



## **THE IMPLICATIONS OF IAS/IFRS\* FOR UK COMPANIES AN UPDATE TO *THE CONVERGENCE HANDBOOK***

*The Convergence Handbook compared International Accounting Standards (IAS) and UK financial reporting requirements as at November 2000 and summarised the implications of IAS for UK companies. It was commissioned by the Accounting Standards Board (ASB), endorsed by the then International Accounting Standards Committee (IASC) and published by the Institute of Chartered Accountants in England and Wales (ICAEW).*

*This fourth update to The Convergence Handbook reflects the effects of standards and exposure drafts issued by the IASC, the IASB and the ASB up to the end of July 2003. Further updates will be issued when the IASB or the ASB issue new or revised proposals or standards. The publication of the updates reflects the ICAEW's continuing efforts to encourage the convergence and improvement of international and national financial reporting requirements and to assist UK companies in the urgent task of preparation for the adoption of IFRS in 2005.*

*The updates have been prepared for the ICAEW by David Cairns OBE, MSc, FCA.*

*\* The term 'International Financial Reporting Standards' (IFRS) embraces all standards and interpretations approved by the IASB and the IASC;<sup>1</sup> it is used to cover 'IAS' and 'IFRS' in this update.*

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<sup>1</sup> IASB, *Preface to International Financial Reporting Standards*, May 2002, para 5.

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## **THE IMPLICATIONS OF IAS/IFRS FOR UK COMPANIES. AN UPDATE TO *THE CONVERGENCE HANDBOOK***

### **I. INTRODUCTION TO RECENT FINANCIAL REPORTING DEVELOPMENTS**

*The Convergence Handbook* compared IFRS and UK financial reporting requirements (UK GAAP) as at November 2000. *The Convergence Handbook* dealt with:

- all existing IAS except IAS 15 *Information Reflecting the Effects of Changing Prices* (which is non-mandatory), IAS 26 *Accounting and Reporting by Retirement Benefit Plans* (which does not apply to business entities) and IAS 39 *Financial Instruments: Recognition and Measurement* (see below);
- all existing UK accounting standards up to and including FRS 19 *Deferred Taxes*, the ASB's statement on *Interim Reports*, Statements of Recommended Practice insofar as they dealt with matters that were dealt with in IAS and the accounting requirements of the Companies Act 1985 (as amended); and
- interpretations approved by the former IASC Standing Interpretations Committee (SIC) and the ASB's Urgent Issues Task Force (UITF).

*The Convergence Handbook* did not deal with IAS 39 *Financial Instruments: Recognition and Measurement* because of the then imminent publication by the IASC, the ASB and several other national standard setting bodies of a draft standard developed by a Joint Working Group.<sup>2</sup> That draft standard may form the basis of a longer-term project by the IASB and national standard setting bodies. This update deals with the principal differences between IAS 39 (including proposed amendments) and proposed UK GAAP.

Since November 2000, there have been several important developments:

- the IASC has been restructured and replaced by the IASB;
- the European Union has approved its IAS regulation;
- the European Parliament has approved amendments to the Fourth and Seventh Directives;
- the DTI has announced that all UK companies can use IFRS from 2005;
- the Committee of European Securities Regulators has issued a standard on a common approach to the enforcement of standards of financial information in Europe;
- the International Audit and Assurance Board (IAASB) has issued additional guidance on the audit of IFRS financial statements;
- the ASB has adopted a policy of convergence of UK GAAP and international standards;
- the IASC issued one further IAS; and
- the IASB and the ASB have issued proposals for several new or revised standards.

This update deals with all these developments.

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<sup>2</sup> Joint Working Group, *Financial Instruments and Similar Items*, draft accounting standard, December 2000.

## **RESTRUCTURING OF THE IASC**

In April 2001, the International Accounting Standards Board (IASB) assumed the responsibility for setting international standards from its predecessor body, the International Accounting Standards Committee (IASC).<sup>3</sup> The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. The IASB's work programme includes three main elements: the improvement of existing IAS; assistance with the application of IAS; and convergence and leadership.<sup>4</sup>

The IASB works closely with national standard setting bodies and has a formal liaison relationship with the national bodies in eight countries including the UK's ASB. The IASB and the US Financial Accounting Standards Board (FASB) announced in November 2002 a short-term project to reduce differences between IAS and US GAAP.<sup>5</sup>

The IASB issues 'International Financial Reporting Standards' (IFRS) rather than 'International Accounting Standards' (IAS). The IASB has adopted all IAS and SIC interpretations which will continue to apply until they are amended or withdrawn by the IASB.

## **EUROPEAN UNION IAS REGULATION**

In June 2002, the European Union approved a regulation<sup>6</sup> that will require all EU companies that have securities traded on any EU regulated market (publicly traded companies) to prepare consolidated financial statements in accordance with IFRS. The regulation applies to accounting periods beginning on or after 1 January 2005. Member States may delay implementation of the regulation until 1 January 2007 for those EU publicly traded companies that have only debt securities publicly traded or which have their securities traded on markets outside the EU and which, for this purpose, currently use other internationally accepted standards as their primary reporting standards. Member States may extend the application of IFRS to non-consolidated financial statements and to entities other than non-publicly traded companies.

