

iGAAP Newsletter

Beyond the standards



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Upfront

The past few months have seen a flurry of activity at the IASB in respect of their project to replace IAS 39, the current standard on financial instruments. The ED on hedge accounting published in December was followed, in January, by a supplementary ED on impairment of financial assets.

In response to this we have included two topics of focus in this quarter's newsletter. The first explores the IASB's proposals for hedge accounting which aim to address a number of practical problems with the existing Standard and the second topic of focus considers the joint proposals of the IASB and FASB in respect of impairment of financial assets managed in an open portfolio.

You will see from the IASB's timetable that April will be a busy month as we are expecting a number of new standards, including Consolidation and Joint Ventures, to be published. There will be plenty to report on in our next newsletter.

Toon Clerckx, Finance Director of Alliance Boots Health & Beauty division, is our interviewee this quarter. With a business operating a large number of stores in the UK he is paying close attention to the latest developments in the IASB's project to replace the current leasing standard.

Deloitte LLP
March 2011

Topic of focus:

Hedge accounting

What's changing in the world of hedge accounting?

In response to popular demand, the rules on hedge accounting in IAS 39 Financial Instruments: Recognition and Measurement are being re-written by the IASB. It is a comprehensive project that addresses a number of practical problems with IAS 39. The IASB issued an exposure draft (ED) in December 2010 and the comment period ended on 9 March 2011. Overall, the comments have been very supportive of the thrust of the project which has been working towards a more principles based standard focused on better reflecting an entity's risk management activities in the financial statements.

IAS 39 replacement project

The hedge accounting project represents phase three of the wider project to replace IAS 39 in its entirety with a new standard, IFRS 9. The hedge accounting project has two work streams. The first is focussed on the *general hedge* accounting model and is the subject of the ED issued in December 2010. The second is focussed on the *portfolio* hedge accounting model. This work stream is still in progress (see below) and an ED on the topic is expected by the end of the year.

Phase one of the IAS 39 replacement project, on classification and measurement of financial instruments, is complete and included in IFRS 9. When phase two, on impairment of amortised cost assets, and phase three on hedge accounting are complete, the new requirements will be added to IFRS 9.

Project objectives

The overarching objectives of the hedge accounting project are to (1) reduce complexity by relying more on principles instead of rules; and (2) better reflect risk management activities in the financial statements. These objectives have been challenging at times for the IASB, if not competing. For example, true simplicity would come from abolishing hedge accounting entirely. However, this would not allow for a sensible reflection of risk management activities in the financial statements. Given this tension between the objectives, the proposals do introduce complexity in some areas for the benefit of better reflecting risk management. Below is analysis of some key proposals in the ED.

Effectiveness testing

The ED if finalised would overhaul the effectiveness testing requirements in IAS 39 which have long been criticised for being arbitrary. IAS 39 requires a hedge to be 'highly effective' on a forward-looking, expected basis, as well as a backward-looking, actual basis, if it is to qualify for hedge accounting (known respectively as the prospective effectiveness assessment test and the retrospective effectiveness assessment test). The 'highly effective' threshold is applied as a bright line, quantitative, threshold of 80 to 125 per cent offset. This has resulted in hedges sometimes failing for accounting purposes due to technical problems whilst remaining sound from a risk management perspective (e.g. due to small changes in fair values of the hedged item and hedging instrument it is easy to fall out of the strict 80 to 125 per cent range). Also, some entities have found the quantitative analysis to demonstrate compliance with the quantitative threshold to be too onerous.

Retrospective test

To address these issues the IASB has proposed removing the retrospective effectiveness test. This change would avoid test failures arising from unexpected events and 'technicalities'. An entity would still be required to calculate fair value changes of both the hedged item and hedging instrument in order to post the necessary accounting journals to record the actual effectiveness of the hedge.

Under these proposals there could be more focus on the extent of effectiveness of a hedge which might be regarded as more meaningful. Hence if a hedge is only 60 per cent effective, more questions may be asked on the risk management strategy whereas under IAS 39 it would not have been visible as hedge accounting would not have been permitted in the period.

Prospective test

The proposals replace the prospective effectiveness test with a lower threshold requirement. Under the ED, a hedge has to be expected to achieve 'other than accidental offset' to be eligible for hedge accounting. Put another way, the hedge must have an expectation of offset that is not merely due to luck. Hence this would be far easier to comply with than the current threshold of 80 to 125 per cent offset. Due to the lower prospective effectiveness threshold, the ED would also allow more testing to be done on a qualitative basis rather than a quantitative test. This could significantly reduce the burden of effectiveness testing.

Minimise hedge ineffectiveness and rebalancing

Due to the removal of the 80 to 125 per cent threshold, the ED introduces a new principle to guide an entity to use the optimum hedge ratio for a given hedging relationship. The ED requires the hedge ratio (i.e. the proportion of the hedged item versus the proportion of the hedging instrument) to be set such that it 'minimises expected hedge ineffectiveness' at inception of the hedge (i.e. a forward-looking test). Subsequent to inception, the hedge ratio must be updated (or 'rebalanced') to continue to comply with this requirement on an on-going basis.

