

IFRS News

Shedding light on the IASB's activities*

IFRS News – Issue 42
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Issue of the month

ED amendment to IAS 23

The IASB published an exposure draft on proposed amendments to IAS 23, Borrowing Costs, for public comment on 25 May 2006 as part of the short-term convergence project with the FASB.

The ED proposes to eliminate a major difference between IFRS and US GAAP on capitalisation of interest expense. The ED will require borrowing costs to be capitalised as part of the asset's cost. All interest and related costs that an entity incurs attributable to the acquisition, construction or production should be capitalised.

IAS 23 currently gives management a choice of how to account for borrowing costs that are attributable to qualifying assets. These borrowing costs are recorded as an expense when incurred under the benchmark treatment. The allowed alternative treatment permits capitalising borrowing costs to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. The capitalised borrowing costs are included in the cost of that asset.

A qualifying asset is an asset that takes a substantial period of time to get ready for its intended use or sale. Examples are factories, land, machines, licence-related assets and other assets that require a substantial period of time to prepare for their intended use or sale.

A number of companies have anticipated the convergence with US GAAP and have chosen to capitalise borrowing costs as part of their self-constructed assets. Companies that have a policy to expense all borrowing costs as incurred will need to consider the implications for their systems.

The proposed transition provisions allow prospective or retrospective adoption. An entity can apply the amendments to qualifying assets for which it begins capitalisation on or after the effective date (most likely 1 January 2008). Management may also apply this amendment by designating an earlier date. These proposed transition provisions would allow entities to go back – for example, 10 or 15 years – to collect information to determine the effect of this amendment on opening equity.

A few consequential amendments are proposed to other standards and interpretations. The most significant is to IFRS 1, First-time Adoption of IFRS. This change is in order to add an exemption allowing first-time adopters to use the transition arrangements of the ED.

The Board believes that the elimination of one of the two options in accounting for borrowing costs directly attributable to a qualifying asset would improve financial reporting and result in more

comparable information.

Some observers have commented that the proposal appears to be convergence for convergence's sake. However, it is a

key milestone on the EC- and SEC-supported Roadmap. Questions have also been raised about how welcome these changes will be in Europe. Comments on the ED are due by 29 September 2006.

Canada's progress towards IFRS

The Accounting Standards Board of Canada (AcSB) announced in April last year its decision to eliminate all differences between Canadian GAAP and IFRS within five years. It will adopt new IFRSs resulting from the current IASB/FASB convergence project and replace existing Canadian GAAP with IFRSs. AcSB chairman Paul Cherry and IASB liaison member for the AcSB Tricia O'Malley talk to *IFRS News* about the reasons behind the move and what it means for Canadian companies.

Paul Cherry

What was behind the Canadian Board's decision to move to IFRS? Why now?

The Canadian Board had followed a very well thought out strategy since 1999 to harmonise Canadian GAAP with US GAAP. It was never intended that our standards should be the same as US standards but that there would be no difference on major points of principle. We pursued this policy systematically for nearly six years. This decision to move towards US GAAP was market-driven, but as we moved further down that path towards harmonisation, frustration set in. We discovered that in practice, fear of regulatory intervention and civil liability issues were forcing many people essentially to adopt US GAAP in its entirety. This was exactly what we didn't want to happen. It prompted us to change tack. There's no point in trying to write briefer principle-based standards if in practice people ignore them and refer directly to the corresponding US rules. We canvassed opinions and received an overwhelming consensus, including from US registrants, that US GAAP was not an appropriate proposition for Canada. The US system is designed for US markets and for their approach to public companies.

Our average public company is much smaller, and our capital markets are a fraction of the size of US markets. Our infrastructure and accounting profession would be unable to cope with the enormity of the task, and it would be outrageously expensive. This was the catalyst to look

for another solution: to move to IFRS. IFRS had not been a global contender when we began the debate in 1995 to move away from Canadian GAAP. It just wasn't developed enough or widely enough applied. But this time around, the international standards were a better proposition, given their quality and completeness, to the point where they have brand recognition in the global marketplace. The convergence between IFRS and US GAAP made IFRS all the more attractive.

We needed to get on with making the decision because this path we had taken of harmonising with the US was starting to reinforce itself. I was concerned that in a couple of years' time, we would be so entangled with US GAAP that we would have reached the point of no return.