EU publicly traded companies will be required to comply with only those IFRS that have been adopted by the European Commission. In making its decision, the Commission must satisfy itself that IFRS result in a true and fair view of the financial position and performance of the entity, are conducive to the European public good and result in financial statements that are useful to the users of those statements.

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<sup>3</sup> Further information about the structure of the IASB and the IASC can be found in David Cairns, *Applying International Accounting Standards*, 3rd edition, Tolleys, 2002, Chapters 1 and 2.

<sup>4</sup> Further information about the IASB's work programme can be found at [www.iasb.org.uk](http://www.iasb.org.uk).

<sup>5</sup> Further information about this project can be found at [www.iasb.org.uk](http://www.iasb.org.uk) and [www.fasb.org](http://www.fasb.org).

<sup>6</sup> Regulation (EC) no 1606/2002 of The European Parliament and The Council of 19 July 2002 on the application of International Accounting Standards, *Official Journal of the European Communities*, 11 September 2002.

The Commission is being assisted by:

- the Accounting Regulatory Committee (ARC) which operates at the political level under established EU rules for decision making by regulatory committees and is composed of representatives of the Member States and chaired by the Commission; and
- the European Financial Reporting Advisory Group (EFRAG) which is a private-sector initiative that is composed of representatives of users and preparers of financial statements, the accounting profession and national standard setters.

In June 2002, EFRAG advised the Commission that it should adopt all existing IAS and SIC interpretations because they meet the criteria set out in the IAS regulation.<sup>7</sup> In July 2003, the ARC voted in favour of a draft Commission regulation proposing the endorsement of all existing IAS and related interpretations, with the exception of IAS 32 and 39. The ARC and the Commission will consider the revised IAS 32 and 39 when they become available. The Commission is expected to issue its regulation during 2003.

In January 2003, the European Parliament approved amendments to the EU Fourth and Seventh Directives which remove all inconsistencies between the Directives and IFRS. The amendments complement the IAS regulation by allowing Member States that do not extend the use of IFRS to non-listed and parent companies to require those entities to follow national standards of similar, high quality as IFRS. The European Parliament had earlier approved the Fair Value Directive which allows companies to account for financial assets and financial liabilities at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

### **Implementation in the United Kingdom**

The UK Government has welcomed the adoption of the EU IAS regulation and strongly supports the EU's move to use IFRS. The regulation applies directly to UK publicly traded companies. Its implementation does not require any new or amended legislation in the United Kingdom or any other Member State.

In July 2003, the Department of Trade and Industry (DTI) announced that all UK companies will be able to use IFRS as an alternative to UK standards from 2005.<sup>8</sup> The DTI has indicated that the Government does not see a case for deferring application of the regulation until 2007 for certain publicly traded companies. The DTI has also issued a consultation paper<sup>9</sup> on the implementation of the Fair Value Directive.

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<sup>7</sup> EFRAG, 'Letter to European Commission', 19 June 2002.

<sup>8</sup> Department of Trade and Industry press release 'UK extends use of International Accounting Standards', 17 July 2003. See also Department of Trade and Industry, *International Accounting Standards*, a consultation document on the possible extension of the European regulation on International Accounting Standards, URN 02/1158, 30 August 2002.

<sup>9</sup> Department of Trade and Industry, *Fair Value Accounting*, A consultation document on the use of fair value accounting for certain financial instruments and disclosure of dividends by companies and other undertakings, URN 03/960, 12 June 2003.

## **ENFORCEMENT**

The European Commission has recognised the need for an infrastructure that will ensure rigorous application of IFRS by publicly traded companies.<sup>10</sup> In March 2003, the Committee of European Securities Regulators (CESR) issued a standard<sup>11</sup> on the enforcement of standards of financial information in Europe. The standard envisages the ex-ante approval of prospectuses, the ex-post enforcement of IFRS financial statements, the correction of material misstatements in any IFRS financial statements and co-ordination among European securities regulators.

The UK's Financial Services Authority is a member of CESR although the Financial Reporting Review Panel will play a key role in enforcing compliance with IFRS by UK companies.

## **THE AUDIT OF IFRS FINANCIAL STATEMENTS**

The International Audit and Assurance Standards Board (IAASB) has issued International Auditing Practice Statement (IAPS 1014),<sup>12</sup> *Reporting by Auditors on Compliance with International Financial Reporting Standards*, which addresses audit reports on financial statements that are prepared:

- solely in accordance with IFRS;
- in accordance with IFRS and a national financial reporting framework; or
- in accordance with a national financial reporting framework with disclosure of the extent of compliance with IFRS.

## **THE ASB'S CONVERGENCE POLICY**

The ASB is working with the IASB and other national standard setters in order to seek improvements in IFRS and convergence of national and international standards. The ASB is one of several national standard setters that have a formal liaison relationship with the IASB. This relationship involves regular meetings and other consultations as well as several joint standard setting projects, including the ASB's joint project with the IASB on reporting financial performance. One member of the IASB (Professor Geoffrey Whittington) is directly responsible for liaison with the ASB.

