

# IFRS News

Shedding light on the IASB's activities\*

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## In this issue...

- 1 Issue of the month**  
Exposure Draft  
on IAS 1
- 2 Waste electronic  
equipment**  
Disposal of WEEE from  
private households
- 4 SAC's Pat McConnell**  
An analyst's view  
of IFRS
- 6 IASB's direction**  
Claude Lopater's view  
of the Board's priorities
- 7 Industry-specific  
issues**  
Pharmaceutical sector  
**Contacts**

## Issue of the month

### ED amendment to IAS 1

The IASB released an exposure draft last month amending IAS 1, *Presentation of Financial Statements*, as part of a broader review of performance reporting. *IFRS News* examines the key proposals.

The Board highlights the ED's key proposal as being the disclosure of all transactions with owners and shareholders in one statement, separate from all items of total income and expense in another statement. It states: 'The purpose of the proposals is to provide better information to users by requiring the aggregation of items with shared characteristics'. However, the proposed revisions will continue to permit two statements for income and expense: one, a 'traditional' income statement, and one showing other income and expense items recognised through equity (for example, available-for-sale movements, required revaluations on a step acquisition, hedging reserves and similar items).

The significant proposals are as follows:

- The presentation of an opening balance sheet;
- Owner changes in equity to be presented separately from non-owner changes in equity in a statement of changes in equity;
- The presentation of non-owner changes in equity in either one or two statements (the income statement and the statement of recognised income and expenses (SoRIE), or a single statement that combines both);
- The disclosure of details of reclassification adjustments (recycling between the income statement and the SoRIE); and
- The disclosure of dividends and earnings per share in the statement of changes in equity or in the notes.

Questions have been raised about why the Board issued an ED with such limited changes, particularly given that five board members voted against it. Four voted against the ED because they disagreed with the proposal of a single statement. They argued that a single statement would draw undue focus to the bottom line. They also argued that the Board should first decide what categories and line items should be presented on the face of the SoRIE. The Board's concession to these concerns was to allow the option of presenting all income and expenses in one statement or two, although it believes a single performance statement is the preferable method. One board member voted against the ED on the grounds that it was not consistent with the Board's desire to use plain language in the standards. Plain English campaigners may have to return to the barricades in protest at the loss of the terms 'balance sheet' and 'income statement'.



## Disposal of WEEE from private households

Yap-Kim Bong and Matthieu Moussy explain the treatment of the obligations to dispose of WEEE from private households.



Have you ever wondered what happened to your old computer after you threw it out? European Union member states are now required to enact local laws forcing certain entities to be responsible for financing the costs of the treatment and disposal of used waste of electrical and electronic equipment (WEEE).

The Directive (2002/96/EC and 2003/108/EC) distinguishes the treatment of:

- goods used by private households and goods used other than by private households ('commercial users'); and
- goods put on the market by the producers before 13 August 2005 ('historical waste') and after 13 August 2005 ('new waste').

A summary of treatments prescribed by the Directive follows. Certain member states may elect not to adopt the Directive on a wholesale basis but enact different treatments in their local laws (for example, French local law does not distinguish between the treatment of historical waste and new waste from private households).

The decision tree on p3 provides a high-level overview of factors that management should consider when reviewing their specific disposal obligations on the new waste from private households. The considerations can also be applied to new waste from commercial users if the fact patterns are similar.

The decision tree on p3 is for guidance only. Management should consider the detailed requirements of local laws and schemes as well as the accounting standards. Consultation with professional advisers may be required.

### Important considerations

Member states' local laws govern the specific requirements of the disposal activities and the manner in which any collective scheme will operate and interact with the producers and the responsible government oversight agency. The appropriate accounting for the waste obligations will therefore depend on local law and individual companies' decisions regarding their participation in the various schemes.

