

iGAAP Newsletter

Beyond the standards



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As we move into 2010, the challenges for preparers of financial statements continue – including those resulting from changes in IFRSs.

An important change, particularly for acquisitive businesses, is the introduction of the revised version of IFRS 3 on business combinations. Our practical issue this quarter highlights some issues arising in respect of the changes to acquisition accounting resulting from this new standard.

In other news, the International Accounting Standards Board (IASB) presses on with its project to replace IAS 39 with a hopefully more workable standard on financial instrument accounting. The latest output from this is an exposure draft (ED) setting out suggested revisions to the treatment of impairment of financial assets, these proposals are discussed in detail in this quarter's topic of focus.

Next on the agenda for the IASB's financial instruments project is an ED on the complex issue of hedge accounting, this is expected to be released in the second quarter of 2010 and will be discussed in a future newsletter.

As discussed in our December 2009 quarterly newsletter, the IFRS for SMEs looks set to lead to major changes in financial reporting for non-publicly accountable companies in the United Kingdom. Our interview this quarter is with Paul Pacter, who was integral to the development of that framework and who is now central to efforts to encourage its adoption around the world.

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ACCA and Deloitte international narrative reporting survey – seeking your input

Next month, ACCA (the Association of Chartered Certified Accountants) and Deloitte LLP will be embarking on a joint international survey, exploring current and anticipated future challenges in narrative reporting.

The survey will be carried out in Africa, Australia, China, Malaysia, Singapore, Switzerland, UAE, UK and USA and will:

- investigate the critical challenges, principally for CFOs of publicly accountable entities, in preparing narrative disclosures; and
- identify likely future trends in narrative reporting in different reporting environments around the world.

Preparers in these countries are invited to register their interest in being part of this new study by visiting www.accaglobal.com/narrativereportingsurvey

Interested parties will be invited to participate, confidentially, in the survey when it is launched on 15 April 2010. In return for participation, all survey respondents will receive a complimentary copy of the final report on the findings, which is scheduled for publication in September 2010.

Practical issue: Business combinations

The revised version of IFRS 3 'Business Combinations' (issued by the IASB in 2008) is effective for business combinations with an acquisition date in a period beginning on or after 1 July 2009. This means that a December year end company making acquisitions in 2010 will need to take account of the requirements of this standard.

IFRS 3(2008) imposes several new requirements on companies making acquisitions, both by changing the requirements of the previous standard (IFRS 3 as issued in 2004) and by clarifying areas where guidance under the previous standard was limited.

This article looks at some of the changes and questions resulting from implementation of IFRS 3(2008) and related changes to IAS 27 'Consolidated and Separate Financial Statements' (IAS 27 as issued in 2008).

Acquisition costs

IFRS 3(2004) required the inclusion of directly attributable costs in the cost of acquisition. As a result, the accounting for many acquisitions has previously included the capitalisation of costs such as legal and other adviser costs, resulting in a higher value of goodwill.

IFRS 3(2008) requires such costs to be recognised as an expense as incurred. This has the benefit of simplicity, as the judgement previously required in assessing which costs were directly attributable to an acquisition is no longer required. But it does mean that an acquisition may now involve the recognition of a significant cost before the benefits of the acquisition to the group's ongoing profitability are realised. The only exception to this is costs relating directly to the issue of debt or equity instruments, which may still be offset against the debt or equity balance in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' and IAS 32 'Financial Instruments: Presentation' respectively.

Some companies may, quite validly, have capitalised costs in 2009 (i.e. under the requirements of IFRS 3(2004)) relating to an acquisition which was subsequently completed in 2010 (i.e. under the requirements of IFRS 3(2008)). Such costs should be expensed when the revised standard is adopted.

Non-controlling interest

There are a number of issues arising from non-controlling interests (NCI) under IFRS 3(2008).

Scope of NCI

The term 'minority interest' used by IFRS 3(2004) was changed to NCI as there are circumstances where the parent does not hold the majority of a subsidiary's equity, but does have control. In addition, the definitions of the two terms are worded differently.

Minority interest under IFRS 3(2004)	Non-controlling interest under IFRS 3(2008)
That portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.	The equity in a subsidiary not attributable, directly or indirectly, to a parent.

The exclusion of the reference to 'portion of profit and loss and net assets' and discussions on related topics under IFRS 3(2008) have highlighted that equity instruments which do not presently give the holder rights to a portion of the subsidiary's net assets (and which may not have been classified as minority interests by some preparers) may meet the definition of NCI. Examples of such instruments may include:

- the equity component of a compound instrument;
- options or warrants over the subsidiary's shares;
- equity-settled share based payment awards to be settled in the subsidiary's shares; and
- preference shares classified as equity.

Measurement of NCI

The measurement of NCI is unusual in that it is an area for which IFRS 3(2008) has introduced additional flexibility.

IFRS 3(2004) required a minority interest to be measured at the minority owners' share of the fair value of the acquiree's identifiable net assets. IFRS 3(2008) allows this treatment, but also offers an alternative of measuring NCI at full fair value.

As shown below, applying this option will frequently lead to recognition of a higher goodwill value on acquisition.

Example

In 2010, Entity A acquires an 80% controlling interest in Entity B for cash consideration of £1 million. As at the date of acquisition, the fair value of Entity B's identifiable net assets (including intangible assets) is determined to be £500,000 and it is determined that the fair value of the 20% non-controlling interest is £250,000 (i.e. a quarter of the value of the 80% interest acquired).

