2006 IFRS Survey

International Financial Reporting Standards

Communicating the changes

BDO

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1 Foreword and survey objectives

This survey is our first opportunity to look at the first full year IFRS financial statements of fully listed companies.

Background

At the start of 2006 we produced our first survey, communicating the changes that had been reported by mid-market companies in their 2005 interim financial statements prepared using International Financial Reporting Standards (IFRS).

That survey concentrated on the decisions taken on conversion to IFRS, in particular which transitional exemptions had been used and the methods adopted to reconcile previous results under UK GAAP to IFRS.

This survey is our first opportunity to look at the first full year IFRS financial statements of fully listed companies. As in the previous survey, the companies researched are those in the FTSE 350 but outside of the FTSE 100.

Why FTSE 101-350?

Many surveys and published analyses of IFRS application have concentrated on the very largest UK firms. By examining groups outside of the FTSE 100 we have been able to consider a broader spectrum of industry sectors, whilst at the same time focusing on companies with comparable scale and resources to many AIM as well as smaller fully listed groups.

Structure of survey

The first part of this survey deals with the presentation of the Income Statement under IFRS and covers:

i) Use of boxes and shading to highlight specific items within the Income Statement.

ii) Presentation of expenses either by 'Nature' or by 'Function'.

iii) The use of 'Exceptional items' and how they are being presented to highlight unusual transactions.

iv) The extent and types of additional line items in the Income Statement.

The second part of the survey looks at certain higher profile International Accounting Standards where the type and extent of disclosure has varied. We have chosen to examine application of the following in more detail:

- IAS 19 Employee benefits.
- IAS 24 Related Party Disclosure.
- IAS 36 Impairment of Assets.
- IAS 32 Financial Instruments: Disclosure and Presentation.

The final part of the survey looks in more depth at particular industry sectors and examines common themes, emerging trends and certain industry specific accounting and disclosure.

AIM-listed companies

As well as reviewing what accounting treatment the companies surveyed have adopted, this survey is intended as a guide to AIM-listed companies who will be required to report under IFRS for the first time for periods commencing after 1 January 2007. Additionally, many groups coming to AIM as well as a number of existing members are choosing to present converted IFRS financial information early than mandated.

This is a crucial period for AIM companies as the transition date for 31 December 2007 adopters (1 January 2006) is already behind us, as well as the comparative balance sheet date for

Our hope is that this survey is one piece of guidance to help AIM companies report for the first time and fully listed groups make further improvements to their IFRS financial statements.

the first mandatory interim financial statements under IFRS in June 2007 (1 July 2006).

Our experience with fully listed clients is that there is much to plan and do starting with drawing up a timetable for conversion, assessing the impact of IFRS and directing resources to critical issues (which include valuations, financial instruments, impairment issues and new format and disclosure).

Our hope is that this survey is one piece of guidance to help AIM companies report for the first time and fully listed groups make further improvements to their IFRS financial statements.

Such companies will also need values at 31 December 2006 for IAS 39 and impairment test purposes.

2 Executive summary

An early review

As explained on the previous pages, this survey has focused on analysing each of the full year financial statements issued by fully listed companies in the mid-market in the early part of 2006.

What we have found, is that there is already an emergence of some common reporting approaches particularly in respect of the Income Statement although at the same time treatments have also diverged in some unexpected ways leading us to speculate as to how companies and standard setters will respond in the future.

We have considered the impact of certain standards where the treatment under IFRS is markedly different to historic practice under UK GAAP and also at specific sectors to see if trends are already occurring at an industry level. Again, we have found a mixture of harmonization of approach brought about by new IFRS prescription combined with some diversity, most notably with respect to impairment disclosures.

Income Statement

The format of the Income Statement is less prescriptive than the profit and loss account under UK GAAP.

Overall there has been an attempt by some companies to make their 2005 Income Statements as comparable in appearance as the previous year Profit and Loss account prepared under UK GAAP.

However, in trying to emphasise underlying recurring performance this has led, in some cases, to longer and more complex Income Statements with increased use of columns, boxes and shading.

We have noted frequent reporting of unusual items as 'Exceptional' with a range of different interpretations of what constitutes an 'Exceptional item'. Exceptional items were of course common place within UK GAAP and, often used in conjunction with columnar and boxed presentation. When accompanied with clear, concise and consistent disclosure, 'exceptional items' often helped comparability with previous accounting periods and assisted understandability of results. It still seems, based on the results from our survey comparability between companies and consistency of application in this area has further room for improvement.

New standards

We have noted a number of the examples of different approaches taken to disclosure under certain key standards which highlight just how difficult comparability will be to achieve:

IAS 32 Financial Instruments: Disclosure and Presentation

- Over 90 per cent of companies surveyed disclose derivative financial instruments in a separate note.
- Over 70 per cent of the companies surveyed disclose how they deal with interest, foreign currency and credit risk but only 58 per cent disclose how they deal with liquidity risk.

IFRS 2 Share based payments

- 60 per cent of the companies surveyed use the Black-Scholes Merton model to value share options, which is the model discussed in the standard.
- 36 per cent and 27 per cent of the companies surveyed use either the

binomial or Monte Carlo method in addition to or instead of Black-Scholes Merton.

IAS 36 Impairment of assets

- 87 per cent of the companies surveyed appeared to fall short of the detailed disclosure of goodwill allocation and forecast assumptions required under the standard.

IAS 19 Employee Benefits

- 58 per cent of the companies surveyed disclose the assumptions used in respect of mortality rates as part of the actuarial valuation the remainder provide no details.

IAS 24 Related Party Transactions

- 64 per cent of the companies surveyed made disclosures of transactions with key management as well as details of remuneration provided to these individuals.

Sectors

The survey indicated certain sector specific issues 'common themes' and/or diversity of IFRS application as follows:

- In the **Retail** sector there is common use of derivative instruments together with use of associated hedge accounting as permitted in IAS 39. In particular, forward foreign exchange contracts in this sector are predominantly treated and accounted for as hedges.
- In the **Media** sector there is the expected increase in the types and carrying values of intangible assets following the introduction of IFRS. This has required companies to consider what are the appropriate amortisation periods over which such intangibles should be written off.
- Most companies surveyed in the **Natural Resources** sectors are applying the successful efforts method of accounting. This is expected to lead to an increased frequency of impairment reviews necessary for separately identified pools of cost compared with the alternative 'full cost' accounting method.
- In the **Real Estate** sector there is evidence (given a market of rising property prices) of increases in reported income as revaluation gains on investment properties are recognised in the Income Statement. There is also a tendency for shareholders' equity to decline as deferred tax is provided on these taxable temporary differences.
- In the **Travel and Leisure** sector several have reclassified payments in respect of land under operating leases as prepayments rather than tangible fixed assets to align with IAS 21. In many cases the amortisation of that prepayment is greater than the previous depreciation charge leading to a net adverse income statement effect.
- For transport companies it is common for detailed disclosures to be necessary under IAS 39 covering hedging of fuel cost exposures.
- In the **Support Services** sector we found companies involved in PFI contract work have each set out how they have approached the accounting for such contracts given that no explicit accounting standard exists under IFRS at present. There have been a range of approaches here.

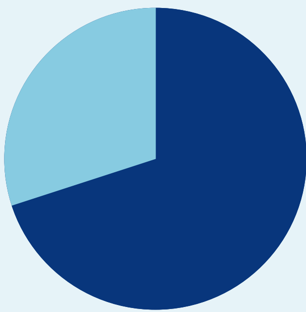
Over time, history will suggest that benchmark treatment will emerge and standards will be revised to increase comparability and consistency.

Implications

- IFRS reporting continues to develop and this survey covers the reporting made by those that have had to 'go first' in the UK.
- Whether any of the early accounting and disclosure approaches of these companies become 'benchmarks' remains to be seen.
- Over time, history will suggest that benchmark treatment will emerge and standards will be revised to increase comparability and consistency. The key for assessing the quality of policies and disclosure adopted by companies reporting under IFRS for the first time is that each should be chosen intelligently to best reflect the specific economic conditions and needs of users whilst staying within the rules.
- It is interesting to speculate on the level of diversity the standard setters and users of the accounts will ultimately settle on as being acceptable. This will mostly depend on whether IASB resist the temptation to further increase the number of rules and level of prescription.
- Our view is that use of judgement by users is a good thing and excessive prescription a regressive step. However we are already seeing some evidence that comparability between companies has not been fully achieved in this first round of reporting and we expect the FRRP and IASB to focus on this further.

3 Population

Parent company under UK GAAP or IFRS



UK GAAP
IFRS

Source: Company accounts and websites

Survey population

This survey considers companies in the FTSE 350 but outside of the FTSE 100.

