

**Published for our clients and staff in the Europe-Africa region**

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REGION**

**April 2002**

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### **IASB NEWS**

**Where are IAS used today?** We have compiled a country-by-country table to summarise the use of International Accounting Standards as the primary GAAP by domestic listed companies. See page 2.

**IASB's first exposure draft on an accounting issue.** IASB is proposing to amend IAS 19, Employee Benefits, for what it regards as a "counter-intuitive" result produced by that Standard's "corridor approach". Not only did we submit comments on the technical issues, we expressed serious concern about the brevity of the comment period (30 days). See page 4.

**New Interpretation on web site costs.** IASB has issued an interpretation, SIC 32, Intangible Assets—Web Site Costs, that went into effect 25 March 2002. See page 5.

**Interpretations Committee is reorganised.** The IASC Foundation Trustees approve important changes to IASB's Constitution relating to the Standing Interpretations Committee, including a name change: International Financial Reporting Interpretations Committee (IFRIC). See page 6.

**Potential IFRIC agenda issues.** All of the outstanding SIC issues were completed. IFRIC is developing its own agenda. See page 6.

**Certification of IAS/IFRS experts.** The IASC Foundation Trustees are considering certification programmes. See page 6.

**Revised IASB project timetables.** Exposure Drafts on First-Time Application, Improvements, and IAS 32 and 39 Amendments were put off until second quarter 2002, with final Standards delayed until 2003. See page 7.

**Progress on IASB agenda projects.** We have 15 pages of details, including a summary of our firm's comments on the proposed Preface to IFRS. See pages 8-22.

**News from the United States.** David Tweedie and Paul Volcker testify before US Congress. Former SEC Chairmen support IAS. SEC Chairman Pitt urges "principles based" standards. New SEC disclosure rules. US Public Oversight Board is dissolved. AICPA members defeat global credential. EU Commissioner urges IAS in the United States. See pages 24-26.

**News about IAS in Europe.** Parliament adopts IAS resolution. Pan-European disclosure legislation is being developed. Consistency of EU Directives and IAS. International auditing standards in Europe? See pages 27-30.

**New from Deloitte Touche Tohmatsu.** Practical Guide to IAS. Revised version of IAS in Your Pocket. Model IAS financial statements in Chinese (and English). See page 31

### **IAS PLUS WEB SITE**

We had over 90,000 visitors during 2001. Join us at [www.iasplus.com](http://www.iasplus.com). You will find the latest IASB and IFRIC news, summaries of proposed and final pronouncements, IASB project updates, notes from IASB meetings, reference materials, disclosure checklists, IAS links, and lots more.

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## WHERE ARE INTERNATIONAL ACCOUNTING STANDARDS USED TODAY?

We have compiled the following table to summarise our understanding of the use of IAS as the primary GAAP by domestic listed companies in their consolidated financial statements provided to investors. Please send us any additions or corrections you may have to this list. We plan to keep it updated on [www.iasplus.com](http://www.iasplus.com).

Use of IAS as the Primary GAAP by Listed Domestic Companies in their Consolidated Financial Statements for Investors	Not Permitted	Permitted	Required for Some Domestic Listed Companies	Required for All Domestic Listed Companies
Argentina	X			
Armenia				X
Australia	X			
Austria		X		2005
Bahrain			Banks	
Bangladesh				X
Barbados				X
Belgium		X		2005
Benin	X			
Bermuda		X		
Bolivia		X		
Botswana		X		
Brazil	X			
Brunei Darussalam				X
Bulgaria		X		
Burkina Faso	X			
Cambodia	X			
Canada	X			
Cayman Islands		X		
Chile	X			
China			B-Shares	
Colombia	X			
Costa Rica				X
Cote D'Ivoire (Ivory Coast)	X			
Croatia (Hrvatska)				X
Cyprus				X
Czech Republic	X			
Denmark		X		2005
Dominican Republic				X
Ecuador				X
Egypt				X
El Salvador		X		
Estonia	X			
Fiji	X			
Finland		X		2005
France	X			2005
Georgia				X
Germany		X		2005
Ghana	X			
Greece	X			2003
Guatemala	X			
Haiti				X
Honduras				X
Hong Kong		X		
Hungary		X	X	
Iceland	X			2005
India	X			
Indonesia	X			
Ireland	X			2005
Israel	X			
Italy				2005
Jamaica				X
Japan	X			
Kenya				X

Use of IAS as the Primary GAAP by Listed Domestic Companies in their Consolidated Financial Statements for Investors	Not Permitted	Permitted	Required for Some Domestic Listed Companies	Required for All Domestic Listed Companies
Korea (South)	X			
Kuwait				X
Kyrgyzstan	X			
Laos		X		
Latvia		X		
Lesotho		X		
Lithuania		X		
Luxembourg		X		2005
Macedonia				X
Malaysia	X			
Mali	X			
Malta				X
Mexico	X			
Moldova	X			
Myanmar		X		
Namibia	X			
Nepal				X
Netherlands		X		2005
New Zealand	X			
Niger	X			
Oman				X
Pakistan	X			
Panama				X
Peru				X
Philippines	X			
Poland	X			
Portugal	X			2005
Romania	X			
Russian Federation		X		
Saudi Arabia	X			
Singapore	X			
Slovak Republic	X			
Slovenia	X			
Spain	X			2005
Sri Lanka	X			
Swaziland		X		
Sweden	X			2005
Switzerland		X		
Syria	X			
Taiwan	X			
Tanzania	X			
Thailand	X			
Togo	X			
Trinidad and Tobago				X
Tunisia	X			
Turkey		X		
Uganda		X		
Ukraine			Banks	
United Arab Emirates			Banks	
United Kingdom	X			2005
United States	X			
Uzbekistan	X			
Venezuela	X			
Vietnam	X			
Yugoslavia				X
Zambia		X		
Zimbabwe		X		

*Under IAS 19, actuarial gains and losses may be recognised gradually (amortised) if the cumulative unrecognised amount exceeds 10% of the employer's gross benefit obligation or 10% of the fair value of the plan assets. The excess outside this 10% 'corridor' is amortised over the expected average remaining working lives of the employees participating in the plan. This 'corridor approach' was hotly debated by IASC during the development of IAS 19.*

*On page 8 of this newsletter, we set out our firm's major comments on IASB's proposed Preface to IFRS. We favour minimum exposure periods of at least 90 days for IASB Discussion Documents and Exposure Drafts and at least 60 days for Draft Interpretations.*

## **IASB PROPOSES "ASSET CEILING" AMENDMENT TO IAS 19**

On 25 February 2002, IASB published an exposure draft of a proposed amendment to IAS 19, Employee Benefits, to prevent what the Board regarded as a "counter-intuitive" result produced by the interaction of two aspects of IAS 19 – the option to defer gains and losses in the pension fund and the limit on the amount that can be recognised as an asset (the 'asset ceiling').

Because of the wording of the asset ceiling, a gain is sometimes recognised when a plan is in surplus solely as a result of deferring and amortising an actuarial loss or added past service cost in the current period. Conversely, deferral of actuarial gains sometimes causes a loss to be recognised. The IASB concluded that reporting gains and losses in these circumstances is not appropriate, and the proposed amendment would prevent their recognition. Comments were due 25 March 2002.

The Deloitte Touche Tohmatsu letter of comment acknowledged that the current requirements in IAS 19.58 may result in the recognition of a gain or loss in the income statement that is the result of deferring the recognition of an actuarial gain or loss under IAS 19.92. However, it is our view that the larger issue is the need for an asset ceiling and, ultimately, the acceptability of a "corridor" approach in accounting for actuarial gains and losses. Therefore, instead of addressing this selected issue related to a specific anomaly, we believe it would be preferable for the IASB to address this, and other issues with the application of IAS 19, as part of a larger project on employee benefits.

In addition, we pointed out that the International Financial Reporting Interpretation Committee is expected to add to its agenda a project on how to determine the present value of economic benefits available in the form of refunds or reduction in future contributions to the plan under IAS 19.58(b)(ii). This suggests that there are additional issues associated with the asset ceiling. We support this initiative and the need to develop further guidance on how to determine this amount.

## **WE EXPRESS CONCERN ABOUT A 30-DAY COMMENT PERIOD ON AN EXPOSURE DRAFT**

In a letter to IASB Chairman Sir David Tweedie and the IASC Foundation Trustees, Deloitte Touche Tohmatsu has expressed 'serious concern' about the shortness of the comment period on IASB's first exposure draft (ED) on an accounting issue, Amendment to IAS 19, Employee Benefits: The Asset Ceiling. We wrote:

*"In an international environment, translation and solicitation of input at the national level by national accountancy bodies are required in developing replies to EDs. On top of that, the issue raised in the ED is a complex one, and one that has existed since IAS 19 took effect over three years ago. In this particular case, the proposal in the ED has broad implications for some of the fundamental concepts of IAS 19 - implications that respondents to the ED must consider carefully. We certainly do not see this as an issue that in any way justifies a 30-day comment period.*

*"We believe that, as a matter of policy, IASB Exposure Drafts should have at least a 90-day comment period other than in an exceptional situation. Further, we believe that IASB should develop and articulate, as part of the Preface, criteria to identify such an exceptional situation."*

The full text of our letter is available on [www.iasplus.com](http://www.iasplus.com).

*SIC 32 requires capitalisation of certain web site development costs provided that the enterprise can demonstrate how the web site will generate future benefits, for instance by enabling orders to be placed. However, all expenditure to develop a web site intended solely or primarily to promote the enterprise's products and services is advertising cost that must be charged to expense under IAS 38.*

## IASB ISSUES SIC 32 ON WEB SITE COSTS

At its March 2002 meeting, IASB approved issuance of SIC 32, Intangible Assets–Web Site Costs. The new Interpretation was released on 25 March and took effect on that date.

SIC 32 concludes that a web site developed by an enterprise using internal expenditure, whether for internal or external access, is an internally generated intangible asset that is subject to the requirements of IAS 38, Intangible Assets.

In general, web site development costs should be recognised as an intangible asset if, and only if, in addition to complying with the general requirements described in IAS 38.19 for recognition and initial measurement, the enterprise can demonstrate how its web site will generate probable future economic benefits, as required by IAS 38.45(d). SIC 32 notes that costs to develop a web site solely or primarily for promoting and advertising the enterprise's own products and services should be recognised as an expense when incurred.

SIC 32 identifies the following stages of web site development:

- ☐ Planning
- ☐ Application and infrastructure development
- ☐ Graphical design
- ☐ Content development
- ☐ Operating

SIC 32 addresses the appropriate accounting treatment for internal expenditure on each of those stages:

- ☐ **Planning.** The Planning stage is similar in nature to the research phase in IAS 38.42-.44. Expenditure incurred in this stage should be recognised as an expense when it is incurred.
- ☐ **Application and Infrastructure Development, Graphical Design, and Content Development.** These stages, to the extent that content is developed for purposes other than to advertise and promote an enterprise's own products and services, are similar in nature to the development phase in IAS 38.45-.52. Expenditure incurred in these stages should be included in the cost of a web site recognised as an intangible asset when the expenditure can be directly attributed, or allocated on a reasonable and consistent basis, to preparing the web site for its intended use. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an enterprise's own products and services) specifically for a web site, or expenditure to enable use of the content (such as a fee for acquiring a licence to reproduce) on the web site, should be included in the cost of development when this condition is met. However, in accordance with IAS 38.59, expenditure on an intangible item that was initially recognised as an expense in previous financial statements should not be recognised as part of the cost of an intangible asset at a later.
- ☐ **Operating.** The Operating stage begins once development of a web site is complete. Expenditure incurred in this stage should be recognised as an expense when it is incurred unless it meets the criteria in IAS 38.60.

