

Contents

- UITF 43 and interpretation of equivalence
 - Outline of UITF guidance
- FRS 20 Share-based payment
 - Application for private companies
- IAS 36 and goodwill impairment
 - Goodwill disclosures for second year IFRS preparers
- FRRP Activity Report
 - Outline of findings
- IFRS newsletters
 - Summary

UITF 43 and interpretation of equivalence

The Urgent Issues Task Force (UITF) has issued UITF Abstract 43 *The interpretation of equivalence for the purposes of section 228A of the Companies Act 1985*. Section 228A of the Companies Act 1985 complements the existing exemption in section 228 for intermediate parent undertakings where its parent is established under the laws of an European Economic Area (EEA) State. Subject to certain conditions, it provides an exemption from preparing consolidated accounts for intermediate parent undertakings whose parent entity is not established under the law of a European Economic Area (EEA) State. The Abstract has effect for accounting periods beginning on or after 1 January 2005.

In order to qualify for the exemption, the company must either be a wholly-owned subsidiary or the parent must hold more than 50 percent of the shares and no request to prepare group accounts must have been received from minority interests within six months of the previous financial year end. Exemption is also conditional upon compliance with **all** of the following conditions:

- the relevant company and all of its subsidiary undertakings (as defined in s258 and FRS 2) are included in the consolidated accounts for a larger group drawn up to the same date or to an earlier date in the same financial year
- the larger group's accounts and, where appropriate, the annual report (the equivalent of the UK directors' report) are drawn up in accordance with the relevant EU directives, or in a manner so **equivalent**
- the consolidated accounts are audited
- the company discloses in its individual accounts that it is exempt from preparing group accounts and states the name of its higher parent in whose consolidated accounts it is included and place of its incorporation (if outside Great Britain)
- the company delivers to the Registrar a copy of the group accounts together with the annual report (where appropriate) and audit report in English.

© 2006 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.

The main issue addressed by this Abstract is the question of whether a higher parent's consolidated accounts are drawn up in a manner equivalent to the directives. Whilst the Abstract notes that EU-adopted IFRS, IFRS and national GAAPs in EEA States are directives equivalent, beyond that it does not provide a definitive list of GAAPs considered equivalent. It does however state that, in other cases, equivalence of a set of accounts does not require compliance with every provision of the directives, but only with the basic requirements thereof.

It specifically considers US, Canadian and Japanese GAAPs and states that subject to three points they 'normally' lead to equivalent accounts. The three points are: the scope of consolidation, which may be an issue for example with US GAAP for unconsolidated qualifying special purpose entities (QSPEs) (the particular circumstances of QSPE's will need to be examined on a case-by-case basis to determine whether they meet the minimum directive requirements for consolidation); consistency of policies used for consolidation; and potentially the use of specialised industry standards/practices. However, these are not an exhaustive list of potential areas of non-equivalence and in our view a review of the parent's published accounting policies will be necessary in assessing equivalence.

The Abstract has little to say about yet other GAAPs but does acknowledge that some are based on IFRS. In our view an approach similar to that above will be appropriate in such cases.

The Abstract is available at
www.frc.org.uk/asb/uitf/pub1181.html



FRS 20 Share-based payment

FRS 20 (IFRS 2) *Share-based payment* is effective for all UK GAAP companies (except those applying the Financial Reporting Standard for Smaller Entities (FRSSE)) for years commencing on or after 1 January 2006. This means that unlisted private groups and their subsidiaries as well as subsidiaries of listed groups that prepare individual financial statements under UK GAAP are required to apply FRS 20 to share-based payment transactions. This article focuses on the importance of understanding share buy-back arrangements in deciding the accounting for employee share award schemes of unlisted companies.

Schemes in which the employee receives a share-based award are within the scope of FRS 20. Typically, the employee is required to remain in employment for a period of time and will subsequently either be able to exercise the share options or become entitled to the shares.

As there is often no market for shares in an unlisted company or subsidiaries in a group, the employee is often able to sell his shares back to the company or its Employee Benefit Trust in order to realise cash. Buy-back arrangements take various forms; the arrangements might include a put option whereby the employee can require the company to purchase the shares at any time after vesting, or include terms for mandatory redemption on leaving or retirement. Sometimes companies may have no particular arrangement in place but have a practice of buying shares back from their employees. This raises the question as to whether the awards granted should be accounted for as equity- or cash-settled.

Equity-settled awards are accounted for at the fair value of the award at grant date and recognised over the expected vesting period, taking into consideration only potential forfeitures for not meeting conditions unrelated to the share price. Cash-settled awards are also recognised over the vesting period but are remeasured to fair value at each balance sheet date until settled.

One way in which awards are classified between cash- or equity-settled is through analysing the entity's obligation to the counterparty. If the entity may be required to settle in cash, in effect this is identical to giving the employee choice of settlement. Therefore if, for example, the terms of the award include a put option the arrangement will be classified as cash-settled as the entity has an obligation to pay cash if the employee exercises his right to put.

Alternatively, the entity may not have an obligation if the employee wishes to sell back his shares; such discretionary arrangements are similar to the entity having the choice of settlement. Where the awards issued are subject to discretionary share buy-back arrangements, these would also be classified as cash-settled if the company has a past practice or stated policy of repurchasing shares.

