ICAEW FINANCIAL REPORTING FACULTY

JULY 2012

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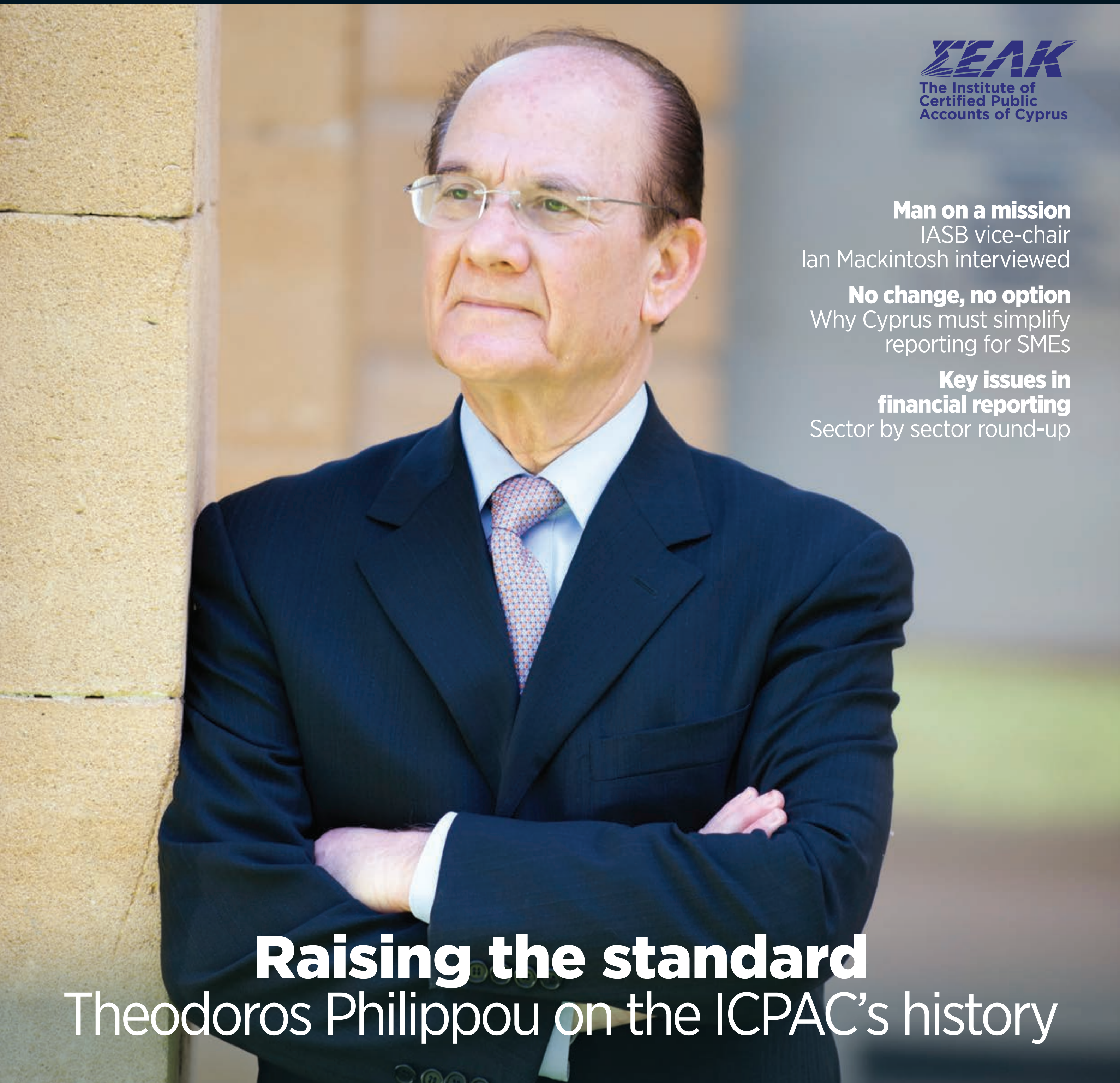
BY ALL ACCOUNTS CYPRUS

"BANKS IN CYPRUS CANNOT AFFORD TO BE COMPLACENT" P18



ΣΕΛΚ The Institute of Certified Public Accounts of Cyprus

Man on a mission
IASB vice-chair Ian Mackintosh interviewed

No change, no option
Why Cyprus must simplify reporting for SMEs

Key issues in financial reporting
Sector by sector round-up

Raising the standard
Theodoros Philippou on the ICPAC's history

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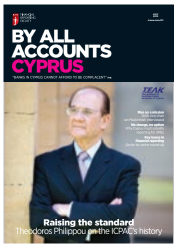

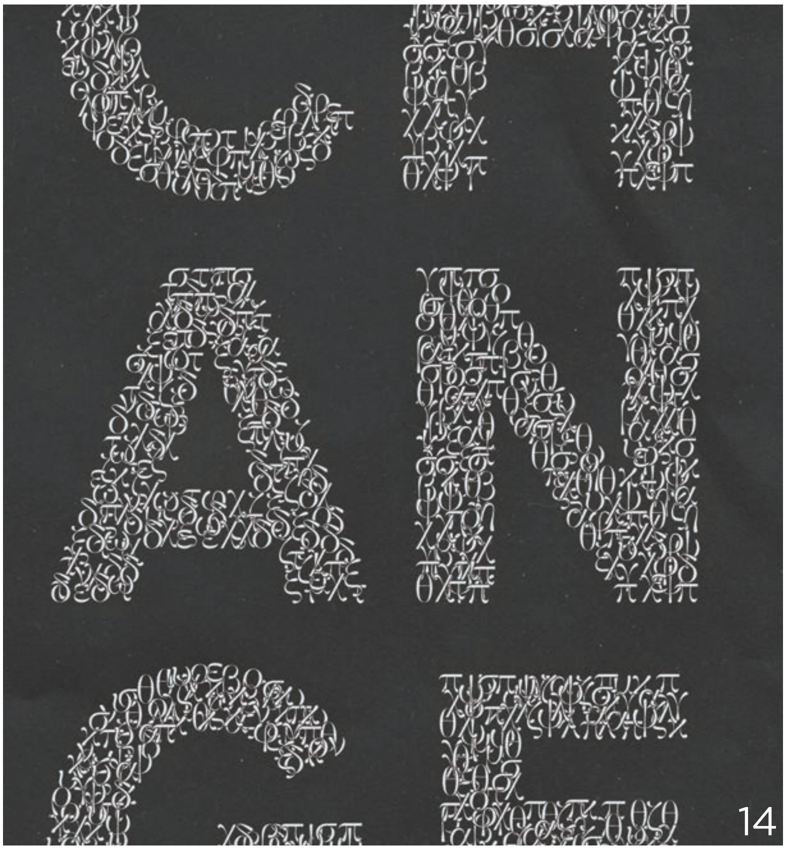
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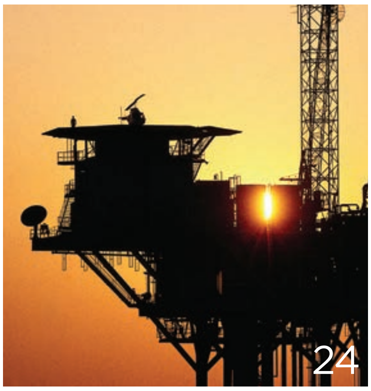
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COVER IMAGE: MARCO ANSALONI, JOE POCHODZAJ, OLIVER BURSTON/IKON IMAGES, CORBIS

"IFRSs did not cause the financial crisis. They produce accounts that are true and fair"

Ian Mackintosh is vice chair of the IASB


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Welcome

I am delighted that ICAEW's Financial Reporting Faculty is publishing, for the first time, a special edition for Cyprus of its acclaimed member journal, *By All Accounts*. Cyprus is an important market for ICAEW, with over 1,400 members and 600 students. It was the first market outside the UK to offer the ACA qualification and it has the largest ICAEW student population outside the UK. Last year we appointed Christiana Diola to our team in Cyprus. She will work alongside Kate Holroyd-Smith, enabling us to provide further support to our members and students in the country.

At the heart of our work in Cyprus is our relationship with the Institute of Certified Public Accountants of Cyprus (ICPAC), and this special edition has been produced jointly with them. Its publication marks a new stage in the ongoing collaboration between ICAEW and the ICPAC. We look forward to working closely with them in the years ahead. Together we can continue to strengthen Cyprus's finance and accountancy profession.

I would like to thank former ICPAC general manager Theodoros Philippou and the Accountant General, Rea Georgiou, for agreeing to be interviewed by the faculty. Thanks also to the many other local professionals who have contributed articles and advice.

Michael Izza

Michael Izza
ICAEW CEO

The ICPAC has and continues to play a significant role in the development of the accounting profession and the overall economy of Cyprus for over 50 years. The ICPAC has always recognised the benefits of co-operating with other accountancy bodies from around the world and I am pleased to see our relationship with ICAEW going from strength to strength. Our two institutes have organised a number of successful joint events in recent months and we look forward to running other similar events in the future. We also look forward to working more closely with ICAEW in other areas as together we support and develop the profession in Cyprus and the region.

During the second half of 2012, our country will take over the presidency of the Council of the European Union. The baton is passed to Cyprus as we seek to address the effects of the global economic crisis while enjoying the optimism about the discovery of natural gas in our Exclusive Economic Zone. Interesting times lie ahead, and our institute is called upon to continue our contribution and support to the Cyprus economy.

In this journal you can read about emerging accounting issues affecting the major sectors of Cyprus's economy, including financial services, shipping, tourism and agriculture. You can also catch up on all the latest developments in IFRS and find out about significant changes that lie ahead for small and medium-sized entities and for public sector organisations. I'm sure you'll find it an interesting read.

Theodoros Parperis
ICPAC President

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ICAEW and Cyprus

FINANCIAL REPORTING FACULTY VISITS CYPRUS

Earlier this year, the Financial Reporting Faculty launched a series of international roadshows. Members around the world will now be able attend local events to help them keep up-to-date on all the latest financial reporting developments and to hear first-hand about ICAEW's thought leadership work.