A web site that is recognised as an intangible asset under SIC 32 should be measured after initial recognition by applying the requirements of IAS 38.63-.78. The best estimate of a web site's useful life is expected to be short.

*IFRIC's 12 voting members are appointed for three-year renewable terms. The Chair has the right to speak on technical issues at IFRIC meetings, but not to vote. One or two IASB members attend IFRIC meetings as non-voting observers with the right to speak. IFRIC members serve as individuals and not as representatives of any organisations with which they are affiliated.*

*With the publication of SIC 32 (see the previous page), the former Standing Interpretations Committee completed all of the projects on its agenda. IFRIC must now decide which issues it should tackle.*

*In Europe alone, nearly 7,000 listed companies will be switching from their national GAAP to International Accounting Standards in the next several years. The demand for training in IAS is considerable, and the IASC Foundation Trustees are seeking ways to meet that demand.*

*In the past, many IASC Standards had included application examples within the body of the Standard, sometimes enclosed in boxes (for example, see IAS 12, 19, 36, 37, and 38. IASB plans to "streamline" its Standards by putting such examples in appendices while maintaining their authoritativeness.*

## CHANGES FOR IASB INTERPRETATIONS PROCESS

At their meeting in March, following solicitation of public comment, the Trustees of the IASC Foundation made the following changes to IASB's Constitution with respect to the Standing Interpretations Committee:

- ❑ The committee's name is changed to the International Financial Reporting Interpretations Committee (IFRIC).
- ❑ The committee's mandate is broadened so it can address issues not specifically covered in an existing IFRS.
- ❑ The position of a non-voting chair of IFRIC is created, that position to be filled by one of the members of the IASB, the Director of Technical Activities, or a member of the IASB's senior technical staff. Subsequently, IASB appointed Kevin Stevenson, Director of Technical Activities, as chair of IFRIC.

## POTENTIAL IFRIC AGENDA ISSUES

At its April meeting, the International Financial Reporting Interpretations Committee (IFRIC) will consider the following potential agenda topics:

- ❑ Discretionary Distributions
- ❑ Economic Compulsion
- ❑ Effective Date and Transition Provisions
- ❑ IAS 19 *Employee Benefits*—The Asset Ceiling
- ❑ IAS 19 *Employee Benefits*—Post-Employment Benefits Liability Measurement
- ❑ Linkage of Transactions
- ❑ Transactions with Owners

## IASCF IS PLANNING CERTIFICATION PROGRAMMES IN IFRS AND IAS

The anticipated adoption of IAS throughout Europe and elsewhere has created a demand for high quality learning materials and training programmes. The IASC Foundation (IASCF) Trustees have invited those who are experienced in providing learning materials and training programmes to submit proposals for materials and programmes to train and examine individuals on their skills in financial reporting under IASs and IFRSs. These programmes would carry the certificate "IASCF-approved training". Two levels of certification are envisioned: Application Level (Certification in IASs and IFRSs) and Advanced Level (Diploma in IASs and IFRSs).

## FORMAT OF IFRS

During the discussion of several projects at the IASB's March meeting, the Board indicated that guidance in IFRS will be of two types:

- ❑ IFRS will include one or more "application supplements" in appendices that will form part of the Standard.
- ❑ IFRS will include illustrative examples "at the back of the Standard" that are not appendices to the Standard and do not form part of the Standard.



*In addition to these nine agenda projects, IASB has 16 “second priority” projects in which it is working with individual national standard setters on a partnership basis. For a list, see our web site: [www.iasplus.com](http://www.iasplus.com).*

## REVISED TIMETABLE FOR IASB PROJECTS

IASB has postponed its planned issuance of final standards on First-Time Application of IFRS, Improvements to Existing IAS, and Amendments to IAS 32 and IAS 39 from fourth quarter 2002 to some time in 2003. Exposure Drafts on those projects, which had been expected in March, are now scheduled for some time in the second quarter of 2002.

The table below is a revised timetable for IASB’s agenda projects, based on IASB announcements and discussion at Board meetings.

TIMETABLE FOR IASB'S AGENDA PROJECTS	
<b>Preface to IFRS</b>	Exposure Draft was issued 8 November 2001 Comments were due 15 February 2002 Board discussion of comments began in April 2002
<b>Improvements Projects</b>	Exposure Draft in 2 <sup>nd</sup> quarter 2002 Final Standard in 2003
<b>First-Time Application of IFRS</b>	Exposure Draft in 2 <sup>nd</sup> quarter 2002 Final Standard in 2003
<b>Business Combinations</b>	Exposure Draft in 2 <sup>nd</sup> quarter 2002 Final Standard in 2003
<b>Share-Based Payment</b>	Exposure Draft in 4 <sup>th</sup> quarter 2002 Final Standard in 2003
<b>Activities of Financial Institutions</b>	Exposure Draft in 3 <sup>rd</sup> quarter 2002 Final Standard in 2003.
<b>IAS 32 and 39 Amendments</b>	Exposure Draft in 2 <sup>nd</sup> quarter 2002 Final Standard 2003
<b>Performance Reporting</b>	This is a partnership project with the UK Accounting Standards Board. The nature of the initial document to be issued will be decided in 2 <sup>nd</sup> quarter 2002. Other timing is undecided.
<b>Insurance Contracts</b>	Exposure Draft in 4 <sup>th</sup> quarter 2002 Final Standard in 2003

*An observer from Deloitte Touche Tohmatsu attends every IASB meeting, and we publish the Board’s tentative decisions on our web site, [www.iasplus.com](http://www.iasplus.com), usually the next day.*

## IASB AGENDA PROJECT UPDATES

In the January 2002 edition of this newsletter, we summarised the tentative decisions made by the Board, through 31 December 2001, on its eight technical agenda projects. You can view or download a copy of that newsletter at [www.iasplus.com](http://www.iasplus.com).

On the next several pages, we present an **update** of additional decisions made by the Board during January through March 2002 on the following projects:

- ☐ Preface to IFRS (page 8)
- ☐ Improvements to IAS (page 9)
- ☐ First-Time Application of IFRS (page 13)
- ☐ Business Combinations (page 15)
- ☐ Share-Based Payment (page 17)
- ☐ Activities of financial Institutions (page 17)
- ☐ Amendments to IAS 32 and IAS 39 (page 17)
- ☐ Performance Reporting (page 18)
- ☐ Insurance Contracts (page 20)

*The new Preface to IFRS will replace the existing Preface to IAS, which was last revised in 1982 and which reflects the structure and procedures of the former IASC.*

## PROJECT UPDATE: PREFACE TO IFRS

In November 2001, IASB invited comments on a new Preface to International Financial Reporting Standards (IFRS). Comments were due by 15 February 2002. In the January edition of this newsletter, we summarised the key provisions of the proposed Preface. (You can get a copy at [www.iasplus.com](http://www.iasplus.com).)

The table below sets out the main points we made in the Deloitte Touche Tohmatsu letter of comment to IASB on the proposed Preface.

### OUR MAJOR COMMENTS ON THE PROPOSED PREFACE TO IFRS

- ❑ The Preface should address in broad principle the IASB's approach to considering the special reporting needs of small and medium-sized profit-oriented entities.
- ❑ We favour retaining the use of bold italic type for principles and plain type for the elaborative and guidance material. We think this makes the standard more user-friendly and adds clarity. Standards without this distinction can be difficult to follow.
- ❑ We support the Board's intention to provide "robust and useful guidance to illustrate the basic principles". We are concerned that, in an international environment, there can be a tendency in some jurisdictions to regard guidance as "optional". To ensure credibility of IAS/IFRS financial reports, IASB should do all it can to discourage that view.
- ❑ We believe that the preface should clarify the procedures for IASB Board involvement in issuance of draft Interpretations.
- ❑ We support including within the mandate of the IASB information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions.
- ❑ The proposed Preface notes that IFRS set out presentation requirements. We believe that IASB should expressly acknowledge here that presentation is not limited to printed financial statements and printed reports but also includes accounting information presented in electronic media (such as Internet web sites). Otherwise, the term "presentation" will be interpreted too narrowly.
- ❑ We support stating in the Preface that minimum exposure periods will be at least 90 days for IASB Discussion Documents and Exposure Drafts and 60 days for Draft Interpretations. In an international environment, translation and solicitation of input at the national level by national accountancy bodies are required.
- ❑ The Preface should specify how potential IASB and IFRIC agenda projects are identified and how they are formally added to IASB's and IFRIC's agendas, including whether public input will be solicited.
- ❑ All comment documents issued by the IASB should be made available on the Internet without charge.
- ❑ The Preface should set out IASB's policy as to when re-exposure is required.
- ❑ The Preface should state a "plain English" objective for all IASB documents.
- ❑ All papers that will be discussed by the IASB Board and IFRIC at public meetings should be made available to observers at those meetings. Otherwise, discussion is very hard to follow.
- ❑ The lead time for the effective date of a new Standard should not be shorter than one year.



## PROJECT UPDATE: IMPROVEMENTS TO IAS

Here is a summary of tentative decisions made during first quarter 2002.

### IAS 1, Presentation of Financial Statements

*Under the existing IAS 1, the “true and fair override” of an IASB Standard or Interpretation is invoked only in very rare circumstances. The proposed amendment would further restrict those circumstances.*

- ❑ IAS 1.13 will be amended to retain a true and fair override provision, to clarify that it applies to Interpretations as well as to Standards, and to clarify what to do if the national legal or regulatory framework does not permit departure from the Standard or Interpretation, as follows: In the extremely rare circumstances in which management concludes that compliance with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework:

–if the relevant regulatory framework requires or otherwise does not prohibit a departure from the requirement, the entity makes that departure and discloses information about the departure; or

–if the relevant regulatory framework prohibits departure from the requirement, the entity, to the maximum extent possible, reduces the perceived misleading aspects of compliance by disclosing information about the nature and amounts of the items involved.

- ❑ Disclosures will be added for key assumptions and any management judgements made with regards to measurement issues.

### IAS 16, Property, Plant and Equipment

*Currently, gain or loss is not recognised on exchanges of similar assets.*

- ❑ Exchanges of similar items of property, plant, and equipment will be recorded at fair value, and gain or loss will be recognised, unless neither the fair value of the asset given up nor the fair value of the asset acquired can be measured reliably. Currently, no gain or loss is recognised under IAS 16.22. This principle will also be extended to previously recognised intangible assets by amending IAS 38. Exchanges of similar goods and services would continue to be accounted for at carrying amounts.

*IAS 16.12 currently suggests that a component approach to asset recognition and depreciation is sometimes appropriate, but it does not provide guidance as to the appropriate circumstances.*

- ❑ IAS 16 will require a components approach for depreciation. Each material component of a composite asset with different useful lives or different patterns of depreciation is accounted for separately for the purpose of depreciation and accounting for subsequent expenditure (including replacement and renewal). See IAS 16.12.

*Currently, incidental revenue during construction is often treated as a reduction of an asset's cost for practical reasons.*

- ❑ Regarding cost capitalisation, references to start-up costs, pre-operating costs, pre-production costs, and similar items will be removed from IAS 16.17, and more general principles will be provided.
- ❑ SIC 6 on costs of modifying software is to be withdrawn.
- ❑ Incidental revenue (and related expenses) during the construction or development of property, plant, or equipment will be reported as items of income and expense, not as a reduction of the capitalised costs.
- ❑ An entity should review an asset's estimated useful life at each balance sheet date, rather than 'periodically' as currently required by IAS 16.49.
- ❑ Items of property, plant, and equipment held for sale will continue to be depreciated and tested for impairment. IAS 36.9(f) will be amended to include ceasing to use the asset as a trigger for impairment review.