At the date of our research of the possible 250 companies that could have reported under IFRS only 120 had done so. The companies surveyed are predominantly those with a 31 December year end.

Whilst IFRS is compulsory for consolidated financial statements of the companies surveyed, the option remains to continue to report under UK GAAP in respect of the parent company financial statements.

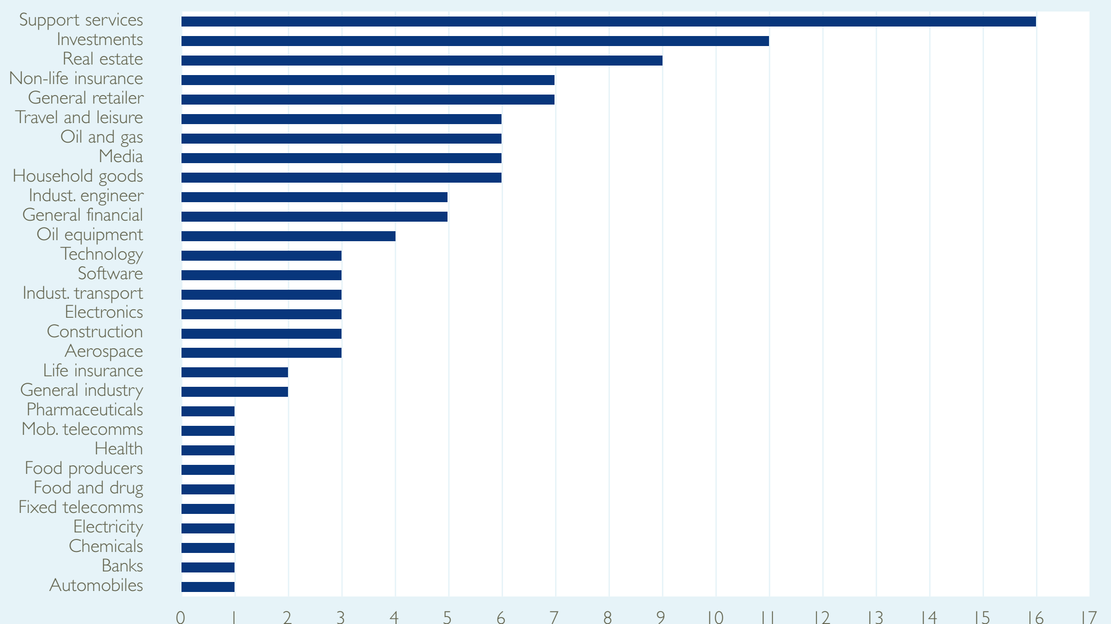
We looked in detail at certain sectors to identify whether trends were already emerging in how certain financial information was being reported and also how technical treatments particularly relevant to the sector, were being applied.

Our research has shown just under 70 per cent of companies have reported their parent company financial statements under UK GAAP rather than IFRS.

The impact on taxation and distributable reserves is the most likely reason why IFRS has not been adopted at parent company level.

Where companies have reported under UK GAAP they have usually shown these statements as a totally separate section at the back of their published accounts.

Survey population



Source: Company accounts and web sites

4 Income Statement

Reporting standards and guidance

IAS 1 Presentation of Financial Statements

IAS 1 states that its objective is: "…to prescribe the basis and presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with financial statements of other entities. To achieve this objective, this Standard sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content."

As the convergence to IFRS continues globally the standard setters objective is for adoption to significantly improve comparability of financial statements across borders.

This survey looks first at how the move to IFRS has impacted reporting of trading performance by UK listed groups.

Paragraph 81 of IAS 1 sets out the minimum line items to be included on the income statement. These are:

- revenue
- finance costs
- share of the profit or loss of associates and joint ventures accounted for under the equity method
- tax expense
- profit/loss on disposal of discontinued operations
- profit or loss.

These requirements are substantially less prescriptive than UK GAAP and potentially provide ample opportunity for varied presentational approaches by listed groups.

UK GAAP

Under UK GAAP the layout of the profit and loss account was determined by following the formats set out in Companies Act 1985. These are much more detailed and prescriptive than equivalent requirements within IAS 1.

In reporting material 'unusual items' many companies chose to highlight items under the heading 'exceptional', if possible after 'Operating profit'. The introduction of FRS 3 – Reporting Financial Performance ensured that 'exceptional' items were better defined and had to be shown under the relevant format heading.

Prior to the adoption of IFRS the use of boxes/shading to highlight such items had become common practice.

Early IFRS experience

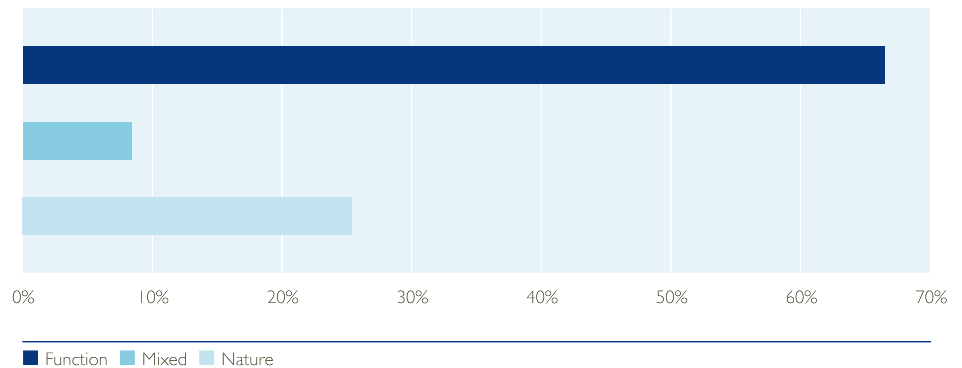
UK companies have applied a diverse approach to the format and presentation, of the Income Statement.

Several have made the first IFRS Income Statement resemble the previous UK GAAP Profit and Loss Account.

Whilst this may make the reading and understanding of the financial statements easier for users, there is evidence that the IFRS Income Statement has an increased tendency to become crowded with additional information, impairing overall clarity of this key performance statement.

A number of particular features of the Income Statements surveyed are worthy of comment and are covered in more detail below.

Presentation of expenses by nature or function



Source: Financial statements

Presentation of expenses by nature or function

Under IAS 1 companies have the choice to prepare their Income Statement by Nature or Function depending on "whichever provide information that is reliable and more relevant".

Nature is similar to Companies Act format 2, with separate lines for items such as staff costs and depreciation. Function is similar to Companies Act format 1, with separate lines for items such as cost of goods sold and administrative expenses.

In our survey, Function proved to be most popular option (as it was under UK GAAP) with 66 per cent of companies adopting it. 25 per cent of companies presented their Income Statement by Nature.

For nine per cent of companies it was unclear whether they had adopted a nature or function presentation as the analysis was mixed between the two formats.

As IAS 1 clearly requires companies to make a choice between the two formats, mixing of formats presents a risk that the financial statements might be giving a misleading impression of total expenses.

In all of the cases where the two formats were mixed it appeared to have been done to enable impairment of goodwill and intangible asset amortisation to be shown separately.

Intertek Group plc splits these two items out of administrative expenses but, by using boxes, makes it clear that they are part of the total expense.

	2005 £m	2004 £m
Amortisation of intangible assets	(2.1)	(1.4)
Impairment of goodwill	(2.0)	–
Other administrative expenses	(45.4)	(31.6)
Total administrative expenses	(49.5)	(33.0)

In Intertek's 2004 financial statements it showed goodwill amortisation in a box as part of its overall administrative expenses.

Additional line items

As noted above, IAS 1 Paragraph 81 provides the minimum items required on the face of the Income Statement.

Paragraph 83 of the standard appears to introduce a degree of flexibility by noting that:

"Additional line items, headings and subtotals shall be presented on the face of the Income Statement when such presentation is relevant to the understanding of the entity's financial performance."

The companies in this survey have in the most part disclosed more information on the face of the Income Statement than required by IAS 1.

In the majority of cases this additional disclosure is used to emphasise underlying profitability of the company as well as comparability with the previous financial statements produced under UK GAAP.