Financial options as hedged instruments

Financial options are common hedging instruments for hedging a one-sided risk. For example, if an entity wants to protect itself from an increase in an exchange rate, it may purchase a foreign currency option which gives it a right to buy the foreign currency at a predetermined amount fixed in the entity's functional currency. Under IAS 39, such purchased options are eligible for hedge accounting, however, not all of the profit or loss volatility arising from fair valuing the option contract can be mitigated through hedge accounting. The fair value change of the *time value* of the option will generally be recognised in profit or loss on a fair value basis. Some have complained that this volatility is not meaningful. The IASB has responded by proposing a new way to account for the change in fair value of the time value component of an option when the intrinsic value is designated in a hedging relationship. The new proposals are detailed, with variations on the accounting depending on different factors (such as the nature of the hedged item and whether the terms of option match the hedged item). At a high level, under the proposals, the volatility arising from fair valuing the time value of an option is recognised in other comprehensive income (OCI) and transferred out from OCI to profit or loss on a more predictable and stable basis.

Risk components of non-financial items

Entities often only hedge specific risk exposures of an item instead of hedging an item for all risks. There are various good reasons for this. For example, it could be because it is not cost effective to hedge all the risks, or there is no hedging instrument to effectively hedge all risks, or an entity simply wants to retain exposure to certain risks because it hopes to profit from that risk. However, when it comes to hedge accounting, if the hedged item is a non-financial item, under IAS 39, only the whole price risk or foreign exchange risk can be designated in a hedge. The ED proposes widening this to allow designation of risk components of non-financial items that are 'separately identifiable and reliably measurable'. This significantly increases the risks that could be hedge accounted. However, it also introduces more judgement in cases where the risk component is not contractually specified. For example, in the case of forecast transactions, such as sales and purchases, where the risk component will need to be implied from the overall price risk as it is not contractually specified. The ED uses an example of an entity hedging the crude oil price risk component of jet fuel. Here the crude oil risk component is implied in the hedged jet fuel price.

Other proposals in brief

- Derivatives can be aggregated with other non-derivative exposures and the combination can be an eligible hedged item. This contrasts with IAS 39 which does not allow a derivative to be a hedged item (i.e. under IAS 39 you cannot hedge a derivative with a derivative).
- The presentation of fair value hedges would change under the ED. The ED proposes that fair value hedge adjustments be shown in a separate line of the statement of financial position and not as part of the hedged item as is the case for IAS 39 fair value hedges of recognised items. Furthermore it proposes that the fair value changes of the hedged item and hedging instrument be presented in other comprehensive income with hedge ineffectiveness reclassified to profit or loss.
- Net position hedges are common place in risk management. However, IAS 39 does not permit hedge accounting on this basis. The ED proposes that net positions are eligible hedged items if certain conditions are met.

What next?

Following the close of the comment period on 9 March 2011, the IASB has restarted its deliberations on the project. Amongst the broad support for the ED, there are many suggestions for amendments and more guidance. There are also some calls for more co-operation on the hedge accounting project with the FASB. To date, the FASB and IASB's projects on hedge accounting have been running independently. That is mainly because of the different timetables but also because of different objectives. The IASB had planned a comprehensive review whilst the FASB only a limited one. If collaboration with the FASB continues to be limited then the IASB may well meet their objective of having the new hedge accounting requirement finalised by the summer.

What is the portfolio hedge accounting project?

The portfolio hedge accounting model is the remaining part the hedge accounting project that continues to be discussed by the Board. This model would be applicable to entities that hedge portfolios of items together. This is particularly relevant for financial institutions that hedge interest rate risk on a portfolio basis. IAS 39 has some provisions that specifically apply to portfolio hedges for interest rate risk and is the starting point from which the IASB is considering portfolio hedging more widely.

When can these reforms be applied?

IFRS 9 has a mandatory effective date of annual periods beginning on or after 1 January 2013. This date may potentially be pushed back as the completion of IFRS 9 has taken longer than previously expected and the IASB is trying to align the effective date of IFRS 9 and the new insurance standard which is not yet finalised. Early application of IFRS 9 is permitted, but currently is not possible for entities in the European Union as IFRS 9 has yet to be endorsed for use in Europe.

A coffee with ... Toon Clerckx



Toon Clerckx is Finance Director of Alliance Boots Health & Beauty division. Originally from Belgium, he worked and lived in Germany, The Netherlands, Belgium etc., before moving to the US where he was CFO at the Consumer Lifestyle division of Phillips. He then moved to the UK to take up the role of Finance Director of the Health & Beauty division at Alliance Boots.

I understand that previously you were CFO at Philips in the States. How long have you been with Boots in the UK?

Since January last year, one year and a couple of months. So enough time to settle in and get used to the British way of doing things. I was the CFO for Western Europe and North America and it is a very different way of working. Although Alliance Boots is also a truly international company the Health & Beauty division has a large UK base. I really enjoy the speed of the retail business and working for private equity!

Out of the current IASB proposals which are you most focussed on and which do you think will have the greatest impact for Boots and Alliance?

We are continuously following up on each of the standards that come out to make sure that there is nothing that might impact us, and to help steer us in the direction where it would work best for us. As you know we have about 2500 stores in Boots and more than 600 Boots opticians in the UK, so by far the most important is the lease accounting exposure draft. In its current format, this exposure draft would also have the biggest impact for us.

