ICAEW FINANCIAL REPORTING FACULTY

BY ALL ACCOUNTS

MEMBERS' JOURNAL

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THE FUTURE OF UK GAAP

We speak to Ian Mackintosh about the ASB's proposals and examine their possible implications

PLUS...

IASB proposals on leasing and revenue recognition

IFRS and Islamic finance

IFRS: what will be in place by 2011?

Why do financial instruments have to be so complicated?

New briefing papers and factsheets

Business models in accounting

FROM THE CHAIRMAN

I'm delighted to welcome you to the third issue of the faculty's journal, *By All Accounts*.

As we look ahead to 2011, I think it's important to reflect on what the Financial Reporting Faculty has achieved over the past 12 months and what we have planned for the coming months. We have continued to expand our range of factsheets and briefing papers; indeed three new publications are profiled in this issue alone. Many more are in the pipeline. We have a faculty App for those of you who have an iphone! We have expanded the range of training provided to our members, with our successful roadshow series now complemented by free online webinars. Many more such events are planned for next year. In particular, our roadshows will be visiting more cities than ever. We are working hard on a major revamp of our online community and blogging platform. And members will, of course, continue to have access to our standard trackers and eIFRS, which I know many of you find invaluable.

We also provide this journal to all our members at least twice a year. This is our third issue and it is complemented by special interest supplements on both the public sector and Hong Kong. I hope you'll find it informative.

I trust you have found the Financial Reporting Faculty good value for money and will want to renew your membership in 2011. There is a lot going on at the moment in the world of financial reporting, both in the UK and internationally. We're here to help!

FROM THE FACULTY HEAD

Launched less than two years ago, the Financial Reporting Faculty promises to provide its members with 'practical help in a complex world'. And even in the relatively short time we have been in existence, the world seems to have become more and more complex. Of course, as accountants we seem to have been talking about change in our profession for ever, but as we move into 2011 it seems the pace of change is becoming ever more relentless.

After what seems like a long wait, the ASB has finally published firm proposals on the future of UK financial reporting. These proposals would see the death of UK GAAP as we know it and a major shift in how most UK companies prepare their financial statements. We're delighted to include in this issue an interview with Ian Mackintosh, the ASB Chair and the IASB's vice-chairman designate. We also include expert opinion and analysis of the details of the proposals and how they may affect you or your clients.

It's not just UK GAAP that's undergoing significant changes. The IASB have issued exposure drafts on revenue recognition and leases that could have a massive impact on many IFRS adopters. We look at the possible implications of both proposals. We also reflect on some of the changes that become effective for December 2010 year-ends, as well as outlining what looks like a long list of new and revised standards we can expect to see published in the first half of 2011.

This edition of the faculty journal explores not only these but also many of the other current challenges facing faculty members. We hope that you find it interesting. Ideas for the next edition are very welcome.

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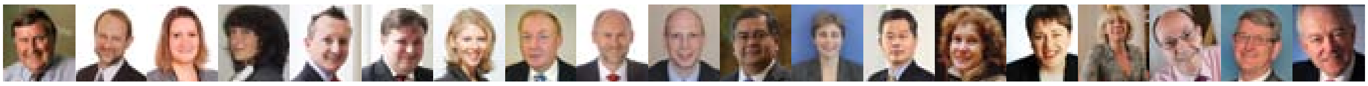

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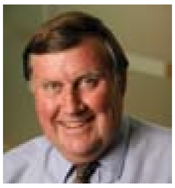
A BRAVE NEW WORLD?

Just ahead of the long-awaited publication of the exposure draft charting out the future of UK financial reporting, financial journalist Robert Bruce talked exclusively for the faculty about the road ahead to Ian Mackintosh, Chairman of the ASB and Vice-Chairman designate of the IASB.



These are difficult times for national standard-setters. In Germany it was touch and go whether they would still have a national standard-setter by the end of 2010. A combination of squabbles about funding, responsibilities, and which agency should be running it had imperilled its future. Ian Mackintosh, who will become Vice-Chairman of the IASB from next July, chairs the global group of National Standard-Setters and has at the same time been piloting the UK's Accounting Standards Board (ASB) through choppy waters towards a brave new world of IFRS-based UK financial reporting.

It has been a difficult task. Listed companies in the UK have applied IFRS since the EU switchover in 2005. But arguments about the shape of a new financial reporting regime for smaller companies and the level of detail appropriate have rumbled on ever since. There are hard-fought views and arguments from all quarters. But Mackintosh has had his eyes on one particular prize in all this. And it looks as though, with the Exposure Draft *The Future of Financial Reporting in the UK and the Republic of Ireland* now published, he has moved one significant step closer to achieving it.

On his desk are two books. One, current *UK GAAP*, is a tome which would act as a very effective doorstop or a prop for a very lop-sided table. The other is a very slim volume: *The IFRS for SMEs*. He reaches out and puts his hand on top of the enormously fat book. 'That', he says, 'will be replaced by that', and he taps the small book.

He explains: 'There will be simplified accounting for many large and medium-sized unlisted companies, which will use the IFRS for SMEs instead of existing UK GAAP. There will also be substantial disclosure exemptions for any or all subsidiaries. However, there will be appropriate accountability for publicly accountable entities, who will now use full IFRS whether they are listed or not.'

This is the first achievement. For him greater simplicity and less complexity will spring from having a smaller rulebook to hand.

Meanwhile the smallest unlisted companies will continue on their existing track. 'It will be status quo for the smallest companies', he says. 'They will continue to follow the Financial Reporting Standard for Smaller Entities (FRSSE), and that is the vast majority of companies in this country.'

And that, in a nutshell, is the Mackintosh vision for financial reporting in the UK. He sees it as a sensible structure, long in the planning, and fulfilling the right role for domestic financial reporting standards. And, given that financial reporting standards are frequently rendered unstable by change and more change, he sees another goal achieved. 'It is a framework which is sustainable in the long-term', he says.

But why, say the critics, was such a level of change necessary to bring this about? Mackintosh argues that it is an inevitable consequence of the European decision, eight years ago, to make IFRS mandatory for listed companies across the European Union. 'Change is inevitable', he says, 'because since the introduction of IFRS in the UK our constituents and our Board have always thought it important to reconsider UK GAAP.' That opened up the possibility of several different routes forward. 'And we chose to use the IFRS for SMEs', he says. 'Some said why not re-invent existing UK GAAP? But that would have been a very large job and would have involved lots of change and lots of time. And we would have ended up with a different framework to IFRS.'

But UK GAAP has not disappeared. It has just slimmed down. 'We still call our new proposals UK GAAP', he says. 'But it will be distinctly smaller than the standards we currently have. The ASB retains the right to change and modify the IFRS for SMEs', he points out. Some changes have been made as a result of the feedback to the original ASB proposals.

'There will be simplified accounting for many large and medium-sized unlisted companies, which will use the IFRS for SMEs instead of existing UK GAAP.'

'There are disclosure exemptions and there is an exemption from parent company and subsidiary cash flow statements', he says. 'There is also an exemption for small credit unions and we have changed the tax chapter.'

And there will be further amendments to fit in with existing legislation. 'It will be amended to fit the EU directives', he says. 'We have no choice. It will also be amended to fit UK company law.'

All this is not about converging or replacing UK GAAP with full IFRS. 'Because of the new rules on publicly accountable entities, there will be a few more UK companies using full IFRS than at present.' But only a few; many will use IFRS for SMEs instead. Drawing on his past career with the Australian Accounting Standards Board, he points out that 'in Australia, everybody uses full IFRS'.

There will also be work on public benefit entities. 'We are proposing and have begun work on an FRS for public benefit entities', he says. 'It won't be comprehensive. But it will cover areas where they are different, for example where they receive gifts.' He adds, 'The SORPs will continue. There is very great support for them and they will continue to provide additional guidance.'

Mackintosh is also insisting that people have more than enough time to prepare. 'There will be a full six months consultation', he says, 'until the end of April 2011; and then at least 18 months from the date of issuing it until it can be applied. So the earliest date for mandatory application will be June 2014 year-ends, but it is more likely to be December 2014 year-ends. It will give people a fair chance to get organised.'

And he is confident that people will, in the end, be happy. He sees IFRS for SMEs as a very user-friendly standard and thinks that for most the transition should be relatively easy.

As for the future of domestic standard-setters around the world, he is confident. For him he sees the fundamental aim of the UK ASB as being 'to contribute to the establishment and improvement of standards for financial reporting'. Part of it is as a help to international standard-setters in terms of research and new ideas. But it is also a question of working with the government, with all levels of the IASB and with European constituents, as well as liaising with other standard-setters and regulators in Europe, the US and beyond. It is a long way off a limited role.

'Everyone agrees they need national standard-setters', he says, 'but not everyone can organise the funding.' Germany is the prime example. But the finance hurdle should be overcome, says Mackintosh: 'There is an important ongoing role for local standard-setters, as well as bodies like ICAEW', he says. 'There is a key part to play in influencing and helping the IASB. And there is the need for research and innovative thinking.'

One issue is complexity in full IFRS and the need for local standard-setters and others to combat it. Here he remains the optimist. 'We have got complex financial reports and we have got complex financial reporting standards', he says. 'But to be fair to the IASB, the work it has done on financial instruments, for example, is substantially less complex than IAS 39.' That said the technical arguments are not likely to make future IFRS financial reporting substantially simpler: 'It does tend to go round and round in circles.' That slimmer book of financial reporting requirements sounds more attractive by the moment.

ENTER FRSME: WHAT'S THE DIFFERENCE?

Brian Shearer and Katherine Martin, respectively National Director of Financial Reporting and Assistant Manager at Grant Thornton, introduce the contents of the ASB's radical exposure draft on the future of UK financial reporting.

INTRODUCTION

The proposed overhaul of UK GAAP is considered to be the most dramatic change for decades. There is no doubt that the proposals will have a significant effect on businesses which currently apply UK FRSs. This article sets out the main areas of impact for those currently using UK GAAP and the key differences that the Financial Reporting Standard for Medium-sized Entities (FRSME) will bring.

WHICH TIER TO APPLY?

The first step for UK GAAP preparers when the new accounting standards are introduced will be to determine which tier, and therefore which accounting framework, they will apply.

Some will find that they are publicly accountable, and will have to use 'full' EU-adopted IFRS for the first time. This will be more of a burden to some than to others.

To alleviate this burden for some entities, the ASB has proposed that the smallest credit unions and friendly societies can use the FRSME, if they meet all three of the small size limits (rather than two of three) but are not eligible for the FRSSE because they are prudentially regulated.

For entities which are eligible for the small companies regime, the FRSSE continues to be available, as the ASB intends to consult separately on the FRSSE at a future date. Currently a significant number of entities which could use the FRSSE do not do so. However, the retention of the FRSSE may provide an opportunity to maintain current accounting policies through its adoption, rather than undergoing transition to the FRSME. This may be simply delaying the inevitable, but some small businesses may wish to wait for the teething problems with the FRSME to be resolved, before adopting it themselves.

