

# Accounting Alert

## Staying on top of developments



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This Accounting Alert provides you with information about a number of recent developments in financial reporting, including exposure drafts issued by the International Accounting Standards Board (IASB) and New Zealand Financial Reporting Standards Board (FRSB). The IASB is expected to be very busy this year as they plan to issue new standards on revenue recognition, leases, insurance and financial instruments before the Chairman and several other IASB members step down in June. We summarise the hedge accounting exposure draft below, the last of the exposure drafts to be issued on these topics.

We will continue to keep you apprised of developments as they occur, so watch this space ...

## Relief for some entities affected by Budget 2010 in relation to loss of tax depreciation on buildings

Our **special tax and accounting alert** issued in June 2010 outlined the impact on deferred tax from the 2010 Budget's removal of tax depreciation on buildings, with several entities subsequently reporting significant increases in their deferred tax liabilities.

The IASB has now released an amendment to the income taxes standard which provides relief for some affected entities. The amendment introduces a rebuttable presumption that recovery of the carrying amount of investment property carried at fair value will be through sale unless the investment property is depreciable and is held within a business model whose objective is to consume all the economic benefits over time, rather than through sale.

The proposal in the exposure draft extended this exemption to property, plant and equipment and intangible assets if they were accounted for using a revaluation model, but due to comment letters received this was not passed through to the final amendment. Therefore, entities with buildings classified as property, plant and equipment will not get the relief hoped for.

The effective date of the amendment is for annual periods beginning on or after 1 January 2012 with earlier application permitted.

Further information can be found in the following Deloitte newsletter available on [www.iasplus.com](http://www.iasplus.com): **IFRS in Focus: IASB issues amendments to IAS 12**, and the **amendment** is available on the NZICA website.

## Changes to financial instruments ongoing

The IASB is continuing with its project phases to ultimately replace IAS 39: *Financial Instruments: Recognition and Measurement* with a new standard IFRS 9: *Financial Instruments*. The first phase of the project is complete with the issue of revisions to IFRS 9 covering accounting for financial liabilities. The second phase on impairment is outstanding, and in December 2010 the IASB released an exposure draft on hedge accounting, the third phase of the project. A separate project looking to change the derecognition requirements of IAS 39 has been shelved with the IASB carrying over the existing requirements to IFRS 9, although amendments to IFRS 7: *Financial Instruments: Disclosures* have been proposed to improve disclosure in this area.

### Amendments to IFRS 7

**Amendments to IFRS 7** have been made to improve disclosures around the transfer of financial assets (for example, in securitisation transactions), including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period.

The enhanced disclosure requirements apply to annual periods beginning on or after 1 July 2011 with comparative information not required in the first year of application.

### Revisions to IFRS 9 for financial liability accounting

The initial IFRS 9 issued addressed classification and measurement of financial assets only. IFRS 9 has now been updated to include accounting for financial liabilities. The classification and measurement requirements from IAS 39 remain largely unchanged except that:

- fair value changes arising from the entity's own credit risk in relation to financial liabilities measured at fair value using the fair value option (that are not held for trading, loan commitments or financial guarantee contracts), are recognised in other comprehensive income unless this creates or increases an accounting mismatch, and
- the cost exemption in IAS 39 for derivative liabilities to be settled by delivery of unquoted equity instruments is eliminated.

Further information can be found in the following Deloitte newsletter available on [www.iasplus.com](http://www.iasplus.com):

**IFRS in Focus: IASB issues revisions to IFRS 9 for financial liability accounting**, and the **revised NZ IFRS 9** is available on the NZICA website.

### Hedge accounting exposure draft

The IASB is proposing an overhaul to hedge accounting to align hedge accounting with an entity's risk management activities when hedging financial and non-financial risk exposures. Along with enhanced disclosures, the aim is to help investors to better understand the impact of an entity's hedging activities on future cash flows.

Some of the proposals include:

- An easing of qualifying hedge criteria allowing for more instruments and 'economic hedges' to qualify for hedge accounting.
- Allowing risk components of non-financial items to be hedged if they are separately identifiable and reliably measurable, such as operating lease rentals linked to inflation, or the oil price component of jet fuel.
- Removal of the bright line tests for effectiveness testing of hedges. Instead of an arbitrary 80 – 125% effectiveness range, testing will be conducted by reference to the entity's risk management objective, relying more on judgement. In addition testing will only be required prospectively removing the requirement to test retrospectively.