	NCI at % of net assets £		NCI at fair value £
Consideration	1,000,000		1,000,000
Non-controlling interest	100,000	(20% of £500,000)	250,000
	<u>1,100,000</u>		<u>1,250,000</u>
Less identifiable net assets acquired	(500,000)		(500,000)
Goodwill	<u>600,000</u>		<u>750,000</u>

There is no requirement for a consistent accounting policy in this respect, the decision on which value to apply to NCI may be made on an acquisition by acquisition basis.

In its exposure draft 'Improvements to IFRSs' issued in August 2009, the IASB has proposed an amendment to IFRS 3 to make clear that NCI which does not give the holder a proportionate share of the subsidiary's net assets (for example, the equity component of a compound instrument) should be measured at fair value at the date of acquisition.

Impairment testing

IAS 36 'Impairment of Assets' was amended on introduction of IFRS 3(2008) to make clear that where the option to measure NCI as a proportion of net assets is taken, the recognised goodwill must be 'grossed up' for impairment testing purposes. This is in order to eliminate the mismatch between 100% of the cash-generating unit's cash flows being included in the calculated recoverable amount, but less than 100% of the fair value of goodwill on acquisition being recognised in the consolidated financial statements.

Care needs to be taken where a 100% subsidiary was initially acquired but NCI subsequently arises, for example, due to a decrease in ownership interest that does not result in a loss of control. In this circumstance, the full value of goodwill will be recognised on acquisition and will be unaffected by the subsequent partial disposal (which will be accounted for as an equity transaction) and accordingly no 'gross up' for impairment testing is required whether the NCI is measured at fair value or at the relevant proportion of net assets.

Contingent consideration

Under IFRS 3(2004), adjustments to the cost of an acquisition resulting from variability in the purchase agreement (commonly, consideration contingent on the level of earnings achieved by the acquired entity in the years after acquisition) were accounted for as adjustments to the cost of the acquisition (i.e. as a debit or credit to goodwill).

IFRS 3(2008) requires all such adjustments to be recognised in profit or loss as they occur. Again, this reduces complexity, as it is no longer necessary to determine which changes were part of the original agreement and which have arisen through subsequent negotiation, but increases the possibility of significant “one-off” gains or losses.

Adjustments in respect of earlier acquisitions

It is important to note that IFRS 3(2008) applies only to acquisitions made after the standard’s effective date. Any adjustments in respect of acquisitions accounted for under IFRS 3(2004) continue to be subject to the requirements of that standard.

As illustrated below, this may give rise to the unusual circumstance of two equivalent events occurring in the same period being accounted for differently.

Example

Entity A (a December year end company) acquired Entity B in 2009, the consideration payable was agreed as:

- an immediate payment of £1 million; and
- a further payment of £600,000 after two years if cumulative profits of Entity B in the two years following acquisition exceed £10 million.

At the date of acquisition, achievement of this level of post-acquisition profit was deemed to be likely and the fair value of the contingent consideration assessed as £500,000.

In 2010, Entity A acquires Entity C in an unrelated deal with the same consideration terms. Again, the fair value of contingent consideration is determined to be £500,000.

In 2011, it becomes clear that neither Entity B nor Entity C is going to reach the level of profitability required to trigger the contingent payments. At this point, it is determined that the fair value of the contingent consideration for both transactions is £nil.

The appropriate accounting entries for Entity A in 2011 are as follows:

Dr	Contingent consideration liability	£1,000,000	
	Cr Goodwill (in respect of Entity B)		£500,000
	Cr Profit or loss (in respect of Entity C)		£500,000

In order to facilitate the accounting for such adjustments, it will be necessary for companies making frequent acquisitions to keep track of which standard was applied to acquisitions occurring near to the date of transition from IFRS 3(2004) to IFRS 3(2008).

Disclosure requirements

The disclosure requirements of IFRS 3(2008) are more detailed than those of its predecessor standard, the additional disclosure requirements include:

- the fair value, gross contractual amounts receivable and best estimate of contractual cash flows not expected to be collected for each major class of acquired receivable;

- details of the terms, range of outcomes and maximum amount of contingent consideration arrangements; and
- the amount and measurement basis of any NCI and, where NCI is measured at fair value, details of the valuation technique used.

It is also noteworthy that a consequential amendment to IAS 34 'Interim Financial Reporting' means that the same level of disclosure on acquisitions is now required in half-yearly financial reports as is required in annual reports. Previously, only some of the IFRS 3(2004) disclosure requirements were repeated for half-yearly financial reports.

FRC Study: Accounting for acquisitions

The Financial Reporting Council (FRC) published in January 2010 a study entitled 'Accounting for acquisitions' which summarised the results of its examination of 20 acquisitions undertaken by UK companies in 2008 and accounted for under IFRS 3(2004).

The FRC study concluded that the results of the survey were, overall, 'disappointing'. Criticisms were made in the following areas:

- linkage between the rationale for the acquisition in the company's business review, the explanation of the acquisition in the financial statements and the classes of intangible asset recognised;
- the separate recognition of identifiable intangible assets (in particular, the aggregation of different types of customer related intangible); and
- the explanation of the residual goodwill balance.

