

IAS Plus.

Published for our clients and staff in the UK

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IAS plus website

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IASB publishes thirteen “improved” standards

December 2003 saw the publication in final form of thirteen revised standards arising out of the “improvements project”. These are:

- IAS 1 Presentation of Financial Statements.
- IAS 2 Inventories.
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.
- IAS 10 Events After The Balance Sheet Date.
- IAS 16 Property, Plant and Equipment.
- IAS 17 Leases.
- IAS 21 The Effects of Changes in Foreign Exchange Rates.
- IAS 24 Related Party Disclosures.
- IAS 27 Consolidated and Separate Financial Statements.
- IAS 28 Investments in Associates.
- IAS 31 Interests in Joint Ventures.
- IAS 33 Earnings per Share.
- IAS 40 Investment Property.

The revised standards generally follow closely the proposals published in May 2002 although there have been some changes made in the light of comments received by the IASB. All of the revised standards apply to periods beginning on or after 1 January 2005 with earlier adoption encouraged. From the perspective of those UK companies that are required to (or elect to) adopt IFRS in 2005, these will be the standards that will apply on first time adoption under IFRS 1.

Key features of the revised standards and their impact on UK companies are set out in the pages which follow. However, there are many detailed differences between these standards and UK GAAP which cannot be summarised in a publication of this type. Companies will need to undertake a detailed appraisal of the effect of moving to IFRS if they have not already done so. For companies with December year ends, it is important to remember that 1 January 2004 is the date of transition to IFRS and the preparation of the opening IFRS balance sheet should be a priority, certainly as soon as the UK GAAP 2003 annual report is out of the way.

The “stable platform” for 2005

Publication of the thirteen revised standards listed above is a major step towards achieving the “stable platform” of standards that the IASB is committed to finalising by March 2004. These will be the standards which will be mandatory for periods beginning on or after 1 January 2005 although other revised or new standards may be available for optional early adoption. The IASB has also published the revisions to IAS 32 and IAS 39 in December 2003.

The IASB still needs to complete the work on a number of standards in order to achieve the ‘stable platform’. During the period to 31 March we are expecting to see:

- a standard on share-based payments derived from the proposals in ED 2/FRED 31;
- a standard arising out of phase 1 of the business combinations project (ED 3) to replace IAS 22 and related amendments to IAS 36 on impairment of assets and IAS 38 on intangible assets;
- a standard on disposal of non-current assets and presentation of discontinued operations based on the proposals in ED 4/FRED 32 which should supersede IAS 35;
- an interim standard on accounting for insurance contracts based on ED 5; and
- an amendment to IAS 39 dealing with macro hedging.

In addition, in January 2004 the IASB published ED 6 “Exploration for and evaluation of mineral resources” for comment by 16 April. This is a draft of an interim standard which will permit certain exemptions from other standards, pending more complete consideration of the accounting issues involved. Although the standard will not be issued in final form by 31 March 2004, it is nevertheless the IASB’s intention that the standard will be mandatory for periods beginning on or after 1 January 2005. However, the Board is of the view that the proposals in the draft standard should facilitate an orderly transition to IFRS and should not result in changes to existing accounting practices.

IFRS 1 on first time adoption of IFRS has been issued in its final form but is likely to be subject to some amendments arising out of these projects.

Given that the revised business combinations standard will not have to be applied retrospectively and that some of these other changes are of limited relevance to many companies, it can be seen that substantially all of the standards that are required to restate the 1 January 2004 balance sheet to IFRS are now available.

The following standards are already in force and no changes are proposed that would be mandatory for 2005:

- IAS 7 Cash Flow Statements.
- IAS 11 Construction Contracts.
- IAS 12 Income Taxes.
- IAS 14 Segment Reporting.
- IAS 18 Revenue.
- IAS 19 Employee Benefits.
- IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.
- IAS 23 Borrowing Costs.
- IAS 29 Financial Reporting in Hyperinflationary Economies.
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets.
- IAS 41 Agriculture.

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Other matters

Under the IAS Regulation, IASB standards have to be adopted for use within the EU. On 29 September 2003 the European Commission announced that it had approved a Regulation adopting all existing international standards except IAS 32 and IAS 39. Although some uncertainties remain, companies should plan on the basis that all of the standards forming the “stable platform” described above will in due course be endorsed by the Commission for use in 2005.

