

International Accounting Standards

from UK standards to IAS

– an accelerated route to understanding the key principles



Paul Rodgers

International Accounting Standards

From UK standards to IAS – an accelerated route to understanding the key principles

Paul Rodgers



ELSEVIER

AMSTERDAM • BOSTON • HEIDELBERG • LONDON
NEW YORK • OXFORD • PARIS • SAN DIEGO
SAN FRANCISCO • SINGAPORE • SYDNEY • TOKYO

CIMA Publishing is an imprint of Elsevier

CIMA

PUBLISHING

CIMA Publishing is an imprint of Elsevier
Linacre House, Jordan Hill, Oxford OX2 8DP, UK
30 Corporate Drive, Suite 400, Burlington, MA 01803, USA

First edition 2007

Copyright © 2007 Elsevier Ltd. All rights reserved

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise without the prior written permission of the publisher

Permissions may be sought directly from Elsevier's Science & Technology Rights Department in Oxford, UK: phone (+44) (0) 1865 843830; fax (+44) (0) 1865 853333; e-mail: permissions@elsevier.com. Alternatively you can submit your request online by visiting the Elsevier web site at <http://elsevier.com/locate/permissions>, and selecting *Obtaining permission to use Elsevier material*

Notice

No responsibility is assumed by the publisher for any injury and/or damage to persons or property as a matter of products liability, negligence or otherwise, or from any use or operation of any methods, products, instructions or ideas contained in the material herein.

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

978 0 7506 8203 9

For information on all CIMA publications visit our website at books.elsevier.com

Typeset by Integra Software Services Pvt. Ltd, Pondicherry, India
www.integra-india.com

Printed and bound in Great Britain

07 08 09 10 10 9 8 7 6 5 4 3 2 1

Working together to grow
libraries in developing countries

www.elsevier.com | www.bookaid.org | www.sabre.org

ELSEVIER

BOOK AID
International

Sabre Foundation

Nothing is to be feared. It is only to be understood.

Marie Curie (1867–1934)

This page intentionally left blank

Contents

Introduction	xi
1 Harmonization – The Story So Far	1
A long winding road	3
2005 – The year when the accounting world would change forever	5
The EU was not alone	7
Convergence with US GAAP	7
Finance directors beware	8
Let us not lose sight of the benefits	9
Key Facts	9
2 The Mechanics of Transition	11
Which UK companies have had to make the transition to IFRS?	13
The small company conundrum	15
First-time adoption: The basics	17
Key Facts	20
3 The Conceptual Framework	21
The Christmas tree approach	23
Key Facts	26
4 Presentation – The Big Picture	27
What to expect in financial statements prepared under IFRS	29
Key Facts	30
5 Presentation – The Balance Sheet	31
Setting expectations	33
Illustrations	34
Key differences	38
Analytical consequences	40
Main sources of guidance	40
Key Facts	40

6	Presentation – The Performance Statement	41
	Setting expectations	43
	Illustrations	43
	Key differences	45
	Dealing with the unusual	46
	Discontinued operations	47
	Analytical consequences	54
	Main sources of guidance	56
	Key Facts	56
7	Presentation – The Cash Flow Statement	57
	Setting expectations	59
	Illustrations	59
	What is cash?	62
	Cash flow classification	63
	Is a cash flow statement always required?	64
	Treasury management	64
	Main sources of guidance	68
	Key Facts	68
8	Presentation – Other Primary Statements and Associated Disclosures	71
	Setting expectations	73
	Illustrations	74
	A closer look at UK GAAP	76
	Key differences	78
	The historic costs note	79
	Main sources of guidance	80
	Key Facts	81
9	Presentation – Related Parties and Segmental Disclosures	83
	Setting expectations	85
	Related party definitions	85
	Materiality	87
	Related party disclosures	88
	The scope of segmental reporting	90
	What is a segment?	91
	Segmental disclosures	94
	Illustrations of segmental reporting	96

