

Beyond the GAAP

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Editorial

The cloud of volcanic ash from Iceland has even affected the IASB's work! In April, the Board's meeting - which was largely a joint meeting with the FASB - had to be shortened because of the disruptions to air traffic in Europe. A delay that the two standard setters could certainly have done without.

As half-yearly financial reports will be prepared soon, Beyond the GAAP has decided to present the transitional issues of the revised IFRS 3 and IAS 27 for groups that have not decided to early apply these revised standard and start applying them in 2010.

Enjoy your reading!

Michel Barbet-Massin

Jean-Louis Lebrun

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News

Nomination to the IASB

On 15 April the Trustees of the IASCF announced the appointment of Paul Pacter as a full-time member of the IASB. Mr Pacter replaces James Leisenring.

Over the last six years, Mr Pacter has served as Director of IFRS for SMEs project.

In the course of his career, Mr Pacter has also held the posts of deputy research director at the FASB, executive director of the Financial Accounting Foundation, and vice-president of the US Government Accounting Standards Board.

At his own request this appointment is for a limited two-year period, taking effect on 1 July 2010 and ending on 30 June 2012. As a member of the IASB, Mr Pacter will continue to chair the IFRS for SMEs project's adoption group.

IFRS News

⇒ Consolidation exemption for investment companies: IASB to publish a limited-scope exposure draft

In April, the IASB decided to include in its work plan the publication of a limited-scope exposure draft in order to establish application guidance for investment companies. It will be remembered that in February, the IASB decided to exempt investment companies from the obligation to consolidate the entities over which they exercise control. Investment companies which meet certain conditions could therefore present these shareholdings at fair value.

⇒ New IASB work plan as of 19 April 2010

The IASB has again updated its work plan (see Beyond the GAAP, N° 32- March 2010), in part to take account of the publication delays incurred during the first quarter of 2010. The impact of extending the comment period for the proposed revision of IAS 37 has also been taken into account.

The new work plan heralds no fewer than 11 new or revised standards for 2010! In particular, there are the two standards on consolidation (control and disclosures), two new parts of the standard on financial instruments (financial liabilities and impairment), the standard on Joint ventures and the standard on provisions.

⇒ Fair Value Measurement: a new exposure draft

In the course of its deliberations on the future standard on fair value measurement, the IASB decided in early April to publish a limited scope exposure draft of the measurement uncertainty analysis disclosure. These disclosures would include the effects of interdependence or correlation between input data during the fair value sensitivity analysis.

The comment period for the exposure draft will coincide with the FASB's comment period for the proposed amendments to Topic 820 on fair value measurement.

The IASB will also publish a Request for Views on its website to seek feedback on the US draft text.

The two Boards will then conduct a joint analysis of all the comments received.

⇒ Derecognition of financial instruments: the FASB and IASB disagree

The meeting in April aimed to present the IASB's approach to the FASB via a number of examples of transactions.

Discussions between the two standard setters ended in disagreement. The FASB raised several major objections to the derecognition model presented by the IASB. Therefore, the FASB would like to re-open discussion on the fundamental principles of the approach, whereas the IASB was preparing to finalise the exposure draft expected for summer 2010.

The two Boards have opted to postpone their discussion until the forthcoming joint meeting planned on 1 June (date to be confirmed). The challenge will be to establish the best way forward for this project that is part of the convergence process.

⇒ Questionnaire on the exposure draft *Financial instruments: amortised cost and Impairment*

On 26 April 2010, the IASB published a questionnaire for users of financial statements on amortised cost measurement and the impairment of financial instruments.

The IASB is thus seeking input from users of financial statements on the proposals in the exposure draft *Financial instruments: Amortised cost and Impairment*. Two versions are available:

- An abridged version containing 15 questions;
- A comprehensive version which contains detailed examples and asks for comprehensive responses about the proposal.

The IASB asks commentators to complete the version that is most appropriate for their level of technical expertise and understanding of the topic, and has set the closing date at 30 June 2010.