The very first such event was held in Cyprus from 2-4 April when Eddy James, faculty technical manager, delivered a series of successful presentations to members, students and academics. All events were well attended, including a presentation on *IFRS in Transition: Financial Instruments*, held jointly with the ICPAC. Feedback was very positive and, says Eddy: "We have already received a request for us to make a return visit".

While in Cyprus, Eddy also met with a number of key local stakeholders – including the Deputy Accountant General and the General Manager of the ICPAC – and senior figures from a number of local firms.

"We have already received a request to make a return visit"

Eddy James, faculty technical manager

ASSOCIATED PRESS

MORE LOCAL EVENTS PLANNED SOON

Following the success of the first roadshow, ICAEW are planning more events in Cyprus in the months ahead beginning on 25 June when Iain Coke, Head of the Financial Services Faculty, will be visiting the republic as part of our *Inspiring Confidence in Financial Services* roadshow. More events will be scheduled soon, so keep an eye on your inbox and our website for news on what's coming your way in the months ahead.

DOING BUSINESS IN CYPRUS

On 25 April, ICAEW and the ICPAC held an event at Chartered Accountants' Hall in London entitled *Cyprus – A Tried and Tested Jurisdiction*. With a practical focus, this conference was aimed at business professionals, investment bankers, lawyers and anyone interested in finding out more about the tried and tested tax structures in Cyprus, including reference to the recent developments in the areas of oil and gas. Speakers at this high profile event included ICAEW President Clive Parritt and the ICPAC President Theodoros Parperis.

FINANCIAL REPORTING APP

The Financial Reporting Faculty's iPhone and iPad apps are a handy way to keep up to date with all the latest developments in the world of financial reporting, no matter where you are. They have now been downloaded well over 10,000 times. If you haven't downloaded one yet, simply visit the Apple App Store and search for "ICAEW".

JOIN THE FACULTY TODAY

If you want to find out more about the Financial Reporting Faculty, visit icaew.com/frf or use your smart phone to scan the QR code above.

CYPRUS STUDENTS AMONG THE BRIGHTEST AND BEST

Cyprus was well represented when ICAEW held a special ceremony in London on 26 March to recognise its highest achieving accountancy students. Of the 63 prizes awarded, five went to students from Cyprus. Moreover, four of the top 10 places in the Annual International Order of Merit at Professional Stage went to students from Cyprus. This is no mean feat considering English is not always the students' first language.

THE CYPRUS-BASED PRIZEWINNERS

Mr Kyriaki Christodoulou of PwC in Larnaca, won the Watts prize for the *Audit and Assurance* paper in the December 2011 sitting.

Mr Pantelis Pavlou of E&Y in Nicosia, won the Little prize for the *Taxation* paper in September 2011 and the Plender prize for second place in the Overall Order of Merit at the Professional Stage.

Mr Velisorios Masouras of KPMG in Nicosia won the Knox prize for the *Financial Reporting* paper in September 2011, and the Cassleton Elliot prize for the fifth place in the Overall Order of Merit at the Professional Stage.

Ms Vana Andreou of Deloitte in Nicosia, won the Nothcott prize for fourth place at the Overall Order of Merit at the Professional Stage.

Mr Loukas Antoniou of Deloitte in Nicosia, won the Hewitt prize for third place in the Overall Order of Merit at the Professional Stage.

In the main edition...

Don't forget to seek out the July edition of *By All Accounts*, the Financial Reporting Faculty journal. Here's a look at what's inside

MAIN EDITION: THE KEY FEATURES

We hope you enjoy this Cyprus special edition of *By All Accounts*. But there really is something for everyone in the main edition of the faculty magazine, too. Highlights include an extended version of the interview with IASB vice-chair Ian Mackintosh; updates from other countries such as Hong Kong and Singapore; developments in integrated reporting; and guidance on the IASB's new approach to hedge accounting.

THE FUTURE OF UK GAAP

We're also covering progress on the ASB's roadmap for the future of financial reporting in the UK and Ireland. The proposals were issued back in January – and now that reaction is in, the Board's Michelle Sansom has been explaining how it came up with FREDs 46 to 48. ICAEW members have their say, too.

The reaction? Mixed. Members praise the limited practical changes in the updated exposure drafts while at the same time acknowledging that they represent a big improvement over FREDs 43 to 45. However, they also sense there's a missed opportunity. Some raised concerns about whether enough had been done for public benefit entities and whether the yet to be published sector-specific SORPs would be consistent with each other, while others worried that the proposals would increase complexity for certain sectors, including financial services and agriculture. Sansom stresses the final standard won't be out until the end of the year – and although the formal consultation finished in April, you can follow developments at frc.org.uk/asb

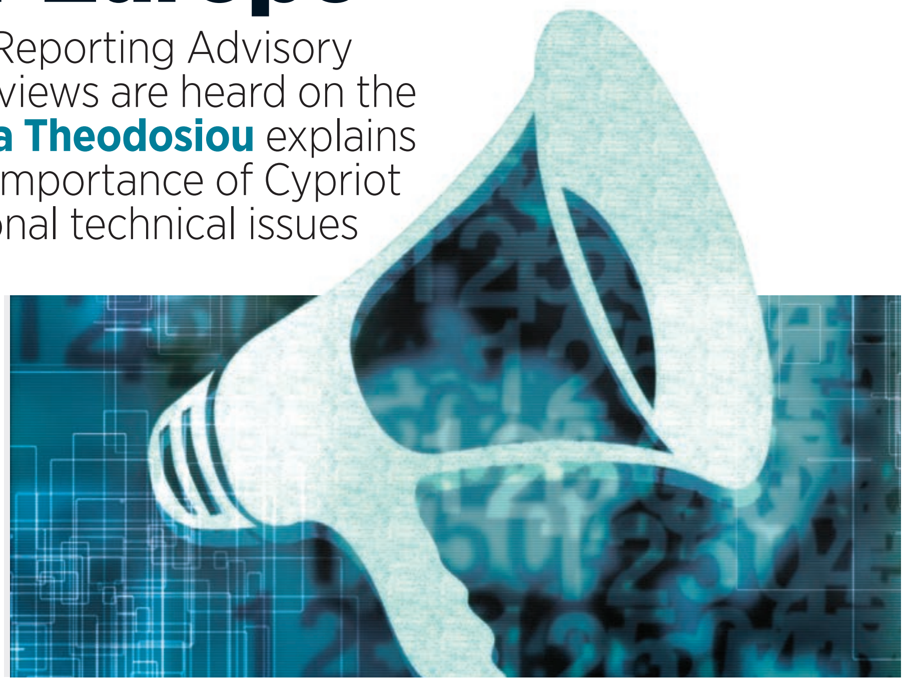
UNFOLDING THE STORY

As a partner piece to our look at integrated reporting, we also feature Pearson CFO Robin Freestone's take on narrative reporting. While narratives have improved "immeasurably" over the past 20 years – allowing annual report users to get a real picture of a company in the round – he says boiler-plate statements and other clutter are still getting in the way of a good story.

Worse, he worries, fewer people are even bothering to read annual reports these days. Freestone is equally unhappy with the idea of going all-out for compliance reporting (like the US) or for boiling everything down to data made available online. He believes there must be a middle way – a chance for annual reports to evolve and maintain their role in painting a full picture. We need better ways of answering shareholder's big questions – especially in areas like net debt and M&A strategy – while minimising the pages of disclosures on irrelevant accounting nuances.

A voice for Europe

The European Financial Reporting Advisory Group ensures Europe's views are heard on the global stage. **Apostolena Theodosiou** explains how and underlines the importance of Cypriot involvement in international technical issues



CORBIS

I arrived at the European Financial Reporting Advisory Group (EFRAG) during interesting times. The IASB is pushing forward with its remaining convergence projects. It is intent on achieving its goal of making IFRSs a truly global set of standards while simultaneously trying to achieve convergence with US GAAP. At the same time, it is planning for the future and deciding its forward priorities. All against the backdrop of the ongoing financial crisis.

But where does EFRAG fit into all of this? Put simply, our role is to provide a pan-European voice in the international standard-setting process.

One major line of work is EFRAG's contribution to the IASB's due process. We publish draft comment letters that are discussed at a variety of outreach events in order to obtain input from and stimulate debate among European constituents. All the input is considered by our Technical Expert Group. The objective is to ensure that European views are heard by the IASB at all stages and that the resulting global standards are appropriate for use in Europe.

Another major line is EFRAG's proactive work. In partnership with National Standard Setters, our aim is to contribute to and influence early thinking on significant financial reporting issues through our thought leadership work. EFRAG carries out this proactive work to provide Europe with the opportunity to contribute to the development of accounting thought on selected issues, aimed at inclusion on the IASB's agenda. Comments received on published discussion papers are scrutinised and deliberated by EFRAG before final positions are formulated.

EFRAG is also the body designated with the responsibility of assisting the EC in the endorsement of IFRSs as issued by the IASB. This process is fed by both our due process and proactive work, ensuring that potentially controversial issues are considered by the IASB well in advance of the finalisation of the new standards or amendments. The ultimate objective is that the endorsement process is run uneventfully. From the IASB's perspective, obtaining EFRAG's technical position with the European view is important because each member state has different accounting standard-setting activities, practices, habits, traditions, laws and tax regulations. Agreeing and monitoring implementation of a position that has been looked into from all these different standpoints helps build a common understanding of financial reporting among the participants. And it is deemed to include issues identified in jurisdictions outside Europe. EFRAG's work, notably its draft comment letters, is used all over the world and has given EFRAG international visibility and recognition.

Our aim is to influence early thinking on financial reporting

Although financial reporting for listed companies is the main focus, we also provide technical advice and support to the EC on the Accounting Directives and accounting for SMEs. The proposed Accounting Directive will replace the 4th and 7th Directives. The debate on certain articles – for example, fair values – is ongoing, so this important issue may have to be taken forward during the Cypriot presidency of the Council of the European Union if negotiations are not concluded by the end of June.

In essence, EFRAG's work is extremely challenging and refreshing, contributing to the future of financial reporting in Europe and beyond. Involvement at any stage of the process invaluable. I hope that my participation at EFRAG will inspire more Cypriot people to be involved in technical issues at a high level, proving that Cyprus is worthy of being regarded as a small country with a big pool of talented professionals in the financial services arena.