This report drew a response from the chairman of the IASB, Sir David Tweedie, re-iterating the point made in the FRC study that the acquisitions surveyed were accounted for under the old version of IFRS 3 which has now been replaced. Sir David also stated that IFRS 3(2008) "should lead to a step change in the recording of intangible assets."

Changes to IFRS 3 which may lead to recognition of additional intangible assets, and therefore to a lower residual goodwill value, include:

- the removal of a criterion in IFRS 3(2004) that only intangible assets for which fair value can be measured reliably should be recognised; and
- the inclusion in the illustrative guidance to IFRS 3(2008) of additional examples of intangible assets which would be separately recognised (for example, drilling or timber cutting rights and separate customer contracts and relationships for the same customer).

The removal of the reliable measurement criterion is undoubtedly a change in the requirements of IFRS 3. However, it is noted that the FRC study makes no reference to companies stating that intangible assets were not recognised because their fair value could not be measured reliably. Similarly, only two companies of the 100 sampled in the recent Deloitte survey of financial statements "Finishing (in) figures" mentioned reliable measurement in their descriptions of goodwill.

Further guidance on IFRS 3(2008) can be found in the Deloitte publication *IGAAP 2010: IFRS Reporting in the UK*.

A coffee with ... Paul Pacter



Paul Pacter is Director of Standards for Small and Medium-Sized Entities (SMEs) at the International Accounting Standards Board in London. Concurrently he is also Director in the Global IFRS Office of Deloitte Touche Tohmatsu in Hong Kong where he manages Deloitte's www.iasplus.com website.

How encouraged are you by the current level of adoption of IFRS for SMEs by individual countries and how would you like to see this develop in the next couple of years?

After nearly six years of work, the IFRS for SMEs was issued in July 2009. Now, my role at IASB has shifted to promoting adoption of the standard and helping in its implementation around the world. The story on adoptions, just eight months after issuance, is very heartening.

Remember, the IASB is a private sector body, not a government agency. It has no power to tell any country or any company in the world that they must follow IASB standards. Nor does IASB have the power to decide which companies should even be required to prepare general purpose financial statements. What the IASB does is develop standards that are available for legislatures, regulators, and professional bodies to adopt if they deem it appropriate in the public interest for their jurisdiction.

On IAS Plus, I keep track of which jurisdictions have adopted full IFRSs, and the various ways they have done so, warts and all (by warts I mean tinkering, carveouts, and delays). Not surprisingly, I am trying to track adoptions of the IFRS for SMEs as well. As of March 2010, I am aware of 58 jurisdictions that either have already adopted the IFRS for SMEs or have publicly stated an intention to do so in the next three years. To me, that is huge success in eight months.

I went to work for FASB (the US accounting standard setter) when it was formed in 1973, and I have been involved in standard setting ever since. Standard setters sometimes get a feeling that they are producing a product that is forced upon the customer rather than chosen by the customer. For the IFRS for SMEs, it has been customer choice.

And, by the way, the IASB has the potential for millions of customers (SMEs) – as compared to far fewer than 100,000 publicly traded companies globally. For the most part, SMEs have not been involved with the IASB before. In issuing the IFRS for SMEs, the Board recognised that it needed to provide much more help in implementing the standard than it normally does for full IFRSs. This help includes:

- Model financial statements and a presentation and disclosure checklist accompanied the standard.
- Comprehensive self-study training materials, one module per section of IFRS for SMEs.
- 3-day regional train-the-trainers workshops, primarily in emerging markets.
- PowerPoint training presentations posted on IASB website.
- Formation of an SME Implementation Group (which I will chair) to (a) consider implementation questions raised by users of the IFRS for SMEs and published unofficial implementation guidance (Q&As) and (b) consider, and make recommendations to the IASB on, the need to amend the IFRS for SMEs.

More widely, how would you like to see IFRSs develop in the coming years?

If we didn't know it before, the Great Recession has proved that the world's economies are globalised. Companies buy and sell goods across borders. Capital providers seek investment and lending opportunities globally. Companies seek capital on the most favourable terms regardless of source. Credit ratings, business combinations, buying shares on-line – all cross-border these days.

Inconsistencies in accounting standards and disclosures can confuse or even obscure the kinds of analyses and comparisons that all of these users of financial information try to make. So a single set of global accounting standards makes the best sense.

I am American, and I worked for FASB for many years. Not surprisingly, I have long thought (and still do) that the United States has an outstanding body of accounting standards, a rigorous enforcement mechanism, and a business culture of integrity. The fact that, in the few years after the Enron scandal broke, several thousand US public companies were forced to restate their financial statements came as a shock. It made clear to me that the best standards in the world do not ensure good financial reporting. For me, those unfortunate events reinforced the case for a single set of high-quality global accounting standards.

Do you see political influence on accounting standards as beneficial?

For the most part, companies prepare financial statements not because they want to do it but because they are told that they have to do it by legislators or regulators (or occasionally by the accounting profession empowered by government). Why do governments mandate company financial reporting? Because they believe that there is a public interest in having good financial information about companies widely available – to help ensure that capital goes to where it is most deserving.

So I do believe that the government has a legitimate interest in ensuring that the process for developing accounting standards is sound, independent, and works in the public interest. For instance, I think it's appropriate for the US Securities and Exchange Commission to be a bit of an 'eminence grise' at the FASB. Likewise, I think the IASB's new Monitoring Board of public authorities is a sensible approach to government oversight at an international level.

