

The continued credit crisis has set in motion a raft of alterations to accounting standards. **John O'Neill** outlines these changes and their impact.

Crisis kickback



Jupiter

THE UK IS STILL battling the effects of the credit crunch. Some of the turmoil that hit the financial and insurance markets in the last quarter of 2008 is still present.

By comparison, equity markets in 2009 have been stable and rising; interest rates have been low and steady; credit default risks are better understood; and the currency markets are less volatile. There is some confidence in valuation methods for assets and liabilities and a widespread failure of available data and techniques to determine year-end values in the balance sheet is not expected.

Against this background, 2009 has seen the implementation of a range of accounting standards. Some are a reaction to events in 2008 while others are the continuing emergence and convergence of international standards. Many of these coming into force for this year end will affect both insurers and brokers.

For companies reporting under the International Financial Reporting Standards there have been a significant number of new standards and interpretations as December 2008 saw the end of a moratorium by the International Accounting Standards Board on the issuance of new guidance. These changes include, for companies adopting IFRS for the first time, a relaxation of the requirements in valuing subsidiaries or minority holdings (IFRS1).

The company can decide the accounting treatment to use for its investments on a case-by-case basis, potentially reducing how many sets of accounts it prepares. There are also changes in the treatment of vesting and non-vesting conditions for share-based payment schemes (IFRS2). This will require the company to review and possibly reclassify existing reports for employee benefits still in the grants vesting period.

In certain circumstances a revision to the fair value at the date of grant may be required. Disclosure requirements regarding valuation methods and liquidity risk are increased (IFRS7) for financial instruments.

The basis for determining fair values of

assets, including the source of information used, is classified into three levels. Disclosure is also made on movements between these levels. Liquidity risk requirements mean companies must show maximum exposure by instrument and prepare a maturity profile for the assets. In addition, for publicly traded companies, there is a new set of rules for segment reporting (IFRS8) designed to extend external reports to put them in line with internal management reporting.

For companies reporting under IAS there are parallel developments. One important change (IAS1) is that the 'statement of financial position' will replace the 'balance sheet' and the 'statement of cashflows' will replace the 'cashflow statement'. This change in nomenclature is not mandatory but use of the existing terms is clearly on the way out.

Of more substance is the introduction of a 'statement of comprehensive income'. This includes the income and outgoing components of the profit and loss account. It also includes, either in the same or as a separate statement, 'other comprehensive income'. This income includes unrealised gains and losses on saleable assets, deferred gains and losses on hedges and actuarial gains and losses on final salary pension schemes.

There are disclosure requirements where items are re-classified between the profit and loss account and the OCI statement. There is also a requirement to identify income tax for each component of the OCI.

Implementing these changes has required revisions to systems and procedures to capture the additional or existing information in a different way. The effort involved is further increased by the requirement to re-state prior balance sheets (or statements of financial position) plus notes where an insurer or broker has changed accounting policies or re-stated financials.

It is also an opportunity, welcome or unwelcome, to review the consistency of information in the accounts with other statements, such as press releases.

Other IAS1 amendments include changes in the disclosure requirements for equity holdings movements and dividend payment records. The aim of these developments is to improve the usefulness of financial statements. The inclusion of income and capital items in the same or similar schedules eliminates some of the weaknesses of the earlier regime.

One of the major challenges for financial reporting in 2008 was the large number of investment vehicles that were either not well documented or not well understood, at least by some of the parties involved.

Two standards address this: IAS32 and International Financial Reporting Interpretations Committee 9. There is a refinement (IAS32) to the definition of equity, which will allow companies to show as equity some investments previously shown as financial liabilities. There is also a new set of rules for classifying hybrid investments (IFRIC9).

For international companies there is guidance (IFRIC16) on hedging currency gains and losses in foreign operations and for companies re-structuring there is guidance (IAS27) on valuing acquisitions and reporting dividends. The dividend change is likely to accelerate profit recognition.

Some companies may also find they are caught up in changes to 'customer loyalty awards' (IFRIC13), where the loyalty award may now be accounted for separately. This could affect levels of reported profit with a knock-on effect to covenants and remuneration scales. Others holding property or running property funds could be adversely affected by new valuation rules for property development contracts (IFRIC15), which may defer income and dim performance.

All in all, the accountants are going to be extremely busy over the festive and reporting season.

POST

John O'Neill is a partner in the insurance team at Barnett Waddingham