

## Coping with IFRS



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Chris Higson, London Business School<sup>1</sup>  
Mark Sproul, Company Reporting<sup>2</sup>

Since January 2005 all listed firms within Europe must produce their group accounts using International Financial Reporting Standards (IFRS). Changing from national GAAP to IFRS is an immense undertaking for firms, but it is a big step towards a more sensible world where the financial statements of firms are comparable wherever those firms happen to be located.

IFRS has generated a lot of anxiety among investors, who have suffered some nasty accounting surprises in recent years and can be forgiven for fearing that IFRS will bring some more. Most firms have been very slow to reduce investor uncertainty. For instance, the Committee of European Securities Regulators (CESR) asked firms to indicate the major differences they anticipated under IFRS in their 2003 annual reports, but a full two thirds of Europe's largest firms failed to provide any meaningful discussion.

This paper suggests how users of financial statements should deal with the challenge of IFRS. The first step is to recognise that, though IFRS brings many detailed changes, its substantive effects on the appearance of the financial statements will be relatively few. We have a good idea what the main effects will be, and analysts can judge their scale and sectoral impact by looking at the significant number of firms across Europe that already report under IFRS. Moreover, a number of the substantive IFRS changes have been well trailed and firms already disclose the data needed to estimate their impact, so they should not surprise an alert analyst who has been following the accounting debate over recent years. We would include the cessation of goodwill amortisation, full recognition of pension liabilities, and expensing of stock options in this group. Two areas stand out as having significant continuing uncertainty associated with them - the treatment of financial instruments, and of deferred tax – and we would counsel analysts to focus their attention on these.

The increased use of fair values and of impairment reviews in IFRS will make firms' income more volatile, and in a number of areas IFRS requires much more disclosure than hitherto. There has been a tendency in the past to deal with the apparently transitory and exceptional components of a firm's income by just ignoring them. Increasingly, IFRS challenges analysts to develop their techniques for extracting the information contained in volatility and in increased disclosures.

## Reasons To Be Calm

### **IFRS should already be well understood**

Given some of the current debate one might think that IFRS had been pulled out of a hat. On the contrary, IFRS is a body of accounting rules that, with just one or two exceptions, is the product of a long gestation and its conceptual basis has been much debated and should be familiar. Moreover IFRS is firmly in the Anglo-Saxon accounting tradition and embodies much of the recent evolution in UK GAAP and US GAAP.

Some of the departures from existing UK practice - for instance, impairment rather than amortisation of goodwill, the abolition of pooling - reflect IFRS sensibly aligning with US

<sup>1</sup> Chris Higson is a professor at London Business School. Contact: [chigson@london.edu](mailto:chigson@london.edu); London Business School, Regents Park, London NW1 4SA, United Kingdom. This paper is available at [www.london.edu/faculty/chigson](http://www.london.edu/faculty/chigson).

<sup>2</sup> Mark Sproul is at Company Reporting. Contact: [mark.sproul@comrep.co.uk](mailto:mark.sproul@comrep.co.uk); Company Reporting Ltd, 11 John's Place, Edinburgh EH67EL, United Kingdom, [www.companyreporting.com](http://www.companyreporting.com). © Chris Higson March 5th 2005