However, the public interest is not served if information does not honestly present the underlying economic reality. Perceptions of reality differ, and that's an important part of the debate over accounting standards. But if political influence leads to standards intended to bias the decision makers toward or away from a particular decision, that is not beneficial. One of the early standards I wrote was FASB Statement 19 on oil and gas accounting in 1977. That was shortly after the so-called 'Oil Embargo' that led to long lines at petrol pumps and rationing around the world. US public policy was to encourage exploration for new reserves. And there was great political pressure on FASB to allow the full cost method of accounting (i.e. the capitalisation of exploration costs even if no reserves are discovered). Exploration companies said they would stop exploring if successful efforts accounting (i.e. capitalisation of only the costs of successful exploration projects) was mandated (a contention that many found spurious). To me – and to the FASB – the issue was whether the exploration costs met the definition of an asset.

Unfortunately, just one year before that, politics had a negative influence on US GAAP. Although many US banks had made loans that, rationally, were badly under water, due to pressure from bank regulators FASB Statement 15 concluded that a bank didn't have to recognise a loss if the *undiscounted* expected future cash flows (even if restructured to many years into the future, with interest forgiven) were more than the carrying amount of the receivable. The fledgling FASB survived, but Statement 15 was far from its shining hour.

You're now based in Hong Kong, do you feel you get a different perspective there than you would in Europe or the US?

Yes. Perhaps the biggest eye-opener, when I arrived in Hong Kong ten years ago, was that the controlling interest in many (maybe most) public companies still rests with the founding family. And regulation is much more *laissez faire* than in the United States. In Hong Kong we have nearly 800,000 companies. And the law says every one of them must be audited by a CPA. But the law does not require those audited financial statements to be filed with government, posted on a website, or otherwise made publicly available anywhere. I can see how small practitioners might like such a law, but I wonder how it serves the public interest.

Public capital markets are a relatively new phenomenon in Asia. Which means that financial statements have traditionally been much less important than in, say, the United States. In Korea and Japan, companies got much of their capital from banks, suppliers, and customers with whom they had long-standing business relationships. And in China, Vietnam, and other planned economies, until recently companies got much of their capital directly from government or from financial institutions controlled by government. Decisions weren't necessarily based on financial statements.

In Asia, many countries are 'developing' or 'emerging markets'. Accounting standards have tended not to be as rigorous as US GAAP or IFRSs. Even today, there are almost no Asian countries where IFRSs are required for listed companies. Hong Kong has adopted IFRSs as local GAAP very closely, but not 100%. China has adopted many of the principles but not the guidance. Korea will start IFRS equivalents in 2011. Japan will make a decision probably in 2012. Singapore has adopted most but not all IFRSs unchanged (they have committed to full convergence by 2012). Malaysia many but not all. Indonesia and Thailand have adopted some. Philippines tinkered with some standards. India, Pakistan, Sri Lanka, and Taiwan have announced plans to converge in the next several years.

When you started the IAS Plus website, did you expect to grow as far and as quickly as it has in terms of the amount of content and the amount of users?

Before joining Deloitte in June 2000, I worked for the IASC – predecessor of the IASB. In the mid-1990s the Internet was just emerging as the preeminent information resource in the world. I bought a book on HTML, and with permission of the IASC leadership I started the IASC's website – the now-defunct www.iasc.org.uk (we had to have the .uk because the International Aloe Science Council already had www.iasc.org). Deloitte's IAS Plus went live in December 2000. We had 89,000 visitors total in all of 2001 – just a little more than we get in one week today. That rose to 267,000 for 2002 and has continued growing. In 2009 we had 2,210,000 visitors from 231 countries, and 6,810,000 page views. 14% of the visitors to IAS Plus in 2010 have been from the UK, more than from any other country.

At the moment, www.iasplus.com has nearly 800 HTML web pages and 4,700 downloadable files (nearly all of those PDFs), along with 1,220 graphics files.

I never expected it to get this big, either in terms of visitor traffic or number of pages and files. Although I get a lot of input for content from a large network of contacts, I do all of the work on the website myself. I do not know how to do any slick Java and Flash programming, and I doubt I will ever win an artistic award for any of those 1,220 graphics files. I just try to be sure the content is useful, timely, accurate, and easily accessible. It has been seven days a week, 365 days a year, since December 2000. I love it.

And the best part of doing IAS Plus is that I get 'fan mail'. About weekly, a stranger writes to tell me how much they get out of the site and to thank me and Deloitte for maintaining it. Not many accounting jobs bring fan mail!

The good, the bad and the ugly

The IASB's project to replace IAS 39	I was the author and project manager of the original IAS 39 adopted in December 1998. It did a huge amount of 'good' in bringing rigor to accounting for financial instruments around the world, but the wide variety of measurement principles, the complex approach to derecognition, and some aspects of impairment recognition were a bit 'ugly'. The IASB's current work to replace IAS 39 is needed, especially with the growing importance of financial instruments on (and sometimes off) most companies' balance sheets.
The EU endorsement process	I understand and accept the need to have such a process in some jurisdictions (the 'sovereignty' issue). But I think the EU process is cumbersome and overly political. EU government ministers and the EU Parliament are both involved, not to mention EFRAG, ARC, SARG and the Internal Markets staff. Still, it's hard for EU to emulate the US approach (the SEC as informal 'endorser') because there is no pan-European capital markets regulator.
Convergence of IFRSs and US GAAP	This is a two-edged sword. It may be a necessary condition for adoption of IFRSs by the SEC. But it's holding the IASB back on some projects, and pushing them in directions they might not choose independently.
Industry specific accounting standards	I think we are better off with sound principles that apply across industries. If industry groups want to provide guidance on applying those principles in their industry, fine. This could well be an area for national standard setters to be working alongside the IASB.