Do you think that it has the potential to impact on the way you do business, the leases you would enter, and is that good or bad?

There are quite a few things that could change. Let's be clear though, I think the current draft will not be accepted as it is, so this is all theoretical. One could imagine that landlords in marketing their property may say no more renewal options in the contract, they could look at shorter lease terms, they could look at changing some of lease payments to some kind of service contract where you pay a monthly fee for servicing the property. So, it is not clear right now how it will ultimately impact the market and us as well.

Which aspects of the proposed leasing standard trouble you most?

I accept the need to reduce complexity and improve comparability, and I fully support the fact that we need to have full disclosure of all the assets and liabilities in the financial statements. But in my view the current exposure draft does not meet those needs. I think the proposed accounting treatment will actually introduce volatility in both the balance sheet and the income statement, in its current format at least. It would therefore fail to reflect the true nature of the commercial arrangement we have in place. That's where we are today. It is clear that the primary focus is on the technical detail of what the lease liability should look like and how the whole transaction needs to be reflected in the balance sheet. I am not sure there has been as much focus on the implications on the income statement. While focussing foremost on the balance sheet may be IASB's general approach on all issues, the size and the magnitude of the impact of the leasing proposals is beyond that of most other proposals that I have seen. The nature of the transactions we have, the lease term and the way the portfolio is set up, it just takes a very long time to normalise the income statement impact. So, although I think a thorough job has been done on the technical justification of how things should be calculated, I don't necessarily agree with all of them. We have provided our input to the IASB as a company and also through the British Retail Consortium (BRC).

You are a Board member of the BRC, do you think other members have the same concerns as you, or is there a divergence of views?

We retailers enter into operating leases, primarily on property, as a necessary way of conducting our primary trade. For other entities, lease transactions, in general, are often entered into for financing reasons and that is a big difference. Our market is not as fluid as many other markets. For some assets there is a real option to buy or to lease; you can buy or lease your fleet, IT infrastructure etc., and when you lease it is a clear financing transaction that you are entering into. With real estate it's not as fluid. If we limited ourselves to buying property, rather than leasing, we would limit the options to trade, because the assets are not available to buy.

I think depending on the type of the retailer and whether they are mainly leasing or mainly own the freehold, will determine how large the issue this is for them. I would say that all of them recognise the problem. There is also the administrative burden which everybody recognises.

Moving away from leasing, are there other projects which you are focussing on, for example are the revenue proposals of particular concern?

As I said we are keeping an eye on them. I don't expect that most of them will have a material impact on our business. The financial instruments project is not going to impact us in any material way. If you look at the consolidation one, and the use of special purpose vehicles, the impact on us will be limited. On revenue I think the main issue being addressed is recognition on long term contracts and so again I would think there is not much within my business that is going to be affected.

Do you think that there are areas of IFRS that the Board are not looking at now that are areas of concern for you?

I think we have relatively few grey areas on the balance sheet. IFRIC 13 has provided clarity in an area where I know there were different treatments by different retailers, but I think that has been cleared up now. I am comfortable with the guidance and the standards we have today.

Boots and its subsidiaries are still under UK GAAP, have you been following the ASBs proposals in respect of UK GAAP and will you be responding to the exposure draft?

We do report in UK GAAP and we consolidate in IFRS. The proposals on the future of UK GAAP are broadly positive to me; the most important thing for us is the disclosure exemption for subsidiaries. But we have no plans to respond to this draft; when we respond to an exposure draft we tend to pick our topics and this is not one where we feel the need to take a leading position.

If the disclosure exemptions for subsidiaries of IFRS reporters were made available early, is that something that Boots would take up?

I don't know. We will have to look at all the implications but I do think that the exemptions are good.

How difficult do you find it to focus on the developments in accounting when you are also trying to run your business?

In my previous jobs I have been very much involved in the technical accounting elements of the job. I was involved in the accounting implications around electronic waste and recycling and the implementation of FAS133 and IAS 39. I have often been involved in the discussions with IASB and formulating the replies to the exposure drafts. The technical aspect however is only part of the job, ultimately running the business and preparing our financial statements are interlinked. As I said we have to keep an eye on the impact of changes to our financial statements. It is the job of the CFO or the FD to make those two elements link to each other. It's the role of finance to make sure that people have simple operational targets that if met will ultimately have the right effect on your financial statements.

There is a split in my view between the financial reporting and technical accounting of the business and the driving of the performance of the business. One is geared more towards efficiency and effectiveness, how can we do it faster and how can we make whatever we produce clear to the reader so it tells the story, and the other one is geared around giving the organisation clear and easy to understand targets that they can themselves contribute to and that they are held to account if they are associated with it.

What do you think is the most enjoyable part of your role and where do you put financial reporting on that?

Completely on the top of the list! I really don't know. It is an integral part of the role, you can't split the two. My heart is probably in driving the business, the commercial side of the financial role rather than the technical side and this evolved over time.

Good, bad, ugly?

The replacement of UK GAAP so as to align with International Standards	Good
IASBs move away from the predominately converge with US standards agenda	Good
British chocolate	Good. But bad compared to Belgian chocolate!
The Olympic Games in London	Good
Martin Clunes depicting life working in the personal grooming industry	Never heard of Reggie Perrin!

