

Q&A Report

IFRS: Important Developments

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Host: Randall Sogoloff

Presenter: Philip Barden

1. Will the hedging standard be issued in Q4 2011 rather than Q1 2012?

The IASB has indicated that they plan to post a “review draft” of the final hedge accounting standard by the end of 2011. The IASB will allow constituents to comment on the review draft for a period of 90 days, but it is unclear whether they will discuss the comments or finalize the review draft as is. The IASB wants to provide the FASB some additional time to develop a plan for their hedge accounting project before finalizing their standard.

2. In which hierarchy will the residual value be computed – first for service or for products?

At present, we expect that the Exposure Draft (ED) will propose to allow a residual approach if the stand-alone selling price of a good or service is highly variable or uncertain. In such circumstances, an entity might estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. Therefore, the residual approach might be applied either to a good or a service, depending on the specific facts and circumstances.

3. Curious about the impact of these revenue recognition principles on IFRS 9. Your high level views?

At this stage, we are not aware of any significant changes proposed to IFRS 9 as a result of the ED. However, the question of scope is likely to be important. We expect the ED to distinguish between unconditional rights to consideration (which would be accounted for in accordance with IFRS 9) and other rights to consideration (which would be accounted for in accordance with the proposals in the ED). The measurement requirements of the ED are likely to be quite different from those of IFRS 9, particularly in relation to variable consideration.

4. What about contract in foreign currencies when the payment terms are different? For example, the same contract billed one year in advance and the other billed one year in arrears. Would not this affect financing result on the contract in local currency?

The ED is expected to propose that an entity would adjust the promised amount of consideration to reflect the time value of money if a contract has a financing component that is significant to the contract. This would apply both to payments in advance and payments in arrears. However, as a practical expedient, we believe the ED will propose that no adjustment for the time value of money is required if, at contract inception, the period between customer payment and transfer of goods or services is expected to be one year or less.

At this stage, we are not expecting the ED to include any specific guidance on foreign exchange, but the normal requirements of IAS 21 *The Effects of Changes in Foreign Exchange Rates* would continue to apply. For a contract in a foreign currency, an entity's foreign exchange gains and losses would typically be different depending on when the customer pays.

5. Should Incoterms be considered in revenue recognition in trading business? If yes, how should we apply it in revenue recognition?

Under IAS 18 *Revenue*, Incoterms are often part of the evidence that should be considered when determining the appropriate point at which to recognize revenue. This is because they can affect when particular risks are transferred from the seller to the customer. Although the ED will propose a model based on the concept of control, one of the indicators of control is expected to be that the customer has the significant risks and rewards of ownership of the asset. Therefore, Incoterms are likely still to be relevant under the proposals in the ED.

6. Can you describe the amendments to IAS 32 in the offsetting project?

The amendments will clarify the following:

A right of set-off must be legally enforceable both in the normal course of business and in the event of default, bankruptcy, and insolvency of one of the counterparties.

Gross settlement systems that have the following distinguishing factors would be considered equivalent to net settlement:

- Financial assets and financial liabilities that meet the right of offset criterion are submitted for processing at exactly the same point
- Once submitted for processing, the transactions cannot be cancelled or altered [there is no liquidity or credit risk]

- There is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing unless the processing fails [there are no potential change in cash flows]
- If the processing of one asset or liability that is offset against another fails, then the processing of the related security used as collateral also fails [there is always net exposure / similar to a securities transfer system or delivery versus payment]
- Processing is carried out through the same settlement depository [for example, delivery versus payment or the same depository account]
- There is a high likelihood that an intraday credit facility is available and would be honored until the settlement process is complete [there is no settlement (liquidity / credit) risk]

The offsetting criteria and amendments to the offsetting application guidance will remain in IAS 32, and should be applied retrospectively and be effective for annual and interim reporting periods beginning on or after 1 January 2013.

7. How does the IASB's investment entity ED differ from the FASB's proposal?

The following are the significant differences:

- The FASB would explicitly include an investment company that is regulated under the Investment Company Act of 1940 in the scope of the proposals
- The IASB would require an investment entity to consolidate an investee that provides services that relate only to the entity's own investment activities and the IASB would require an investment entity that takes control of collateral as a result of defaults relating to its investments to account for such assets and related liabilities in accordance with other applicable IFRSs. The FASB proposals would require fair value accounting in these instances
- The IASB would require an investment entity to consolidate all entities that it controls, including those controlled through an investment entity, unless the parent itself is an investment entity. The FASB proposals would retain fair value accounting for a noninvestment company parent
- Differences also exist for fund-of-funds structures, master-feeder structures, when an investment entity no longer meets the investment entity definition and certain disclosure requirements

8. What are some possible projects the IASB could add to their future agenda?

The IASB has indicated that completing the Conceptual Framework and developing a disclosure framework will be priorities. There are numerous projects that could be added, including agriculture, earnings per share, emissions trading, financial statement presentation, income taxes, and rate-regulated activities. There are many other potential projects.

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