Topic of focus: Impairment of financial assets

In the current economic environment the accounting rules on recognising and measuring impairment on financial assets has come under close scrutiny. Both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) are in the process of rewriting the rules on accounting for financial instruments including when an impairment loss on a financial asset is recognised and how it is measured. The end goal is a common set of rules for use on both sides of the Atlantic. However, the IASB is working on an accelerated basis and has already issued a final standard on classification and measurement of financial assets (the proposals in these areas were discussed in our September 2009 newsletter and IFRS 9: *Financial Instruments* was subsequently issued on 12 November 2009) that sets out which assets are assessed for impairment. In addition, it issued an exposure draft (ED), *Amortised Cost and Impairment*, on 5 November 2009 proposing a replacement to IAS 39's incurred loss model with an expected loss approach. The IASB's intention has been to address as soon as possible some of the key weaknesses of the current rules.

The rules on impairment are inextricably linked with the rules on classification and measurement. IAS 39 has been criticised for the many different classification categories and the resulting different approaches to measuring impairment. For example, debt instruments classified as either available-for-sale (AFS), held-to-maturity (HTM) or loan and receivable (L&R), and equity investments classified as AFS or held at cost must all be assessed for impairment. The measurement of impairment differs depending on the classification. For AFS assets, impairment is based on fair values; for HTM and L&R assets it is based on discounting expected cash flows using historical discount rates; and for equities measured at cost it is based on assessing discounted cash flows using current discount rates. To top it off, the rules on reversing impairments differ, with reversals required for debt instruments but prohibited for equity investments.

IFRS 9 cuts down this complexity to a single impairment requirement only for debt instruments measured at amortised cost. An impairment assessment is not required for investment in equity securities as all such assets within the scope of IFRS 9 would be measured at fair value through either profit or loss or other comprehensive income. IFRS 9 limits the extent of assessing for impairment but does not, to date, change the way impairment is measured. The current "incurred loss" approach to recognising impairment has been criticised for prohibiting recognition of expected losses, however likely, unless there has been a 'trigger event', such as default. This approach has the effect of deferring the recognition of expected losses leading to a 'cliff effect' when – for example during a recession – a number of loans go bad. This is sometimes referred to as a 'pro-cyclical' effect as the resulting accounting exacerbates the effects of an economic downturn.

Some commentators, particular bank regulators, have suggested that impairment provisioning should instead be 'anti-cyclical'. Two often cited 'anti-cyclical' provisioning techniques are through-the-cycle provisioning and dynamic provisioning. Through-the-cycle provisioning would see provisions being built up from income on loans in the good times to be released against future loan losses in the bad times, although not necessarily on the same loans. One feature of dynamic provisioning is that a provision can be set aside for loans when they are written leading to a loss on day one.

Expected loss model

The IASB has not opted for either of these two methods in its ED as neither is considered to portray neutrally the economic characteristics of the recognised loans. Instead the IASB's approach is one that smoothes the effect of expected losses over the expected life of a loan. For example a five year loan written with an interest rate of 7% may have an expected return of 5% after taking into account expected losses. Under the expected loss model the effective interest rate (EIR) applied to the amortised cost carrying value of the loan would be 5% this would be the net interest income recognised and a provision would be built up by setting aside the difference between the contractual interest and the EIR. This provision would be used to absorb expected losses when they materialise. This approach does not recognise a loss on initial recognition of a loan nor does it retain provisions from old loans to be set off against losses on future loans.

This method does not, however, eliminate all volatility from the recognition of impairment losses. Only where estimates of initial expected losses are accurate is the recognition of the effective return smooth over the life of a loan.

If there are changes in the expectation of losses over the life of the loan then this will result in an immediate gain or loss being recognised in profit or loss. At each reporting date an entity would not need to consider whether there is a credit trigger as under IAS 39, but would instead be required to continuously reassess its expectations of future cash flows.

Two IASB board members voted against publication of the ED partly because they believe the approach will not provide sufficient benefit in improving financial information to justify the costs of adopting this methodology. Concerns were also raised that the approach would increase the potential for earnings management because in their view the loss expectations of management cannot be audited. To address some of these concerns the ED proposes additional presentation and disclosure requirements.

Not just for banks

The sickness may have been primarily a feature of banks and other financial institutions, but the cure would apply to everyone.

The expected loss approach is proposed for use in respect of all debt assets, including trade receivables. The ED's approach would lead to expected credit losses being incorporated into trade receivables on initial recognition, reducing both this value and the value of revenue recognised. Subsequent adjustments to expected loss rates would then be recognised within interest income.

To take a simple example, a company selling goods on normal commercial terms (for example, settlement 30 days from the date of invoicing) would currently recognise a sale for £100 at its full invoice value and then recognise any future credit losses outside revenue as they occur. Under the IASB's proposals, the company would estimate its expected level of bad debts (say, 5%) and reduce the value of revenue accordingly (so, to £95). If £100 of cash is subsequently received, the £5 would be presented as interest income rather than as revenue.