This questionnaire can be accessed at:

<http://www.iasb.org/Current+Projects/IASB+Projects/Financial+Instruments+Impairment+of+Financial+Assetseplacement+of+IAS+39+Financial+Instruments+Recog/F+I+User+questionnaire.htm>

➤ Extractive activities

On 6 April, the IASB published a Discussion paper entitled *Extractive activities*. This document exposes the results of the project team's research work on extractive activities, i.e. research and extraction in the minerals industry and the oil and gas industry.

At present these industry-specific issues are only partly treated in IFRS 6, *Exploration for and Evaluation of Mineral Resources*, published in 2004 as an interim measure.

This 184-page document, prepared for the IASB by national accounting standard-setters in Australia, Canada, Norway and South Africa, tackles a range of issues including scope, measurement and specific disclosures for these activities. As it stands, this document is not intended to reflect the views of the IASB.

Comments may be submitted until 30 July 2010. The EFRAG draft comment letter was published on 23 April and is available at www.efrag.org.

In the light of the comments received on this document, the IASB will decide whether or not to include the project in its already busy work plan.

The document can be consulted at:

<http://www.iasb.org/NR/rdonlyres/735F0CFC-2F50-43D3-B5A1-0D62EB5DDB99/0/DPExtractiveActivitiesApr10.pdf>

➤ Publication of an exposure draft on defined benefit plans

On 29 April 2010 the IASB published for comment an exposure draft entitled *Defined Benefit Plans*. This exposure draft presents various amendments to IAS 19 on recognition, presentation and disclosures of defined benefit plans¹.

The main amendments proposed by the IASB relate to:

- the immediate recognition of any changes in the present value of the defined benefit obligation and in the fair value of plan assets. Methods aimed at deferring the recognition of these changes, including the "corridor" method, would therefore be prohibited;
- the presentation of the components of defined benefit cost :
 - (a) the service cost component in profit or loss;
 - (b) the finance cost component, ie net interest on the net defined benefit liability or asset, as part of finance costs in profit or loss;
 - (c) the remeasurement component in other comprehensive income;
- the disclosures on defined benefit plans, in particular disclosures on the risks associated with these plans.

Comments may be submitted until 6 September 2010.

Beyond the GAAP will return more in detail to this exposure draft in a future edition. The exposure draft can be accessed at:

<http://www.iasb.org/NR/rdonlyres/C6F8EF54-ADE4-4C9C-B23A-AEFAE9BFE815/0/EDIAS19DefinedBenefit0410.pdf>

¹ *Defined benefit plans* are plans under which the employer pays employee benefits - such as health or retirement benefits - after the end of employment, and assumes the risk of rises in the cost of the benefits or of the inadequate performance of the plan assets.

Some important decisions on the Leases project

At the joint meetings held in March and April 2010, the IASB and FASB took a number of significant tentative decisions on their joint project on leases. Beyond the GAAP updates the most important of these decisions.

➔ Lessor accounting

For lessors, the "performance obligation" model has so far been preferred by a majority of members of two Boards (for more information, see Beyond the GAAP, N° 31- February 2010).

At the joint meeting of March 2010, and following discussions on the presentation of the lessor's financial statements, the IASB indicated that it would like to reconsider an alternative model (the "derecognition approach").

This decision may delay the publication of the exposure draft expected in June 2010, as announced in the quarterly progress report of 31 March 2010 on joint IASB / FASB projects.

➔ Sale and lease back transactions

In April, the two Boards discussed sale and lease back transactions that had seldom been addressed previously. The approach envisaged at this stage consists of examining the two transactions together (the sale and the leaseback) and to determine whether the underlying asset has been "sold", in other words if the seller/lessee has transferred to the purchaser/lessor:

- control of the asset, and
- all but a trivial amount of the risks and rewards associated with the underlying asset.

If the underlying asset has been "sold" and the sale and leaseback are both at fair value, no gains or losses on disposal would be deferred. However, if the sale or leaseback is not measured at fair value, the assets, liabilities, losses or gains would be adjusted to reflect current market rentals. According to the staff, the adjustment of the "right of use" in the lessee's accounting to reflect market rentals would be recognised as an ajustement to any gain or loss on disposal. The adjustment of the underlying asset in the lessor's accounting would have as counterparty the performance obligation.