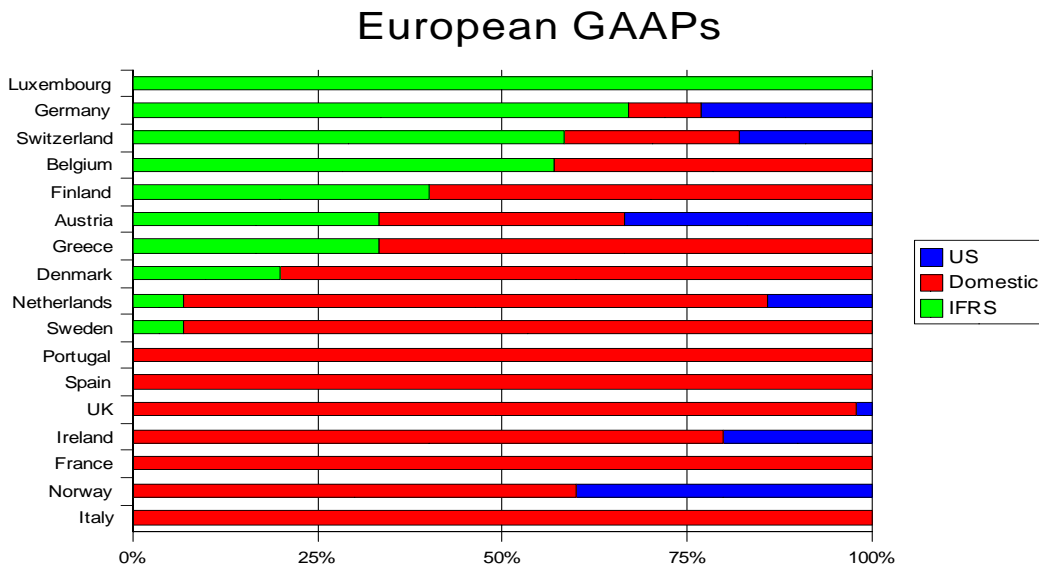
GAAP in key areas. In consequence, IFRS and US GAAP are already quite close and final convergence should not be a big step. It is notable that some European firms that have been using US GAAP but are now adopting IFRS report a relatively minor impact.

Takeover accounting provides a good example of how an accounting change can be quantitatively large in its impact – for instance the abolition of goodwill amortisation – but innocuous. The debate on the accounting treatment of takeovers, and of goodwill and intangibles, dates from the 1980s. The alert analyst will almost certainly have developed a method of working that is robust to differences in the treatment of goodwill impairment and amortisation. Many analysts now show goodwill amortisation separately, strip it out of headline earnings, or both.

In the relatively new areas of accounting for stock options and for pension liabilities UK GAAP and US GAAP are following a similar script to IFRS but have not implemented it yet. Even here, there has been extensive debate and in some cases firms already make footnote disclosures of the data they would have to report under IFRS. However, the standards related to disclosure (IAS 32) and recognition (IAS 39) of financial instruments are some of the more controversial elements of IFRS, and we discuss these later.

### IFRS is already being used

UK firms have not yet been permitted to report fully under IFRS but, elsewhere in Europe and beyond, many of their peers have already adopted IFRS and these firms provide useful case studies. The chart below shows that by 2003 one in five FTSEurofirst 300 firms (the largest European firms by market capitalisation) were already reporting under IFRS. The extent of adoption differs widely by country - 60% of large firms in Belgium, Germany and Switzerland have already adopted IFRS, while in Spain, Portugal, Italy, and France no firms have yet done so.



Source: [www.companyreporting.com](http://www.companyreporting.com)

The chart highlights another important fact, which is the number of large European firms that use US GAAP; 10% overall in the FTSEurofirst 300. German GAAP, in particular, has often been used by commentators to exemplify the differences between ‘code law’ accounting systems and ‘common law’ systems such as US GAAP and UK GAAP. But globally ambitious German firms have already migrated away from German GAAP, following the lead of Daimler Benz. By 2003 67% of the largest German firms were using IFRS and 23% US GAAP, leaving only 10% following German GAAP.

A few large UK firms had issued a detailed assessment of the likely impact of IFRS by the end of 2004, and by February 2005 around 10% of the UK FTSE 100 had briefed analysts on the impact of IFRS. Thus far, pro-forma disclosures show some significant IFRS effects, but a modest impact on earnings overall. From these disclosures, and also from a thorough review of the financial statements of European firms that already use IFRS, the following areas consistently emerge as significant:

- share-based payments
- goodwill amortisation
- deferred taxation
- financial instruments
- recognition of pension liabilities

We discuss each of these in more detail below.

Banks and pharmaceutical firms have been to the fore in providing helpful guidance on IFRS to investors. In part, this may reflect the high level of speculation among commentators about the impact of IFRS on these two sectors; in the case of pharmaceutical firms, the impact of accounting for intangibles, and in the case of banks uncertainty in relation to IAS 39 and the use of fair value accounting.

