

# Financial Reporting Brief.



The momentum towards global harmonisation of financial reporting standards took a major step forward during the quarter with the publication of a standard for small and medium-sized entities.

The International Accounting Standards Board (IASB) has published 'IFRS for SMEs' specifically for entities that are not publicly accountable. This was followed in the UK and Ireland with a policy proposal on the future of UK and Irish accounting in the form of a consultation paper published by the Accounting Standards Board (ASB).

The IASB has also published an exposure draft of a new standard 'Financial Instruments: Classification and Measurement' which is the first part of a three phase project to replace IAS 39. An exposure draft arising from the third year of the IASB's annual improvements project, proposing 16 amendments to 10 standards and one interpretation has also been published. Other IASB developments include proposed amendments re discount rates for pension obligations and classification of rights issues, amendments to IFRS 1 on first-time adoption and a draft discussion paper on extractive activities.

The Committee of European Securities Regulators (CESR) has also been active with the publication of the sixth batch of extracts from the confidential database of enforcement decisions taken by EU enforcers, and the publication of the conclusions of a study of application of reclassification amendments to IAS 39 and IFRS 7 by 100 large EU financial companies.

The ASB has issued amendments to standards in respect of group cash settled share-based transactions and embedded derivatives.

The Financial Reporting Review Panel (FRRP) has published its activity report for the year to March 2009 which highlights the need for companies to provide more disclosure in areas of sensitivity during these volatile times.

The Financial Reporting Council (FRC) has published a progress report on its review of the effectiveness of the Combined Code and is also considering the implications of the Walker report on the governance of banks and other financial institutions.

The Companies Report 2008 and the IAASA Annual Report for 2008 have both been issued.

New regulations have been introduced which will give shareholders of publicly listed companies greater power to hold management to account and have their say about the way such companies are run.

This brief comments on accounting and regulatory developments during the third quarter of 2009.

# International Accounting Standards Board (IASB) and related bodies - developments

## IFRS for SMEs

The IASB has issued IFRS for SMEs, developed specifically for entities that do not have public accountability. It is a stand-alone product that is separate from the full set of IFRS with simplifications that reflect the needs of users of SMEs' financial statements and cost/benefit considerations. Compared with full IFRS, it is less complex in a number of ways:

- Topics not relevant to SMEs are omitted
- Easier option only allowed where there are accounting policy choices
- Many of the principles of recognition and measurement in full IFRS are simplified
- Significantly fewer disclosures are required

Implementation of the standard is subject to legislative measures in each country and the ASB's draft policy proposal on the future of UK/Irish GAAP is commented on elsewhere in this Brief.

## Financial instruments: classification and measurement

The IASB has published an Exposure Draft (ED) on the above subject as the first part of the three-phase project to replace IAS 39, with plans to finalise the proposals in time for non-mandatory application in 2009 year-end financial statements. The IASB plans to complete the replacement of IAS 39 in 2010 with mandatory implementation planned for 2012.

The proposals made include the following:

- A financial asset or liability would be measured at amortised cost if the instrument has basic loan features (e.g. a fixed return) and the instrument is managed on a contractual yield basis. If neither of the conditions is met, instruments would be measured at fair value, to include equity instruments
- The asset classifications of 'held to maturity' and 'available for sale' would be eliminated
- The 'fair value option' would be retained where such designation eliminates an 'accounting mismatch' whereby a financial instrument would be accounted for at fair value through profit and loss account

The IASB plans to publish its proposals in respect of the other two phases – impairment and hedge accounting - before the end of 2009.

## Improvements to IFRS

The IASB has published an ED arising from its 2009 annual improvements project proposing 16 'minor' amendments to 10 standards and 1 interpretation. The proposed effective date for most of the amendments is for annual periods beginning on or after 1 January 2011, with early adoption permitted, except for those where proposed amendments relate to IFRS 3 which have an effective date of 1 July 2010.