Topic of focus: Impairment of financial assets

Following the recent financial crisis the accounting rules on recognising and measuring impairment on financial assets have come under close scrutiny by standard setters, regulators and politicians. Both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) issued in the first instance separate exposure drafts (EDs) proposing changes in this area (the proposals in the IASB ED were also discussed in the March 2010 iGAAP newsletter). Both advocated a move to an expected loss approach, albeit in different ways. Although this broad direction was welcomed, many commentators emphasised the importance of convergence between IFRS and US GAAP in this key area and the need for a model that is capable of being applied to “open portfolios” (where assets are both added to and removed from the portfolio over its life) as many financial institutions manage assets in this way. In response to this the IASB and the FASB issued in January 2011 a jointly developed Supplementary document “Financial Instruments: Impairment” (the “Supplement”) to the IASB’s “ED/2009/12 Financial Instruments Amortised Cost and Impairment” with a comment deadline of 1 April 2011.

Convergence and practicality

Both the IASB and FASB have tried to address the criticism that under the current accounting rules the provision for loan losses was too little too late. Prior to the Boards coming together to discuss a joint model they each developed their own models. It is worth considering these older models as they are helpful in understanding how the converged solution arose.

The IASB’s main focus of their original proposals was to ensure that the provision for credit losses builds up over the life of loans, rather than in lumps as with IAS 39. Building up provisions over time is consistent with the economics of lending, a premium for the risk of non-payment is embedded in the interest that the lender charges the borrower and this is earned over time. This concept introduced what is now referred to as a time apportionment approach. Some constituents have observed that the IASB’s approach centres on the income statement, not on the recoverability of the asset in the balance sheet. Some raised concerns that it would not result in an adequate level of provisioning, especially in the case of assets with an early loss pattern, as the actual amount of non-payment by the borrower at a given date might be more than the amount that has been provided for at that date. For some this was counterintuitive as in certain circumstances it could result in lower provisions than under the incurred loss approach in IAS 39.

The FASB’s main focus of their original proposals was that the impairment allowance should reflect all credit losses expected over the life of the instrument based on information that is available at the measurement date. This approach ensures that the allowance balance is sufficient to cover all estimated credit losses, regardless of the timing of those losses. However, it also meant that all expected credit losses on day one of an asset’s life would be provided for thereby creating an immediate loss. Some constituents observed that the FASB’s approach centres on the balance sheet, rather than the income statement, as the primary concern is whether the asset is recoverable. For some, the proposal was inconsistent with the economics of lending as it front loads all the losses at the date of lending even though economically when the loan is made the lender has not yet suffered a credit loss.

Concerns in relation to operational difficulties featured heavily in the comment letters received by the IASB in response to their proposals. The IASB has responded to these concerns and the model in the Supplement is an attempt to create an approach that is operational and relatively simple to implement by a range of entities. It is also reflected in the fact that a large number of the questions in the invitation to comment that forms part of the Supplement ask how operational various elements of the approach might be.

As a result of feedback on the previous EDs and the appetite for a converged outcome the Supplement proposes a model that combines certain elements of both the IASB and FASB approaches.

A tale of two books

The model proposed in the Supplement attempts to ‘square the circle’ by introducing a time apportionment approach to build up losses over the life of assets yet also tries to ensure that when losses have actually been incurred the provision is sufficient to cover these losses. It does this by differentiating assets into two books: the “good book” and the “bad book” (alternatively, this can be thought of performing and non-performing loans).

For assets in the “good book”, the Supplement proposes that amounts of the impairment allowance would be the higher of:

- i) Lifetime expected credit losses time apportioned over the remaining life of the portfolio; and
- ii) The credit losses expected to occur within the foreseeable future on assets in the portfolio (“floor”).

When an asset is transferred from a “good book” to a “bad book” all remaining expected credit losses are recognised immediately.

The inclusion of the floor as the minimum allowance for the good book (equal to the credit losses expected to occur in the foreseeable future) addresses concerns over insufficient provisioning raised in relation to the IASB’s initial proposals. It also introduces an element of the FASB approach (of immediate recognition of expected credit losses) albeit limited to a time horizon of the foreseeable future. The presence of the floor also means that the increase in allowances for asset transfers from the “good book” to the “bad book” will not be as extreme as would otherwise be the case. This will be particularly true when the foreseeable future equates to all or substantially all of the remaining life of the assets.

Which assets are in the good and bad book will depend on management’s expectations about the collectability of the cash flows of the financial asset. An asset would be transferred to the bad book when the credit risk management objective of the entity changes from receiving contractual payments from the debtor to recovery of all or a portion of the financial asset. The proposed application guidance provides a number of indicators based on credit risk management activity that would suggest when this is the case.

Example

An entity manages two portfolios of performing loans (“good books”). Portfolio A comprises loans with a nominal balance of CU 1,000,000 and Portfolio B comprises prime mortgage loans with a nominal balance of CU 50,000,000. The table below provides the information the entity will use in calculating impairment for the two portfolios using the straight-line undiscounted time-proportional approach as permitted in the Supplement.