- *GlaxoSmithKline* reports the difference between its 2003 UK GAAP and IFRS profit before tax as £0.3 billion (5%) mainly as a result of recognising a charge for share-based payments. Balance sheet net assets are reduced by £0.2 billion to £5.6 billion.
- *AstraZeneca* shows a decreased eps of \$0.02 and a decrease in net assets of US\$48 million to US\$13.2 billion.
- *RBS* applied IFRS to its 2004 results and estimated that basic earnings would increase by more than 10%, principally as a result of goodwill no longer being amortised. Balance sheet ‘footings’, that is total assets, and the total of liabilities and shareholders funds, have increased by £100 billion (22%) although shareholders’ funds remain largely unaffected.
- *Barclays* estimates that profit before tax will increase by £125 million (3%) whilst shareholders’ funds fall by £1.3 billion (7%). Balance sheet footings increase by £141 billion (30%).
- *Northern Rock* estimates that IFRS would only have led to a small variance on 2004’s restated pre tax profits.

Other companies who have briefed investors include:

- *Vodafone* will no longer charge £7.3 billion amortisation of goodwill, the main contributor to turning a pre tax loss of £2.2 billion for the six months to 30 September 2004 into a pre tax profit of £4.5 billion.
- *British Land's* contingent tax has the most notable impact increasing provisions and reducing net assets by £710 million (9%).

- *ICI* shows an increase of 22.3p in basic earnings per share to 40.1p whilst the balance sheet moves from net assets of £808 million to net liabilities of £247 million. The reduction in net assets is a result largely of its pension liability of £1.2 billion.
- *Xstrata* will recognise a deferred tax liability of US\$1 billion, which will reduce shareholders' funds by 15%.

## Understanding IFRS

In this section we discuss how IFRS is likely to affect the appearance of the balance sheet and income statement. Unless otherwise stated, the comparison is with UK GAAP. We are not attempting a comprehensive description of IFRS here, but simply to flag the main issues. We examine the impact of IFRS in terms of balance sheet completeness, presentation and valuation, and then discuss its impact on the income statement and, finally, segment disclosure.

### Balance sheet completeness

One of the most challenging issues for any GAAP system is where to mark the boundaries of the firm. In practice this presents itself in two areas in particular - tests for the consolidation of subsidiaries, and tests for a finance lease. IFRS does not significantly change the definition of a subsidiary, though it does permit proportional consolidation of joint-ventures (IAS 31 "Investments in joint-ventures"). Though IFRS (IAS 17 "Leasing") may lead to a reclassification of some leases it does not, at present, propose radical reform of operating lease accounting.

### Employee benefits

The failure to recognize pension liabilities has been a major omission in existing GAAP. Probably the most significant way in which IFRS enhances the completeness of balance sheets is the requirement for firms to recognise their pension liability or asset in full in the balance sheet (IAS19 "Employee benefits"). Since almost all UK firms still have a net pension liability, balance sheet recognition has a widespread and often very large impact. For example, *Allied Domecq* has adopted FRS 17 and recognised net pension liabilities of £387 million which cut its shareholders' funds by some 40%. *National Grid Transco* disclosed a net pension liability of £1.6 billion and had this been recognised, shareholders' funds would have reduced by 106%.

Those few firms that have adopted UK FRS 17 "Retirement benefits" in full already recognise their pension liabilities and the remainder provide transitional footnote disclosure of surplus or liability. In consequence, analysts are already able to ascertain the impact that recognising pension liabilities will have on the balance sheet<sup>1</sup>. [*References are to notes containing further details and examples, at the end of the paper.*]

### Deferred taxes

IFRS (IAS 12 "Income taxes") requires fuller deferred tax provisioning than under UK GAAP, for two main reasons. Firstly, while under UK GAAP deferred tax is recognised only in respect of timing differences, IAS 12 recognises temporary differences that can arise from both timing and permanent differences. Second, IFRS requires that provisions be made even when the critical events that would cause deferred tax to become payable have not occurred

by the balance sheet date. Both these factors generally increase the charge to profit. At present, discounting deferred tax in the UK is the benchmark treatment of utility companies although most others tend not to discount the liability. However, the option to discount is removed.

The wider scope of IAS 12 and the withdrawal of discounting will increase the deferred tax provisions recognised in the balance sheet, at the expense of shareholders' funds. Some of these deferred tax changes are complex and will be hard for analysts to predict<sup>ii</sup>.