	The future	109
	Main sources of guidance	109
	Key Facts	109
10	Tangible Non-current Assets	111
	Setting expectations	113
	Depreciation	113
	Revaluation	114
	Capitalization of borrowing costs	116
	Government grants	117
	Investment properties	118
	Main sources of guidance	122
	Key Facts	122
11	Intangible Assets	123
	Setting expectations	125
	Goodwill	125
	Other intangibles	129
	Research and development	130
	Illustration of IAS GAAP	132
	Main sources of guidance	135
	Key Facts	136
12	Asset Impairment	137
	Setting expectations	139
	Grouping assets and impairment allocation	140
	Value in use – discount rates	141
	Value in use – look-back tests	142
	Reversal of impairment	142
	Main sources of guidance	142
	Key Facts	143
13	Leasing	145
	Setting expectations	147
	Determining lease classification	150
	Land and building issues	151
	Operating lease disclosures	151
	Allocation of finance costs	153
	Main sources of guidance	153
	Key Facts	154

14	Stock and Long-term Contracts	155
	Setting expectations	157
	What's in a name?	157
	Reduced disclosure	158
	Main sources of guidance	159
	Key Facts	159
15	Taxation	161
	Setting expectations	163
	FRS 19 snapshot	163
	IAS 12 – Temporary differences instead of timing differences	164
	Discounting	165
	Intragroup transactions	166
	Deferred tax assets	166
	Disclosure	167
	Main sources of guidance	168
	Key Facts	168
16	Retirement Benefits	171
	Setting expectations	173
	Accounting for actuarial gains and losses	175
	Valuing scheme assets	179
	Presentation	180
	IAS 19 – A broader emit	180
	Main sources of guidance	181
	Key Facts	181
17	Revenue Recognition	183
	Setting expectations	185
	IAS 18 – a brief synopsis	185
	Main sources of guidance	186
	Key Facts	186
18	Group Accounts – Acquisition Accounting	187
	Setting expectations	189
	What is a subsidiary?	189
	Exemptions from the requirement to produce group accounts	190
	Excluded subsidiaries	191
	Non-coterminous year ends	192

	Special purpose entities	193
	Distributions out of pre-acquisition profits	193
	Disclosure	194
	Do not forget those goodwill differences	198
	Main sources of guidance	199
	Key Facts	199
19	Group Accounts – Associates	201
	Setting expectations	203
	Defining an associated undertaking	203
	The use of equity accounting	203
	The cost method	204
	Consequences of a poorly performing associate	205
	Presentation	205
	Main sources of guidance	208
	Key Facts	209
20	Group Accounts – Joint Ventures	211
	Setting expectations	213
	Accounting for a joint venture	214
	Déjà vu	217
	Main sources of guidance	218
	Key Facts	218
21	Group Accounts – Merger Accounting: The End of the Road	219
	Setting expectations	221
	When can merger accounting be used in the UK?	221
	Key differences compared to acquisition accounting	222
	Main sources of guidance	223
	Key Facts	223
22	Narrowing the Divide – UK GAAP Goes International	225
	Setting expectations	227
	Share-based payment	228
	Events after the balance-sheet date	232
	Earnings per share	235
	Foreign currency translation	237

	Hyperinflationary economies	241
	Financial instruments	241
	Main sources of guidance	249
	Key Facts	250
23	Flicking the Switch: First-time Adoption	253
	Setting expectations	255
	Additional disclosures	255
	Exemptions	264
	Main sources of guidance	265
	Key facts	265
	Index	267

Introduction

The World never stands still and the same is true of the business community and the people that comprise it. Business organizations strive to improve their profits, borrow to fund growth or sell assets to facilitate survival, but the one thing they can never do is stand still or at least not for very long.

Furthermore the commercial universe comprises not of a meagre handful of business entities but millions ranging in size from the sole trader to the international conglomerate. If all of these factors are combined there appears to be a recipe for chaos, but this is not the case. As the number and complexity of business organizations has increased so have the rules and guidelines that constrain them.

The balance between these two forces is always a matter for debate with some commentators stating that the entrepreneurial spirit of business is being crushed by red tape, whilst others look for increased controls following a series of high profile corporate frauds such as WorldCom which required a \$74.4 billion restatement of income. These rules come from many sources:

- ◆ Corporate legislation
- ◆ Industry guidelines
- ◆ Listing requirements and other stock exchange rules for public companies
- ◆ Accounting standards.