Consensus formed very easily. Companies agreed that it made no sense to adopt the thousands of pages of detailed US rules that everyone is imploring the Americans to get rid of. In addition, the bigger the 'IFRS family' is, the greater the chance of an appropriate balance between the FASB and the IASB.

What has been the response to the decision locally?

It has been extremely positive. The decision was based on what best serves our capital markets, bearing in mind that Canada represents less than 4% of the global capital market. We have not based it on a detailed comparison of the technical requirements of US GAAP

versus IFRS. They both are first-class bases of reporting. Once US GAAP was ruled out, IFRS was the natural alternative.

We have around 500 public companies listed in the US, and they've been reconciling to US GAAP for years. In future they can simply adopt US GAAP, if that's what they want to do (although I don't think many will) or report under IFRS and have a much easier reconciliation.

We haven't made our decision based on the assumption that this reconciliation will be removed. That would be a wonderful bonus, but if it's not removed, the reconciliation from IFRS will still be much less onerous than under Canadian GAAP.

How different is Canadian GAAP from IFRS? What is the big impact going to be?

If you compare a set of financial statements prepared under Canadian GAAP with financial statements prepared by the same entity under IFRS, they would look very similar in terms of the level of disclosure. Interestingly, the few major differences that exist we probably share with the US, because we've been busy aligning our major points of principle with US GAAP. There are five or six areas where Canadian and US practice is aligned with but significantly different from IFRS. However, although the differences in number are not vast, in terms of impact, they're really important.

One of the few major areas of difference is impairment. Another is the model under SIC-12, Consolidation – Special Purpose Entities. It is not nearly as prescriptive as the nasty rule that we share with the US on variable interest entities. The intention is to bring a lot of arrangements that are presently off-balance-sheet into a consolidated set of financial statements. The effect is enormous. A third example is the approach used for securitisations under IAS 39, which is quite different from the approach that we copied from the US.

The IASB and the FASB are very aware of these differences. I think the model for joint projects to come up with global standards is working well, and I'm optimistic that the current differences will disappear. This convergence will also greatly assist Canada in the transition to IFRS.

The move to IFRS requires a change in mindset. I've been encouraging people to stop doing line-by-line comparisons. If you drew up a table comparing IFRS, US GAAP and Canadian GAAP requirements, it might look daunting. Instead we should look at the IFRS column and start afresh rather than focusing on the differences

How high is awareness of the implications among those for whom IFRS is not day-to-day business?

It's a concern. We have been out and about talking to constituents. We don't underestimate the communications challenge. We're liaising with Financial Executives International [association for CFOs and other senior finance executives], and we're plugging into the

accountancy bodies. But the hardest ones to reach are the sole practitioners in public practice. We have a lot of very small accounting firms that have some public companies as clients. It's in their own commercial interest to get educated about IFRS. Having said that, I think we're over the hump now for public companies. We're not as far along in terms of what we're going to do for our private companies.

What is the current thinking on requirements for private companies? If you require something other than full IFRS, will this cause confusion for users?

Yes, that is a risk. Some people feel strongly that there should be no differences between the two systems. I think what would be truly confusing would be to have a system for private companies that only slightly differs from the system for public companies. Any differences would have to be significant, but we're not going to introduce significant differences just to make life easier.

We are still canvassing opinion and will be reporting the preliminary results to our Board later this month. We need to know if the uses that are made of private company financial statements in Canada are significantly different from uses made of public companies' financial statements. If we conclude that there are no significant differences, I think we'll just adopt IFRS – possibly lightening up the disclosure. The Board will make that decision this year. If we conclude there are important differences, we will need more time to evaluate various accounting treatments. So it might take another year

to ascertain which specific adjustments to various standards are warranted. IFRS is driven by the needs of investors, mainly in equity securities. But if you're a private company, you might question the need to put so much emphasis on fair value measurements. We may need to reassess the cost-benefit of fair value measurements for private companies. You don't have people making investment decisions in private companies the way they do for public companies.

I don't think the same system that serves our sophisticated public companies is the right approach for the private sector. Our private sector, although not as visible as the public, is actually much larger in terms of its significance to the economy. My goal is to demonstrate that we have a system that specifically considers private company issues. It is not right to focus on public companies first and then simply make a few concessions to private companies, which is perceived as an afterthought. The system should demonstrate that the standards positively satisfy the financial reporting needs of those companies that are not publicly traded.