On 30 December 2003, the Committee of European Securities Regulators issued a “Recommendation for additional guidance regarding the transition to IFRS”. This guidance does not have mandatory effect on UK listed companies but encourages them to make certain disclosures about the transition to IFRS ahead of the information they will be required to disclose in 2005 in accordance with IFRS 1. Of particular relevance at this time is the encouragement given to listed companies to describe their plans and degree of achievement in their move towards IFRS when they publish their 2003 financial statements. The guidance notes that this description could usefully cover the general policies to address the operational and control issues as well as the risks and uncertainties associated with the transition as they affect the business. It also notes that the communication could include information about the major differences identified between the present accounting policies and the ones they know with sufficient certainty that they will have to apply under IFRS in 2005.

The objective of the standard is to prescribe the basis of preparation of financial statements and to ensure comparability, both with the entity's financial statements for previous periods and with financial statements of other entities. The standard sets out requirements for the structure and the minimum content of financial statements.

IAS 1 Presentation of Financial Statements

Key features of the revised standard

- IAS 1 includes guidance on the meaning of ‘present fairly’ and emphasises that the application of IFRS is presumed to achieve a fair presentation. It requires departure from a standard in very rare circumstances where compliance would be misleading (except where not permitted by the relevant regulatory framework).
- The contents of a complete set of financial statements are specified and there is a general requirement for comparatives. Criteria for the classification of assets and liabilities as current/ non-current are defined.
- A choice is given as to the presentation of the balance sheet between separating current and non-current assets and liabilities, or presenting assets and liabilities in order of their liquidity (or in reverse order of liquidity) without a current/non-current distinction. Liquidity presentation of assets and liabilities is required only when it provides a more relevant and reliable presentation.
- The improved standard specifies minimum items on the face of the balance sheet and minimum items on the face of the income statement.
- Additional items may be needed to comply with another standard or to present fairly the entity's financial position or when such presentation is relevant to an understanding of the entity's financial performance.
- Disclosure of “extraordinary items” is prohibited.
- An analysis of expenses, either by nature or by function, should be given either on the face of the income statement or in the notes.
- A statement of changes in equity is to be presented although this requirement may be met in various ways.
- Disclosure in the notes is required of accounting policies followed, information required by other IAS, narrative descriptions or detailed analyses of items shown on the face of the financial statements, and other disclosures necessary for an understanding and fair presentation of the financial statements.
- Judgements of estimations and key assumptions concerning the future that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year must be disclosed.

IAS 1 has no direct equivalent in UK GAAP but it covers issues that are dealt with in the Companies Act formats, FRS 3 and FRS 18. In general, there is greater flexibility under IAS 1 than under the equivalent UK requirements. Under the IAS Regulation companies adopting IFRS need not apply the Companies Act formats.

The objective of the standard is to prescribe the accounting treatment for inventories. The amount of cost to be recognised as an asset and carried forward until the related revenues are recognised is addressed.

Key impacts on UK companies

- Income statement headings under IAS 1 are less detailed than in the Companies Act formats (which need not be applied by companies adopting IFRS under the IAS Regulation).
- IAS 1 describes two classifications for expenses (nature and function) which equate to Companies Act formats 1 and 2.
- There is more flexibility over balance sheet formats than permitted by the Companies Act formats.
- There is no equivalent under IFRS of the requirement in FRS 3 to disclose the effects of acquisitions. (Requirements for discontinuing operations are specified in IAS 35.)
- IAS 1 goes further than FRS 18 in respect of the disclosure of judgements made in the application of accounting policies and key sources of estimation uncertainty.
- There are some differences in the definitions of current assets and current liabilities. For example, a liability will be classified as current when it is expected to be settled in the entity's normal operating cycle, even if it is not due to be settled within twelve months after the balance sheet date.
- IAS 1 does not use the term "exceptional item" and, in particular has no equivalent of the FRS 3 "paragraph 20 items" which are shown below operating profit. But there is a requirement for separate disclosure of material items of income and expense. Examples given of such items are similar to those that would be regarded as exceptional items under UK GAAP. Companies wishing to show operating profit would need to include in it items such as reorganisation and restructuring costs.
- The UK statement of recognised gains and losses (STRGL) and reconciliation of movements in shareholders' funds are combined into a single statement of changes in equity under IAS 1. But the statement of changes in equity is not a performance statement and, therefore, amounts reported in certain cases are required to be "recycled" to the income statement.