Apostolena Theodosiou is currently on a year's secondment from the University of Cyprus as a project manager with the EFRAG. For more information on EFRAG's work visit efrag.org

IFRS round-up

Eddy James takes us through the latest IFRS developments

FINANCIAL INSTRUMENTS

The IASB has issued amendments to IFRS 9 *Financial Instruments* that defer the standard's mandatory effective date from 1 January 2013 to 1 January 2015. The deferral will make it possible for all phases of the project to have the same mandatory effective date. While early adoption is still permitted, the European Commission is refusing to countenance endorsement of IFRS 9 until the whole package has been finalised. Therefore it is not currently available to entities in Cyprus or elsewhere in the EU.

So how close are we to having a complete new standard? First the good news. Headway is being made on developing a new general hedge accounting model. The exposure draft issued by the IASB in December 2010 suggested introducing a more principles-based approach to hedging that would strengthen the link between an entity's risk management strategies and its accounting. In response to feedback received, the IASB has sought to remove some of the restrictions included in the exposure draft, enabling more entities to reflect their risk management strategies in their financial statements. The IASB is aiming to finalise its proposals later this year.

The bad news is that work on other elements of IFRS 9 is continuing to progress slowly. New exposure drafts on impairment of financial assets and macro hedging are currently expected in the second half of this year.

Moreover, following the IASB's decision to undertake a limited-scope review of IFRS 9's requirements with regard to the classification and measurement of financial assets, we can also expect a further exposure draft on this topic later this year.

Progress has been made updating IAS 32 *Financial Instruments: Presentation*, with amendments being made to address inconsistencies in current practice when applying the standard's offsetting criteria. In addition, new disclosures have been added to IFRS 7 *Financial Instruments: Disclosures* to help investors and other financial statement users better assess the potential effect of offsetting arrangements.

OLIVER BURSTON/IKON IMAGES

The overriding message seems to be that the IASB should finish the important projects in progress and then take its foot off the gas and only fix what really needs fixing

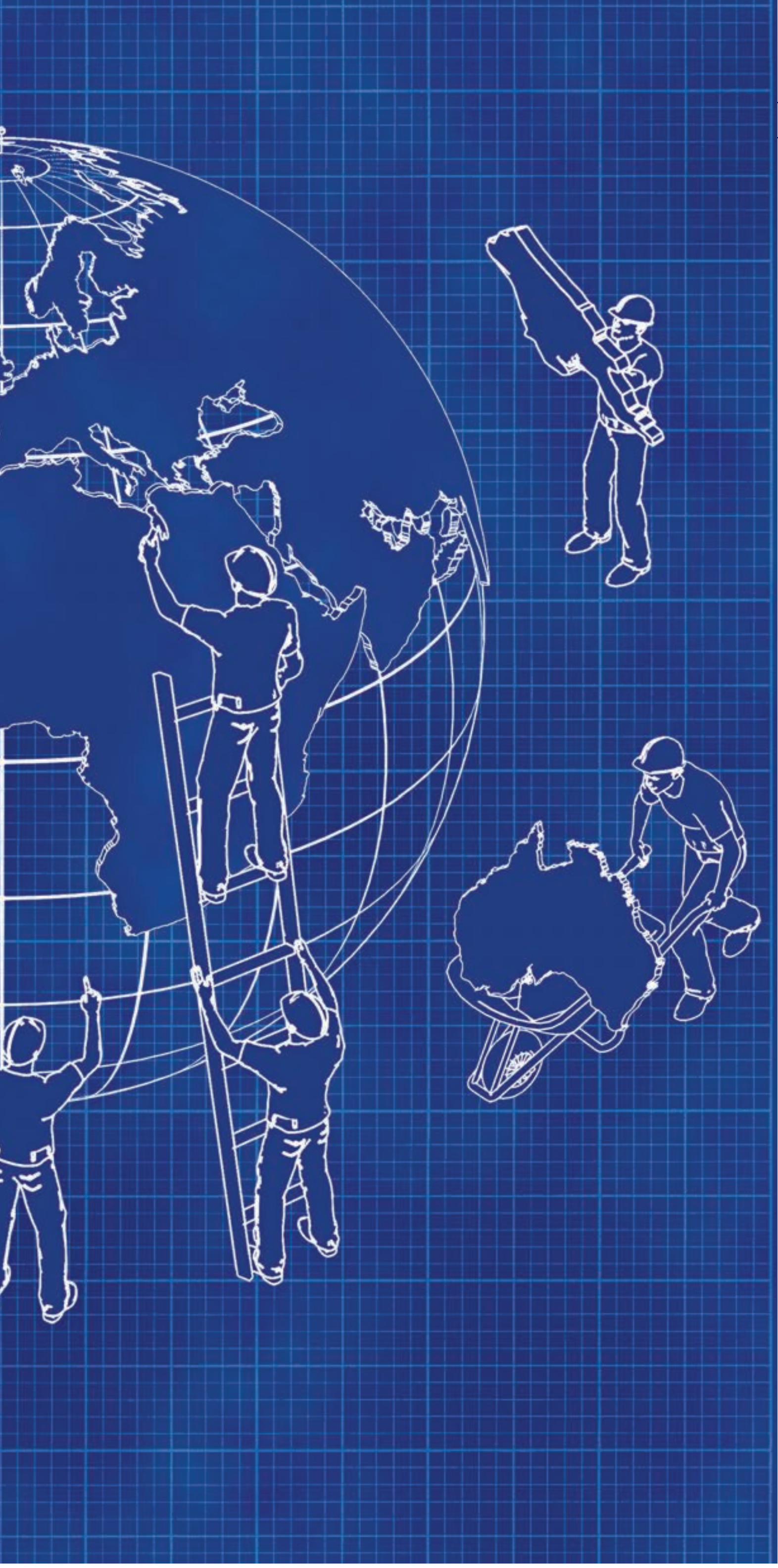
REVENUE RECOGNITION

The IASB's proposals on revenue recognition were re-exposed in November last year, with comments due by mid-March 2012. While, like its predecessor, the latest exposure draft is based on the notion of control, it includes a number of significant improvements. The latest proposals are clearer in many key areas and it is now easier to understand how the underlying principles can be applied not only to goods but also to services. However, the wording around continuous performance may still need a little tightening to ensure consistent application. But, overall, we do not seem that far away from a final standard.

The IASB is considering comments received, but has yet to set a target date for issuing a new IFRS. It is unlikely that anything will be finalised this year.

LEASES

The IASB has a vision of introducing a single accounting treatment for all lease contracts that would



improve transparency by bringing many arrangements previously off-balance sheet into the light of day.

Turning that vision into a reality is proving challenging and to date the IASB and US standard-setter the FASB have not been able to make much progress toward agreeing on a universal new model.

Proposals were originally issued in 2010 but, following significant concerns about their operability, the boards agreed to issue revised proposals. We are still waiting for them to issue a new exposure draft containing their latest thinking. This is currently scheduled to be published in the second half of this year. A final standard is now not expected until 2013 at the earliest.

INSURANCE CONTRACTS

Work is still ongoing on the IASB's insurance contracts project. A review draft or revised exposure draft is due in the second half of this year. Further delays mean that a comprehensive standard on this topic is still some way away – a matter of concern in the industry and beyond.

POSSIBLE AMENDMENTS TO IFRS 10

The IASB is looking at two possible amendments to IFRS 10 *Consolidated Financial Statements*.

The first proposes creating a separate type of entity that would be exempt from the consolidation requirements of IFRS 10 provided certain strict criteria are met. Instead such 'investment entities' would be required to account for all their investments at fair value through profit or loss, while making additional disclosures about the nature and type of these investments.

The second proposal seeks to allay concerns that IFRS 10's transition provisions were more burdensome than originally intended by providing more clarity on what is required.

AMENDMENT TO IFRS 1

The IASB has made an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The amendment sets out how a first-time adopter would account for a government loan with a below-market rate of interest when they transition to IFRS.

WHERE NEXT FOR THE IASB?

The IASB is currently working its way through the 250 or so comment letters that it received in response to its recent consultation on its future agenda. The consultation has yet to conclude, but in a number of recent speeches IASB chairman Hans Hoogervorst has alluded to some common themes that are emerging. While nothing is certain at this stage, it is fair to say that the direction of travel is becoming clearer.

The overriding message seems to be that the IASB should finish the important projects that are in progress and then take its foot off the gas for a little while and only fix what really needs fixing and no more. So while there have been widespread calls for a period of calm after the rapid change of recent years, many respondents also urged the IASB to prioritise completing its ongoing projects on revenue recognition, leases and financial instruments and to finalise revisions to the conceptual framework.

Other common themes include a desire to tackle what many see as disclosure overload and a feeling that the IASB must decide on a firmer theoretical underpinning of the concept of other comprehensive income.

A number of smaller projects – such as agriculture, business combinations under common control, hyperinflation and rate-regulated industries – also featured highly on the wish lists of many respondents. These projects may well find their way onto the IASB's future agenda.

Eddy James is a technical manager in the faculty

A time for timeliness?

Ian Mackintosh tells the faculty's Nigel Sleigh-Johnson and Eddy James about his work as IASB vice-chair

A few eyebrows were raised when Hans Hoogervorst was appointed as the new chairman of the International Accounting Standards Board (IASB) last year. Much was made of the fact that he was a politician rather than an accountant. But a clever hand had been played. Because not only did they appoint the former Dutch Finance Minister as chair, they also appointed Ian Mackintosh as his vice-chair. And Mackintosh is a standard setting veteran, with more than 30 years' experience, including stints at the UK Accounting Standards Board and the Australian Accounting Standards Board.

When he welcomed us to his surprisingly bijou office in London's Cannon Street one rainy spring morning, the convivial New Zealander seemed relaxed and happy in a role he has not yet occupied for a year. He spoke initially of the vibrancy and spirit in the IASB offices, but then took us by surprise by declaring solemnly: "There is a real tension at the heart of the IASB…"

Intrigued, we couldn't help but leap in.

