

Contents

- Pension accounting – fewer assets and larger liabilities?
 - Impact of IFRIC 14 on UK pension schemes
- Update on periodic reporting under DTR
 - Recent developments
- Half-yearly financial reports
 - ASB guidance
- FRED 41: Related Party Disclosures
 - Proposed replacement to FRS 8
- First time implementation of IFRSs – AIM companies
 - FRC reminder of available guidance
- Amendment to FRS 3
 - Alignment with FRS 23 and FRS 26
- Statement of Principles – Public Benefit Entities
 - ASB issues guidance
- IFRS newsletters
 - Summary

Pension accounting – fewer assets and larger liabilities?

The impact of a recent pronouncement from the International Financial Reporting Interpretations Committee (IFRIC) is likely to be significant for many companies reporting under IFRS that operate defined benefit pension schemes. This may be so whether the schemes are currently in surplus or in deficit. This article explores the potential impact for companies with UK schemes.

IFRIC 14 IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* was issued in July 2007. It is mandatory for periods starting on or after 1 January 2008, but only after it has been adopted for use in EU. In the view of KPMG in the UK, entities may change their accounting policies to comply with it prior to endorsement since its requirements do not conflict with those of IAS 19 *Employee Benefits* itself, although the transitional provisions of IFRIC 14 would not then be available.

IFRIC 14 considers two related issues:

- If a scheme is in surplus, how much of an asset can the employer recognise?
- If there is a minimum funding regime, when must an additional liability be recognised above and beyond the IAS 19 deficit (or to reduce or eliminate an IAS 19 asset)?

Asset recognition

IAS 19 limits the measurement of a defined benefit asset when a scheme is in surplus to the amount known as the asset ceiling. The main element of this is described as “the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan”. (Any unrecognised net actuarial losses – i.e., of those entities using the corridor method - or past service cost would add to this ceiling but will be ignored in this article.) IFRIC 14 interprets when a benefit is ‘available’ and confirms that the surplus does not need to be immediately realisable at the balance sheet date to qualify but that the company can look forward over the life of the scheme. However, for UK schemes this may not be as helpful as it sounds because of the strict legal framework within which such schemes operate.

© 2007 KPMG LLP, the UK member firm of KPMG International, a Swiss cooperative. All rights reserved.

Third-party links are provided as a convenience to our users. KPMG LLP does not control and is not responsible for any of these sites or their content. KPMG LLP is obligated to protect its reputation and trademarks and KPMG LLP reserves the right to request removal of any link to our Web site.

In order for a pension scheme surplus to be recognised as an asset on the company's balance sheet, there is the overriding requirement for it to meet the general definition of an asset. So it must be controlled by the company: this is reflected in the IFRIC's comment that the company must have the right to obtain a refund or reduction in contributions.

IFRIC 14 concludes that a refund will be 'available' only if the company has an unconditional right to a refund, either during the life of the plan (with no settlement of the liabilities), on wind-up or on the final member's leaving the scheme. A company will not necessarily have an unconditional right to a refund from a UK scheme at any time because agreement of the trustees to a payment to the company may well be required: companies may need to take legal advice on this matter. (The reference in IFRIC 14 to uncertain future events outside the company's control may also be relevant.) If the company does not have an unconditional right to a refund, this will mean that no asset can be recognised in respect of a scheme in surplus that has no active members (because there is no scope for future contribution reductions).

For a scheme where benefits continue to be earned, the company will need to consider the second potential route to an asset – reductions in future contributions. This is when a minimum funding requirement (MFR) might have an effect.

An asset in respect of future contribution reductions can be recognised to the extent that (in present value terms) the IAS 19 current service cost in future years exceeds the estimated minimum funding contributions in respect of future service accrual, considered year by year.

An MFR is described in IFRIC 14 as "any requirements to fund a post-employment... defined benefit plan". To the extent that the company is obliged to pay a certain minimum level of contributions to a scheme, this will restrict its ability to reduce its future contributions. For UK schemes, trustees and companies must sign up to a legally binding schedule of contributions, which will cover at least five years, and in our view this would be an MFR. The schedule is based on assumptions made for funding purposes: since the trustees' agreement is required to any future schedule, it is difficult to see that a company could anticipate a contribution level beyond the schedule period of anything less than the annual cost of future benefit accrual, calculated on that funding basis.