IAS 2 Inventories

Key features of the revised standard

- Scope is all inventories except WIP under construction contracts (see IAS 11), financial instruments (see IAS 39) and biological assets related to agricultural activity and agricultural produce at the point of harvest (see IAS 41).
- Inventories are measured at the lower of cost and net realisable value. However, these measurement requirements do not apply to commodity broker-traders who measure inventory at fair value less costs to sell and the inventories of producers of agricultural products and mineral products which are measured at net realisable value.
- Permitted cost formulae are first-in-first-out (FIFO) and weighted average cost. Last-in-first-out (LIFO) is prohibited.
- Costs of inventories comprise all costs of purchase, conversion and other costs incurred in bringing the inventories to their present location and condition.
- Purchase costs comprise purchase price, import duties and other taxes (unless recoverable), transport, handling and other costs directly attributable to acquisition. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
- Conversion costs are those directly related to the units of production, such as direct labour and systematic allocation of fixed and variable production overheads incurred in converting materials into finished goods.
- Exchange differences arising directly on the recent acquisition of inventories invoiced in a foreign currency are not permitted to be included in the cost of purchase.
- Excluded costs to be recognized as expenses include abnormal amounts of wasted materials, storage costs (unless before a further production stage) and selling costs.
- For inventories purchased with deferred settlement terms, the difference between the purchase price for normal credit terms and the amount paid is recognised as interest expense over the period of financing.

Adoption of IAS 2 will generally have little impact on UK companies because the requirements are similar to SSAP 9. But there are differences in the detail, including the scope of the standards, which will have to be considered.

The objective of the standard is to prescribe the criteria for selecting accounting policies, and the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors.

- Where, subsequent to the write-down of inventory to its NRV, the economic circumstances change such that the NRV is increased and the write down is reversed, the amount of the reversal is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.
- Disclosures include the carrying amount of inventories carried at fair value less costs to sell, amount of any write-down of inventories and amount of any reversal of any write-down recognised as an expense in the period.

Key impacts on UK companies

- IAS 2 will have little impact on most UK companies because its requirements are similar to those in SSAP 9. The one significant difference that existed (the use of the LIFO cost formula) has been eliminated by the revision.
- IAS 2 includes some additional disclosure requirements, for example the amount of any write-down of inventories recognised as an expense in the period.
- Additionally, although certain inventories are outside the scope of IAS 2, it does require disclosure of inventories measured under other standards and carried at fair value less costs to sell.
- SSAP 9 contains (in an Appendix) more detailed guidance on the allocation of overheads than is provided in IAS 2.
- SSAP 9 (Appendix 1, paragraph 2) permits inclusion of marketing and selling costs in strictly limited circumstances. This is not permitted by IAS 2.
- Under IAS 2 companies are not permitted to include foreign exchange gains and losses in acquired inventory invoiced in a foreign currency.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Key features of the revised standard

- The standard specifies how accounting policies are to be determined in the absence of a specific standard or interpretation. It introduces a hierarchy of sources that management should refer to when selecting an accounting policy which include the IASB framework and most recent pronouncements of other standard-setting bodies that use similar conceptual frameworks.
- The standard requires consistency in the selection and application of accounting policies unless another standard specifically requires or permits other appropriate policies.
- The standard allows a change in accounting policies only if the change:
 - is required by a standard or interpretation; or
 - results in providing more reliable and relevant information.
- The standard generally requires such changes to be retrospective (i.e. comparatives to be restated). Comparative information for prior periods is presented as if new accounting policies had always been applied and prior period errors had never occurred.
- Changes in accounting estimates are accounted for prospectively in the income statement in the period of change/future periods as applicable. Changes in assets, liabilities or equity arising from changes in estimates are accounted for by adjusting the related asset, liability, or equity as appropriate in the period of change.
- Material prior period errors should be corrected by restatement of comparatives. The standard does not distinguish between fundamental errors and other material errors.
- Situations where retrospective application and retrospective restatement may be impracticable are also considered.
- The standard includes detailed disclosure requirements for adjustments arising out of changes of accounting policies and correction of prior period errors.
- Disclosure is required of an impending change of accounting policy when the entity has yet to implement a new standard or interpretation that has been issued but not yet come into effect.

IAS 8 is broadly consistent with the requirements of UK GAAP under FRS 3 and FRS 18. One of the most significant changes is that all material errors (i.e. not just “fundamental” errors) should be corrected through a restatement of comparative figures.

The objective of the standard is to prescribe when an entity should adjust its financial statements for events occurring after the balance sheet date and to prescribe disclosures that it should give about events after the balance sheet date.

The change which is likely to have most effect on UK companies is the exclusion of dividends declared after the balance sheet date from current liabilities.

Key impacts on UK companies

- The changes made to IAS 8 (and related changes to IAS 1) have tended to reduce the differences with the equivalent UK GAAP requirements in FRS 3 and FRS 18.
- IAS 8 now requires the correction of all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by restating the comparative amounts. This is a change from the previous IAS 8 which was consistent with FRS 3 in requiring this treatment only for “fundamental” errors.
- Corrections of errors should be distinguished from changes in accounting estimates which are recognised prospectively.
- The mandatory disclosure of impending changes of accounting policy (see above) is new for UK companies.

