

# Technically *Speaking*

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External Publication

## Global Economic Crisis - Avoiding an Empty Jar.

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*Part 4*

#### **Global Credit Crunch -**

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*Beyond regulatory compliance*



**Deloitte.**

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# Welcome

Dear Reader

Welcome to our sixth external edition of "Technically Speaking". From all of us at Deloitte, we wish you a successful 2009!

This quarterly publication aims to provide insights, guidance and summaries of issues that are affecting the accounting, auditing and regulatory environment as well as other matters of general interest.

This edition features articles on the Global Financial Crisis – an accounting perspective, another article in the series on IFRS 7, XBRL and a focus on the Deloitte I4U (IFRS) Learning initiative.

We welcome your comments on the publication and ask that you contact our editor Nicolette Meadows ([nmeadows@deloitte.co.za](mailto:nmeadows@deloitte.co.za)) if you have any questions or suggestions for future issues.

Kind regards



**Business Unit Leader**  
**Accounting & Auditing**



# An Accounting Perspective on the Global Credit Crunch

When googling “credit crunch”, there are approximately 9,800,000 hits. It is probably the most talked about financial subject at present. The focus of this article will not be to add to the already huge amount of articles explaining why it reared its ugly head or what could have been done to prevent it, but rather to explain the potential effects of the credit crunch on your financial reporting.

The credit crunch is exactly what it says – the crunch of credit or the shortage of credit in the market.

The shortage of credit, and therefore cash, in the market has the following effects on the economy:

- decrease in credit extensions as a result of bankruptcies and defaults by borrowers;
- demand for credit therefore increases relative to supply which causes increased lending rates; and
- results in reduced consumer spending and therefore reduced economic growth.

With these issues in mind, the following accounting standards require careful consideration:

Accounting Standard	Impact
<b>International Financial Reporting Standard (IFRS) 2 – Share-based Payments</b>	<ul style="list-style-type: none"> <li>• A large number of entities have issued share options to Black Economic Empowerment (BEE) partners with specified vesting periods. The credit crunch may have resulted in instances where the strike price of the options exceeds the market price of the underlying shares at the end of the vesting period. These options are “out of the money” and will not be exercised by the BEE partners. Entities might therefore have to reconsider their BEE transactions and may consider repricing the deals. Such repricing would be a modification under IFRS 2. Modifications in the terms of share-based payment transactions which result in the employee being in a better position than before the modification, generally result in the difference between the original issue and the new issue being expensed immediately.</li> <li>• Consideration should be given to the measurement of new BEE transactions by reference to fair value. The models used to calculate fair value make use of inputs such as exercise price, share price, expected dividends, and expected volatility, all of which may have changed significantly.</li> </ul>
<b>IFRS 3 – Business Combinations</b>	<ul style="list-style-type: none"> <li>• The fair values of the identifiable assets acquired used in the calculation of goodwill need to be carefully considered and may be lower than expected. This could result in higher than expected goodwill and consequent consideration of impairment.</li> <li>• Acquirers who are still within the 12 month remeasurement period permitted by the standard should not restate acquisition date fair values for changes which have occurred as a result of the credit crunch post acquisition.</li> </ul>
<b>International Accounting Standard (IAS) 2 – Inventories</b>	<ul style="list-style-type: none"> <li>• Inventory is calculated at the lower of cost and net realisable value. Decreased consumer spending results in a reduction in demand which in turn may result in lower net realisable values.</li> </ul>
<b>IAS 10 – Going Concern</b>	<ul style="list-style-type: none"> <li>• Deterioration in operating results and financial position may indicate a need to consider if the going concern assumption is still applicable.</li> </ul>
<b>IAS 12 – Income Taxes</b>	<ul style="list-style-type: none"> <li>• The recoverability of deferred tax assets should possibly be re-assessed.</li> </ul>
<b>IAS 16 – Property, Plant and Equipment IAS 38 – Intangibles IAS 36 – Impairment</b>	<ul style="list-style-type: none"> <li>• The impairment of assets needs to be investigated when an indicator of impairment exists. The fact that the market capitalisation of an entity is less than the carrying amount of its net assets is an indicator of impairment.</li> <li>• One should be cautious in cash flow estimates in the assessment of the value in use of an asset.</li> <li>• The residual values of fixed assets might be lower than expected as a result of decreasing realisable values.</li> <li>• Discount rates, particularly for foreign markets where long term rates are declining, should be carefully considered where the impairment calculation uses discounted cash flow methodology.</li> </ul>