Disclosures

Interest income is to be presented both before and after expected credit losses which will give prominence to the margin of contractual income that the borrower is charged to recover the lender's expectations of future credit losses. Separate presentation is also proposed for gains and losses arising from changes in the expectation of credit losses which will give insight into the direction and timing of management's re-estimations. Disclosure explaining changes in estimates would also be required.

The ED proposes that all provisions be in a separate allowance account (which is set off against the loan balance on the face of the balance sheet) instead of directly reducing the carrying value of a loan. Entities would be required to disclose in the notes the size of their allowance accounts which could vary depending on their policy for determining when receivables should be written off. Hence a reconciliation of its use is also required.

An analysis of the year of origination and maturity of loan assets held at amortised cost is also proposed. These disclosures could be quite extensive for entities involved in long term lending arrangements such as residential mortgages. Stress testing information is also required where this is prepared for internal risk management.

Implementation

The objective of the ED is simple. Putting it into practice will not be. For lending entities such as banks, the new approach would require significant demands on information systems with continuous monitoring of expected cash flows required due to the potential complexities in applying the proposed approach in practice. Whilst trading companies that have not previously considered themselves to be involved in lending activities would need to assess expected and actual losses through the life of a receivable. The IASB has acknowledged this by allowing some practical expedients in applying the proposed model. The IASB has also established an expert advisory panel to consider further guidance and practical expedients that may be needed. Although the standard, if adopted, would not be effective until at least 2013, the decision whether to proceed with the proposals is expected to be in the second half of 2010 – this is when the real work will start.

Activities of the IASB

IASB re-exposes liability measurement proposals

The IASB has published for comment a revised exposure draft (ED) of one section of a replacement for IAS 37 Provisions, Contingent Liabilities and Contingent Assets. That section deals with measurement of liabilities that are within the scope of IAS 37.

IAS 37 applies to liabilities not covered by other accounting standards, including liabilities to decommission assets, environmental liabilities, obligations under onerous contracts, and liabilities arising from legal disputes. In June 2005, the IASB had published Proposals to amend IAS 37, including revised measurement requirements. In the light of the comments received, the IASB has decided to issue revised proposals that include more guidance on measurement.

The principal recommendations of the revised ED are as follows:

- IAS 37 currently requires an entity to record an obligation as a liability only if it is probable (i.e. there is a likelihood greater than 50%) that the obligation will result in an outflow of cash or other resources from the entity. The revised ED does not include the 'probability of outflows' criterion. Instead, an entity would account for all present obligations and uncertainty about the amount and timing of outflows would be taken into account by using a measurement that reflects their expected value, namely the probability-weighted average of the outflows for the range of possible outcomes.
- Liabilities within the scope of IAS 37 would be measured at the amount that the entity would rationally pay at the measurement date to be relieved of the liability. Normally, this amount would be an estimate of the present value of the resources required to fulfil the liability, which would take into account the expected outflows of resources, the time value of money, and the risk that the actual outflows might ultimately differ from the expected outflows.
- If the liability is to pay cash to a counterparty (for example to settle a legal dispute), the outflows would be the expected cash payments plus any associated costs, such as legal fees.
- If the liability is to undertake a service (for example, to decommission plant) at a future date, the outflows would be the amounts that the entity estimates it would pay a contractor at the future date to undertake the service on its behalf (i.e. the estimated cost of the services plus an appropriate profit margin).

The deadline for comment on the ED is 19 May 2010 and the IASB intends to replace IAS 37 in the third quarter of 2010.

IFRS for SMEs training material published

The International Accounting Standards Committee Foundation (IASCF) has published the first 12 modules of its comprehensive set of training materials for the IFRS for SMEs. There will be one training module for each of the 35 sections in the IFRS for SMEs, and the remaining 23 modules are planned for release in the next few months. Each module is one pdf file and can be downloaded without charge from the IASCF website.

IASB amends IFRS 1 to add IFRS 7 disclosure exemption

The IASB has amended IFRS 1 First-time Adoption of International Financial Reporting Standards to exempt first-time adopters of IFRSs from providing the additional disclosures introduced in March 2009 by Improving Disclosures about Financial Instruments (Amendments to IFRS 7).

The amendment gives first-time adopters the same transition provisions that Amendments to IFRS 7 provides to current IFRS preparers and is effective on 1 July 2010, with earlier application permitted.

The following amendments can be downloaded from the IASB's website at www.iasb.org

Deloitte (Global) has published special editions of the IAS Plus Update newsletter summarising each amendment. You can find them at www.iasplus.com

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1001ias37ed.pdf> and Deloitte in the UK has issued an iGAAP Alert which is available at <http://www.deloitte.co.uk/audit>

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1001ifrs1amendment.pdf>

IASCF constitution changes take effect

The Trustees of the IASC Foundation (IASCF) have approved changes to the Foundation's Constitution. Those changes took effect on 1 March 2010.

One of the changes was to rename three groups in the organisation to be more closely aligned with the standards (IFRSs), as follows:

- the IASC Foundation has become the IFRS Foundation;
- the International Financial Reporting Interpretations Committee is now the IFRS Interpretations Committee; and
- the Standards Advisory Council is now the IFRS Advisory Council.