IAS 10 Events after the Balance Sheet Date

Key features of the revised standard

- Defines events after the balance sheet date as being those events, favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue.
- Two types of events are identified, adjusting events and non-adjusting events.
- Adjusting events are those that provide evidence of conditions that existed at the balance sheet date. The entity should adjust amounts recognised in the financial statements to reflect the outcome of such events after the balance sheet date.
- Non-adjusting events are those events that are indicative of conditions that arose after the balance sheet date. The entity should not adjust the amounts recognised in its financial statements to reflect non-adjusting events.
- Disclosures are required to be made for material non-adjusting events of the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.
- Dividends declared after the balance sheet date should not be recognised as a liability at the balance sheet date. But such dividends are disclosed in the notes to the financial statements in accordance with IAS 1.
- The date when the financial statements were authorised for issue and who gave that authorisation should be disclosed.

Key impacts on UK companies

- IAS 10 and SSAP 17 have broadly similar requirements for adjusting and non-adjusting post-balance sheet date events with one exception. SSAP 17 includes within the definition of adjusting events “events which because of statutory or conventional requirements are reflected in financial statements”. These include proposed dividends, amounts appropriated to reserves and dividends receivable from subsidiary and associated companies. Under IAS 10 these are treated as non-adjusting events.
- In the individual financial statements of parent companies, the inability to accrue dividends declared by subsidiaries after the balance sheet date will require careful planning to ensure that adequate profits are available for distribution by the parent company.

The objective of the standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

IAS 16 Property, Plant and Equipment

Key features of the revised standard

- The cost of an item of property, plant and equipment is recognised as an asset if, and only if, it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably.
- Measurement at recognition includes:
 - costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service an item; and
 - costs of the asset's dismantlement, removal or restoration, the obligation for which is incurred as a consequence of using the item.
- An asset acquired in an exchange transaction should be valued at fair value unless the exchange transaction lacks commercial substance.
- After initial recognition, an entity should choose either the cost model or the revaluation model as its accounting policy for each entire class of property, plant and equipment. An entity may carry all items of property, plant and equipment of a class at a revalued amount, if the fair value can be measured reliably.
- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately. The standard provides guidance on the depreciable amount, the depreciation period and the depreciation method.
- The residual value of an item is defined as the amount the entity estimates it would receive currently if the asset were already of the age and in the condition expected at the end of its useful life. Residual value and useful economic life are to be reviewed at least at each financial year end.
- Property, plant and equipment is required to begin to be depreciated when it is available for use and to continue to be depreciated until it is derecognised, even if it is idle.
- An entity should apply IAS 36 to determine whether an item of property, plant and equipment is impaired.
- The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal.
- Gains on disposal of property, plant and equipment may not be recognised as revenue.

IAS 16 is broadly similar to FRS 15 although there are significant differences, particularly in relation to revalued assets.

Key impacts on UK companies

- The basis for measurement on initial recognition is similar to FRS 15 although there are some detailed differences in the guidance. The changes made to IAS 16 bring it more into line with the approach taken by FRS 15 to subsequent expenditure and the need to separately depreciate components. It is arguable that IAS 16 requires component depreciation to be used more widely than has been the case under FRS 15.
- FRS 15 requires residual values to be based on the prices prevailing at the date of acquisition or revaluation. IAS 16 now requires residual values to be assessed based on prices prevailing at the balance sheet date. This will tend to reduce depreciation charges and may mean that in some cases no depreciation charge is required under IFRS when it would be required under UK GAAP.
- FRS 15 does not deal with exchanges of assets whereas IAS 16 requires such transactions to be recorded at fair value unless they lack commercial substance. The approach taken in UITF Abstract 36 (which applies only to contracts for sales of capacity) is much more restrictive than IAS 16 and requires the assets to have a "readily ascertainable market value" for a gain to be recognised.
- IAS 16 is less prescriptive than FRS 15 when assets are revalued in terms of the basis of valuation and frequency of valuations. IAS 16 states that revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from fair value at the balance sheet date.
- The requirement under IAS 16 to use "fair value" presumes the use of open market value rather than existing use value which is required in most cases by FRS 15. Open market value may be much higher than existing use value where it reflects an alternative (more profitable) use.

The objective of this standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to leases.

IAS 17 and SSAP 21 will generally provide the same classification of leases. Some leases of buildings may have to be reclassified as finance leases. The prohibition of the net cash investment method will be a significant change for UK lessors.