Was the tension between the IASB and those troublesome Americans, whose procrastination some think is threatening the success of the global IFRS project? Apparently not. While admitting that he had "no idea" when or if the SEC would commit to introducing IFRSs in the US, Mackintosh exudes confidence: "There is light at the end of the tunnel. While I don't think we will reach a converged solution on everything, the two boards are working as hard as they can to get things as converged as they possibly can be."

Or maybe it's a tension between the IASB and the EU, with the latter dragging their heals on endorsing the recent package of standards on consolidations and refusing to even consider looking at IFRS 9 *Financial Instruments* until the whole standard is finalised? Wrong again. Mackintosh explains: "EFRAG is recommending endorsement of the package of five new and revised standards albeit with the implementation delayed from 2013 to 2014. But they are is also recommending early implementation. And we should be ready to show them most of the remainder of IFRS 9 in time to get it endorsed in time for its effective date of 2015."

ROBUST REBUTTAL

A final try. Perhaps he's referring to an anxiety within the IASB about those commentators who are pointing the finger at standard-setters and claiming that IFRSs somehow caused or contributed to the global financial crisis? Not at all. Mackintosh is robust in his rebuttal of these claims: "IFRSs did not cause the crisis. There is a large amount of agreement on this point. There are one or two vocal critics, but their criticism is not well based. IFRSs do not remove judgement or override prudence. And they certainly do produce accounts that are true and fair; legal opinions and statements from the UK government have made that very clear time and again."

> "IFRSs did not cause the crisis… they do not remove judgement or override prudence"

OK. We give in. Mackintosh clarifies: "The tension is between quality, convergence and timeliness. It is immensely challenging to find the right balance between the three, but absolutely critical. Quality is of course something we can never walk away from, but there comes a point where there are diminishing returns. Convergence is also important. It is something we remain very much committed to finishing. But maybe the time for timeliness is now upon us."

We can't help thinking that he has a point. The G20 set the IASB and FASB a deadline of June 2011 to complete their remaining convergence projects. But almost a year later, major projects on financial instruments, leasing, revenue recognition and insurance contracts remain stubbornly on the IASB's agenda. But Mackintosh is undeterred: "While it is a continuing challenge to complete these projects, the staff and the Boards continue to work extremely hard on them. All of these projects should move to the next stage by the end of this year and – with the

CHARLOTTE PLAYER

"We already have over 100 countries applying IFRSs. I think it is inevitable that IFRSs will become the global standard"

possible exception of the macro hedging element of the financial instruments project – all of them should be completed by the end of 2013. An implementation date of 2015 for all these new standards remains our aim."

So what next? The IASB has recently been consulting on its future work plan. Mackintosh explains that one overarching theme was clear: "Many respondents have called for a period of calm. We have already issued lots of standards that will become effective in 2013 and 2014. Moreover, we expect several major new standards to be effective in 2015. Preparers and users of financial statements are already facing lots of change even if we just finish what we are already working on. So going forward I think we should be careful to only fix what needs fixing."

WHAT NEEDS FIXING

So what needs fixing? Mackintosh continues: "Lots of people have been asking us to complete the conceptual framework. Then there are disclosures. You hear a lot these days about disclosure overload and we need to address this too. But don't just assume, as some do, that quantity is the problem. What is really important is whether the disclosures are relevant or not."

What about specific standards? Are there any that respondents are particularly unhappy with? Here it seems that there is little unanimity. Mackintosh tells us: "What ultimately gets added to our agenda is going to be a difficult judgement call, as different constituents around the world have different priorities. In Asia, they want us to improve our agriculture standard. In Canada, they are concerned with the lack of specific guidance on rate regulated activities. Countries like South Korea and India have some concerns about foreign exchange. Others advocate developing a standard on Islamic finance. But we don't need to rush our agenda decisions. We already have plenty to work on for the remainder of this year!"

While the IASB has spent in excess of five years focusing on its convergence work with the US standard-setter, with IFRSs becoming ever more global perhaps the time has come for the US to become one of many competing voices rather than the main player on the stage?

As Mackintosh put it: "I foresee an ongoing, close relationship with the FASB, but on a non-exclusive basis where we work with others in a similar capacity. Of course, the US decision on IFRS will have some bearing on this."

But what is the end-game? It seems only right to let Mackintosh have the final word: "We already have over 100 countries applying IFRSs. In the long-run, as markets become ever more international, I think it is inevitable that IFRSs will become the global standard."

Mackintosh is known as a pragmatist. But we come away thinking he is also clearly a man with a vision, and a mission.

***A full version of this article appears in the July 2012 edition of* By All Accounts.**

Accrual twist

Accountant General **Rea Georgiou** tells us about plans to introduce accruals accounting at a central government level

What accounting system is currently used at a central government level?
The accounting and budgeting of the ministries and independent authorities are performed through a single accounting system that results in a single set of financial statements on a modified cash basis. The modification of the cash basis relates to the capitalisation of financial assets and liabilities – such as investments, bank balances and borrowings – and their presentation on the statement of assets and liabilities.

What are the pros and cons of this system?
One advantage of cash accounting is that it is simple to use and no special training or skills are needed. It is easy to understand, easy to audit and ultimately easy to implement. Furthermore the connection to the budget – which is prepared and voted on a cash basis – is clear and immediate.

However, there are many disadvantages. To begin with, receipts and payments are recorded as and when performed. Hence payments or receipts may be postponed or prepaid provided there are approved funds. Therefore there is no application of the matching concept. Furthermore, not all necessary information is provided to users of financial statements, which means decision-makers cannot make decisions based on this information.

Why is there a desire to change to an accruals basis of accounting?
Under the accruals basis of accounting, users of the financial statements are provided with a comprehensive and more accurate picture of the financial transactions of the government. This is because it presents not only what the government has paid and received during the year but also what the government should have paid and received, as well as the use of fixed assets bought in previous years.

This method also provides the users of the financial statements with details of all the receivables and payables at the end of the financial year.

Did the financial crisis play any role in the decision to move to an accruals basis of accounting?
The financial crisis has raised several issues for the public sector and has reinforced the importance of high-quality standards for financial reporting by governments. It has also increased the need for accountability and for transparency in the government's financial transactions.

We already knew accruals accounting was the way forward. That is why we had taken steps in this direction before 2008. The financial crisis was a good opportunity for us to promote moving towards this goal as soon as possible. It also makes the change to accruals accounting inevitable as it is necessary to improve and control expenditure in the public sector in a professional way.

> The first challenge is to adopt proper accounting policies

What are the challenges of moving to accruals accounting?
The first challenge is to adopt proper accounting policies, relevant and applicable to the public sector. We will also have to identify and value all assets and liabilities (including any hidden ones) and recognise them on the balance sheet. Contingencies is another major challenge.

There are also some practical issues that we will have to deal with. We believe that when moving to accruals accounting we need to have in place accounting software that will be adequate enough to support all the transactions, procedures, manuals and data that accruals will require. We will need to ensure that this software communicates with existing software.

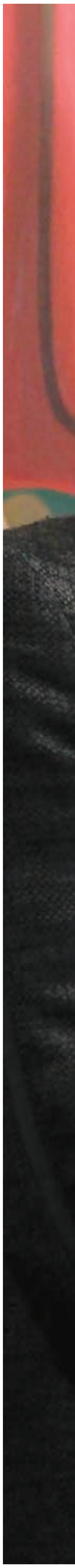
This is something we feel is going to take time and money. In addition, we will have to educate our employees about the new accounting method and the new accounting system. Another major challenge will be convincing people both internally and externally of the benefits of accruals accounting and giving the message to the decision-makers that under this method they will be able to find a lot more decision-useful information.

However, we anticipate that our biggest challenge will be the fact that we will be coordinating two major projects simultaneously. The first project will be the move to accruals accounting and all the related changes in legislation, regulations and procedures; the second will be the implementation of the new accounting software system to support accruals accounting.

Because these two projects will be running concurrently we will need to be prepared well in advance for all the obstacles that might arise and to ensure that we are ready to resolve any contradictions between them.

What are the benefits of moving to accruals accounting?
The information contained in reports prepared on an accrual basis is useful both for accountability and decision-making.

At a more detailed level, reporting on an accruals basis provides a government with the opportunity to demonstrate successful management of its resources and is useful in evaluating a government's performance in terms of its service costs, efficiency and



An effort has been made to modernise our law and financial regulations

more appropriate replacement policies, identification and disposal of surplus assets, and better management of risks such as loss due to theft or damage. The identification of assets and the recognition of depreciation help managers to understand the impact of using fixed assets in the delivery of services, and encourage managers to consider alternative ways of managing costs and delivering services.

Accruals accounting also provides a consistent framework for the identification of existing liabilities, and potential or contingent liabilities. Recognising such obligations allows governments to acknowledge and plan for the payment of all liabilities, such as pension costs, not just borrowings.

It also provides information on the impact of existing liabilities on future resources and allows governments to assess whether they can continue to provide services and the extent to which they can afford new ones.

What steps have been taken to move towards accruals accounting?

The Treasury has recognised that moving to an accruals basis of accounting requires new legislation and regulations. As a result, an effort has been made to modernise our law and financial regulations, a final draft of which is ready for approval.

In addition, we have moved to prepare tender documents for implementing the new accounting software system, a procedure that takes some months to be completed, before awarding the contract to the successful candidate. According to our estimates, the new system will be in place in about four years.

The Treasury has also organised meetings with the government departments we anticipate will be affected more from this transformation, including the Auditor General, the Internal Audit Department, the Statistics Department and the Ministry of Finance. We have received useful feedback from them on how to implement this project.

For all these reasons we believe that both support and commitment from the politicians is vital if we want to succeed. We are therefore in the process of preparing all the necessary documents to present it to the Ministry of Finance and to the Council of Ministers.

Rea Georgiou is Accountant General of Cyprus and chair of the auditors' oversight board

No change is not an option

Has the time come for Cyprus to simplify the reporting regime for small and medium-sized companies? **Marios Agathangelou** takes a look

No change is not an option. This is the authoritative statement made so often these days, as if to scare someone off. But is it really time for a change? Have accounting standards really become that complex after all? And if the answer is yes, is there any genuine commitment by standard-setters to simplify things and implement the change required?