Portfolio	Remaining Lifetime Expected Credit Losses	Weighted Average Age	Weighted Average Expected Life	Time-proportional Amount $D = A \times (B/C)$	Foreseeable Future Period (FFP)	Expected Credit Losses During FFP	Impairment Allowance $G = \text{max of D or F}$
	A	B	C		E	F	
A	3,000	1 year	3 years	1,000	1 year	2,500	2,500
B	75,000	3 years	12 years	18,750	1 year	12,000	18,750

Greater losses are expected in Portfolio A in the foreseeable future than the allowance calculated under the time proportional approach and therefore the entity records an allowance amount equal to those losses anticipated in the foreseeable future. The allowance amount for Portfolio B as calculated under the time-proportional approach exceeds those losses expected in the foreseeable future and therefore the entity records an allowance amount as calculated under the time-proportional approach.

Decoupling and flexibility

The IASB’s original proposals were very prescriptive in setting out how entities should spread expected credit losses over the life of the assets, through the effective interest rate calculation, thereby reflecting the initially expected credit losses in the overall return on an asset. The Supplement deals with establishing the level of the allowance account separately from the determination of the effective interest rate thereby responding to calls for the IASB to pursue a “decoupled” approach. The Supplement allows instead the calculation of the time proportional expected credit losses in three ways; spreading either the estimated credit losses on a straight line basis over the expected life of the portfolio, on a discounted or undiscounted basis, or spreading the estimated losses using an annuity approach – converting the credit losses in to annuities based on the portfolio’s expected life and accumulating these annuities for the portfolio’s age. The Supplement allows the use of any reasonable discount rate between the risk free rate and the effective interest rate. This flexibility is another result of the IASB’s attempts to address the operational concerns raised in response to its initial proposals.

Further questions

The proposed text of the requirements certainly has the merit of being brief. For what is arguably a complex area of accounting the proposals are contained in only three proposed paragraphs in the main body of the standard with 16 paragraphs of application guidance and some illustrative examples. Whilst this is in keeping the IASB's aim to create principle based standards the current guidance does appear to leave some important questions unanswered. For example it is unclear whether "expected credit losses in the foreseeable future" means cash flows contractually due in the foreseeable future that the entity does not expect to receive or losses that are expected to be incurred in the foreseeable future (i.e. losses that are incurred in the foreseeable future but where the related cash flows may contractually be due beyond the foreseeable future).

Another area that has raised concerns is how foreseeable future should be interpreted. The Supplement does not provide a specific time period, rather defining it as "a future time period for which specific projections of events and conditions are possible and the amount of credit losses can be reasonably estimated". The subjective nature of this concept raises concerns over the practicality of application and comparability of information. In addition to the operational concerns knowing which expected losses arise in the foreseeable future and those that arise beyond the foreseeable future will be especially important in determining whether the floor will apply in determining the allowance. With short-term borrowing these time periods might be the same, for other loans they may not.

The differentiation between the good book and bad book is likely to find favour in some quarters if it aligns itself with current credit risk management practices. Whilst clearly applicable to originated loans the concept may not be as easily understood when applied to securities and purchased portfolios of distressed debt, or simply trade receivables. Care will need to be taken in fine tuning an approach that is operational for banks that is also operational and meaningful for others.

Presentation and disclosure requirements

The FASB has yet to consider the presentation and disclosure aspects of impairment, but the IASB have proposed presentation and disclosure requirements related to the proposals in the Supplement in an appendix.

In keeping with a "decoupled" approach to establishing allowances within the impairment model, the IASB proposes that interest revenue and impairment losses be presented as separate line items in the statement of comprehensive income.

The proposed disclosures intend to provide financial statement users with information about the allowance account, expected credit loss estimates (including inputs, assumptions, back testing) and internal credit risk management processes. Some of the requirements (about the length of the foreseeable future period) are an attempt to address some of the concerns about the potential for a lack of comparability across entities. Given this and the fact that the efforts in gathering the necessary data may be significant the proposals are likely to attract substantial comments from both investors (as users of the accounts) and preparers.

Still to come

The scope of the Supplement is limited to open portfolios as these are operationally most challenging and the Boards felt that concluding on these first would be fundamental in finalising a Standard. However, the Boards have requested feedback on whether the model would be operational if applied to individual financial assets, closed portfolios, loan commitments and financial guarantee contracts. If this ED is to be pursued more guidance would need to be developed on how the model would be applied to those instruments. Significantly, there are important aspects of measurement that the Supplement does not address. This is still to come.

The work of the Boards is far from done. However, to date they should be credited with taking on the most difficult aspects first and trying to develop a model that is capable of being applied in practice. Finalising a Standard by the end of June 2011 is not impossible, but will certainly be challenging.

Activities of the IASB

IASB publishes exposure draft on offsetting

The IASB and the US Financial Accounting Standards Board (FASB) have issued an exposure draft (ED) on the offsetting of financial assets and financial liabilities in the statement of financial position.

The main proposals of the ED are as follows:

- The offsetting of a recognised financial asset and a recognised financial liability if, and only if, an entity has an enforceable, unconditional right of set-off and intends either to settle the asset and liability on a net basis or to realise the asset and settle the liability simultaneously ('the offsetting criteria').
- Clarification that the offsetting criteria apply when the right of set-off arises from either a bilateral arrangement or from a multilateral arrangement. The proposals also clarify that a right of set-off must be legally enforceable in all circumstances (including default by or bankruptcy of a counterparty) and its exercisability must not be contingent on a future event.