The ASB commissioned *The Convergence Handbook* and, during 2001, sought comments on the *Handbook's* proposals for the convergence of UK and international requirements. The

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<sup>10</sup> European Commission, *EU Financial Reporting Strategy; the Way Forward*, COM (2000) 359, 2000.

<sup>11</sup> The Committee of European Securities Regulators, Standard 1 on Financial Information: *Enforcement of Standards on Financial Information in Europe*, CESR 03-073, 12 March 2003.

<sup>12</sup> The IAPS may be obtained from [www.ifac.org](http://www.ifac.org).

consultations confirmed the ASB's aim of providing as smooth a path as possible for the transition from UK GAAP to IFRS. The ASB intends to align UK accounting standards with IFRS whenever practicable. It proposed to do this, in the main, by a phased replacement of existing UK standards with new UK standards based on the equivalent IFRS. As explained below, it has already issued eight convergence exposure drafts, three exposure drafts of new standards that are identical to the equivalent IASB exposure drafts and invited comments on other IASB exposure drafts.

## **II CHANGES TO IAS/IFRS AND UK GAAP SINCE NOVEMBER 2000**

### **IAS 41**

In December 2000, the IASC approved IAS 41 *Agriculture*. This requires the measurement of most biological assets and agricultural produce at amounts based on fair value and the inclusion of the resulting gains and losses in the profit or loss for the period. There is no equivalent UK standard and the requirements of IAS 41 probably differ significantly from existing UK practice.

### **IASB Improvements and FREDs 23-29**

In May 2002, the IASB published an exposure draft *Improvements to IAS* that proposes revisions to 12 IAS. At the same time, the ASB published FRED 23 *Financial Instruments: Hedge Accounting* plus six other exposure drafts<sup>13</sup> that propose greater convergence between UK GAAP and IAS (as revised). Many of, but not all, the proposals in the drafts reflect the recommendations in *The Convergence Handbook*.

### **Financial Instruments**

In June 2002, the IASB published an exposure draft of proposed amendments to the two IAS on financial instruments: IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB also indicated that it expects that IAS 32 and IAS 39 (as amended) will remain in place for a considerable period and will form part of the IFRS applicable for accounting periods beginning on or after 1 January 2005. Also in June 2002, the ASB published FRED 30 *Financial Instruments: Disclosure and Presentation. Recognition and Measurement* which proposes the incorporation into UK GAAP of the whole of the amended IAS 32 and many of the

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<sup>13</sup> FRED 24 *The Effects of Changes in Foreign Exchange Rates; Financial Reporting in Hyperinflationary Economies*; FRED 25 *Related Party Disclosures*; FRED 26 *Earnings Per Share*; FRED 27 *Events After the Balance Sheet Date*; FRED 28 *Inventories; Construction and Service Contracts*; FRED 29 *Property, Plant and Equipment; Borrowing Costs*. Further information about the ASB's work programme can be found at [www.asb.org.uk](http://www.asb.org.uk).

measurement aspects of IAS 39. In August 2003, the IASB and the ASB issued exposure drafts on fair value hedging for a portfolio hedge of interest rate risk (macro hedging).

### **Share-based Payment**

In November 2002, the IASB published exposure draft ED 2 *Share-based Payment* which proposes that all share-based payments, including grants of shares or share options to employees, should be recognised in the financial statements at fair value as at grant date. At the same time, the ASB issued a virtually identical exposure draft FRED 31 *Share-based Payment* of a proposed UK accounting standard.<sup>14</sup> The adoption of these standards would result in significant changes in the practice adopted by most UK publicly traded companies.

### **Business Combinations**

In December 2002, the IASB published exposure draft ED 3 *Business Combinations* which proposes revisions to IAS 22 *Business Combinations*. It also published an exposure draft of consequential amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. ED 3 proposes to prohibit the use of the pooling of interests method and the amortisation of goodwill and negative goodwill, changes that would lead to new conflicts between IFRS and existing UK GAAP. Other proposed changes would eliminate many of, but not all, the detailed differences between IAS 22 and FRS 6/FRS 7. The ASB published a consultation paper seeking views on the application in the UK of the proposals in ED 3 and the consequential amendments to IAS 36 and IAS 38.

### **Retirement Benefits**

In December 2002, the ASB issued an amendment to FRS 17 *Retirement Benefits* which defers the full adoption of FRS 17 until accounting periods beginning on or after 1 January 2005, the date on which the EU IAS regulation comes into effect for publicly traded companies. Therefore many UK publicly traded companies may choose to continue to apply the accounting requirements of SSAP 24 *Pension Costs* prior to their adoption of IAS 19 *Employee Benefits* in 2005. The IASB is undertaking a convergence project that is likely to lead to changes to IAS 19.

### **First Time Adoption of IFRS**

In June 2003, the IASB issued IFRS 1 *First-time Adoption of International Financial Reporting Standards* which requires that companies should apply retrospectively the version of IFRS current at their first IFRS reporting date. IFRS 1 allows limited exemptions and exceptions to retrospective application, the most significant of which relate to business combinations, pension costs and hedge accounting.

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<sup>14</sup> There are some small drafting differences between ED 2 and FRED 31 which deal with cross-referencing to other UK GAAP, the relationship with the UK FRSSSE and consequential changes to existing UK GAAP. The differences do not affect the substance of the proposals.