### IAS 17, Leases

- ❑ Initial direct costs incurred by lessors should be capitalised and amortised over the lease term. The alternative in IAS 17.33 to expense initial direct costs up front will be eliminated. The costs to be capitalised will be direct and incremental costs and may include both internal and external costs.

*Many property developers and valuers have urged IASB to allow long-term leases of land to be treated as finance leases so that the leased land component of investment property can be measured at fair value. IAS 17.11 currently requires all leases of land to be treated as operating leases (no asset recognised).*

*Removing the option to capitalise borrowing costs would have resulted in divergence, rather than convergence, with the accounting standards in many countries.*

*Parent-company (unconsolidated) financial statements do not provide information about all of the resources and activities under the control of the management of the parent company. Even if a subsidiary is “virtually” wholly owned, its debt-holders and minority shareholders are generally better served with consolidated statements.*

## PROJECT UPDATE: IMPROVEMENTS TO IAS, continued

- ❑ The definition of investment property in IAS 40 will be amended so that property rights held under an operating lease can qualify as investment property if the other conditions for investment property are met and the lessee's policy is to account for investment property using the fair value model. IAS 17 will be amended so that, in this case, the lessee would account for the lease as if it were a finance lease.

### IAS 21, Changes in Foreign Exchange Rates

- ❑ IAS 21 would be amended to take account of the situation recently experienced in Argentina, where a currency is suspended and this straddles a year end. At present the standard is silent on this issue. The revision states that where there is non-exchangeability of a currency at the year-end, the rate that should be used is the exchange rate at the date when exchangeability is first re-established.
- ❑ Translation of comparative prior period amounts will be as follows:
  - (a) if the functional currency is not hyperinflationary, translate comparative assets and liabilities at the closing rate and translate comparative income and expense items at historical exchange rates at the time the income was earned and expenses incurred.
  - (b) if the functional currency is hyperinflationary and the presentation currency is also hyperinflationary, translate all balance sheet and income statement items at the current closing rate.
  - (c) if the functional currency is hyperinflationary and the presentation currency is not hyperinflationary, prior period comparative amounts remain as previously reported, that is, they are not updated for subsequent changes in price levels or exchange rates.

### IAS 23, Borrowing Costs

- ❑ Based on discussions with the liaison standard-setters, the Board agreed to remove from the Improvements Project the issue of whether eliminate the choice in IAS 23 of capitalising borrowing costs that meet certain conditions. At previous meetings, the Board had tentatively decided to remove this option from IAS 23.

### IAS 24, Related Party Disclosures

- ❑ The Board had previously agreed that financial statements of parent companies and wholly owned subsidiaries could omit IAS 24 disclosures only if those financial statements are published in a single document together with the consolidated financial statements for the group to which the entity belongs. At its March meeting, the Board reverted back to the existing IAS 24.4, which allows the exemption if the parent company or wholly-owned subsidiary financial statements are made available at the same time as the consolidated statements.
- ❑ The Board agreed to require separate disclosure of related party transactions and outstanding balances for key management personnel.

### IAS 27, Consolidated Financial Statements

- ❑ The IAS 27.8 exemption from consolidation for wholly owned subsidiaries would be tightened by requiring the following conditions:
  - (a) the wholly-owned subsidiary's equity and debt securities are not publicly traded;
  - (b) it is not in the process of issuing equity or debt securities in public securities markets;
  - (c) the immediate parent or ultimate parent publishes consolidated financial statements that comply with IFRS; and
  - (d) if the subsidiary is not wholly owned, the parent obtains the approval of the owners of the minority interest.

## PROJECT UPDATE: IMPROVEMENTS TO IAS, continued

### IAS 27, Consolidated Financial Statements (continued)

- ❑ If the exemption is applied, an entity should disclose:
  - (a) the reason for not publishing consolidated financial statements; and
  - (b) the name of the parent that publishes consolidated financial statements that comply with IFRS.
- ❑ Minority interests should be presented in equity, separately from parent shareholders' equity. However, current requirements for accounting recognition and measurement of minority interest should not be changed in the improvements project. The consequences of equity classification (for example, step acquisitions and dilution gains and losses) are to be discussed in phase II of the business combinations project.
- ❑ SIC 33, Potential Voting Rights, will be incorporated into IAS 27. However SIC 12, Consolidation - Special Purpose Entities, will not be. The Board will reconsider consolidation of special purpose entities in a future project.
- ❑ The exemptions from consolidation would be tightened:

Temporary investment: IAS 27.13(a) excludes a subsidiary from consolidation when control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future. The Board agreed that this exception should be retained and have clarified that such subsidiaries, when excluded from consolidation, should be measured at fair value with changes in fair value included in the profit and loss of the period of change in accordance with IAS 39. Also, if there is no likelihood of sale within 12 months, then the subsidiary should be consolidated.

Restrictions on transfer of funds: IAS 27.13(b) excludes a subsidiary from consolidation 'when it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent'. A similar exception is included in IAS 28.8(b) and IAS 31.35(b). The exemption will be removed, and IAS 27 (and IAS 28 and IAS 31) will be revised to indicate that severe long-term restrictions on the ability to transfer funds might preclude control (significant influence). In addition, it was agreed that disclosure of any restrictions is necessary, but that IAS 1 probably already requires this.

### IAS 28, Equity Method of Accounting

- ❑ An investor's share of losses of an associate should be recognised only to the extent of the interest in the associate.
- ❑ IAS 28 will be amended to clarify that an interest in an associate is the carrying amount of the investment in equity shares plus other interests such as loans and long-term advances. This affects the base to be reduced when an associate incurs losses. SIC 20, Equity Accounting Method—Recognition of Losses, will be rescinded.
- ❑ SIC 3, Elimination of Unrealised Profits and Losses on Transactions with Associates, and SIC 33, Potential Voting Rights and Allocation of Ownership Interests, will be incorporated into IAS 28.
- ❑ All references to consolidated financial statements would be removed from IAS 28, to make it clear that when accounting for associates the equity method should be used, except for in the individual financial statements of the investor where the proposed amendments to IAS 27 will apply (that is, cost or IAS 39).
- ❑ If an investor does not prepare consolidated financial statements because it does not have any subsidiaries, it must use the equity method to account for investments in associates. IAS 28.14(a) and (c) would therefore be deleted.

*Presentation of minority interest in equity is consistent with their equity interest in certain of the net assets that are included in the consolidated net assets.*

*Similar exemptions are provided in IAS 28 and IAS 31, and similar "tightening" of these exemptions would be done in those Standards as well.*

## PROJECT UPDATE: IMPROVEMENTS TO IAS, continued

*Although some IAS allow more accounting choices in parent company financial statements than in consolidated statements, that does not justify departure from any IAS (for instance, for the purpose of reporting distributable income under the law) if the parent statements are identified as conforming to IAS.*

*Currently, IAS 31 “does not indicate a preference for any particular treatment” in the separate (non-consolidated) financial statements of a venturer.*

### IAS 27 and IAS 28, Parent Company Statements

- ❑ The same standards should apply to parent company financial statements and consolidated financial statements.
- ❑ Parent company statements that are described as conforming to IAS must comply fully with IAS.
- ❑ The separate financial statements of a parent should disclose:
  - reasons why separate statements are prepared;
  - the existence of consolidated or equity method financial statements; and
  - description of the method used to account for investments in subsidiaries, associates, and jointly controlled entities
- ❑ In the investor’s separate financial statements, investments in subsidiaries, associates, and joint ventures should be either measured at cost or accounted for as a financial asset under IAS 39. The alternative to use the equity method would, therefore, be removed. The same method must be used for each of those categories of investments. It will be clarified that IAS 39 can be used even though investments in subsidiaries, associates, and joint ventures are otherwise excluded from the scope of IAS 39.
- ❑ Investments in subsidiaries excluded from consolidation and accounted for under IAS 39 in the consolidated financial statements should also be accounted for under IAS 39 in the parent’s separate financial statements. There is no reason for a change in treatment between the individual and consolidated statements.

### IAS 31, Investments in Jointly Controlled Entities

- ❑ All references to consolidated financial statements would be removed from IAS 31, to make it clear that paragraphs 25-37 apply to the financial statements of a venturer whether those statements are consolidated or company-only.
- ❑ If an investor does not prepare consolidated financial statements because it does not have any subsidiaries, it must use the equity method to account for investments in jointly controlled entities. IAS 31.38 would be amended.

### IAS 28 and IAS 31, Venture Capital Investments

- ❑ Venture capital investments held by venture capital organisations, mutual funds, unit trusts, and similar entities, for which there is significant influence or joint control, should not be accounted for using the equity method under IAS 28 or using proportionate consolidation under IAS 31. Instead, they should be measured at fair value under IAS 39 as a financial asset held for trading. Therefore, there should be a scope exclusion in IAS 28 and IAS 31 for such venture capital investments that are measured at fair value in accordance with established industry practice. (Of course, they would be consolidated if they were controlled.)
- ❑ The Board intends to develop a definition of venture capital investment.

### IAS 40, Investment Property

- ❑ Reconsideration of IAS 40’s choice of accounting for investment properties under either a fair value model or a cost model will not be part of the Improvements Project. The Improvements Exposure Draft will note that the Board intends to address this issue in conjunction with the Performance Reporting project.
- ❑ The definition of investment property will be amended so that property rights held under an operating lease can qualify as investment property if the other conditions for investment property are met and the lessee’s policy is to account for investment property using the fair value model. IAS 17 would be amended so that, in this case, the lessee would account for the lease as if it were a finance lease.

## PROJECT UPDATE: FIRST-TIME APPLICATION

*The general approach under the Board's tentative decisions in this project is that IFRS applicable at the date of adoption should be applied retrospectively (with a few exceptions) when a company switches from national GAAP to IAS.*

*All comparative information presented should be restated under IFRS. Companies will need to prepare for the conversion to IFRS sufficiently in advance, in order to collect the information to prepare an opening balance sheet under IFRS at the "date of transition" to IFRS (the beginning of the earliest year presented).*

The Board tentatively agreed on the following key general principles in its November 2001 meeting:

- ❑ the First-Time Application Standard will apply to the first annual financial statements in which an entity adopts IFRS as its primary basis of accounting and explicitly states its compliance with all IFRS;
- ❑ all information presented in a first set of IFRS financial statements should be prepared using IFRS in effect at the balance sheet date of the latest financial year presented;
- ❑ limited exceptions to the restatement of assets and liabilities in the opening balance sheet are considered:
  - for business combinations that occurred before the date of transition to IFRS;
  - where restatement under IFRS requires undue cost and effort. If this is the case, an enterprise should measure the asset or the liability at fair value at the date of transition and this amount will become the "deemed cost" of the asset or liability for subsequent measurement purposes; and
  - for employee benefits: at the date of transition, an enterprise should measure its defined benefit employee obligations as the difference between the present value of the defined benefit obligation and the fair value of any plan assets (all actuarial gains or losses and past service cost should be recognised at the date of transition).

The following key tentative decisions were made in the first quarter of 2002:

- ❑ If restatement under IFRS requires undue cost or effort, the ability to measure an asset or liability at the date of transition at fair value should be limited to items of property, plant, and equipment and investment properties accounted for under the cost model (under the alternative in IAS 40, Investment Property).
- ❑ Further relief from the restatement of cost under IFRS should be granted where an event of a special nature in the life of an enterprise (such as a privatisation or an IPO) fundamentally affected a policy of cost-based measurements under local GAAP.
- ❑ No special relief should be granted for internally generated intangible assets that exist at the date of transition to IFRS and that have not been recognised. However, an entity will restate in the opening balance sheet only those internally generated intangible assets that exist at the date of transition to IFRS for which it can be demonstrated that appropriate systems existed in the past to determine whether the recognition requirements of IAS 38, Intangible Assets, were met at a previous point in time.
- ❑ Consistent with the tentative decisions under the project on Business Combinations, an entity should not recognise any negative goodwill as a separate item in its opening balance sheet. Any negative goodwill separately recognised under local GAAP shall be eliminated against retained earnings.