The choice to 'opt-up' into a higher tier remains. For some entities the loss of accounting treatment options under the FRSME (as outlined below) may be so significant that they would benefit from adopting full IFRS. In particular, where an entity qualifies, full IFRS and the extended reductions in disclosures for subsidiaries may be an attractive option, to avoid consolidation adjustments on incorporation into IFRS group accounts.

The remaining entities will be adopting the FRSME, which is based on the IASB's IFRS for SMEs but with UK adaptations. So, what will the effect be?

PRESENTATION – WHAT WILL FRSME FINANCIAL STATEMENTS LOOK LIKE?

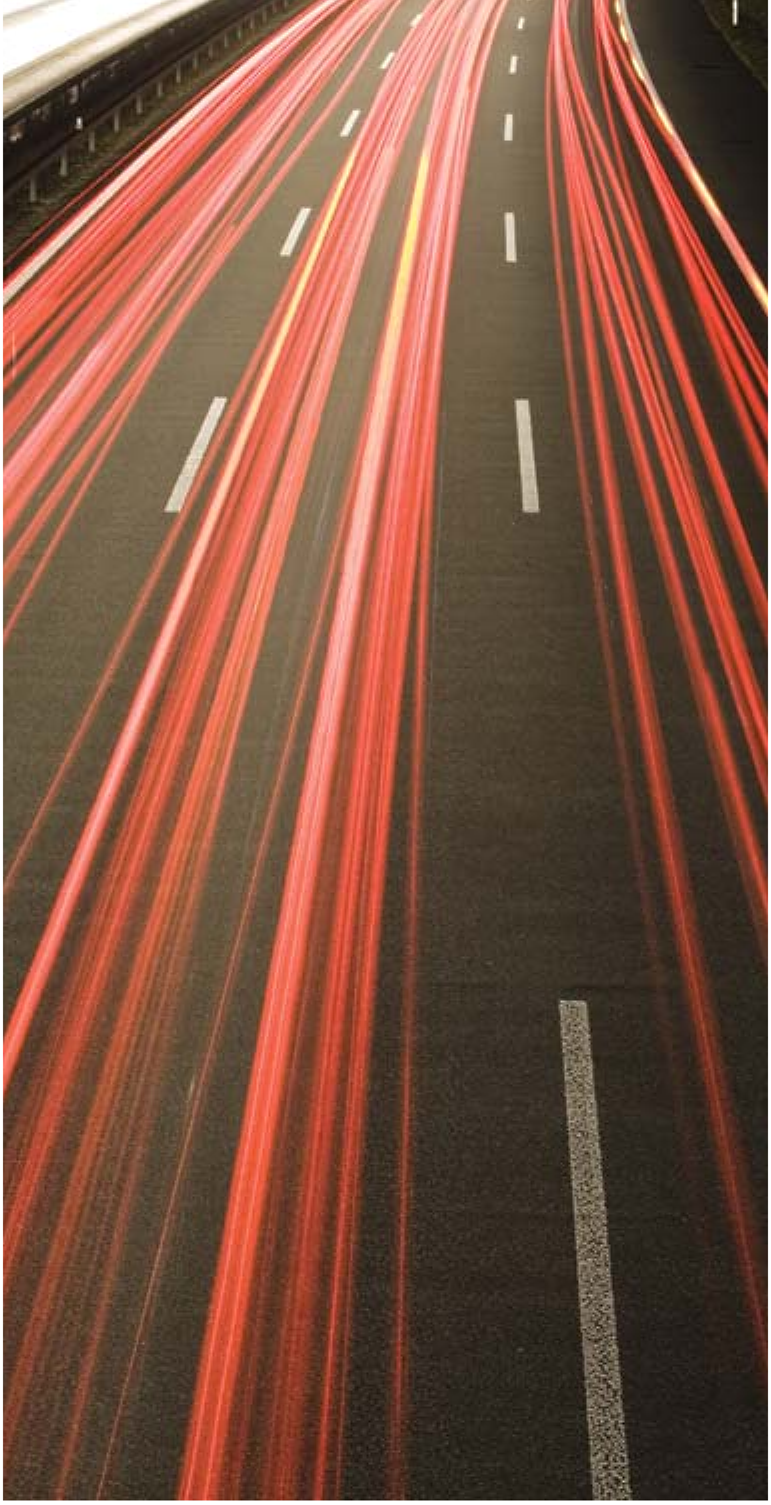
When looking at a set of IFRS accounts compared to UK GAAP, the most obvious change is the different format of the primary statements. So, will a set of financial statements under the FRSME have a statement of comprehensive income and a statement of financial position rather than a profit and loss account and balance sheet?

It seems that the answer is no. FRSME accounts will still be prepared under the Fourth and Seventh EU Directives (the 'Accounting Directives'). Therefore, they will still follow the formats prescribed by the Companies Act for the profit and loss account and balance sheet. Some extra lines and subtotals may be needed to comply with the requirements of both, but the FRSME is flexible regarding both the titles of the primary statements and the naming of the line items.

More differences are likely to be seen in areas not addressed by company law. Rather than a statement of total recognised gains and losses (STRGL), the FRSME requires a statement of comprehensive income (SoCI). Alternatively, any items of 'other comprehensive income' can be added to the profit

Table 1: Which tier to apply

	Nature of entity	Accounting regime	Reduced disclosures for …
Tier 1	Entities that have public accountability	Full EU-adopted IFRS	Qualifying subsidiaries
Tier 2	Large and medium-sized entities without public accountability Small publicly accountable entities that are prudentially regulated	Financial Reporting Standard for Medium-sized Entities (FRSME)	Qualifying subsidiaries
Tier 3	Small entities without public accountability	Financial Reporting Standard for Smaller Entities (FRSSE)	



and loss account to produce a single statement of comprehensive income.

Rather than showing movements in shareholders' funds in a note, the FRSME requires a statement of changes in equity (SoCE) as a primary statement. However, for businesses with only profit or loss for the year, dividends paid and adjustments from prior period errors and changes in accounting policy, the SoCI and SoCE can be combined into a single statement of income and retained earnings (SoIRE).

Cash flow statements prepared under the FRSME will show cash flows under three headings, operating, investing and financing activities, rather than the eight required by UK GAAP. Cash flow statement exemptions have been introduced into the FRSME, for qualifying subsidiaries and for parent company accounts presented with consolidated accounts.

Certain other disclosure exemptions are also permitted for qualifying subsidiaries, defined as those included in publicly available consolidated accounts and where there is no objection from any shareholder. These cover financial instruments (to the extent permitted by the Companies Act), pension schemes and share based-payments. Notably, there is no exemption for related-party transactions between wholly-owned subsidiaries in the current proposals, although the ASB is specifically consulting on this point.

AREAS OF DIFFERENCE MOST LIKELY TO HAVE A SIGNIFICANT IMPACT

The significant accounting differences on transition to the FRSME are going to depend entirely on individual circumstances. However, there are some changes that will have a greater impact and others that will require a completely different approach. Some of these key differences are described here.

Financial instruments

For many people, understanding the treatment of financial instruments may prove to be the most challenging area, particularly since it does not resemble the treatment under IAS 39/FRS 26. An option does exist in the FRSME to apply the recognition and measurement principles of IAS 39, but this is likely to be of benefit only in limited circumstances.

The FRSME divides financial instruments into two categories, basic and other. It sets out conditions for an instrument to qualify as basic; anything which fails those conditions is an other instrument. Basic financial instruments are those with straightforward terms, such as trade debtors, trade creditors and simple bank loans. These are measured at amortised cost, although current assets and liabilities are measured at the amount of cash to be received or paid.

Other financial instruments cover items such as derivatives and other more complex instruments. All other financial instruments are measured at fair value. Since fair valuation can be a complex, time-consuming and expensive process, there may be benefit in reviewing the terms of financial instruments such as loan agreements and preference shares to see whether they are other financial instruments and, if so, whether the terms could be amended to make them basic.

The other financial instruments most likely to be held by businesses applying the FRSME are derivatives, such as foreign exchange forward contracts. Recognition at fair value should not impose more of a burden, since a fair value is currently required for disclosure in the financial statements, but it may increase profit volatility.

Deferred tax

The ASB took the decision to replace the income tax section of the IFRS for SMEs with IAS 12 in drafting the FRSME. The main difference to current UK GAAP lies in the method used to calculate deferred tax. The UK GAAP approach is based on the idea of timing differences, while the calculation of deferred tax in the FRSME is based on temporary differences. These are differences between the carrying amount of an asset or liability in the accounts and the tax base of the asset or liability.

In some cases there may be no difference, for example pension costs, but in other circumstances there may be more deferred tax amounts to recognise and more complex calculations to perform.

Revaluation of property

Many UK businesses take advantage of the option to revalue their fixed assets to their current value, particularly for property, to reflect increases in value in the balance sheet. Bank loans secured against the property will often include covenant tests which assume that the balance sheet reflects the current value.

The FRSME does not allow a revaluation option for property, plant and equipment. This means that any property not held as investment property will have to be measured at cost less depreciation and any impairment losses. Although a previous revaluation, or the fair value on the date of transition, can be used as a deemed cost, no future increases in value will be able to be recognised. This could mean that businesses will be at risk of failing covenant tests on existing bank loans, although valuations of property could still be obtained for bank purposes even though they will not be reflected in the financial statements.

Expensing of development costs

Current UK GAAP distinguishes between research costs, which are expensed as incurred, and development costs, which may be deferred where strict conditions are met. Many businesses, particularly in the technology and media sectors, take advantage of this option to defer recognising development expenses.

In contrast with 'full' IFRS which requires the capitalisation of development costs, the FRSME requires that any expenses incurred internally on intangible assets are recognised immediately. For a start-up company particularly, this could mean that the accounts will show higher losses during the development phase. Although this may make the performance of the business appear worse, it may mean that costs which are not eligible for R&D tax credits will be tax-deductible earlier.

Other differences

There are, of course, many other differences between UK GAAP and the FRSME. Some of the more significant are outlined in table 2 below.

CONCLUSION

FRSME accounts will look much the same and many numbers will be the same. Everyone will need to consider financial instruments and deferred tax, but the extent to which the other differences apply will depend on individual circumstances. So, in short, there's no need to panic – for most, the transition is unlikely to be as much of a drama as it may at first appear.

Table 2: Other differences

Issue	FRSME treatment
Investment property	Movements in fair value are recognised in profit or loss, but do not affect distributable reserves.
Borrowing costs	All borrowing costs are expensed as incurred.
Recognition of intangible assets on acquisition	No requirement for assets and liabilities to be capable of being disposed of or settled separately for them to be recognised in a business combination. This is likely to lead to the recognition of more intangible assets in acquisitions.
Treatment of goodwill	The useful life of goodwill is presumed to be five years or less unless it has a longer useful economic life (modified as compared with the IFRS for SMEs).
Grant income recognition	Income for a grant which includes performance conditions is recognised when the performance conditions are met. There are no specific provisions for the treatment of grants relating to the purchase of assets.
Investments in quoted shares	Measurement at fair value is required for investments in shares which are publicly traded or where their fair value can be measured reliably.