Well, we've got the G20's declaration on strengthening the financial system by taking action to reduce the complexity of accounting standards for financial instruments. If the standard-setters don't listen to the leaders of the world's most powerful nations, who will they listen to?

Then we've got the IASB issuing the IFRS for SMEs in an attempt to make accounting and reporting easier for small and medium-sized entities. Did it succeed? I'm not quite sure. One thing is certain: the EU did not endorse it so companies in member states can't apply it even if they want to.

And then we've got the EU itself, which is introducing relaxed accounting rules for its estimated 19 million micro companies. This move is in line with its commitment to reduce the reporting and administrative burden of smaller entities. They say that relaxed disclosures are set to come into effect over the next two years.

Furthermore, the EU is working on updating the 4th and the 7th Accounting Directives (originally issued in 1978 and 1983 respectively) as part of a wider project that aims to help small business, improve accountability and modernise the EU approach to social responsibility.

The European Commission has proposed a new regime for small companies, based on a simpler profit and loss account and balance sheet and a limited number of accompanying notes providing further information on their financial position. So is there a commitment to change – and to simplification? I'd say probably yes.

But what about Cyprus and IFRSs? We have a long, long relationship with international accounting standards, going back to the early 1980s. But is it time for Cyprus to reconsider? Remember, it is currently mandatory to apply IFRSs to all companies, irrespective of their size. Surely some form of simplification would be welcome.

IFRSs have become complex over the years. This is not just a result of standard-setters' attempts to deal with more and more ingenious and carefully laid schemes of accounting frauds and off-balance sheet transactions. It's also to satisfy the needs of a wider pool of users of financial statements, such as investors and financial analysts, rather than merely shareholders. The standards we have today are unrecognisable from those Cyprus adopted more than 30 years ago.

> The standards today are unrecognisable from those Cyprus adopted more than 30 years ago

So can the average business in Cyprus continue to bear the cost of full IFRS accounting? Or even worse, can it actually apply provisions such as amortised cost and fair value?

Moreover, Cyprus-registered companies are not only Cypriot businesses trading locally. In fact the majority of registered companies are international business companies (IBCs) that wish to benefit from Cyprus's beneficial tax regime and wide network of double tax treaties. Does full IFRS accounting and the disclosure complexities that come with it add any value to these IBCs?

The truth is that IFRSs were never meant for smaller entities or, even more so, for micro entities. Even for larger entities some provisions are hard to understand and put into practice. I read an article recently that was criticising the constant use in IFRS 13 of "the fair value" (rather than "a fair value"), as if there were just one fair value for each asset and each liability in any given market. The mind boggles.

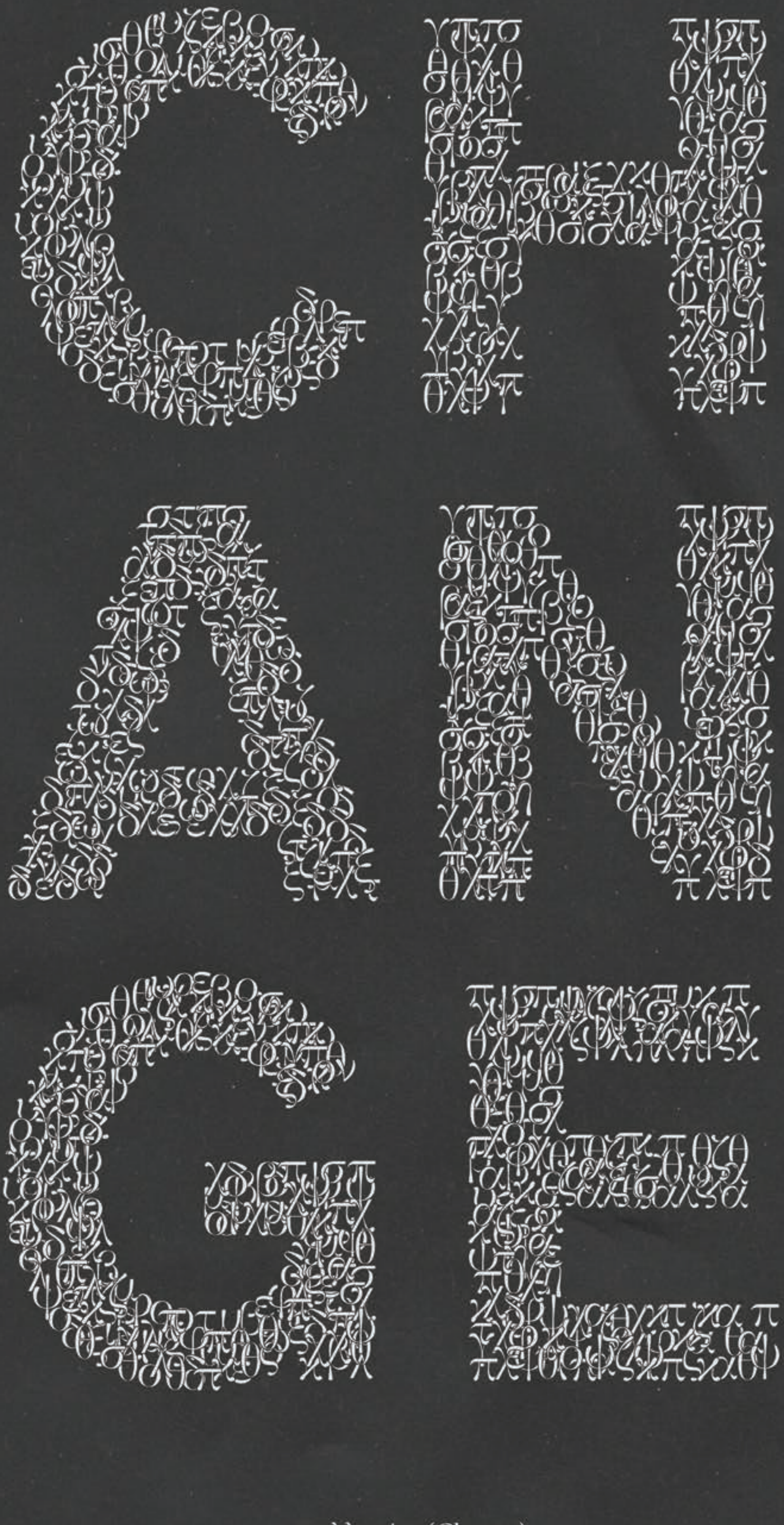
Traditionally businesses in Cyprus were – and still are to a large degree – family businesses with non-complex transactions. A large number would qualify as micro entities based on the limits proposed by the EU (two out of three of the following criteria must be met: a balance sheet total not exceeding €350,000, turnover not exceeding €700,000 and an average number of employees not exceeding 10).

A simpler accounting regime could actually relieve these companies from the high cost and administrative burden of applying full IFRSs. However, the options now available in EU law for micro companies perhaps go too far.

Is Cyprus ready for radical change? I think it's time to at least put the options on the table. We should consider how best to assist the private micro, small and medium-sized entities by reducing complexity and improving accountability. A new, simpler regime for these companies would be broadly welcomed. And anyone who didn't like it could always opt for full IFRSs anyway.

JOE POCHODZAJ

Marios Agathangelou is a partner at Crowe Horwath



αλλαγή – (Change)

Mighty oaks from little acorns grow

Former ICPAC general manager **Theodoros Philippou** tells Eddy James and Christiana Diola how the institute grew into the influential organisation it is today

After serving as general manager of the Institute of Certified Public Accountants of Cyprus (ICPAC) for the past decade, Theodoros Philippou retired late last year. But the septuagenarian, who also served as the institute's president from 1984 to 1986, is in no mood to slow down quite yet. When we met him on a warm spring day at the ICPAC's offices in Cyprus's capital, Nicosia, he seemed as busy as ever and keen to discuss current projects and future plans. More of those later. The primary purpose of our meeting was to talk about the past, to look back over the 50 or so years since the institute was founded and to chart its progress from humble beginnings to the organisation it is now.

As Theodoros explains, "In the early 1960s a group of fewer than 10 qualified accountants got together and agreed to establish the ICPAC. For young accountants today it is difficult to visualise what this handful of accountants went through to establish such a powerful institute from a zero base. It was very difficult, it was very time consuming, but they had a vision."

When the ICPAC was established on 4 April 1961 there were just 21 founder members. Initially growth was slow. By 1971 there were still less than 100 members, and none of them were women. But things were about to change.

Theodoros takes up the story. "Following the events of 1974 the whole country and economy was dilapidated," he says. "Unemployment reached 25%. People were leaving in droves."

The figures speak for themselves: Cyprus lost 70% of its wealth-producing resources; the tourist sector lost 65% of its hotels and tourist accommodation; the industrial sector lost 46% of production; and the mining and quarrying sector shrank 56%.

But the ICPAC had a plan. And thankfully the government listened. As Theodoros explains, the fledging professional body "took the initiative" and "demonstrated leadership" by presenting proposals that would ultimately lead to the island's economy shifting from dependence on agriculture to a focus on services and light manufacturing. Their vision was of Cyprus as a "reputable financial and commercial centre".