### **Disposal of Non-current Assets and Presentation of Discontinued Operations**

In July 2003, the IASB published exposure draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*. It proposes that assets or groups of assets that are held for sale should be carried at the lower of carrying amount and fair value less costs to sell. Such assets should not be depreciated. ED 4 proposes that the IAS 35 definition of discontinuing operations should be replaced by a broader definition of discontinued operations and that the additional disclosures should start later than envisaged by IAS 35.

The ASB issued a virtually identical exposure draft of a proposed UK accounting standard: FRED 32 *Disposal of Non-current Assets and Presentation of Discontinued Operations*.

### **Insurance Contracts**

In July 2003, the IASB issued exposure draft ED 5 *Insurance Contracts* which proposes limited improvements to accounting and disclosure practices for insurance contracts. It proposes the elimination of catastrophe and equalisation provisions, a loss recognition test when no such test exists under the insurer's existing accounting policies and the derecognition of insurance liabilities only when they are discharged or cancelled or expire. A second phase of the project will address broader conceptual and practical issues. ED 5 proposes to prohibit an insurer adopting new accounting policies that conflict with the likely proposals in the second phase.

### **III IFRS IN 2005**

The IASB has indicated that the following IFRS will apply for accounting periods beginning on or after 1 January 2005:

- existing IAS as modified by the proposals in the recent improvements, financial instruments and business combinations exposure drafts, the outcome of the recently announced IASB/FASB convergence project and the next stage of the business combinations project; and
- IFRS on first-time adoption (IFRS 1), share-based payments (ED 2) and insurance contracts (ED 5).

The IASB has not yet issued exposure drafts of the changes, if any, that may result from the IASB/FASB convergence project or the second stage of its business combination project.<sup>15</sup> The IASB intends to publish all IFRS that will apply in 2005 before the middle of 2004.

### **IV THE IMPLICATIONS FOR UK COMPANIES**

This update to *The Convergence Handbook* provides an overview of the current state of differences between IFRS and UK GAAP as proposed as at the end of August 2003. It focuses on the implications for UK companies, in particular whether they will be required to change their accounting and disclosure practices.

Table 1 summarises the differences between IFRS and UK GAAP that are likely to remain after the implementation of the ASB and IASB proposals referred to above. Table 1 includes differences that were not included in *The Convergence Handbook* but which are likely to arise as a result of the adoption of IAS 39 and IAS 41, the deferral of FRS 17 and the proposed changes to IAS/IFRS and UK GAAP published since November 2000. In many cases, UK companies will be required to change their accounting and disclosure practices for the items listed in Table 1. The relationship between the original *Convergence Handbook* and Table 1 can be illustrated as follows:

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<sup>15</sup> Reports on the current status of all these projects can be found at [www.iasb.org.uk](http://www.iasb.org.uk).

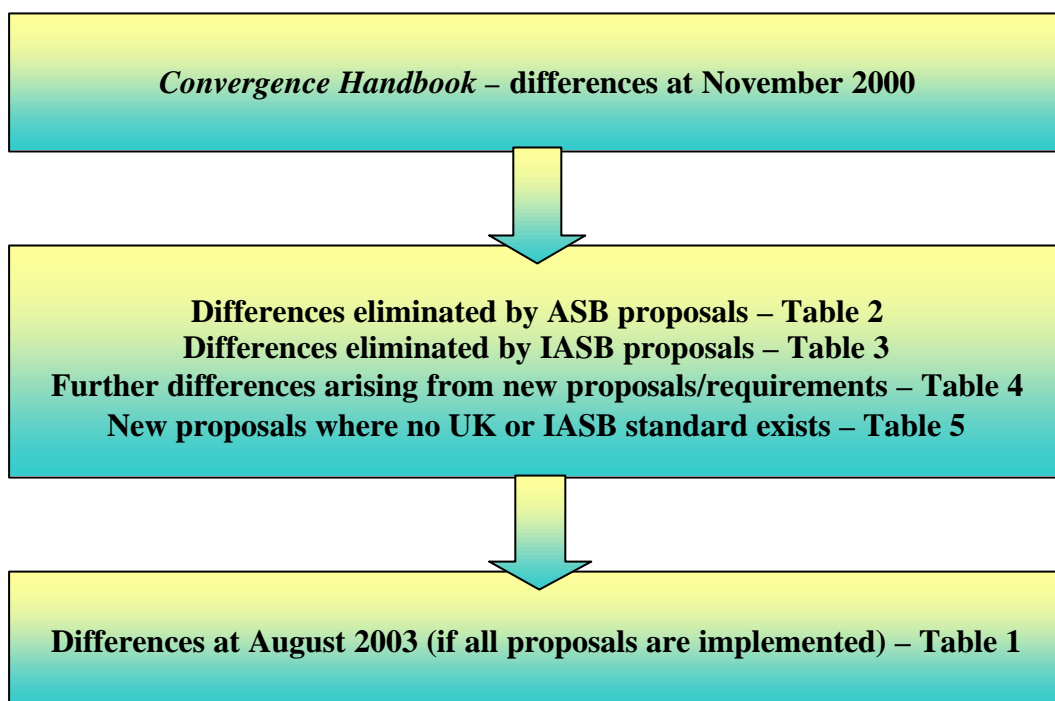


Table 2 summarises the differences between IFRS and UK GAAP that were identified in *The Convergence Handbook* that will disappear if ASB’s post-November 2000 proposals to move UK GAAP closer to IFRS are implemented. In many cases, UK companies will be required to change their accounting and disclosure practices.