SMOOTHING THE TRANSITION TO FRSME

Danielle Stewart, Partner at Baker Tilly and a member of the faculty board, shares her top tips on how to cope with the impending changes to UK GAAP.

Ian Mackintosh, in his interview on pages 4–5, has explained the rationale behind the ASB's final proposals for the future of UK GAAP and Brian Shearer and Katherine Martin, also in this issue, set out the details of the technical requirements of the proposed new standard, the Financial Reporting Standard for Medium-sized Entities (FRSME).

In this short piece, I intend to give some practical tips for accountants who will have to prepare financial statements using the FRSME.

GET TRAINING!

Every company accountant who is intending to prepare financial statements under the FRSME (rather than outsourcing to a professional firm) should attend external training that deals with the differences between the FRSME and current UK GAAP. There are too many subtleties to expect to be able to simply read the standard and then prepare an accurate set of accounts.

And if you are an accountant in a professional firm, you should ensure that you and your staff keep up to speed with all developments in the future of UK GAAP as they occur; it is up to you to help guide your clients through the biggest change to UK financial reporting in the last 40 years. No doubt all of the traditional providers of CPD, including the professional bodies, will provide courses suitable for every requirement.

THINK AHEAD

The first trial balance that will be affected by the new measurement rules will be the opening balances of the prior period comparatives to the first full FRSME year. If a company has a 31 December year end, the first year that the FRSME will apply will be the year ending 31 December 2014. The comparative period will be the year ending on 31 December 2013 and so the first date that the new measurement calculations will apply will be 1 January 2013.

One figure which will require some forethought, with many finance departments calculating it for the first time under the new regime, is an accrual for staff holiday pay; this is much more easily calculated at the relevant time, because companies are unlikely to have sufficiently detailed records to allow this to be calculated after the event.

In addition, fair values may need to be obtained. Some financial instruments need to be fair valued under the FRSME; for example an interest rate 'cap' that places an upper limit on a variable rate loan. The company will need to notify its bank no later than December 2012 that a fair value will be required as at 1 January 2013. This is because it is unlikely that banks will retain historical data for financial instruments and later requests may lead to problems.

Companies may also want to obtain the fair value of a non-investment property. Under the FRSME, such properties will have to be carried at cost less depreciation/impairment, so companies would be well advised to take advantage of the transitional provision which allows them to be brought in at fair value on the date of transition.

CHANGES TO ACCOUNTING POLICIES

Another important area that will need to be considered is to identify and plan carefully for the impact of recognition, measurement and disclosure differences on conversion to the FRSME.

The main differences are listed in Brian Shearer and Katherine Martin's article; some of these are likely to have a negative effect on the balance sheet, which might need to be explained in advance to banks, venture capital providers and shareholders.

For example, scientific projects which have reached the stage of being developed for commercial application are usually progressed using funding from universities and local enterprise development funds. The requirement to write off all development costs will destroy their balance sheets,

> 'It is up to you to help guide your clients through the biggest change to UK financial reporting in the last 40 years.'

and it will take a brave or very informed investor not to have a problem with this. Such companies might have to consider adopting full IFRS, rather than manage the fallout from this problem.

Another practical difficulty that is likely to occur, perhaps not immediately but when the next boom occurs, applies to companies which habitually revalue their non-investment properties and borrow against the resulting equity. Banks will need to be warned in advance that in this respect the financial

statements will no longer provide a meaningful picture of the company's net assets; covenants may be breached. Such contractual arrangements may need to be renegotiated, and for something like this, the earlier it is addressed, the less likely it will become an issue.

DON'T WORRY ... WE'RE HERE TO HELP

My final and most important top tip is not to regard the introduction of these new requirements as a problem. Yes, if you are not familiar with IFRS, you will need to learn some new ways of doing things ... even if you are familiar with IFRS, there are new formats to learn, and some recognition and measurement differences to get your mind around, but whatever happens, the Financial Reporting Faculty is here to help you see a practical way through this latest addition to the complex world of financial reporting!

WANT TO KNOW MORE?

The Financial Reporting Faculty webinar on the Future of UK GAAP on 17 November 2010 was presented by David Loweth of the ASB and Kathryn Cearns, Consultant Accountant at Herbert Smith LLP. A recording is available to view at icaew.com/futureofukgaap

Additional webinars on the FRSME are being presented by Brian Shearer and Danielle Stewart on 13 December 2010 and 12 January 2011. Details can be found at icaew.com/frf (under 'more events'). In the first of the two webinars, we look at how the new FRSME fits into the proposed UK financial reporting framework, which companies will have to apply it and, for those organisations that have a choice, the possible advantages and disadvantages of switching to the new standard. The second webinar addresses the more specific requirements of the FRSME and the practical implications of applying the standard.

Each faculty webinar is recorded so you can access them at a later date.

THE CALM BEFORE THE STORM?

Eddy James, Faculty Manager, explains the latest developments in UK GAAP and considers what changes will arrive before the proposed 'big bang' in 2013–14.

A lot of space in this issue has been rightly dedicated to the future of UK GAAP. However, the proposed changes won't take effect until 2013–14 at the earliest … and in the meantime there are ongoing changes to existing standards that you need to be aware of. So let's take a look at some developments that will apply for the first time in 2011 for many of the entities which currently use UK GAAP.

FRS 30 *HERITAGE ASSETS*

A heritage asset is defined by FRS 30 as 'a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture'. Therefore FRS 30 will primarily affect museums and art galleries, though other organisations may also find some of their assets fall within its scope.

The main impact of the new standard, which is mandatory for periods beginning on or after 1 April 2010, is the introduction of significant new disclosure requirements for reporting the content and value of collections. Regardless of whether heritage assets are reported in the balance sheet or not, these new disclosures will provide information about an entity's total holding of such assets and its stewardship of them.

It is worth noting that historic assets used by the entity itself in its operations should be accounted for under the existing requirements for fixed assets, as they are not held primarily for their contribution to knowledge and culture and hence are not considered heritage assets. Such assets should continue to be accounted for as operational assets in accordance with FRS 15 *Tangible Fixed Assets.*

UITF 47 *EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS*

UITF 47 provides accounting guidance where all or part of a financial liability is extinguished by the issue of equity instruments. Such arrangements are often referred to as 'debt for equity swaps'. During the economic crisis, a number of well-known UK entities found themselves involved in such transactions, including Jessops, Samsonite, Foxtons, the Independent Newspaper Group and Admiral Taverns.

The abstract states that an entity should normally measure the equity instruments issued to settle the outstanding liability at their fair value on the date of extinguishment. Any difference between the carrying amount of the liability extinguished and the fair value of equity instruments issued is recognised in profit or loss.

UITF 47 mirrors the requirements of IFRIC 19 and is effective for periods beginning on or after 1 July 2010 for those entities within the scope of or which chose to apply FRS 26 *Financial Instruments: Recognition and Measurement*.

OTHER AMENDMENTS TO MAINTAIN CONVERGENCE WITH IFRS

Other changes to UK standards bring in to UK GAAP amendments made to the equivalent international standards. These include an amendment to FRS 25 relating to the classification of rights issues denominated in a foreign currency and a handful of minor changes arising as a consequence of the IASB's annual improvements project.

WHAT ELSE IS ON THE HORIZON?

A quick glance at the latest ASB Status Report reveals that there are few, if any, further changes in the pipeline. It appears that the main focus is very much on the future direction of UK GAAP. This appears to be the calm before the storm. Enjoy the relative tranquillity; much bigger challenges lie ahead if the ASB pushes ahead with its radical plans!

PROPOSALS TO IMPROVE LEASE ACCOUNTING

Barbara Davidson, Technical Manager at the IASB on the lease accounting project, gives her views on the IASB proposals on lease accounting.

The accounting for leases has been debated for many years. Today's lease classification requirements produce significant differences in financial statements. Finance leases result in the recognition of assets and liabilities in the financial statements of lessees; but operating leases do not.

Operating lease obligations represent the greatest source of off-balance sheet funding for many companies and are seen as a significant source of leverage. Because assets and liabilities are not recorded for such leases, investors and analysts must make estimates using general and sometimes incomplete information from the notes. As a result, many argue that off-balance sheet accounting for leases does not provide the best and most accurate information to investors.

The different accounting for operating leases and finance leases also encourages entities to structure a lease to obtain a particular accounting outcome. This impairs comparability.

The joint lease project by the IASB and the US FASB is designed to address these problems. The Boards published the Exposure Draft (ED) *Leases* on 17 August 2010. The proposed changes address concerns about the current model and aim to provide investors with better information about the cash flows arising from lease contracts. The problems outlined above would be addressed by eliminating the distinction between operating and finance leases and recording all leases on the balance sheet. Investors would have more complete and useful information, significantly reducing the need for them to make additional adjustments. Lessees' financial statements would also be more comparable. Under the model proposed in the ED, a lessee would record an asset for all lease contracts (the 'right-of-use' asset). The lessee would also record a liability to make lease payments.

OPTIONS TO EXTEND AND CONTINGENT RENTALS

Many lease contracts also include complex features, such as options to extend the lease or payments based on contingent events. The ED proposes a method of accounting for these items that should provide users with better information about cash flows arising from lease contracts that contain features of this type.

The IASB considered requiring separate accounting for options to extend. However, there was concern that this approach would be too complex to apply. The IASB also considered simply disclosing the existence of options, but this approach could result in significant understatement of assets and liabilities, as well as creating structuring opportunities. The IASB therefore decided to include the cash flows from optional periods in the recognised lease assets and liabilities when it is considered likely that the option to extend the lease will be exercised.

In a similar way as for extension options, excluding contingent payments from the amounts recognised in the financial statements could lead to understatement of the related assets and liabilities, which would not provide useful information to investors, and could again present structuring opportunities. Consequently, the IASB proposes that expected payments under contingent rental arrangements should be included in the measurement of the recognised assets and liabilities.

Under the proposals, estimates of amounts payable during optional periods and under contingent rental arrangements are reassessed if there is an indication that there has been a significant change in these assets or liabilities.

SHORT-TERM LEASES

The proposals include an option to apply simplified accounting for short-term leases ie, leases with a maximum possible lease term of 12 months or less. This was included to address the concern that the costs associated with applying the proposals to shorter-term leases might outweigh the benefits.

LESSOR ACCOUNTING

The ED also includes proposed changes to lessor accounting. Under these proposals, lessors would record a 'right to receive lease payments' for all lease contracts. The accounting for the underlying asset would depend on the lessor's exposure to risks or benefits associated with that asset.

The ED was open for comment until 15 December 2010. The IASB is currently considering views and suggestions received on the proposed model, and will be undertaking fieldwork to assess the costs and benefits of the proposals.

The views expressed in this article are the author's own and do not represent the views of the IASB.

A STEP TOO FAR: ARE THE IASB'S LEASES PROPOSALS JUST TOO COMPLICATED?