The proposals would require an entity to disclose information about offsetting and related arrangements (such as collateral agreements) to enable users of its financial statements to understand the effect of those arrangements on its financial position.

Comments on the ED are requested by 28 April 2011.

IASB publishes supplement to exposure draft on impairment

The IASB and FASB have published for public comment joint proposals on the impairment of financial assets, a supplementary document ('the supplement') to the IASB's exposure draft (ED) on the topic published in November 2009.

The supplement seeks to address concerns over the application of the expected loss model proposed by the ED, specifically in the context of 'open portfolios', by proposing separate approaches to recognising expected losses for performing assets in a 'good book' and for troubled assets in a 'bad book'. Expected credit losses in the 'good book' would be recognised under a time-proportional approach (subject to a minimum allowance of at least those credit losses expected to occur in the foreseeable future, a period of not less than twelve months from the reporting date). Expected losses on 'bad book' assets would be recognised in full.

The supplement also includes an IASB-only Appendix, including separate proposals on impairment of financial assets specifically addressing scope, presentation and disclosure.

Comments on the ED are requested by 1 April 2011.

SME Implementation Group publishes draft guidance for public comment

The SME Implementation Group, responsible for assisting the IASB on matters related to the implementation of the IFRS for SMEs, published for public comment its first draft guidance on the IFRS for SMEs in the form of a question and answer document (Q&A).

The Q&A addresses whether a parent entity that itself does not have public accountability may present its separate financial statements in accordance with the IFRS for SMEs if it is part of a group that is required (or elects) to present consolidated financial statements in accordance with full IFRSs.

The draft document is open for comment until 4 April 2011 and can be found at <http://go.ifrs.org/IFRS+for+SMEs+QandA>

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

Deloitte (Global) has issued an IFRS in Focus Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1102offsetting.pdf> and Deloitte in the UK has issued an iGAAP Alert which is available at www.deloitte.co.uk/auditpublications

Deloitte (Global) has issued an IFRS in Focus Newsletter covering this topic in more detail, which is available at <http://www.iasplus.com/iasplus/1102impairment.pdf> and Deloitte in the UK has issued an iGAAP Alert which is available at www.deloitte.co.uk/auditpublications

Takatsugu (Tak) Ochi appointed as member of the IASB

The Trustees of the IFRS Foundation, the oversight body of the International Accounting Standards Board (IASB), have announced the appointment of Takatsugu (Tak) Ochi as a member of the IASB for an initial five-year term from 1 July 2011.

He is currently Assistant General Manager, Financial Resources Management Group of Sumitomo Corporation and a member of the IFRS Interpretations Committee, Secretary-General of the Nippon Keidanren (Japan Business Federation) Taskforce for early adoption of IFRS and an adviser to the Accounting Standards Board of Japan (ASBJ). Mr Ochi will relinquish existing roles upon joining the IASB.

Hans Hoogervorst, Chair-designate of the IASB, and Ian Mackintosh, Vice-Chair-designate of the IASB, will also begin their initial terms on 1 July 2011.

The Trustees have also confirmed the reappointment of Philippe Danjou, to serve a second five-year term.

The press release can be found at <http://www.ifrs.org/News/Press+Releases/Tak+Ochi+appointed+IASB.htm>

Andy Simmonds of Deloitte reappointed to EFRAG Technical Expert Group

The EFRAG Supervisory Board has announced the composition of the EFRAG Technical Expert Group, to take effect in April 2011. Friedrich Siener from Daimler AG is appointed as new Member of EFRAG TEG. The existing EFRAG TEG members who were available for reappointment – Gabi Ebbers, Araceli Mora, Anna Sirocka and Andy Simmonds – have been reappointed.

UK GAAP Round Up

ASB publishes proposals for a Public Benefit Entity Standard for Tier 2 Entities

The Accounting Standards Board (ASB) has published Financial Reporting Exposure Draft (FRED) 45 which sets out proposals to be included in a Financial Reporting Standard for Public Benefit Entities (FRSPBE) to accompany the proposed Financial Reporting Standard for Medium-size Entities (FRSME). It will be mandatory for public benefit entities that apply the proposed FRSME for periods beginning on or after 1 July 2013.

The FRSPBE aims to clarify how some transactions specific to the PBE sector should be accounted for as IFRS based standards are written for the 'for-profit' sector. Issues which have been addressed include concessionary loans, incoming resources from non-exchange transactions (donations etc), funding commitments, impairment of assets, property held for the provision of social benefits and entity combinations.

FRED 45 is available at <http://www.frc.org.uk/asb/press/pub2546.html> and comments are requested by 31 July 2011.

The Treasury and Department for Business, Innovation and Skills publish 'The Plan for Growth'

Following the Budget on 23 March 2011, the Treasury and the Department for Business, Innovation and Skills published 'The Plan for Growth'. The Government wants to create the right conditions for business to succeed, removing barriers that are preventing them from performing to their full potential. The document includes a number of recommendations in the area of financial reporting including proposals to:

- Reduce the number of UK SMEs required to undertake audits and reduce financial reporting burdens for these firms.
- Bring forward legislation in 2012 to exempt many subsidiaries from producing audited accounts.
- Encourage the European Commission to exempt the smallest companies from reporting requirements.
- Simplify narrative reporting for quoted companies to make it clearer and more focused.