## PROJECT UPDATE: FIRST-TIME APPLICATION, continued

- ❑ The Board considered how an entity that is applying IFRS for the first time would apply the provisions in IAS 39. The Board tentatively decided:
  - Consistent with the proposals for the revisions to IAS 39 and unlike the current version of IAS 39, no relief should be granted for the restatement of financial instruments that have been derecognised under local GAAP, where the derecognition criteria under IFRS were not met.
  - To include the hedging transition provisions of IAS 39 but to rewrite them so that they encompass the related questions and answers developed by the IAS 39 Implementation Guidance Committee. The hedging transition provisions would apply at the date of transition to IFRS.
  - Not to establish special transitional provisions for embedded derivatives. Therefore, at the date of transition to IFRS, embedded derivatives must be split out or, alternatively, the hybrid instrument in which they are embedded must be accounted for at fair value in its entirety.
  - At the date of transition to IFRS, the cumulative adjustment to fair value for financial assets classified as available-for-sale and remeasured to fair value should be reported in retained earnings definitively, and not in a separate component of equity. When the financial asset is subsequently sold, only those gains or losses that arose after the date of transition to IFRS will be ‘recycled’ and reported in net profit or loss.
- ❑ An entity must present a reconciliation (and explanation of reconciling items) of the following amounts presented under local GAAP and restated under IFRS:
  - net profit or loss of the last financial year where it was presented under local GAAP; and
  - beginning and closing equity of the last financial year where they were presented under local GAAP.

If an entity presents an interim financial report under IAS 34 for part of the annual period covered by its first IFRS financial statements, each such interim financial report should include the reconciliations indicated above, as well as reconciliations of the amounts presented for net profit or loss during the last comparative interim period presented under local GAAP.



*The uniting (pooling) of interests method of accounting for business combination would be abolished. Mandatory amortisation of goodwill would be replaced by non-amortisation plus an impairment test. National accounting standards in Australia, Austria, Canada, Czech Republic, Hungary, New Zealand, and United States (among others) have already banned the uniting (pooling) method.*

## PROJECT UPDATE: BUSINESS COMBINATIONS

- ❑ In March, the Board reaffirmed its key tentative conclusions reached at prior meetings that:
  - All business combination transactions within the scope of the Standard should be accounted for by the purchase method.
  - Goodwill should not be amortised but, rather, should be subject to an impairment test.
- ❑ Three Board members indicated that they were considering dissenting to the exposure draft and a fourth indicated he probably would not dissent to the exposure draft but might dissent to the final Standard unless comments on the ED persuaded him otherwise.

### Scope

- ❑ The Board has agreed that business combinations involving entities under common control (that is, business combinations in which all of the entities participating are ultimately controlled by the same party both before and after the business combination) should be excluded from the scope of the revised Standard. Accounting for such transactions will be addressed in phase II of the business combinations project.
- ❑ Rather than exempting combinations of mutual entities and combinations of entities by contract, the new IFRS would have a delayed effective date for those business combinations pending completion of Phase II of the business combinations project; meanwhile existing IAS 22 would continue to apply.

### Minority Interests

- ❑ The Board agreed that IAS 27 should be amended as part of the improvements project to require minority interests to be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity. It was also clarified that this amendment does not prejudice issues regarding minority interest transactions; nor should it lead to entities changing their current practices for recognising and measuring minority interests.
- ❑ Acquisitions of some or all of the minority interests in a subsidiary by the parent, by the subsidiary itself, or by another entity within the group will not be included in the scope of the revised business combinations Standard. The accounting for such transactions will be addressed as part of the joint IASB/FASB project on issues related to application of the purchase method (Phase II of IASB's business combinations project).

### Disclosure

Some of the disclosures that will be required as a result of the project include:

- ❑ For each significant business combination, disclose the carrying amounts of each entity's assets and liabilities immediately before the business combination and amounts recognised as at the date of acquisition. Such disclosures will be required in aggregate for those business combinations that are individually immaterial.
- ❑ For interim reporting purposes, the disclosures in IAS 34 will be conformed to those that will be required in the annual financial statements.

## PROJECT UPDATE: BUSINESS COMBINATIONS, continued

- ❑ In relation to the calculation of recoverable amount of goodwill and intangible assets with indefinite useful lives, disclose:
  - The key assumptions on which the cash flow projections are based should be disclosed, along with sensitivity analysis. However, such disclosures will not be required where net selling price exceeds carrying amount for a CGU and is determinable using observable market prices.
  - If assumptions do not reflect past experience, that fact and the justification must be disclosed.
  - A description and amount of the cash flows are to be disclosed.
  - If the projected period is greater than 5 years, disclosure is to be expanded beyond those in IAS 36.

Such disclosures should be made at a segment level unless goodwill or identifiable intangible assets with indefinite lives are a significant portion of a cash-generating unit (CGU) or the basis of determining recoverable amount differs between CGUs, in which case disclosure should be at a CGU level.

In addition, disclosures are proposed where assets are reallocated between segments or CGUs for impairment test purposes.

- ❑ The IAS 38 disclosures will be amended to reflect the tentative decisions to allow intangible assets to have an indefinite useful life and to introduce the requirement for comparative information.
- ❑ The disclosures from SIC 28, 'Date of Exchange' and Fair Value of Equity Instruments, and SIC 22, Subsequent Adjustment of Fair Values and Goodwill Initially Reported, will be incorporated, into the Standard. Therefore amongst other things, disclosures will be required if the price used is different from market price.
- ❑ The aggregate profit or loss for the year must be disclosed for a newly combined entity as if the business combination had occurred at the start of the year, unless such disclosures would require undue cost and effort.

### Identifiable Assets and Liabilities

- ❑ Intangible assets acquired in a business combination should be recognised separately from goodwill if it arises from contractual or legal rights or is separable. An 'assembled workforce', in the absence of a legal contract, will not meet the recognition criteria for an intangible asset. However, a labour contract can be an asset if it is at a favourable price.
- ❑ IAS 38 will be amended so it no longer requires a detailed impairment calculation for goodwill or other intangibles being amortised over an estimated life longer than 20 years.
- ❑ If the estimated life of an intangible asset is changed from indefinite to a finite life, such change will be accounted for as a change in estimate (prospectively).
- ❑ A liability will not be recognised for an obligation that is triggered as a result of a business combination (such as a 'golden parachute' payment). This will be an expense of the combined entity.
- ❑ IAS 22.71 currently requires that acquired assets or liabilities identified after the end of the 'allocation period' be recognised with a corresponding credit to income. The revised Standard will say that if the asset or liability was overlooked at the time of the acquisition, it should be recognised as a correction of an error (restatement) rather than as income. Similar requirements will exist where the initial measurement value is revised.

*While the Board has not yet taken a formal vote on whether to require recognition or disclosure of the fair values of share-based payments, Board member comments indicate a general sympathy with a recognition approach.*

*The replacement for IAS 30 will focus on activities (deposit-taking, lending, and securities business) regardless of the type of entity that undertakes those activities.*

*Other key changes to IAS 39 that have been reported in prior issues of this newsletter:*

- ❑ *An enterprise may elect to measure most financial assets and financial liabilities at fair value, instrument by instrument, by designating them as part of the held-for-trading portfolio when they are acquired or issued.*
- ❑ *The option to measure at fair value will apply to originated loans under certain circumstances (for example, mortgage loans) by designating them as available-for-sale.*
- ❑ *Financial assets that do not have a fixed maturity will be eligible for classification as a loan or receivable originated by the entity.*
- ❑ *Changes in fair values of available-for-sale financial assets will be reported in equity until the asset is sold. The current IAS 39 option of reporting the value change in net income will be eliminated.*

*continued...*

## PROJECT UPDATE: SHARE-BASED PAYMENT

The Board concluded that if IASB were ultimately to require either recognition or disclosure of the fair values of share-based payments, disclosure should be required of:

- ❑ which model was used to determine the fair value, and
- ❑ inputs to that model, including which interest rate is used (both % and which market the rate comes from); historical and expected price volatility and discussion of the reasons for any differences between the two; and historical and expected dividend yield and discussion of the reasons for any differences between the two.

## PROJECT UPDATE: ACTIVITIES OF FINANCIAL INSTITUTIONS

This project was not discussed by the Board during its first-quarter 2002 meetings. The project involves reconsideration of IAS 30 and focuses on disclosure and presentation issues relating to deposit-taking, lending, and securities business activities. Goals of the project are to eliminate redundancies between IAS 30 and other Standards, bring the existing IAS 30 requirements up to date, and to enhance disclosures, particularly in the areas of risk exposure, asset quality, and capital adequacy.

## PROJECT UPDATE: AMENDMENTS TO IAS 32 and 39

### Derecognition

The derecognition provisions of IAS 39 will be clarified by establishing as the guiding principle a ‘continuing involvement’ approach that disallows derecognition to the extent to which the transferor has continuing involvement in an asset or a portion of an asset it has transferred.

A transferor has a continuing involvement when:

- ❑ It could, or could be required to, reacquire control of the transferred asset (for example, if the financial asset can be called back by the transferor, the transfer does not qualify for derecognition to the extent of the asset that is subject to the call option); or
- ❑ Compensation based on the performance of the transferred asset will be paid (for example, if the transferor provides a guarantee, derecognition is precluded up to the amount of the guarantee).

No exceptions are made to the general principle. The following existing exceptions in IAS 39 are eliminated:

- ❑ The notion that the transferor must not retain substantially all of the risk and returns of certain assets in order for any portion of those assets to qualify for derecognition; and
- ❑ The transferee ‘right to sell or repledge’ condition for derecognition.

Guidance will be provided dealing with pass-through arrangements. When the transferor continues to collect cash flows from the transferred asset, additional conditions must be met for a transfer to qualify for derecognition, including:

- ❑ The transferor has no obligation to pay cash flows to the transferee unless it collects equivalent cash flows from the transferred asset;
- ❑ The transferor cannot use the transferred asset for its benefit; and
- ❑ The transferor is obligated to remit on a timely basis any cash flows it collects on behalf of the transferee.

*Still more key changes to IAS 39 that have been reported in prior issues of this newsletter:*

- ❑ *Embedded derivatives contained in a liability host contract need not to be split out if the enterprise elects to measure the hybrid instrument at fair value with changes recorded in the income statement.*
- ❑ *Hedges of firm commitments will be classified as fair value hedges, not cash flow hedges.*
- ❑ *Gain or loss on a derivative acquired to hedge the acquisition cost of an asset or liability must remain in equity and separately amortised to net profit or loss in the period(s) in which the acquired asset or liability affects net profit or loss, such as through depreciation expense, interest income, or cost of goods sold. That is, “basis adjustment” will be prohibited.*

*The Board is leaning toward a single performance statement for all recognised income and expense items, with no “recycling”. Also, no more extraordinary items, and all changes in accounting policy reflected by retrospective restatement (not cumulative effect in earnings).*

## PROJECT UPDATE: AMENDMENTS TO IAS 32 and 39, continued

### Valuation Techniques

The Board discussed valuation techniques, which is a major issue following the collapse of Enron. The Board agreed that more guidance is needed on fair value but was unsure of what else to include as the objective was felt to be very clear. Additional disclosure regarding the valuation technique was decided to be the best solution.

### Impairment of Investments and Equity Carried at Fair Value

Impaired investments and equity instruments should be written down to the impaired amount with the write down going through the income statement. No reversal of the impairment is allowed, as it is permanent. This treatment tends to converge with the current US treatment. It was also agreed that debt and equity instruments must be treated in the same way.