John Drake, a chartered accountant with over 20 years' experience in the leasing industry, gives his personal views on the IASB proposals and explains why he thinks more work is needed before a new standard is published.

There is probably a consensus that there are failings in IAS 17 *Leases* with regard to classification between finance and operating leases and the consequential quite different accounting treatments. In addressing this problem the IASB have proposed solutions that are inconsistent, complex, volatile, and administratively burdensome on both lessees and lessors.

The introduction of the 'right of use' model means that lessees must, for all leases, capitalise an asset and recognise a liability in a way very similar to the current treatment of finance leases. This principle probably has broad support and addresses the problem of eliminating the 'bright line' in classifying leases. There would be much less controversy if left simply at that.

Unfortunately the measurement of the asset and liability includes options to extend and contingent rentals, both of which may not lead to any future cash flows. This is not consistent with the IASB's own framework definition of a liability as a 'present obligation of an entity to transfer an asset'.

The problem is exacerbated by the requirement to assess how much of these options to extend and contingent rentals should be included. The IASB proposes a complex and judgemental method, with the lease term defined as 'the longest possible term that is more likely than not to occur' and using a probability-based approach to determine the quantum of rental payments. The myriad of possible outcomes make these estimates highly subjective. Surely a better alternative would be to retain the current approach of including such options only if they are reasonably certain to occur?

The reassessment of these subjective measures given changing economic, business or technological circumstances could produce high volatility in earnings. Does this really help users understand the underlying financial performance? The need to make such judgments and the difficulties of building systems to manage them is a cost that the IASB has largely dismissed in its explanations by providing that a reassessment is only required if a significant change in lease payments is expected. The challenge is to determine what is 'significant'. How will you know this until an assessment is made?

The IASB's proposals also address lessor accounting, recognising that it makes sense to maximise consistency with lessee accounting.

Unfortunately they don't achieve that objective by introducing two different approaches.

The 'derecognition approach' recognises a right to receive rentals, reflecting the lessee's obligation to pay, leaving only the lessor's retained residual value within its tangible fixed assets. The method is a logical reflection of the lessee's right of use.

The IASB, however, are proposing an alternative 'performance obligation' approach where the lessor retains exposure to significant risks or benefits. A key objective of the IASB proposals was to remove the perceived artificial distinction between finance and operating leases; how can it be consistent to have two approaches for lessors if there is only one approach for lessees? The performance obligation approach creates for the lessor an asset to receive rentals while retaining the asset in tangible fixed assets. The IASB argue that these assets are distinct, but the effect is that the same asset is capitalised by both lessee and lessor!

The performance obligation approach results in income recognition very different to the derecognition approach, as fixed assets are generally amortised on a straight-line basis while financial assets are amortised on an interest basis. This results in an inconsistency between the recognition of lessor income and lessee expense. Furthermore, it is easy to foresee different lessors treating identical arrangements differently due to differing judgements of risks and benefits. The conclusion must be that there should be a single approach for lessors, the derecognition approach, which reflects the treatment applied by lessees.

The IASB recognise that leasing is an important source of finance and that the accounting will have significant impact on business, yet are aiming to issue a standard by June 2011. Getting the accounting right must be more important than achieving this target.

REVENUE RECOGNITION: CHALLENGES AHEAD?

Phil Barden, Associate Partner in Deloitte's UK technical department and a member of the faculty's Financial Reporting Committee, considers some of the potential impacts of the IASB's proposals on revenue recognition.

On 22 October 2010, the comment period ended for the joint IASB and FASB Exposure Draft (ED) *Revenue from Contracts with Customers*. The Boards will now consider the responses received, and the input from subsequent roundtable discussions, with the aim of finalising a new standard in 2011.

It seems clear that the proposals will have a significant impact for some IFRS reporters. But just how widespread will that impact be?

CONTROL OF SERVICES

Frustratingly, at this stage, it is hard to say. The most radical proposal in the ED is to remove the current distinction between goods and services, and to focus instead on when the customer obtains control of whatever is being supplied. This change could, in theory, affect the accounting required for both goods and services – but the greatest uncertainty is over the latter.

'The move to a control model is not the only important change proposed by the ED.'

If a customer obtains 'control of a service' only at the end of a contract, revenue will be recognised at that point, which would often be later than under existing IFRSs. But for at least some services, control will be transferred continuously, in which case, revenue will still be recognised over the period of the contract.

The problem is that it is not always easy to understand what might be meant by a customer having 'control of a service'. And the ED is not terribly clear on this subject. Although it includes an overall principle and sets out four indicators, the former is opaque and the latter are not yet fully developed.

A key question relates to customer-specific work that a seller has carried out but which is not yet 'in the hands' of the customer. Examples might include design work that is still in progress, or testing that is being performed on medical samples. If the customer cannot avoid paying for what has been done so far, does the customer have control of this 'work in progress'? Would the customer need to have the right to take physical possession of the incomplete work and ask someone else to finish it? Or is it sufficient that it could not be used to supply someone else? The ED is unclear.

MULTIPLE ELEMENT ARRANGEMENTS

The move to a control model is not the only important change proposed by the ED. It introduces new guidance, and in some cases mandates particular methodologies, in areas that IFRSs have previously left to judgement.

An important example is the allocation of the total contract price between the different items being supplied under a contract. Existing IFRSs do not include any guidance on this, but the ED would require a strict allocation in proportion to the stand-alone selling prices of those items. In many cases, this methodology will give perfectly reasonable outcomes, but in some cases it will not. In particular, where a high margin item is sold with low margin items, a discount may be given only on the former – but the ED may require it to be allocated across all items, perhaps making the latter loss-making and requiring a day one loss to be recognised on what is overall a profitable contract. That doesn't seem right. So what are the alternatives?

Some believe that a company should have the freedom to devise its own methodology for allocating the total contract price, because any imposed methodology is likely sometimes to give outcomes that don't reflect the contract economics. But others would argue that a standard allowing complete freedom would not be sufficiently robust, and would not result in proper comparability between companies. It is not easy to balance these different objectives. And, of course, whereas existing IFRSs are relatively light on rules, the opposite is true of existing US GAAP. So it would not be surprising for the IASB and FASB to have slightly different perspectives.

FINAL THOUGHTS

The IASB is keen to finalise the new revenue standard before Sir David Tweedie retires in 2011. But this will be a real challenge, not least because of the issues described above. An improved and converged revenue standard is worth having. But this project has been running for many years – it's a marathon, not a sprint – and revenue is a key element of financial reporting. The most important thing is to take enough time at these final stages to get the standard right.

DO FINANCIAL INSTRUMENTS HAVE TO BE SO COMPLICATED?

Andy Simmonds, Partner at Deloitte, member of the ASB and Faculty Chair, asks whether we need such detailed guidance on accounting for financial instruments and whether the IFRS for SMEs guidance on this topic offers a solution that is sufficient for most corporates.

I've been around the block a few times – taught accounting for 7 years, worked in a big firm technical department for 25 years and been a partner for 11 of those years. But my heart sinks when the topic of financial instruments comes up. Each technical department now has a group of 'financial instruments specialists' who alone are qualified to dispense hideous answers based on the latest IFRIC rejection notice. It feels like the lunatics have taken over the asylum. Why is it all so complicated? Is it a case of the banks coughing, and everyone catching their unpleasant virus? Do we need hundreds of pages of accounting rules covering embedded derivatives, eligible hedged items, and fair value options? Or is there another way?

I've just completed writing our Deloitte guidance on the IFRS for SMEs. I can't say 'I've seen the light', but it is a lot simpler – and probably sufficient to deal with most corporates.

The first attraction is the length of the material – 15 pages on basic financial instruments and another 7 on more complex instruments. This compares to 345 pages in full IFRS on recognition and measurement, and a further 82 pages on disclosure!

A second attraction is that entities with only basic transactions need look only at the 15 pages on basic instruments (that is Section 11 in the IFRS for SMEs). The approach to basic instruments is generally a cost basis, with income and expenses spread on an accruals basis.

Where an entity engages in swaps or forward exchange transactions, then they need to refer to the 7 pages of Section 12 in the IFRS for SMEs, which cover more complex instruments. Unlike current UK GAAP, this ensures that all contracts with nil cost, but which may acquire a positive or negative value, are not overlooked but are included on the balance sheet at their fair value. I regard this as very necessary – some of the failures of the past were due to these types of 'derivative' instruments being hidden off-balance sheet, and then suddenly emerging with catastrophic effect.

The IFRS for SMEs offers just four strategies for hedge accounting using complex instruments. The four 'permitted' strategies in the IFRS for SMEs are to hedge account for:

- changes in interest rates on debt items;
- changes in foreign currency of a future transaction;
- changes in the price of a commodity of a future sale or purchase; and
- changes in foreign currency of foreign net investments.

Where an entity wishes to engage in anything more exotic, for example using options, or combining instruments in a hedged portfolio, then they could switch to the 345 pages of full IFRS accounting, but still avoid the 82 pages of full IFRS disclosures.

Could the IFRS for SMEs be improved? Undoubtedly 'yes'. It has been written from scratch, and the first version is yet to be fully tested in practice. Helpfully, the IASB has put in place the mechanism for reviewing how it is working, and recommending improvements for the second edition in a few years' time. There are some simple changes that could be made – for example, allowing entities to hedge a foreign currency purchase up to the time the bill is paid, and not just to the invoice date.

While I believe that life now is more complex than I would like, there is still much to commend the IFRS for SMEs, and I look forward to it becoming the basis of UK GAAP.

One final thought. Could the IASB divide their full standards on financial instruments into basic guidance suited to most corporates, and complex guidance for those who want to play complex games? Why not?

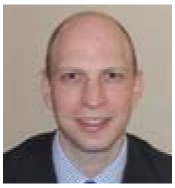
Section 11
Deals with basic instruments

Section 12
Deals with more complex instruments and simple hedging strategies

Full IFRS
Full range of instruments and hedging strategies

PROFIT ALERT!

John Boulton, Faculty Manager, looks at how changes to IFRS 3 could impact your bottom line.



There have been a number of changes to IFRS that come into force in 2010, some eye-catching, others less so. Finance directors are likely to be particularly interested in those that affect profitability, and in this article I explore one of these in more detail.

Recently completed an acquisition? Unfortunately there's now a rather significant debit to be posted to profit. In previous periods, acquisition costs would have been capitalised as part of the investment and therefore would find their way into goodwill on the consolidated balance sheet. No longer. Those costs are now required to be expensed.

This change is one of a number of revisions that have been made to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements*. The changes are far reaching and further details of them can be found in the faculty factsheet *IFRS 3 Revised*. Revised IFRS 3 (and IAS 27) is effective for accounting periods beginning on or after 1 July 2009.

