

Global EYE on IFRS

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Executive summary

A message from David Lindsell, Ernst & Young's Global Director of IFRS Services

Welcome to the November 2005 issue of *Global Eye on IFRS*. In this eleventh edition of the newsletter we present the following articles:

- On page 2, we discuss Ernst & Young's position on the IASB's and the FASB's business combinations and consolidation proposals. In our view, the Boards have not made a sufficiently compelling case for the major changes they are proposing.
- Our technical focus article on page 5 considers entities completing the transition to IFRS and discusses the differing approaches undertaken on the road to IFRS conversion.
- At its September and October meetings, the IASB discussed financial instruments and continued its discussions on consolidation (including the controversial topic of de facto control) and performance reporting. At the joint meeting with the Financial Accounting Standards Board in October, the Boards discussed the conceptual framework, performance reporting and short-term convergence. The IASB highlights article on page 8 outlines those discussions.
- On page 10, we interview Erich Ammann, the Chief Financial Officer of Schindler Group, who discusses IFRS from a corporate management perspective. Erich describes how IFRS has impacted Schindler as a global organisation.

We welcome your feedback on *Global Eye on IFRS*. A complete list of Ernst & Young contacts can be found on page 14. The next issue of the newsletter will be published in January 2006 and will contain, amongst other items, an interview with Ernst & Young's global leader in the utilities industry sector. 

Executive summary 1

Featured article

Ernst & Young's position on the IASB and FASB business combinations and consolidation proposals 2

Technical focus

Completing the transition to IFRS—more to do 5

Technical focus

IASB highlights 8

Interview

IFRS from the perspective of corporate management 10

Resources 12

Contacts 14

Ernst & Young's position on the IASB and FASB business combinations and consolidation proposals

In June, the IASB issued exposure drafts of proposed amendments to IFRS 3 *Business Combinations*, IAS 27 *Consolidated and Separate Financial Statements*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*. If converted to standards in their present form, the proposals will change significantly the accounting for business combinations and the accounting for minority interest (now re-named 'non-controlling interest') transactions. The proposed amendments to IAS 37—which will also undergo a name change to *Non-financial liabilities*—will have an equally profound impact on the way companies account for contingencies.

The most significant of the proposed changes would result in:

- a fundamental change from the current, cost-based approach—whereby the cost of the acquired entity is allocated to the assets and liabilities assumed—to a fair-value based approach whereby the acquirer recognises the fair value of the whole of the acquired business, regardless of the acquirer's percentage ownership. This is likely to result in substantial grossing-up of goodwill and related minority interests in acquisitions involving less than 100%.
- recognising contingent consideration obligations at their acquisition date fair values, with subsequent changes in fair value generally reflected in profit and loss. This represents a significant change from the current practice of recognising contingent consideration obligations only when the contingency is probable and can be measured reliably.
- eliminating the terms 'contingent liability' and 'contingent asset' from accounting standards and the requirement to recognise 'contingencies' at their fair value where there is a related unconditional obligation (a liability) or unconditional right (an intangible asset). For example, litigation creates an unconditional obligation to perform as the court decides, and even though it may be unlikely that damages will be awarded, the obligation will have a fair value as it would be necessary to pay a third party to assume the risk.
- removing the reliable measurement criterion for intangible assets acquired in a business combination.
- expensing acquisition-related transaction costs.
- re-measuring to fair value and recognising in profit and loss gains or losses on a non-controlling interest held in the acquiree at the date control is obtained and, in the event of a partial disposal, at the date control is lost.

Substantially the same proposals have been issued by the US FASB as the objective of the two Boards is to achieve convergence of IFRS and US GAAP in accounting for business combinations.

In Ernst & Young's view, the Boards have not made a sufficiently compelling case for the fundamental change in approach to accounting for business combinations that they are proposing. Although we support the long-term objective of convergence on international and US accounting standards, the Boards need to demonstrate that proposals involving major changes in accounting practice will significantly improve the understandability, relevance, reliability and comparability of the information provided in financial statements. This is particularly true at this time, when preparers and users of financial statements in many countries are grappling with the challenge of conversion to IFRS and need a period of relative stability in accounting standards for preparers to embed their new accounting policies and processes and for users to become familiar with IFRS financial reports.