Table 3 summarises the differences between IFRS and UK GAAP that were identified in *The Convergence Handbook* that will disappear if the IASB proposals to bring existing IAS closer to UK GAAP are implemented. UK companies should not be affected by these differences.

Table 4 summarises differences between IFRS and UK GAAP that were not included in *The Convergence Handbook* but which are likely to arise from IAS 39 (as amended) and IAS 41 or which are likely to arise as a result of recent IASB and ASB requirements and proposals. In many cases, UK companies will be required to change their accounting and disclosure practices.

Table 5 summarises recent ASB and IASB proposals that will result in similar standards where there are no existing UK or IASB requirements. In many cases, UK companies will be required to change their accounting and disclosure practices.

The Tables show that the adoption of IFRS will have several different implications for UK companies. One of the most significant implications is that UK companies will no longer be able to use those UK GAAP requirements or options that are not permitted by IFRS.

For example, current and proposed IFRS do not permit:

- the UK form of cash flow statement (FRS 1);
- the use of the pooling of interests method (FRS 6);
- the amortisation of goodwill (FRS 10);
- a timing differences approach to deferred tax (FRS 19);
- the expensing of all development costs (SSAP 13);
- the use of actuarial methods other than the projected unit credit method and the use of non-market based measurements and assumptions in the determination of pension costs (SSAP 24);
- the use of cost based measurements for some financial assets;
- the non-recognition on the balance sheet of derivatives; or
- the use of a cost model for most biological assets and all agricultural produce.

Another significant implication for UK companies is that the scope of some IFRS requirements is more extensive than the equivalent UK GAAP requirements, for example the scope of IAS requirements on revenue (IAS 18), employee benefits (IAS 19) and financial instruments (IAS 39). In addition, the IAS 14 requirements on segment reporting may require UK publicly traded companies to redefine their reportable segments and disclose more information about some segments.

While UK companies may find some IFRS requirements more extensive than current UK GAAP requirements, they will find that other IFRS requirements are more flexible than current UK GAAP. For example, FRS 5 deals in more detail than IFRS with accounting for the substance of transactions involving assets and liabilities. IAS 19 allows a corridor approach for the deferral and amortisation of actuarial gains and losses and IAS 31 allows the use of proportionate consolidation for joint venture entities.

These examples and the Tables do not tell the whole story. Prior to their adoption of IFRS, UK publicly traded companies must address the current state of the detailed differences between current UK GAAP and IFRS. They must study IFRS and IASB exposure drafts as well as other authoritative texts on IFRS such as the author's *Applying International Accounting Standards*.<sup>16</sup> They may need to organise further education and training for their accounting and non-accounting staffs. They must also consider the implications of the change to IFRS for their internal systems, management reporting and investor relations as well as contracts, compensation arrangements and other agreements that rely on financial information. They may need to seek professional advice.

There is one other important implication for UK companies. IFRS and UK GAAP are changing rapidly. The changes reflect the desire for both the convergence and the improvement of financial reporting requirements. UK companies should play a major part in this process by involving themselves fully from an early stage in the development of new and revised international and UK standards.

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<sup>16</sup> David Cairns, *Applying International Accounting Standards*, 3rd edition, Butterworths Tolley, 2002, ISBN 0 406 95208 6.

**TABLE 1**

**Key differences between IFRS and UK GAAP that would remain after the implementation of current ASB and IASB proposals – in many cases, UK companies will be required to change their accounting and disclosure practices when adopting IFRS**

*Current UK GAAP requirements not allowed by current and proposed IAS*

SSAP 4 Accounting for Government Grants

Deferral of grants related to acquisition of biological assets carried at fair value (see IAS 41 *Agriculture*).

SSAP 9 Stocks and Long-term Contracts

Measurement at cost of agricultural produce at point of harvest (see IAS 41 *Agriculture*).

SSAP 19 Investment Properties

Inclusion of gains and losses arising on revaluation in equity (via the statement of total recognised gains and losses).

SSAP 20 Foreign Currency Translation

Retention of foreign exchange differences in equity on disposal of a foreign entity without including them in the gain or loss on disposal.

SSAP 21 Accounting for Leases

Net cash investment method for the recognition of finance income by lessors.

FRS 1 Cash Flow Statements

Reporting changes in cash, rather than changes in cash and cash equivalents.

FRS 7 Fair Values in Acquisition Accounting

Prohibition on recognition of deferred tax assets that were not assets of the acquiree.

FRS 9 Associates and Joint Ventures

Gross equity method for joint venture entities.

FRS 11 Impairment of Assets

Comparisons of actual cash flows with forecasts for each of five years following an impairment review where recoverable amount is based on value in use – IAS 36 does not require such reviews and the IASB has rejected such a test (see ED 3 *Business Combinations*).