As an illustration of the use of columns to separate non-recurring items within the Income Statement, an extract from the accounts of **United Business Media plc.** is shown below:

	Before Non-recurring items 2005 £m	Non-recurring items 2005 £m	Total 2005 £m Before	Non-recurring items 2004 £m	Non-recurring items 2004 £m	As restated Total 2004 £m
Continuing operations						
Revenue	675.8	–	675.8	557.3	–	557.3
Other operating income	11.9	–	11.9	9.1	–	9.1
Operating expenses	(575.8)	–	(575.8)	(473.8)	–	(473.8)
Non-recurring reorganisation and restructuring costs	–	(37.2)	(37.2)	–	–	–
Share of results from associates and joint ventures (after tax)	4.2	8.5	12.7	6.0	–	6.0
Income from investments	3.0	–	3.0	5.2	–	5.2
Group operating profit	119.1	(28.7)	90.4	103.8	–	103.8
Non-recurring items						
Profit on disposal of equity accounted investments	–	150.7	150.7	–	–	–
Amounts written off investments	–	–	–	–	(11.7)	(11.7)
		150.7	150.7	–	(11.7)	(11.7)
Earnings before interest and taxes ("EBIT")	119.1	122.0	241.1	103.8	(11.7)	92.1
Finance income/(costs)						
Interest income	28.2	–	28.2	26.5	–	26.5
Interest cost	(15.5)	–	(15.5)	(14.1)	–	(14.1)
Financing income – other than interest	8.4	–	8.4	–	–	–
Financing cost – other than interest	(13.8)	(13.7)	(27.5)	–	–	–
Financing cost – pension schemes	(2.5)	–	(2.5)	(3.4)	–	(3.4)
Profit before tax	123.9	108.3	232.2	112.8	(11.7)	101.1
Taxation	(23.6)	(1.2)	(24.8)	(23.1)	–	(23.1)
Non-recurring taxation credit	–	–	–	–	121.0	121.0
Profit for the year from continuing operations	100.3	107.1	207.4	89.7	109.3	199.0
Discontinued operations						
Profit for the year from discontinued operations (after tax)	–	270.1	270.1	19.7	18.9	38.6
Profit for the year	100.3	377.2	477.5	109.4	128.2	237.6

An example of a simpler approach which is similar to their UK GAAP report of 2005 is **Matalan plc**. Its Income Statement for the 52 weeks ended 25 February 2006 has the following headings:

Continuing operations

Revenue

Cost of sales

Gross profit

Administrative expenses

Operating profit

Operating profit pre-exceptional item

Exceptional item

Exceptional item – impairment of software and development costs

Operating profit

Interest payable and similar charges

Interest receivable and similar income

Net finance costs

Profit before taxation

Taxation

Profit for the period from continuing operations

Discontinued operations

Loss for the period from discontinued operations

Profit for the period

Exceptional items

As noted previously under UK GAAP 'exceptional' items were common however they were occasionally used inappropriately in order to separate 'bad news' from 'underlying' results.

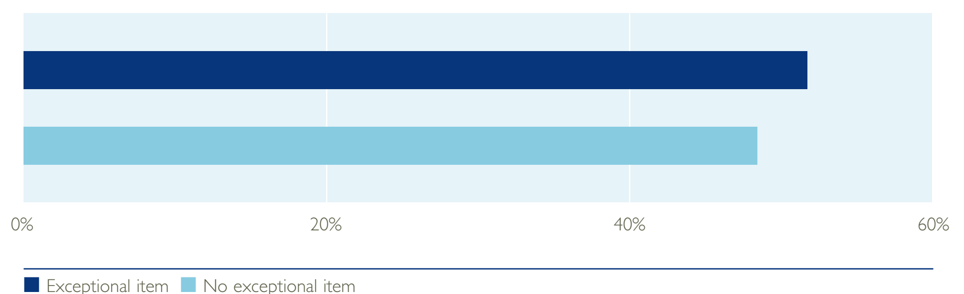
The description of items as 'exceptional' on the face of an IFRS Income Statement was generally avoided by companies in IFRS interim reporting, with references to items as 'unusual' or by another more specific description most common.

Our survey has identified some evidence that practice is now shifting back towards the more liberal use of the term 'exceptional item'.

52 per cent of companies surveyed have some kind of exceptional item on the face of their Income Statement.

In our view, sensible use of exceptional items can add to the usefulness of an Income Statement, provided exceptional items are defined sensibly and their treatment is consistently applied and disclosed. In particular, if a company has a stated accounting policy setting out precisely what constitutes an exceptional item then understandibility should be enhanced.

Exceptional items



Source: Financial statements

Our survey has identified some evidence that practice is now shifting back towards the more liberal use of the term 'exceptional item'.

Of those that did have exceptional items only 57 per cent presented a related accounting policy.

An example of which is by **Woolworths plc**:

"Items that are both material in size, unusual and infrequent in nature are presented as exceptional items in the Income Statement. The Directors are of the opinion that the separate recording of exceptional items provides helpful information about the Group's underlying performance."

The companies that do not have a stated accounting policy do have detailed notes and narrative concerning how their 'exceptional items' that year have arisen.

A number of companies show their Income Statement with three columns across the face, with one column being titled 'Exceptional costs' or 'Restructuring costs'.

Abbott Group plc uses this format in its financial statements

Before exceptional items 2005	Exceptional items 2005	After exceptional items 2005
£'000	£'000	£'000

The exceptional item details are then set out in a note to the financial statements as follows:

	2005 £'000	2004 £'000
Exceptional items		
Gain on sale of property	**2,504**	–
Aborted acquisition costs	**(817)**	–
Bank facility restructuring fees	**(641)**	(694)
	1,046	(694)

Findel plc does not use the phrase 'exceptional' on the face of its Income Statement. However, restructuring costs and amortisation of intangible assets are shown as separate line items in order to emphasise the profit increase before these costs.

	2006 £'000	2005 £'000
Profit before tax		
Before amortisation of intangible assets and restructuring costs	**52,052**	45,458
Amortisation of intangibles	**(930)**	(661)
Restructuring costs	**(16,055)**	(3,274)
Profit before tax	**35,067**	41,523

In **Findel's** accounting policies note there is a separate paragraph for Restructuring costs which reads:

"The restructuring of the group's existing operations and the integration of acquisitions give rise to significant incremental non-recurring costs. The group views restructuring costs as costs associated with investment in the future performance of the business and not part of the group's trading performance. These costs have a material impact on the absolute amount of and trend in the group operating profit and operating margins. Therefore such restructuring costs are shown as a separate line item within operating profit on the face of the income statement."

So again there is no explicit reference to them being 'exceptional' items.

However in the Finance Director's Review the Group presents its policy towards what it terms 'benchmark measures'.

"Benchmark measures

In order to ensure consistency of reporting the group has, in common with other companies in its sector, identified measures of benchmark profit from operations, profit before tax and earnings per share which it believes will aid in understanding its business. Benchmark measures are stated before amortisation of acquisition intangibles and before exceptional items such as restructuring costs, gains or losses on disposal or closure of businesses and goodwill impairment charges."

"Restructuring costs

The restructuring of the Educational Supplies division begun in the previous financial year was completed in the year. This involved rationalising systems, premises and product ranges, and the separation of the Healthcare activities of the division. The costs of this restructuring in the current period amounted to £16.1m and have been reported as an exceptional charge against the operating profit of the division."

In order to present sub-totals and the split of costs or income on the face of the Income Statement it was sometimes the case for companies applying UK GAAP to use shading or boxes.

Meggitt plc do not make any reference to exceptional items on their Income Statement, but however their 'underlying operating profit' and 'underlying profit after tax' are disclosed at the bottom of that statement and show a reconciliation between the two in the notes to the financial statements.

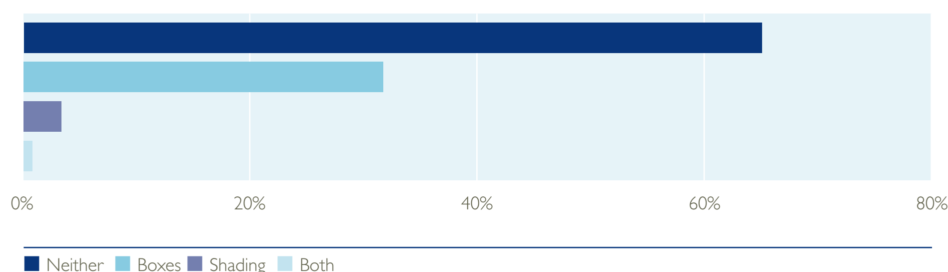
Within this note Meggitt plc refers to 'Exceptional operating costs' and then subsequently details what these exceptional costs are.

Boxes and shading on the Income Statement

In order to present sub-totals and the split of costs or income on the face of the Income Statement it was sometimes the case for companies applying UK GAAP to use shading or boxes. Use of alternative presentation methods such as this can enhance comparability and clarity although consistency is of paramount importance.

In our survey about a third of companies used boxes or shading in their income statement, with most opting for some type of box presentation. For the remainder, more detail was provided within the notes or under separate lines on the face of the Income Statement.

