

# Financial Reporting Update

May/June/July 2007

KPMG LLP (UK)

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## ASB issues consultation paper on small and medium-sized entities

In April 2007 the Accounting Standards Board (ASB) issued the IASB's exposure draft of a proposed *IFRS for Small and Medium-sized Entities* (IFRS for SMEs) as a consultation paper, with an invitation to comment on the draft and its potential implications for UK entities. This consultation has wide-ranging implications for the future of UK financial reporting.

The importance of this consultation is its place in guiding the future course of financial reporting in the UK. The ASB has identified three implications of applying the IFRS for SMEs in the UK and is seeking views on these matters:

- The role that the IFRS for SMEs might play in the ASB's convergence project – i.e., could it be a standard for 'mid-tier' entities that are too large for the FRSSE but are not required, and do not want, to adopt full IFRS?
- Might the IFRS for SMEs be a suitable replacement for the FRSSE?
- What changes would need to be made to the IFRS for SMEs for it to fulfil either of those roles?

In order to help respondents in their thinking, the ASB sets out in the preface to the IFRS for SMEs what it considers to be the main differences between UK GAAP and the IFRS for SMEs, and between the FRRSE and the IFRS for SMEs (the IASB's Basis for Conclusions gives a summary of the key differences between full IFRS and the IFRS for SMEs).

A summary of the key differences is given below:

*UK GAAP v IFRS for SMEs*

- UK GAAP permits merger accounting in certain circumstances. The IFRS for SMEs permits only the purchase method (business combinations under common control are exempt from this requirement).
- Certain related party disclosure exemptions are available under UK GAAP for parent undertakings which prepare group accounts and subsidiary undertakings. No such exemptions are provided by the IFRS for SMEs. The disclosure requirements in the IFRS for SMEs are different from UK GAAP.
- The UK GAAP recognition criteria for goodwill and intangible assets are different from those of the IFRS for SMEs (under the IFRS for SMEs, more intangible assets will generally be recognised). Goodwill is amortised under UK GAAP. Under the IFRS for SMEs, goodwill is not amortised but subject to an annual impairment test.
- The IFRS for SMEs requires deferred tax to be recognised on *temporary* differences, in contrast to UK GAAP's *timing* difference approach. The disclosure requirements regarding deferred tax are different under the IFRS for SMEs.
- The IFRS for SMEs allows entities to apply either a simplified financial instruments reporting regime or full IAS 39 (FRS 26) and IFRS 7 (FRS 29).
- The IFRS for SMEs requires immediate recognition in profit and loss of actuarial gains and losses on defined benefit pension schemes.

*FRSSE v IFRS for SMEs:*

- The FRSSE does not require a cash flow statement.
- In line with UK GAAP, the FRSSE requires deferred tax to be provided on most timing differences. The IFRS for SMEs has a different measurement basis (as indicated above).
- The IFRS for SMEs has more detailed provisions regarding the recognition and measurement of financial instruments than the FRSSE.
- In line with UK GAAP, the FRSSE requires goodwill to be amortised; the IFRS for SMEs requires goodwill to be carried at cost less impairment.
- The FRSSE requires cash-settled share based payments to be measured at the best estimate of the expenditure required to settle the liability. However, the FRSSE requires only disclosure with regard to equity-settled share based payments. In contrast, the IFRS for SMEs applies IFRS 2 in measuring and disclosing all share based payments.
- The disclosure requirements of the IFRS for SMEs are generally more detailed than those of the FRRSE.

The consultation paper is available at:

<http://www.frc.org.uk/asb/press/pub1298.html>

The deadline for responding is 31 July 2007 and we encourage all those still reporting under UK GAAP to make their views known.



## Voluntary disclosure of qualified audit reports

In June 2007, the Financial Reporting Review Panel (FRRP) issued a consultation document in which it set out a proposal for a voluntary disclosure regime for qualified audit reports.

The proposal, which came unexpectedly, is that auditors of those companies within the FRRP's remit (see below) would notify the FRRP whenever they issue a qualified audit report. In its press release the FRRP confirmed that audit reports containing an emphasis of matter paragraph, which typically refer to uncertainty over the going concern status, would not require notification.

The consultation paper offers a brief explanation of the purpose of the regime, which is that earlier notification would assist the FRRP in identifying defective accounts and taking the more appropriate course of action in dealing with non-compliant accounts – i.e., correction either by way of prior year adjustment in subsequent accounts or by requiring the filing of revised accounts.

