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IFRS Insights

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IASB announces IFRS for Small and Medium-sized Entities

Update and overview

In July 2009, the International Accounting Standards Board (IASB) issued *International Financial Reporting Standards for Small and Medium-sized Entities* ("IFRS for SMEs" or "The Standard"). *IFRS for SMEs* is a simplified, self-contained set of accounting principles tailored for smaller, non-listed companies without "public accountability." *IFRS for SMEs* is based on full IFRS, which has been developed primarily for listed companies.

IFRS for SMEs was developed by extracting the fundamental concepts from the IASB's Framework for the Preparation and Presentation of Financial Statements and the principles and related mandatory guidance from IFRS, with appropriate modifications in light of users' needs and cost-benefit considerations. As a result, *IFRS for SMEs* is roughly 10 percent of the length of full IFRS. The modifications made to full IFRS in developing the *IFRS for SMEs* are of three broad types, summarized below:

- **Omitted topics.** IFRS topics not relevant to a typical SME are omitted from the Standard.
- **Disallowed options.** For a number of those occasions in which full IFRS provides an accounting policy choice, only the simpler option is included in *IFRS for SMEs*.
- **Recognition, measurement simplifications, and disclosure reductions.** *IFRS for SMEs* makes certain simplifications to the recognition and measurement requirements in full IFRS. In addition, the disclosure requirements in *IFRS for SMEs* are substantially reduced when compared with those in full IFRS.

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IASB announces IFRS for Small and Medium-sized Entities (continued)

Who is eligible to use it?

The Standard is intended for an entity with no public accountability. An entity has public accountability if:

- it has issued, or is in the process of issuing, debt or equity securities in a public market; or
- it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment bank.

Note that small listed companies would not be eligible to use IFRS for SMEs.

For some small and mid-size U.S. private companies, this means they may have another reporting option — in addition to U.S. GAAP or full IFRS. For U.S. public companies, it also could serve as a "proof of concept" for the potential adoption of IFRS. The IASB intends for the Standard to be self-contained for a typical SME with about 50 employees.

Over the last few years, U.S. GAAP requirements have taken on an increasing level of complexity. This trend has been a challenge for many companies, public and private, as well as for financial statement users. In 2008, the SEC's advisory Committee on Improvements to Financial Reporting (CIFR) issued its final report and recommendations geared toward increasing the usefulness of financial information while reducing the complexity of the financial reporting system. In the report, CIFR noted that the complexity in U.S. GAAP was driven in large part by the volume of formal and informal accounting guidance. The increase in complexity has likely contributed to higher compliance costs, especially for private companies.

IFRS for SMEs is focused on improving financial reporting by:

- Removing choices, eliminating topics that are not relevant for private entities, and simplifying the recognition and measurements in certain areas.
- Enabling investors, lenders, and other financial statement users to better compare financial performance among private entities across country borders.
- Reducing the burden of financial statement preparation for private entities, with particular attention given to cost/benefit considerations.

For more information on IFRS for private companies, access the Deloitte publication, "IFRS: What it means for private company reporting."

Survey results

IFRS Survey 2009 for private companies

A Deloitte survey was conducted in June 2009 to gather data and information about the challenges of current U.S. GAAP and the level of interest in IFRS for private companies. The survey of private companies shows many respondents support separate accounting standards for private and public companies, yet a significant number of respondents are still unaware of the IASB's newly issued standard, IFRS for SMEs. Interest among private companies for a separate set of accounting and financial reporting standards could increase further with more education.

Highlights of the survey data, which include small and mid-size entities with less than $1billion in revenues — referenced here as "SME respondents" — follow:

- 51% of SME respondents believe that there should be separate accounting standards for public and private companies.
- 43% of SME respondents are not aware or don't know of the IASB's standard IFRS for SMEs, indicating the need for more education.
- SME respondents view fair value measurement (42%), accounting for income taxes (23%), and consolidations (10%) as the top areas of U.S. GAAP in need of simplification.
- 10% of SME respondents either currently use IFRS or would consider adopting IFRS for SMEs in the near term, while 63% would adopt when required.

Access the report, "IFRS Survey 2009 for Private Companies," for the complete survey results.

IFRS Roadmap: Planning a Safe, Economical Trip

New *Deloitte Review* article

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Industry view: IFRS for insurance companies

A look at the accounting landscape

Insurance companies may be in a very different position than other industries when it comes to IFRS. Joint projects between the Financial Accounting Standards Board (FASB) and the IASB on new potential standards could result in major changes in U.S. GAAP. The potential effective dates of the new standards could also precede SEC mandates for IFRS under its proposed IFRS Roadmap. These new standards, when promulgated, would affect all insurance companies (regardless of whether they are stock or mutual, public or private) that publish financial statements in accordance with U.S. GAAP.

Put another way, the reach of the new "converged" standards would be much wider compared to an SEC mandated IFRS conversion, which would directly affect only listed insurance companies or those filing with the SEC for other reasons.

Accounting outlook on convergence for insurance companies

For a typical insurance company, the measurement basis for financial assets and liabilities is one of the significant drivers of earnings. Under current U.S. GAAP, a handful of critical accounting standards govern a substantial portion of the balance sheet, particularly standards that apply to assets and those that apply to insurance liabilities and reinsurance.

The asset standards for U.S. GAAP affect the measurement of investments and derivatives — and drive how an insurer determines fair value and impairment as well as how it accounts for hedging activities.

One key convergence project that the FASB and IASB are jointly working on is expected to completely rewrite accounting for financial instruments. The scope of this project would ultimately cover investments in debt and equity securities, asset backed instruments, loans, derivatives, hedging activities, impairments, and disclosures. In other words, the only significant remaining assets in a typical insurance balance sheet that would **not** be within the scope of this project would be cash and cash equivalents, intangible assets, deferred tax assets and property.