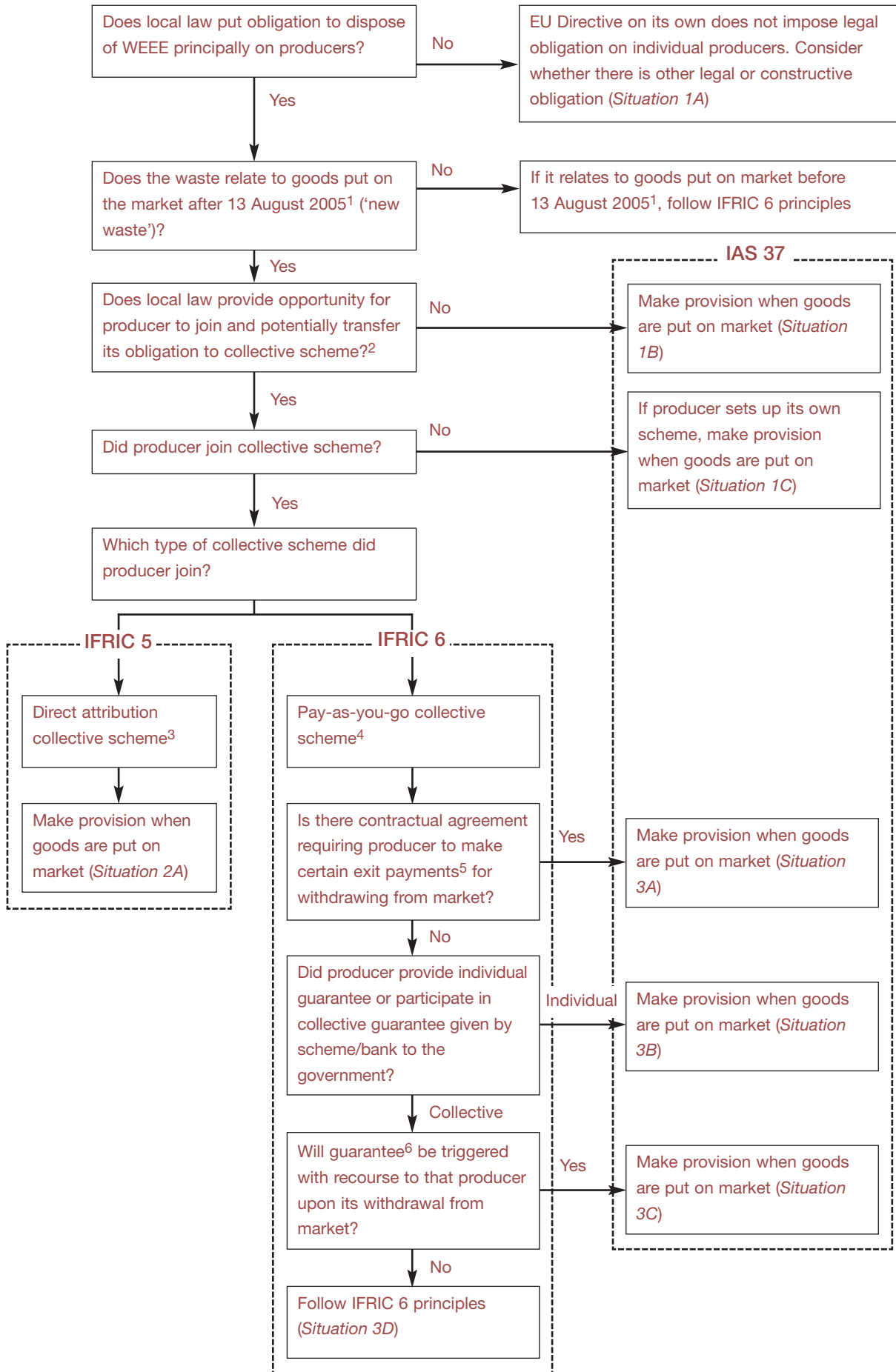
Management should:

- Determine the population of all the member states that will need to be reviewed;
- Implement a process to keep up to date with the status of the local laws in those countries;
- Begin the process to determine whether or not to participate in the local collective scheme;
- Ensure appropriate local expertise (for example, local legal counsel, operations, and accounting and finance personnel) is in place to evaluate respective local laws and the nature of scheme participation;
- Determine the framework that the entity's 'obligations' falls under (ie, IAS 37, IFRIC 5 or IFRIC 6) and how they should be accounted for; and
- Understand how the scheme impacts the measurement of the obligation.