Due process

There are fundamentally different views of the proposals among the Boards' constituents around the world. These differences are the result of many factors, including differences from country to country in the extent to which non-controlling interests in subsidiaries exist, differences in how the reporting entity is viewed, differences in historical accounting background, different legal environments in which the proposals would need to be applied and differing perspectives on the use of fair value as an appropriate measurement attribute (and related differences in view regarding the reliability of fair value measurements for accounting purposes).

In view of these differences and given the magnitude of the proposed changes, as well as the significant number of organisations around the world that would be subject to them, we would have expected the Boards to publish a discussion document for public comment instead of proceeding immediately to issue exposure drafts of proposed amendments to the relevant standards. For the same reasons, we would have expected both Boards to have carried out more extensive field visits with preparers and users in order to understand the benefits—and assess the costs—that would result from implementing the proposals, as well as to learn about any practical difficulties that should be considered. In our view, more extensive field



visits with a geographically diverse sample of preparers and representatives of the investment community should be carried out and the proposals revised and re-exposed in the light of the findings.

View of the reporting entity

The proposals reflect a major shift away from viewing the primary purpose of consolidated financial statements as the provision of information for shareholders of the parent company (and accordingly focusing on *ownership* interests)—the so-called ‘parent company extension’ concept—and towards viewing financial statements as information about the resources *controlled* by the reporting entity—the so-called ‘economic entity’ concept. This change in how the reporting entity is viewed drives many of the specific changes proposed in the exposure drafts, including recognition of the non-controlling interest’s share of goodwill and the accounting for increases and decreases in ownership interests in a subsidiary after control is obtained.

While we agree that non-controlling interests do not meet the definition of a liability in the IASB Framework, we are not convinced that this should necessarily lead to the accounting that is proposed, and we believe that the Boards need to explain in greater detail the accounting theory and conceptual support for each approach, and the reasons why the economic entity view of the consolidated financial statements is believed by the Boards to provide information that is of greater value to users than the information provided by the parent company view.

Accounting for a ‘fair value exchange’ as opposed to the cost of a business combination

In our view, the Boards have ignored the measurement uncertainties associated with determining the fair value of an acquiree in a partial acquisition and also the inherent inconsistencies in the proposed approach for allocating goodwill to the non-controlling interest. The goodwill allocated to the acquirer’s interest is transaction-based, whereas the goodwill allocated to the non-controlling interest is simply the excess of the fair value of the acquiree as a whole over the fair value of its assets and liabilities and the goodwill allocated to the acquirer. As a result, the entire uncertainty associated with measuring the fair value of the acquiree will be reflected in the amount allocated to the non-controlling interest. Furthermore, the goodwill allocated to the acquirer will include any synergies unique to the acquirer reflected in the purchase consideration, but these are not reflected in the fair value of the acquired business. We do not understand how this can be regarded as sufficiently relevant or reliable to be recognised in financial statements.

The need for information about the Boards’ plans for other aspects of accounting for business combinations

The proposals would not achieve full convergence of IFRS and US GAAP in relation to accounting for business combinations. The concept of control currently differs as between IFRS and US GAAP and the IASB wishes to make significant changes

Continued on page 4

Continued from page 3

to it that would increase the differences, while the IASB has indicated that it intends to explore whether the 'fresh start' method might be applied to certain combinations when the FASB has already considered and rejected this method. In our view, preparers and users of financial statements need to be given sufficient information about the full scope of potential changes in accounting for business combinations in order to understand how current proposals might be affected by subsequent phases. Furthermore, the need to address known areas relating to business combinations in which IFRS is lacking, such as combinations involving entities under common control and the creation of joint ventures, is more urgent than the need to change the existing standard on business combinations.

Intangible assets acquired in a business combination

We do not share the Boards' view that all identifiable intangible assets can be measured with sufficient reliability to be recognised separately from goodwill. Active markets do not exist for most intangible assets or even for analogous assets, and in most cases there are few, if any, exchange transactions for similar assets (other than as part of a business combination). Furthermore, in deciding to remove the criterion of reliable measurement for intangible assets from IFRS 3, the IASB is ignoring the evidence of its own research into this issue.