### **Recognition of intangibles**

The exclusion of home-grown intangibles has long been the main source of incompleteness on the asset side of balance sheets and some commentators have argued that IFRS allows firms to capitalise internally generated intangible assets. If so, this would be a major change; but this aspect of IFRS has been greatly exaggerated. IAS 38 "Intangible assets" encourages firms to recognise a wider range of *acquired* intangibles, at the expense of residual goodwill. But it maintains continuity with the long-standing approach of Anglo-Saxon accounting towards home-grown intangibles. That is, the costs of building intangibles should be generally be expensed, but the development element within R&D expenditure might be capitalised and amortised.

The change is that capitalisation is now required rather than permitted for development expenditure that meets certain tests. This parallels the treatment of software development in US GAAP, though the category of qualifying expenditure under IFRS is somewhat broader. For those that capitalise there will be a one-off effect, increasing net assets in the opening balance sheet. Thereafter, impairment testing introduces the potential of increased volatility in income. We review the evidence from early adopters in a note<sup>iii</sup> – the impact of development capitalisation is quite limited and highly sector specific.

### **Balance sheet presentation**

IFRS affects the presentation of the balance sheet in several ways. A fundamental presentational principle concerns 'netting'. IFRS (IAS 32 "Financial instruments: disclosure and presentation") 'un-nets' some assets and liabilities that UK GAAP would traditionally allow to be carried in the balance sheet net, for example, deferred tax assets and liabilities. The gross presentation affects balance sheet 'footings' but not net assets or equity. Banks are especially affected by un-netting; for instance, as noted above, *RBS* expects its balance sheet footings to increase by £100 billion (22%), as a consequence of the stricter netting rules.

A balance sheet presentational effect that will affect the debt/equity ratio of some firms is IAS32's elimination of the intermediate 'non-equity shareholders' funds category – hybrids such as preferred stock and convertibles now have to be allocated to debt or equity or partitioned into their debt and equity components.

### **Balance sheet valuation**

An important feature of IFRS is the increased use of fair values in the balance sheet. Again, IFRS is in line with the trend in UK GAAP and US GAAP on this, but takes it further in one or two areas, particularly relative to UK GAAP. So, for example, IFRS (IAS 41 "Agriculture") requires firms that have biological assets such as forests and plantations to recognise them at fair value. This will have a significant impact on the balance sheet of certain firms. For example,

*Stora Enso* has adopted IFRS already and the effect of recording forestry assets at fair value was to increase its net assets by €706 million to €1.6 billion. The use of impairment reviews rather than amortisation for goodwill is also a form of, downward only, fair valuation. Like UK GAAP, but in contrast to US GAAP, IFRS (IAS 16 “Property, plant and equipment”) allows but does not require the fair valuation of tangible fixed assets and, under certain circumstances, the fair valuation of intangibles. Though in principle this is an important source of difference with US GAAP, in practice there appears to be very little appetite amongst firms for the revaluation of fixed assets.

### **Financial instruments**

The IFRS standard that remains most controversial and unclear in its potential effects is IAS 39 “Financial instruments: recognition and measurement”. IAS 39 will affect any firm with financial instruments and derivative positions, and particularly banks and insurance firms. There are two sources of uncertainty; one is that the standard requires certain types of financial instruments, including derivatives, to be fair valued that would hitherto have been carried at cost, with a potentially significant impact on the income statement and the balance sheet and on transparency. The second is that the rules themselves are not yet finally agreed. The EU endorsed a version of IAS 39 that carved out clauses on full fair value and portfolio hedging, leaving some confusion as to the impact of IAS 39. A revised version of IAS 39 was issued in December 2003, and a further exposure draft limited the use of the fair value option to specified situations. Until this is finally resolved some non-comparability will remain, with some firms adopting full IAS 39 and others IAS 39-lite<sup>iv</sup>.

### **The income statement**

Discussion of the impact of GAAP on the income statement, particularly in the context of creative accounting and accounting fraud, tends to focus on revenue recognition and cost capitalisation. In terms of routine revenue recognition, there appears to be little substantial difference between IFRS (IAS 18 “Revenue”) and existing UK GAAP as embodied in Application Note G to FRS 5 “Reporting the substance of transactions”. In terms of cost capitalisation, IFRS also brings little change save for the impact of capitalising development expenditure in certain sectors, as discussed earlier.

