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Audit - Technical (External)

TechnicallySpeaking

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Word of welcome

Dear reader,

*Welcome to our fourth external edition of "**Technically Speaking**".*

This quarterly publication aims to provide insights, guidance and summaries of issues that are affecting the accounting, auditing and regulatory environment as well as other matters of general interest.

*We welcome your comments on the publication and ask that you contact our editor, **Nicolette Meadows (nmeadows@deloitte.co.za)**, if you have any questions or suggestions for future issues.*

Kind regards

Graeme Berry

Graeme Berry,
Business Unit Leader: A&A

The latest Exposure Drafts issued by the International Accounting Standards Board

by Bandile Nxele, Riekert Olivier and Theodore de Jager

Exposure Draft 9 ("ED 9") – Joint Arrangements

On 13 September 2007 the International Accounting Standards Board ("IASB") published a proposal to improve the accounting for joint arrangements. A joint arrangement is a contractual arrangement whereby two or more parties undertake an economic activity together and share decision-making relating to that activity. Joint arrangements include joint assets, joint operations, and joint ventures. The standard that will follow is intended to replace IAS 31 – *Interests in Joint Ventures.*

This project forms part of the IASB's short-term convergence with US Generally Accepted Accounting Principles ("US GAAP").

ED 9 focuses on two aspects of the current standard:

- Currently the accounting treatment follows the legal form in which activities take place rather than the substance of the transaction and does not always reflect the contractual rights and obligations agreed by the parties. A more realistic reflection of the joint arrangement in the financial reports of the parties involved will be achieved by shifting the focus to these rights and obligations. For example, if an entity has rights to assets and obligations in respect of certain liabilities, the entity will recognise its portion of those assets and liabilities.
- ED 9 proposes to remove the choice that preparers currently have when accounting for interests in jointly controlled entities, i.e. equity accounting or proportionate consolidation. Parties will be required to recognise both the rights to assets and the responsibility for liabilities, even if the joint arrangement operates in a separate legal entity. If the parties only have a right to the outcome of the joint arrangement, their net interest in the arrangement will be recognised using the equity method, and an entity won't be allowed to proportionately consolidate.

The IASB also improved the requirements for disclosing information about joint arrangements, subsidiaries and associates. The final standard is expected to be issued during the fourth quarter of 2008.

ED Cost of an Investment in a Subsidiary, Jointly Controlled Entities and Associates

This ED proposes that if an entity receives a dividend from an investment which is accounted for on the cost basis, it should recognise the dividend income and subsequently test the investment for impairment. This would result in the distinction between pre-acquisition and post–acquisition dividends being removed.

IFRIC D21 Real Estate Sales

IFRIC D21 aims to standardise accounting practice among real estate developers for sales of units, such as 'off plan' apartments or houses before construction is complete. At present, real estate developers interpret IFRS differently and record revenue for the sale of the units at different stages of development. Some record revenue only when they have handed over the completed unit to the buyer, while others record revenue earlier, as construction progresses using the stage of completion method.

IFRIC D21 proposes that revenue should be recorded as construction progresses only if the developer is providing construction services, rather than selling goods (completed real estate units). IAS 11 *Construction contracts* is then applicable to this real estate sale. Indicators of this include buyer being able to specify the major structural elements of the design of the real estate before construction begins and the seller transferring to the buyer control and the significant risks and rewards of ownership of the work in progress in its current status. If IAS 11 is not applicable IAS 18 *Revenue* should be applied, resulting in revenue being recorded at a later stage.

Riekert Olivier,
Manager, A&A Accounting

IFRIC DRAFT INTERPRETATION D23 - Distributions of Non-cash Assets to Owners

The International Financial Reporting Interpretations Committee released a draft Interpretation, *D23 Distributions of Non-cash Assets to Owners* for public comment. The comment period closed on 25 April 2008.

IFRIC D23 addresses the accounting for distributions of non-cash assets to owners, for example unbundling transactions and dividends *in specie*.

Where a non-cash distribution has been declared, the dividend payable should be measured at the fair value of the asset to be distributed. When the dividend payable is settled, the entity should recognise the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable (at fair value) in profit and loss for the period. For example, Company A distributes land with a carrying amount of R2 million and fair value of R 6 million to its shareholders as a dividend *in specie*. In terms of IFRIC D23, Company A will therefore recognise a gain as a separate line item in the income statement of R4 million on the settlement of the liability of R6 million.