### Footnotes for decision tree on p3

- <sup>1</sup> This date can be changed during the transposition to the local law; if changed, it is normally to a later date.
- <sup>2</sup> The producer should obtain a legal opinion to determine whether the local law provides opportunity for the producer to join and transfer its obligation to a collective scheme.
- <sup>3</sup> The producer's share of disposal costs is calculated under the Direct Attribution Collective Scheme, based on the producer's verified share of clearly identifiable WEEE. The waste management cost is linked to the actual number (or weight) of the goods put on the market by the producer.
- <sup>4</sup> The producer's share of disposal costs is calculated, under the pay-as-you-go collective scheme, based on the quantity of electrical and electronic equipment that was put on the market by that producer during the measurement period. A new producer that joined the market during the measurement period will need to pay a portion of the WEEE costs, even though the waste management costs in that measurement period do not arise from its products. A producer that exited the market and did not sell any goods during a measurement period need not pay any portion of the WEEE costs in that measurement period, even if some of the costs relate to its products.
- <sup>5</sup> Exit payments are calculated based on the number of products put on the market by that producer that had not been disposed of by the private households/commercial users. For one-off exit payments that are insignificant amounts (for example, made up of what the producer has owed the scheme for the past measurement period), consider the box in the decision tree, 'Did producer provide individual guarantee or participate in collective guarantee given by scheme/bank to the government?'
- <sup>6</sup> A guarantee with no expiry date and that requires the producer to be responsible for the waste costs determined based on the number of goods it put on the market in the past is deemed 'will be triggered with recourse upon exit'. A guarantee with a specified time period (for example, yearly), and/or a guarantee that lapses in the year of exit, if it does not make the producer responsible for paying waste costs determined substantially based on the number of goods it put on the market in the past, is deemed 'will not be triggered with recourse upon exit'.

**Factors to consider in reviewing disposal obligations**





## IFRS from the analyst's perspective

Pat McConnell, a senior managing director at Bear Stearns in the US, is a member of the IASB's Standards Advisory Council (SAC), representing the analysts' views. She talks to *IFRS News* about IFRS from the analyst's perspective.

### What contribution do you make to the SAC as an analyst?

General purpose financial statements are meant to be used to make investment decisions, among other things. As an analyst, I bring the perspective of someone who uses financial statements to make investment decisions and helps others make these decisions – someone who needs to understand the economics of the business and forecast its future cash flows. I keep that role in mind when the Board discusses various IFRSs and help them decide which measurement bases and accounting methods will provide the most useful information to do this.

Does this perspective ever conflict with what the Board is trying to do? No, but it can be in conflict with other constituents' interests. I push for the information that I would ideally like to have as an analyst. Management might agree that this information is useful, but often it's either not cost effective to provide it, or the degree of aggregation that would be used in the financial statements wouldn't be understandable,

or companies might consider it information that they don't want their competitors to have. Auditors might argue that it is not feasible to audit the information I am asking for. There are trade-offs between the views of the constituents that the IASB has to take into consideration when coming up with the final decision.

### In this trade-off, which interest group loses out?

Every standard has a different balance. The Board has not veered in favour of one constituent or another except to say that it views the role of financial statements as providing information useful for making decisions. So if they were to veer in one direction, it would be more likely in the direction of the users. Analysts come out of it well most of the time.

### What are the hardest accounting areas for analysts to understand?

It varies from industry to industry. Certainly financial instruments have become extremely complicated over the last decade. The uses for financial

instruments are not always transparent. They are by far the most difficult area to grapple with.