- IAS 16 contains different requirements on reporting revaluation losses to FRS 15. Revaluation losses under IAS 16 are first debited to equity against the revaluation surplus to the extent of any credit balance in the revaluation surplus in respect of that asset, and only then to the income statement. This is different to the treatment under FRS 15.
- FRS 15 permits “renewals accounting” for infrastructure systems and networks with no finite life. IAS 16 does not permit this treatment.
- The requirement for annual impairment reviews of assets with a life in excess of fifty years (including indefinite lives) has no equivalent in IAS 16.
- FRS 15 deals with borrowing costs which are dealt with under IFRS in IAS 23 rather than IAS 16. Both FRS 15 and IAS 23 permit a choice of policy for borrowing costs but the detailed rules differ about the amount to be capitalised and the circumstances in which it is permitted.

IAS 17 Leases

Key features of the revised standard

- A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an asset. All other leases are classified as operating leases. Classification depends on the substance of the transaction rather than the form. The standard details five primary, and three secondary, indicators of a finance lease.
- When classifying a lease, an entity should normally consider the land and building elements separately. The minimum lease payments are allocated between the land and buildings elements in proportion to the relative fair values of the leasehold interests.
- Lessees recognise finance leases as assets and liabilities in the balance sheet. Lease payments under operating leases are recognised generally on a straight-line basis over the lease term.
- Lessors recognise finance leases as receivables. Lessors should include initial direct costs incurred in negotiating a lease in the initial measurement of finance lease receivables. They are therefore spread over the lease term on the same basis as the lease income. This treatment does not apply to manufacturer or dealer lessors where such costs are recognised as an expense when the selling profit is recognised. Lessors recognise assets subject to operating leases according to the nature of the asset (e.g. as property, plant and equipment).
- The standard also addresses sale and leaseback transactions.

Key impacts on UK companies

- Finance lease indicators under IAS 17 will result in substantially the same classification as under UK GAAP. IAS 17 does not contain any rebuttable presumption equivalent to the SSAP 21 90% test. Instead it focuses on whether, in substance, substantially all the risks and rewards of ownership have been transferred.
- UK practice has been to classify most leases of land and buildings as operating leases. Under IFRS, an entity would be required to test the lease under the standard, and could potentially have a different classification, particularly as the land and buildings elements must now be considered separately. Leases of land will be classified as operating leases unless title passes at the end of the lease term. Leases of buildings will be evaluated in the same manner as any other lease.
- For lessors, IAS 17 mandates use of the pre-tax “net investment method” of apportioning income on finance leases. SSAP 21 mandates post-tax “net cash investment method” which may result in more income being taken earlier.
- Operating lease incentives are dealt with in SIC 15 and UITF Abstract 28. These are similar, but SIC 15 refers to spreading over the lease term whereas Abstract 28 requires the use of a shorter period to the first rent review at which lease payments will be reset to market rent.

The objective of the standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

IAS 21 The Effects of Changes in Foreign Exchange Rates

Key features of the revised standard

Results and financial position should be measured in the functional currency of the entity, which is the currency of the primary economic environment in which it operates. Detailed guidance is provided on the determination of functional currency.

When recording transactions in the functional currency:

- Foreign currency transactions are initially recognised at the spot rate on the date of the transaction.
- At subsequent balance sheet dates, monetary items are translated at closing rate; non-monetary items at historical cost are retained at the transaction date rate; and non-monetary items at fair value are translated at the rate ruling at the date the value was determined.
- Exchange differences on monetary items are recognised through the income statement.
- Changes in functional currency are required to be accounted for prospectively.

An entity has a free choice of 'presentation currency'. When presenting financial statements in a currency other than the functional currency (e.g. consolidated financial statements including foreign operations):

- Assets and liabilities are translated at closing rate.
- Goodwill and fair value adjustments are translated at closing rate.
- Income and expenses are translated at the rate ruling at the dates of the transactions (although in practice an average rate may be used in the absence of significant fluctuations).
- The resulting exchange differences are recognised as a separate component of equity.
- On disposal of a foreign operation, the cumulative exchange differences deferred in a separate component of equity are recognised in the income statement.
- Special rules apply to foreign entities operating in a hyperinflationary economy (see also IAS 29).

The standard also prescribes a number of disclosure requirements.

Key impacts on UK companies

- IAS 21 is based on broadly similar principles to SSAP 20. But there are a number of significant differences that will affect UK companies when they begin reporting under IFRS.
- SSAP 20 allows the translation of the profit and loss account of a foreign entity using either the closing rate or an average rate. IAS 21 permits only an average rate to be used.
- IAS 21 and SSAP 20 both require use of the net investment method and both take exchange differences to reserves (via the STRGL in the UK). But under IAS 21 differences are recycled to the income statement on disposal of a subsidiary whereas UK GAAP prohibits recycling. There is an exemption under IFRS 1 from the need to make this adjustment for exchange differences which arose before the date of transition to IFRS.
- IAS 21 explicitly permits a free choice of presentation currency which may be different from the functional currency (i.e. the currency of the primary economic environment in which the entity operates). For example, this makes it clear that a UK company can present its financial statements in sterling even if all its operations are in the US.
- IAS 21 provides detailed guidance on how to determine the functional currency. This detailed guidance and the lack of choice over the functional currency in IAS 21 is likely to be a significant issue for some UK companies.
- The use of the temporal method, which is required in certain cases under SSAP 20, is not permitted under IAS 21. But this will have little effect in practice because in such cases IAS 21 would require the functional currency of the foreign entity to be the same as that of the parent.