Say a company had an IAS 19 service cost of 12 percent, a normal level of contributions of 13 percent on a funding basis, and an agreed level of contributions for the next five years of 10 percent. No refund is available. In our view the asset ceiling would be calculated as the present value of five years' worth of contribution reductions of two percent (12 - 10), less an excess cost of one percent (13 - 12) for the remaining duration of the scheme. (The amount recognised cannot go negative but stops at zero.)

Additional liability?

An MFR might also give a company an additional obligation, akin to an onerous contract, above and beyond its IAS 19 liability. If a scheme is in deficit and additional contributions must be made in respect of past service (under the schedule, which will incorporate any recovery plan to make good a funding deficit), the company must consider whether those contributions would turn the scheme into surplus on an IAS 19 basis. If they would, it must then assess on the basis set out above whether that surplus could be recognised as an asset. To the extent that it could not be, an additional provision must be made: for a company with an IAS 19 liability, this would be equal to the present value of the committed deficit contributions, less the IAS 19 deficit, less any recoverable surplus. (If the company previously had an IAS 19 asset, this would be reduced or eliminated by the additional provision required.) Effectively, the asset restriction that would otherwise occur in the future must be accelerated and recognised when the company becomes committed to make past service contributions from which it does not expect to be able to benefit.

Summary

IFRIC 14 may well make it difficult to recognise an asset in respect of a UK pension scheme for companies reporting under EU-adopted IFRS. Companies are used to not anticipating refunds, since this was not permitted by UK GAAP, but the restrictions on anticipating reductions in future contributions are new. Even though IFRIC 14 is not yet mandatory, directors may wish to take its requirements into account in considering future schedules of contributions.

IFRIC 14 is available at:

www.iasb.org/Current+Projects/IFRIC+Projects.html

**Update on periodic reporting under DTR**

As reported in the March/April 2007 *Financial Reporting Update* the new Disclosure and Transparency Rules (DTR) have resulted in some changes to the periodic reporting requirements for UK incorporated companies with certain types of securities admitted to trading on a relevant UK market and regulated by the Financial Services Authority (FSA). These changes apply for financial years commencing on or after 20 January 2007.

Responsibility statements

In the annual financial report of companies with *transferable securities* (as defined in the DTR) admitted to trading on a regulated market, DTR 4.1.12 requires that the “persons responsible” within the company make responsibility statements setting out that to the best of their knowledge the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view and the management report includes a fair review of the development, performance and position of the business and a description of the principal risks and uncertainties.

DTR 4.1.12 also requires that the name and function of any person who makes a responsibility statement are clearly indicated within it. The “persons responsible” under company law are all the directors collectively. The implication of this may be that all directors are required to make the responsibility statement and be named within it rather than, say, just one or two on behalf of the board. The question is a legal one and companies may wish to obtain specific legal advice.

DTR 4.2.10 contains similar requirements in relation to responsibility statements in half-yearly financial reports. The “persons responsible” for half-yearly financial reports are less clear as there are no statutory provisions in this area. Again, companies may wish to obtain specific legal advice.

Half-yearly financial reports

Companies with *either shares or debt securities* (as defined in the DTR) admitted to trading on a regulated market, and that are required to prepare their consolidated financial statements in accordance with EU-adopted IFRSs, are also required to include within the half-yearly financial report a condensed set of financial statements in accordance with IAS 34 *Interim Financial Reporting* (DTR 4.2). Compliance with IAS 34 is likely to result in more disclosure.

There is an exception to this, as follows (although it is unlikely to be used often). The DTR includes a transitional provision which allows companies with debt securities admitted to the FSA’s official list before 1 January 2005 (under what was Chapter 23 of the Listing Rules) not to prepare their half-yearly financial reports in accordance with DTR 4.2 for 10 years following 1 January 2005. However, few companies have only such debt securities and, in any case, the Professional Securities Market (PSM), where many such securities are now listed, is not a regulated market and thus having securities listed on the PSM does not trigger the periodic reporting rules of the DTR.

Owing to the DTR’s effective date, the first companies to be affected by the change are principally those with a 31 January 2008 year end – i.e., with half-yearly periods ending in July 2007 – and publication of these first IAS 34 reports either has happened recently or is imminent.