We also have major reservations about the recognition of non-contractual customer-related intangibles acquired in a business combination. It is not clear to us how a vendor controls the economic benefit of an at-will customer relationship when the customer can stop purchasing goods or services at any time and solely at its discretion. In our view, the cash flows that are expected to be generated from these relationships are inextricably linked to the ongoing activities of the entity and are, therefore, part of goodwill.

Contingent consideration and contingent liabilities assumed in a business combination

As in the case of intangible assets, the Boards fail to acknowledge the practical difficulties of determining the fair value of contingent consideration. Indeed, true contingent consideration would not be used if it were possible for the parties to agree on the fair value of the acquiree. Accordingly, the Boards' assertion, that re-measurement adjustments subsequent to the acquisition date will relate to post-combination changes in the fair value of the contingent consideration (and should therefore be recognised in profit and loss), is flawed.

In the case of what are currently known as 'contingent liabilities' we have serious concerns about the possibility of measuring reliably the amount that an entity would rationally pay to settle a present obligation or to transfer a single liability to a third party, especially where the likelihood of an actual outflow of resources is low. As there are few actual transactions in which the risk associated with non-financial liabilities is transferred, measurement of such liabilities is likely to be highly subjective and of questionable reliability.

We are very doubtful whether the IASB's analysis of contingent liabilities in terms of conditional and unconditional obligations is workable. In particular, it seems to us that the requirement to fair value all unconditional obligations (regardless of the probability that they will result in an actual outflow of resources) could lead to the recognition of a large number of obligations in respect of all the laws and contractual arrangements that may potentially have been violated.

In any event, the removal of the recognition criterion of probability for non-financial liabilities is inconsistent with the definition of a liability in the IASB's *Framework for the Preparation and Presentation of Financial Statements*. The Framework is intended to assist the process of standard-setting and not to be overridden by it. 

Technical focus

Completing the transition to IFRS— more to do

For some organisations adopting IFRS, the transition has been the largest project ever led by the finance function. For others, the project has been less ambitious, but not necessarily less demanding. The varying approaches to conversion reflect two broad attitudes as to the underlying nature of this change, depending on whether the project has been approached as:

- a key business change programme, or
- a technical accounting exercise.

The approach adopted has usually been driven by the perceived level of required change and this, in the first instance, is driven by the relative alignment (or otherwise) of local GAAP to IFRS. Generally, the greater the commonality in accounting principles, the more likely that conversion has been seen as a technical accounting exercise. In certain countries (eg, the United Kingdom), many companies believe that IFRS has not resulted in much (unanticipated) change, whilst in others (eg, Germany and France) the impact has been much more pervasive.

Where finance functions have run their conversion project as a technical accounting exercise, other business functions and operating units have only been involved on an ‘as needed’ basis. This approach has been sufficient for the purpose of converting historical information and enabling ‘topside’ adjustments to previously published local GAAP numbers to be identified and calculated. However, whilst this approach is adequate as an interim measure, it is not viable for ‘live’ internal or external financial reporting.

Preparing for the year end financial reporting process

For first time adopters, whichever route to conversion they have followed, the preparation of the first set of financial statements under IFRS will provide the acid test as to whether the process was sufficiently complete and robust. Whilst many companies will now have dealt with the various measurement challenges through the IFRS restatement process and the preparation of interim accounts, the year end accounts mark another significant milestone as organisations tackle the many disclosure changes related to the implementation of IFRS for the first time.

To address this challenge, substantial preparation needs to be completed before year end. Ignoring this, or delaying until the financial year is over, will leave an entity at risk of errors, omissions and delays in reporting at year end, with the related reputational damage that this may entail. Key steps in pre-year end preparation should include:

- preparing a mock-up of the full year IFRS consolidated accounts, including full accounting policies and detailed notes; this will identify any gaps in the availability of data for disclosure purposes and any system changes required to capture the information that will need to be presented in the year end accounts
- revising the group accounting manual to incorporate all changes related to IFRS, rolling out the document and ensuring that subsidiary and business unit finance teams receive appropriate training in calculating and recording additional financial information required by IFRS
- considering additional disclosure requirements within the consolidated accounts stemming from local regulation and legislation (eg, the disclosures relating to subsidiary companies, directors’ remuneration or the separate financial statements of the parent company)
- addressing any new transactions and arrangements in the first year of adoption that were not considered during the initial transition phase or at the half year, including, for example, new awards under share-based payment schemes or recent acquisitions.