However, IFRS has other effects on the income statement that are significant; in particular, the requirement to expense the fair value of stock options used in compensation, and the abolition of goodwill amortisation. More generally, the main reason that fair valuation in the balance sheet is controversial is that firms take some of the changes in fair value directly to income, making income correspondingly more volatile. These are sources of additional income volatility in IFRS, as is the effect of replacing goodwill amortisation by annual impairment reviews.

### **Share-based payments**

IFRS 2 “Share-based payment” introduces a major change in practice as firms must charge the fair value of equity instruments to income. For example, *AstraZeneca* expects IFRS to reduce its profit before tax of £3.1 billion by £136 million. Not all firms expect an impact of this magnitude and its impact depends entirely on the extent to which any individual firm

uses stock-based compensation<sup>v</sup>. This is a change that has been well trailed, and analysts have sufficient data to estimate the effects of this change.

### **Goodwill amortisation**

IFRS (IFRS 3 “Business combinations”, IAS 36 “Impairment of assets”) adopts US practice in requiring goodwill to be carried unamortised but tested for impairment at least annually<sup>vi</sup>. Since almost all UK firms (94% of listed firms) that have goodwill amortise it, cessation of goodwill amortisation will increase the measured income of those firms. The removal of goodwill amortisation will have a particularly large effect in sectors, like information technology, that tend to amortise goodwill over a short period. Since firms already disclose their goodwill amortisation charges, the IFRS3 uplift to profit is predictable. However, firms are now at increased risk of countervailing impairment charges, so a predictable charge is replaced by one that is not easily predictable by investors.

### **Segment disclosure**

Though we have discussed the impact of IFRS on recognition and measurement, an important question is whether IFRS is also likely to bring forth greater disclosure. IFRS (IAS 14 “Segment reporting”) promises enhanced segment reporting; disclosures are required in respect of both the primary and secondary basis of segmentation and, for the primary basis of segmentation, the cost of property, plant and equipment, and intangible assets acquired for each segment during the period. Firms will no longer be able to utilise the UK GAAP exemption that disclosure would be seriously prejudicial to their interests. It remains to be seen to what extent this brings forth valuable additional disclosure be firms.

## **Summary – Coping With IFRS**

IFRS comprises some 2000-plus pages of accounting regulations and, at the level of detail, there are a lot of differences between IFRS and its predecessor national GAAPs. Frequently the new rules seem just arbitrarily different, which is an inevitable consequence of shifting everyone onto a common standard.

In this paper we discussed how users of financial statements should cope with the challenge of IFRS. The first step is to identify those changes that are likely to have a significant impact on the appearance of the income statement and balance sheet. A reading of IFRS, and a detailed review of firms across Europe that have already disclosed IFRS numbers, suggests that these differences are in fact relatively few. The analyst should then ask the rather different question - which of these differences actually contain information, and have the potential to surprise? We argued that relatively little of the IFRS restatement should be threatening to an alert investor who has been following the accounting debate over recent years. Three of the most significant IFRS changes – cessation of goodwill amortisation, full recognition of pension liabilities, expensing of stock options – have been well trailed and analysts are already getting sufficient disclosure from firms to estimate the impact of these changes. Two areas stand out as having significant continuing uncertainty associated with them - the treatment of financial instruments and of deferred tax.

Analysts will need to become comfortable with handling increased earnings volatility in the future, and in dealing with rather greater levels of disclosure. There has been a tendency

amongst analysts to deal with the transitory and exceptional components of income by just ignoring them and by relying on incomplete income measures like EBITDA or pre-exceptional operating profit. The increased use of fair values and of impairment reviews under IFRS will make it harder for analysts to do this. This is one of a number of positive aspects of the direction in which IFRS takes firms.

Given the size of the task and the slowness of many in getting started, we suspect that some firms will struggle to meet their IFRS reporting timetable. But we argued in this paper that, from a user perspective, 'IFRS anxiety' has been overdone. The transition to IFRS means additional work for analysts but, with preparation, the potential for unpleasant surprises should be limited. Of course, we acknowledge that at the level of the individual firm there will always be some surprises and in 2005 some of these will be 'IFRS surprises' where the different lens of IFRS has revealed a facet of the firm that was unexpected. Finally, of course, we cannot legislate against the ability of some analysts to be surprised by things they could have known.