➔ Subleases

In April, the two Boards decided that the intermediate lessor, i.e. the party between the head lessor and the sublessee, should recognise the head lease using the lessee model and the sublease in accordance with the lessor model, on the grounds that these leases are two distinct transactions.

Measurement differences could therefore arise in the intermediate lessor's financial statements. Consider for example, a head lease and sublease whose rentals are linked to usage and the terms of the head lease and sublease are identical. In measuring the obligation to pay rentals one would include an estimate of the amounts payable under the contingent rental arrangement. However, one would only include amounts payable under the contingent rental arrangement in the receivable if it could be measured reliably.

➤ Long-term leases of land

The two Boards reviewed the decision taken in February 2010 regarding long-term leases of land. The future standard will contain no exemption for leases of this type, as it was considered that the criteria for distinguishing an outright sale or purchase of an asset (excluded from the standard) from a lease were applicable to assets of all kinds.

➤ Purchase options

In the lessor's accounting, the two Boards had previously considered that an option to purchase the underlying asset should be accounted for in the same way as the ultimate renewal option. Thus the proposals of the discussion paper suggest that if a lease contains multiple options, the lessee would determine its obligation to pay rentals on the basis of the most likely outcome: purchase, renewal or return of the asset at the end of the lease.

In February 2010 the two Boards indicated that if it is reasonably certain that the purchase option will be exercised, the contract should be treated as a sale/purchase rather than as a lease.

At the joint meeting in April 2010, the two Boards tentatively decided that there should be symmetry in the accounting for purchase options by lessees and lessors.

➤ Disclosures

In March and April, the two Boards tentatively approved a set of disclosures for lessee and lessor.

What are the transitional issues of the new standards on business combinations and consolidation?

The revised IFRS 3 on *Business Combinations* and IAS 27 on *Consolidated and Separate Financial Statements* were endorsed by Europe on 12 June 2009 and are applicable with effect from the 2010 reporting period for European entities which finalise their accounts at the end of the calendar year.

We wanted to remind readers of the impact of these new standards at the transition date (i.e. 1 January 2010) in the case of groups which finalise their accounts at the end of December and which have not opted for early application.

In our next edition we will return to the accounting treatment for new business combinations and to other operations, whether or not control of the subsidiary is lost (transactions with minority shareholders without loss of control and transactions leading to loss of control).

In practice, IFRS 3R and IAS 27R must be applied prospectively.

Theoretically, IAS 27R must be applied retrospectively, but the extent of the exceptions it sets out mean that in reality it is of prospective application.

IFRS 3R states that assets and liabilities resulting from business combinations prior to its first application are not affected by the first application of the revised standard.

Therefore, for these business combinations, it is not possible to recognise goodwill on non-controlling interests on or after the date of transition, even if the application of IAS 27R will reduce the group equity more sharply in the event of subsequent repurchase of non-controlling interests.

➔ **Contingent consideration**

Under the former IFRS 3, contingent consideration was included in the acquisition costs, without time limits, when the payment was probable and it was possible to assess the amount reliably.

The revised standard requires that contingent consideration is measured at fair value on the date control is obtained, even if it is only potential. In the event that the contingent consideration is paid in cash, changes in fair value of any payments after the allocation period are recognised in profit or loss.

The accounting treatment of adjustments to contingent consideration relating to business combinations prior to the first application of IFRS 3R was the subject of some debate.

In the IFRS improvements published in August 2009, these adjustments are still subject to the earlier version of IFRS 3 (i.e. 2004), and therefore give rise to an adjustment of goodwill after the date of first application of IFRS 3R (for example contingent consideration paid in 2012 that relates to a business combination carried out in 2006).

The IASB presents this amendment as a simple clarification, rather than a real change, which in our view authorises its immediate application (before formal endorsement in Europe).

However, consider the example of a group closing its accounts at the end of the calendar year, a strict reading of the text requires recognition of adjustments to contingent consideration in profit or loss in the half-yearly accounts at 30 June 2010 (even if this means amending the accounting treatment adopted at the end of June in the accounts established at the end of December if this draft has been endorsed by both the IASB and Europe at this date).