As set out above, in the half-yearly financial report the directors are required to make a responsibility statement and so to state that the condensed set of financial statements gives a true and fair view. This is a problem because, in the view of KPMG in the UK, a true and fair view can be given only by a *complete* set of financial statements. However, the DTR permits an alternative formulation of stating that the condensed set of financial statements has been prepared in accordance with IAS 34 as adopted by the EU (or the ASB equivalent, for those not using EU-adopted IFRSs, as discussed in the next article *Half-yearly financial reports*). In the view of KPMG in the UK, the directors should use only this alternative formulation – i.e., they should not state that the condensed set of financial statements gives a true and fair view.

Interim management statements

DTR 4.3 requires companies with shares (as defined in the DTR) admitted to trading on a regulated market to produce interim management statements (IMSs) between ten weeks after the beginning and six weeks before the end of each of the first and second six month periods of the year, to cover the period between the start of the relevant six month period and the publication date. The IMS should contain a general description of financial position and performance during the period, explanations of material events and transactions that have taken place in the period and their impact on the financial position.

Again, the first companies to be affected are generally those with a 31 January 2008 year end which had to publish their first IMS between 12 April 2007 and 19 June 2007.

Guidance on the content of IMSs is limited and the Financial Services Authority (FSA) has stated (*List!* issue 14, updated April 2007) that it supports a market-led solution resulting from discussion between preparers and users.

We reviewed the IMSs of all 27 companies within the FTSE 100 with years commencing between 20 January and 1 April 2007 to identify interesting and developing trends in the application of DTR 4.3. These companies were all required to produce their first IMS by 19 August 2007.

Only three companies produced “full” quarterly reports – i.e., included primary statements, selected notes and a management report commentary, all of which were in excess of 20 pages long. One of these companies stated compliance with IAS 34 *Interim Financial Reporting* as adopted by the EU and two of these companies obtained review opinions from their auditors.

The remaining 24 companies all produced an IMS. The name used to describe the statement varied although a majority of companies (18) included the words ‘interim management statement’ in the title. The length of the IMS also varied with 18 IMSs being either one or two pages long, five between four and six pages long and one 12 pages long.

All 24 IMSs included narrative discussion with all but one company including numerical information within the narrative. However, eight companies presented further numerical information in tabular form with the content of these tables varying from revenue or percentage changes in revenue by business or location to non-financial KPIs.

Companies generally provided some discussion of financial performance but far less discussion, if any, of financial position. Most companies also provided some commentary on those events and transactions in the period they considered to be material although the impact of those events on the company’s financial position was not always clear.

An IMS must be published within a publication window of approximately 70 days. In our survey the actual date of publication varied between 21 and 67 days (although all but three companies were within a much narrower window of 30 to 52 days). As we might expect, companies producing “full” quarterly financial reports tended to publish later than those publishing (shorter) IMSs.

Very few companies in our survey explicitly complied with the requirement that the information covers the period up to the date of publication of the IMS. This may reflect the practical issues associated with compiling such up-to-date information. Perhaps interestingly, companies in our survey did not tend to adopt an approach of stating that there were no significant changes between the latest date covered by the financial information and the IMS publication date.

Our survey confirms our expectation of divergent practice and the emergence of best practice only over time. In the meantime, companies are encouraged to discuss their approach to IMSs with users. Two areas worthy of increased focus may be the requirements to provide a general description of financial position (DTR 4.3.5) and to present information that covers the period up to the date of publication of the IMS (DTR 4.3.4). It will be interesting to follow how practice evolves and whether the FSA considers it necessary to issue additional guidance, perhaps following its intended review of market practice in 18 to 24 months’ time.

The DTR are available at:

www.fsahandbook.info/FSA/html/handbook/DTR



Half-yearly financial reports

On 16 July 2007, the ASB issued a Statement *Half-Yearly Financial Reports* which is designed to provide guidance for any UK or Irish entities that are required or voluntarily choose to prepare half-yearly financial reports, other than those required by the DTR of the FSA to apply IAS 34 *Interim Financial Reporting*.

The ASB has revised its 1997 Statement *Interim Reports*, renaming it *Half-Yearly Financial Reports* to reflect the language of the DTR. However, the ASB has made only a small number of necessary changes, including changes in terminology.