## Endnotes

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### <sup>i</sup> Pension liabilities

Under IAS 19 "Employee benefits" firms are required to recognise pension assets and liabilities in full in the balance sheet. Although the liability will be recognised from the transition date onwards, the initial impact will be the most significant with subsequent periods reflecting only the fluctuation in the difference between the fair value of pension assets and pension liabilities.

Hitherto, UK firms have not been required to recognise their pension scheme surplus or liability. At present, they account for their pension schemes under SSAP 24 "Accounting for pension costs" and must provide transitional footnote disclosure of surplus or liability under UK FRS 17 "Retirement benefits" if they have not yet applied it in full. By May 2004, only 7% of the FTSE 350 had adopted FRS 17 in full, although more firms have done so recently. Although FRS 17 and IAS 19 are broadly similar, one difference is the "corridor" method in IAS 19 which allows firms discretion in recognising movements of less than 10% in their pension positions, though firms retain the option to recognise actuarial gains and losses in full in line with FRS 17. Since the most UK firms still have a net pension liability, adoption of IAS 19 will result in an almost global decrease in shareholders' funds unless firms have already adopted FRS 17 in full. For example, *Allied Domecq* and *Associated British Foods* have adopted FRS 17 and recognised net pension liabilities of £387 million and net pension assets of £58 million respectively. For *Allied*, recognition of the liability has cut its shareholders' funds by some 40% but for *British Land* there is a modest rise of 2%. However, for some firms the impact will be very large. *National Grid Transco* disclosed a net pension liability of £1.6 billion. Had this been recognised, shareholders' funds would have reduced by 106%. *AEA Technology* disclosed a net pension liability of £153 million which would have reduced shareholders' funds to negative £142 million. *British Airways'* £1.2 billion net pension liability would have reduced shareholders' funds by 92%, and *BT's* £3.6 billion liability would have reduced shareholders' funds by 142%.

### <sup>ii</sup> Deferred tax

The impact of the deferred tax standard is likely to vary significantly from firm to firm. For example, in contrast to French GAAP, IAS 12 requires the recording of deferred tax liabilities pertaining to intangible fixed assets recognised on business combinations, and prohibits the discounting of deferred tax. *Lagardère* expects to record additional deferred tax provisions of €270 million under IFRS. Upon adoption of IFRS, *Xstrata* will recognize a deferred tax liability of circa \$1 billion in respect of the difference between the carrying value of mineral reserves and resources on the balance sheet and the tax base. This will reduce shareholders' funds by some 15%.

### <sup>iii</sup> Capitalisation of intangible assets

Just from a reading of IFRS alone, it would be hard to predict which sectors have development expenditure that is likely to meet the tests and what the scale of any resulting capitalisation would be. Hence the study of early adopters

is invaluable here, and suggests that the standard is likely to impact sectors such as general industrials, consumer goods and automobiles, but not health care firms and pharmaceuticals.

*Novartis* has been reporting under IFRS for at least the last four years and has at no point capitalised development expenditure despite, in its latest annual report, a US\$4.2 billion charge for research and development expenditure. *AstraZeneca* and *GlaxoSmithKline*, with research and development charges of US\$3.5 billion and £2.8 billion respectively, have indicated that the uncertainty of the work they do means that capitalisation is not an option. On the other hand, the aerospace manufacturer *EADS* already reports under IFRS and capitalises some development expenditure. Although analysts expected this to have a retrospective impact, the firm did not have systems in place to gather the necessary information, so no prior year adjustment was made. In its latest annual report *EADS* shows development costs capitalised of €4 million, compared to research costs of €2.2 billion and profit before tax of €692 million. *Rolls-Royce* will be in a similar position when it moves from UK GAAP to IFRS. *Rolls-Royce's* latest annual report showed a total research and development spend of £281 million and profit before tax of £180 million. Car manufacturers are also capitalising development under IFRS. *BMW* already follows IFRS and carries capitalised development of €4.9 billion on its balance sheet which has incurred amortisation of €0.6 million during 2003, in contrast to €1.6 billion expenditure expensed immediately, and profit before tax of €3.2 billion. *Renault* has already adopted IFRS where it does not conflict with French GAAP and under IFRS 38 capitalises development costs that are then amortised over 5 years. Consequently, *Renault* carries €1.2 billion of development assets less amortisation of €96 million. *Renault* wrote off €1.1 billion straight to profit and loss account leaving it with a €3 billion profit before tax. This year *Fiat* expensed €1.7 billion research and development compared to its €1.3 billion loss before tax.