Boxes and shading on the Income Statement

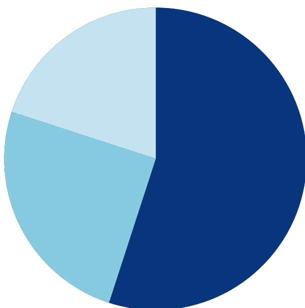


Source: Financial statements

Charter plc was the only company which used both boxes and shading. The shading is used to highlight the analysis of operating profit between 'normal' and exceptional items and the boxes are used to show the split of financing charges between various components as follows:

	2005 £m	2004 £m
Operating profit	101.7	51.9
Analysed as:		
Operating profit excluding exceptional items	97.5	54.9
Exceptional items	4.2	(3.0)
	101.7	51.9
Finance charge excluding gains/(losses) on inter-company loan balances	(9.9)	(14.7)
Finance income excluding gains/(losses) on inter-company loan balances	3.6	3.2
Gains/(losses) on retranslation of inter-company loan balances	3.6	(3.0)
Net financing charge	(2.7)	(14.5)

Reasons for using boxes



- Breakdown of a figure
- Emphasis on number
- Non-cash items

Source: Company accounts

Boxes have been used by companies in our survey to provide extra emphasis of:

- A breakdown of a particular figure on the face of the Income Statement into its constituent parts.
- A significant number in the Income Statement.
- To show on the face of the Income Statement the impact of non-cash items such as amortisation and impairment. (There is evidence that the flexibility given by Paragraph 81 of IAS 1 has encouraged more use of this presentation than under Companies Act 1985. 78 per cent of those companies choosing this presentation did not have any equivalent structure in the prior year UK GAAP profit and loss account).

The majority of companies used the box to add separate analysis on the face of the Income Statement which under UK GAAP were shown as a note to the accounts.

Shading is used to highlight the analysis of operating profit between ‘normal’ and exceptional items and the boxes are used to show the split of financing charges between various components.

Good examples of each category of box presentation were given by the following:

Tomkins plc demonstrate how a box is used to show finance costs in their gross elements as required under IFRS but then disclose the net total as was permitted under UK GAAP:

	Year ended 31 Dec 2005 £m	Year ended 1 Jan 2005 £m
Interest payable	(83.5)	(64.8)
Investment income	40.3	38.8
Other finance income	4.2	–
Net finance costs	(39.0)	(26.0)

Spirent plc uses a box to emphasise both the unusual and non-cash elements within its operating profit:

	2005	2004	2003
Operating (loss)/profit	(39.0)	15.2	11.3
Add back:			
Material one-time items	8.4	2.9	7.5
Goodwill impairment	37.0	–	–
Share-based-payments	5.1	4.8	0.9
Operating profit before material one-time items, goodwill impairment and share-based payments	11.5	22.9	19.7

Intertek plc uses a box to show the impact of amortisation and impairment on its administrative expenses:

	2005	2004
Amortisation of intangible assets	(2.1)	(1.4)
Impairment of goodwill	(2.0)	–
Other administrative expenses	(45.4)	(31.6)
Total administrative expenses	(49.5)	(33.0)

Shading

Although less common, shading has also been used to provide analysis of certain aspects within the Income Statement.

Millennium & Copthorne Hotels plc has used shading to analyse its operating profit and its share of profit of joint ventures and associates as follows:

	2005 £m	2004 £m
Group operating profit	**121.4**	125.0
Analysed between:		
Group operating profit before other income and impairment	**99.6**	85.2
Other operating income	**28.3**	55.0
Impairment	**(6.5)**	(15.2)
Share of profit of joint ventures and associates	**3.5**	1.7
Analysed between:		
Operating profit	**8.5**	7.8
Interest	**(1.3)**	(3.2)
Taxation	**(1.4)**	(0.8)
Minority interests	**(2.3)**	(2.1)

Columns

Additional columns have also been used to separately identify exceptional items, non-recurring items, goodwill impairment and amortisation of intangible assets.

Gyrus Group plc use five columns across the face of their Income Statement as follows:

- 2005 pre-acquisition of American Cystoscope Makers Inc and Restructuring costs.
- Acquisition of American Cystoscope Makers Inc.
- Restructuring.
- Impact of fair value adjustments on acquired inventory and option accounting.
- 2005 (Total).

Alternative Income Statements

Interestingly **Jardine Lloyd Thompson Group plc** included an 'Alternative Income Statement' at note 2 to its financial statements. This is presented with columns for underlying profit, reclassifications, impairment charges, exceptional items and total.

In explaining why they have included such a note Jardine Lloyd Thompson Group plc states:

"The format of the consolidated Income Statement on page 46 conforms to the requirements of IFRS. The alternative Income Statement set out below, which is provided by way of additional information, has been prepared on a basis that conforms more closely to the approach adopted by the Group in assessing its performance."

Key observations

The results of our survey indicate that the additional flexibility provided by Paragraph 81 of IAS 1 has led to the following in respect of the Income Statement:

- Overall an attempt by companies to make their Income Statements as comparable in appearance as the previous year Profit and Loss account under UK GAAP.
- This has primarily been achieved by having additional line items well in excess of the minimum permitted by IAS 1 and a general tendency to report performance by Function.
- A tendency to emphasise underlying recurring performance, has led to longer and more complex Income Statements with numerous instances of columns, boxes and shaded presentation.
- This has also led to more reporting of unusual items as 'exceptional' with a range of different interpretations or no disclosed interpretation at all of what constitutes an 'exceptional item'.
- Whilst all this may have helped comparability with the previous UK GAAP, it still seems that comparability with other entities has been harder to achieve.
- It is our expectation that regulators and users will watch the format of Income Statements closely for any sign that presentation, through undue prominence of 'non-GAAP' measures, excessive complexity or inconsistent treatment, becomes less meaningful or more misleading.

A tendency to emphasise underlying recurring performance, has led to longer and more complex Income Statements with numerous instances of columns, boxes and shaded presentation.

5 Application of international standards

A new regime of standards

In this section our survey looks at a number of standards that are either:

- Notably different from previous treatment under UK GAAP.
- Require additional disclosure than was previously required under UK GAAP.

The section challenged the premise that IFRS will improve comparability, by looking at differences between companies in the disclosures made under these key standards.

IAS 32 Financial Instruments: Disclosure and Presentation

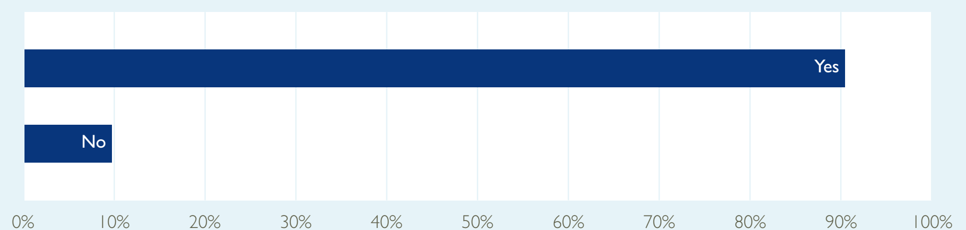
IAS 32's objective is to enhance users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

It requires disclosure of information about factors that affect the amount, timing and certainty of a company's cash flows relating to financial instruments and the accounting policies applied to those instruments. It also requires disclosure of information about the nature and extent of an entity's use of financial instruments, their purpose and the risks and policies associated with their use.

We considered the following for the companies surveyed:

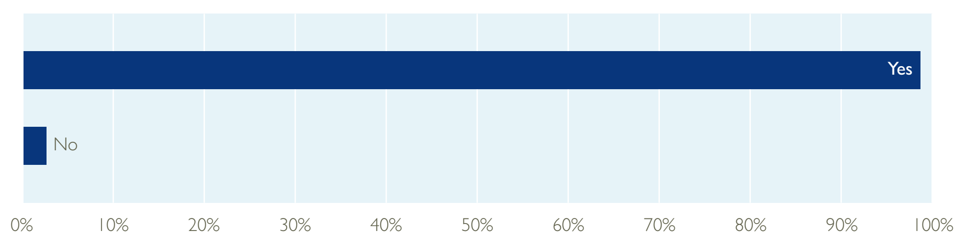
- Does the company have a separate financial instruments note in its financial statements?
- Does the company state its objectives and policies in respect of financial instruments?
- How prominent are policies in respect of the four main financial instrument risk areas?

Separate financial instruments note?