The profit impact of the revisions doesn't stop at acquisition costs. New IFRS 3 introduces substantial guidance on assessing when an intangible asset is separately identifiable, the net impact of which is likely to result in a greater number of intangibles and therefore a higher amortisation charge. And there is another potential debit (or perhaps a credit) to profit or loss. Contingent consideration must now be anticipated and finalised at the acquisition date. Subsequent adjustments to reflect the actual amount paid (or refunded) must be made to profit or loss. Again, possibly a very material amount.

Further earnings volatility will arise where an entity completes an acquisition in stages, as the pre-existing stake in the new subsidiary must be revalued to fair value at the point where control is obtained. Similarly, if there is a partial disposal where a non-controlling interest in a former subsidiary is retained, this remaining stake must be fair valued at the point when control is lost. In both cases, any gain or loss goes to the income statement.

As the numbers of mergers and acquisitions begin to pick up, companies would be well advised to pay close attention to the impact of the new IFRS requirements.

A faculty factsheet is available on this topic, *IFRS 3 Revised*. It examines all of the key changes to IFRS 3 and IAS 27 and considers the practicalities of applying the new requirements. Members involved in 2010 IFRS reporting should also consult the new faculty factsheet on 2010 changes, *2010 IFRS Accounts*. If you want a printed copy of either factsheet, let us know at frfac@icaew.com

FINANCIAL REPORTING IN HONG KONG

Hong Kong is the second largest city in terms of ICAEW membership, so for the first time *By All Accounts* has published a Hong Kong supplement. Here we include an extract from our exclusive interview with Dr Zhang Wei-Guo of the IASB and highlight some of the other articles included in the supplement.

In October Dr Zhang Wei-Guo, IASB Board member since 2007, spoke exclusively to the faculty's Eddy James and Nigel Sleigh-Johnson.

Are there any lessons that the US could learn from China's experience of transitioning from a rules-based approach to a more principles-based approach?
I have noticed that US constituents have raised concerns about issues such as law suits, enforcement, understandability, training etc. But these are the same issues encountered all over the world! If countries like China, Japan and South Korea can move to IFRS, why can't the US? It should be relatively easy for them to do so as international standards are based on the notion of common law that is familiar to all Anglo-Saxon countries, and there are no language issues to contend with.

I think one thing is quite important here. Each country moving to IFRS needs to have a real willingness to abolish established practice, a strong commitment to change.

The focus at the moment is very much on convergence with US GAAP. How much do you think can realistically be achieved by 2011?
We already have redoubled our efforts to achieve the convergence timetable, as requested by the G20. Maybe we won't finalise some of our projects on time. Some may slip. But I think the achievement has nonetheless been remarkable. However, I do not think non-US constituents would like to see another round of convergence after 2011.

What do you consider to be the IASB's biggest achievement? And what has been your biggest disappointment?
Our biggest achievement is the growing influence of IFRS around the world. If you go back one or two decades, many countries would question whether international standards were better than US GAAP. Some people preferred to move towards US GAAP. But now I think the answer is clear, there are no economies discussing the possibility of adopting or converging with US GAAP.

Even so, given our huge efforts on convergence, it is disappointing that we have not achieved more. We might not be able to complete everything next year as we'd hoped.

If you could give one piece of advice to Sir David Tweedie's successor as Chairman of the IASB, what would it be?
Standard-setters should have broad views. I don't think we can set standards purely based on a conceptual framework or on mathematical reasoning. To some extent, accounting is a social science. You must take into consideration different socio-economic factors and take a pragmatic approach. So think about issues such as costs and benefits, implementation, enforceability and most importantly the economic consequences of any new standards.

OTHER ARTICLES INCLUDE

Rewriting the Companies Ordinance
Andrew Tortoishell and Nicky Cardno, Partner and Professional Support Consultant respectively at Herbert Smith, Hong Kong, look ahead to major accounting-related changes expected to Hong Kong company law.

Getting accounts right!
Stephen Chan, Partner and Head of Technical & Training, BDO Hong Kong, provides some timely reminders for faculty members of the findings of the HKICPA's latest Quality Assurance Report.

Hong Kong financial reporting: some current issues
The HKICPA recently invited comments on an exposure draft of a new Hong Kong Interpretation on accounting for term loans, and on the IASB Exposure Draft *Deferred Tax: Recovery of Underlying Assets (proposed amendments to IAS 12).* Steve Ong FCPA, FCA, Director of Standard Setting at the HKICPA, explains why.

The full text of the interview with Dr Zhang Wei-Guo and the rest of the Hong Kong supplement can be accessed by faculty members at icaew.com/frfcommunity

FINANCIAL REPORTING IN THE PUBLIC SECTOR

Following the success of the first public sector supplement to *By All Accounts,* published in July 2010, a second supplement has been published. Here we highlight some of the contents.

This year has seen the start of some potentially momentous changes for the UK public sector. With a new coalition government in place and the budget deficit higher than it has been for many years, radical plans are being put forward by the UK government to rebuild confidence in the British economy.

The government has decided to tackle the deficit mainly through very substantial reductions in spending. There will as a consequence be a focus on reducing waste and inefficiencies in the public sector, where they exist. The Comprehensive Spending Review (CSR) has started to show the way forward, and public sector finance professionals will be on the front line of many of the published initiatives. They will need to adapt to an environment where they need to operate on a 'more with less' basis. Government finance teams will need to play a key role in holding the delivery of the CSR to account at departmental level, and the finance director role will become more strategic as a consequence.

The next few months, and indeed the next few years, will see many changes in the public sector. In the public sector supplement, we discuss some of the key challenges involved.

PENSIONS

Jonathan Downes and Janet Eilbeck of PwC highlight how changes in pensions arrangements will have a major impact on the public sector over the coming months.

THE GREEN AGENDA

There have been surprising announcements in relation to the green agenda. Mark Williams from Deloitte suggests that the green agenda is a complex, multi-faced challenge that demands a strategic cross-cutting response.

IMPLEMENTATION OF IFRS

On the positive side, Chris Wobschall from HM Treasury reports that it was a good year for public sector financial reporting and that IFRS has been delivered successfully in central government and the NHS despite a very demanding timetable.

POLICY DEVELOPMENT: AN INTANGIBLE ASSET?

Elizabeth Dobson explains through a case study that in some cases, policy development may constitute an intangible asset.

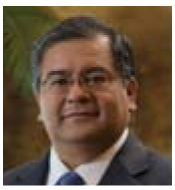
VALUE FOR MONEY

Paul Dossett from Grant Thornton discusses how, in a new age of local accountability and increased public scrutiny, local authorities need to demonstrate that they are achieving value for money while reducing costs.

The full text of the Public Sector supplement can be accessed by faculty members at icaew.com/frfcommunity

APPLYING IFRS TO ISLAMIC FINANCE

Mohammad Faiz Azmi, Global Islamic Finance Leader at PricewaterhouseCoopers, looks at the growth of Islamic finance and the problems this may create for the IASB in their quest to make IFRS a truly global set of standards.



One of the new areas in international business is the growing awareness and adoption of Sharia principles in finance. This new area is referred to as Islamic finance and encapsulates banking, capital market and asset management activities. Islamic finance has its roots in key locations around the world such as Kuala Lumpur, Dubai, Bahrain and London.

There are a number of key foundation blocks that are needed in order to facilitate its growth; the main ones being the taxation and legal frameworks. With the increasing number of cross-border and regional transactions as well as investments, there is now an increasing focus on the accounting framework used, and a growing need to enhance comparability and transparency among Islamic finance players.

BACKGROUND

Islamic finance is based on Sharia principles such as the avoidance of interest or usury, speculation or gambling, uncertainties or ambiguities and certain defined activities, such as those which are alcohol related. It is based on a number of classical contracts used some 1400 years ago that have been adapted to fit in with modern times by Sharia scholars or lawyers.

The common view is that while trading and profits are permitted, money lending as a commercial activity is not. Further, the use of profit-sharing elements and real assets are more prevalent in Islamic finance.

While Islamic finance was widely-embraced centuries ago, its modern revival can be traced back to the 1960s by pioneers in a few Muslim countries like Egypt, Malaysia and Pakistan. A second wave of government-driven entities emerged in the 1970s and 1980s, with a third wave of privately-owned players occurring in the 1990s. The real growth has only been in the last decade, with the emergence of international players creating Islamic 'windows' or entities to do with Islamic finance. The industry is relatively young, and still undergoing a process of evolution with many issues yet to be resolved. Thus, in certain aspects, such as product range, market penetration, and regulatory practices, it may be unfair to compare Islamic finance with the more established conventional market.

FRAMEWORKS

There are essentially two major accounting frameworks in the world, US GAAP and IFRS. As Islamic finance is principally practised in the Middle and Far East, IFRS is usually the most commonly used framework. The degree of carve outs or departures from IFRS employed varies from country to country. Some jurisdictions, like Malaysia and the United Kingdom, do not have specific Islamic accounting standards and simply follow IFRS. However, countries like Bahrain, Pakistan and Indonesia have specific Islamic accounting standards which operate alongside IFRS but are not always in compliance with them.

One country in particular, Bahrain, stands out, as they have their own accounting framework as issued by the Auditing & Accounting Organization of Islamic Financial Institutions (AAOIFI), which is also used as a benchmark by many other countries. However, one should note that many of these countries have not yet, as a principle, fully adopted IFRS as their governing accounting framework.

The IASB have publicly stated that they are looking at Islamic finance in their quest to make IFRS a truly global set of standards. To assist them in their deliberations, the Asian-Oceanian Standard-Setters Group (AOSSG) published a research paper in September 2010 examining the issues that prevent IFRS from being fully adopted globally.

KEY ISSUES

The two key issues arising from this research are the acceptability of substance over form and the time value of money, both of which are firmly embedded in IFRS.

The objection to substance over form is that since many classical contracts are used in a structured way to be Sharia compliant, there would be resistance to showing a different accounting treatment. The most common example is that some Islamic rental agreements, or Ijarah, could be treated as finance leases under IFRS rather than as rental agreements.

Sharia prohibits the payment or acceptance of interest fees for loans of money and this creates concerns about using the time value of money. While some jurisdictions do accept the use of the concept for valuation and impairment purposes and as a proxy to market prices, there are others who believe that the mere use of any interest concept, whether explicit or implied, is abhorrent.

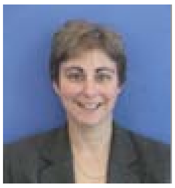
While the AOSSG detailed some 15 specific issues relating to the application of IFRS to Islamic finance, many are due principally to these two key issues.

CHALLENGES

Going forward, the challenge is to reconcile some of these views and have a single, globally accepted accounting framework, which will assist the growth of Islamic finance internationally. The IASB is to be commended for trying to find a solution but much soul searching needs to be done among national regulators and standard-setters as to whether 'carve outs' to IFRS are still the correct approach going forward.

IFRS: WHAT WILL BE IN PLACE FOR 2011?

Sondra Tarshis, Director at Mazars LLP and a member of the faculty's Financial Reporting Committee, provides an update on the IASB-FASB convergence programme and explains what new standards we can expect to see finalised by June 2011.