What will be the role of the Canadian standard setter going forward?

To make this strategy a success, the AcSB must redefine its mandate. People have said it will mean a big loss of influence, but we lost that influence six years ago when we began harmonising with US GAAP. I think maybe that's why this IFRS decision has been relatively easy for the Canadian board. When I joined in 2001, about two years into our harmonisation strategy, the frustration

Biography – Paul Cherry

- Bachelor of Commerce from Queen's University, Ontario;
- Fellow of the Institute of Ontario;
- Fellow of the Institute of Chartered Accountants of New Brunswick;
- Former chief accountant of the Ontario Securities Commission;
- Former senior technical partner at PwC in Toronto;
- Former director of national accounting and auditing services of Coopers & Lybrand;
- Former Canadian representative on the International Accounting Standards Committee;
- Former chairman of the IASC Standing Interpretations Committee;
- Former member and chair of the CICA Emerging Issues Committee;
- Chair of the Accounting Standards Board (appointed May 2001).



levels were already showing. We would spend a lot of time debating a standard, but at the end of the day, if you're harmonising with the US, what choices do you have? If you're going to harmonise, you have to accept that decisions are being made by someone else. It used to be the FASB; in the future it'll be the IASB.

We are keen to participate in some of the IASB's joint projects. We already have two staff members involved in the conceptual framework project and we did the measurement objectives discussion paper. I think the joint projects are working extremely well.

We're also going to work on the Canadian framework over the next four or five years to see if we can apply it in a way that is also faithful to the IASB framework. When we cross over fully to IFRS, the IASB will have the benefit of that experience. If we discover that there are some difficult issues that need to be addressed, then that's a benefit to the IASB. So I think there's a role for us, in terms of contributing to the IASB agenda, even during transition.

Tricia O'Malley

I was on the task force in 1995 that recommended the strategy the AcSB had been pursuing in moving towards US GAAP. We had considered moving to IFRS at that time. Our interim report recommended that the AcSB simultaneously try to ride both horses. Our constituents told us we didn't have the resources; plus the IASB predecessor body, the IASC, was in the

process of restructuring. It was not clear whether the outcome would satisfy the criteria we had developed for a body that we would be prepared to let set accounting standards for Canada, the so-called full time technical expert model.

For some of the task force, there was more concern about the process for maintaining the body of standards and setting new ones than about the existing body of standards themselves. Clearly, those concerns have been pretty much resolved now. And as Paul points out, the more robust set of standards and wider use have dealt with the other concerns.

Ten years on, the AcSB has taken a very careful and deliberate approach to developing both the strategy for moving to IFRS, and the plans for its implementation. They are looking to use their expertise to manage the transition on behalf of their constituents, which will undoubtedly make life a good deal easier for those affected. The AcSB has also recognised that one of the most important parts of the whole process is communication to support the change management. I think they have set out a reasonable timetable. However, I think they're going to have to be firm about sticking to their deadline for changeover, otherwise progress will be limited to the speed of the slowest constituent. As one of my IASB colleagues remarked when we were discussing the same issues for Europe, 'Changing the deadline will not reduce the lead time people will say they need; it will just result in them putting off starting work.'

What will the role be of the AcSB after the move to IFRS?

The AcSB is going to be in much the same position as other major national standard setters in jurisdictions that have adopted IFRS. They will continue to contribute by participating in research endeavours, providing staff resources to active projects, commenting on proposals and so on. For the IASB, it is essential that there continue to be other groups with standard-setting expertise with whom we can engage in debate. We look around the table at the IASB and at the resumés of our staff and realise that almost everyone gained experience in standard setting with their national standard setters. Where are the future Board and staff members going to get similar experience if all the other standard setters close up shop?

What will be your role during and after the move to IFRSs? What have you been able to contribute so far on the AcSB's behalf?

I don't see much change in the role of the IASB member with liaison responsibilities for the AcSB from now, during transition or after. It relates to what that person can contribute to the AcSB.