### Hedging of Firm Commitments

- ❑ Hedges of firm commitments should be classified as fair value hedges (which is the US treatment in SFAS 133), and not as cash flow hedges (which is the current IAS 39 treatment).
- ❑ Basis adjustment will be prohibited when a cash flow hedge of a forecasted transaction results in the recognition of an asset or a liability. This proposal would converge with US GAAP.

### Transition

The old paragraph 39.172(h) will be replaced. If a financial instrument qualified for derecognition under the old rules but did not qualify for derecognition under the new rules, the financial instrument must be re-recognised on the balance sheet.

### SIC 5 and SIC 17

SIC 5, Classification of Financial Instruments—Contingent Settlement Provisions, and SIC 17, Equity – Costs of an Equity Transaction will be incorporated into IAS 32.

## PROJECT UPDATE: PERFORMANCE REPORTING

This project was discussed by the Board at its January and February 2002 meetings, though no tentative decisions were made. The discussions continued to suggest, however, strong support within the Board for the following broad principles:

- ❑ **Single performance statement.** All recognised income and expense items should be presented in a single statement of performance.
- ❑ **All-inclusive.** The statement should include the effects of all changes in net assets during the period other than transactions with owners.
- ❑ **Predictive ability.** Information in the performance statement should help to predict rates of change so the users can make better judgements. Segment reporting will help with this. Segment reporting may be aggregated in the performance statement.
- ❑ **No ‘recycling’.** Recycling of income and expense items should not be allowed; that is, items should be reported in the performance statement as income or expense only once.

## PROJECT UPDATE: PERFORMANCE REPORTING, continued

- ❑ **Realised vs. unrealised.** Profits should not be based on a notion of realisation. Realisation has different meanings in different countries. In Europe and Asia realisation refers to net profit available for distribution. However, in the United States realisation refers to capital maintenance. A critical issue in Europe would be whether 'mark to market' gains are distributable. The Board's view is that distributable profits is not an accounting issue but a legal issue.
- ❑ **Operating vs. non-operating.** A split between operating and non-operating profits should not be made. Many entities have more than one core operation and it can change with time so it is difficult to make such a split and it may not always be appropriate.
- ❑ **Trading vs. holding gains.** Differentiation between trading gains and holding gains seems to be accepted as a working principle.
- ❑ **Fair value changes.** In principle, changes in fair values of assets in a period should be split based on causes, for example, value changes resulting from performance during the period, changes in economic conditions, and changes in market expectations.
- ❑ **Extraordinary items.** The extraordinary item category should be abolished.
- ❑ **Unusual items.** These should not be separately aggregated on the face of the income statement but rather disclosed in the notes.
- ❑ **Costs of capital.** There is a need to distinguish between costs of debt and costs of equity – to enable assessment of return on equity and return on total capital employed. However, the Board has noted practical concerns, including ambiguity as to where pension or insurance costs should be classified.
- ❑ **Gains resulting from accounting choices.** There should be segregation of gains and losses recognised in the period that result from a choice of accounting convention. For example, the profit on disposal of a fixed asset will be different if the accounting convention chosen is historical cost rather than revalued amounts.
- ❑ **Format of performance statement.** A prescribed format and subtotals for the performance statement is needed, but management should be given freedom to specify key performance indicators by having discretion over line items provided and the sequencing of those items. Management would not be allowed to add their own subtotals. Presentation of the performance statement needs to be discussed before the detail of this principle is decided.

At the March meeting, discussion focused on application of the following principle to tangible fixed assets: *For assets and liabilities held at current values, a useful distinction can be made in the performance statement between expected income, unexpected income of the period, and unexpected capital gains and losses.* Discussion centred on the meaning of 'expected' and 'unexpected' in the context of fixed assets. No tentative decisions were made.



## PROJECT UPDATE: INSURANCE CONTRACTS

*The IASC steering committee has been reconstituted as an IASB advisory group. It developed in June 2001 a Draft Statement of Principles to serve as the basis for IASB discussions. The DSOP can be downloaded from IASB's web site ([www.iasb.org.uk](http://www.iasb.org.uk)).*

*While the draft is not a formal IASB discussion document, IASB has invited those who wish to comment to send their views directly to Peter Clark, the project manager: [pclark@iasb.org.uk](mailto:pclark@iasb.org.uk).*

*IASB plans to publish an exposure draft of a Standard in the fourth quarter of 2002.*

The Board has continued to discuss the Draft Statement of Principles (DSOP) prepared by the former IASC Steering Committee. The project focuses on the accounting for insurance contracts, and therefore its application is not limited to insurance companies alone. As a summary of the key decisions previously made:

- ❑ An insurance contract is a contract under which one party (the insurer) accepts an insurance risk by agreeing with another party (the policyholder) to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary (other than an event that is only a change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable). Certain investment-linked contracts may be called insurance contracts but they do not meet the above definition because there is little or no insurance risk. These are covered by IAS 39 rather than this project.
- ❑ Insurance contracts should be measured at entity-specific value.
- ❑ The deferred and fund methods of accounting for insurance contracts should not be used.

The IASB has accepted a number of working hypotheses to guide its future work and during the last quarter has agreed in broad terms with a number of the principles contained in chapters 4-6 and 8-12 of the DSOP. These include:

- ❑ In determining entity-specific value, each cash flow scenario used to determine expected present value should be based on reasonable, supportable and explicit assumptions that:
  - (a) reflect:
    - (i) all future events, including changes in legislation and future technological change, that may affect future cash flows from the closed book of existing insurance contracts in that scenario;
    - (ii) inflation by estimating discount rates and cash flows either both in real terms (excluding general inflation, but including specific inflation) or both in nominal terms; and
    - (iii) all entity-specific future cash flows that would arise in that scenario for the current insurer, even cash flows that would not arise for other market participants if they took over the current insurer's rights and obligations under the insurance contract;
- ❑ The following future cash flows should not be included in determining the expected present value of future pre-tax cash flows arising from the closed book of insurance contracts:
  - (a) income tax payments and receipts;
  - (b) cash flows arising from future insurance contracts;
  - (c) payments to and from reinsurers;
  - (d) investment returns from current or future investments (except for certain performance-linked contracts); and
  - (e) cash flows between different components of the reporting entity.
- ❑ Should insurance liabilities be measured at fair value and fair value is not observable directly in the market, fair value should be estimated by using the above principles, but with the following two differences:
  - (a) fair value should not reflect entity-specific future cash flows that would not arise for other market participants if they took over the current insurer's rights and obligations under the contract; and
  - (b) if there is contrary data indicating that market participants would not use the same assumptions as the insurer, fair value should reflect that market information.



## PROJECT UPDATE: INSURANCE CONTRACTS, continued

- ❑ The entity-specific value of an insurance liability should not reflect the insurer's own credit standing. Conceptually fair value should reflect the insurer's own credit standing, but this would have practical implications that need further investigation that the IASB did not want to undertake at this time.
- ❑ An insurer should not recognise catastrophe provisions relating to possible future claims beyond the end of the contracts included in the closed book. Similarly, an insurer should not recognise equalisation provisions to cover random fluctuations of claim expenses around the expected value of claims.
- ❑ Acquisition costs should be recognised as an expense when they are incurred.
- ❑ The entity-specific value and fair value of insurance liabilities and insurance assets should always reflect risk and uncertainty. Adjustments for risk and uncertainty should be reflected preferably in the cash flows, or alternatively in the discount rate(s), without any double counting.
- ❑ In the exceptional cases when no reliable estimate can be made of the market value margin at initial recognition of an insurance liability or insurance asset, an insurer should set the market value margin at a level that leads to no net underwriting profit or loss from the contract, until a reliable estimate of the market value margin becomes possible.
- ❑ A reinsurance contract should be defined as an insurance contract issued by one insurer (the reinsurer) to indemnify another insurer (the cedant) against losses on an insurance contract issued by the cedant.
- ❑ Reinsurers and cedants should apply all the recognition, derecognition and measurement requirements in principles 2.1-7.6 to all reinsurance contracts.
- ❑ If a reinsurance transaction doesn't qualify for derecognition of the related direct insurance liability under principle 2.3, a cedant should present:
  - an insurance asset arising under reinsurance contracts as an asset, not as a deduction from the related direct insurance liability; and
  - reinsurance premiums as an expense and the reinsurer's share of claim expense as income.
- ❑ The Board rejected the principle that a policyholder should apply principles 3.1 to 7.6 in measuring its contractual rights and obligations under a direct insurance contract. The Board felt that there were acceptable approximations to measure contractual rights and obligations under direct insurance contracts, therefore it was decided that these approximations should always be used, rather than introducing arbitrary dividing lines. It was decided that more work and research needed to be done in this area, especially with regard to any investment components of the contracts.

## PROJECT UPDATE: INSURANCE CONTRACTS, continued

At its meeting in March 2002, the Board considered two alternative approaches to performance reporting:

- ❑ The traditional insurance reporting model, which separates underwriting and investing and financing activities; and
- ❑ The reporting model developed by the Insurance Steering Committee, which would report three components of performance: profit or loss from new business, ongoing profit or loss from prior years' business, and profit or loss from investing and financing activities.

The two approaches are illustrated as follows:

### Income Statement: Traditional insurance reporting model

Premiums earned	xxx	
Claims incurred	(xxx)	
Amortisation of acquisition costs	(xxx)	
Maintenance costs	<u>xxx</u>	
Profit (loss) – underwriting business		xxx
Investing and financing activities:		
Investment income		<u>xxx</u>
Net profit (loss)		xxx

### Income Statement: Steering Committee reporting model

New business–new policyholders:		
EPV of premiums	xxx	
EPV of claims	(xxx)	
Provision for risk and uncertainty	xxx	
EPV of maintenance costs	(xxx)	
Acquisition costs	<u>(xxx)</u>	
Profit (loss) – new business		xxx
Previous years' business:		
Changes in estimates/assumptions	xxx	
Release of risk	xxx	
Change in adjustment for risk and uncertainty	<u>xxx</u>	
Profit (loss) – insurance business		xxx
Investing and financing activities:		
Unwinding of discount – insurance provisions	(xxx)	
Effect of changes in discount rate	xxx	
Return on investments	<u>xxx</u>	
Profit (loss) – investing and financing activities		<u>xxx</u>
Net profit (loss)		xxx

The two approaches to performance reporting differ not only in presentation format but more fundamentally with respect to when profit or loss from insurance contracts should be recognised. The traditional model is a deferral and matching approach. The Steering Committee proposal is to recognise more profit or loss at the time the contract is entered into. The Board felt that further educational sessions are needed on these issues and made no tentative decisions at this meeting.

The Project Manager reported on some of the field visits they are making to insurance companies. Several companies in Canada are using a form of the Steering Committee model. They said it causes substantial added costs and the information content is worth the added cost, not only for the benefit of managers running the business but also directors who are not insurance experts.

*Except for administrative and personnel matters, all of these meetings are open to public observation. Registration forms are on IASB's web site.*

## **UPCOMING MEETINGS OF IASB, SAC, IASCF**

### **International Accounting Standards Board (IASB)**

- ❑ 17-19 April 2002, London, UK
- ❑ 20-24 May 2002, London, UK (20-21 May with chairs of national standard setters)
- ❑ 17-21 June 2002, Berlin, Germany (20-21 June with the Standards Advisory Council)
- ❑ 17-19 July 2002, London, UK
- ❑ 18-20 September 2002, Norwalk, CT, USA

### **Standards Advisory Council (SAC)**

- ❑ 20-21 June 2002, Berlin, Germany

### **Trustees of the IASC Foundation (IASCF)**

- ❑ 12 June 2002, London, UK
- ❑ 19 November 2002, Hong Kong, China

### **International Financial Reporting Interpretations Committee (IFRIC)**

- ❑ 23-24 April 2002, London, UK
- ❑ 23-24 July 2002, London, UK
- ❑ 28-29 August 2002, London, UK
- ❑ 25-26 November 2002, London, UK

## **SHIPPING OF 2002 BOUND VOLUME BEGINS LATER THIS MONTH**

*A CD version of the Bound Volume will also be available, with updates three times per year.*

IASB will print its 2002 Bound Volume of Standards and Interpretations in mid-April. They are taking advance orders by e-mail now. Their priority will be to send copies to subscribers and some others first, then to process advance orders received. Given the volume of orders to be sent, it will take several weeks for shipping, plus delivery time.