Unlisted companies need to consider all aspects of their share-based payment arrangements carefully. Often employee rights to sell back shares are included in the Articles of Association or in correspondence that accompanies the option or share purchase agreement. For many private companies, the scheme is likely to be cash-settled and a liability may remain on the balance sheet for some time, e.g., until an employee's retirement if the company is obliged to purchase them from him at that time. This liability must be remeasured each year and hence companies should take this into account when planning their year end procedures as a valuation of the liability at each year end will be required.

In rare cases the share-based payment arrangement may be equity-settled. For example, if a company has a share buy-back scheme for all shareholders and it has a body of existing shareholders who are not employees, this may demonstrate that the buy-back arrangement relates to all shareholders and not just to those who receive awards in their capacity as employees. However, where the link to employment is evident from the extent and nature of historical buy-back transactions, it is difficult to conclude that these arrangements are other than cash-settled.



IAS 36 and goodwill impairment

IAS 36 *Impairment of Assets* requires cash generating units (CGUs) that contain goodwill to be tested for impairment annually and whenever there is any indication of impairment. The standard requires extensive disclosures of the estimates and assumptions used in the calculation of the CGUs' recoverable amounts for the purposes of the impairment test. However, in order to reduce the financial burden of carrying out annual impairment tests, the standard allows the recoverable amount calculated for a CGU in prior periods to be used in the current period, subject to certain conditions being met.

The most recent detailed calculation of the recoverable amount of a CGU to which goodwill has been allocated may be brought forward from a preceding period and used in the current period provided that:

- the assets and liabilities of the CGU have not changed significantly since the most recent calculation of recoverable amount
- that recoverable amount calculation exceeded the carrying amount of the CGU by a substantial margin
- the likelihood (based on an analysis of events and circumstances occurring since the last calculation of recoverable amount) that a current calculation of recoverable amount would fall below the current carrying amount of the CGU is remote.

In the event that a company preparing accounts under IFRSs as adopted by the EU meets all these criteria, the disclosures of its estimates and assumptions used in calculating the recoverable amount will be based on the recoverable amount from the prior period, i.e., an entity will simply repeat disclosures reported in its prior year accounts.



FRRP Activity Report

The Financial Reporting Review Panel (FRRP) has recently issued its activity report for the year to 31 March 2006. It reviewed 208 sets of annual accounts prepared under UK GAAP and 76 interim reports prepared for the first time on the basis of IFRSs as adopted by the EU.

Reporting on its reviews of UK GAAP annual financial statements, the Panel found no evidence of systemic weakness, though 33 companies undertook to make improvements to their future financial reporting. These improvements were not restricted to a particular area of accounting but recurring matters included: the description of revenue recognition policies (in particular in the case of multiple revenue streams and/or supplier rebates and incentives), the clear disclosure of accounting policies generally, the disclosure of uncertainties concerning provisions, and compliance with the now extensive financial instrument disclosures. Although these issues were identified from reviews of UK GAAP accounts, the Panel notes specifically that the requirements under IFRS are broadly similar and that its findings will continue to be of relevance for listed companies in their IFRS accounts.

The results of the Panel's review of interim reports were first published in February 2006 and noted only a small number of significant issues, with only 16 companies agreeing to make amendments in future accounts. The disclosure requirements for these interims were limited to the Listing Rules as very few companies had chosen to apply IAS 34, which is not yet mandatory in the UK. However, the Panel did note general issues with the format of the income statement and the description of the basis of additional non-GAAP amounts. Consistent with its findings on annual (UK GAAP) financial statements, the Panel also noted that the wording of, in particular, accounting policies was not always clear or did not address certain aspects of the business.

During the last year the Panel also published the results of its specific review of defined benefit disclosures (under both FRS 17 and IAS 19). Again, the general level of disclosure was good, though the Panel concluded that the pension reporting under IFRSs could have been improved in a number of ways, including fuller and clearer disclosure of uncertainties inherent in pension estimates, such as mortality assumptions and the expected rate of return on assets. This review was discussed in the July/August 2006 edition of *Update*.

The FRRP Activity Report is available at

www.frc.org.uk/frrp/press/pub1172.html

The overall message from the Panel's reviews is that the level of compliance with the relevant requirements is generally good, thanks, in no small measure, to the hard work that has gone into the transition to IFRS. However, there is acknowledgment also that there is always room for improvement, particularly in the completeness and clarity of disclosures.



IFRS newsletters

KPMG IFRG Limited has published the following since the July/August 2006 *Update*, which are available on our Web site at www.kpmg.co.uk:

- *IFRS in Brief, October 2006* – a summary of the September 2006 meeting of the IASB
- *IFRS Briefing Sheet, Issue 54* – IFRIC Draft Interpretation D19 – The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements
- *IFRS Briefing Sheet, Issue 55* – IASB's Project Overview
- *IFRS Briefing Sheet, Issue 56* – IFRIC Draft Interpretation D20 Customer Loyalty Programmes

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.

© 2006 KPMG LLP, the UK member firm of 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 Natural

Publication name: Financial Reporting Update

Publication number: 216-589

Publication date: September/October 2006

Printed on recycled material