Details of changes to the constitution are available on the IASB's website at www.iasb.org

IASB issues Conceptual Framework ED on reporting entity

The IASB and the US Financial Accounting Standards Board (FASB) have published for public comment an ED on the reporting entity concept. The proposals form part of a Joint Project to develop a common and improved conceptual framework that provides the basis for developing future accounting standards.

The principal positions reached in the ED are as follows:

- A reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided.
- An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself. If an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements.
- A portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity.

Comments on the ED are invited by 16 July 2010.

Deloitte (Global) has issued an IAS Plus Update Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1003ed/reportingentity.pdf>

UK GAAP round up

ASB issues Amendment to FRS 25 – Classification of Rights Issues

The Accounting Standards Board (ASB) has issued an amendment to FRS 25 (IAS 32) Financial Instruments: Presentation 'Classification of Rights Issues'. The amendment requires a rights issue involving the exchange of a fixed number of an entity's own equity instruments for a fixed amount of cash denominated in a foreign currency to be classified as an equity instrument.

The amendment follows the issue of 'Classification of Rights Issues – Amendment to IAS 32' published by the International Accounting Standards Board (IASB) in October 2009.

Entities are required to apply the amendment for annual periods beginning on or after 1 February 2010, earlier adoption is permitted.

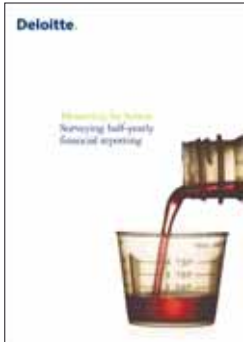
ASB reports on responses to its policy proposal 'The Future of UK GAAP'

The ASB has reported that it has received in excess of 150 responses to its policy proposal: 'The Future of UK GAAP', which was issued in August 2009 and sets out recommendations for the future reporting requirements for UK and Irish entities, with an emphasis on moving UK GAAP towards an international framework.

The ASB now plans to host events to share with UK and Irish constituents its initial analysis of the responses and how the process might be taken forward. After this consultation, it is the ASB's intention to publish an exposure draft outlining the Board's recommendations for the Future of UK GAAP.

The responses to the policy proposal are available for viewing on the ASB's website at www.frc.org.uk/asb/technical/projects/responses_policy.cfm

Publications



Measuring by halves – Surveying half-yearly financial reporting

In “Measuring by halves”, the half-yearly financial reports made by 130 listed companies are analysed.

This publication reviews:

- compliance with the Disclosure and Transparency Rules and IAS 34;
- how companies dealt with developments in IFRSs; and
- what information companies choose to include in their Interim Management Report (the narrative part of the half-yearly financial report).

Of particular interest in the current survey were how companies dealt with the requirements of IFRS 8 and what impact this new standard had on their segmental reporting.

Measuring by halves is available at:

www.deloitte.co.uk/audit



IFRS for SMEs in your pocket – UK edition

“IFRS for SMEs in your pocket – UK edition”, is an 80-page guide that sets out:

- summaries of each section of the IFRS for SMEs;
- key areas of difference with full IFRSs; and
- key UK GAAP conversion issues.

This publication will be of interest to any entities which may use IFRS for SMEs in the future, whether they are currently UK GAAP or IFRS reporters.

IFRS for SMEs in your pocket – UK edition is available at:

www.deloitte.co.uk/audit

IFRS issued but not yet effective or endorsed by the EU

Title	Subject	Mandatory for accounting periods beginning on or after	Endorsed* or when endorsement expected (EFRAG 25 March 2010)
IAS/IFRS standards			
IAS 24 (revised November 2009)	Related Party Disclosures	1 January 2011	Q2 2010
IFRS 9 (November 2009)	Financial Instruments: Classification and Measurement	1 January 2013	To be confirmed
Improvements to IFRSs (April 2009)	Improvements to IFRSs 2009	1 July 2009 or 1 January 2010 (varies by standard) ¹	24 March 2010
Amendments to IFRS 2 (June 2009)	Group Cash-settled Share-based Payment Transactions	1 January 2010	24 March 2010
Amendments to IFRS 1 (July 2009)	Additional Exemptions for First-time adopters	1 January 2010	Q2 2010
Amendment to IFRS 1 (January 2010)	Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters	1 July 2010	Q2 2010
Amendments to IAS 32 (October 2009)	Classification of Rights Issues	1 February 2010	24 December 2009
Interpretations			
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	1 July 2010	Q2 2010
Amendment to IFRIC 14	Prepayments of a Minimum Funding Requirement	1 January 2011	Q2 2010

* The critical date when considering endorsement is the date of approval of the financial statements.

Note 1: EU endorsement is for periods beginning on or after 1 January 2010.