### How could FI financial reporting be made more understandable?

The most meaningful way to account for financial instruments is at fair value with the changes in fair value going through earnings. This would do away with much of the complexity of the current accounting model, which is fair value mixed with amortised cost and lower of cost or market. As the Board moves towards fair value, the accounting will become more transparent. I wish they could have got there five years ago, but there are a lot of issues regarding fair value measurement that have to be resolved; the current accounting is not optimal. But the IASB is taking baby steps. I am confident things are moving in the right direction.

### What do analysts understand about the impact IFRS will have?

For everyone involved in IFRS it is like walking into a dark cave without a

### IASB's Standards Advisory Council

The Standards Advisory Council is a forum for the Board to consult individuals, and representatives of organisations affected by its work, that are committed to the development of high quality IFRSs.

It gives the Board advice on a range of issues, including the following:

- the IASB's agenda;
- the project timetable (work programme) including project priorities and any changes in agenda and priorities; and
- IASB projects, with emphasis on practical application and implementation issues, including matters relating to

existing standards that may warrant consideration by IFRIC.

The SAC also supports the IASB in the promotion and adoption of IFRS around the world. This may include the publishing of articles supporting IFRS and addressing public meetings on the same subject. The restructuring of the SAC in 2005 aimed to encourage the committee to be a more effective source of advice to the Board and trustees. The membership of the SAC provides a broad geographical spread and a range of functional backgrounds, including members from user groups, preparers, financial analysts, academics, auditors, regulators and accounting bodies. For more details on members and to read an interview with the chairman Nelson Carvalho, see next month's edition of *IFRS News*.

flashlight. IFRS was voluntary before the European Commission mandated its use in the EU. Only a handful of companies were purporting to use it before then. It was not taught widely at university, and there were no professional exams on the subject that I am aware of. Therefore preparers, auditors and analysts are all in the same boat grappling with the implications.

Analysts generally are trying to get up to speed with the new standards. It'll be easier for some than for others. Analysts following US GAAP will find it easier to comprehend the implications of the switch to IFRS. Those following European companies may need more work to get up to speed. IFRS is closest to US GAAP, followed by UK and Australian GAAPs and then Scandinavian GAAPs.

### What financial reporting areas are likely to bring the biggest surprises?

It will vary by industry. The inefficiency of the current IFRS requirements for financial instruments means that it is likely to be hardest to predict the impact of IFRS on financial institutions, particularly because the EC gave companies an option not to apply a major part of IAS 39. As a result, companies are not necessarily going to be comparable. Some will elect to follow all of IAS 39; others none of it. Complicating that is the fact that IAS 39 itself is somewhat an 'election'. Companies can choose to hedge their risks or not; if they choose to, they can choose whether to apply IAS 39 special hedge accounting or not. Those areas are going to be the hardest to understand.

### Who else should be educating the analysts?

The first responsibility is with the analysts themselves. That being said, there are a number of organisations that have provided conferences on these standards to help preparers, users, auditors – everyone – get up to speed with the requirements. The Chartered Financial Analyst (CFA) Institute has

moved the chartered analyst exam towards IFRS and organises conferences on IFRS. It has had at least one session on the subject for the last 10 years.

### Do you believe that the move to IFRS will have an impact on companies' share prices?

It's a difficult question to answer. In some cases it may, but I don't think it'll

always be in a predictable direction. IFRS may make a company more transparent; therefore analysts will see things that they hadn't seen before or understand them in a different way. That may leave the analysts to conclude that a company was more valuable than they thought, or the reverse. You are not coming to IFRS from one GAAP but from many different GAAPs, so you can't predict even in a generalised way the direction of the changes.

### You worked on a project for improving financial reporting from an analyst's perspective. What was involved?

The CFA Centre for Financial Market Integrity produced a paper 'A Comprehensive Business Reporting Model – financial reporting for investors' in October 2005. The report's objective was to be more proactive with standard setters and not just to react to exposure drafts on particular issues. We tried to look at the big picture and ask where financial reporting should be going.