IFRIC D23 also requires that *IFRS 5 – Non-Current Assets Held for Sale* should be applied to these distributions.

IFRIC D23 will not apply to:

- distributions in which the owners of the same class of equity instruments are treated differently as this might imply that an owner was involved in an exchange transaction; and
- distributions made to entities which are within the same group.

For more information, please contact your client service partner.

Bandile Nxele,
Manager, A&A Accounting

IASB – What's new?

by Theodore de Jager

No new IFRSs effective until 2009

The International Accounting Standards Board (IASB) is of the opinion that by addressing issues relating to the timing of effective dates and consultation, it would continue both to encourage consistent and rigorous application of IFRS and to facilitate broad input into the IASB's work programme. They have therefore concluded that no major amendments or new standards will be effective prior to 2009.

New standards and interpretations

The following standards and interpretations with dates effective on or after 1 March 2007 have been issued, but are not yet effective:

Standard	Effective date
IFRS 8 – *Operating Segments*	Annual periods beginning on or after 1 January 2009
IAS 1 – *Presentation of Financial Statements*	Annual periods beginning on or after 1 January 2009
IAS 23 – *Borrowing Costs*	Qualifying assets for which commencement date for capitalisation is on or after 1 January 2009
IFRS 3 (revised) - *Business Combinations*	Business combinations entered into on or after 1 July 2009
IFRIC 11 – IFRS 2 - *Group and Treasury Share Transactions*	Annual periods beginning on or after 1 March 2007
IFRIC 12 – *Service Concession Arrangements*	Annual periods beginning on or after 1 January 2008
IFRIC 13 – *Customer Loyalty Programmes*	Annual periods beginning on or after 1 July 2008
IFRIC 14 – IAS 19 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*	Annual periods beginning on or after 1 January 2008

For more information on the above standards and interpretations, please contact your client service partner or refer to www.iasplus.com.

Theodore de Jager,
Manager, A&A Audit & Regulatory

Amendments proposed to IFRS 2 - Share Based Payments and IFRIC 11 - Group and Treasury Share Transactions

by Fatima Abba

The proposed amendments are in response to requests for guidance for group entities on how to treat arrangements where the subsidiary's employees will receive cash payments for services provided that are linked to the share price of the subsidiary's parent.

Under the arrangement, the parent has an obligation to make the required cash payments to the subsidiary's employees. The subsidiary itself does not have any obligation to make such payments.

The amendment clarifies that the subsidiary should measure the goods or services received in accordance with the requirements for cash-settled share-based payment transactions. This treatment means the subsidiary shall measure the services received from its employees on the basis of the fair value of the corresponding liability incurred by the parent. Any change in the fair value of this liability should be recorded in the income statement of the subsidiary over the life of the award. The corresponding entry would go to equity (treated as an adjustment to the equity contributions from the parent).

The interpretation does not address how to account for any intra-group payment that exists between the parent and subsidiary to reimburse the parent for making the cash payments to the employees of the subsidiary.

For more information, please contact your client service partner.

Fatima Abba,
Senior Manager, A&A Accounting

Revisions to IFRS 3 Business Combinations (IFRS 3) (Revised) and IAS 27 Consolidated and Separate Financial Statements (IAS 27) (Revised)

by Justin Truscott

On 10 January 2008 the IASB released IFRS 3 (Revised) and IAS 27 (Revised), the product of the second phase of their business combinations project. The revised standards introduce significant change to some of the more controversial aspects of the current IFRS 3 in an effort to reduce the potential for inconsistent treatment of business combinations in the market. The revisions also move towards convergence with US GAAP, although some differences still remain. These standards are effective for business combinations in annual financial statements on or after 1 July 2009.

The key areas of change are summarised below:

Acquisition costs such as professional fees can no longer be capitalised to the cost of a business combination but must be expensed as incurred.