## Retirement benefits: discount rate

The IASB has published proposals to amend the requirements of IAS 19 'Employee Benefits' whereby its requirement to determine the rate used to discount employee benefits with reference to government bond yields where there is no deep market in corporate bonds would be removed, and replaced by a requirement to estimate the yield on high quality corporate bonds. The IASB intends to permit entities to adopt the proposed amendments in their 2009 financial statements.

## Classification of rights issues

The IASB has published proposals to amend IAS 32 'Financial Instruments: Presentation' which seek to clarify the accounting treatment when rights issues are denominated in a functional currency other than that of the issuer. The proposals state that if such rights are issued pro rata to an entity's existing shareholders for a fixed amount of currency, they should be classified as equity regardless of currency. The IASB plans to issue the final amendment before the end of 2009 with early application permitted.

## IFRIC Proposal on Debt Extinguishments

IFRIC has published a draft interpretation (D25) 'Extinguishing Financial Liabilities with Equity Instruments' which addresses the appropriate accounting when a creditor agrees to accept an entity's shares or other equity instruments to settle the financial liability.

## Amendments to IFRS 1 'First-time adoption'

The IASB has amended IFRS 1 with regard to retrospective application of IFRSs in two particular first-time adoption situations:

- Full-cost oil and gas assets – entities permitted to use the carrying amount under their 'old GAAP'
- Determining whether an arrangement contains a lease – exempts an entity from having to apply IFRIC 4 when it adopts IFRS if determination previously carried out under its 'old GAAP'

The amendments are effective for annual periods beginning 1 January 2010, with earlier application permitted.

## Rate-regulated activities

The IASB has published proposals on accounting for rate regulated activities with the objective of defining regulatory assets and liabilities and establishing whether and how assets and liabilities resulting from rate-regulated activities should be recognised and measured under IFRS.

## Extractive activities

The IASB has posted on its website a working draft of a discussion paper 'Extractive Activities'. It is posted for information only and the IASB plans to invite comments on the project team's proposals in the first quarter of 2010. Key proposals in the working draft include those in relation to asset recognition, measurement and unit of account.

## Committee of European Securities Regulators (CESR) Activity

CESR has been active in a number of respects during the quarter, including:

- CESR published its sixth batch of extracts from the confidential database of enforcement decisions taken by EU enforcers, with topics covered including impairment, cash flow statements, contingent liabilities and others
- CESR published the conclusions of a study of the application of the reclassification amendments to IAS 39 and IFRS 7 by 100 large EU financial companies indicating the following
  - 61% of companies used the option to reclassify in annual financial statements
  - Impact was positive on profits to the extent of 28 billion Euros
  - Inadequate compliance with the disclosure requirements of IFRS 7

# Accounting Standards Board and related bodies – developments

## Future reporting requirements

The ASB has published a consultation paper 'Policy Proposal: The future of UK GAAP' which sets out its proposals for the future reporting requirements for UK and Irish entities. The ASB's proposals envisage a differential reporting regime based on public accountability and propose, from 1 January 2012, a three-tier approach as follows:

- Tier 1 – publicly accountable entities would apply IFRS as adopted by the EU
- Tier 2 – all other entities, other than those who can apply FRSE, could apply the IFRS for SMEs
- Tier 3 – small entities could choose to continue to apply FRSE

Entities within Tier 2 and Tier 3 would have the option of using EU-adopted IFRS if they elected to, and those in Tier 3 would have the option of using IFRS for SMEs.

The consultation paper also sets out ASB considerations and proposals for subsidiary companies and for public-benefit entities.

The ASB is seeking comments on the proposals by 1 February 2010.

## Financial Reporting Review Panel (FRRP) Activity Report

The FRRP has published its activity report based on findings from its review of financial statements in the year to 31 March 2009, during which 326 sets of financial statements were reviewed and 112 companies were approached for further information or explanation.