FRS 17 Retirement Benefits

Recognition of actuarial gains and losses in the statement of recognised gains and losses (pending the IASB's reconsideration of IAS 19, the ASB has deferred the effective date of the requirement for the immediate recognition of all actuarial gains and losses until accounting periods beginning on or after 1 January 2005. However, the IASB has tentatively agree to require the immediate recognition of all actuarial gains and losses).

Deduction of deferred tax relating to employee benefits from retirement benefit liabilities and assets (pending the IASB's reconsideration of IAS 19, the ASB has deferred the effective date of the accounting requirement in FRS 17 until accounting periods beginning on or after 1 January 2005).

FRS 19 Deferred Tax

Timing differences approach to deferred tax assets and liabilities.

Non-recognition of deferred tax on some revaluation gains.

***Current UK GAAP optional treatments not allowed by current and proposed IFRS***

SSAP 13 Accounting for Research and Development

Expensing of development costs that meet criteria for asset recognition.

SSAP 24 Pension Costs

Use of actuarial methods other than the projected unit credit method.

Use of a discount rate other than rates that are determined by reference to the market yields at the balance sheet date on high quality corporate bonds.

Use of other actuarial assumptions that are not based on market expectations at the balance sheet date.

The measurement of any plan assets at amounts other than their fair values at the balance sheet date.

FRS 19 Deferred Tax

Discounting of deferred tax assets and liabilities.

***Current and proposed IFRS requirements that are more extensive than current and proposed UK GAAP***

IAS 14 Segment Reporting

Definitions of reportable segments.

Disclosures for primary segments.

IAS 17 Leases

Separate classification of the land and buildings elements of leases.

Classification by the lessor of the initial direct costs of a finance lease.

IAS 18 Revenue

Sale of goods (the ASB has issued a Discussion Paper on revenue recognition).

IAS 19 Employee Benefits

Employee benefits other than retirement benefits.

IAS 39 Financial Instruments: Recognition and Measurement

Recognition and derecognition of financial assets and financial liabilities including:

- the recognition of all derivatives on the balance sheet;
- the identification and (possible) separate accounting for embedded derivatives;
- the derecognition of financial assets only when control of the contractual rights is lost, together with guidance on the derecognition of part of a financial asset and derecognition of a financial asset coupled with recognition of a new financial asset or liability;
- the derecognition of liabilities only when they are extinguished, together with guidance on the derecognition of part of a liability and derecognition of a financial liability coupled with recognition of a new financial asset or liability; and
- restrictions on the use of certain instruments as hedging instruments or as hedged items and on the use of hedge accounting.

IAS 41 Agriculture

Measurement of most biological assets and all agricultural produce at the point of harvest at value-based amounts.

***Current and proposed IFRS that would give more flexibility for UK companies***

IAS 1 Presentation of Financial Statements

Statement of changes in equity (as alternative to statement of total recognised gains and losses).

FRS 5 Reporting the Substance of Transactions

Absence of requirements concerning the accounting for the substance of transactions involving assets and liabilities.

IAS 19 Employee Benefits (companies that have fully adopted FRS 17 prior to their adoption IFRS)

Deferral and amortisation of actuarial gains and losses (with or without 10% corridor approach) – pending the IASB’s reconsideration of IAS 19, the ASB has deferred the effective date of its requirement for the immediate recognition of all actuarial gains and losses until accounting periods beginning on or after 1 January 2005. The IASB has tentatively agreed to require the immediate recognition of all actuarial gains and losses and to prohibit the use of the corridor approach.

IAS 19 Employee Benefits (companies that are using SSAP 24 prior to their adoption of IFRS)

Deferral and amortisation of actuarial gains and losses using 10% corridor approach.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

Deduction of grants from the cost of related assets.

IAS 31 Financial Reporting of Interests in Joint Ventures

Use of proportionate consolidation for joint venture entities.

IAS 38 Intangible Assets

Recognition of an asset as an intangible asset when it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations (see current text of IAS 38 and exposure draft of proposed amendments to IAS 38).

IAS 40 Investment Property

Cost alternative with depreciation recognised as an expense in the profit and loss account.

**TABLE 2**

**Key differences between existing IFRS and UK GAAP that were identified in *The Convergence Handbook* and which will disappear if current ASB proposals to move UK GAAP closer to IFRS are adopted – in many cases, UK companies will be required to change their accounting and disclosure practices when adopting either revised UK GAAP or IFRS**

***Current UK GAAP requirements that are not allowed by current IFRS***

SSAP 17 Accounting for Post Balance Sheet Events

Recognition of proposed dividends as a liability – the ASB proposes to conform SSAP 17 with IAS 10 (see FRED 27) and the DTI proposes to amend to the Companies Act.

FRS 4 Capital Instruments

Classification by an issuer of shares according to their legal form rather than their substance – the ASB proposes to replace FRS 4 with IAS 32 (see FRED 30) (subject to a necessary amendment to the Companies Act).

FRS 5 Reporting the Substance of Transactions

Offset of financial assets and financial liabilities when there is no intent to realise or settle by offset – the ASB proposes to replace this part of FRS 5 with IAS 32.