- Extending the use of hedge accounting to net positions.
- Changes to hedge relationships would be allowed in some circumstances without having to close down the existing hedge and start again.
- Some or all of the time value element of a purchased option can be deferred in other comprehensive income as a cost of hedging instead of being taken to profit or loss which may make options more attractive as hedging instruments.
- Changes in the presentation of fair value hedges with the gains and losses recognised in other comprehensive income and any ineffectiveness in profit or loss.
- Enhanced disclosures that focus on the risks being hedged, how those risks are being managed and the effect of hedging those risks upon the primary financial statements.

The IASB is continuing to discuss proposals for hedge accounting for open portfolios and macro hedging.

Comments are due to the FRSB by 1 March 2011 and to the IASB by 9 March 2011.

Further information can be found in the following Deloitte newsletter available on [www.iasplus.com](http://www.iasplus.com):

***IFRS in Focus: IASB issues exposure draft on hedge accounting***

Stephen Cooper, a Board member of the IASB has also written an article for the IASB's investor perspectives series on ***Reforming hedge accounting***

The **exposure draft**, the **basis for conclusions and illustrative examples** and the **request for comment** are available on the NZICA website.

## IFRS Practice Statement on Management Commentary

The IASB has issued a practice statement on management commentary outlining a framework for presenting narrative information accompanying financial statements prepared in accordance with International Financial Reporting Standards (IFRS). As a practice statement, it is not binding on entities unless specifically required by their jurisdiction. The Practice Statement is not currently binding for New Zealand entities.

The core principles for management commentary are to provide management's view of the entity's performance, position and progress, and to supplement and complement information presented in the financial statements. To align with these principles, management commentary should include forward looking information and follow the qualitative characteristics described in the *Conceptual Framework for Financial Reporting*.

Elements of management commentary will depend on the facts and circumstances of an entity. The practice statement outlines the following areas for information:

Nature of the business	Management's objectives and strategies for meeting them	Significant resources, risks and relationships	Results of operations and assessment of prospects	Critical performance measures and indicators used by management
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Further information can be found in the following Deloitte newsletter available on [www.iasplus.com](http://www.iasplus.com):

***IFRS in Focus: IASB issues Practice Statement on management commentary***

The **IFRS Practice Statement** is available on the IASB's website.

## Securities Commission – Review of Financial Reporting by Issuers (Cycle 12)

Cycle 12 of the Securities Commission's financial reporting surveillance programme covers issuers with financial periods ending between 30 June 2009 and 31 January 2010. The Commission has noted that under NZ IFRS it is writing to more issuers and raising more matters than it did under previous NZ GAAP. In particular, we note that the number of issuers being written to following review of their financial statements was on average only 44% under previous NZ GAAP but is 82% under NZ IFRS. While this reflects the increased complexity of NZ IFRS, the Commission is looking for this data to improve.

The main areas from Cycle 12 warranting letters to issuers included:

- inadequate or incorrect information on financial instruments covering topics such as the classification of financial assets, accounting policies for impairment, disclosure of concentrations of credit risk by security type and disclosures regarding fair-value assumptions,
- inadequate explanations for transactions in the cash flow statement, and
- inadequate disclosure of significant assumptions underlying valuations of property, plant and equipment.

Matters around goodwill impairment, segmental reporting and non audit services are also continuing to be identified.

The Cycle 12 report also notes that the Commission supports additional non-GAAP disclosures that improve a user's understanding of the financial statements, however these need to be properly disclosed and communicated consistently applied and not replace or be disclosed more prominently than financial information that does comply with GAAP.

The report also includes information from a workshop held with financial reporting preparers and auditors in Auckland on in July 2010. In particular, the Commission considers that issuers should:



The **Cycle 12** report is available on the Securities Commission's website at [www.seccom.govt.nz](http://www.seccom.govt.nz)

Our Deloitte publication **Reporting underlying profit**, also includes some best practice guidelines and an example of reporting alternative non-GAAP measures.

## Other topics of interest

### **Request for Views on Effective Dates and Transition Methods**

Given the significance of the projects to be finalised this year (revenue recognition, leases, insurance and financial instruments), the IASB is asking for feedback on the time and effort that will be involved in implementing the new IFRSs expected to be issued in 2011 and asks questions about the appropriate transition methods and effective dates for these standards.