Organisations that have already embarked on this exercise are often surprised at the length of time taken to draw up and agree on the precise form and content of skeleton accounts, due in large part to the additional volume of disclosures required. In Ernst & Young’s experience, the areas causing the most concern are segmental reporting, related parties, impairment, share-based payment and financial instruments disclosures. Many of these areas require the disclosure of new information that has not been seen in the marketplace before, such as the assumptions related to future performance that are input into share-based payment valuation and impairment models.

Continued on page 6

Continued from page 5

Embedding IFRS into the business

For organisations that have chosen to treat the conversion to IFRS as a key business change programme, rather than a technical accounting exercise, a key objective has been to move IFRS beyond head office and embed it into the heart of the business. Experience to date confirms that, for such organisations, the conversion has required non-financial as well as financial personnel throughout the organisation to assist in the capture, processing and interpretation for IFRS reporting purposes.

Consequently, those entities that have to date treated the exercise as a technical accounting exercise must now make sure that all relevant functions throughout the organisation are educated and involved with IFRS on an ongoing basis. The impact of IFRS on these various functions includes the following:

- *Communications and public relations*—financial communications will have to explain the changes in the presentation of financial information, as well as the fundamental shift towards fair value accounting and its impact on traditional ratios and key performance indicators
- *legal*—in-house legal staff will need to support accounting staff in determining the IFRS accounting implications of contractual terms and conditions in accordance with IFRS; entities may need to revise their processes and systems for entering into, drafting, approving or monitoring contracts
- *treasury*—detailed hedge documentation and ongoing effectiveness testing is required to achieve hedge accounting under IFRS; participation may also be required from subsidiary treasury departments if they enter into their own derivative contracts
- *human resources*—the volatility caused by IFRS may mean that the calculation base for certain types of compensation (eg, profit sharing, bonuses, share option awards) needs to be adjusted; more fundamentally, there may be a need to carry out a strategic review of an organisation's reward and recognition schemes to take into account the different accounting requirements of IFRS
- *taxation*—the tax department will have to work closely with accounting staff to examine the IFRS impact of major transactions and any new financing structures implemented within the group
- *marketing and sales*—IFRS will impact a number of areas, including managing the portfolio of brands and trade marks now recognised on the balance sheet, determining

the net realisable value of inventories and reviewing sales contracts for revenue recognition issues, conditions of sale and embedded derivatives

- *production/R&D*—information from production/R&D personnel will drive accounting on a broad range of topics, including the definition of normal capacity and the measurement of inventories, determining the components of property, plant and equipment, and distinguishing between research and development phases.

What if you haven't started yet?

So far, this article has assumed that all organisations are making good progress with their conversion projects. In these cases, much time and effort will already have been spent in order to reach this stage in their conversion. In general, organisations have needed extra finance resources, lengthy consultation with advisors (eg, auditors, valuation specialists, actuaries), extra audit committee meetings to approve the significant accounting decisions and communication with investors and analysts to educate them about the main changes in the financial statements. In terms of the tasks undertaken to achieve conversion, they will have already:

- performed the substantial task of reviewing over 2,000 pages of IFRS standards and guidance to identify all areas where local GAAP (as applied to the parent company's financial statements) potentially differs from IFRS
- reviewed the 2004 consolidation in detail, surveying local reporting units where necessary, to determine areas of actual difference between the parent company's local GAAP and IFRS
- agreed on their revised accounting policies and the options in IFRS 1 *First-time Adoption of International Financial Reporting Standards*
- restated their prior year financial statements from local GAAP to IFRS and issued these figures, together with narrative explanation, to educate their investors to the changes in their financial statements
- issued their first half year financial statements under IFRS.

However, not all organisations are so far advanced and, for those who are required to adopt IFRS in 2005 but have not yet embedded IFRS into their routine internal and external financial reporting processes, time has virtually run out.