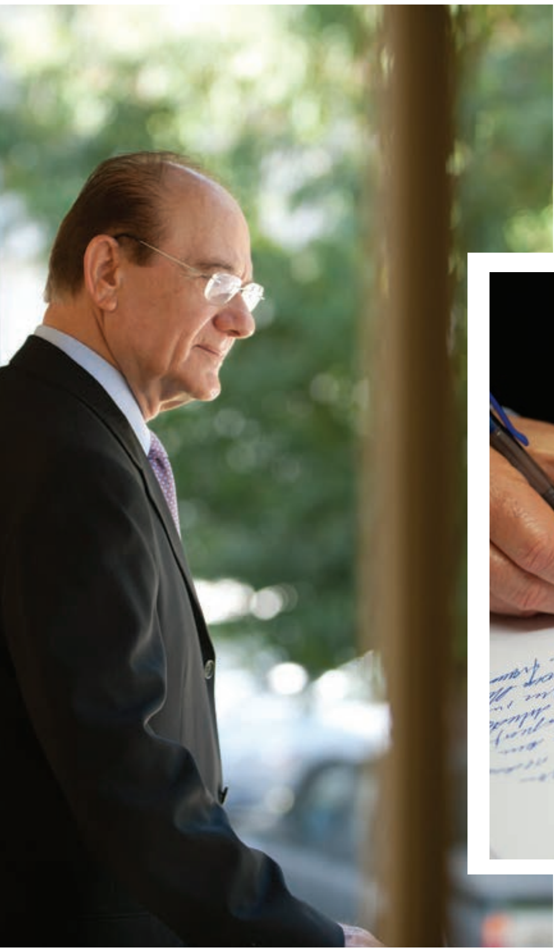
As the dream became reality, demand for accountants grew, as did the ICPAC's membership – and its reputation for adhering to the highest professional and ethical standards. Today there are more than 3,000 members, a third of whom are women.

As the economy changed its focus towards the service sector, it became more international in outlook. And changes in tax legislation helped attract investment from overseas. But Theodoros explains: "As a legacy of the colonial era, the accounting profession was dominated by UK accountants and all financial reporting was based on UK standards. But is it right for an independent country to use the standards of another country? Isn't it better to go for something international?"

INTERNATIONAL RESCUE

And so the ICPAC made a brave decision. In 1981 it decided to adopt International Accounting Standards (the predecessor of today's IFRSs) and was apparently the first country in the world to do so.

In the early 1980s Theodoros was involved in training the ICPAC's members on using the new standards. Back then international standards weren't as well respected or as robust as they are now. He admits there was "an incomplete framework" of international standards and sometimes you had to "look elsewhere for guidance". But the membership embraced the change – and



"I am in favour of harmonisation, but not at any cost"

Theodoros assures us with a smile that this was not just because failure to do so was considered a disciplinary matter. However, it would be another 21 years before the European Commission required all listed entities in Europe to adopt IFRSs.

It comes as no surprise to hear that Theodoros is a big fan of IFRSs. "In today's capital markets money moves quickly between countries. To facilitate this there must be harmonisation and a single set of accounting standards," he says.

He believes IFRSs will eventually be a truly global set of standards. Many have followed where Cyprus led, with more than 100 countries now using IFRSs.

When talk turns to whether or not the US will ever adopt IFRSs, Theodoros wryly observes, "The US will adopt it only when they have succeeded in introducing most of US GAAP into IFRSs."

He worries that this means standards are becoming increasingly rule-based, with less emphasis on principles. He is also concerned at Europe's waning influence over the future direction of IFRSs. "I am in favour of harmonisation, but not at any cost," he says.

Theodoros has seen his country transformed from an underdeveloped agrarian economy into a modern international financial and commercial centre. But after three decades of unbroken economic growth, the financial crisis led to the Cypriot economy contracting in 2009 and it has continued to struggle ever since.

MARCO ANSALONI

FINANCIAL SETBACKS

"Our two biggest banks invested a lot of money in Greek government bonds and they have suffered significant losses," says Theodoros. "But there are no fears that depositors will lose their money. The Cypriot government is being supportive, as is the European Central Bank."

Yet the ICPAC's membership has continued to grow. "In these tough economic times more people are interested in becoming accountants," he says. "Not only does the ICPAC have more members than ever but student numbers are growing. People are interested in obtaining a good business qualification that is marketable across the EU and beyond."

Theodoros may have retired from his role as the ICPAC's general manager but he isn't ready for a quiet life with pipe and slippers quite yet. He remains an active and widely respected figure and there is no doubt he still has a lot to offer the accountancy profession in Cyprus. He is particularly excited about the recent discovery of natural gas and the prospect of energy becoming "a new driving force of Cyprus's economy".

He also is looking forward to Cyprus's upcoming EU presidency and the challenges that will no doubt come with this important role.

Theodoros is keen to help find a way to cut red tape for small businesses. He says this can be achieved by developing an accounting framework based on the IFRS for SMEs and by replacing the full-scope audit currently required with an alternative form of assurance.

In facing up to these challenges and opportunities, Theodoros believes the very values that have allowed the ICPAC to flourish will continue to serve it well in the future.

"The core values of our profession – independence, objectivity, integrity and trust – are recognised by the business world and society in general," he says. "Particularly in difficult times such as the ones we are going through now, these values are the solid foundations that sustain the profession. Our commitment, our responsibility, is to serve them with a dedication to quality."

Banks face the challenge

Savvas Pentaris looks at the issues affecting Cypriot banks and warns that the introduction of IFRS 9 means further challenges lie ahead

The last couple of years have been challenging for Cypriot banks. The economic slowdown across the Eurozone area – and particularly the severe recession in Greece – is having a continuing and significant impact on Cypriot banks as a result of their exposure to Greece through their branches and their investments in government bonds in that country.

Following the restructuring of Greece's public debt in March and the resulting significant impairment losses on Greek government bonds, Cypriot banks are in the process of implementing their recapitalisation plans. This will enable them to meet the relevant minimum capital ratios set by the Central Bank of Cyprus as well as the European Banking Authority capital buffers calculated through a capital exercise last September.

In addition to securing the required capital – which is the top priority for Cypriot banks this year – other strategic priorities in this difficult economic time include the effective management of liquidity and funding needs and strong management of credit quality and non-performing loans. Banks also face a number of financial reporting challenges, which they will need to address as these could have a significant effect on their financial position and performance.

The most significant change will be the introduction of the new financial instruments standard, IFRS 9. This will replace IAS 39 *Financial Instruments: Recognition and Measurement* and consists of three phases: classification and measurement; impairment; and hedge accounting.

The impact of IFRS 9 for Cypriot banks is expected to be considerable. Almost the entire asset side of the balance sheet will be affected, while the processes for determining loan loss provisions for items at amortised cost, such as loans and advances to customers, will be dramatically different.

CLASSIFICATION AND MEASUREMENT

The first phase of IFRS 9, which has been finalised subject to an ongoing limited scope review, considers the classification and measurement of financial assets and financial liabilities.

IFRS 9 replaces the four measurement categories for financial assets under IAS 39 with two categories: fair value and amortised cost. The requirements for financial liabilities remain largely unchanged.

IFRS 9 also eliminates the complex, rule-based requirements for separating embedded derivatives from financial assets, the tainting rules for held-to-maturity investments and the difficulties in determining impairment for available-for-sale (AFS) assets.

Entities that hold impaired AFS debt securities will no longer need to recognise the full fair value decline in profit or loss, as they currently do upon impairment, provided they meet the criteria for amortised cost. For any equity instruments recorded at fair value through other comprehensive income (OCI), all falls in fair value will be recorded in OCI.

All this clarity and simplification will be much welcomed by Cypriot banks.

On the other hand, although many items in the current AFS portfolio might be measured at amortised cost under the new rules, some are likely be recorded at fair value (through profit or loss or OCI). Entities will need to apply judgement in determining the appropriate classification.

> Almost the entire asset side of the balance sheet will be affected

The effects of applying IFRS 9 will differ from one bank to another depending on their individual portfolios and their own business models. In order to determine the correct accounting treatment under IFRS 9, banks will need to assess and potentially revise their business models and segment their asset portfolios accordingly. Under certain circumstances, adoption of the new standard may result in increased earnings volatility, especially if a large number of assets are included in the fair value category.

> Banks in Cyprus cannot afford to be complacent

IFRS 9 will be effective from 1 January 2015. Early adoption is allowed but the standard has not yet been endorsed by the EU. Therefore Cypriot banks cannot currently apply it. However, given that, once adopted, entities will need to restate their comparative information for the two preceding years, Cypriot banks need to assess the operational implications of the new accounting requirements as soon as possible.

IMPAIRMENT

The most significant change to be introduced by IFRS 9 will be the shift in the determination of impairment losses from an incurred loss to an expected loss model. Based on the latest proposals, the new impairment model would determine expectations of future credit losses based on reasonable and supportable historical, current and forward-looking information. Where there is a deterioration in creditworthiness, lifetime expected losses will need to be provided either on a portfolio or an asset by asset basis.

The proposals do not mandate a specific approach for estimating lifetime expected losses – something that will present Cypriot banks with challenges.

In practice, entities may develop projections for expected losses on the basis of specific inputs such as forecast information for shorter-term periods. They may also use long-term average loss rates based on historical data for more distant periods.

Under the proposals, estimates of lifetime expected losses could vary significantly, depending on how the bad book is defined and what is deemed to be the foreseeable future period.

HEDGE ACCOUNTING

The IASB's stated objective is to substantially simplify hedge accounting, by better aligning the accounting for hedging activities with risk management practices.

Hedging of risk components will be permitted for both financial and non-financial items, if these are separately identifiable and measurable. Derivatives, in combination with non-derivatives, will be permitted as eligible hedged items.

However, the most significant change would be the removal of the so-called bright line test of 80% to 125% for hedge effectiveness testing, although ineffectiveness would still need to be measured and included in profit or loss when it occurs.

It should also be noted that proposals related to macro hedging have yet to be developed. You may recall that the EU created a carve-out from IAS 39 in 2005 in respect to macro hedging for interest rate risk. It is expected that the IASB will attempt to address this when discussing macro hedging. However, it is not yet clear whether the new proposals will be successful in this respect.

PREPARING FOR THE NEW REGIME

The changes set out here will have an impact on the business, systems and processes, as well as the investor communications, of banks. In parallel with assessing the impact of the IFRS changes, Cypriot banks will need to consider the interaction between the accounting changes and the wider regulatory and macroeconomic challenges such as Basel III, the Foreign Account Tax Compliance Act (FATCA) and new banking levies and taxes.

In order to make an informed assessment, entities will need to understand the significant accounting and operational business impacts. Some of the new or proposed standards, in particular – those relating to the classification, measurement and impairment of financial instruments – are less rules-based. As such, management will need to exercise considerable judgement.

Given the far-reaching nature of the upcoming changes, the banking industry in Cyprus cannot afford to be complacent. Banks will need to evaluate these implications, consider the timing of the adoption of any new standards and plan their responses as soon as possible.