Linked presentation of non-recourse finance arrangements.

***Current UK GAAP optional treatments that are not allowed by current IFRS***

SSAP 20 Foreign Currency Translation

Use of the closing rate for the translation of the profit and loss account of foreign entities – the ASB proposes to conform SSAP 20 with IAS 21 and require the use of the rate of exchange at the date of the transactions or, as an approximation of that rate, the average rate for the period (see FRED 24).

***Current IFRS requirements that are more extensive than current UK GAAP***

IAS 11 Construction Contracts

Combining of separate construction contracts – the ASB proposes to conform SSAP 9 with IAS 11 (see FRED 28).

Segmenting of a single construction contract – the ASB proposes to conform SSAP 9 with IAS 11 (see FRED 28).

**IAS 39 Financial Instruments: Recognition and Measurement**

Measurement of financial assets and financial liabilities including:

- the measurement of all derivatives at fair value with gains and losses included in the profit and loss account (subject to the accounting for cash flow hedges);
- the measurement of financial assets held for trading at fair value with gains and losses included in the profit and loss account;
- the measurement of originated loans and receivables at amortised cost (subject to impairment losses) with all recognised gains and losses included in the profit and loss account;
- the measurement of ‘held to maturity investments’ at amortised cost (subject to impairment losses) with all recognised gains and losses included in the profit and loss account and restrictions on the use of this classification of investments; and
- the measurement of ‘available for sale securities’ at fair value with gains and losses included either in the profit and loss account or equity until disposal.

*(The ASB proposes to incorporate the IAS 39 measurement requirements into UK GAAP – see FRED 30)*

***Current IFRS that give more flexibility for UK companies***

**IAS 16 Property, Plant and Equipment**

Use of market values other than existing use values for revalued property – the ASB proposes to conform FRS 15 with IAS 16. This means that the existing requirements and guidance relating to the current value of revalued property, plant and equipment and appendix 1 dealing with RICS definitions would be removed from FRS 15 (see FRED 29).

*(The IASB, the ASB and other standard setting bodies are working together to achieve convergence of their respective requirements on revaluation accounting.)*

**TABLE 3**

**Key differences between IFRS and UK GAAP that were identified in *The Convergence Handbook* and which will disappear if current IASB proposals to bring IFRS closer to UK GAAP are adopted – UK companies should not be affected by these differences or the IASB's proposed changes**

***Current UK GAAP requirements that are not allowed by current IFRS***

*SSAP 19 Investment Properties*

Inclusion of long-leasehold properties in investment property – the IASB now proposes to allow the classification of property held under an operating lease as an investment property provided that it is accounted for as a finance lease and under the fair value model (see exposure draft of Improvements to IAS – IAS 40).

*FRS 3 Reporting Financial Performance*

Disclosures limited to discontinued, rather than discontinuing, operations – the IASB now proposes to replace the notion of discontinuing operations in IAS 35 with a notion of discontinued operations. However, more operations are likely to be classified as discontinued under the IASB proposals than under FRS 3.

*FRS 6 Acquisitions and Mergers*

Determination of the fair values of identifiable assets and liabilities acquired at the date of acquisition and the revaluation of those assets and liabilities to fair value as and when the group increases its interest in a subsidiary.

*FRS 7 Fair Values in Acquisition Accounting*

Recognition of estimate of contingent purchase consideration as at date of acquisition.

***Current IFRS requirements that are more extensive than current UK GAAP***

*IAS 24 Related Party Disclosures*

Disclosure of pricing policies for all material related party transactions - the IASB proposes to remove this requirement, conforming IAS 24 with FRS 8 (see exposure draft of Improvements to IAS – IAS 24).

***Current IFRS that would have given more flexibility for UK companies***

***Inventories***

Use of LIFO – the IASB proposes to prohibit the use of LIFO and, therefore, conform IAS 2 with SSAP 9 (see exposure draft of Improvements to IAS – IAS 2).

***IAS 8 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies***

Inclusion of effects of changes in accounting policies in the profit and loss account – the IASB proposes to prohibit this treatment for voluntary changes in accounting policies and, therefore, conform IAS 8 with FRS 3 (see exposure draft of Improvements to IAS – IAS 8).

Inclusion of the effects of the correction of fundamental errors in the profit and loss account – the IASB proposes to prohibit this treatment and, therefore, conform IAS 8 with FRS 3 (see exposure draft of Improvements to IAS – IAS 8). However, the IASB proposal goes further than FRS 3 by also prohibiting the inclusion of the effects of material errors in the profit and loss account. FRS 3 requires that the effects of material – but not fundamental – errors be included in the profit and loss account.

Classification of some gains and losses as extraordinary items – the IASB proposes to prohibit the classification of items as extraordinary and, therefore, conform IAS 8 with FRS 3 (see exposure draft of Improvements to IAS – IAS 8).

***IAS 22 Business Combinations***

Recognition of some reorganisation and restructuring provisions that were not liabilities of the acquiree as acquired liabilities and, hence, as part of the fair value exercise for acquired assets and liabilities – the IASB proposes to prohibit the recognition of such provisions as acquired liabilities (see ED 3 *Business Combinations*) and, therefore, conform IAS 22 with the approach taken in IAS 37, FRS 7 and FRS 12.