#### iv **Financial instruments**

*Munich Re* is one of only a few firms to adopt early IAS 32 and IAS 39 revised. The provision of deferred premium refunds is recognized in the opening balance of revenue reserves and other reserves and reduces prior year profit by €793 million. The Swiss financial services firm *UBS* has decided to adopt these revised standards from 1 January 2004. Because IAS 32 restricts the use of netting, certain replacement values that have been previously offset will be reported gross increasing the balance sheet footings by approximately CHF165 billion at 31 December 2003. *UBS* does not expect this to impact upon net profit, shareholders' equity, eps or regulatory capital. *RBS* and *Barclays* described similar impacts in their respective IFRS trading statements. Another UK firm identifying the impact is *GlaxoSmithKline* for whom the adoption of IAS 39 would have resulted in profit before tax for 2003 reducing by £65 million.

IFRS 4 "Insurance contracts" requires firms to unbundle the insurance and deposit components of insurance contracts and, for a contract that is unbundled, requires that IAS 39 be applied to the deposit component. However, the expectation is that many insurance contracts will not need unbundled so that the current treatment will continue to apply. Where there is a reclassification of these contracts to financial instruments we do not expect this to have a material impact on key performance indicators. Although we have yet to see a firm adopt IFRS 4, the Swiss financial services firm *Zurich Financial Services* gives an idea of its impact. *Zurich* argues that IFRS does not contain guidelines governing the accounting treatment of certain transactions including those that are specific to insurance products. When a specific topic is not addressed by the standards, the IFRS framework permits reference to another comprehensive body of accounting principles. In these cases the firm refers to US GAAP (which in this respect is broadly similar to IFRS) for guidance. *Zurich* states that, during 2003, the Derivatives Implementation Group in the US issued the derivatives accounting standard interpretation B36 "Modified co-insurance arrangements and debt instruments that incorporate credit risk exposures that are unrelated or only partially related to the creditworthiness of the obligor under those instruments" which requires separate accounting for certain derivatives embedded in re-insurance transactions. As a consequence, it has performed comprehensive reviews of its insurance products and adjusted its accounting treatment accordingly. The principal effects are the reclassification of US\$2.7 billion debt securities from available-for-sale to trading securities, and a US\$83 million reduction of the previously reported 2002 net loss.

#### v **Share-based payments**

The effect of the change will be company specific and will depend on the level of options granted. An example of the impact can be ascertained from *Unilever* which adopted US SFAS 123 "Accounting for stock-based compensation" and in 2003 recognised remuneration costs of €166 million in respect of the fair value of options granted amortised

over the vesting period of the awards, compared to profit before tax of €4.5 billion. *GlaxoSmithKline*, according to its IFRS briefing, would have suffered an additional charge of £344 million relative to profit before tax of £6.3 billion. The firm expects this to fall to a year on year charge of around £200-£250 million, the current charge being abnormally high in a post merger year. *British Land* has adopted FRS 20, which is similar to IFRS 2, and this did not have a material affect on its results, and it describes the future impact of IFRS 2 as immaterial.

<sup>vi</sup> **Goodwill and takeover accounting**

Though the abolition of goodwill amortisation will have the most widespread impact, there are other significant provisions concerning takeover accounting in IFRS 3. One is that negative goodwill be recognised in the profit and loss account immediately whereas currently under UK GAAP and IAS 22 “Business combinations”, it is held on the balance sheet and written off to profit and loss over an appropriate period. However, in current market conditions negative goodwill is a relatively rare event. A major change is that merger accounting (or pooling) will no longer be available, resulting in recognition of goodwill and recognition of acquired assets at fair values. Because IFRS will not require the restatement of past mergers the immediate impact of IFRS in this area will be negligible. A study by Company Reporting in October 2002 found that only 2% of UK firms were using merger accounting for business combinations. Nonetheless, these involved some of the UK’s largest firms and in many cases merger accounting was apparently being used to classify takeovers as mergers so as to avoid goodwill and fair value recognition. Some recent mergers worthy of note include BP/Amoco, Halifax/Bank of Scotland, BHP/Billiton and Logica/CMG.