Accounting Standard	Impact
<b>IAS 19 – Employee Benefits</b>	<ul style="list-style-type: none"> <li>• The decrease in market value of funds invested could cause defined benefit plans to be in deficit.</li> <li>• Defined benefit liabilities could also be understated due to higher discount rates being used. Consider the appropriateness of discount rates applied.</li> </ul>
<b>IAS 37 - Provisions, Contingent Liabilities and Contingent Assets</b>	<ul style="list-style-type: none"> <li>• In times of difficulty, entities may understate provisions.</li> <li>• Provisions which are discounted could be understated due to relatively high discount rates being used.</li> </ul>
<b>IAS 39 - Financial Instruments: Recognition and Measurement</b>	<ul style="list-style-type: none"> <li>• One of the biggest impacts of the credit crunch has been the effect on the fair values of financial assets held at fair value through profit and loss (FVTPL) and available-for-sale financial assets (AFS). The deterioration of the world's financial markets resulted in the International Accounting Standards Board (IASB) allowing the reclassification of financial instruments which were held at fair value.</li> <li>• Reclassification is allowed during rare circumstances. The IASB have indicated the financial crisis to be such a circumstance. The Accounting Practices Board (APB) is however of the view that it is highly unlikely that there are such circumstances in South Africa. Rare circumstances may only exist for South African companies that have operations or financial assets in other countries (<a href="https://www.saica.co.za/documents/APBchangesIAS39IFRS7_27October2008.pdf">https://www.saica.co.za/documents/APBchangesIAS39IFRS7_27October2008.pdf</a>). For detailed information on allowed reclassifications please refer to <a href="http://www.iasplus.com/iasplus/0810reclassifications.pdf">http://www.iasplus.com/iasplus/0810reclassifications.pdf</a></li> <li>• Caution should be taken when different valuation models are used in the calculation of fair value during this crisis period to obtain a predetermined outcome.</li> <li>• The inability of consumers to repay their debt might also be cause for impairment, for example, additional provisions being made for accounts receivable and loans.</li> <li>• Consider the appropriateness of discount rates and other assumptions used in valuations.</li> <li>• Consider carefully the appropriateness and application of valuation models applied to instruments for which the markets are no longer active.</li> </ul>
<b>IAS 40 – Investment Property</b>	<ul style="list-style-type: none"> <li>• Investment property measured at fair value might decrease as a result of a decline in the property market.</li> </ul>

For more information please contact your client service partner.



**Riek Olivier**  
Manager: A&A



# IFRS 7 and its liquidity risk disclosure requirements: *Part 4*

Liquidity risk is defined in IFRS 7, Financial Instruments: Disclosures (IFRS 7) as, ‘the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities’

The main text of IFRS 7 contains a single paragraph that addresses the specific disclosure requirements for liquidity risk. The application thereof requires guidance. The liquidity disclosure requirements pose a number of interesting considerations. The articles contained in our previous editions of *Technically Speaking* (1) introduced the list of these interesting considerations and (2) covered the first four considerations ((i) Demand based liabilities, (ii) Floating rate liabilities, (iii) Foreign denominated financial liabilities and (iv) Off balance sheet financial liabilities). This article will cover the final two considerations.

## 1. Derivative financial instruments

All derivatives that are financial liabilities at the reporting date should be included in the liquidity analysis. Regardless of whether they are held for trading intentions or for specific long term hedging purposes, the cash flows should be presented on a contractual, undiscounted basis. Again, where the cash flows of derivatives are variable in nature, one should consider whether the absolute or curve approach should be used in disclosing the cash flows.

IFRS 7 distinguishes between net and gross settled derivatives for the purposes of the liquidity analysis:

- *Net settled derivatives* – those for which there are contractual net cash flows (e.g. local interest rate swaps) where disclosure of the future net cash flows is required; and

- *Gross settled derivatives* – incorporate separate pay and receive legs (e.g. forward exchange contracts, cross currency swaps and option contracts) where disclosure of the gross (outflow) leg is required.