The original target date for the IASB and FASB (the Boards) to complete their convergence programme was June 2011. This was considered helpful for the next wave of countries moving to IFRS. It was also designed to enable the SEC to decide whether they should require IFRS for US registrants on a timely basis.

However, before the G20 meeting in Toronto in June 2010, the Boards explained that their stakeholders were concerned about their ability to provide high-quality input on the large number of major exposure drafts that would be needed to achieve the deadline. There was simply too much to do in the available time. Therefore, the Boards modified their strategy. They retained the targeted completion date for projects where the improvements to IFRS and US GAAP were most urgent and set a later date for projects with a relatively lower priority or which will require further research and analysis. Nonetheless, the timetable remains ambitious.

The IASB intends to have the standards shown in the table opposite completed by June 2011 or earlier.

In addition to those projects, there are a number of narrow-scope improvements that are also expected to be completed by June 2011.

While the scope of some projects has been restricted to relatively minor changes or additional disclosures, others such as leasing, revenue recognition, insurance and financial instruments, would result in significant changes to existing practice. Some of these topics are discussed in more detail in this issue.

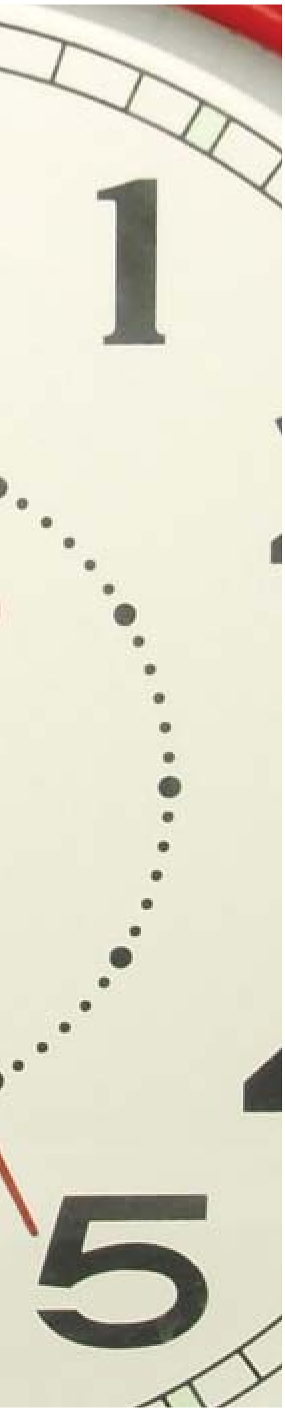
It is far from certain that the revised deadline is achievable since much depends on feedback from the stakeholders. The effective date of application for most of the new standards is not yet decided, although the Boards have recently begun consulting on how and when the new standards will be introduced. Whatever they conclude, it is clear that there will be a substantial amount of change affecting most areas of the balance sheet in the next few years.

FORWARD PLANNING

The complete set of new and revised standards will require the reworking of many of the accounting policy decisions made on first time application

of IFRS and the development of new systems and processes, and will result in much additional disclosure. The volume of work required to make these changes should not be underestimated. As such, entities should consider planning and budgeting for how they will transition to the new suite of standards that are planned for 2011.

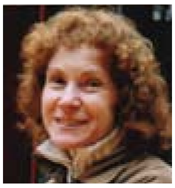
Table: IASB workplan – projected timetable



		Exposure draft	Standard
Financial instruments	Classification and measurement: financial assets and financial liabilities		IFRS 9
	Impairment methodology: amortised cost and impairment of financial assets – expected cash flow approach to determining effective interest and impairment	November 2009 (comments due 30 June 2010)	Q2 2011
	Hedge accounting – fundamental reconsideration of the hedge accounting requirements	Q4 2010	
	Asset and liability offset – to address the differences on balance sheet netting of derivatives and other financial instruments between IFRS and US GAAP	Q4 2010	
Fair value measurement	Single source of guidance on fair value measurement	May 2009 (comments due 28 September 2009)	Q1 2011
	Limited exposure draft on disclosure of measurement uncertainty	June 2010 (comments due 7 September 2010)	
Consolidation	Consolidation and disclosure – applies a single control model to all entities and enhanced disclosures about the entity's involvement with other entities	Publicly available working draft August 2010	Q4 2010
	Investment companies – defines investment entities and requires fair value through profit or loss for investments that the investment entity controls rather than consolidation	Q4 2010	Q2 2011
Derecognition	Amendment to IFRS 7 – requires increased disclosure on derecognition transactions		Amendment to IFRS 7 effective periods beginning on or after 1 July 2011
Insurance contracts	Phase 2 of IFRS 4 with requirements for the recognition, measurement, presentation and disclosure of insurance contracts	July 2010 (comments due 30 November 2010)	Q2 2011
Post-employment benefits including pensions	Changes to the recognition, presentation and disclosure of defined benefit plans	April 2010 (comments due 6 September 2010)	Q1 2011
Leases	A new single approach to lease accounting where all assets and liabilities arising from leasing contracts are recognised on balance sheet	August 2010 (comments due 15 December 2010)	Q2 2011
Revenue Recognition	Aims to establish principles for recognising revenue that can be applied across various industries	June 2010 (comments due 22 October 2010)	Q2 2011
Financial statement presentation	Limited amendment to IAS 1 – requires a single performance statement with separate presentation of OCI	May 2010 (comments due 30 September 2010)	Q1 2011
Joint ventures	Establishes a principle-based approach to the accounting for joint arrangements and improves the disclosure requirements	September 2007 (comments due 11 January 2008)	Q4 2010

NO ACCOUNTING FOR SERVICE CHARGES?

Mary-Lou Wedderburn, a consultant on assurance and business law, outlines the key features of ICAEW's new draft guidance on accounting for service charges.



ICAEW has developed a Technical Release to provide guidance on accounting for service charges, which will be released shortly as an exposure draft. In the course of developing the guidance it became clear that the scope of the guidance has to go beyond consideration of service charge accounts themselves, and include the treatment of service charges in the accounts of the 'landlord'.

The government has indicated that it does not intend to proceed with the development of regulations on the preparation and examination of service charge accounts and requirements for service charge monies to be held in designated bank accounts. This means that the original requirements of the Landlord and Tenant Acts (LTAs) 1985 and 1987 continue to apply. ICAEW's draft guidance has been produced on this basis, but will be updated for further developments, if necessary.

WHO IS A LANDLORD?

'Landlord' is defined by section 30 of the LTA 1985 as including any person who has a right to enforce payment of a service charge. It thus includes companies formed to acquire the freehold of a block of flats or to manage the common parts, in which the members are leaseholders. The interaction of the Companies Act 2006, the provisions of property leases and the requirements of the LTAs has caused a lot of confusion. The guidance is tailored to cover residents' management companies (RMCs) and similar company structures that collect service charges to pay for the maintenance of the common parts of leasehold properties.

DESIGNATED BANK ACCOUNTS

The government's proposed new regulations would have required service charge monies to be held in a separate, designated bank account, but as the original requirements under the LTAs continue to apply this is not a legal requirement. Nevertheless, the guidance recommends as good practice the setting up of a separate service charge bank account, primarily to avoid the loss of the tenants' monies in case of the management/landlord company's insolvency.

SERVICE CHARGE ACCOUNTS

The exposure draft states that where service charge monies and related transactions do not belong to the company, they should not be included in the company's statutory accounts. It may not always be straightforward to decide whether service charge transactions or tenants' monies should be included in a management company's statutory accounts and a more detailed analysis of whether the company acts purely as an agent or transacts as principal, and hence 'owns' the transactions, may be required. The guidance recommends that separate service charge accounts are drawn up, which include all service charge transactions and balances.

The service charge accounts should be capable of standing alone and prepared in accordance with generally accepted accounting principles. The accounts should comprise an income and expenditure account and a balance sheet, showing balances such as service charges owed or paid in advance, any reserve funds etc, and balances on the service charge bank accounts. There will also normally need to be notes to explain figures in the main statements, in particular movements on reserves.

AGREED UPON PROCEDURES

So far as assurance over the service charge accounts is concerned, the guidance has concentrated on an 'agreed upon procedures' engagement, with practical examples of procedures, paragraphs for an engagement letter, and a specimen accountant's report. The nature of the engagement will in most instances be driven by the terms of the lease and lessees' wishes and if a full audit, rather than agreed upon procedures, is required then that is what should be carried out.

In practice, reports under s21, LTA 1985 are rare, because tenants only need to request a summary of costs where the landlord does not provide annual service charge accounts (normally accompanied by an auditor's or independent accountant's report), on a voluntary basis.

YOUR COMMENTS WELCOME

The guidance is being issued as a consultation draft to give members the opportunity to consider and test the proposals. Faculty members should address comments to marylouise.wedderburn@icaew.com, to arrive by 31 January 2011.

FEELING REJECTED? WE CAN HELP

With Companies House in the UK rejecting record numbers of annual accounts, the Financial Reporting Faculty has published a briefing paper to help members avoid common errors. Eddy James, Faculty Manager, explains.

Companies House is currently rejecting a very high number of annual accounts submitted by reporting entities and their advisers. The rejection rate for the first half of 2010 was a shocking 11.1%. The majority of rejections are due to simple errors or omissions, but the impact on the company can be severe.

The main reasons given by Companies House for rejection are:

- Incorrect or missing statements eg, statements relating to the application of the small or medium-sized companies regime.
- Incorrect or missing audit exemption statements eg, where small or dormant companies are claiming total audit exemption.
- Signatory name missing off balance sheet or balance sheet signature omitted.
- Duplicate 'made up date' ie, accounts show same date as previously filed accounts.
- Accounting reference date/made up date absent or incorrect.

Undoubtedly some of these issues are the result of the new Companies Act coming in to force. Changes were made for periods beginning on or after 6 April 2008 (or 1 October 2008 for LLPs) following the commencement of the relevant sections of the Companies Act 2006. So make sure that the wording you use is up to date.

In addition, Companies House has changed its own rules in some areas, such as where the names and signatures of directors need to appear. A director must sign the foot of the balance sheet. Every balance sheet and directors' report must also state the name of the person who signed on behalf of the board. A signature without a printed name or vice versa will lead to the accounts being rejected. Both must be present.

Other simple errors can lead to accounts being rejected, so it's worth checking that you have complied with some basic requirements before submitting your accounts. Remember that almost every paper document sent to Companies House, including your accounts, must state in a prominent position the registered name and number of the company. Paper documents should be on A4 size, plain white paper with a matt finish. The text should be black, clear, legible and of uniform density. Letters and numbers must be clear and legible so that Companies House can make an acceptable copy of the document. The following guidelines may help.

When you fill in a form:

- Use black ink or black type – blue ink or any other colour is not acceptable.
- Use bold lettering (some elegant thin typefaces and pens give poor quality copies).
- Don't send a carbon copy or use a dot matrix printer.
- Remember – photocopies can result in a grey shade that will not scan well.

When you complete other documents, remember:

- The points above relating to completing forms.
- To use A4 size paper with a good margin.
- To supply them in portrait format (that is, with the shorter edge across the top).
- To include the company number and name.

