease obligations on the balance sheet, but highlighting some issues that will need careful thought as the proposals are developed further.

While awaiting comments on the DP, the IASB started to deliberate how a right-of-use model might be used in the financial statements of lessors. The IASB tentatively decided that lessors should continue to recognise the leased item in the statement of financial position along with a rental payment receivable and a liability to provide the lessee with access to the leased item during the lease term. The IASB also continued to deliberate some issues such as sale and leaseback transactions and transitional provisions, which were not discussed in any detail in the discussion paper.

# SORP's Update

## Local Authorities

At its May meeting, the ASB approved its Statement of Assurance for the 2009 Code of Practice for Local Authority Accounting. This included an 'except for' opinion with regard to the accounting requirements for PFI transactions and Similar Contracts, which were based upon the Treasury's IFRS based Financial Reporting Manual.

The 2009 Code will apply for local authorities 2009-10 accounts and is expected to be the last that will be prepared under the ASB's Statement of Recommended Practice (SORP) regime. From 2010-11, local authorities will apply an IFRS based Code of Practice that will be prepared under revised governance arrangements involving oversight by the Financial Reporting Advisory Board. This should ensure greater consistency with accounting practice in central government and support the move to Whole of Government Accounts.

CIPFA/LASAAC has begun a consultation on its IFRS based Code of Practice and has published an Invitation to Comment and Exposure Draft of the 2010 Code. The consultation closes on 11 September 2009.

## Limited Liability Partnerships (LLPs)

The Consultative Committee of Accounting Bodies (CCAB) is consulting on a revision to its SORP, in particular to provide guidance on the treatment of puttable instruments, following an August 2008 amendment to FRS 25 (IAS 32) 'Financial Instruments: Presentation'. The amendment has implications for LLPs by requiring, in limited circumstances, liabilities to be reclassified as equity.

# UITF Update

The UITF did not hold a meeting in July 2009 but continues to monitor the work of the IFRIC.

# IFRIC Update

In May 2009, the IFRIC published thirteen tentative agenda decisions for comment. The IFRIC consider comments received at its July 2009 meeting. A summary of the tentative agenda decisions are available for comment from the IASB website.

# People

**Professor Geoff Whittington** is to step down from the Board at the end of August, which marks the end of an era in that Geoff has been involved with the Board in one form or another since it started in 1990. However, Geoff is not totally lost to the Board, as he has been appointed to the Board's Committee on Accounting for Public-benefit Entities (CAPE). In addition, **Richard Bray** and **Miles Hedges** have been reappointed to CAPE.

**Howard Evans, Marian MacBryde, John McDonnell** and **Brian Shearer** have been reappointed to the Urgent Issues task Force (UITF) for a further two-year term.

**Hugh Francis** has been appointed and **Deborah Chesworth** and **Lynn Pearcy** reappointed to the Board's Financial Services and other Special Industries Committee (FSOSIC).

On the staff side, **Deepa Raval** has joined as a Project Director, working in particular on financial instruments and financial services issues. Project Director **Mario Abela** will be leaving the staff of the ASB in early September to take up the post of Research Director at EFRAG.

## Further Information

For further information on any of these topics please contact Peter Godsall at Aldwych House.

**Email:** [p.godsall@frc-asb.org.uk](mailto:p.godsall@frc-asb.org.uk)

## The Board's Publications

Copies of the Board's publications may, except where otherwise stated, be obtained from:

### FRC Publications

145 London Road  
Kingston upon Thames  
KT2 6BR

**Tel:** +44(0) 20 8247 1264

**Fax:** +44(0) 20 8247 1124

**Email:** [customer.services@cch.co.uk](mailto:customer.services@cch.co.uk)

**Website:** [www.frcpublications.com](http://www.frcpublications.com)

## Accounting Standards Board

5th Floor  
Aldwych House  
71-91 Aldwych  
London WC2B 4HN

**Tel:** +44(0) 20 7492 2300

**Fax:** +44(0) 20 7492 2301

**Website:** [www.frc.org.uk/asb](http://www.frc.org.uk/asb)



**ACCOUNTING  
STANDARDS  
BOARD**

ISSN 1360-1342

a part of the   
Financial Reporting Council

The Financial Reporting Council Limited is a company limited by guarantee.  
Registered in England number 2486363.  
Registered Office: 5th Floor, Aldwych House, 71-91 Aldwych, London WC2B 4HN.