Further details can be found at http://www.hm-treasury.gov.uk/ukecon_growth_index.htm and <http://www.frc.org.uk/press/pub2552.html>

ASB and EFRAG issue a Discussion Paper: 'Considering the effects of Accounting Standards'

The Accounting Standards Board (ASB) and the European Financial Reporting Advisory Group (EFRAG) have published joint recommendations aimed at improving the way in which accounting standard setters develop and implement standards. The proposals call on standard setters to improve their due process from start to finish by considering the effects of accounting standards. These proposals are aimed at strengthening that process and enhancing its transparency, to increase the accountability and credibility of the standard setter, and thus to contribute positively to delivering improved financial reporting.

The Discussion Paper (DP), 'Considering the Effects of Accounting Standards', has been published as part of the European proactive agenda for stimulating the global accounting debate and influencing the direction of IFRSs. The stated intention of ASB and EFRAG is to encourage discussion of the issues set out in the DP and to use feedback from the consultation process to assess support for the proposals and enhance them, so that they can form the basis of possible improvements to the IASB's due process.

The DP is available at <http://www.frc.org.uk/asb/press/pub2497.html> and comments are requested by 31 August 2011.

Financial Reporting Review Panel highlights challenges in the reporting of principal risks and uncertainties

The Financial Reporting Review Panel (FRRP) has issued a press release highlighting their concerns over how companies are reporting the principal risks and uncertainties facing their businesses.

The press release notes that the FRRP has challenged a number of companies on their reporting in this area, which is required by Companies Act 2006, and encourages boards of directors to consider the following questions in formulating their disclosures:

- Do the disclosures state clearly which are the principal risks and uncertainties facing the business?
- Are those risks and uncertainties described as principal the main risks and uncertainties that currently face the business? For example, have the risks and uncertainties listed as principal been the subject of recent discussions at board or audit committee meetings? Are there risks which have been the subject of such discussions which should be considered as principal?
- Is the description of each principal risk and uncertainty sufficient for shareholders to understand the nature of that risk or uncertainty and how it might affect the company?
- Are the principal risks and uncertainties described in a manner consistent with the way in which they are discussed within the company?
- Are the principal risks and uncertainties shown consistent with the rest of the report and accounts? Are there risks and uncertainties on the list which are not referred to elsewhere or are there significant risks and uncertainties discussed elsewhere which do not appear on the list?
- Is there a description, in the directors' report, or elsewhere in the report and accounts and explicitly cross-referenced from the directors' report, of how the company manages each of the principal risks and uncertainties?

The press release is available at <http://www.frc.org.uk/frp/press/pub2503.html>

ICAEW issues TECH 01/11 Guidance for directors on accounting records under the Companies Act 2006

Companies are required by the Companies Act 2006 to maintain 'adequate accounting records', a term which is not defined in the Act. TECH 01/11 provides guidance on the contents, form and organisation of accounting records as required by the 2006 Act. This guidance supersedes guidance issued by the ICAEW in Technical Release FRAG 5/92.

The new guidance is similar to that in FRAG 5/92 except that references and terminology have been brought up to date. It confirms that the Companies Act 2006 did not make any substantive changes to the requirement to maintain accounting records.

Tech 01/11 is available at <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases>

ASB issues exposure draft on enhanced derecognition disclosure requirements for transfers of financial assets

The ASB has issued for public comment an exposure draft (ED) aimed at improving the disclosures on transfers of financial assets. The proposals amend the disclosure requirements in FRS 29 *Financial Instruments: Disclosures* and consist of new disclosure requirements that would help users of financial statements evaluate an entity's risk exposure arising from transfers of financial assets as well as any resulting impact on its financial position.

The disclosure requirements proposed in the ED were added to IFRS 7 *Financial Instruments: Disclosures* in October 2010 and would ensure that the requirements of the two standards remain converged.

The ED is available at <http://www.frc.org.uk/asb/press/pub2522.html> and comments are requested by 30 April 2011.

The Financial Reporting Council launches inquiry into going concern

The Financial Reporting Council (FRC) has announced the launch of an Inquiry to identify lessons for companies and auditors addressing going concern and liquidity risks. The Panel of Inquiry will put forward measures, if required, to improve the existing reporting regime and issue related guidance for companies and auditors.

The press release is available here <http://www.frc.org.uk/press/pub2531.html>

Financial Reporting Council to consult on getting more Women into the Boardroom

The Financial Reporting Council (FRC) has announced that it will consult on the recommendation addressed to the FRC in Lord Davies' report, "Women on Boards", that was published on 24 February 2011.

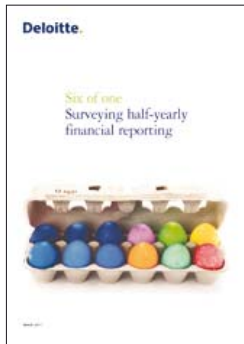
Lord Davies has recommended that "the Financial Reporting Council should amend the UK Corporate Governance Code to require listed companies to establish a policy concerning boardroom diversity, including measurable objectives for implementing the policy, and disclose annually a summary of the policy and progress made in achieving the objectives".