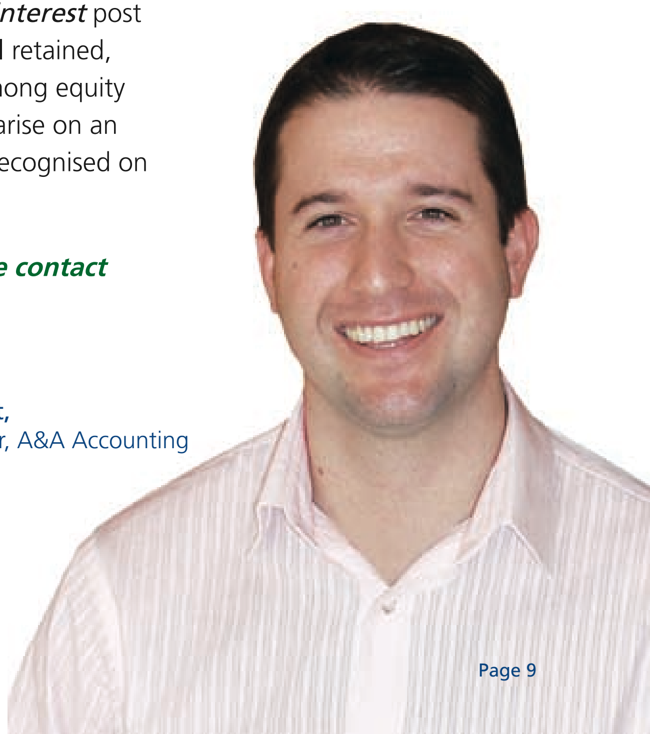
Contingent consideration - (e.g. earnout payments) payable in a business combination is measured at fair value and included within the cost of the combination on acquisition. Changes to the consideration payable are recorded within profit or loss unless the reason for the change provides additional information on factors that existed at acquisition, in which case the adjustment must be posted to goodwill.

Entities have the choice to measure ***non-controlling interests*** (minority interests) either at their share of the fair value of the net assets acquired or alternatively at their fair value. Measurement at the fair value of the net assets acquired will result in the same treatment currently required under the existing IFRS 3. However, the application of the fair value alternative will result in a grossed up goodwill balance being recorded by the acquirer, i.e. goodwill on the non-controlling interest will also be included within the acquirer's accounts.

In situations where an acquirer increases its existing holding in an entity to the extent that it gains control of such entity (so-called ***"step acquisitions"***), goodwill is determined at the date control is acquired and not at each date interests were obtained, as is currently the case. Goodwill is determined as the difference between the cost of acquisition and the fair value of the net assets acquired, any non-controlling interests and the fair value of previously held interests. The adjustment to re-measure previously held interests to fair value must be recorded in profit or loss.

Movements in an acquirer's interest post acquisition, where control is still retained, are regarded as transactions among equity holders, i.e. goodwill does not arise on an increase and no gain or loss is recognised on any decrease in the interest.

For more information, please contact your client service partner.



Justin Truscott,
Senior manager, A&A Accounting

IFRS 7 and its liquidity risk disclosure requirements: *Part 2*

Liquidity risk is defined in IFRS 7, Financial Instruments: Disclosures (IFRS 7) as, *'the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities'*.

The main text of IFRS 7 contains a single paragraph that addresses the specific disclosure requirements for liquidity risk. The application thereof requires guidance. The liquidity disclosure requirements pose a number of interesting considerations. The article contained in our previous edition of *Technically Speaking* introduced the list of these interesting considerations. This article is going to cover the first two considerations.

1. Demand based liabilities

The cash flows associated with a liability should be disclosed based on the earliest date on which an entity (the issuer of the liability) could be called upon to pay. Deposits that are repayable on demand should be disclosed in the earliest time band as they are immediately repayable.

2. Floating rate liabilities

Whilst fixed rate liabilities provide a fixed rate that may be used to determine future cash flows, such an analysis is not possible for floating rate liabilities. IFRS 7 provides that, *'where the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the reporting date. For example, where the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.'*

What is unclear is whether this implies that one needs to look at the 'absolute level' of the index at the reporting date or whether it is referring to conditions relating to the future 'curve' at the reporting date.

Whilst there is debate as to which approach is the most appropriate, many have concluded that curve approach should be used. This is because it is consistent with the notion that yield curves are used in determining the fair value of derivative financial instruments. The use of the curve approach also provides for the best reflection of the conditions at reporting date relating to the expected cash outflows in the future. We also recommend that the manner in which the cash flows are determined be clearly disclosed in the annual financial statements.