The change which is likely to have most effect on UK companies is the requirement to retranslate goodwill at each balance sheet date. But there are a lot of more subtle changes that will affect companies in different ways. Extra records will have to be kept, for example, to analyse exchange differences taken to reserves (for recycling). Hedge accounting will have to comply with the rigorous requirements of IAS 39.

- SSAP 20 permits, in specified conditions, hedge accounting to be adopted for exchange differences on foreign net investments and related borrowings. SSAP 20 also permits recording of the transactions at the contracted rate where an entity uses a foreign currency forward contract to hedge transactions in a foreign currency. IAS 21 contains no such provisions because under IFRS hedge accounting is dealt with in IAS 39. In practice, this means that it may be more difficult to qualify for hedge accounting and the mechanics of the accounting are far more complex.
- UK GAAP does not specify whether goodwill should be treated as a foreign currency asset and retranslated at each balance sheet date. IAS 21 requires goodwill (and any fair value adjustments) to be retranslated at closing rate. Companies that have not previously done this will have to prepare an analysis of goodwill by functional currency.

The objective of the standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

IAS 24 will lead to substantial additional disclosures in the individual financial statements of parents and subsidiaries. Detailed changes in the definition of related party will require careful consideration on the facts of each case.

IAS 24 Related Party Disclosures

Key features of the revised standard

- The standard contains a detailed definition of a related party which is generally based on the existence of control, including joint control, or significant influence.
- Disclosure of relationships between parents and subsidiaries is required irrespective of whether there have been any transactions between those related parties. The name of the entity's parent and, if different, the ultimate controlling party must be disclosed.
- Disclosure of nature of the related party relationships as well as information about transactions is required including:
 - Amounts of transactions.
 - Amounts of outstanding balances (and their terms, conditions, nature of consideration, and details of guarantees).
 - Provisions for doubtful debts.
 - Expense recognised in period for bad or doubtful related party debts.
- Disclosure of related party transactions is required, regardless of whether or not a price is charged.
- Disclosures are required to be made separately for specified categories of related party but disclosure of the identity of related parties is not required.
- Disclosure of the compensation of key management personnel is required.
- State-controlled entities that are profit-oriented are no longer exempted from disclosing transactions with other state-controlled entities.

Key impacts on UK companies

- IAS 24 is broadly similar to FRS 8. The changes made to IAS 24 have tended to narrow the differences that existed. The new requirement in revised IAS 24 to disclose the identity of the ultimate controlling party is modelled on the requirement that was introduced in the UK eight years ago by FRS 8. But there are a lot of differences in the detail which will have an effect in practice.
- Although the definitions of related party in IAS 21 and FRS 8 are broadly similar in that they are generally based on the existence of control or significant influence, there are differences in wording which will be significant in the less straightforward cases.
- The details required to be disclosed for related party transactions and balances are broadly the same but the names of the transacting parties are not required under IAS 24.
- There is no equivalent of the exemption in FRS 8 for the financial statements of subsidiaries.
- There is no equivalent of the exemption in FRS 8 for the individual financial statements of the parent when consolidated financial statements are presented.

The standard applies to the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent. The standard also applies to accounting for investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of a parent, a venturer or investor.

IAS 27 is based on similar principles to FRS 2 and will involve little change for most UK companies in terms of the requirement to prepare consolidated financial statements.

IAS 27 Consolidated and Separate Financial Statements

Key features of the revised standard

- The standard is based on the concept of control which is defined as the power to govern financial and operating policies of an entity so as to obtain benefits from its activities.
- A parent should present consolidated financial statements in which it consolidates its investments in subsidiaries. A subsidiary is an entity that is controlled by the parent.
- There is an exception to this requirement where the parent is itself a subsidiary of another parent, which produces consolidated financial statements available to the public that comply with IFRS, and several other conditions are met.
- The revised standard stipulates, for clarification, that the requirement to consolidate investments in subsidiaries applies to venture capital organisations, mutual funds, unit trusts and similar entities.
- A subsidiary should be excluded from consolidation where the subsidiary is acquired and held exclusively with a view to disposal within twelve months from acquisition and management is actively seeking a buyer.
- Severe long-term restrictions on transfer of funds do not justify not consolidating a subsidiary.
- The standard details consolidation procedure requirements such as elimination of intra-group transactions and uniform accounting policies.
- Minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity.
- The standard also specifies the basis upon which investments in subsidiaries, jointly controlled entities and associates should be accounted for in separate (i.e. non-consolidated) financial statements where a reporting entity presents such financial statements. Such investments should be accounted for at cost or in accordance with IAS 39.