Let us focus on the larger corporations as these will be represented by household names with which we can all associate. These usually have a large and diverse investor base plus interactions with many other stakeholder groups ranging from suppliers/customers to government. The most readily available source of information on the business for all these user groups is the published financial statements, and it should come as no surprise that these have evolved from a simple historic record of transactions as seen 50 years ago to the detailed multi-part document seen today. Since the 1990s the evolution of financial statements has had three main strands.

1. *Corporate governance* There is a general principle that the management team of a company will enter into transactions that are in the best interests of the shareholders and other stakeholder groups.

Sadly the confidence of these stakeholders has been undermined by a series of high profile frauds and it was one of these, namely the financial mismanagement at the Enron Corporation, which initiated a groundswell for improved corporate governance.

The concept of corporate governance asks ‘how well the managers manage’, and has seen a tidal wave of new legislation and best practice rules instigated in all the major investment markets around the World. Most noteworthy of these has been the Sarbannes–Oxley Act in the USA and the Combined Code in the UK.

Disclosures relating to corporate governance and the audit of its compliance are now an integral feature of published accounts.

2. Social and environmental reporting Unlike corporate governance the majority of the rules on reporting how a business interacts with the environment are voluntary, but with increasing awareness of issues such as global warming and sustainability of resources this looks set to change.

The absence of statute initially created the danger that only those organizations that were perceived as environmentally aware would provide stakeholders with details of their policies. However, this is rapidly changing as it becomes apparent that socially aware policies can improve brand perception and hence add to shareholder value.

3. International harmonization With the development of the Internet, increased ease of international travel and the development of companies through international growth and acquisition, the days when an investor would usually be based in the same country as the business in which they had invested have passed. This brings huge opportunities but also creates a dilemma for a potential investor trying to appraise the relative merits of expanding their portfolio into new markets.

The accounting rules and conventions of different countries have been developed when little regard was needed for international consistency. This insular approach has now been found wanting on the global stage, and so the wheels were set in motion towards the harmonization of these divergent rules.

Of all the changes identified above it is the latter that has proved the most daunting with a natural instinct for the creators of national

accounting rules to advocate their own work, and the logistics of changing local legislation.

However, the drive to harmonize accounting is often perceived as a technical exercise that will occupy the brains of accounting academics but have little real bearing on the average stakeholder. Hopefully the fact that you have picked up this book means that you are aware this is not the case, but if you have any lingering doubts let us take a snapshot of the evidence.

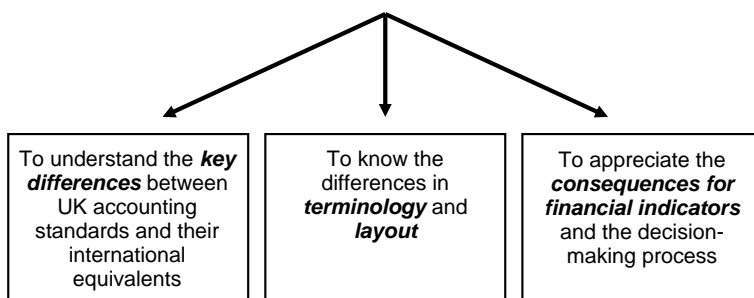
- ◆ Although harmonization is initially focussed on listed companies it has implications for businesses of every size either directly or indirectly through trading relationships.
- ◆ The reported performance and position of a business can be dramatically altered by the change to new accounting rules. Without an understanding of the main issues, investment appraisal could be seriously undermined.
- ◆ Providers of finance will need to review financial covenants included in funding agreements as the thresholds set may no longer be appropriate.

At this point you might be sensing a degree of trepidation envisaging the stacks of paperwork you need to read bulging with the technical jargon of accountants.

BUT

Fear not!

There is a sensible compromise between blissful ignorance and the finely tailored skills of a public company finance director – think what you really need.



The objective of this book is to provide a succinct and straightforward route map to meeting these needs. It will allow you to pick and choose subjects of particular interest or taken in aggregate provide a direct path to a big picture understanding of the consequences of the switch to international accounting – let us get to work!