The good news for these organisations is they can learn from the early adopters and, with this in mind, Ernst & Young has developed a tool to kick-start the conversion process. The *IFRS Contingency Plan* includes project management tools, simple diagnostics, guidance on how to compile a manual of accounting policies, an example of financial statements prepared under IFRS and other useful reference materials including online IFRS training.

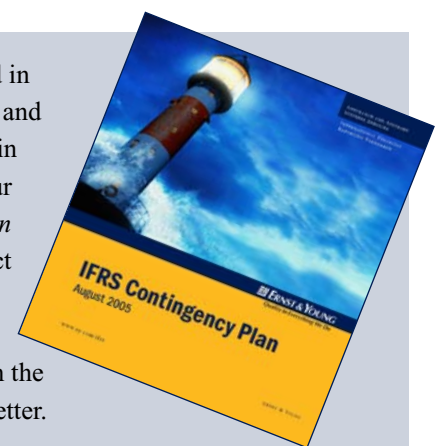
When will the process be over?

Whichever route is taken to IFRS conversion, many entities hope that the end is in sight and that they can look forward to a period of relative stability. This may be wishful thinking as there will continue to be significant changes in accounting practice as the new accounting framework matures. These changes will come from a number of sources, including:

- the evolution of generally accepted IFRS practice as a result of the practical application and interpretation of IFRS
- further major changes in accounting standards as the IASB moves towards convergence with US GAAP and enshrines its fair value, asset and liability accounting model in areas such as business combinations, consolidation and revenue recognition
- the amendment of local laws and regulations to accommodate the move to IFRS
- the increasing awareness of and engagement by stakeholders (in particular preparers and users of financial statements as well as regulators) in assessing the impact of adopted and proposed IFRS on the quality, reliability and relevance of reported financial information.

Entities will therefore need to keep up to date with IFRS-related developments, both within their industries and within their local markets, in order to ensure that their IFRS conversions weather the storms ahead. 🌐

If your entity is behind in its conversion to IFRS and you would like to obtain information on how our *IFRS Contingency Plan* can help, please contact the appropriate Ernst & Young representative listed on the last page of this newsletter.



Technical focus

IASB highlights

The IASB (the Board) met in London from 20 to 22 September and 18 to 20 October, and then again from 24 to 25 October in Norwalk, Connecticut (US) at a joint meeting with the Financial Accounting Standards Board (FASB). The Board discussed the following topics:

Financial instruments—classification of instruments denominated in a foreign currency

As reported in our July edition of *Global EYE on IFRS*, at its April meeting, the International Financial Reporting Interpretations Committee (IFRIC) concluded that a contract that will be settled by an entity delivering a fixed number of its own equity instruments in exchange for a fixed amount of foreign currency (such as a foreign currency denominated convertible bond and derivatives on an entity's own equity instruments settled by a fixed amount of cash denominated in a foreign currency) does not contain an equity component. The IFRIC had recommended to the Board that classification of such instruments as equity required an amendment to IAS 32 *Financial Instruments: Disclosure and Presentation*. (Refer to our April 2005 and July 2005 editions of *Developments in IFRS for financial instruments* for further discussion on this issue.)

In September the IASB decided not to proceed with an amendment to IAS 32 as it felt that in order to permit equity classification an amendment to IAS 32 would contain detailed and arbitrary rules. Therefore, indirectly, the IASB has confirmed the April 2005 IFRIC decision that a fixed amount of foreign currency is considered a variable amount of cash and, therefore, the instrument

should be classified as a liability. There will be an embedded derivative that requires separation and will create profit or loss volatility arising from changes in the entity's own share price and foreign exchange rates.

Draft technical correction – IAS 21 The Effects of Changes in Foreign Exchange Rates—Net Investment in a Foreign Operation

On 30 September 2005, the IASB issued the first Draft Technical Correction (DTC 1), with a 30-day comment period. DTC 1 proposed amendments to IAS 21 and is an example of the use that the Board plans to make of the technical corrections policy. Currently, IAS 21 permits intra-group loans, denominated in the same currency as the functional currency of either the parent or subsidiary, to be included as part of the reporting entity's net investment, if they are not likely to be repaid in the foreseeable future. DTC 1 proposes to expand the wording of IAS 21 to clarify that this includes loans between any members of the group (eg, between subsidiaries), and also to permit the loans to be denominated in any currency. This proposed amendment will allow many more funding structures to be accounted for as net investments in foreign operations.