If your accounts do not meet Companies House requirements they be will returned to you for correction. If the accounts are submitted close to the filing deadline and subsequently rejected, an automatic late filing penalty will be issued if the accounts are not returned by the filing deadline. The grace period of 14 days for accounts that are rejected near the deadline ceased to exist on 1 October 2009.

Failure to deliver accounts on time is a criminal offence. All the directors risk prosecution and if convicted, each director could end up with a criminal record and a fine of up to £5,000 for each offence. In addition, the law imposes a civil penalty for late filing of accounts on the company. The amount of the penalty depends on how late the accounts arrive and whether the company is private or public at the balance sheet date. Fines are doubled for repeat offenders. The company can ultimately be struck off if the situation is not remedied.

The faculty has developed a briefing paper that provides a reminder of obligations to file accounts, looks at the main reasons why accounts are rejected and how to avoid common errors. It is available now at icaew.com/frf

REVISION OF DEFECTIVE ACCOUNTS

Kathryn Cearns, Consultant Accountant at Herbert Smith LLP and Chair of the faculty's Financial Reporting Committee, introduces a new faculty factsheet.

A new Financial Reporting Faculty factsheet, *Revision of Defective Accounts* is due to be published before the end of 2010. The regime for revision of accounts has been in place for some time, but the rules are complicated. The factsheet attempts to summarise the legal requirements, while also giving some practical help.

ERRORS IN ACCOUNTS AND REPORTS

Errors can sometimes occur in the preparation of accounts and reports. These can be corrected in the following period, through a catch-up adjustment in the current year for non-material errors or using a prior period adjustment to the comparative information in the financial statements.

Sometimes, however, the directors may wish to revise the financial statements (or they may have been encouraged to do so by the Financial Reporting Review Panel). Revision ensures accounts which are free from material misstatement are available to shareholders and the public record (ie, the registrar).

Broadly speaking, defective accounts are those that do not comply with the Companies Act 2006 (CA 2006) or the IAS Regulation. The procedures for revising defective accounts on a voluntary basis in CA 2006 are 'enabling' rather than compulsory when a problem is found, with details on the regime included in Regulations to the Act.

PRACTICALITIES

Given that replacement of defective accounts is entirely voluntary, the first question when a problem has been found is whether the company ought to consider replacing the accounts and reports identified as defective.

Timing of discovery of the problem in the context of the timetable for production, approval and filing of the financial statements, is often crucial. In some cases, legal advice may be required, particularly if dividends have been declared by reference to the financial statements which, if proved not to be true and fair, might render the dividend unlawful.

The directors are likely to consider whether the error is of such significance that they wish to replace the defective accounts, even if correction in the next annual report and accounts is feasible. There will be a pragmatic trade-off between the cost of carrying out the replacement and the benefits of avoiding third parties using potentially misleading accounts. Obviously, minor typographical errors will not be worth correcting, and a problem found in accounts published some time ago will be less likely to affect a user than one found in very recent accounts.

THE LAW

A voluntary revision is permitted in any case where it appears to the directors that any of the following did not comply with the requirements of CA 2006 and, where applicable, the IAS Regulation (for those companies preparing accounts using IFRS):

- the company's annual accounts (both individual entity accounts and group accounts);
- the directors' report;
- the directors' remuneration report; and
- a summary financial statement of the company.

There is an important restriction as to what may be revised in cases where the annual accounts and reports have been sent out to members, delivered to the registrar or, in the case of a public company, laid before the company in general meeting. In such cases the revision must be confined to:

- correcting only those respects in which the previous accounts and reports did not comply with the Act; and
- consequential amendments.

The directors of a company may choose either of two methods for replacing defective accounts or reports:

- replacement of the original with a corrected set of accounts or reports; or
- issue of a supplementary note.

As well as covering these practical issues, the factsheet discusses the legal requirements in detail, to give some help to those facing this situation. This includes guidance on filing and circulating the replacement accounts or supplementary note, and how to deal with the consequential impact, if any, on abbreviated accounts and summary financial statements. There are also issues to consider if the changes affect the ability to claim exemptions, eg, exemptions under the small company regime.

All faculty factsheets can be downloaded from icaew.com/frfifrsfactsheets. If you want a printed copy, let us know at frfac@icaew.com

UK REGULATION OF COMPANY ACCOUNTS – NOT JUST ABOUT STANDARDS

Marianne Mau, Faculty Manager, introduces a new factsheet.

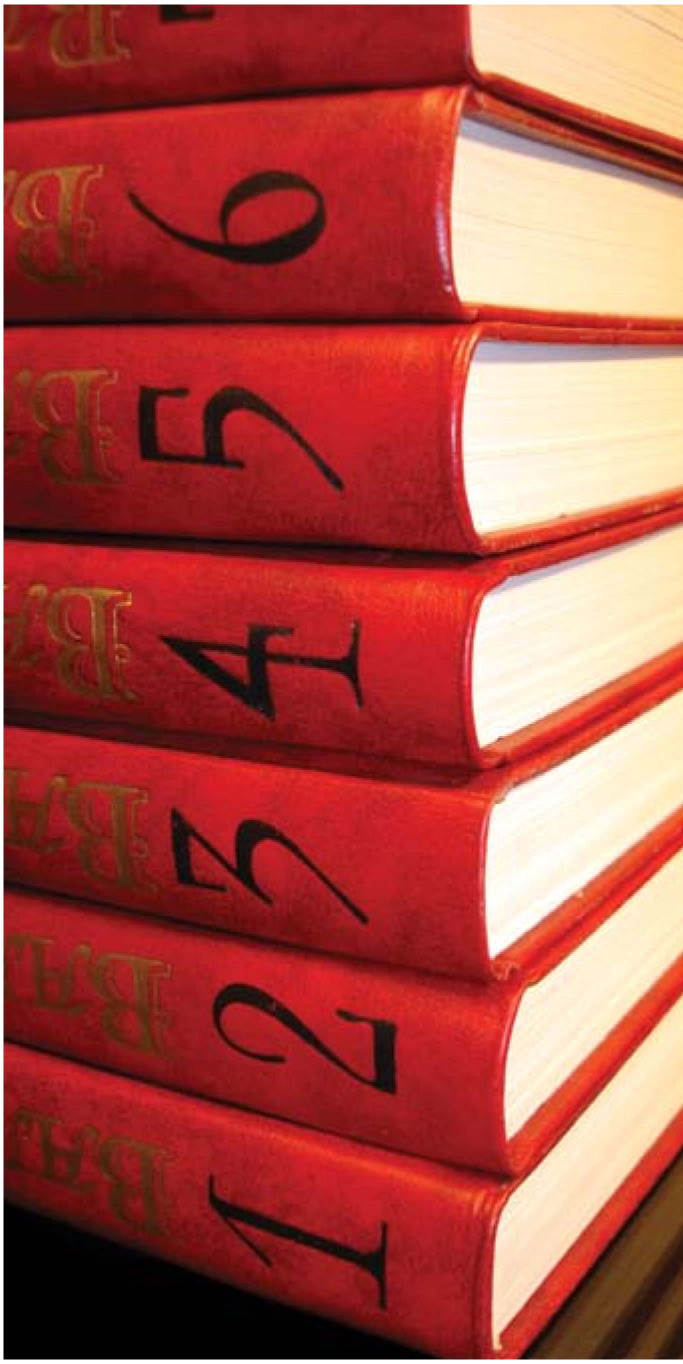
Ensuring that accounts are prepared in accordance with the appropriate accounting standards can be challenging enough; ensuring that accounts are also prepared in accordance with relevant legislation can add an additional layer of complexity which can be hard to fathom. This is particularly true where standards and legislation collide.

The faculty was launched just as companies were coming to grips with new provisions of the Companies Act 2006 (CA 2006), which mainly came into force for accounting periods beginning on or after 6 April 2008. In line with our objective of providing practical help, we published two factsheets: *CA 2006 – Small Companies* and *CA 2006 – Medium and Large Companies* to guide members through the new requirements.

As we now reach the end of 2010, most companies will be familiar with the changes introduced by CA 2006 and the time has come to withdraw the two factsheets and replace them with something more useful. Thus *UK Regulation for Company Accounts* provides an overview of the regulatory issues arising from legislation which affect UK companies. It applies to both UK and IFRS adopters, but covers neither the specific requirements relating to charitable companies and LLPs, nor the additional requirements affecting AIM and listed companies. Establishing whether you are eligible for the small company regime, the choice between IFRS and UK GAAP, and the additional disclosure requirements from legislation, are among the issues covered. As always, the information in the factsheet is complemented by references to sources of further detail.

A further factsheet looking at the requirements from legislation and the standards which commonly cause practical problems in their application will be published in 2011.

All faculty factsheets can be downloaded from icaew.com/frfifrsfactsheets. If you want a printed copy, let us know at frfac@icaew.com



LEGISLATING FOR BETTER NARRATIVE REPORTING: DON'T!

Kathryn Cearns, Consultant Accountant at Herbert Smith LLP and Chair of the faculty's Financial Reporting Committee, questions whether the government should really be looking at digging up the corpse of the Operating and Financial Review.

The new UK government announced in its 'coalition agreement' that it would reintroduce the Operating and Financial Review (OFR), the mandatory package of narrative reporting measures for companies that was introduced by their predecessors, only to be abolished (on the grounds of avoiding gold-plating EU rules) before anyone had applied the rules. The main driver for the coalition proposal seems to relate to social and environmental reporting.

The Department for Business, Innovation and Skills duly issued a consultation on narrative reporting, which closed on 19 October 2010. The consultation is fairly non-committal, asking a series of questions about whether the current narrative reporting regime is broken or not.

CURRENT UK RULES

UK companies that are not small must produce a Business Review under s417 of the Companies Act 2006 (CA 2006). Importantly, the objective of the Business Review is 'to inform members of the company and help them assess how the directors have performed their duty under s172 to promote the success of the company'. The focus is on the directors giving an account to shareholders on how they are managing the company for its long-term success. There are additional requirements for quoted companies in s417(5) in the areas of:

- future prospects;
- environmental, employee and community issues; and
- essential contractual and other arrangements.

These are only required to be disclosed to the extent that they are necessary for an understanding of the business in the context of the overall objective of the Business Review, although if the company has nothing to disclose under any of the headings, it must state that fact.

WHAT SHOULD CHANGE?

The additional requirements brought into CA 2006 for quoted companies under s417(5) effectively required them to do pretty much all that was required in the abandoned OFR. The only discrepancies are that:

- the objective of the Business Review is slightly different (there was no s172 duty to link to the OFR at that time);
- there is no mandatory standard (the ASB's OFR standard was turned into a non-mandatory statement of best practice); and
- the audit requirements are reduced.

Nevertheless, this is an opportunity to consider whether there should be improvements to narrative reporting and, if so, whether they should be introduced by statutory, regulatory or non-regulatory means.