Upon culmination of the project, it is expected that FASB Statement Nos. 115 and 133, along with other interpretive guidance, including all related FASB Staff Positions (FSP's), Emerging Issue Task Force (EITF) Issues, and Derivatives Implementation Group (DIG) Issues would be replaced by a single financial instrument standard.

This project has been fast tracked by the FASB and IASB, but the expected timing and scope of the phases are different between FASB and IASB. The first of three exposure drafts by the IASB, covering investment classification and measurement, was issued in July 2009. The timeline for the remaining two IASB exposure drafts, expected to cover hedging activities and impairments, is 2010. These standards could become effective as early as 2012 — or even 2009 for companies wishing to early adopt.

The FASB and IASB are also jointly working on a project that would completely rewrite the accounting standards applicable to insurance liabilities, which typically make up a substantial proportion of the liabilities of an insurer. In addition, the standard covers accounting for reinsurance contracts and thus the accounting for reinsurance assets, another major asset on an insurer's balance sheet.

Momentum for this project continues to build. An industry estimate is that the FASB and IASB will issue a converged exposure draft by the end of 2009 or early in 2010 with issuance in 2011 — and an effective date potentially as early as 2013.

The insurance contracts standard is expected to apply a single measurement model to property-casualty insurers, life insurers, health insurers, and reinsurance companies — essentially to any entity that enters into a contract that transfers insurance risk from one party to another. To date, based on deliberations between the standard setters, the broad contours of the proposed standard are already known. It is expected to impose a fulfillment value standard, which is different from the exit value or fair value originally proposed in the discussion paper in 2007, and is predicated on an insurer exiting a contractual obligation through fulfilling the terms of the contract. The liability measurement would be based on three building blocks: (1) projected future cash flows; (2) discounting those cash flows to reflect the time value of money; and (3) the addition of a margin to reflect the uncertainty of future cash flows, and to provide profit to the insurer for the services provided and risk taken.

At their July joint meeting, the FASB and IASB still had not reconciled all their differences, so the timing and scope of the ultimate standards remains an issue. The treatment of margins and deferred acquisition costs are still key differences between the two boards.

Potential implications

The practical consequences of these standards are far reaching, and could affect many parts of an organization, including accountants, actuaries, IT professionals, those designing products, supervising hedging and reinsurance, planning performance awards, and even investor relations professionals.

Insurance companies could face a different accounting environment when new converged standards are issued by the FASB. A potential outcome involves accounting for investments and insurance liabilities in a manner similar to IFRS, with adoption dates long before the SEC mandates full IFRS conversion under its proposed Roadmap.

Technical corner: IAS 19

Accounting for employee benefits

Accounting for employee benefits, whether under U.S. GAAP or IFRS, can be complicated and controversial. Additionally, these benefits (short-term, long-term, post-employment and termination) are often significant to an entity's financial statements, and therefore it is critical for companies assessing a move to IFRS to understand the differences between U.S. GAAP and IAS 19, *Employee Benefits*. Areas of notable difference include:

- **Recognition of actuarial gains/losses** — IAS 19 provides several options for recognizing actuarial gains/losses: 1) deferral through the "corridor" approach, in which actuarial gains and losses are recognized in excess of the greater of 10% of the present value of the defined benefit obligation, and 10% of the fair value of any plan assets, 2) any systematic, faster, recognition method provided the same basis is applied for both gains and losses, 3) immediate recognition in net income, or 4) immediate recognition in other comprehensive income with no impact to net income.

  U.S. GAAP is similar to IAS 19, however when applying the corridor approach, actuarial gains and losses are recognized over the remaining average service period. Additionally, gains or losses recognized in other comprehensive income are "recycled" into net income.

- **Post-employment benefit assets** — Under IFRS, post-employment benefit assets cannot exceed the net total unrecognized past service cost and actuarial losses plus the present value of benefits available from refunds or reduction of future contributions to the plan. There is no such limitation under U.S. GAAP.

- **Prior service costs** — Prior service costs related to benefits that have already vested are recognized immediately under IAS 19, whereas under U.S. GAAP they are generally amortized over the remaining service period of employees.

- **Multi-employer plan** — IFRS requires that a multi-employer defined benefit plan, in which required information is available, should be accounted for as a defined benefit plan. However, U.S. GAAP requires it to be accounted for as a defined contribution plan.

- **Termination benefits** — Under U.S. GAAP, special (one-time) termination benefits are generally recognized when they are communicated to employees unless employees will render service beyond a "minimum retention period." Contractual termination benefits are recognized when it is probable that employees will be entitled to such benefits and the amount can be reasonably estimated. Under IFRS, there is no distinction between special and other benefits. Termination benefits are recognized when the employer is demonstrably committed to pay.

Entities also should keep apprised of the IASB's project on post-employment benefits, as an exposure draft is expected to be issued later this year, with a final standard to be published in 2011.

IFRS Contacts

Joel Osnoss – New York
Deloitte & Touche LLP
+1 212 436 3352
josnoss@deloitte.com

Alfred Popken – New York
Deloitte & Touche LLP
+1 212 436 3693
apopken@deloitte.com

Sam Doolittle – San Francisco
Deloitte & Touche LLP
+1 415 783 4343
sdoolittle@deloitte.com

D.J. Gannon – Washington DC
Deloitte & Touche LLP
+1 202 220 2110
dgannon@deloitte.com

Tom Omberg – New York
Deloitte & Touche LLP
+1 212 436 4126
tomberg@deloitte.com

Nick Difazio – Detroit
Deloitte & Touche LLP
+1 313 396 3208
ndifazio@deloitte.com

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