Proposed technical correction – IFRS 1 First-time Adoption of International Financial Reporting Standards

At its October meeting, the IASB decided not to issue a technical correction eliminating the inconsistency in how a first time adopter is to treat deferred tax arising from a previously acquired intangible

asset in a business combination. Under IFRS 1 *First-time Adoption of International Financial Reporting Standards*, if an intangible asset acquired in a past business combination has been recognised in accordance with the company's previous GAAP, but no deferred tax liability was previously recognised, it is necessary on transition to IFRS to recognise the deferred tax liability and deduct it from opening retained earnings, instead of increasing goodwill (which is what is required by IAS 12 *Income Taxes*). The Board decided not to propose a technical correction to IFRS 1.

Revenue recognition

As discussed in the July 2005 edition of *Global EYE on IFRS*, the IASB had developed an approach under which an entity would recognise revenue when it discharges its contractual obligations to a customer and performance obligations would be measured at the amount an entity would have to pay to transfer the obligations to a third party (ie, the 'legal lay-off amount'). In contrast, the FASB was intending to pursue an approach under which performance obligations would be measured as the amount at which the good or service provided could be sold to a customer (this would normally equal the consideration received or receivable from the customer). In September, the Boards decided that total customer consideration should be allocated to each component of a contract that has utility to the customer, based on the price at which the underlying good, service or other right would be sold on a stand-alone basis, thereby reversing the IASB's previous decision on the measurement of performance obligations at the 'legal lay-off amount'.



Consolidation – control under IAS 27 Consolidated and Separate Financial Statements

The IASB continued its discussions on its consolidation project, the most important outcome of which was a statement made by the Board in the October *IASB Update* outlining its views on what is known as ‘de facto control’, given that they had recently become aware of differences in how IAS 27 might be applied in practice. De facto control can exist in circumstances in which an entity owns less than half the voting power in an entity and is achievable if the balance of holdings is dispersed and the other shareholders have not organised their interests in such a way that they exercise more votes than the minority holder. In the October *IASB Update*, the Board states that while some hold the view that IAS 27 requires an entity to have legal control over a majority of the voting rights to consolidate another entity, in its view, the control concept in IAS 27 includes de facto control.

The Board acknowledged that IAS 27 lacked guidance on this issue, thereby increasing the risk that two entities in the same situation may reach a different conclusion with respect to control. However, the Board is not proposing to amend IAS 27 by using any guidance under de facto control, preferring instead to wait until it is able to address all control issues with IAS 27 at one time. Therefore, the Board acknowledges that differences in the application of IAS 27

with respect to de facto control may persist up until the project on control is completed and an amended/replaced IAS 27 is applicable.

Reporting financial performance

The IASB discussed sweep issues in relation to the proposed amendments to IAS 1 *Presentation of Financial Statements*, some of which included:

- using the term ‘recognised income and expense’ instead of ‘comprehensive income’ when describing non-owner changes in equity
- naming the four primary statements:
 - statement of financial position
 - statement of changes in equity
 - statement of recognised income and expense
 - statement of cash flows
- permitting an entity to use alternative titles for its financial statements

The Exposure Draft of the proposed amendments to IAS 1 will have a comment period of 120 days and the effective date would be for accounting periods beginning on or after 1 January 2007.

Although the Board expressed its preference for a single statement of earnings and comprehensive income (now entitled ‘statement of recognised income and expense’), a majority of the Board would be willing to allow an entity the choice of presenting income and expenses in either one statement or two, provided the FASB also agrees to that proposal.


At the joint meeting, the Boards tentatively agreed that the statement of recognised income and expense should include a financing category, which would aggregate transactions and events of a financing type and would be applied consistently by all entities, excluding financial institutions. Further work will be undertaken by the Board in defining a financing activity.

Short-term convergence: borrowing costs

The Board decided to move to mandatory capitalisation of borrowing costs, thus removing the current option contained in IAS 23 *Borrowing Costs* allowing borrowing costs to be expensed. The IASB staff has been asked to prepare a paper for the Board outlining all differences between IAS 23 and SFAS 34 *Capitalization of Interest Cost*, enabling the IASB to decide whether or not it should make changes to the definitions of qualifying assets and interest costs to be capitalised.