## 2. Time periods used for liquidity analysis

Whilst IFRS 7 does not prescribe which time periods should be used in the liquidity analysis, the time bands used should, where applicable, be equivalent to those reported internally. It is however recommended that the time bands provide sufficient disclosure of material cash flow requirements. For example, an entity may have significant liquidity requirements in a month's time, in which case aggregating all the liquidity requirements of the first year into one time band may not be appropriate.

For more information regarding Financial Instrument disclosures, please contact your client service partner.



# XBRL beyond regulatory compliance...

In previous editions of Technically Speaking we explained what **eXtensible Business Reporting Language (XBRL)** is and where adoption around the world, and in the South African market, is heading. This article will briefly explain the benefits of XBRL beyond regulatory compliance.

## Risks to CFOs:

- Increasingly complex compliance regulations;
- More tight filing deadlines;
- Pervasive use of complex spreadsheets in the finance department;
- Expanding disclosure in interim and annual reports;
- More people involved in preparing these reports; and
- CFO retains accountability for these external financial reports.

## A broken process...

It is safe to assume that many organisations use Microsoft Word and Excel documents to prepare monthly and annual financial statement reports. These documents are usually very complex and contain links between different files and for some of the inputs, data has to be entered manually. In addition, this process usually has to be started from scratch in every new accounting period. It requires manually intensive work to maintain the integrity of these documents, which becomes time-consuming.

Furthermore, only about 40 – 50% of the information in your annual and interim financial statements is derived from the trial balance – the rest comes from these other external sources and documents. Often the knowledge of maintaining and updating these documents resides with a limited number of individuals within the organisation.

As a result of this “broken process” financial information only reaches the market two or three months after your financial year-end!

## Will XBRL solve this “spreadsheet nightmare”?

No, not exactly... But the implementation of **XBRL requires that organisations re-assess their current financial reporting process**. The reason being is that with XBRL comes automation and in order to assign appropriate tags, financial information in current application systems needs to be granular enough for the tagging process to be effective.

There are solutions available in the market that can automate the financial reporting process (like the process explained above). Furthermore, nothing stops you from creating your own taxonomy to meet your own reporting requirements. An automated solution reduces the risk of errors and means a reduction in the reporting cycle time, while improving data integrity.

Furthermore, the software has XBRL embedded in it. This means that once your data is tagged, you will be able to export your data in XBRL format for further consumption by regulators, investors, analysts, etc.

## Conclusion

XBRL results in organisations re-assessing their current financial reporting process in order to do things smarter and faster. Why not start educating yourself now and be one of the first...?

For more information, please contact Gavin Marais at [gmarais@deloitte.co.za](mailto:gmarais@deloitte.co.za).



**Gavin Marais**  
XBRL Southern Africa  
Leader



**Theodore de Jager**  
Manager: AGA



# I4U (IFRS for you) - Creating a new spin on keeping clients up to date!



During 2008 Deloitte introduced I4U (IFRS for you) as a meaningful solution in meeting the SAICA Continuing Professional Development (CPD) requirements of our clients in the field of financial reporting.

## So what is I4U?

I4U is a series of financial reporting update seminars facilitated by experienced presenters in the comfort of your client's own office. Through real-life examples these seminars provide participants with IFRS updates, IFRIC interpretations, SAICA guidance and other accounting and regulatory best practices. Clients are empowered through these sessions with a practical understanding of their personal implementation considerations around hot accounting topics.

For more information, please contact your client service partner.



**Lindie Muller**  
Senior manager: A&A





# In Closing

## Note from the Editor

Dear Reader

Thank you for reading the sixth edition of our client focused technical publication “Technically Speaking”, which we hope you enjoyed. You can subscribe to receive a copy of our quarterly publication on the website [www.deloitte.com/za](http://www.deloitte.com/za). You will receive an automatic email alert whenever a new issue is published:

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We welcome your comments and suggestions, which can be emailed to [technicallyspeaking@deloitte.co.za](mailto:technicallyspeaking@deloitte.co.za).

Nicki

Nicolette Meadows



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