My major contribution is acting as a communication link. Although the AcSB and its staff are capable of making their views known on technical topics – and they do – having been at their meetings helps me to explain the concerns in more detail to our staff and possibly to

Biography – Tricia O'Malley

- Former partner in the national assurance and professional practice group of KPMG;
- Former chair of Canadian Accounting Standards Board (AcSB);
- Former member of the AcSB's Emerging Issues Committee;
- Former vice chair of AcSB ;
- Former AcSB representative at the G4+1 and the Financial Instruments Joint Working Group of national standard setters;
- Former chair of the Ontario Securities Commission's financial disclosure advisory board;
- Former member of the independent advisory committee on accounting and auditing matters of the Auditor General of Canada;
- Former President of the Canadian Academic Accounting Association;
- Member of IASB (appointed January 2001).



the Board. This highlights the importance of one of the organisational features that was put in place when the AcSB was restructured in 1999. The IASB person with liaison responsibility for the AcSB is a non-voting member of the AcSB. I try to attend all their meetings, and their agenda includes a standing item updating members on IASB activities. This process was in place even before the strategy review began.

I think this ongoing dialogue helped the AcSB get comfortable with the proposal

to move to IFRS. After all, I didn't have detailed knowledge of IFRS when I began on the Board, but I picked it up fairly quickly. I could also provide them with some assurance that it wasn't all that different – especially not in philosophy or approach – from the Canadian GAAP that they and their constituents were used to. In addition, I could explain the Board's thinking on major new projects, giving them a flavour of the considerations shaping our conclusions that isn't available from the decision summaries in the *IASB Update*.

During and after the transition I think it will be more of the same, though the level of activity is likely to increase as the AcSB staff works on moving Canadian GAAP to IFRS. I have already had a lot of enquiries such as, 'What did the IASB mean by X?'. Sometimes I have to confess I don't know, because they're looking at parts of older standards we didn't even consider in the Improvements project. But these questions are good for us too because they will help us clarify those standards the next time we have them open for revision.



IFRIC part 2 – impact at local level

PwC's global IFRS leader Ian Wright has been a member of IFRIC since December 2001. In this second interview in a two-part series, he talks to *IFRS News* about constituents' input to the IFRIC agenda and concerns over national interpretation.

Does IFRIC get many comment letters? Does it take notice of what constituents say?

IFRIC gets 30 to 50 comment letters on its draft interpretations. However, when you consider that 7,000 listed companies alone in the EU and many more in places like Australia, Hong Kong and South Africa use these standards, the number taking an interest seems small.

I continue to be surprised when I meet the finance teams of even larger companies that many do not have a group of people dedicated to following the debate at the IASB and IFRIC or even at their own national standard setter or review group. I think it's an area in which we will see companies investing over the next year or so, when they come to reflect on first-time application of IFRS and its future impact on their companies.

IFRIC has been very responsive to constituents' comments. For example, its proposed approach to changes in decommissioning liabilities was met with comment letters predominantly asking for convergence with US GAAP (where changes are capitalised as part of the asset), which IFRIC then adopted.

Other examples include IFRIC's modification of its proposed approach to recognising that 'rights of use' of assets by being able to control the output are covered by IAS 17, as a result of constituents' requests to converge with a US interpretative abstract. (The US Emerging Issues Task Force, which issues the abstracts, started a project at the same time but completed it more quickly, as its due process requirements are less than IFRIC's.) IFRIC adopted the same model.

A final example is in the area of service concessions. Many comment letters expressed a desire to get to a consistent way of accounting for service concessions following a financial asset-type approach. IFRIC has found a way to narrow the gap, although I suspect this will not go as far as constituents would like.

Overall, the comment letter process is rather revealing. Virtually no letter ever expresses the view that an interpretation can be reduced in size. Many comment letters ask for additional detail and further guidance. This was particularly true for service concessions, where there were calls for the interpretations to be extended to accounting by grantors (generally governments) and to give more

detail about all service concession elements, such as the accounting for network extensions and renewals.

Finally, a number of comment letters reveal a lack of current knowledge about the IFRS literature. I expect the quality of comment letters to improve as companies finish their conversions and bed down their knowledge of the standards.

What about local interpretation of IFRS?

I think there is a perception that IFRIC cannot address issues effectively. We have therefore been seeing an increasing level of interpretation activity in individual countries.

There is an increasing risk that the interpretation and regulatory bodies around the world will create differences in IFRS application. Imagine reconciling IFRS as enforced in one jurisdiction to IFRS as enforced in another. It would undermine the credibility of IFRS. There are more than 150 regulators and 25 national standard setters in Europe and many others worldwide. We have to establish an understanding that the right way to behave is not to issue local interpretations unless absolutely necessary.