There is a single price for the 2002 Bound Volume: £47 or US\$73 (shipping included). You can place an advance order only by sending an email with shipping details and credit card information to [publications@iasb.org.uk](mailto:publications@iasb.org.uk). After shipping has begun, you can place your order on IASB's web site.

## NEWS FROM THE UNITED STATES

### CHAIRMEN OF IASB AND IASCF TESTIFY BEFORE US CONGRESS

*Others who have testified at hearings by this committee include:*

- ❑ *the current Chairman and five former Chairmen of the SEC (see story on next page)*
- ❑ *the current and former Chairmen of FASB*
- ❑ *former Chief Accountants of the SEC*
- ❑ *accounting educators*
- ❑ *representatives of consumer and labour organisations*
- ❑ *CEOs of securities firms and investment organisations*
- ❑ *officers of the American Institute of Certified Public Accountants*
- ❑ *others from the public accounting profession including James E. Copeland, CEO of Deloitte & Touche.*

*Details can be found at the Committee's web site:  
<http://banking.senate.gov>*

IASB Chairman Sir David Tweedie and IASC Foundation Chairman Paul Volcker testified at a hearing conducted by the US Senate Committee on Banking, Housing, and Urban Affairs on 14 February 2002 on "Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: International Accounting Standards and Necessary Reforms to Improve Financial Reporting".

#### Excerpts from Sir David's statement:

*"I do not plan to comment on specific accounting and auditing issues surrounding Enron, although there are many. None of us knows enough about the specifics of the transactions, the information available to the auditors, and the judgements involved to form a solid professional conclusion. As we learn more, we may find the U.S. accounting standards should be improved. If so, we plan to learn from this case and to make sure that international accounting standards do not have similar problems...."*

*"Why have an international standard setter?"*

- ❑ *First, there is a recognised and growing need for international accounting standards.*
- ❑ *Second, no individual standard setter has a monopoly on the best solutions to accounting problems.*
- ❑ *Third, no national standard setter is in a position to set accounting standards that can gain acceptance around the world.*
- ❑ *Lastly, there are many areas of financial reporting in which a national standard setter finds it difficult to act alone."*

#### Excerpts from Mr. Volcker's statement.

*"We have had too many restatements of earnings, too many doubts about 'pro forma' earnings, too many sudden charges of billions of dollars to 'goodwill', too many perceived auditing failures accompanying bankruptcies to make us at all comfortable. To the contrary, it has become clear that some fundamental changes and reforms will be required to provide assurance that our financial reporting will be accurate, transparent, and meaningful...."*

*"I think of good financial reporting as resting on three pillars:*

- ❑ *Accounting standards setting out with clarity logically consistent and comprehensive 'rules of the game' that reasonably reflect underlying economic reality.*
- ❑ *Accounting and auditing practices and policies able to translate those standards into accurate, understandable, and timely reports by individual public companies.*
- ❑ *A legislative and regulatory framework capable of providing and maintaining needed discipline."*

## SUPPORT FOR IAS FROM FORMER SEC CHAIRMEN

Five former SEC Chairmen (Roderick M. Hills, Harold M. Williams, David Ruder, Richard C. Breeden, and Arthur Levitt, Jr.) testified at the US Congressional committee hearing on “Accounting and Investor Protection Issues Raised by Enron and Other Public Companies”.

- ❑ Chairmen Breeden and Levitt supported giving the SEC the authority to adopt other standards when it finds shortcomings in FASB’s standards. Chairman Breeden said: “the SEC should be able to adopt International Accounting Standards or standards drafted by other authorities, as well as its own staff, where it finds that FASB standards are not in the interest of investors. The FASB is too slow, standards are too complex, and it is not sufficiently accountable for action.”
- ❑ In his oral testimony, Chairman Levitt praised IASB’s willingness to tackle expense recognition for stock options.
- ❑ Chairman Breeden expressed a preference for IASB’s “Ten Commandments” approach to principle-based standards in contrast to FASB’s “cookbook” approach.
- ❑ Chairman Williams noted: “Rule making itself is very difficult particularly as financial activity and economic transactions become increasingly complicated and sophisticated. For example, the FASB has engaged for a number of years in an effort to create a clear standard for disclosing off-the-books transactions and special purpose entities. They have not been able to come up with a rule acceptable to the business community and the profession. That acceptability should not ultimately be the determining factor.”

## SEC CHAIRMAN URGES “PRINCIPLES-BASED” STANDARDS

In a speech before the Federal Bar Council, SEC Chairman Harvey L. Pitt called for a “move toward a principles-based set of accounting standards”:

*“Present-day accounting standards are cumbersome and offer far too detailed prescriptive requirements for companies and their accountants to follow. That approach, by necessity, encourages accountants to ‘check the boxes’ — that is, to read accounting principles narrowly, to ascertain whether there is technical compliance with applicable accounting principles.*

*“But the first principle should always be the one Judge Henry Friendly articulated four decades ago... If literal compliance with GAAP creates a fraudulent or materially misleading impression in the minds of shareholders, the accountants could, and would, be held criminally liable.*

*“That is why we are advocating fundamental and far-reaching changes in the Financial Accounting Standards Board. We seek to move toward a principles-based set of accounting standards.”*

## NEW SEC DISCLOSURE REQUIREMENTS APPLY TO FOREIGN REGISTRANTS

The US SEC has issued a statement on disclosure requirements for public companies that applies to both domestic and foreign registrants. The statement sets forth the Commission’s views regarding certain disclosures that should be considered by public companies while preparing annual reports for the year recently ended. The disclosure areas are liquidity and capital resources including off-balance sheet arrangements; certain trading activities that include non-exchange traded contracts accounted for at fair value; and effects of transactions with related and certain other parties. The document is available on the SEC’s web site: [www.sec.gov](http://www.sec.gov).

**Details:**

[www.publicoversightboard.org/](http://www.publicoversightboard.org/)

## **US PUBLIC OVERSIGHT BOARD IS DISSOLVED**

The US Public Oversight Board (POB) – which since 1977 has been the independent, private-sector oversight body for the accounting profession – voted to dissolve as of 31 March 2002. The decision was made as a result of a public Statement issued by Harvey L. Pitt, Chairman of the US Securities and Exchange Commission, – precipitated by the Enron case, – that seemed to suggest the SEC's proposals for changing the system of self-regulation of the accounting profession do not include a place for the POB.

Former FASB Chairman Donald J. Kirk, who was vice chairman of the POB, will continue as caretaker head of the POB to allow for orderly completion of peer reviews that are under way. A number of countries have set up or are considering a professional self-regulatory structure similar to that in the United States.

**Details:** <http://www.aicpa.org/news/p010302.htm>

## **AICPA MEMBERS SOUNDLY DEFEAT GLOBAL CREDENTIAL**

By a vote of 83,390 (62.5%) opposed to 50,034 (37.5%) in favour, members of the American Institute of CPAs have defeated the proposal to create a global professional credential. The global credential, alternatively referred to as XYZ, Cognitor, and Strategic Business Professional (IISBP), was proposed as a supplement to the national accounting credential such as CPA and CA. The credential was intended to recognise an individual's ability to integrate knowledge from multiple business disciplines and to apply that knowledge to provide strategic business insight. Besides the AICPA, a number of other national accounting bodies had agreed to participate in the global credential process, including Australia, Canada, France, Italy, and New Zealand. The AICPA had spent about \$5 million over the past three years in developing the initiative.

## **EU COMMISSIONER URGES IAS IN THE UNITED STATES**

In an interview with the Financial Times, Frits Bolkestein, European internal market commissioner, urged the US SEC to replace the 'cookery book' approach of US GAAP with the more 'substance over form' approach of IAS. The Commission plans to require listed European companies to use IAS by 2005. Mr. Bolkestein expressed concern about what he felt is a rule-book approach of US GAAP: "You tick the boxes and out come the answers," he is quoted as saying. "Having rules is a good thing, but having rigid rules is not the best thing.... American investors are no more protected than European investors."

At a minimum, he will ask the SEC to allow US-listed European companies to submit IAS financial statements without reconciliation to US GAAP.



## NEWS ABOUT IAS IN EUROPE

On our website [www.iasplus.com](http://www.iasplus.com), we maintain a comprehensive summary of IAS-related events taking place in Europe. Presented below are the key events of the past three months.

*Several European countries, are considering requiring IAS for all companies, not just listed companies.*

### EUROPEAN PARLIAMENT OVERWHELMINGLY ADOPTS IAS RESOLUTION

By a vote of 492 for, 5 against, and 29 abstentions, on 12 March 2002 the European Parliament endorsed the Commission's proposal that all EU listed companies must follow standards issued by the International Accounting Standards Board in their consolidated financial statements starting no later than 2005. Companies preparing for listing would not be required to follow IAS.

Member States are permitted to decide whether non-listed companies must also follow IAS. Member States also have the option to exempt certain companies temporarily from the IAS requirement – but only until 2007 – in two cases: (1) companies that are listed both in the EU and on a non-EU exchange and that follow another set of internationally accepted standards as the primary basis of their consolidated financial statements and (2) companies that have only publicly traded debt securities. The first exemption would apply mainly to European companies listed in the US that currently use US GAAP for their primary financial statements.

The legislation is unclear as to whether companies from outside Europe whose shares are traded on a European exchange will also be required to follow IAS.

### EUROPE IS DEVELOPING COMPREHENSIVE DISCLOSURE LEGISLATION

With the objective of creating a fully integrated pan-European securities market, the European Commission is preparing a new proposal for a Directive dealing with ongoing and periodic transparency requirements of securities issuers. The proposed Directive is likely to be submitted to the European Parliament and Council by the summer of 2002. The proposal will be based on views expressed by 90 respondents to a July 2001 EC invitation to comment. The main points expressed by respondents related to:

- ❑ Consolidation of all existing periodic and ongoing disclosure obligations into a single legal text.
- ❑ Upgrading of the periodic disclosure obligations of enterprises admitted for trading on a regulated market (including compulsory quarterly reporting).
- ❑ Publication of information via the Internet.
- ❑ Each Member State should have a single authority responsible for public disclosure by securities issuers.

## **EUROPEAN COMMISSION ASKS EUROPEAN SECURITIES' REGULATORS TO BEGIN WORK ON IMPLEMENTING MEASURES ON MARKET ABUSE AND PROSPECTUSES**

In March 2002, the European Commission has asked the Committee of European Securities Regulators (CESR) to start work on technical advice on market abuse and prospectuses. The CESR's advice will be considered by the Commission in preparing possible future technical implementing measures for the proposed Directives on the two areas concerned. This is the Commission's first request to the CESR for technical advice, in line with the new approach to implementing financial services legislation agreed with by the European Parliament on 5 February 2002, on the basis of the Lamfalussy Report on the Regulation of European Securities Markets. The CESR will need to begin work on market abuse and prospectuses now if the EU is to meet the 2003 target date for full integration of European securities markets, set by European leaders at the Stockholm European Council in March 2001 and endorsed at the Barcelona European Council in March 2002, where rapid progress was called for. Any work done by the CESR at this early stage shall not prejudice the negotiations on the final texts of the two Directives. Negotiations on these continue in the European Parliament and Council.