The IASB recently issued the following discussion paper:

- Management commentary – the comment period closes 28 April 2006.

The information in this article is based on the observer notes and decision summaries published by the IASB following each meeting. 

IFRS from the perspective of corporate management



Erich Ammann
CFO of
Schindler Group

This month our interview is with Erich Ammann

Erich Ammann has been a member of the management committee and CFO of the Schindler Group since 1 November 2001.

Erich joined the organisation in 1988 as an area controller. From 1992 to 1997 he was CFO of Schindler USA and from 1997 he was group controller.

Erich obtained a degree in Business Administration from St. Gallen School of Economics and Business Administration in Switzerland, and in 1994 he gained an Executive MBA from the Wharton School at the University of Pennsylvania in the U.S.

In previous issues of *Global Eye on IFRS* we have interviewed Ernst & Young partners to get their perspective on a variety of IFRS-related issues. In this issue we examine IFRS from the perspective of a preparer of financial statements. *Global Eye on IFRS* recently spoke with Mr. Erich Ammann, Chief Financial Officer of Schindler Group, to get his perspective on how IFRS have impacted this global organisation.

Q. Why did Schindler convert to IFRS in 1999, and what has been your experience with the standards?

Before converting to IFRS, Schindler reported according to Swiss GAAP, which was not always easy for our local group companies and their external auditors to understand. By converting to IFRS, Schindler was able to introduce a well accepted and well known set of accounting standards world-wide. This helped tremendously to improve the quality of and to harmonise accounting and reporting in the Schindler Group. We also used the opportunity fully to align internal and external reporting, which enhanced operational management's understanding of our published financial statements.

The acceptance of IFRS was very good, both internally and externally. The higher transparency and clarity of IFRS were welcomed and improved our reputation in the financial press, with the analysts and with shareholders.

Overall, the experience has been very positive. The conversion phase was intense, but we used it as an alignment and training opportunity at the same time. With hindsight, it was worth the effort!

Q. Some commentators believe that the most recently issued IFRS are 'ivory tower' standards because the concept of 'relevance over reliability' has resulted in very theoretical, rather than practically applicable, standards. Do you agree?

I share the concern. It is a challenge to apply some of the new standards. In a global company like ours, we have to push the standards and their interpretation down to our local group companies. Some of the new concepts, based on fair value accounting, will be difficult to adopt and will lead to high implementation and training efforts. Their practical value for managing and understanding business developments is questionable.

Q. How do you view the introduction of the fair value model in a number of recent standards (eg, impairment testing, share-based payments, financial instruments) and the IASB's stated intention to develop other standards (such as business combinations) under the fair value concept, even though it may sometimes be difficult and/or arbitrary to determine fair values?

For many balance sheet items such as provisions and liabilities, it is difficult to evaluate the true market value because there is no permanent, reliable market available. We will have to develop mathematical models and make assumptions to determine the fair values. I am rather sceptical about whether this will enhance the quality and continuity of financial accounting and reporting.



Q. Schindler's financial objectives are determined based on earnings before interest and taxes (EBIT). When the comprehensive income statement is introduced, it will, a) result in a presentation where this number is no longer apparent, and b) bring significant volatility. Do you believe this is a good move, and how will it impact the way you communicate financial performance to investors and analysts? In other words, what is the best measure to determine performance under IFRS?

As I mentioned before, Schindler's internal and external reporting under IFRS has become integrated. The financial performance of our group companies is measured in accordance with the Management Result, which is equal to EBIT. Therefore, the alignment of internal and external financial objectives is very simple and transparent. I am afraid that this advantage may be lost with the new standards because only highly-skilled specialists at headquarters will be able to understand the comprehensive income statement. Already interpreting IFRS 3 *Business Combinations* has led to uncertainties and concerns from our line managers. Similarly, communicating with investors and analysts may become more difficult because there will be a greater scope for interpretation.

Q. Convergence, particularly with US GAAP, will also add complexity to IFRS. Do you believe further convergence with US GAAP is beneficial to European companies despite the additional complexity and volatility, or should another model be found?