Key impacts on UK companies

- The definitions of control in IAS 27 and FRS 2 are slightly differently worded with IAS 27 focusing on "power to control", while FRS 2 focuses on ability to control. So, a participating interest combined with actual exercise of dominant influence may not be sufficient to consolidate under IAS 27. Similarly the requirements of SIC 12, which deals with the consolidation of special purpose entities, should in most cases achieve the same result as the application of FRS 5 which deals with "quasi subsidiaries", but there will be differences at the margins which will require careful consideration.
- The exemption from preparing consolidated financial statements for intermediate holding companies in IAS 27 is broadly similar to the one in FRS 2 and the Companies Act. But there are some differences in the detailed requirements.
- The revised IAS 27 incorporates the requirement of SIC 33 that an entity must consider the existence and effect of potential voting rights currently exercisable or convertible when assessing whether it has the power to govern the financial and operating policies of another entity. There is no direct equivalent of this in UK GAAP.
- UK companies generally present minority interests in the balance sheet as a separate caption below "shareholders' funds". This is broadly consistent with IAS 27 although it will have to be made clear that the minority interest line is a separate component of shareholders' equity. This change of presentation has some potentially far reaching consequences but these are being considered separately as part of the business combinations project.
- In separate financial statements, if those are presented under IAS, IAS 27 would not permit investments in subsidiaries or associates to be recorded at out-of-date valuations or using the equity method which are both sometimes encountered in the UK. But UK listed companies will not be obliged by law to prepare their separate financial statements in accordance with IFRS (although they will be permitted to do so).

The Standard prescribes the accounting for investments in associates.

IAS 28 and FRS 9 are similar in most respects except where the associate has net liabilities.

The standard prescribes the accounting treatment required for interests in joint ventures, irrespective of the structures or forms under which the joint venture activities take place.

IAS 28 Investments in Associates

Key features of the revised standard

- An associate is an entity over which the investor has significant influence and which is neither a subsidiary nor an interest in a joint venture.
- A holding of 20% or more of the voting power will indicate significant influence unless it can be clearly demonstrated otherwise. If the holding is less than 20%, the investor will be presumed not to have significant influence unless such influence can be clearly demonstrated.
- An investor should use the equity method of accounting for investments in associates.
- Equity accounting is required even if consolidated accounts are not required, for example because the investor has no subsidiaries. But equity accounting is not required where the investor would be exempt from preparing consolidated financial statements under IAS 27.
- When an associate is acquired and held with a view to its disposal within twelve months of acquisition, the standard does not require the equity method to be applied.
- Severe long-term restrictions on transfer of funds do not justify non-equity accounting when significant influence still exists.
- Investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that are classified as held for trading and accounted for in accordance with IAS 39 are outside the scope of IAS 28.

Key impacts on UK companies

- The revision of IAS 28 has tended to narrow the differences between it and FRS 9. So in most cases there will be little effect on UK companies arising from the adoption of IAS 28.
- Although both IAS 28 and FRS 9 refer to significant influence, there are differences in the definitions and guidance which may result in different conclusions at the margins. For example, IAS 28 places more emphasis on the power to influence compared with FRS 9 which refers to the actual exercise of influence.
- IAS 28 suspends equity accounting for associate's losses when the balance sheet carrying value (including all long-term interests that form part of the net investment) is nil. Further losses should only be accrued if the investor has a legal or constructive obligation. UK GAAP requires continued accounting for losses based on the long-term relationship.
- IAS 28 provides an exemption from equity accounting for certain venture capital investments which may appear similar to the exemption in FRS 9. However, under IFRS gains and losses on annual revaluation of such investments to fair value would be included in the income statement rather than in the STRGL.

IAS 31 Interests in Joint Ventures

Key features of the revised standard

- The standard classifies joint ventures as jointly controlled operations, jointly controlled assets or jointly controlled entities.
- For "jointly controlled operations" a venturer recognises assets it controls, liabilities it incurs, expenses it incurs and share of income it earns.
- For "jointly controlled assets" a venturer recognises its share of jointly controlled assets classified according to their nature, any liabilities incurred, its share of jointly incurred liabilities, any income from its share of output of the joint venture together with its share of expenses incurred.
- For "jointly controlled entities" the standard permits alternative treatments: proportionate consolidation and the equity method.
- The standard provides exemptions from application of proportionate consolidation or the equity method similar to those provided for certain parents not to prepare consolidated financial statements.
- When a joint venture is acquired and held with a view to its disposal within twelve months of acquisition, the standard does not require proportionate consolidation or equity accounting.