## **EUROPEAN PARLIAMENT ADOPTS REPORT ON SUPERVISION OF FINANCIAL CONGLOMERATES**

On 14 March 2002, the European Parliament adopted a report supporting the general concept of the proposed Directive on financial conglomerates (financial institutions with both banking/investment services as well as insurance activities). The proposed Directive will introduce group-wide supervision of financial conglomerates and require closer co-operation and information sharing among supervisory authorities across sectors. The report also introduces initial steps to converge the rules for financial conglomerates and those for financial institutions dealing in a single financial sector.

## **EUROPEAN COMMISSION'S SERVICES PUBLISH AN ANALYSIS OF THE REPERCUSSIONS OF THE ENRON COLLAPSE**

The European Commission's services published on 18 April 2002 an initial analysis of the collapse of Enron and the repercussions for the European Union. The document was presented at an informal meeting of ECOFIN on 12-14 April 2002. The Ministers welcomed the paper and endorsed the proposals. It presents five key areas of priority and for each area an outline is given of the actions that already have been taken and the actions to be carried out on a European level to prevent a similar incident from happening in the EU.

The actions which have either taken place or now need to be implemented on the five key areas are:

- ❑ **Financial reporting:**
  - A swift adoption of the proposed regulation requiring the use of IAS by listed EU companies by 2005.
  - Finalisation of the endorsement of IAS by the European Commission, to allow listed companies to prepare for the change to IAS.
  - EU and national enforcement mechanisms are to be developed further, to safeguard proper and harmonised application of IAS in the EU.
  - Pressure should be kept on the IAS process to ensure that new IAS continue to follow a principle-based approach, reflecting European concerns as much as possible.
  - The dialogue with the US authorities should be continued to encourage the acceptance of IAS for European filers in the US without reconciliation to US GAAP.
  - Current Accounting Directives should be updated as soon as possible to enable non-listed companies to apply IAS.

## EUROPEAN COMMISSION'S SERVICES PUBLISH AN ANALYSIS OF THE REPERCUSSIONS OF THE ENRON COLLAPSE, continued

- ❑ **Statutory audit:** a recommendation on auditor independence is to be issued by the end of April 2002 and a new Communication on policy priorities with respect to the auditing strategy is expected before September 2002. This Communication will, most likely, prescribe the use of International Standards on Auditing (ISA) by 2005 in the EU and address the possible adoption of a Code of Ethics. Furthermore it will discuss the role of audit committees and give minimum requirements for proper public oversight of the auditing profession at a national and possibly a European level.
- ❑ **Corporate governance:** expansion of the mandate of the High Level Group of Company Law Experts to further review corporate governance issues and speedy adoption of the new Directive on pension funds.
- ❑ **Transparency:** request the Committee of European Securities Regulators to report on supervisory issues related to the increased complexity of derivatives and derivative trading.
- ❑ **Financial analysts and credit rating agencies:** speedy adoption of the proposed Directive on Market Abuse, as well as considering whether the Investment Services Directive (currently in preparation) should include further requirements for financial analysts, and whether there is a need for regulatory intervention regarding credit rating agencies.

*You will find comprehensive information about the use of IAS in Europe on our web site: [www.iasplus.com](http://www.iasplus.com).*

## EFRAG REPORTS ON CONSISTENCY OF “MODERNISED” DIRECTIVES AND IAS

The European Commission is considering revisions to the 4<sup>th</sup> and 7<sup>th</sup> Accounting Directives, which aim to remove all existing conflicts with IAS. The revised Directives are expected to be approved by the end of 2002.

As part of the project EFRAG has been requested to review and confirm that after the proposed revisions there would be no remaining inconsistencies between IAS and the Directives. The EFRAG Technical Expert Group has concluded, in a Report to the Commission, that there are “no actual inconsistencies between IAS 1 to 41 (and related SIC) and the [‘proposed modernised’] 4<sup>th</sup> and 7<sup>th</sup> Directives”. However, EFRAG has recommended clarification of the proposed Directives with respect to:

- ❑ the treatment of fundamental errors and accounting policy changes under IAS 8 where retroactive application is applied;
- ❑ the corridor approach under IAS 19; and
- ❑ reverse acquisitions under IAS 22.

EFRAG also noted that “a number of standards are in the process of being changed and this could result in conflicts with the proposed Directives”.

## FEE STUDY URGES EU TO REQUIRE INTERNATIONAL STANDARDS ON AUDITING (ISA) BY 2005

A discussion paper published by the Federation of European Accountants (FEE) proposes that by 2005 national auditing standards in the European Union should require auditors of financial statements to:

- ❑ Perform audit procedures that comply with International Standards on Auditing (ISA).
- ❑ Report on financial statements in accordance with ISA.
- ❑ Perform additional audit procedures and report on additional matters in response to specific legal, regulatory, or other needs established at a national level.

*International Standards on Auditing are developed by the International Auditing and Assurance Standards Board of IFAC. Their web site is: [www.iaasb.org](http://www.iaasb.org).*

## BIS CHIEF EXECUTIVE URGES GLOBAL ADOPTION OF IAS

Andrew Crockett, General Manager of the Bank for International Settlements and Chairman of the Global Stability Forum, has called global financial reporting standards “a critical pillar in the international financial architecture”:

*“The prospects of acceptance of international standards look better than ever before, a testimony to the efforts made so far. In particular, the European Commission has supported strongly the concept of international standards. It has proposed that quoted companies in the Union produce consolidated accounts according to international standards by 2005. And it has set up a two-tier mechanism (political and technical) for endorsement. At the same time, uncertainties remain. General support by the US authorities has been tempered by what they see as the potential risk of weakening national standards. It is important that the current momentum be maintained and, if possible, increased.”*

Mr. Crockett proposed a three-pronged approach toward implementing global standards:

- ❑ Securing acceptance of international standards by national standard setters and securities regulators.
- ❑ Reconciling the different perspectives of accounting and prudential authorities.
- ❑ Ensuring the monitoring and enforcement of the standards.

## NEW FROM DELOITTE TOUCHE TOHMATSU

*There is no charge to download these documents.*

### PRACTICAL GUIDE TO IAS IS NOW AVAILABLE FOR DOWNLOAD

We are making available without charge the electronic version of *International Accounting Standards: A Practical Guide to Financial Reporting*, by Deloitte Touche Tohmatsu, second edition, published December 2001. This 224 page book includes:

- ☐ Summaries of all current standards.
- ☐ Model financial statements.
- ☐ A presentation and disclosure checklist.

You can download the book in PDF format from [www.iasplus.com/links/pubs.htm](http://www.iasplus.com/links/pubs.htm). It is 2.53mb, so if you do not have a broadband connection, please be patient.

### IAS IN YOUR POCKET GUIDE IS BEING UPDATED AND TRANSLATED

The second English edition of our popular booklet, *IAS In Your Pocket*, will be available in May. It will contain nearly 80 pages of summaries of IASB Standards and Interpretations, background on IASB projects, and other useful IASB-related information. New in this edition: the summaries of Standards will identify potential changes based on tentative leanings of the IASB in its current agenda projects.

In addition to an English edition, the following versions are or soon will be available:

- ☐ **Polish.** You can download the electronic version at [www.iasplus.com/links/pubs.htm](http://www.iasplus.com/links/pubs.htm).
- ☐ **French.** A printed copy may be ordered from Deloitte Touche Tohmatsu, Service Documentation, 185, Av. Charles de Gaulle, 92524 Neuilly-sur-Seine Cedex, France, fax: +33 1 5561 6609, or e-mail: [publications@deloitte.fr](mailto:publications@deloitte.fr)
- ☐ **Danish, Spanish and Chinese.** Available soon.

### DELOITTE TOUCHE TOHMATSU MODEL IAS FINANCIAL STATEMENTS ARE AVAILABLE IN CHINESE

We have developed, and posted on [www.iasplus.com](http://www.iasplus.com), the Chinese version of our IAS Model Financial Statements. The English version is posted as well.

## ACCOUNTING STANDARDS UPDATE IN THE EUROPE-AFRICA REGION

### DENMARK

Contact: *Stig Enevoldsen*

#### Earlier Application of IAS for Danish Listed Companies Recommended

The Copenhagen Stock Exchange has recommended that Danish listed companies consider adopting IAS earlier than the proposed 1 January 2005 date for all EU listed companies.

#### Share Options To Be Expensed By Banks

In December 2001, a Danish bank made an enquiry to the Danish Financial Supervisory Authority regarding the accounting treatment of an employee share option scheme. The Danish Financial Supervisory Authority ruled that the value of share options at grant date must be recognised in the income statement as staff costs, and that any subsequent changes in the value of the share options must also be recognised in the income statement in the line named "changes in value". No further guidance was given on how to measure the value of share options nor on the period for which the changes in value should be recognised in the income statement.

### FRANCE

Contact: *Laurence Rivat*

In January 2002, the Comité d'Urgence of the Conseil National de la Comptabilité (CNC – French standard setter) issued two interpretations on existing standards. These new interpretations are:

- ❑ Avis 2002 – A – with respect to deferred acquisition costs recorded in consolidated financial statements of insurance companies. In some cases, the amount of acquisition costs is less than the amount of revenue relating to loadings on premiums. In this case, deferring the acquisition costs leads to a higher net margin in the first year. Considering this, the Comité d'Urgence has decided that the recognition of the loadings on premiums should match the recognition of the acquisition costs of the same contracts in the income statement. Therefore, the gross acquisition costs should be deferred, limited to the amount of the future net margins and amortised, to match with the recognition of the future net margins.
- ❑ Avis 2002 – B – with respect to payments in return for authorisation to use an UMTS (Universal Mobile Telecommunications Systems) spectrum that will be used by third generation mobile phones. This interpretation supersedes the interpretation 2001-F (see the January 2002 IASPLUS Newsletter), which was issued before the change by the government of the basis for calculation of the payments. Subsequently, it has been decided that the payments relating to the use of the licence will comprise a fixed amount of € 600 million to be paid up-front, and a variable amount to be paid annually, calculated as a percentage of turnover. The licence will be granted for a twenty-year period. It was agreed that the fixed amount of the licence constitutes an intangible asset to be recorded at grant date. Regarding the expected payments related to variable amounts, if the expected payments cannot be measured reliably, they should be recorded as an expense in the period when they arise. If the variable amount can be reliably measured at grant date, then the present value of all payments should be recognised as an intangible asset (with a liability counterpart) at grant date. The difference between the recognised present value and the total actual payments should be recognised as interest expenses over time. The intangible asset should be amortised over the probable period of utilisation, no more than twenty years. An impairment test should be performed at each reporting date, where there is an indication of impairment.



CNC Current Project on “Amortisation, Depreciation and Impairment of Assets”

The preliminary draft proposal to revise requirements for amortisation, depreciation and impairment of assets was released in April 2002. While the proposal tries to harmonise the requirements with IAS 16, Property, Plant and Equipment, IAS 38, Intangible Assets, and IAS 36, Impairment of Assets, differences will remain.

Under this project, the CNC is currently considering a proposal for compulsory non-amortisation of goodwill, subject to an impairment test approach. However, this test, in its current proposed form, would require impairment testing of goodwill under IAS 36, Impairment of Assets, and not under the current proposals under consideration by the IASB.

Comments are due by mid May 2002.

Additional Statements Issued

At its plenary session of 28 March 2002, the CNC approved the following texts applicable to financial institutions:

- ☐ an Avis on accounting for portfolios and groups of homogenous elements;
- ☐ an Avis on accounting for credit risk in case of probable losses.

These texts will become binding when they will be approved by the Comité de la Réglementation Comptable.

A draft Avis was also distributed for comment on accounting for credit risk in case of expected future losses.