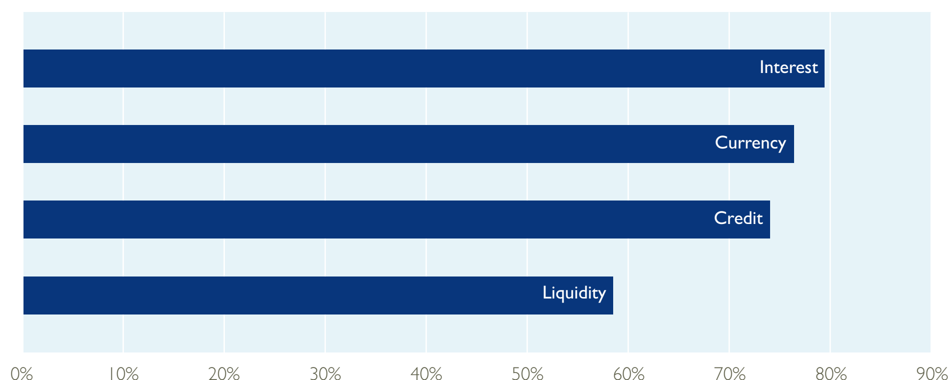
Source: Financial statements

Financial instruments objectives and policies?



Source: Financial statements

Risk area discussed?



Source: Financial statements

The level of prominence of financial instrument disclosures was generally high with a large majority having a dedicated note and almost all setting out objectives and policies clearly.

Our research also showed nearly 20 per cent of the companies surveyed also explained how they deal with price risk.

However, we found that in just over 25 per cent of the companies the discussion of risk was not within the notes to the financial statements but in the Financial Review and we noted a large variation in the detail provided in such disclosures.

An example of a lengthy disclosure is **Petrofac Limited** which discloses details regarding its financial instruments over three pages of notes.

Firstly the company sets out risk management objectives and policies and then the risks arising from its financial instruments. These are:

- Interest rate risk.
- Foreign currency risk.
- Credit risk.
- Liquidity risk.

We found that in just over 25 per cent of the companies the discussion of risk was not within the notes to the financial statements but in the Financial Review.

It then sets out three tables:

- A table comparing the fair value of the financial instruments to the carrying value in the balance sheet.
- A table detailing assets and liabilities which are subject to interest rate risk and showing the years over which these assets and liabilities will reprice or mature.
- Details of derivative instruments designated as cash flow hedges.

Finally the note shows those financial instruments that are subject to foreign exchange risk.

In contrast **Savills plc** uses a different style of disclosure.

Like Petrofac, there is a note setting out how the company manages financial risk which identifies the individual risks it faces and how it deals with them.

As well as the four risks shown in Petrofac's financial statements a fifth risk, 'Price risk,' is also noted as Savills has equity investments as available-for-sale assets.

There is however no separate note to the financial statements headed 'Financial Instruments'. Instead disclosures in respect of financial instruments are made within the cash and borrowings notes.

As part of the 'cash and cash equivalents' note the balance is split into its respective currencies. However there is no comment as to foreign exchange risk even though £36m of the year end balance is denominated in foreign currency.

Within the 'Borrowings' note there is a section which deals with the group's exposure to interest rate risk and the contractual repricing dates.

IFRS 2 Share based payments

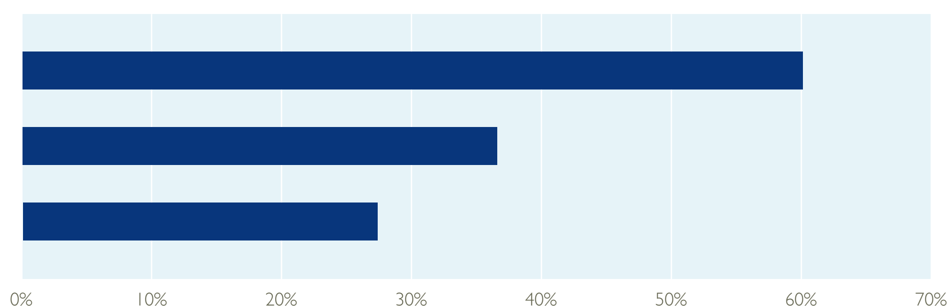
In the reasons given for issuing IFRS 2 the IASB state: "Entities often grant shares or share options to employees or other parties. Share plans and share option plans are a common feature of employee remuneration, for directors, senior executives and many other employees. Some entities issue shares or share options to pay suppliers, such as suppliers of professional services.

Until this IFRS was issued, there was no IFRS covering the recognition and measurement of these transactions. Concerns were raised about the gap in IFRSs, given the increasing prevalence of share-based payment transactions in many countries."

As well as recognition of a change in the Income Statement, a key implication of IFRS 2 has been that companies have to disclose what valuation models they have applied to determine the fair value of the transactions and why they believe that it is the appropriate model.

The Black-Scholes Merton model is specifically referred to in the standard, so we might expect this to be the default model, however encouragingly our survey shows that companies are increasingly trying to use the method they believe best suits the option plan being valued.

Fair value model applied



Source: Financial statements

A quarter of the companies applied more than one valuation model to their various option schemes.

One such company is **The Morgan Crucible Company plc** which makes the following disclosure as to how they are fair valued.

"The fair value of options and awards under each scheme have been measured using the following models:

Long Term Incentive Plan 2004	Monte Carlo model
Executive Share Option Scheme 2004	Monte Carlo model
Morgan Executive Share Option Scheme 1995	Binomial Lattice Option pricing model
UK Employee Share Save Scheme 2003	Black-Scholes Merton model
UK Employee Share Save Scheme 2004	Black-Scholes Merton model
UK Employee Share Save Scheme 2004 (Germany)	Black-Scholes Merton model
UK Employee Share Save Scheme 2005 model	Black-Scholes Merton

The choice of model takes into account the terms and conditions upon which the awards were made and the options were granted."

Taylor Nelson Sofres plc, similarly has a number of different option schemes but is more explicit about why a particular model was chosen and how that model valued the options.

"The Black-Scholes Merton model was selected to value options to and to value performance shares granted with EPS performance criteria because the grants are not complex in nature and the method is straightforward to use. This model values such grants as if they were tradeable options, and generates a single outcome using the assumptions noted below, which can be adjusted to reflect estimates of lapsing due to non-achievement of performance criteria or employee decisions.

The Monte Carlo model was selected to value shares granted with performance criteria based on the Total Shareholder Return of TNS relative to other companies because these are market based criteria and require simulation of multiple possible outcomes to derive an estimated value. This model values such options by simulating 50,000 possible outcomes for TNS and each company in the comparator group, calculating the expected gain for each simulated outcome and discounting the average of these gains to give a present value. This valuation already includes the probability of lapsing due to non-achievement of performance criteria."

A table of assumptions then follows which includes:

- share price at date of option
- exercise price
- expected volatility
- average expected period to exercise
- risk free rate
- expected dividend expressed as a dividend yield.

IAS 36 Impairment of Assets

Under IAS 36 assets must be written down to their recoverable value if the current carrying value exceeds the amount to be recovered through use or sale of the asset.

The main difference from UK GAAP is that under IFRS goodwill is no longer subject to amortisation, only an annual review to assess whether it is impaired.

IAS 36 is clear that goodwill should be allocated to the relevant cash-generating units it relates to. Then, based on the expected future cash flows from those cash-generating units, any impairment can be assessed.

Crucially, as part of the disclosures under IAS 36, the assumptions used in calculating the future cash flows should be disclosed.

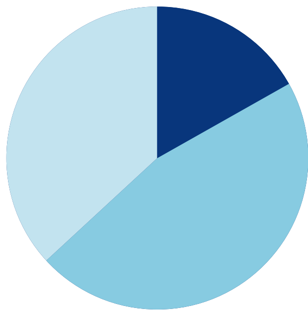
The majority of the companies in the survey have made acquisitions in the past and therefore have goodwill on their balance sheet.

Our research has shown a marked variation in the level of disclosure made in respect of these impairment reviews and the key assumptions underlying them.

We have split these into three categories:

- No disclosure in respect of impairment.

Disclosure of goodwill impairment



- None
- Detailed
- Partial

Source: Financial statements

- A partial disclosure setting out that an impairment review has been undertaken and some of the factors taken into account.
- Detailed disclosure setting out the basis of the impairment review and the assumptions underlying it.

Countrywide plc has produced a detailed disclosure of the goodwill it is carrying and the assumptions made in respect of the impairment review. Firstly it breaks down its goodwill by operating unit.

	2005 £000	2004 £000
Countrywide Residential Lettings	**683**	683
Beresford Adams	**42**	42
Ex Friends Provident Estate Agency branches	**11,729**	11,729
Countrywide Surveyors	**3,846**	3,846
Countrywide Property lawyers	**447**	447
Harvey Donaldson Gibson	**649**	649
Ex Bradford & Bingley Estate Agency branches	**9,214**	9,214
SecureMove Property Services		8,767
TitleAbsolute/ Trade Partners	**2,360**	–
Total goodwill in subsidiary companies	**37,737**	35,377
TNG Holdings Limited	**965**	1,351
Netsquared Limited	**483**	483
Total goodwill in associated companies	**1,448**	1,834
Rightmove plc (joint venture)	**362**	362

Then it sets out in detail how the impairment review has been carried out.