One of the key conclusions is that we need to move to fair value for financial instruments as soon as possible, and eventually to full fair value reporting. It also proposes in the interim, while we have this mixed attribute model, different formats for the balance sheet and what we currently call the income statement and cash flow statement. We believe that direct method cash flow statements presented by nature rather than by function would be more useful. The key statement would be the 'statement of changes in net assets available to common shareholders', replacing the income statement. The statement would have four columns, presenting current period accrual transactions, estimates, changes in fair value, and total net changes in net assets. In other words, it would reconcile the opening and closing balance sheet.

### What was the Board's response?

We made a presentation to a subgroup of IASB members. They were interested in our proposals. Our intention was for them to refer to our proposals in each

#### Patricia McConnell – biography

- MPH in Economics;
- MBA from New York University;
- BA degree from Franklin and Marshall College;
- AA degree from Vermont College for Women;
- Certified Public Accountant;
- Chairperson of the Corporate Disclosure Policy Council of CFA Institute (formerly AIMR);
- Member of the IASB's Standards Advisory Council;
- Senior Managing Director of Bear, Stearns & Company, Inc; head of the accounting and taxation group in equity research. Her group provides technical support to Bear Stearns' industry analysts and to Bear Stearns' clients in financial accounting and corporate taxation as applied in financial analysis for securities valuation. Ms McConnell meets with Bear Stearns' institutional clients, explaining and interpreting the accounting policies and financial reporting of companies in which they invest;
- Former Vice Chair of the International Accounting Standards Board;
- Former Director-at-Large of the New York Society of Security Analysts;
- Former member of CFA Institute's Board of Governors;
- Former chair of CFA Institute's Global Financial Reporting Advocacy Committee;
- Former member of the FASB's Financial Accounting Standards Advisory Council, User Advisory Task Group for Inflation Accounting, and Financial Instruments Project Task Force; and
- Was the project coordinator for the AICPA's Commission on Auditors' Responsibilities.

step of their processes and adhere to our principles. The report sets out what we think the underlying 12 principles of financial reporting should be including the principle that financial statements should be prepared with the perspective of existing common shareholders in mind; the principle that decisions about what information to provide should be made on the basis of relevance and not reliability alone; and the principle that fair

value information is the only information relevant for financial decision-making. In particular, we hope that the Board will refer back to these principles in the conceptual framework project and consider how to capture them in the concepts they are developing.

I am confident that they will take most, if not all, proposals on board. I hope the principles will lead to a debate on issues

that have always been below the surface but are now becoming better understood.

### **If you could improve one area of accounting, what would it be?**

To fair value all financial instruments, with changes in fair value going through earnings. It would make everyone's lives a lot easier. Management may not recognise that yet though, but it would!

## IASB's direction



# It's time for the IASB to listen to the users

**PwC's IFRS technical partner in France, Claude Lopater, gives his personal views on how the IASB should respond to the needs of its stakeholders.**

### **Why do you believe the IASB is out of step with the preparer community?**

The IASB should take account of the time it takes users to adapt to IFRS. For most users around the world, IFRS is new, recent or coming soon (Europe, Australia, Russia and Asia). The efforts that need to be made to adapt to changes in legislation is significant (technical understanding and training, practical consequences and usage, adaptation of information systems, command of financial communication, etc).

Converting to IFRS, particularly for users not situated in Anglo-Saxon countries, requires extra effort given the differences in culture (accounting, legal and fiscal), wording (one word can have hidden connotations) and language (IFRS is in English, even though there are official translations that come along, inevitably, later). Changes in accounting regulation can in themselves turn out to be particularly significant in their fundamental principles. This is the case with the conversion to IFRS, in particular with the application of the balance sheet approach, fair value and its consequences on valuations, substance over form, and the adaptation of the concept of performance, not to mention the difficulties of interpreting IFRS.