Savvas Pentaris
is a senior manager at Ernst & Young

REUTERS

Investor relations

Anna Loizou looks at some of the accounting issues faced by Cyprus's many investment firms

Cyprus's investment industry has experienced significant growth in recent years. Although the services provided and the financial instruments dealt with differ among the various investment firms, there are some common financial reporting issues.

CLIENT FUNDS/ POSITIONS

Many investment firms act as trustees or in other fiduciary capacities that result in the holding of funds or securities or trading in securities on behalf of clients. To the extent that the investment firm is acting purely in a fiduciary capacity for such transactions and balances, it only recognises the fees or commissions it is entitled to in relation to these transactions. The funds and securities held on behalf of clients are recognised off-balance sheet.

In some cases, the investment firm may be the counterparty to the transactions entered into by the clients, in which case client open positions are classified in line with IAS 39 *Financial Instruments: Recognition and Measurement*.

MARGIN ACCOUNTS

Many derivative instruments – such as futures contracts and exchange traded written options – require a margin payment. This is usually treated as a form of collateral for the investment firm to ensure that the clients will perform their contractual obligations. The initial margin may take the form of cash, securities or other – typically liquid – assets. These constitute separate assets and are accounted separately from the derivative positions they are acting as collateral for.

A key consideration is whether the markets in which the investment securities are traded are active

REVENUE RECOGNITION

Investment firms' remuneration typically includes performance fee arrangements. There is divergent industry practice in the accounting for such fees. Uncertainty arises over whether the performance fee receivable should be recognised in accordance with the criteria set out in IAS 18 *Revenue* (ie, when there is sufficient certainty that all the performance conditions will have been met and that a reliable estimate of a probable inflow of economic benefit can be made) or whether it constitutes a financial asset under IAS 39, and should be valued in accordance with the fair value rules as the performance period progresses.

PROPRIETARY POSITIONS

In determining the valuation of their proprietary positions, investment firms need to consider the fair value measurement hierarchy in IAS 39. A key consideration is whether the markets in which the investments securities are traded are active or not. An active market needs regularly occurring arm's length transactions. Therefore, if observed transactions are no longer regularly occurring, or the only observed transactions are distressed or forced sales, the market would no longer be considered active.

It is a matter of judgement whether transactions are "regularly occurring" and "distressed or forced sales". Financial assets should be assessed separately when determining if the market is indeed an active one. If it is not, a valuation technique is required for that financial instrument.

The determination of fair value therefore requires consideration of current market conditions, including the relative liquidity of the market and current credit spreads. For available-for-sale financial assets, additional considerations may arise as to whether declines in fair value of the financial assets constitute fair value losses to be recognised in other comprehensive income or impairment losses to be recognised in the profit and loss.

CONCLUSION

Overall, there are a number of areas of significant judgement in financial reporting by investment firms which may impact greatly the size of the firms' balance sheets, as well as the timing of revenue recognition. The current economic conditions in Cyprus and beyond also bring additional issues to the fore, notably impairment and fair value consideration issues for proprietary positions.

Anna Loizou is a director at PwC

GETTY IMAGES

Trading on tourism

Demetris Papapericleous highlights issues facing hotel operators when applying the IASB's forthcoming revenue recognition standard

In late 2011, the FASB and IASB jointly issued their revised exposure draft on revenue recognition. The proposed new standard is not expected to be effective before 1 January 2015, although early application will be permitted.

The core principle of the proposals is that "an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services".

Often hotels make special offers to customers, such as "pay for five nights and stay for six". Current guidance does not explicitly address such situations. This may lead to diversity in practice.

> Some entities consider special offers as promotional incentives

Some entities, for example, may consider these as promotional incentives and recognise an amount as marketing expense. Under the proposed new standard, the entity should identify promised goods or services that are distinct and should therefore be accounted for separately. This will normally lead to recording revenue at the amount of the net consideration received.

The proposals clarify that any discounts, rebates, refunds, credits, incentives, performance bonuses/penalties, price concessions or other similar items are part of the promised amount of consideration.

An entity shall make an estimate of any such "variable consideration" – which can be updated at the end of the reporting period – in determining the revenue to be recognised. This excludes any adjustments for customer credit risk, as any bad debts will be presented in the income statement as a separate line item next to gross revenue (rather than within operating or administration expenses).

Under the proposals, advances received when hotel bookings are made may need to be adjusted to reflect the time value of money. This will result in recognising an interest expense during the period between the receipt of the advance and the provision of the promised service, and recording revenue at an amount that includes the financing element when the services are delivered. Thankfully, this is not required when the period between the payment and transferring of the service is one year or less.

Demetris Papapericleous
is a partner at Deloitte

OTHER ISSUES

Impairments
IAS 36 *Impairment of Assets* defines an asset's recoverable amount as the higher of fair value less costs to sell (estimated net selling price) and its value in use (present value of expected cashflows).

The carrying values of most hotel properties in Cyprus are based on the former, with valuations being prepared by independent valuers. But the value in use could be much lower. On that basis, an entity operating in the hotel sector may be better off selling the hotel than continuing to operate it. This has been the case for a number of hotel properties that have been converted into properties for sale.

Residual values
IAS 16 *Property, Plant and Equipment* defines residual value as "the estimated amount that an entity would currently obtain from disposal of the asset… if the asset were already of the age and in the condition expected at the end of its useful life".

Determining residual values for hotel properties can have a big impact on the depreciation charge. The most critical consideration is determining whether the management's intentions are to keep the asset until the end of its life, or not. If it is, material residual values should not be expected.

4 CORNERS

The shipping news

In a world of declining vessel values and impairments, there may be stormy seas ahead unless extended disclosures allow investors to make their own judgements, says shipping expert **Marios Orphanos**

The shipping industry, and in particular commoditised shipping, is faced with the crude reality of declining market values, impairment provisions and losses on disposals of vessels.

The continuous decline in vessel values, caused by prolonged depressed freight rates, has put extreme pressure on ship owners. Previously, companies simply used broker valuations to perform impairment tests and support the carrying values of their vessels. Those days are long gone. Most companies have to use value in use (VIU) calculations to support the carrying values of their vessels. In many cases, the market values of vessels are below their carrying values in the financial statements.

VIU calculations are highly subjective and require considerable judgement to be made by management concerning the long-term forecasts of future revenues and costs of vessels and the timing of forecast disposals. Also, under IFRSs, judgement is required in calculating the discount rate to be used in these calculations.

In performing VIU calculations, most ship owners are using inflation-adjusted historic average time charter rates to predict future earnings that should be, and in most cases are, relative to their chartering strategy and their vessels' lives. But will history repeat itself in terms of the boom and bust of the past 10 years? Are the 10-year historic earning averages relevant or is it that such a VIU assumption is another way of avoiding impairment provisions in the hope that the markets will recover sooner rather than later? Will the industry see huge impairment provisions in the years to come?

Significant and unanticipated changes in time charter rates and discount rates used to derive VIU could result in material impairment provisions, as could premature disposals of vessels, perhaps at the insistence of financiers.

Companies reporting under IFRSs are at some disadvantage to their counterparts reporting under US GAAP. In deriving VIU under IFRSs, companies need to calculate the discounted expected cashflows from operating the vessel, as opposed to undiscounted cashflows used under US GAAP to assess whether an impairment appears to be present. On the positive side, an impairment under IFRS may be reversed as and when the market improves, whereas under US GAAP it is permanent.

Shipping is a volatile, highly cyclical industry. Values of vessels are driven not only by demand and supply but also by market sentiment – what you believe the markets will do and what a vessel is worth to you. Perhaps shipping is more volatile now than ever due to the presence of new entrants such as banks, commodity traders, and mining companies, not only as owners and operators but also as speculators.

Although the framework is in place, disclosure requirements under both IFRS and US GAAP are insufficient to enable users to make their own judgements. Regulators in the US are pushing for additional disclosures in the financials of shipping companies, and so should the European regulators.

In my view, extensive disclosures should be required per vessel concerning the carrying values and market values, including undiscounted and discounted VIU, explanations of key assumptions and sensitivity analysis on these assumptions, showing the impact on both undiscounted and discounted cashflows.

Ship owners should also be required to disclose the reasons for the lack of impairment charges for vessel disposals post the reporting period end.

Users of the financial statements need to understand the impact of changes in vessels' market value on the company. They need to be able to perform meaningful comparisons between shipping companies irrespective of the framework of reporting and draw their own conclusions. Extended disclosures would go some way to achieving this.

Marios Orphanos is managing director at shipping group Sovcomflot

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Thought for food

Should IAS 41 be revised to suit a globalised agriculture sector? **Maria A Papacosta** looks at the arguments

By 2050, there will not be enough food supply to feed the Earth's population. As agricultural companies seek more and more capital from the global markets to control the food chain, accounting for agricultural activities will most definitely come under the spotlight. But does the current IFRS system provide the comparability and uniformity needed? Or are further changes required if we are to create a truly global standard?

IAS 41 *Agriculture* has a preference for fair value measurement, which achieves transparency by reflecting current market conditions on a timely basis. However, at the same time it has drawn criticism as a result of:

- the subjectivity involved;
- the cost of ascertaining fair values, especially in emerging markets;
- the undesirable fluctuations in reported earnings; and
- the failure of fair value to capture the true economics of businesses.

Nonetheless, historical cost accounting is still the most widely used valuation basis in strong agricultural countries such as the UK, France and Australia. In these and other countries it is often perceived that the costs of ascertaining fair values in conformity with IAS 41 will outweigh the benefits. So, more often than not, companies rebut the presumption of reliable fair value measurement as a means of justifying the use of historical cost.

This results in a lack of international consistency and comparability.

In some cases, however, disputes over fair values and the appropriate discount rate to apply to future cashflows relating to forestry assets have found their way to the court house. The use of fair values under IAS 41 by the oil palm, rubber and forest plantation industries has not only resulted in heated debates and protests; it also involves highly subjective estimates that hinder comparability across companies and continents.