- Severe long-term restrictions on transfer of funds do not justify not equity accounting or proportionately consolidating.
- The standard does not apply to interests in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that are classified as held for trading and accounted for in accordance with IAS 39.

IAS 31 and FRS 9 are similar in most respects except that IAS 31 permits the use of proportionate consolidation as an alternative to the equity method of accounting.

The objective of the standard is to prescribe principles for the determination and presentation of earnings per share. The focus of the standard is on a consistently determined denominator for the earnings per share calculation.

FRS 14 was based on the previous IAS 33 and so the requirements are very similar. IAS 33 does not permit presentation of any additional amounts per share on the face of the income statement.

Key impacts on UK companies

- IAS 31 describes three classes of joint arrangement: jointly controlled operations; jointly controlled assets; and jointly controlled entities. The first two would generally align with the UK's JANE, while the third would generally align with the UK's joint venture. However, where a UK JANE could be structured as a legal entity (company, partnership, trust etc) it would be treated as a jointly controlled entity under IAS 31.
- FRS 9 requires the use of the gross equity method for joint ventures. The equity method under IAS 31 does not require the additional "gross" disclosures on the face of the balance sheet and income statement.
- UK companies will be permitted to use the proportionate consolidation method to account for interests in joint ventures.

IAS 33 Earnings per Share

Key features of the revised standard

- The standard applies to entities whose ordinary shares or potential ordinary shares are publicly traded and to entities that are in the process of issuing such shares in public markets.
- Basic and diluted EPS should be presented on the face of the income statement with equal prominence. Both should be presented for profit or loss from continuing operations attributable to ordinary equity holders of the parent entity and for total profit or loss attributable to such holders. EPS should be presented for each class of ordinary shares that has a different right to participate in the profit.
- The standard provides detailed guidance on the calculation of basic and diluted EPS including worked examples.
- Guidance and examples are provided on complex matters such as the effects of contingently issuable shares; potential ordinary shares of subsidiaries, joint ventures or associates; participating equity instruments; written put options; purchased put and call options; mandatorily convertible instruments; and contracts that may be settled in ordinary shares or cash at the issuer's option.

Key impacts on UK companies

- FRS 14 and IAS 33 are very similar although each deals with some matters in more detail. In most cases the denominator for the basic EPS calculation will be the same under both standards. The calculation of diluted EPS is more likely to diverge because of differences in the detailed requirements.
- Under IAS 33 there is a requirement to show EPS from continuing operations on the face of the income statement and EPS from discontinuing operations either on the face or in the notes. Although UK companies often make these disclosures, they are not required to do so by FRS 14.
- Many UK companies present alternative EPS amounts (e.g. excluding exceptional items and goodwill amortisation) on the face of the income statement as permitted by FRS 14. This is not permitted by IAS 33 which now specifies that any such additional amounts should be disclosed in the notes (and therefore not on the face of the income statement).

The objective of the standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

The big change for UK companies will be that gains and losses on revaluation of investment property will be included in the profit or loss for the period.

IAS 40 Investment Property

Key features of the revised standard

- Investment property is property held to earn rentals or for capital appreciation or both. Certain exceptions apply.
- The standard permits a choice between the “fair value model” and the “cost model” in accounting for investment property.
- Under the fair value model, the property is measured at fair value with any changes in fair value recognised in the income statement.
- Under the cost model, the property is measured at depreciated cost less any impairment losses (in accordance with IAS 16). The fair value of investment property is still required to be disclosed in a note.
- An entity must apply its chosen model to all its investment property.
- An interest in a property held by a lessee under an operating lease can qualify as investment property provided that:
 - the rest of the definition of investment property is met;
 - the operating lease is accounted for as if it were a finance lease in accordance with IAS 17; and
 - the lessee uses the fair value model for investment property.

Key impacts on UK companies

- UK companies will be permitted to adopt the cost model but this will not avoid the cost and effort of obtaining valuations because the standard requires, except in rare circumstances, disclosure of the fair value when the cost model is used.
- IAS 40 requires investment property to be stated at “fair value” whereas SSAP 19 uses the term “open market value”. These concepts are similar but some differences in valuations may arise in practice.
- Although valuations may be similar under the two standards, the reporting of gains and losses is fundamentally different. IAS 40 requires an annual assessment of fair value with all gains and losses taken through the income statement. Profits will therefore be much more volatile under IAS 40.

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