**TABLE 4**

**New differences between UK GAAP and IFRS that were not identified in *The Convergence Handbook* but which arise from IAS 39 (as amended), IAS 41 or recent IASB or ASB proposals and requirements – in many cases, UK companies will be required to change their accounting and disclosure practices when adopting IFRS**

***Current UK GAAP requirements not allowed by IFRS***

SSAP 4 Accounting for Government Grants

Deferral of grants related to acquisition of biological assets carried at fair value (see IAS 41 *Agriculture*).

SSAP 9 Stocks and Long-term Contracts

Measurement at cost of agricultural produce at point of harvest (see IAS 41 *Agriculture*).

SSAP 24 Pension Costs

Use of actuarial methods other than the projected unit credit method.

Use of a discount rates other than rates that are determined by reference to the market yields at the balance sheet date on high quality corporate bonds.

Use of other actuarial assumptions that are not based on market expectations at the balance sheet date.

The measurement of any plan assets at amounts other than their fair values at the balance sheet date.

FRS 6 Acquisitions and Mergers

Use of the pooling of interests method (merger accounting) for a business combination that is a merger, in particular a combination in which no party is portrayed as either acquirer or acquiree by its own board or management or by that of another party to the combination – the IASB proposes to require that all business combinations should be accounted for as acquisitions using the purchase method (see ED 3 *Business Combinations*).

FRS 10 Goodwill and Intangible Assets

Amortisation of negative goodwill up to the fair values of the non-monetary assets acquired over the periods in which the non-monetary assets are recovered through depreciation or sale – the IASB proposes to require that such amounts should be recognised immediately as a gain (see ED 3 *Business Combinations* which does not use the term ‘negative goodwill’ to describe such amounts).

Reversal of impairment loss on goodwill (see ED 3 *Business Combinations*).

***Current UK GAAP optional treatments not allowed by IFRS***

**FRS 10 Goodwill and Intangible Assets**

Amortisation of goodwill that is regarded as having a limited useful economic life on a systematic basis over that life – the IASB proposes to prohibit the amortisation of goodwill and require an annual impairment test for all goodwill (see ED 3 *Business Combinations*).

***IFRS requirements that are more extensive than current and proposed UK GAAP***

**IAS 17 Leases**

Separation of land and buildings elements of a lease of land and buildings (see exposure draft of Improvements to IAS – IAS 17).

**IAS 39 Financial Instruments: Recognition and Measurement**

Measurement of financial assets and financial liabilities including:

- the measurement of all derivatives at fair value with gains and losses included in the profit and loss account (subject to the accounting for cash flow hedges);
- the measurement of financial assets held for trading at fair value with gains and losses included in the profit and loss account;
- the measurement of originated loans and receivables at amortised cost (subject to impairment losses) with all recognised gains and losses included in the profit and loss account;
- the measurement of ‘held to maturity investments’ at amortised cost (subject to impairment losses) with all recognised gains and losses included in the profit and loss account and restrictions on the use of this classification of investments; and
- the measurement of ‘available for sale securities’ at fair value with gains and losses included either in the profit and loss account or equity until disposal.

**IAS 40 Investment Property**

Classification of an operating lease of an investment property as a finance lease with the consequential effect of the recognition of a liability for the obligation to make lease payments (see exposure draft of Improvements to IAS – IAS 40).

**IAS 41 Agriculture**

Measurement of most biological assets and all agricultural produce at the point of harvest at value-based amounts.

ED 5 Insurance Contracts

Restriction on changes in accounting policies

***IFRS that would give more flexibility for UK companies***

IAS 36 Impairment of Assets

Measurement of impairment losses for goodwill as the difference between the recoverable amount of the cash generating unit to which the goodwill has been allocated and the net fair value of the identifiable assets, liabilities and contingent liabilities that the acquirer would recognise if it acquired the cash generating unit in a business combination on the date of the impairment test – FRS 11 distinguishes between acquired and internally generated goodwill and requires that the impairment test should be carried out only on the acquired goodwill.

**TABLE 5**

**Recent IASB or ASB proposals that will, if adopted, result in similar standards where there are no existing IASB or UK requirements – in many cases, UK companies will be required to change their accounting and disclosure practices when adopting IFRS or revised UK GAAP**

ED 2/FRED 31 Share-based Payments

Recognition of all share-based payments, including grants of shares or share options to employees, at fair value as at grant date.

ED 4/FRED 32 Disposal of Non-current Assets and Presentation of Discontinued Operations

Measurement of assets or groups of assets held for sale at the lower of carrying amount and fair value less costs to sell and the non-depreciation of those assets.

Exposure Draft of Proposed Amendments to IAS 39/Supplement to FRED 30 *Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk*

Restrictions on use of macro hedging.

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*The Convergence Handbook. A Comparison between International Accounting Standards and UK financial reporting requirements is available for £25 by calling + 44 (0)20 8707 772906. The authors are David Cairns and Professor Christopher Nobes of the University of Reading, a former UK representative on the IASC Board.*