➤ Deferred taxes assets of the acquiree recognised after the allocation period

Deferred tax assets acquired after the effective date of the new standard are adjusted in profit and loss without corresponding adjustment of goodwill.

It should be remembered that the earlier version of IFRS 3 required a reduction in the carrying amount of goodwill equivalent to the recognised deferred tax assets at the end of the allocation period (such that the combined effect on profit or loss was nil).

➤ Puts on non-controlling interests

In practice, in the absence of guidelines in the standards, several approaches have been retained for the initial recognition of the obligation to acquire equity instruments from minority shareholders :

- an 'equity' approach, which consists in recognising the liability (put) in equity,
- a 'goodwill' approach, which consists in anticipating the impact of the business combination. The liability (put) is booked against (a) equity (non-controlling interests) and (b) goodwill (for the surplus).

Though the new standards do not directly address the issue of puts on non-controlling interests, the fact that goodwill is now determined once and for all means that the goodwill approach is no longer authorised.

At the date of first application of the new standards, any existing goodwill approach can be either cancelled through equity or maintained in the statement of financial position.

Cancellation of the goodwill can be justified by the new approach taken by IAS 27R (no new goodwill on subsequent acquisition of non-controlling interests).

Maintaining the goodwill in the assets might be justified by the fact that assets and liabilities resulting from business combinations are not affected by the first application of the revised standard.

In its recommendations for 2009, the AMF (the French regulator) accepted that the goodwill approach could be maintained for puts granted before the first application of the new standards.

➤ Acquisition costs associated with an acquisition in progress

IFRS 3 included the acquisition costs in the costs of the business combination, while under IFRS 3R acquisition costs are now recognised as expenses.

The IFRIC decided not to deal with the accounting, in the 2009 financial statements, for acquisition costs incurred at the end of 2009 for a business combination that will be completed during 2010, on the ground that it was a temporary issue.

Nevertheless, the IFRIC indicated that the accounting policy retained for such costs must be clearly set out in the notes (along with the amounts incurred at the end of the reporting period preceding the first application of IFRS 3R).

In practice, the following accounting treatments are possible:

- recognition as expenses from 2009;
- capitalisation in 2009 of the costs incurred, with retrospective change in the accounting policy in 2010 (restatement of the comparative period in order to recognise the costs incurred in 2009 as expenses);
- capitalisation in 2009 of the costs incurred, and recognition as expenses in 2010 (without restatement of the comparative period presented).

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Events/publications

IMA Conference, France

On Tuesday 18 May Jean-Louis LEBRUN, partner at Mazars, and Laurence RIVAT, partner at Deloitte, who are both French members of the IFRS Interpretations Committee (formerly the IFRIC), will host a breakfast debate on the latest developments from this committee, in partnership with IMA France.

Register for the conference on the IMA France web site:

www.ima-france.com

Seminars on "Current developments in IFRS"

Mazars' Technical Department will host a number of seminars throughout 2010 dedicated to current developments in IFRS. These seminars, organised by Francis Lefèbvre Formation, will be held 25 June, 24 September and 10 December 2010.

To register, please contact Francis Lefèbvre Formation –

www.flf.fr, +33 (0)1 44 01 39 99.

Frequently asked questions

IAS/IFRS

- Distinction between a financial guarantee and a credit derivative;
- Acquisition of an entity: accounting treatment applicable to the pre-existing relationship between the acquirer and the acquiree;
- Consolidation of an SPV;
- Acquisition costs incurred in 2009 relating to a business combination finalised in 2010;
- Deferred taxes and business combinations: opportunities for fiscal management and recognition of the acquiree's deferred tax assets.

Upcoming meetings of the IASB, IFRIC and EFRAG

IASB

17 - 21 May 2010

14 - 18 June 2010

19 - 23 July 2010

IFRIC

6 - 7 May 2010

8 - 9 July 2010

2 September 2010

EFRAG

5 - 7 May 2010

9 - 11 June 2010

14 - 16 July 2010

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