**GERMANY**

Contact: *Reinhard Scharpenberg*

**Reform of the German Commercial Code and Stock Corporation Law**

In February 2002, the German Federal Cabinet proposed a bill concerning the reform of the stock corporation law and German Commercial Code (Transparenz- und Publizitätsgesetz–(TransPuG)). This bill will amend the rules of the Commercial Code regarding the preparation of consolidated accounts in order to bring about convergence with internationally accepted accounting standards, e.g. IAS or US GAAP. For example, information to be provided in consolidated financial statements will be enhanced by requiring a statement of changes in equity. Various alternative accounting treatments such as the choice regarding the date of consolidation will be eliminated. Additionally, regulations in the Commercial Code allowing tax regulations to affect consolidated financial statements will be eliminated. Furthermore, capital market oriented companies will be required to prepare consolidated financial statements, even if these companies are included in consolidated financial statements of a parent company.

Various amendments proposed in the TransPuG had already been addressed by the German Accounting Standards Board (GASB) when they issued the exposure draft E-GAS 16 “Duty to Prepare Consolidated Financial Statements and Scope of Consolidation”. E-GAS 16 replaces in fact E-GAS 10, which is no longer considered an exposure draft. However, at its latest meeting, the GASB decided that, given the proposals of the TransPuG, it would not proceed with the due process of E-GAS 16.

**Corporate Governance Codex Published**

Another step to enhance the acceptance of German companies by international investors is the publication of the German Corporate Governance Codex (the Codex) by the government commission "Corporate Governance Codex", in February 2002. Among other issues the Codex addresses reporting and auditing requirements for annual financial statements. It is recommended that consolidated financial statements and interim reports be prepared under internationally accepted accounting principles. Furthermore, the Codex calls for extended disclosures such as compensation of the members of the Management Board or information regarding stock option programs. Compliance with the Codex is on a voluntary basis only. Some German blue chips have already declared that they would follow the Codex.

**Auditing Guidelines on First-Time Application of IAS**

The national professional organisation of auditors (Institut der Wirtschaftsprüfer (IDW)) published an Accounting Practice Statement (IDW RH HFA 1.003) which provides guidelines regarding the first time application of IAS for interim reports. This Accounting Practice Statement has primarily been issued because companies listed on the SMAX segment of the German Stock Exchange are required to prepare financial statements under IAS starting 2002. This Practice Statement requires an opening balance sheet to be prepared for the current period, as well as for the previous period, as if IAS had always been applied. Since comparative IAS financial statements are not available to investors, interim reports should provide information regarding significant accounting policies applied under IAS, particularly stating differences from accounting policies applied under German law.

**GREECE**

Contact: *Manos Pelidis*

The Greek Government recently passed legislation which adopted International Accounting Standards for financial reporting in Greece.

This legislation applies to annual financial statements for periods beginning after December 31, 2002 (i.e. adoption from 2003 onwards), and will be compulsory for all companies listed on the Athens Stock Exchange. The new legislation will apply to both individual and consolidated financial statements and may be optionally applied by any other entity which is audited by the Institute of Certified Accountants Auditors of Greece.

A committee has been set up to consider the detailed implementation of this new legislation. The work of this committee is expected to be completed by June 2002, after which various ministerial decisions will be issued, describing how the adoption will take place.

The Accounting Practices Board (APB) in South Africa (SA) has a policy of harmonising SA Statements of Generally Accepted Accounting Practice (GAAP) with IAS.

With the exception of the effective dates of the Statements, all SA Statements are similar to IAS.

At its October 2001 meeting the APB approved Statement of GAAP AC 137, Agriculture. This accounting statement is based on IAS 41, Agriculture. The effective date of this statement is 1 January 2003. It is expected that this accounting statement will impact the agricultural industry to the extent that it sets out principles for the valuation of biological assets and agricultural produce.

The following SA Exposure Drafts are still outstanding:

- ❑ ED 140: Report of Historical Financial Information to be Included in a Prospectus (No IAS).
- ❑ ED 152 (proposed AC 500) – Preface to the AC 500-series of Statements of Generally Accepted Accounting Practice.
- ❑ ED 153 (proposed AC 501) – Accounting for Secondary Tax on Companies.

Note, the Accounting Practices Committee (APC) is revising the process of issuing local Statements of Generally Accepted Accounting Practice (GAAP). As part of this process they intend to clean out the AC 300-series Opinions and, where required, replace such Opinions with an AC 500-series Interpretation. The AC 500-series pronouncements will be approved for issue by the APB and will have the same authority as the AC 100 - series Statements of GAAP and AC 400 - series Interpretations.

Most of the AC 300 - series Opinions have subsequently been withdrawn and the first two proposed AC 500 - series pronouncements are now being exposed for public comment.

The following SA Draft Interpretations are still outstanding:

- ❑ ED-SIC 428 – Business Combinations – Measurement of Shares Issued as Purchase Consideration
- ❑ ED-SIC 429 – Disclosure – Service Concession Arrangements
- ❑ ED-SIC 430 – Reporting Currency – Translation from Measurement Currency to Presentation Currency
- ❑ ED-SIC 431 – Revenue – Barter Transactions Involving Advertising Services
- ❑ ED-SIC 432 – Intangible Assets – Web Site Costs
- ❑ ED-SIC 433 – Consolidation and Equity Method – Potential Voting Rights
- ❑ ED-SIC 434 – Financial Instruments – Instruments or Rights Redeemable by the Holder

Swedish accounting requirements are based on the Annual Accounts Act incorporating the EU Directives, and on the accounting standards.

In Sweden, there are two standard setters that issue accounting standards. These are the Swedish Financial Accounting Standards Council (SFASC) and the Swedish Accounting Standards Board (SASB). The standards issued by these organisations apply to different companies.

The SFASC Standards apply primarily to listed companies, although the adoption of these standards by non-listed companies is becoming increasingly common. Companies listed on the Stockholm Stock Exchange are obligated by their listing contract with the stock exchange to report in accordance with the SFASC standards. The SFASC base all their standards on IAS. The SFASC standards only differ from IAS standards when IAS is in conflict with Swedish laws, mainly the Swedish Annual Account Act.

For unlisted companies (small, medium and large) the SASB issues standards similar to the SFASC, although with significant relief for small and, to some extent, medium sized companies. The SASB also issues standards and interpretations on specific issues, which are deemed to be of general interest.

### **The Swedish Financial Accounting Standards Council**

Included below are all new standards issued by the SFASC with effective dates during 2001, 2002 and 2003, followed by a brief summary of major differences between the Swedish standard and IAS.

Eight Swedish Accounting Standards issued by the SFASC became effective for financial years beginning on or after 1 January 2001. They were:

- ☐ SFASC 9, Income Taxes (based on IAS 12).
- ☐ SFASC 10, Construction Contracts (based on IAS 11).
- ☐ SFASC 11, Revenues (based on IAS 18).
- ☐ SFASC 12, Property, Plant and Equipment (based on IAS 16).
- ☐ SFASC 13, Associated Company (based on IAS 28).
- ☐ SFASC 14, Joint Ventures (based on IAS 31).
- ☐ SFASC 18, Earnings per Share (based on IAS 33).
- ☐ SFASC 20, Interim Financial Reporting (based on IAS 34).

The major differences between Swedish standards mentioned above and IAS are:

- ☐ SFASC 9, Income Taxes, the Swedish requirements differ from IAS in one material aspect. In certain specific cases, a deferred tax liability may be discounted.
- ☐ SFASC 12, Property, Plant and Equipment, the Swedish standard allows write-ups in some specific cases, which are not in accordance with IAS 16, Property, Plant and Equipment. (IAS 16 allows systematic revaluations of classes of assets, whereas SFASC 12 only allows revaluations under very strict conditions). SFASC 12 also applies to assets relating to agriculture (IAS 41, Agriculture). Finally, any revaluation of tangible fixed assets does not need to be kept up-to-date.
- ☐ SFASC 20, Interim Financial Reporting, according to Swedish requirements, the interim report of the group shall also include profit and loss information relating to the parent company.

Seven new Swedish Accounting Standards issued by the SFASC have become effective for financial years beginning on or after 1 January 2002. Earlier implementation is encouraged. These standards are:

- ❑ SFASC 1:00, Business Combinations (based on IAS 22 and 27).
- ❑ SFASC 15, Intangible Assets (based on IAS 38).
- ❑ SFASC 16, Provision, Contingent Liabilities and Contingent Assets (based on IAS 37).
- ❑ SFASC 17, Impairment of Assets (based on IAS 36).
- ❑ SFASC 19, Discontinuing Operations (based on IAS 35).
- ❑ SFASC 21, Borrowing Costs (based on IAS 23).
- ❑ SFASC 22, Presentation of Financial Statements (based on IAS 1).
- ❑ SFASC 23, Related Party Disclosures (based on IAS 24).

The major differences between the Swedish standards mentioned above and IAS are:

- ❑ SFASC 1:00, Business Combinations, according to Swedish requirements, negative goodwill shall be accounted for as a provision and classified as a liability in the balance sheet. In some cases, subsidiaries can be accounted under the equity method, which is not allowed under IAS. Reverse acquisitions are not covered by SFASC 1:00.
- ❑ SFASC 15, Intangible Assets, the Swedish Annual Account Act prescribes that the useful life for an intangible asset shall not exceed 5 years. If the company estimates that the useful life exceeds 5 years, the reason shall be specified. This disclosure requirement is incorporated in the SFASC.
- ❑ SFASC 23, Related Party Disclosures, includes certain disclosure requirements concerning transactions with group companies. In some cases, these requirements go further than the requirements in IAS 24, Related Party Disclosures.

Furthermore, listed below is a summary of other material differences between Swedish GAAP and IAS.

- ❑ Trading, available-for-sale and derivative financial assets are not recognised at fair value.
- ❑ Trading and derivative liabilities are not recognised at fair value.
- ❑ Hedge accounting is permitted more widely.
- ❑ Pension calculations generally do not use the projected unit credit method, current interest rates or estimates of future salary levels but an accrued benefit obligation based on current salary level.
- ❑ There is no requirement to use the primary/secondary basis for segment reporting.

Five exposure drafts issued by the SFASC are proposed to be effective for financial years beginning on or after 1 January 2003, which will reduce some of these differences. They are:

- ❑ SFASC Exposure Draft, Financial Instruments: Disclosure and Presentation (based on IAS 32).
- ❑ SFASC Exposure Draft, Employee Benefits (based on IAS 19).
- ❑ SFASC Exposure Draft, Investment Property (based on IAS 40).
- ❑ SFASC Exposure Draft, Events After the Balance Sheet Date (based on IAS 10).
- ❑ SFASC Exposure Draft, Segment Reporting (based on IAS 14).

**The Swedish Accounting Standards Board**

Listed below are the new standards issued by the SASB effective for financial years beginning on or after 1 January 2002

- ☐ SASB 2001:1 Income Taxes (based on SFASC 9).
- ☐ SASB 2001:2 Transaction Recording.
- ☐ SASB 2001:3 Property, Plant and Equipment (based on SFASC 12).
- ☐ SASB 2001:4 Statement on How to Account for Inventory Obsolescence.

Areas listed below are those presently being considered by the SASB.

- ☐ Revenue.
- ☐ Impairment of Assets.
- ☐ Provisions, Contingent Liabilities and Contingent Assets.
- ☐ Intangible Assets.
- ☐ Interim Financial Reporting.
- ☐ The Effects of Changes in Foreign Exchange Rates.
- ☐ Non-Profit Entities.
- ☐ Requirement to Maintain Accounting Records.
- ☐ Mergers.

The content of each SASB standard is not further described here. In general, these standards are similar to the SFASC equivalent, but with significant relief for smaller companies.



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