This particularly applies to interpretations relating to converged IFRS and US GAAP standards. IFRIC issues interpretations at an IFRS level; at the US GAAP level, the FASB issues staff papers and the FASB's EITF issues interpretive abstracts. We need the IASB and FASB to lead the others by example and not to generate additional interpretations or guidance on converged standards, except by doing so together.

I'd also like to see other national interpretative bodies looking at issues that are important nationally and then having a dialogue with the IASB and IFRIC to agree a mutually supportive way forwards. This is beginning to happen – for example, IFRIC and the IASB staff are working closely with the CNC in France on customer loyalty arrangements, such as frequent-flyer schemes. However, there is still scope for increased cooperation from other standard setters, interpretation bodies and regulators with IFRIC.

What are the key issues currently on the IFRIC agenda?

Some of the agenda items likely to result in interpretations in the next six months are:

- D9, Employee Benefit Plans with a Promised Return on Contributions or

Notional Contributions. IFRIC proposed that companies should record the higher obligation from the fixed or variable legs, and that you do not project forward returns on a portfolio of assets only to discount them at a high-quality corporate bond rate. This approach received significant support and is consistent with the practice in the marketplace. However, some IFRIC members pointed out that this would understate the liability, and the IASB staff agree with them. IFRIC discussions continue.

- D12-14, Service Concessions. This is an area where there is still some way to go. Many believed that this was a project that should have been done by the IASB rather than IFRIC, but when it arose, the IASB was working all hours on delivering the March 2004 package of amendments to standards. Commentators would like to see a different cut-off between financial asset and intangible asset models, with more financial asset accounting. IFRIC looks like it will move in that direction.
- D18, Interim Reporting and Impairments. This draft interpretation has revealed diametrically opposed views between constituents. IFRIC looks likely to confirm that certain

interim impairments cannot be reversed, taking the view that all sets of financial statements are equally important, whether annual or interim.

Other topics under discussion are:

- IAS 18, Revenue – Customer Loyalty Programmes;
- IAS 18, Revenue – Upfront Revenue Recognition;
- IAS 19, Employee Benefits – The Effect of a Minimum Funding Requirement on the Asset Ceiling;
- IAS 32, Financial Instruments: Presentation – Classification of a Financial Instrument as Liability or Equity.
- IAS 39, Financial Instruments: Recognition and Measurement – Derecognition of Groups of Financial Assets;
- IFRS 2, Share-based Payment – Group and Treasury Share Transactions;
- IFRS 2, Share-based Payment – Employee Benefit Trusts;
- IFRS 2, Share-based Payment – Post-vesting Transfer Restrictions;
- IFRS 3, Business Combinations – Classification of puts and forwards held by minority interests; and
- Service Concession Arrangements.

International Financial Reporting Interpretations Committee

The IASB's interpretative body, the former IASC's Standing Interpretations Committee (SIC), was reconstituted in December 2001 as the International Financial Reporting Interpretations Committee (IFRIC).

The IFRIC reviews, on a timely basis within the context of current IFRSs and the IASB Framework, accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on

the appropriate accounting treatment. In developing interpretations, the IFRIC works closely with similar national committees.

The IFRIC meets about every six weeks. All technical decisions are taken at sessions that are open to public observation.

The IFRIC addresses issues of reasonably widespread importance, not issues that are of concern to only a small minority of entities. The

interpretations cover both:

- newly identified financial reporting issues not specifically dealt with in IFRSs; and
- issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop in the absence of authoritative guidance, with a view to reaching a consensus on the appropriate treatment.

Solutions to crossword on page 8

ACROSS: 1 Consolidation; 8 Motocross; 9 Temp; 11 Exposure; 12 Arabia; 14 Serf; 16 Stocks; 17 Aga; 19 Tug; 20 Amount; 21 Odic; 23 Colite; 24 Emphasis; 27 Eta; 28 Assurance; 29 Reimbursement. **DOWN:** 1 Compensation; 2 Not up; 3 On cost; 4 Iron ration; 5 Apse; 6 Interest; 7 Name brand; 10 Balance sheet; 13 Economist; 15 Regulator; 18 Pastrami; 22 Charge; 25 Singe; 26 Jamb.