The DTR requires that a half-yearly financial report include a directors' responsibility statement which states, among other things, that the condensed set of financial statements included within the half-yearly financial report gives a true and fair view of the assets, liabilities, financial position and profit or loss of the company. However, as discussed in the previous article (*Update on periodic reporting under the DTR*), KPMG in the UK does not believe that a condensed set of financial statements can give a true and fair view. This issue can be avoided by using an alternative formulation (for non-IAS 34 adopters) of stating that the condensed set of financial statements has been prepared in accordance with pronouncements on interim financial reporting issued by the ASB. Therefore, the ASB has stated that the FSA has effectively mandated the use of this Statement by such entities.

The Statement is effective immediately both for those preparing half-yearly financial reports in accordance with the DTR – i.e. for periods starting on or after 20 January 2007 – and, as non-mandatory guidance, for others preparing half-yearly reports.

The ASB's press release and statement are available at:

www.frc.org.uk/asb/press/pub1367.html



FRED 41: Related Party Disclosures

On 12 July 2007 the Accounting Standards Board (ASB) issued Financial Reporting Exposure Draft (FRED) 41 *Related Party Disclosures*, which proposes to replace FRS 8 with a standard based on IAS 24 (as amended by the IASB's proposals issued in February 2007).

The proposals in the FRED are designed to ensure consistency between the requirements of accounting standards and company law, once the latter changes. In March 2007 the Government issued a consultation document *Implementation of Directive 2006/46/EC on Company Reporting – Amending the Accounting Directives* which will introduce the IAS 24 definition of a related party into UK company law. Without an amendment to FRS 8, a conflict would arise between that standard and the Companies Act requirement.

The proposals are intended to lead to greater convergence between UK GAAP and IFRS whilst avoiding any potential conflict between the requirements of financial reporting standards and company law. The main differences between the disclosure requirements of FRS 8, IAS 24 and FRED 41 are:

- FRS 8 does not require disclosure of transactions in the parent's own financial statements or in a subsidiary undertaking's financial statements (in the latter case provided 90 per cent or more of the voting rights are controlled within the group) of transactions with entities that are part of the group provided that the consolidated financial statements in which that subsidiary is included are publicly available: FRED 41 proposes an exemption from disclosure of transactions between two or more members of a group provided that the subsidiaries which are party to the transaction are wholly owned by such a member.
- FRS 8 does not require disclosure of key management personnel compensation; the ASB proposes that disclosure of key management personnel compensation should be made in accordance with IAS 24.
- FRS 8 requires disclosure of the names of the transacting related parties; the ASB is not proposing as part of the FRED to require such disclosure.
- FRED 41 proposes to include guidance on materiality, based on that set out in IAS 1 *Presentation of Financial Statements*.
- FRED 41 proposes separate disclosure of transactions entered into by the company with related parties if they are material and have not been concluded under normal market conditions (whilst this would diverge from IAS 24, it would reflect the proposed legal requirement).

The ASB press release and a copy of FRED 41 are available at:

www.frc.org.uk/asb/press/pub1365.html

It is anticipated that the changes proposed to UK company law above will become effective in 2009, and any changes required to UK FRSs are intended to be made simultaneously.

The deadline for responding is 19 October 2007 and we encourage interested parties to make their views known to the ASB.



First time implementation of IFRSs – AIM companies

UK parent companies listed on the AIM are required to prepare their consolidated accounts under EU-adopted IFRSs for periods starting on or after 1 January 2007. As a consequence, half-yearly reports required by the AIM rules must also be prepared in accordance with the measurement and recognition requirements of EU-adopted IFRSs. The Financial Reporting Council (FRC) has issued a reminder of two documents that AIM companies might find helpful when implementing EU-adopted IFRSs.

One of the documents referred to in the FRC's press release is the Financial Reporting Review Panel's (FRRP) preliminary report, issued in December 2006, on implementation of EU-adopted IFRSs in the accounts of UK listed companies. The FRRP's report identified a number of areas where the quality of reporting could be improved – e.g., disclosure of management judgments and key assumptions, and disclosure regarding annual impairment reviews of goodwill and intangible assets with indefinite lives.

A copy of the ASB's press release is available at:

www.frc.org.uk/press/pub1342.html

We encourage AIM companies to consult the FRRP's preliminary report during their own conversion processes.