"Goodwill has been allocated to the lowest level of reporting unit. In many cases, the operations of the acquired business have been fully integrated with the existing businesses and therefore it is not possible to identify separately the economic flows from those businesses. In which case the goodwill has been tested against the recoverable amount of the cash generating unit reported at the higher level.

The recoverable amount of all the above operations has been calculated as the fair value of the businesses less costs to sell. The fair value has been determined from calculations based on cash flow projections from formally approved budgets and forecasts covering a five year period to 2009. In calculating the forecasts for the periods beyond the budget, the following assumptions have been used:

Growth rate	3.5%
Wage inflation	3.5%
Inflation	2.5%
Discount rate	10.0%

These growth rates are based on past experience. The discount rate used is based on the group's cost of capital. To evaluate the recoverable amount, a terminal value has been assumed at five times the fifth year cash flow.

The results of the impairment test in 2005, confirmed that there had been no impairment to the carrying amount of the goodwill held on the balance sheet."

A common observation by a number of commentators on first time adoption of IAS 36 across UK and overseas listed groups has been the variability of disclosure of goodwill allocation to CGU

and details of forecast assumptions. Our survey is no exception and we have found a situation whereby some companies refer to 'projections and growth rate consistent with the Groups strategic plan', and others set out numerical details. This is probably an unsustainable inconsistency in the application of the requirements of IAS 36.

IAS 19 Employee benefits

IAS 19 principally covers accounting for post-employment benefits including pension scheme accounting. Like FRS 17, the most significant aspect of the standard is that it requires recognition of defined benefit pension scheme surpluses or deficits on the balance sheet of the company.

Much like FRS 17, a large amount of information is required to be disclosed under IAS 19 in relation to defined benefit pension schemes.

Disclosure should be based on the following three principles set out in paragraph 82 of the standard:

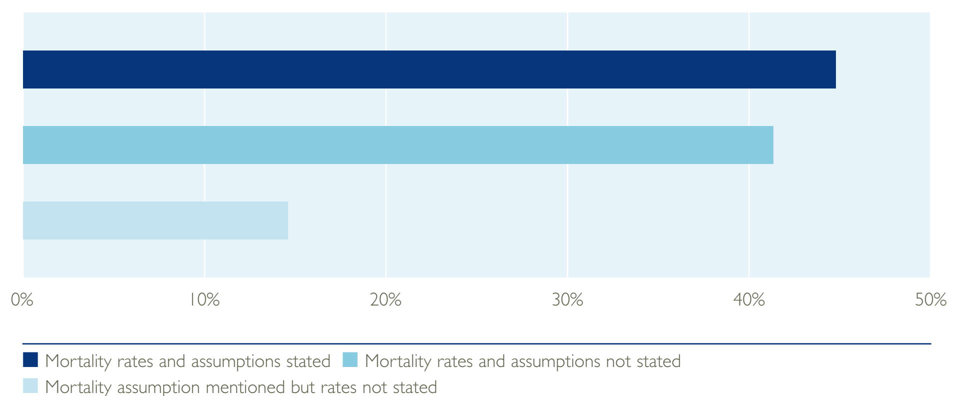
- Information about the uncertainty of employee benefit obligations and costs and the potential consequences of such uncertainty for future cash flows.
- Clear, concise and relevant disclosure as benefit arrangements are often complex.
- Impact of actuarial gains and losses and past service cost on income statement and balance sheet.

This is an area where scope exists for different interpretations of detailed disclosure rules.

Where applicable all the companies surveyed contained notes relating to their defined benefit schemes.

Reporting in respect of present value of the scheme assets and liabilities was also

Disclosure of mortality rate and assumptions



Source: Financial statements

fairly consistent across the companies. This is perhaps unsurprising as this information has been disclosed under FRS 17 for some years now.

Similarly the assumptions made in the actuarial valuation of the scheme in respect of such things as inflation rate, salary increases was fairly consistently disclosed. However, the largest area of variation lay in the degree of disclosure concerning pension mortality assumptions.

Only 44 per cent of companies disclose both the mortality assumptions and the associated rates used.

Arriva plc provides a detailed disclosure of the life expectancy assumptions used as noted below:

Weighted average life expectancy for mortality table to determine benefit obligations:		**2005 years**	2004 years
Member age 65 (current life expectancy)	Male	**18**	18
	Female	21	21
Member age 45 (life expectancy at age 65)	Male	19	19
	Female	22	22

41 per cent of companies disclose neither the mortality assumptions nor the rates.

15 per cent of companies disclose the mortality assumption but do not state the rates used. These companies direct the reader of the financial statements to nationally published mortality tables.

For example **The Davis Service Group plc** states this after disclosing the principal actuarial assumptions:

"The actuarial valuation also assumes that mortality will be in line with nationally published PMA92 and PFA92 mortality tables incorporating projected improvements to life expectancy to 2000 (current pensioners) and 2020 (non-retired members). This is based on the actuary's best estimate of mortality within the scheme."

It is interesting that the flexibility allowed by IAS 19 in providing clear, concise and relevant disclosure has been taken up in the UK by the ASB.

In May 2006 they produced an exposure draft, the main aim of which was to amend FRS 17's current disclosure requirements and replacing them with IAS 19. As part of the background as to why the ASB believes this amendment is necessary they state:

"The ASB is of the view that a Reporting Statement which sets out principles for disclosure, rather than specified requirements, allows entities the flexibility to provide disclosure that

are appropriate to their exposure to risks and rewards arising from defined benefit schemes."

So it appears flexibility with the possible adverse impact on comparability will be the determining factor for defined benefit scheme disclosures from now on.

IAS 24 Related Party Disclosure

IAS 24 is the equivalent of FRS 8 under UK GAAP. Within its definition of a related party IAS 24 includes 'Key management personnel' as persons having authority and responsibility for planning, directing and controlling the activities of the company directly or indirectly.

This therefore captures senior management who are not statutory directors and requires disclosure of their remuneration as well as any other transactions.

The level of disclosure of 'Key management remuneration' as required by IAS 24, is notably different between the companies in our survey.

At the detailed end of the range of disclosures, 34 per cent display a table titled either 'Key management remuneration' or 'Key management compensation.'

The tables disclose that either these are the directors or the directors and other senior management.

Related party disclosures

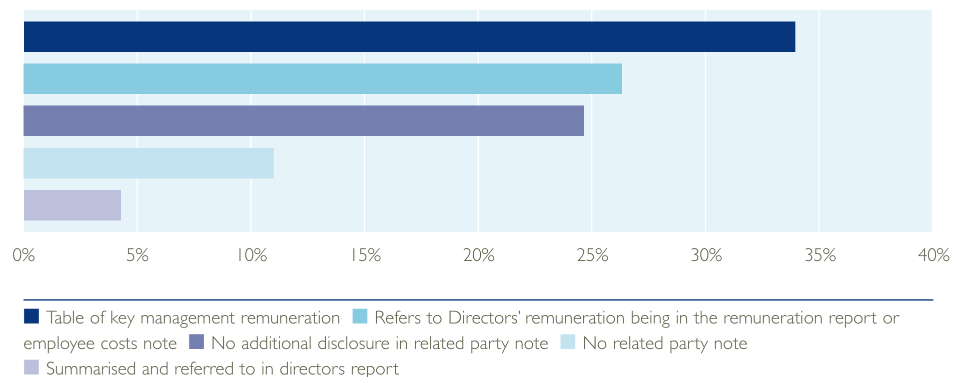


Table of key management remuneration · Refers to Directors' remuneration being in the remuneration report or employee costs note · No additional disclosure in related party note · No related party note · Summarised and referred to in directors report

Source: Financial statements

So it appears flexibility with the possible adverse impact on comparability will be the determining factor for defined benefit scheme disclosures from now on.

For example **Rotork plc** have the following as part of their related parties note:

Key management emoluments

The emoluments of those members of the management team, including directors, who are responsible for planning, directing and controlling the activities of the Group are:

	2005	2004
Emoluments including social security costs	1,987	1,493
Post employment benefits	219	250
Share based payments	569	155
	2,775	1,898

The rest of the companies either deal with the requirements by way of cross reference to the disclosures in the Remuneration Report or make no disclosures at all.

For example **Wilson Bowden plc** noted the following:

Remuneration of key personnel

The remuneration of the Directors and other members of the Group's Executive Committee, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'. Further information about the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on pages.