The FRRP's remit is wide and includes the following companies: public companies; companies within a group headed by a public company; any private company not qualifying as small or medium-sized; any private company within a group that does not qualify as a small or medium-sized group; and any body corporate in the UK that has issued listed securities.

The FRRP wishes to introduce a voluntary referral mechanism but has indicated that if an effective voluntary scheme is not introduced, it will consider investigating whether its legal powers could be used to implement an obligatory disclosure regime. However, the FRRP has stated that it would like to avoid taking such a course of action.

Whilst we understand the FRRP's desire for more timely notification, it seems to us that there are some practical issues regarding this proposal that require further consideration. These include whether the responsibility for notifying the FRRP should fall on the company, rather than the auditor; and the potential for the FRRP to be swamped by potentially a large number of qualified audit reports on companies at the smaller end of the FRRP's range.

The announcement is available at:

<http://www.frc.org.uk/frp/press/pub1331.html>

The FRRP would welcome comments on the proposed scheme and suggestions for alternative arrangements that achieve the same end. We strongly encourage all interested parties to make their views known to the FRRP.



### FRS 20 for subsidiaries

The February 2007 issue of *Update* reported that the ASB had concerns regarding the compliance burden of FRS 20 (IFRS 2) *Share-based payment* and was considering providing an exemption to subsidiary undertakings that grant options over their parent company's shares. In April 2007, the ASB announced that it would not amend FRS 20 to provide such an exemption.

The announcement is available at:

<http://www.frc.org.uk/asb/press/pub1298.html>

The ASB concluded that the importance of not introducing divergence between the UK standard and the international standard outweighed the cost benefit to preparers, and that no amendment to FRS 20 would therefore be proposed.



### Review of the impact of the Combined Code

In April 2007 the Financial Reporting Council (FRC) initiated an assessment of the progress made in implementing the Combined Code on Corporate Governance (the Code).

This follows the review carried out in 2005 which despite the overall conclusion that the Code was "bedding down well", resulted in two significant changes in the Code:

- to allow the chairman of the company to sit on the remuneration committee, and
- to provide a "vote withheld" option on proxy appointment forms.

The 2005 review also identified a number of other issues which the FRC agreed to keep under review, including: the "comply or explain" mechanism, the compliance burden for smaller companies, and the availability of non-executive directors. The 2007 consultation revisits these areas together with the issues raised by company chairmen and senior investors with the FRC in a series of meetings in 2006/7.

The FRC is seeking feedback on the following:

- Does the Code support better board performance over time?
- Is the "comply or explain" approach working effectively?
- What impact has the Code had on smaller companies?
- Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies? If not, in what respects and how do you believe they should be modified?

A copy of the press release is available at:

<http://www.frc.org.uk/press/pub1299.html>

A copy of the consultation paper is available at:

<http://www.frc.org.uk/corporate/combinedcode.cfm>

The deadline for comment is 20 July 2007. It is expected that any changes made to the Code as a result of this consultation will take effect from 1 November 2008.



## IFRS newsletters

KPMG IFRG Limited has published the following since the March/April 2007 *Update*, which are available on our Web site at [www.kpmg.co.uk](http://www.kpmg.co.uk):

- *IFRS in Brief*, April 2007 – a summary of the March 2007 meeting of the IASB
- *IFRS in Brief*, May 2007 – a summary of the April 2007 meeting of the IASB and April 2007 joint meeting of the IASB with the FASB
- *IFRS in Brief*, June 2007 – a summary of the May 2007 meeting of the IASB
- *IFRS Briefing Sheet*, Issue 65 – Status of current projects of the IASB
- *IFRS Briefing Sheet*, Issue 66 – IAS 23 *Borrowing Costs*
- *IFRS Briefing Sheet*, Issue 67 – Proposal for enlarging the IFRIC
- *IFRS Briefing Sheet*, Issue 68 – Preliminary Views on Insurance Contracts



If you would like further information on any of the matters discussed in this *Update*, please talk to your usual contact at KPMG LLP (UK) or call any of our offices. Earlier *Updates* are available on our Web site, at [www.kpmg.co.uk](http://www.kpmg.co.uk).

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Publication name: Financial Reporting Update

Publication number: 307-281

Publication date: July 2007

Printed on recycled material