The overall conclusion of the review is that the standard of corporate reporting is good and that there continues to be improvements in quality. It was noted that AIM companies, who were required to use IFRS for the first time in 2007, had benefited from the experiences of their fully listed peers on transition to IFRS but that further quality improvements were necessary.

The FRRP noted that in the light of current market volatility companies need to focus attention on disclosures in such areas as principal risks and uncertainties, capital and liquidity risks and management, asset impairment and judgements related to the application of accounting policies and sources of estimation uncertainty.

## Group cash-settled share-based payment transactions

The ASB has published an amendment to FRS 20 which is consistent with the amendment made by the IASB to IFRS 2 earlier in 2009. Entities are required to apply the amendments retrospectively for annual periods beginning on or after 1 January 2010.

The amendment clarifies both the scope of the standard and the accounting for group cash-settled share-based payment 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 payments transaction.

## Embedded derivatives

The ASB has published amendments to UITF Abstract 42 'Reassessment of Embedded Derivatives' and FRS 26 on a basis consistent with amendments made by the IASB earlier in 2009. Entities are required to apply the amendments in annual periods ending on or after 31 December 2009.



The amendments clarify the treatment of embedded derivatives when an entity reclassifies a financial asset out of the fair value through profit or loss category.

## Related party disclosures

Chartered Accountants Ireland has published an information sheet as a reminder of the amended disclosure requirements which are effective for accounting periods beginning on or after 6 April 2008. The amendments provide an exemption only for transactions entered into between two or more members of a group, provided that any subsidiary undertaking which is a party to the transaction is wholly owned; the 90% exemption has been removed.

## Review of the combined code

The FRC has published a progress report on its review of the effectiveness of the Combined Code on Corporate Governance which it began in March 2009.

The report summarises the results of the consultations and research that the FRC has carried out to date and invites views on:

- The responsibilities of the chairman and non-executive directors
- The composition of the board, including finding the right balance of independence and expertise
- The frequency of directors' re-election
- Board information, development and support
- Evaluation of the board's effectiveness
- The effectiveness of existing risk management systems
- Remuneration policy and process
- The usefulness of companies' reporting on corporate governance
- Engagement between boards and shareholders

The FRC is also considering the implications of the consultation paper published by Sir David Walker on the governance of banks and other financial institutions. The report contains recommendations that could be taken forward through amendments to the Combined Code and recommends extending the responsibilities of the FRC and the FSA (Financial Services Authority) in relation to engagement between company boards and investors. The FRC is also considering to what extent the Walker recommendations are applicable for some or all listed companies in other sectors and how best to implement them.

# Legal and regulatory developments

## Contacts

### Companies Report

The Companies Report 2008 was published with certain items highlighted:

- A World Bank report 'Doing Business 2009' ranks Ireland fifth out of 181 economies surveyed in terms of ease of registration and related aspects of starting up a business, with particular credit due to the Companies Registration Office
- The report of the ODCE highlighted a number of significant results including the first conviction of a company director for knowingly using company assets in breach of the legal restrictions on the giving of loans to directors
- Work continued on the drafting of the Companies Consolidation and Reform Bill and it is envisaged that substantial progress towards completion of drafting will be made by late 2009

The Companies (Amendment) Act 2009 came into effect from 12 July, and its main features are summarised in the July edition.

### Irish Auditing and Accounting Supervisory Authority (IAASA) Annual Report

IAASA published its Annual Report for 2008 which comments on the review work it is carrying out in relation to annual and half-yearly reports and the findings of those reviews and other areas of IAASA involvement during 2008.

### Shareholders Rights Regulations 2009

New regulations have been signed into law that improve the rights of shareholders of publicly listed companies, including:

- Providing for shareholder participation across borders, notably through exercising of voting rights electronically
- Obliging companies to publish information regarding general meetings on their website, including the results of votes taken
- Increasing powers of shareholders to call general meetings, and their rights at such meetings

The Regulations apply in respect of general meetings of which notice is given or first given on or after 6 August 2009.

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