Narrative reports by UK listed companies are in some cases extremely good, and there has been gradual improvement over time, brought about by market sticks and carrots (the latter including awards for reporting) and regulatory scrutiny (through the Financial Reporting Review Panel, which has only really just started looking at this area of reporting). The high-level statutory requirements (mirrored to a great extent in the Listing Rules) are suitable for encouraging better reporting on a bespoke basis; greater regulation runs the risk of adverse consequences, including boilerplate disclosures.

That doesn't mean improvements shouldn't be considered. These might be summarised as:

- Focus on what the annual report is for. The s172 focus for the Business Review is the right one and information that does not fulfil this objective should not be included.
- Keep the messages clear and straightforward, reducing clutter by only including important information.
- Consider alternative channels to communicate other information: environmental and sustainability reporting is important from a wider public policy perspective. Separate reports with more appropriate assurance will serve wider stakeholders better than shoehorning everything into the annual report.
- Consider allowing summarised material in the annual report to be underpinned by greater detail online (eg, on directors' emoluments).

For most of these the onus is on companies to present a clear story about their business, as succinctly and consistently as possible. The government should leave well alone (except to facilitate different channels for information as noted above) and let the improvements we have seen to date continue through existing incentives.

BUSINESS MODELS IN ACCOUNTING

Should we reflect business models in financial reporting? According to Brian Singleton-Green, Faculty Manager, we always have – and they may help us decide when to use fair value.

The term 'business model' did not appear in accounting standards until 2009, when IFRS 9 *Financial Instruments*, was published. This requires that a firm's business model should be one of the factors in deciding whether financial assets are measured at amortised cost or fair value. Yet although explicit references to business models in accounting standards are new, business models have always been fundamental to financial reporting.

At one level, a firm's business model determines what sector it's in and this in turn is relevant to how it accounts for transactions, assets and liabilities. Insurers, for example, and oil and gas companies, each have their own accounting standards that reflect features of their business models.

At another level, how a firm accounts for a particular asset may reflect its business model. The same property asset will be accounted for differently depending on whether it's a fixed asset, an investment property or an item of inventory. We don't normally see this as a business model issue because we have different standards for each use of the asset. If we had just one accounting standard for physical assets, it might have to make explicit reference to firms' business models to explain how identical properties would be accounted for differently by different firms.

'Until IFRS 9 standard-setters in recent years seem to have been hostile to business-model approaches to accounting.'

The methods by which different types of firm recognise revenue and allocate costs may also reflect their particular business models. An example of this is firms that engage in long-term construction projects, where it is usual to have special requirements for revenue recognition. The proliferation of revenue recognition standards and rulings in the US shows where efforts to reflect business models can lead. But, in the absence of such formal rulings, there would still be a demand for textbooks and other guidance to explain how general accounting principles can be applied to the diverse business models of different industries.

Yet until IFRS 9 standard-setters in recent years seem to have been hostile to business-model approaches to accounting. After all, a firm's business model reflects its managers' intentions, and standard-setters view management intent with great suspicion. Standard-setters also look askance at the idea that what business a firm is in might affect how it should account for things. Their ideal seems to be a set of standards that is context-free – a particular asset or a particular transaction would be accounted for in the same way regardless of the reasons why it is held or the circumstances in which it was undertaken.

But it seems clear to me that there is only one sensible answer to the question 'Should we reflect firms' business models in financial reporting?' and that answer is 'Yes'. The really difficult question is 'How can we **most usefully** reflect firms' business models in financial reporting?'

A new report in the Financial Reporting Faculty's Information for Better Markets series, *Business Models in Accounting: The Theory of the Firm and Financial Reporting*, looks at this question. Drawing on work by Professor Stephen Penman, it suggests that firms' business models can be divided into two categories. Under one type of model the firm buys inputs (goods and services) and transforms them into different outputs, which it sells in different markets. Most firms' business models are of this sort. For this type of firm, the report suggests that we would usually expect historical cost accounting to provide the most useful information.

A second type of business model is to buy assets (eg, stocks and shares) and, in due course, sell them back into the same market without transforming them. For this type of firm, the report suggests that we would usually expect fair value accounting to provide the most useful information.

These are broad generalisations, and there would be many practical problems in applying this analysis. We plan to do more work to test our ideas and would welcome your thoughts on our suggested approach. Copies of the report will be available at icaew.com/index.cfm/route/153938

INTERNATIONAL FINANCIAL REPORTING STANDARDS: WHAT ARE THE BENEFITS?

Dr Philip Brown, FCPA, FASSA, Professor, University of New South Wales, Emeritus Professor, University of Western Australia. Drawing on his presentation at the faculty's December 2010 Information for Better Markets Conference on 'Adopting IFRS: the global experience', Dr Brown examines the evidence.

It is only proper this question be asked. The simplest answer is there must be benefits, otherwise why would IFRS continue to spread? But that answer does not do justice to the question. So I will answer it by summarising benefits found in countries where IFRS have been used for some years.

The evidence suggests major benefits can be gained by adopting IFRS, although the extent of the benefits achieved depends on: which standards were used before adopting IFRS; the education and training of preparers, users, auditors and regulators; the extent and consistency of guidance available to preparers; the presence of legal or other regulatory backing for the standards; and the degree of compliance monitoring and enforcement. Socio-economic factors can make a difference too.

Countries have adopted IFRS for many reasons. For some, the demand has been driven primarily by the needs of large corporations seeking access to international public equity markets, and financial institutions seeking global investment opportunities. To illustrate, a statement issued by the EU in Brussels in 2002 claimed IFRS would 'help eliminate barriers to cross-border trading in securities ... [which] will in turn increase market efficiency and reduce the cost of raising capital for companies, ultimately improving competitiveness and helping boost growth'.

Share market providers such as the Australian Securities Exchange argued for IFRS in the hope of deepening their markets. Labour markets were thought to benefit as well. For example, some believed widespread usage of IFRS would improve career opportunities for professionally-qualified accountants and increase the flexibility of supply. As another example, many in South Korea believe adopting IFRS (to happen in 2011) will expand business opportunities for Korean accounting firms and financial institutions, as well as mitigating the 'Korea discount'.

In sum, key benefits typically sought by adopting IFRS are to eliminate barriers to cross-border investing; to increase the 'quality' of financial reports; and to decrease the cost of capital. A mostly unstated benefit is to share with other countries the costs of standard-setting and of securing compliance with accounting standards.

Around 100 research papers have dealt with various outcomes following the adoption of IFRS.

So what have they found? Following the adoption of IFRS:

- comparability across countries and industries has improved, although country-level differences persist;
- accounting 'quality' has improved (quality has been measured in ingenious ways!);
- if anything, share prices have become tied more closely to accounting fundamentals;
- analysts' EPS forecasts have become more accurate, with the largest improvements being in forecasts for voluntary 'early adopters';
- institutional investors increased their holdings in firms that adopted IFRS (as long as the standards were enforced);
- shares of IFRS adopters have been traded in more liquid markets;
- the cost of equity capital has declined;
- it takes time for the benefits to materialise; and
- compliance monitoring and enforcement are important.

Three caveats. First, the evidence is not unequivocal: academics thrive on argument and dissent, and archival studies, the main source of the evidence I've summarised, are always subject to challenge. Second, we have not yet studied all of the issues that appear to have mattered to governments of the day when they decided to adopt IFRS, but we are making progress. Third, many other changes, especially in corporate governance, have occurred over the past decade and relatively few studies of IFRS have properly accommodated them.

My presentation at the conference expands on these themes.

Webcasts of the presentations at the Information for Better Markets Conference and copies of the papers presented at it will be available at icaew.com/index.cfm/route/125706

AND FINALLY…

As Sir David Tweedie prepares to pack his bags and wave farewell to life at the IASB, in true Big Brother style we look back at some of his best moments.

ON FINANCIAL INSTRUMENTS

'Those of you who have read IAS 39 and understood it have not read it properly.'

'In the medium term, [IAS 39] is a wonderful discipline on banks because it actually reveals to the markets what they're up to. Despite it not being the greatest standard, it has improved things.'

ON HIS FRIENDS IN AMERICA

'US GAAP is an unsustainable Tower of Babel.'

'US GAAP does not rule the world ... like it did 10 years ago.'

'Congress can't extradite me from Scotland.'

'If you did what WorldCom did in an accounting exam, it would be marked "wrong".'

'It's good to be back in the colonies.'

ON FRANCE

'In France, at least nowadays, I'm treated like a king – and you know how the French treat their kings!'

ON THE EU DECISION TO ADOPT IFRS

'It was a decision made with great courage and in almost total ignorance of what exactly the existing standards required.'

ON STANDARD-SETTING

'People get the standards they deserve. If the auditors can say they can use their judgement and if the management stay in the sandpit and don't jump out and run about on the beach, then they get principles. If they start running about on the beach, we'll put rules in to get them back in the sandpit.'

'High-quality, principle-based accounting standards are designed to provide a range of answers that are roughly right, rather than a single number that is precisely wrong.'

ON LEASE ACCOUNTING

'I can guarantee almost all of you here have never flown in a plane that has appeared in the airline's balance sheet. And the reason is they tend not to buy them, they lease them. And we all have leasing standards, and the great news is these leasing standards are perfectly harmonised worldwide. They are all absolutely useless. None of them work.'

ON THE PENSIONS CRISIS

'I did not put the final nail in the coffin [of defined benefit pensions plans] – I just measured it.'

'People have developed this terrible habit of living longer; they have to stop doing that!'

ON THE DEBT VERSUS EQUITY DEBATE

'If it looks like a duck, walks like a duck and quacks like a duck, then it's a duck.'

ON WHO TO CONSOLIDATE

'If you have the power to call the shots, it is yours. We don't care if you have zero per cent equity, it is yours.'

ON THE BOTTOM LINE

'I've always likened the bottom line to a haggis. If you knew what was in it, you wouldn't touch it with a barge pole!'

ON THE FIGHT AGAINST CREATIVE ACCOUNTING

'We're like a cross-eyed javelin thrower competing at the Olympic Games: we may not win, but we'll keep the crowd on the edge of its seats!'

ON OUR PROFESSION

'Accounting isn't rocket science.'

ON AUDITORS

'What is the difference between an auditor and a supermarket shopping trolley? The supermarket shopping trolley has a mind of its own!'

'Why do Big 4 audit partners go round in threes? One who can read; one who can write; and one to look after the two intellectuals!'

HIS FAVOURITE JOKE

'Two partners from the London office of a large accounting firm arriving in the Hebrides to do an investigation, go into a newsagent and, mindful of the need of keeping up to date, ask for a copy of the *Financial Times*. They were taken aback when the old lady behind the counter asked them which they wanted – today's paper or yesterday's paper? Being Londoners and feeling under pressure to keep up to date they of course asked for today's paper. And were promptly told: "Ach weel, you'll have to come back tomorrow".'

AND FINALLY ON HIS IMPENDING RETIREMENT AS IASB CHAIRMAN

'I think people are quite worried about how I might do in my last six months here, with all my vendettas and all these grudges I've been storing up.'