

Q&A Report

IFRS: Important Developments

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Host: Joel Osnoss

Presenters: Randall Sogoloff and Andrew Spooner

1. What does "not all parties need to be joint venturers or joint operators" mean?

There may be situations where you have more than two investors but not all investors are a party to the joint contractual arrangement. Those other parties would not account for their interest under the new joint venture standard but rather would look to IFRS 9 or IAS 28. For example, assuming an entity is formed with three investors – Investor A, B, and C. Investors A and B each has a 40% interest in the entity and Investor C has a 20% interest. Investors A and B are party to a contractual arrangement such that it takes the unanimous consent of both parties to make decisions. In this case, Investors A and B would be joint venturers or operators while Investor C would account for its interest under IAS 28 (assuming it has significant influence).

2. Do you think that many countries will switch from proportionate consolidation to equity method?

Proportionate consolidation is used quite often under the current IAS 31, so we believe many companies will need to switch to the equity method of accounting if the joint arrangement is considered a joint venture under the new standard.

3. If holding 40% of a listed company, the remaining voting rights are held by numerous parties with no relationship. There is no agreement between these parties to act against or for the majority shareholders, does it meet the definition of de facto control?

The conclusion will depend on facts and circumstances. Much will depend on the number of investors, how much larger the holding is as compared to the other holdings, past voting practices of the largest holder and the other investors. Also, is there a board of directors, how controls key management, what are the rights of

the 40% holder, and are there potential voting rights. The scenario provided does not provide enough facts but it is possible that the 40% holder could control.

4. Why the prescription of principal / agent relationship included in "consolidation" but not "revenue"?

The principal / agent relationship for consolidation is a very different concept as compared to revenue. For consolidation, the objective is to determine whether a party is the one with power while under revenue, the objective is to determine whether a party has risks and rewards of ownership of goods. The principal / agent guidance in the new consolidation standard is meant to focus on parties like fund managers that have the power to make significant decisions but may be acting on behalf of investors.

5. Why is "jointly controlled assets" removed? Is this now included in "joint operation"? But in fact the joint venture may not involve "operation"?

The IASB thought that it was redundant to have both jointly controlled asset and operations because the accounting is the same. The IASB clarified that the determination as to whether an arrangement is a joint venture or a joint operation has nothing to do with whether an entity is used or whether there is an operation or just an asset. It is based on the rights and obligations of the joint operators or joint venturers.

6. How possible will the ED hedge accounting be issued by June?

It is not expected to be issued as a final standard in June 2011, although the IASB expect to complete their deliberations and vote on the finalization of the hedge accounting reforms at their June meeting. We expect therefore that the finalized requirements will be included as an amendment to IFRS 9 after June, possible July or August. It is too early to say when it will be published. There is potential that the dates could be pushed back further if the Board discussions include the FASB and result in disagreements between the two Boards, but it is not possible to determine whether this is likely.

It should be noted that the hedge accounting ED we are referring to is the general hedge accounting model only with the macro / portfolio hedge accounting model will be included at a later date. An exposure draft for the macro / portfolio hedge accounting will need to be issued for public comment and we do not expect this to be issued until later this year.

7. How does the new consolidation standard affect mutual fund managers?

The principal / agent guidance in the new standard could significantly impact mutual fund managers. These parties may have concluded under current guidance that they do not control because they are just an agent acting on behalf of the investors. The new standard will provide specific criteria for determining whether a party is a principal or agent. For example, a mutual fund manager that also has an interest in the fund may be considered a principal if it is large enough. Also, a fund manager may be considered as a principal if the fee for services is not at fair value.

8. The concept of "Silo" is so difficult to understand. Can you elaborate in a simple way?

Silos are parts of entities. In other words, depending on how the transaction is set up, a party could control part of the entity and therefore consolidate only part of an entity. The determination is based on whether the assets and liabilities of the part of the entity are separate from the other assets and liabilities of the larger entity. For example, are cash flows separated and are the risks and reward separated?

9. Concerning time value of option, IFRS 9 gives good opportunity to have less volatility in the P&L. What about time value of forward contracts?

The ED only referred to time value for options and therefore did not extend the proposals to forwards and the deferral of the fair value of forward points. As IAS 39 already permits the forward points to be designated as part of the hedged risk, then the fair value associated with them can be deferred in OCI already under IAS 39 in a cash flow hedge. We would expect that this would still apply in the finalized standard. An interesting question is whether if an entity chose not to designate the forward points, and instead chose to designate only the spot risk, how the forward points would be treated (i.e., would the Board permit recognition of the fair value of forward points in other comprehensive income?). We would consider this unlikely; however, it is not clear yet whether the IASB will reconsider their approach to forward points in light of their proposals for time value of options.

10. Do you think this will be all wrapped up before the end of June, being Sir David Tweedie's retirement from the IASB?

The IASB revisited their timetable on 28 March 2011 to make clear that Standards which were expected to be issued by June 2011 would not be issued by that date, rather the Board deliberations and vote would be completed by that date. Therefore, the actual issue of the final standards will not be issued until the second half of 2011 though the Boards are not specific about when in that period.

**11. It sounds like the impairment supplement was written with banks in mind?
Do they like it and do the proposals apply to non-banks?**

There has been considerable focus on the credit risk management processes within banks as their balance sheets include a disproportionate amount of financial assets at amortized cost and also have more complex processes for managing the risks associated with those assets compared with non-banks. Specifically, the Boards were keen to find an impairment model that would be operational for lenders that have open portfolios of loans. However, the finalized requirements will apply to all debt instruments measured at amortized cost under IFRS 9, which of course includes trade receivables, investments in corporate / government bonds, as well as more traditional loans. There may be practical expedients introduced for measuring impairment for short-term receivables but this has not yet been finalized.

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