What's more, disclosure requirements are often burdensome and are another cause of major international differences. For example, in some jurisdictions disclosures tend to be less fulsome than in others. The recently published IFRS 13 *Fair Value Measurement* and its reference to "highest and best use" has also attracted criticism. It will therefore do very little to solve the issues discussed and promote global comparability and uniformity.

On the one hand, IAS 41 is viewed as too wide and burdensome by many. They like to argue that the IFRIC and its successor haven't helped by issuing too few interpretations. On the other hand, the IASB has received few requests for changes.

Whether it's back to the drawing board remains to be seen, but in the meantime proposals asking for a clearer distinction between bearer and consumable biological assets (with the former following accounting principles consistent with IAS 16 *Property, Plant and Equipment*) should be viewed positively by the IASB.

Maria A Papacosta is a partner at KPMG

4 CORNERS

Energy boost

Now that Cyprus has discovered large deposits of hydrocarbons in its Exclusive Economic Zone, **Pamela Taylor** and **Michael Antoniades** consider the accounting challenges that lie ahead

In late 2011 Noble Energy announced the discovery of 7 trillion cubic feet (200 billion cubic meters) of natural gas off the southern coast of Cyprus – enough to meet the country's energy needs for about a century according to some estimates. The discovery was confirmed by the Cyprus government.

These developments have made accounting for oil and gas exploration and evaluation activities increasingly relevant in Cyprus. They've also brought into focus some of the challenges faced by accountants in the sector.

The first challenge is the uncertainty and risk that are key features of oil and gas exploration. When the inherent uncertainty over reserve quantities is combined with the considerable up-front investment and long project lives, it inevitably involves potentially significant risks.

Another challenge is the limited IFRS guidance for specific oil and gas issues, which has resulted in diversity in practice between companies applying IFRSs.

Many pages can be devoted to this subject, but a key question is: how are costs recognised when the future benefits are uncertain?

ACCOUNTING FOR EXPLORATION AND EVALUATION COSTS

IFRS 6 *Exploration for and Evaluation of Mineral Resources* provides guidance for accounting during the exploration and evaluation phase. It allows companies to choose between capitalising and expensing such costs until there is more information about the existence of commercial reserves.

This choice can be made by expenditure type – for example, capitalising test well costs while expensing seismic costs. The choice contributes to the diversity in accounting for exploration and evaluation costs in practice.

Uncertainties over future cashflows also present difficulties in testing assets for impairment, although IFRS 6 gives some relief from the requirements up to the point that commercial reserves have been identified. However, determining and aggregating cash-generating units can be complex, particularly when fields share infrastructure.

> Risk is a key feature of oil and gas exploration

ESTIMATES AND RISKS

Uncertainties mean estimates can significantly affect the financial statements of oil and gas companies. The most obvious of these estimates is the reserves assessment. Although IFRS has no specific disclosure requirements relating to them, reserves valuations affect depreciation and impairment charges.

Reserves estimates also indicate the life of oil fields, which is one key factor in measuring decommissioning provisions.

Exposure to commodity price, currency and other market risks makes financial instruments accounting particularly relevant for oil and gas companies. Risk-sharing arrangements, including joint arrangements, are also common in the sector. So IFRS developments in these areas are also of significant interest to oil and gas companies.

WHAT'S NEXT FOR OIL AND GAS ACCOUNTING?

The future of accounting for exploration and evaluation activity under IFRS is uncertain. IFRS 6 was intended to be a temporary standard while the IASB examined extractive activities. A discussion paper in 2010 made several proposals, including capitalising all expenditure once the legal right to explore is held and standardised reserve disclosures.

Views on the proposals varied. Some respondents advocated the use of existing standards rather than an industry-specific standard, while others suggested the continuation of some existing approaches.

The IASB is expected to decide this year whether or not to take the extractive activities project onto its active agenda. That decision, and any resulting project, will be watched with interest by accountants in the industry.

But for the moment uncertainty remains a feature of oil and gas accounting – as well as of the industry itself.

Pamela Taylor is a senior manager at KPMG in the UK

Michael Antoniades is a partner at KPMG in Nicosia

CORBIS

Mind over matter

Brian Singleton-Green explains what the faculty's Information for Better Markets thought leadership initiative involves – and why it matters

Thought leadership is a strange term and not one, I suspect, that means anything to most people. But Google the words and you get about 100 million entries. To put that in proportion, if you Google "chartered accountant" you get fewer than 15 million entries. So whatever thought leadership is there seems to be a lot of it going on.

ICAEW currently has 13 thought leadership programmes and the faculty's Information for Better Markets initiative is the longest established. What does it involve? There are three key elements to the faculty's thought leadership work – reports, research and events – and they are all inter-related.

REPORTS

The most recent Information for Better Markets reports are:

- *Measurement in Financial Reporting* (2006)
- *Developments in New Reporting Models* (2009)
- *Business Models in Accounting: The Theory of the Firm and Financial Reporting* (2010)
- *Reporting Business Risks: Meeting Expectations* (2011)

We're now working on *Disclosure in Financial Reporting*, which we hope to publish by the end of this year.

These reports tackle big issues in business reporting, analyse them, point out where further work needs to be done, and make recommendations where we can. A distinctive feature of our reports is that we look at relevant academic work and reflect it in what we say. We believe this improves our work and gives it greater credibility with policymakers.

RESEARCH

Sometimes we commission work by researchers to support our thought leadership projects. We also include academics in the people that we consult on our draft reports. The researchers' papers are usually published in the leading journal *Accounting and Business Research*.

EVENTS

When we commission research papers, we generally ask for them to be presented at events that we host: conferences or stand-alone lectures. We have an Information for Better Markets Conference each December and in most years there is a relevant PD Leake Lecture, though this lecture is also used for other ICAEW thought leadership programmes. An important feature of these events is that they bring together academics and non-academics.

To engage with those who are interested in the issues that concern us we also participate in a number of non-ICAEW events around the world – either as speakers, panellists, exhibitors or delegates.

An important feature of these events is that they bring together academics and non-academics

WHY DO WE DO IT?

Our Information for Better Markets work is an important way of raising ICAEW's and the faculty's international profile. Our report on measurement, for example, was recognised as a key contribution to moving the debate away from the emotive question of whether or not everything should be measured at fair value (it won't be).

As a result of our work on business models, ICAEW has been able to make presentations on the subject to both ASB and IASB staff, and been appointed to an EFRAG advisory panel on the role of business models in financial reporting.

Our publication on business risk reporting was circulated as background reading by the international Financial Stability Board. And the IASB has expressed interest in our current project on disclosure.

The faculty's thought leadership work has also improved ICAEW's links with the academic community around the world. It's unhealthy for academics and non-academics to exist in parallel universes, and our work does something to help bridge the gap between them – to the ultimate benefit of both sides.

Brian Singleton-Green is a technical manager in the faculty

To learn more about our Information for Better Markets work, including forthcoming events, visit icaew.com/bettermarkets

GETTY IMAGES

It's all academic

Irene Karamanou highlights recent IFRS research at the University of Cyprus's Department of Public and Business Administration

The mandated switch in 2005 to IFRSs for consolidated financial statements of all publicly traded EU firms has attracted enormous academic interest, as its effects cannot be, *a priori*, determined. Proponents of IFRSs argue that the benefits of a universal accounting regime that enhances disclosure quality and comparability justify the potentially considerable costs associated with such a wide regulatory change. In contrast, opponents of IFRSs have pointed out that moving to a one-size-fits-all solution fails to reflect the important cultural differences that are reflected in the local GAAP of individual countries.

This debate has spawned much academic research into the effects of IFRS adoption. The University of Cyprus has developed significant knowhow in this area and has produced high-quality research that makes important advancements to the literature.

The first couple of papers produced related to the voluntary adoption of IFRSs. Karamanou and Nishiotis (2009) document strong positive abnormal returns at the announcement of a firm's intention to voluntarily adopt IFRSs.

This suggests that the enhanced disclosure associated with such a switch is positively valued by the market and is consistent with a reduction in the company's cost of capital.

In another related paper, the authors found that firms which voluntarily adopt IFRSs enjoy similar valuation benefits to those that list in the US. Prior studies were unable to conclude whether an important factor explaining this valuation premium is the enhanced disclosure requirements of listing on a US exchange.

More recent research work at the university examines the effects of Europe's mandatory switch to IFRSs. Karamanou, Nishiotis and Petrides (2010) examine how IFRS adoption affects trading around earnings announcements. Informed trading prior to an earnings announcement constitutes market abuse, whereby the information related to an impending earnings announcement is pre-released to a select group of market participants. Results indicate that abnormal returns are less positive (negative) in the 30-day period before a positive (negative) earnings surprise, suggesting that IFRS adoption mitigates information asymmetry costs and improves investor protection.

> There has been much academic debate on IFRS adoption

Charitou, Karamanou and Kopita (2011) examine the effect of the mandatory use of IFRSs on firms' information environment and investigate the change in the informativeness of analyst stock recommendations. This may decrease after the adoption of IFRSs if analyst output and financial disclosures serve as substitute sources of information. If on the other hand the two sources are complementary to one another, the analyst recommendations should be more informative. The evidence is consistent with the latter expectation. This result can be explained by the greater reliability of financial information produced under IFRSs.

Finally, Charitou, Karamanou and Lambertides (2010) rely on economic theory to suggest that even though increased disclosure should be beneficial to all firms by reducing information uncertainty, it may also reveal new information that forces the market to revise its cashflow expectations.

An interesting sample consists of firms for which the new information revealed by IFRS adoption is unfavourable, resulting in an overall increase in default risk (loser firms). The authors find that loser firms exhibit the same or better (deteriorating) financial characteristics in the pre- (post-) IFRS adoption period. The authors posit that in a poor disclosure environment, as the one under local GAAP, loser firms were able to conceal bad news, misleading the market.

The increased disclosure associated with IFRS, however, reveals their true type and leads the market to negatively revise valuations. Interestingly, this paper suggests that increased disclosure is beneficial to the markets even though it is not always beneficial to the firms themselves.

The advent of global accounting standards is of huge economic importance, and the university will continue to contribute to the debate.

Irene Karamanou is an assistant professor at the University of Cyprus's Department of Public and Business Administration