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FINANCIAL REPORTING DEVELOPMENTS

Presentation by
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Creating value for clients

Introduction

- FRS 17 *Retirement benefits*
- UK / IFRS Convergence
- FRED 31 *Share based payments*
- UITF Abstract 32 *Employee benefits*

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FRS 17

- Issued November 2000
- Fundamental change for the accounting and disclosure of an employer's relationship with a defined benefit scheme
- Long phase in - full implementation in 2003 (original timetable)
- No change for defined contribution schemes

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Need for a new standard

- UK practice is not in line with International practice
- Prepayment or accrual in balance sheet does not represent the actual surplus or deficit on the pension scheme
- Inadequate information available about the impact that a pension scheme can have on a company's finances

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Deferral

- Much controversy surrounded the appearance of the first widescale appearance of FRS 17 disclosures in early 2002
- The FRS was blamed for the demise of several final salary schemes
- The ASB have agreed to defer full accounting until 2005 - official reason was the convergence agenda
- The notes will still reveal the full story….

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Defined Benefit Schemes

Implementation

- Periods ending on or after 22 June 2001 - first set of disclosures
- 22 June 2002 - Full disclosures
- 22 June 2003 - Full accounting (original)
- *1 January 2005 - Full accounting (revised)*
- *(Prior to adopting the full accounting, SSAP 24 must still be used in the primary statements)*

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Defined Benefit Schemes - Accounting

- Disclosures - FRS 17
- Accounting - SSAP 24
- FRS 17 accounting may be adopted in full early

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Defined Benefit Schemes - Audit (1)

- Obtain information from actuary - (Audit Practice Note 22)
- Additional audit guidance from ICAEW Audit & Assurance Faculty (www.icaew.co.uk)
- Agreed form of letter
- Cost of obtaining information from actuary
- If information cannot be obtained - Qualify audit report

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Defined Benefit Schemes - Audit (2)

Audit issues

- Detailed disclosures
- Assumptions
- Second opinions
- Audit committees & corporate governance

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Convergence Programme

- A programme of convergence between UK GAAP and the standards of the IASB is ongoing
- This is occurring because of an EU Regulation, issued in 2002, which passes responsibility for setting financial reporting standards for listed companies to the European level

Convergence approach

- The ASB is pursuing a “gradual approach”, by amending its standards to bring them into line with the IASB’s standards
- In 2002 seven FREDs were issued as part of this process

Listed companies

- For accounting periods ending after 31 December 2005, all listed companies in the EU must present their group financial statements in accordance with international standards
- Several countries have already changed their laws to require international standards to be used for group reporting by listed companies

Other accounts

- The Regulation does not apply to the accounts of unlisted companies or to the "parent company accounts" of a listed company
- In practice, in the UK, all companies and all accounts will be subject to convergence because of the requirement to apply "applicable accounting standards"

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International Standards

- IAS 19 (Revised)
- The two standards are consistent in most respects
- The FRS requires actuarial gains & losses to be recognised immediately in the STRGL
- The IAS requires actuarial gains & losses to be recognised in the income statement to the extent that they exceed 10% of the greater of the gross assets or gross liabilities in the scheme

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FRED 31 - Objective (1)

- To ensure that an entity recognises all share-based payment transactions in its financial statements, measured at fair value, so as to provide high quality, transparent and comparable information to the users of financial statements

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FRED 31 - Objective (2)

- **FRED is identical to IASB ED 2**
- **The approach is similar to that of US FAS 123**
- **The proposals have particular implications for the accounting of share option schemes and similar incentive arrangements**

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Types of transaction

- **Equity-settled share-based transactions (including share options)**
- **Cash-settled share-based transactions**
- **Transactions in which settlement is in cash, in amounts determined by the price of equity, or by the issue of equity**

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Equity-settled transactions (1)

- **Includes most employee share option schemes and Inland Revenue approved SAYE schemes**
- **The fair value of the transaction, and the corresponding increase in equity must be recognised, by reference to the fair value of the equity instruments issued**
- **For transactions with employees, the fair value of the equity instruments issued must be recognised**

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Equity-settled transactions (2)

- **The transaction represents the total consideration, irrespective of whether the equity instruments are subsequently forfeited or, in the case of options, are not exercised**

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UITF 32 - Introduction

- **This is a strict pronouncement from the UITF, arising because of both frustration and concern over the treatment of transactions with EBTs and similar arrangements**

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Consensus (1)

- **The UITF reached a consensus that, when an entity transfers funds to an intermediary, there should be a *rebuttable presumption* that the sponsoring entity has exchanged one asset for another and that the payment itself *does not represent an immediate expense*.**

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Consensus (2)

- Where a payment to an intermediary is an exchange by the sponsoring entity of one asset for another, any assets that the intermediary acquires in a subsequent exchange transaction will also be under the de facto control of the sponsoring entity.

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Consensus (3)

- The intermediary's assets, and any liabilities that it has, should therefore be recognised as assets and liabilities of the sponsoring entity.
- The subsequent accounting for those assets and liabilities and for expense recognition should follow the normal accounting rules.

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Consensus (4)

- Accordingly, an asset held by the intermediary would cease to be recognised as an asset of the sponsoring entity when, for example, it vests unconditionally in identified beneficiaries.

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