ASB and IASB timetables

ASB Current Projects

The Future of UK GAAP	<ul style="list-style-type: none"> The ASB issued on 11 August 2009 a consultation paper 'Policy Proposal: the future of UK GAAP', which sets out its proposals for the future reporting requirements for UK and Irish entities. The Board's proposals envisage a differential reporting regime based on public accountability, with publicly accountable entities applying IFRS as adopted by the EU, small entities continuing to apply the FRSE and all other entities applying the IFRS for SMEs.
Convergence	<ul style="list-style-type: none"> The ASB and the IASB continually consider what consequential amendments will be needed to UK GAAP once the IASB and IFRIC finalise standards, amendments and interpretations.
Financial statement presentation	<ul style="list-style-type: none"> The ASB, as part of the PAAinE (Pro-Active Accounting in Europe) initiative, has welcomed the discussion paper Performance Reporting prepared jointly by the staff of the Spanish standards-setter (ICAC) and of EFRAG, but does not necessarily agree with all of the views expressed in the paper.
Accounting for Income Tax	<ul style="list-style-type: none"> The ASB and Accounting Standards Committee of Germany (DRSC) have a joint project to consider accounting for income tax from first principles.
Business combinations	<ul style="list-style-type: none"> The ASB, as a result of the IASB issuing a revised IFRS 3 and IAS 27, is reconsidering what action is required to IFRS 36, 37 and 39 as part of its overall convergence strategy.

IASB Project Timeline – Active Projects

Annual Improvements to IFRSs – 2009-2011	<ul style="list-style-type: none"> ED issued August 2009. Final IFRS expected first half of 2010. Further ED expected second half of 2010. Further final IFRS expected first half of 2011.
Common Control Transactions	<ul style="list-style-type: none"> Added to agenda December 2007. Timing not yet determined.
Conceptual Framework Eight phases in all	<ul style="list-style-type: none"> ED on objectives and qualitative characteristics was issued in May 2008. Final chapter expected first half of 2010. ED on reporting entity was issued in March 2010, final chapter expected second half of 2010. DP on measurement expected second half of 2010. DP on elements and recognition expected second half of 2010.
Consolidation, including SPEs*	<ul style="list-style-type: none"> ED issued in December 2008. Round tables held in June 2009. Final IFRS on disclosures about unconsolidated SPEs expected first half of 2010. Final IFRS replacing IAS 27 expected second half of 2010.
Derecognition*	<ul style="list-style-type: none"> ED issued March 2009. Round tables held June 2009. Further ED expected first half of 2010. Final IFRS expected second half of 2010.
Discontinued operations amendment	<ul style="list-style-type: none"> ED issued September 2008. Amendment expected second half of 2010.
Earnings per share amendment	<ul style="list-style-type: none"> Exposure draft issued August 2008. Further discussion expected in 2010.
Emissions Trading Schemes	<ul style="list-style-type: none"> ED expected second half of 2010. Final IFRS expected 2011.

Fair Value Measurement Guidance	<ul style="list-style-type: none"> • ED issued May 2009. • Round tables held second half of 2009. • Final IFRS expected second half of 2010.
Financial Instruments with the Characteristics of Equity*	<ul style="list-style-type: none"> • DP issued February 2008. • ED expected first half of 2010. • Final IFRS expected first half of 2011.
Financial Instruments (replacement of existing standards)*	<ul style="list-style-type: none"> • Classification and measurement of financial assets ED issued July 2009, Final IFRS issued November 2009. • Classification and measurement of financial liabilities ED expected first half of 2010, Final IFRS expected second half of 2010. • Impairment ED issued November 2009, Hedging ED expected first half of 2010, Final IFRSs expected second half of 2010.
Financial Statement Presentation* Phase B: Statement of information in the financial statements	<ul style="list-style-type: none"> • DP issued October 2008. • ED on presentation of items of other comprehensive income expected first half of 2010, Final IFRS expected second half of 2010. • ED on replacement of IAS 1 and IAS 7 expected first half of 2010 followed by round tables second half of 2010, Final IFRS expected 2011.
Income Taxes – limited scope project	<ul style="list-style-type: none"> • ED expected second half of 2010. • Final IFRS expected 2011.
Insurance Contracts – Phase II	<ul style="list-style-type: none"> • DP issued May 2007. • ED expected first half of 2010. • Final IFRS expected 2011.
Joint Arrangements	<ul style="list-style-type: none"> • ED issued September 2007. • Final IFRS expected first half of 2010.
Leases*	<ul style="list-style-type: none"> • DP issued March 2009. • ED expected first half of 2010 followed by round tables second half of 2010. • Final IFRS expected 2011.
Liabilities (IAS 37 amendments)	<ul style="list-style-type: none"> • ED issued June 2005 and certain elements re-exposed in January 2010. • Final IFRS expected second half of 2010.
Management Commentary	<ul style="list-style-type: none"> • Output will be best practice guidance, not an IFRS. • ED issued June 2009. • Final guidance expected second half of 2010.
Post-employment Benefits (including Pensions)*	<ul style="list-style-type: none"> • DP issued March 2008. • ED on defined benefit plans expected first half of 2010. Final IFRS expected 2011. • Final IFRS on termination benefits expected first half of 2010.
Rate-regulated Activities	<ul style="list-style-type: none"> • ED published July 2009. • Final IFRS expected 2011.
Revenue Recognition*	<ul style="list-style-type: none"> • DP issued December 2008. • ED expected first half of 2010 followed by round tables second half of 2010. • Final IFRS expected 2011.

* IASB projects with milestones agreed in the February 2006 IASB-FASB Memorandum of Understanding on convergence – download the MoU at www.iasplus.com/pressrel/0602roadmapmou.pdf

This timetable is derived from the IASB's published timetable supplemented by decisions and comments made at recent meetings of the Board. You will find details on each project, including decision summaries from each Board meeting, at www.iasplus.com/agenda/agenda.htm

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