Moreover, the IASB has said on numerous occasions that users should get involved in the Board's projects and if they do not, they cannot complain about the outcome. But getting involved requires even more time (not only participating in working groups for responses to the projects, but also lobbying and anticipating the IASB's

### **'Users should insist on better service from the IASB.'**

plans), in addition to the time set aside for the conversion itself.

### **What could the preparer/user community and the Board do to facilitate the transition to IFRS?**

Local standard setters usually provide an 'after sales service' for their own standards. The IASB does not. The application of IFRS, based on principles, imposes judgement on the part of its users, but IFRIC puts out few interpretations and does not have sufficient resources to respond. The Board does not consider IFRIC to be an urgent issues task force. Users should insist on better service from the IASB.

As the consistent application of IFRS isn't going to happen tomorrow, the

most significant challenge today is to avoid the differences in application and interpretation of standards in the different countries involved. Furthermore, with conversion to IFRS, we are entering into a framework for which there is no past experience, nor any jurisprudence. The attention of the markets on what is happening and what will happen in the future is considerable, and there is some real anxiety and uncertainty from the point of view of the investor and financial analysts.

This is the reason why the Board should reduce the number of new standards it is issuing and allow time for the application of the existing standards to bed down, while addressing the problems that arise.

Dialogue should also be established between users together. The EC initiative to create a forum of the major players to exchange their views would be welcomed. The initiative at a French level of a 'Forum ACTEO-APE', between representatives of CAC 40's companies and big audit firms with the CNC and AMF as observers, stems from the same idea.

*The full version of this article was published in 'The art of management', Les Echos, 17 November 2005.*



## IFRS issues in the pharmaceutical sector

PwC's global pharmaceutical leader, Simon Friend, outlines the key IFRS issues facing the sector as discussed at a recent meeting of key industry figures.

Senior representatives from five Fortune 500 European pharmaceutical companies, together with PwC engagement team members and members of the firm's Global Accounting Consulting Services, met last month to discuss a broad range of accounting issues facing the industry. This was the latest in series of meetings that started in 2003 and now happen twice a year. 'These meetings are not about trying to enforce a particular accounting treatment,' explains Mary Dolson, a partner in PwC's Global Accounting Services team. 'They are about companies and PwC getting together to find practical solutions to problematic areas.'

Last month the group discussed the issues faced by first-time adopters of IFRS and issues affecting existing IFRS preparers arising from new standards. Many attendees commented that the principal issue in finalising the 2005 accounts was the amount of detail required to provide full and complete disclosures. The additional disclosure requirements were particularly an issue in applying IFRS 7. Preparers recognised the need to consider additional data

capture this year to avoid gaps when preparing their 2007 accounts, including 2006 comparatives.

Hot industry-specific topics that also arose in the meeting include:

- the asset life profile of pharmaceutical intangibles that benefit from patent protection but continue to be sold after patent expiration;
- the basis for assessing impairments of pharmaceutical intangibles;
- valuing pharmaceutical and consumer healthcare inventory in an acquisition;
- the profit and loss treatment of payments to government bodies;
- the deferred tax consequences on inter-company profit; and
- a comparison of disclosed critical accounting policies and IFRS/US GAAP reconciling items.

The meeting also covered the consistency of disclosure between IAS 24, Related Party Disclosure, and

corporate governance disclosures relating to share-based payment charges. The group concluded that companies were following a consistent approach.

Other issues under discussion were:

- the implications of the proposed revisions to IAS 1. Discussions focused on the potential elimination of the profit and loss account as a separate statement. The merits of the proposed changes were questioned;
- ED 8 on segment reporting. The group expressed concern that the proposals would lead to a lack of comparability, becoming increasingly divorced from the financial statements, and that more non-GAAP measures would need to be disclosed; and
- the IFRS/US GAAP convergence project. There was concern over the nature and speed of IFRS/US convergence.

The next meeting of this group is planned for September 2006.

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