The UK Corporate Governance Code was amended in June 2010 to state that, for all UK listed companies, "the search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender."

The FRC will consult on whether further amendments would now be appropriate to accelerate change.

The press release is available here <http://www.frc.org.uk/press/pub2521.html>

Publications



Six of one – Surveying half-yearly financial reporting

'Six of one' analyses the half-yearly financial reporting of 130 listed companies, split into two categories, being investment trusts and other companies. It includes a review of:

- 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).

The publication covers current disclosure requirements and latest developments. It also includes model half-yearly financial statements and a disclosure checklist as well as various "better practice" examples

Six of one is available at: www.deloitte.co.uk/auditpublications

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 16 March 2011)
IAS/IFRS standards			
IFRS 9 (November 2009, revised October 2010)	Financial Instruments: Classification and Measurement	1 January 2013	To be confirmed
Improvements to IFRSs (May 2010)	Improvements to IFRSs 2010	1 July 2010 or 1 January 2011 (varies by standard)	18 February 2011
Amendments to IFRS 7 (October 2010)	Transfers of financial assets	1 July 2011	Q3 2011
Amendments to IAS 12 (December 2010)	Deferred tax: recovery of underlying assets	1 January 2012	Q4 2011
Amendments to IFRS 1 (December 2010)	Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters	1 July 2011	Q4 2011

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

ASB and IASB timetables

ASB Current Projects

The Future of UK GAAP	<ul style="list-style-type: none"> In October 2010, the ASB issued a Financial Reporting Exposure Draft ('the FRED') on the future of UK GAAP. Under these proposals, publicly accountable entities would use full IFRSs as endorsed by the European Union, entities currently able to use the FRSSE would continue to do so and other entities would use the Financial Reporting Standard for Medium-sized Entities ('the FRSME') – a modified version of the IASB's IFRS for SMEs. The FRED proposes that entities be able to voluntarily 'move up' to a higher tier of reporting and that subsidiaries benefit from reduced disclosure requirements. Comments on the FRED are due by 30 April 2011. In March 2011 the ASB issued a FRED setting out proposals to be included in a Financial Reporting Standard for Public Benefit Entities (FRSPBE) to accompany the FRSME. Comments on this FRED are due by 31 July 2011.
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. 'Improvements to Financial Reporting Standards 2010' issued November 2010.

IASB Project Timeline – Active Projects

Annual Improvements to IFRSs – 2009-2011	<ul style="list-style-type: none"> Final IFRS issued May 2010. Further ED expected first half of 2011.
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 issued September 2010. ED on reporting entity was issued in March 2010, deliberations not expected to continue until after June 2011. Consideration of remaining phases not expected until after June 2011.
Consolidation, including SPEs*	<ul style="list-style-type: none"> ED issued in December 2008. Round tables held in June 2009. Final IFRS replacing IAS 27 and detailed disclosures on unconsolidated entities expected first half of 2011. ED on proposed changes for investment companies expected April 2011.
Derecognition – disclosures*	<ul style="list-style-type: none"> ED issued March 2009. Round tables held June 2009. Final IFRS on disclosure requirements for derecognitions issued October 2010.
Discontinued operations amendment	<ul style="list-style-type: none"> ED issued September 2008. Further ED expected first half of 2011 as part of annual improvements project.
Fair Value Measurement Guidance	<ul style="list-style-type: none"> ED issued May 2009. ED on measurement uncertainty analysis disclosures issued June 2010. Final IFRS expected April 2011.
Financial Instruments (replacement of existing standards)*	<ul style="list-style-type: none"> Classification and measurement of financial assets, Final IFRS issued November 2009. Classification and measurement of financial liabilities ED issued May 2010, Final IFRS issued October 2010. Impairment ED issued November 2009, Hedging ED issued December 2010, additional Impairment ED issued January 2011 and Final IFRSs expected second half of 2011 or later. ED on asset and liability offsetting issued January 2011 and Final IFRS expected second half of 2011 or later.
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 issued May 2010. Final IFRS expected April 2011.

Insurance Contracts – Phase II	<ul style="list-style-type: none"> • ED issued July 2010. • Round tables December 2010. • Final IFRS expected second half of 2011 or later.
Joint Arrangements	<ul style="list-style-type: none"> • ED issued September 2007. • Final IFRS expected April 2011.
Leases*	<ul style="list-style-type: none"> • ED issued August 2010. • Round tables December 2010 and January 2011. • Final IFRS expected second half of 2011 or later.
Post-employment Benefits (including Pensions)*	<ul style="list-style-type: none"> • DP issued March 2008. • ED on defined benefit plans issued April 2010. Final IFRS expected first half of 2011. • Final IFRS on termination benefits expected April 2011.
Revenue Recognition*	<ul style="list-style-type: none"> • DP issued December 2008. • ED Issue June 2010, followed by round tables November 2010. • Final IFRS expected second half of 2011 or later.

Work on the projects on common control transactions, earnings per share, emissions trading schemes, financial instruments with characteristics of equity, financial statements presentation (replacement of IAS 1 and IAS 7), liabilities (IAS 37 amendments), income taxes and rate-regulated activities has been deferred. The Board expects to resume discussions on some or all of these topics in the second half of 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

Notes

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