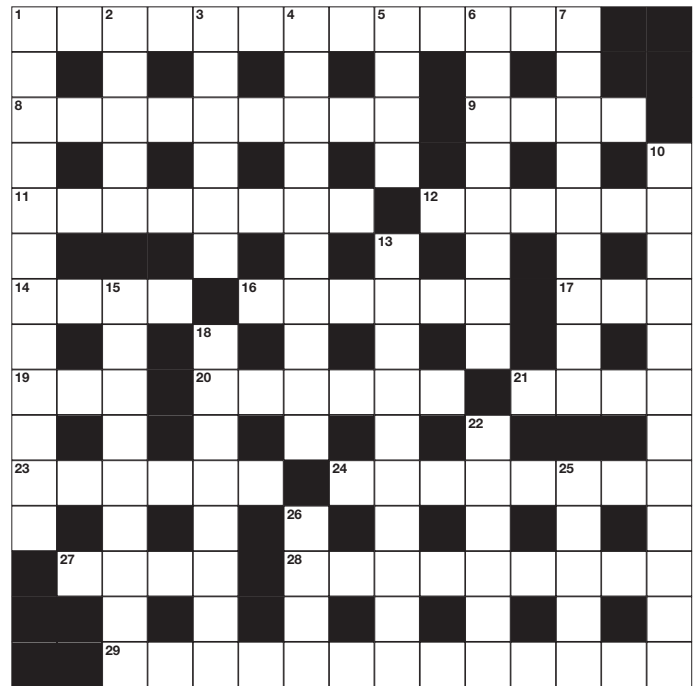
IFRS News Crossword

Across

- 1 Process of preparing the financial statements for a group of companies (13)
- 8 Form of motorcycle scrambling on a very rough circuit (9)
- 9 Worker hired from an agency (abbreviation) (4)
- 11 Susceptibility to risk (8)
- 12 Saudi ____, Middle Eastern country (6)
- 14 Member of low social class in medieval times (4)
- 16 Shares in the US, or inventory (6)
- 17 Turkish governor or commander (3)
- 19 Vessel for towing other vessels; pull (3)
- 20 Quantity (6)
- 21 Of or relating to poems (4)
- 23 Sedimentary rock, eg, limestone (6)
- 24 Forcible expression (8)
- 27 Active volcano in Sicily (4)
- 28 Giving an opinion (9)
- 29 Repayment for money already spent (13)

Down

- 1 Something given as a result of loss or injury, or remuneration (12)
- 2 Down presumably (3,2)
- 3 Running to budget (6)
- 4 Ferric food for an extreme emergency (4,6)
- 5 Arched recess in a church (4)
- 6 Premium paid for the use of money (8)
- 7 Manufacturer's distinguishing make (4,5)
- 10 Summary of company's accounts (7-5)
- 13 One who is frugal and avoids waste (10)



- 15 SEC and IOSCO, for example (9)
- 18 Highly seasoned beef (Italian derivation) (8)
- 22 Financial liability, eg, a tax (6)
- 25 Superficial burn or French monkey (5)
- 26 Side post of door (4)

Correction

The article entitled 'ED amendment to IAS 1' (*IFRS News*, April 2006, p1) contained an error in the explanation of why four board members voted against the exposure draft. The correct explanation is that that the Board members preferred a single statement; they disagreed with the Board's decision to provide a choice of one statement (income statement) or two (income statement plus statement of recognised income and expenses).

IFRS diary

4 May 2006 – Trustees of the International Accounting Standards Committee Foundation publish draft handbook of the IFRIC's due process for public comment.

9 May 2006 – EC endorses amendment to IAS 21, The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation; and IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies.

23 May – IASCF's XBRL team releases 'IFRS-GP 2006 Taxonomy' exposure draft for comment.

25 May 2006 – IASB publishes exposure draft of proposals to amend IAS 23, Borrowing Costs. Comment deadline

29 September 2006.

Australian 'Financial Reporting Update' 2006

PwC in Australia held its annual Financial Reporting Update events around the country in April and May 2006. They attracted over 1,500 clients, partners and staff.

The events updated attendees on the key financial reporting developments affecting Australian companies. They highlighted some of the common issues identified from the Australian firm's recent review of clients' financial statements and focused on

some of the trickier aspects of accounting raised by Australia's equivalents to International Financial Reporting Standards (AIFRS). These include revenue recognition, lease arrangements and business combinations.

The slides used at the event can be downloaded from pwc.com/au/ifrs. Any questions should be directed to louise.halliwel@au.pwc.com



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