Amendment to FRS 3

On 6 July 2007 the ASB issued an amendment to FRS 3 *Reporting Financial Performance* to clarify its application to entities within the scope of FRS 26 (IAS 39) *Financial Instruments: Recognition and Measurement*. The amendment aligns the requirements of FRS 3 to FRS 26 with respect to the presentation of gains and losses on certain financial instruments and FRS 23 (IAS 21) *The Effects of Changes in Foreign Exchange Rates* with respect to the recycling of foreign exchange differences from equity to the profit and loss account.

Under FRS 26, gains and losses on the remeasurement of available-for-sale financial assets are required to be recognised in equity and recycled to the profit and loss account on derecognition. However, pre-amendment FRS 3 required that insurance entities present such gains and losses in the profit and loss account as part of the insurance entity's investment return. A similar issue arose with respect to the recycling of foreign exchange translation differences. Under FRS 23, the cumulative amount of exchange differences recognised through the statement of total recognised gains and losses in relation to a foreign operation is required to be recognised in the profit and loss account when the gain or loss on disposal is recognised. Nevertheless, pre-amendment FRS 3 was in conflict with the FRS 23 requirement for recycling by requiring the profit or loss to be calculated solely by reference to the difference between the sales proceeds and the carrying amount of the disposed assets.

The amendment's principal change to FRS 3 is to clarify these matters by providing an exemption from certain paragraphs of FRS 3 for those entities applying FRS 26 and FRS 23.

The ASB's press release and amendment are available at:
www.frc.org.uk/asb/press/pub1353.html

The amendment to the FRS is effective for periods starting on or after 1 January 2007. Early adoption is permitted.



Statement of Principles – Public Benefit Entities

On 28 June 2007, the Accounting Standards Board (ASB) issued an *Interpretation for Public Benefit Entities of its Statement of Principles for Financial Reporting*. The Interpretation explains how the principles in the Statement apply for public benefit entities.

Public benefit entities are defined as reporting entities whose primary objective is to provide goods or services for the general public or social benefit, and where any equity has been provided with a view to supporting that primary objective rather than with a view to providing a financial return to equity shareholders.

The Interpretation is intended to support the work of those bodies within the public benefit sector that are recognised by the ASB for the purpose of issuing Statements of Recommended Practice (SORPs). (There are currently four SORPs in issue that cover activities undertaken by public benefit entities: local authorities, educational institutions, registered social landlords and charities.)

The interpretation is guidance only and does not have the status equivalent to an accounting standard.

The ASB's press release and interpretation are available at:

<http://www.frc.org.uk/asb/press/pub1348.html>



IFRS newsletters

KPMG IFRG Limited has published the following since the May/June/July 2007 *Update*, which are available on our Web site at www.kpmg.co.uk:

IFRS compared to U.S. GAAP, 1st Edition July 2007 – Overview of significant differences between IFRSs and U.S. GAAP

First Impressions: IFRS 8 Operating Segments – Discussion of the key elements of the new requirements; highlights areas that may result in a change of practice.

IFRS: An Overview 2007 – An executive summary of the key requirements of IFRSs.

IFRS Disclosure Checklist 2007

2007 Illustrative Financial Statements – Illustrates one possible format for financial statements of a fictitious multinational prepared in accordance with IFRSs.

IFRS in Brief, July 2007 – A summary of the June 2007 meeting of the IASB

IFRS Briefing Sheets

- Issue 69 – IFRIC 13 *Customer loyalty programmes*
- Issue 70 – IFRIC Draft Interpretation 21 *Real estate sales*
- Issue 71 – IFRS 14 IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*
- Issue 72 – Status of current IASB projects
- Issue 73 – IFRIC Draft Interpretation D22 *Hedges of a Net Investment in a Foreign Operation*



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.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Third-party links are provided as a convenience to our users. KPMG LLP does not control and is not responsible for any of these sites or their contents. KPMG LLP is obligated to protect its reputation and trademarks and KPMG LLP reserves the right to request removal of any link to our Web site.

© 2007 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. Printed in the United Kingdom.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Designed by Roundel

Publication name: Financial Reporting Update

Publication number: 308-740

Publication date: September 2007

Printed on recycled material