In my opinion the convergence between US GAAP and IFRS is positive. It has helped us to streamline the accounting in our US operation. However, it cannot

be a one-way street. Under IFRS, there is scope for practical adaptation to the needs of business and industry. These positive aspects of IFRS should not be given up.

Q. IFRS require additional disclosures. Are you in favour of this? Are you concerned that some of your competitors are part of conglomerates and, therefore, do not have to provide the same level of detailed disclosures as you are required to provide about your core business?

I accept the requirement for additional disclosures. It provides more transparency for shareholders and investors. The requirements of the new standards will not lead to fundamental changes in our accounting systems. However, we will need to ask our group companies for additional information, which will have to be consolidated at headquarters.

Our industry is very mature and concentrated. It is true that some of our global competitors are divisions of large conglomerates, therefore, transparency is much lower compared to what Schindler has to provide under IFRS. This is certainly a concern.

Q. If you could meet with the IASB, what messages would you give them?

In my opinion, the IASB should consider a break before increasing the complexity of financial reporting. They have done a good job so far and the standards that they have issued are generally excellent. However, a period of consolidation is now required. This would allow companies and their audit firms to fine tune the interpretation and the application of the existing standards, which can only be positive for the quality and reliability of financial reporting. 🌐

The Schindler Group is based in Switzerland and quoted on the Swiss Stock Exchange. It has two major business divisions—Elevator & Escalator (E&E) and ALSO.

Schindler's E&E division is a worldwide operation, with local companies in all major markets. It is the world's leading supplier of escalators and moving walks. On a worldwide scale, the Swiss-based company is the second largest supplier to the elevator and escalator industry. Operating revenue of the E&E division amounted to CHF 6,4 billion (US\$ 5.2 billion) in 2004.

ALSO, a Swiss-based leading independent distribution and logistics company for information and communication technology, is also present in Germany. The organisation was founded in 1984 and has been listed on the Swiss Stock Exchange since 1986. ALSO's operating revenue amounted to CHF 1,9 billion (US\$ 1.5 billion) in 2004.

Schindler converted to IFRS in 1999 and, therefore, has six years experience of IFRS reporting.

Resources

What's New

Good Group (International) Limited, International GAAP® Illustrative Financial Statements for 2005

This updated publication contains the annual report and consolidated financial statements of a fictitious company, Good Group (International) Limited. Each part of the financial statements is cross-referenced to the source authoritative literature with annotations and commentary. It incorporates all IFRS in issue as of 31 May 2005. Therefore, it will be useful for entities converting to IFRS and also to existing IFRS users who are looking at the changes impacting them from 2005. This publication illustrates how IFRS accounts will be presented for the year ending 31 December 2005.



International GAAP® Disclosure Checklist 2005, for financial periods ending 31 December 2005

This checklist covers all standards and interpretations applicable to accounting periods beginning on 1 January 2005 (that is, it has been designed to deal with 31 December 2005 year-ends, and not year-ends ending thereafter). The checklist takes account of all IFRS guidance that was approved before 31 August 2005. In addition to the mandatory disclosure requirements this checklist also includes the encouraged and suggested disclosure requirements under IFRS. The checklist is available online, offline and via a downloadable PDF file.



IFRS – The implications for European banks

In the lead up to the interim reporting season in Europe, many listed European companies have released disclosures in relation to the impact of IFRS on their financial statements. This publication provides a summary and analysis of disclosures made by the 20 largest European banks by market capitalisation.



Development in IFRS for financial instruments

This newsletter summarises the main conclusions and Ernst & Young's interpretation of discussions relating to financial instruments at the IASB and the International Financial Reporting Interpretations Committee meetings held in September and October 2005. You can download a copy at ey.com/ifrs.





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- IFRS™/US GAAP Comparison – provides a comprehensive financial reporting reference which compares and contrasts the requirements of International GAAP and US GAAP. (1 user subscription – £150.00 or €220 annually)
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- International GAAP® Disclosure Checklist 2005 – this electronic checklist shows the disclosure and presentation requirements under IFRS, along with relevant guidance on the scope and interpretation of certain disclosure requirements. Available with any IFRS-related subscription.
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