	2005 £'000	2004 £'000
Short term employee benefits	4,133	4,149
Post-employment benefits	676	626
Termination benefits	422	–
Total remuneration of key personnel	5,231	4,775

36 per cent of the companies in our survey made no explicit disclosures in respect of key management remuneration/compensation, which underlines the inconsistency in application of the requirements of IAS 24 in this round of IFRS reporting.

We would expect clearer and more detailed disclosure in respect of this area in the future as the concept of 'key management' becomes more familiar, whether it be in the body of the financial statements or the Remuneration Report.

Key observations

The five standards chosen in this section and the examples of different approaches taken to disclosures under them, show that achievement of absolute comparability between different companies is just as difficult as it was under UK GAAP.

The current flexibility provided by IAS's in combination with some variable interpretation by first time reporting companies means that we must wait another year to see if major comparability improvements can be made.

6 By sector

In this section we have examined whether within the short timeframe in which IFRS reporting has been established there are any signs that trends have begun to emerge within certain industry sectors.

We also discuss how the key accounting and disclosure impact more industry specific standards.

Retail

There are seven companies included in our survey that are in the sector 'General Retailer'.

All seven of the companies had detailed disclosures in respect of financial instruments. In particular they added notes concerning the exchange rate risks they face in purchasing from overseas and in advance of sales and how they hedge such risks.

It is noticeable that all seven companies have taken advantage of the exemption afforded by IFRS 1 not to restate the comparative information under IAS 32 and 39 but to leave under UK GAAP including disclosures previously reported under FRS 13.

Inchcape plc sets out in note 25 to its financial statements the impact of adopting IAS 32 and 39:

"The principal impact of adopting IAS 32 and IAS 39 at 1 January 2005 relates to the accounting for derivative financial instruments. Under UK GAAP, derivatives taken out to hedge foreign currency exposures generally remained off balance sheet with the associated liability being booked at the forward contract rate. Under IFRS, the liability is booked at spot rate and the derivative is initially recognised at fair value and subsequently remeasured to fair value with any movement being taken to the income statement unless designated and documented as being a hedge of a highly probable forecast transaction or commitment (cash flow hedge), in which case the gain or loss is taken to the shareholders' equity until the hedged firm commitment affects the income statement.

The impact of these standards has been to reduce shareholders' equity by £4.5m at 1 January 2005."

The impact of the implementation these standards have had on the equity of the seven companies surveyed ranges from a reduction of £4.5m to an increase of £2.9m.

All seven of the companies have been able to use hedge accounting as defined in IAS 39 for some of their financial instruments. To do this the hedge relationship must meet all the conditions set out in Paragraph 88 which are:

- At inception the hedging relationship and a designated objective and strategy for undertaking the hedge is formally documented.
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributed to the hedged risk.
- For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.
- The effectiveness of the hedge can be reliably measured.
- The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting period for which it was designated.

We note that for companies in the Retail sector derivative instruments are relatively common and most are opting to apply hedge accounting as set out in IAS 39.

The financial instruments that have been reported under hedge accounting were forward foreign currency contracts. To a lesser extent some interest rate swaps have also been treated under hedge accounting.

Kesa Electonics plc discloses how it has treated these financial instruments as follows:

"Hedges

Cash flow hedges

The Group uses forward foreign currency contracts to hedge expected future purchases in US dollars for which the Group has firm commitments. The contracts typically cover periods of less than six months. The forward currency contracts are being used to hedge the foreign currency risk of the firm commitments. Where cash flow hedges on forward foreign currency contracts are assessed as effective, the movement in the fair value is taken to the hedging reserve within equity. The fair value of forward foreign exchange contracts is calculated by marking the contracts to market using prevailing forward exchange rates. At 31 January 2006, a net unrealised loss of £0.1m with a related deferred tax asset was included within equity in respect of these contracts. At 31 January 2006, the value of future US dollar purchases hedged was $44.7m.

Interest rate swaps

…Where the hedge on the interest rate swap is assessed to be effective, the movement in the fair value is taken to the hedging reserve within equity. At 31 January, a net unrealised loss of £0.8m with a related deferred tax asset of £0.2m was included within equity in respect of the interest rate swap."

We note that for companies in the Retail sector derivative instruments are relatively common and most are opting to apply hedge accounting as set out in IAS 39.

In particular their forward foreign exchange contracts are predominantly treated as hedges.

Media

There are six companies included in our survey that are in the Media sector.

All six have significant balances for goodwill and intangible assets from acquisitions in the past and during 2005.

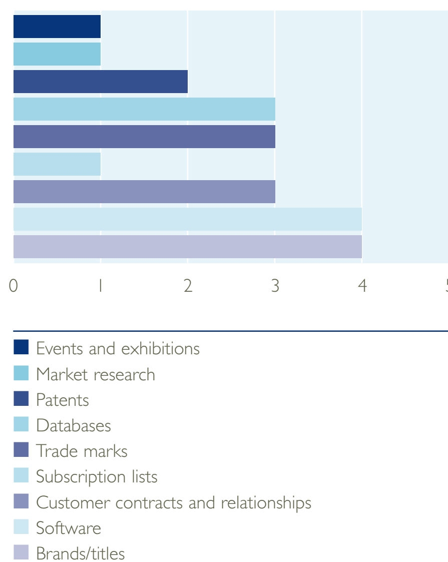
A major difference of IFRS 3 Business Combinations from UK GAAP is that it requires intangible assets that can be individually separated and reliably measured (eg customer lists, customer

relationships, brands) to be treated as intangible assets rather than just included as part of goodwill.

All six companies took advantage of the exemption granted by IFRS 1 not to restate prior year acquisitions under IFRS 3.

All six companies made acquisitions in this current year which has led to them identifying and reporting additional intangible assets as follows:

Types of intangible asset



Source: Financial statements

United Business Media plc specifically identifies six separate types of intangible asset in its note to the financial statements:

- Brands.
- Software.
- Customer contracts and relationships.
- Subscription lists.
- Trademarks.
- Databases.

These have an aggregate carrying value of £79.9m compared to the £Nil carrying value in the last UK GAAP financial statements.

In its disclosure concerning the impact of adopting IFRS the company states that some £50m of carrying value previously shown as goodwill is now classified as intangible assets.

The Media sector can expect an increase in the types and carrying value of intangible assets recorded in their balance sheet.

This will require companies to think carefully about obtaining supportable valuation at the time of a business combination and to consider what are the appropriate amortisation periods over which such intangibles should be written off.

Natural resources

There are six companies in our survey that are classed in the Oil and Gas sector.

IFRS 6 Exploration for and evaluation of Mineral Resources, although not effective until periods beginning on 1 January 2006, has already impacted upon these companies, as all six have adopted the standard early.

IFRS 6's objective is to provide an IFRS accounting policy for exploration and evaluation costs in respect of mineral resources, however the IASB acknowledge that it is a first step towards convergence of varying accounting practices around the world.

Of the six companies, two have continued using the full cost method of

accounting for exploration activities and four are using the successful efforts method.

Premier Oil plc is the only company of the six that has changed from full cost accounting under UK GAAP to successful efforts under IFRS and makes the following disclosure about the reasons for changing and the impact of such on their results:

"Premier previously announced its restated financial results for 2004 in accordance with International Financial Reporting Standards (IFRS). We also published a new set of group accounting policies which included the adoption of the successful efforts method of accounting for oil and gas assets which the Board believes provide a more transparent view of the performance of the group's producing assets and exploration activities.

Profit after tax for 2005 was US$38.6 million (2004: US$22.1 million) an increase of 75 per cent. Following the change to the successful efforts method this profit takes into account a write-off of US$20.6 million for unsuccessful wells drilled in India (Lakkhi-1), Pakistan (Maliri-1), Gabon (Iboga-1), Egypt (Al Fagr) and Mauritania (Espadon and Sotto). In addition, we charged US$17.0 million of pre-licence exploration expenditure to the income statement. The corresponding figures in 2004 under the same successful efforts policy were US$28.7 million and US$12.2 million respectively."

Burren Energy plc are one of the companies that has continued to use the full cost method its reasoning for this is:

"We consider that a full cost approach better reflects the medium term nature of exploration projects where the success or failure of individual wells does not necessarily reflect the value impact on the project taken as a whole."

The overriding objective of the disclosures under the standard are that they are relevant and reliable. It is likely therefore (although it is too early to be certain), that companies will be permitted to move from full cost to successful efforts but not vice versa.

The reasoning behind this is that under the IFRS framework the capitalisation of unsuccessful costs does not meet the definition of an asset. However IFRS 6 is clear that it does require companies to change from full cost if it was their previous accounting policy.