The comment period has closed to the FRSB but is open for a couple more days (until 31 January 2011) to the IASB. For more information read our **IFRS in Focus**. The **Request for Views** is available on the NZICA website.

### **Proposed Amendments to FRS 43: Summary Financial Statements**

The FRSB has issued an exposure draft (ED 124) proposing to amend FRS 43 in order to address how the standard applies to summary reporting such as five-year summaries presented under the Securities Regulations 2009. In particular the exposure draft proposes to:

- extend its scope to summary financial statements included in the same document as full financial statements if required by regulation,
- clarify that where an entity has restated or reclassified comparative information, multi-period summaries must be drawn from the restated or classified information, and
- align with the auditing standard ISA (NZ) 810 *Engagements to Report on Summary Financial Statements*. The ISA anticipates that summary financial statements may not disclose events that occur subsequent to the date when the full financial statements were issued, with the auditor being required to state that subsequent events have not been reflected in the summary financial statements. FRS 43 currently requires the disclosure of subsequent events so the exposure draft proposes to remove this requirement.

Comments are due to the FRSB by 31 March 2011.

The **Exposure Draft** is available on the NZICA website.



### Exposure Draft regarding Concessionary Loans

The FRSB has issued an exposure draft to add explanatory comment to NZ IAS 39, NZ IFRS 9 and NZ IFRS 7 for public benefit entities in regards to concessionary loans (ED 125). While the proposals are to add guidance on accounting for concessionary loans and require additional disclosures they should not change existing practice.

Concessionary loans are loans granted or received at off-market terms. Examples provided include loans to developing countries, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. As these loans are off-market, the transaction price on initial recognition may not be its fair value.

The guidance sets out a process to follow in determining the components for the transaction.

- determine whether the concessionary loan is in fact a loan or a grant, increase in equity, equity contribution to another entity, or a combination of these items,
- if the transaction (or a part of it) is a loan, determine whether the transaction price is fair value. Fair value is determined following the principles of NZ IAS 39.AG69-82,
- any difference between the fair value of the loan and the transaction price (the loan proceeds) is:
  - recognised as income in profit or loss for loans received by an entity, unless the loan represents an equity contribution from another entity, and
  - recognised as an expense in profit or loss for loans granted by an entity, unless the loan represents an equity contribution to another entity (effectively is a distribution).

The proposals require disclosure of the fair value adjustment made on initial recognition of concessionary loans granted.

The **Exposure Draft** is available on the NZICA website.

### International public sector activity

The International Public Sector Accounting Standards Board (IPSASB) has issued an exposure draft and two consultation papers on its development of a conceptual framework for the general purpose financial reporting of public sector entities:

- The exposure draft covers the *Role, Authority, and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*. It proposes objectives for financial reporting that are to provide information for accountability and decision-making purposes and suggests that the scope of financial reporting should include more comprehensive financial and non-financial information than is traditionally included in financial statements.
- One of the consultation papers covers the elements of financial statements and their recognition. It identifies alternative asset and liability-led and revenue and expense-led approaches to financial statements and considers the key characteristics of assets, liabilities, revenue and expenses.
- The other paper addresses measurement of assets and liabilities, considering the measurement bases that may be appropriate for the elements that are recognised in financial statements, discussing historical cost, market value, replacement cost and deprival value.

Comments are due to the FRSB by 15 May 2011 and to the IPSASB by 15 June 2011. While these standards are not currently mandated for use in New Zealand, the Ministry of Economic Development (MED) and the Accounting Standards Review Board (ASRB) are currently undertaking a review of the financial reporting framework in New Zealand. As part of this review they are considering the suite of standards issued by the IPSASB as an alternative to IFRS for public benefit entities.

The Exposure Draft and Consultation Papers are available on the IFAC website at [www.ifac.org/Guidance/EXD-Outstanding.php](http://www.ifac.org/Guidance/EXD-Outstanding.php).

### Revenue recognition for technology companies

The IASB is currently reviewing comments received on its exposure draft looking to replace existing revenue standards (IAS 11 *Construction Contracts* and IAS 18 *Revenue* and related interpretations) with a new standard on *Revenue from Contracts with Customers*.

Deloitte UK has published *Accounting in the technology industry: Re-computing revenue*, giving examples of how the proposed approach in the Exposure Draft will be applied in scenarios common to technology companies who report under IFRS.

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