Key observations

For companies in Natural Resources industries we would expect over time a move towards the successful efforts method of accounting.

Pre-licence costs previously capitalised as intangible assets will be written off on adoption of IFRS 6.

More detailed and more frequent impairment reviews will need to be undertaken as the aggregation of pools of costs is at a much lower level than previously the case.

Real estate

There are nine companies in the survey in the Real Estate sector.

IAS 40 Investment properties has had a significant impact on the Income Statements of these companies as it requires gains from changes in the fair value of investment properties to be taken through the income statement.

For the valuation gains there is no impact on shareholders' equity in moving from UK GAAP to IFRS.

Under UK GAAP these movements were taken through the statement of recognised gains and losses (STRGL).

We look below at three companies in the survey and the impact of IFRS in the 2005 financial statements.

Net valuation gains	2005 £m	2004 £m
Slough Estates plc	409.1	166.7
Brixton plc	243.8	111.7
Great Portland Estates plc	171.3	48.4

Slough Estates plc disclose where these valuation gains have been shown either in the Income Statement or the statement of recognised income and expenses (SORIE) and also on which properties they have arisen:

The total net valuation gains for the period are shown in the financial statements as follows:

	2005 £m	2004 £m
Income statement	409.1	166.7
Statement of recognised income and expenses	48.4	24.1
Total valuation gains reported	457.5	190.8

And arise on the following properties:

Investment properties	423.3	175.8
Development and owner occupied properties	34.2	15.0
	457.5	190.8

The above gains that still have to be taken through SORIE are in respect of properties that are in the course of development.

For the valuation gains there is no impact on shareholders' equity in moving from UK GAAP to IFRS.

There is however a deferred tax implication for recognising such gains as IAS 12 requires a provision to be made for taxable temporary differences. Under UK GAAP no such provision is permitted.

The deferred taxation charged and therefore the resulting decrease in shareholders' equity was as follows:

Deferred tax charge	2005 £m
Slough Estates plc1	30.5
Brixton plc	68.1
Great Portland Estates plc	34.8

Real estate companies are further penalised by IFRS as they cannot recognise the deferred tax asset arising from indexation allowances.

Slough Estates plc highlights this in the following disclosure:

"A contingent tax asset of £93.6 million (2004: £90.7 million) relating to unused indexation allowance has not been recognised in the financial statements due to the restrictions in IFRS"

The financial statements then explain this restriction as follows:

"Summary of significant accounting policies" and within the policy titled 'Income tax' it states:" Indexation relief on land is recognised as a reduction of the deferred tax liability but not on buildings unless the properties are in the process of being sold."

Key observations

For companies in the Real Estate sector we would expect (given a market of rising property prices) increases in their reported income as revaluation gains on investment properties are shown in the Income Statement.

These gains would not increase shareholders' equity as these gains would have previously be shown in the UK GAAP STRGL.

We would instead expect shareholders' equity to decline as deferred tax has to be provided on these taxable temporary differences.

These deferred tax provisions cannot be reduced by indexation allowance on properties that are not being sold at the balance sheet date.

Travel and leisure

There are six companies in the travel and leisure sector. Of these two are in the gaming industry, three are in the transport industry and one is a hotelier.

The hotelier, **Millennium & Copthorne Hotels plc**, has both the investment property changes as described in the previous section, and the following disclosure about the impact of IFRS on its treatment of long leases of land and buildings:

"The Group has adopted the requirements of IAS 17 'Leases'. IAS 17 requires a lease of land and buildings to be considered separately between its land and building constituent parts. Land is only able to be treated as a tangible fixed asset, held under finance lease, where it is considered likely that the Group will obtain title to the land during or at the end of the lease term.

The Group holds a number of hotels under long leases where the title is not anticipated to pass to the Group under the terms of the lease. In respect of these leases, under UK GAAP, payment made on entering into or acquiring leasehold land and buildings was previously all included within tangible fixed assets and the cost less residual value was depreciated over the shorter of its lease length and useful economic life.

Under IFRS the initial payment made in respect of operating leased land is required to be accounted for as a prepayment and amortised in full over the lease term in accordance with the pattern of benefits provided."

The company goes on to disclose that this treatment has led to an additional amortisation charge above what would have been made under UK GAAP of some £8.2m. However shareholders' equity is unaffected as a matching credit has been taken to the revaluation reserve.

Of the three transport companies, two operate vehicles the other is a car rental company.

The companies that operate vehicles have been impacted by changes in hedge accounting under IAS 39 in trying to cover their fuel price exposure.

National Express plc discloses that it has some fairly complex hedging instruments using swaps in different fuels used to run its vehicles. We imagine this must require them to use some kind of regression analysis to accurately assess hedge effectiveness.

The disclosure in the financial statements states:

"The Group has a number of fuel price swaps in place to hedge the different types of fuel used in each division. Ultra low sulphur diesel and gasoil as used in the UK Bus, UK Coach, UK Trains and European Coach & Bus (Alsa) divisions is hedged by swaps in the same type of fuel. Diesel used in the North American division is hedged by heating oil swaps which have been determined to be effective hedges of the fuel used with a strong correlation in price movements between the two products."

The two companies in the gaming sector did not have any significant IFRS reporting issues.

Key observations

There are a number of very different industries within the Travel and Leisure sector, so the number of companies covered by our survey is quite small.

However hoteliers have been impacted by investment property revaluations and the resulting deferred tax provisions as set out in the Real Estate section above.

Companies with leased properties have had to reclassify payments in respect of land under operating leases as prepayments rather than tangible fixed assets and in a number of cases the amortisation of that prepayment to be greater than the previous depreciation charge.

For companies that operate transport, ie airlines, train, bus companies we would expect significant reporting under IAS 39 in trying to hedge their fuel cost exposures.

Support services

There are sixteen companies in the survey in this sector, however they cover a vary wide array of 'support' services. It is therefore difficult to determine any policies or disclosures which are common to most.

Nevertheless, our research has found some interesting disclosures from companies accounting for PFI projects under IFRS.

John Laing plc discloses how they have arrived at their accounting treatment:

"In the absence of an accounting standard relating to service concessions, the Group has interpreted the provisions of IFRS in determining the appropriate treatment of the principal assets of, and income streams from, PFI and similar contracts. Where it can be demonstrated that the balance of risks and rewards derived from the underlying asset are not borne by the Group, the asset created and/or provided under the contract is accounted for as a financial asset and is classified as available for sale, otherwise it is accounted for as a fixed asset."

For companies that operate transport, ie airlines, train, bus companies we would expect significant reporting under IAS 39 in trying to hedge their fuel cost exposures.

Interserve plc similarly discloses:

"The Group has determined the appropriate treatment of the principal assets of, and income streams from, PFI and similar contracts. Where the balance of risks and rewards derived from the underlying assets is not borne by the Group, the asset provided is accounted for as a financial asset and is classified as available-for-sale."

Serco Group plc in its Financial Review sets out the history and future expectations in respect of accounting for PFI contracts as follows:

"In March 2005 the International Financial Reporting Interpretations Council (IFRIC) issued a draft interpretation on accounting for service concession arrangements. These are arrangements such as PFI's, under which a government or other body grants contracts for the supply of public services – such as prisons or hospitals – to private operators. The IFRIC is still working towards a final interpretation which it expects to publish in the second half of 2006.

In the absence of specific guidance within IFRS, from 1 January 2005 we have recognised our PFI debtors at amortised cost, as defined by IAS 39. This maintains an accounting treatment consistent with UK GAAP and existing IFRS.

The draft guidance from IFRIC, if it were issued in final form, could require a number of changes to the accounting treatment of service concession arrangements. This could result in a significant increase in the carrying value of the Group's PFI debtors."

Key observations

Despite having sixteen companies in our survey which are defined as being in the Support Services sector, the range of services provided by them is so diverse it is difficult to determine any common policies or disclosures.

We would expect that future first time reporters that are involved in PFI contract work would set out how they have approached the accounting for such contracts given that no explicit accounting standard exists.

Specific accounting requirements will be set for such contracts sometime in 2006 but the effective date of such requirements is unknown.

7 Final conclusion

The companies included in our survey have faced significant challenges in adopting IFRS with no established practice in the UK to follow. Preferred treatments and disclosure approaches will only emerge over time.

Our survey shows that be it the Income Statement, particular International Standards or industry sectors there is still a large variation in approach and disclosure.

We can expect that over time these differences/inconsistencies will be removed to some extent by a combination of the development of common practice or by more prescriptive standards. One would hope however that legitimate variation through companies striving to present the underlying economic circumstances factor fully does remain.

Our survey shows that be it the Income Statement, particular International Standards or industry sectors there is still a large variation in approach and disclosure.

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