In the forthcoming editions of *Technically Speaking*, we will be discussing the remaining four considerations of:

- foreign denominated financial liabilities,
- off balance sheet financial liabilities,
- derivative financial instruments and
- time periods used for liquidity analysis.

For more information regarding Financial Instrument disclosures, please contact your client service partner.

IFRS Issues

Can a condensed interim financial report be described as "complying with International Financial Reporting Standards"?

Question

When an entity is preparing a condensed interim financial report under International Accounting Standard 34, *Interim Financial Reporting* (IAS 34), can that report be described as "complying with International Financial Reporting Standards (IFRS)"?

Answer

No. IAS 34.19 states that an interim financial report should not be described as complying with IFRS unless it complies with all of the requirements of IFRS. As condensed interim financial reports do not include all of the disclosures required by IAS 1, Presentation of Financial Statements, and other Standards, they do not meet this requirement. Under IAS 34.19, condensed interim financial reports should be described as being "in compliance with IAS 34, Interim Financial Reporting".

Inclusion of bank overdrafts within cash equivalents

Question

Should bank overdrafts always be classified as cash equivalents in terms of IAS 7, *Cash Flow Statements* (IAS 7)?

Answer

IAS 7.8 states that "in some countries, bank overdrafts which are repayable on demand form an integral part of an entity's cash management, and in such circumstances they are included in cash equivalents". IAS 7 does not therefore mandate the inclusion of bank overdrafts in cash equivalents in all circumstances. But it does require their inclusion where the bank overdraft forms an integral part of the entity's cash management. IAS 7.8 states that a characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

IAS 7.8 also emphasises that bank borrowings are generally considered to be financing activities. Therefore, the standard does not allow for other short-term loans (e.g., short-term bank loans, advances from factors or similar credit arrangements, credit import loans, trust receipt loans) to be classified as cash equivalents, since they are financing in nature.

Wave farewell to the US GAAP reconciliation

by Lindie Muller

Over the past two years, International Financial Reporting Standards (IFRS) literature has seen many amendments and issue of new Standards as a result of the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) convergence project.

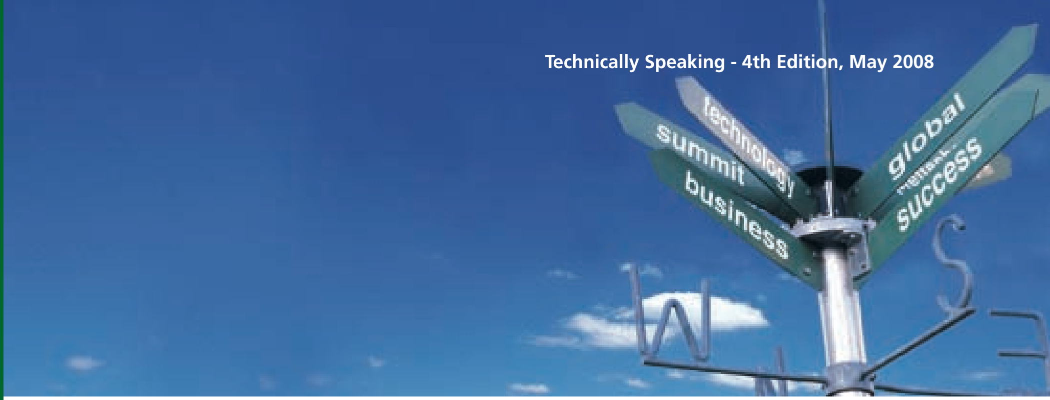
The planting of the convergence bulb blossomed on 15 November 2007 when the US Securities and Exchange Commission (SEC) showed their support of IFRS as a uniform global standard by voting to allow foreign private issuers to submit financial statements to the Commission using IFRS as adopted by the International Accounting Standards Board without having to include a reconciliation of the IFRS data to US GAAP. This final rule that was issued on 21 December 2007 has been very warmly received by most affected foreign private issuers.

Many have asked why the SEC specifically required the use of an IASB approved version of IFRS. The purpose of the requirement to use IFRS as approved by the IASB was to encourage the continued development of a homogeneous set of worldwide standards that are not applied differently in every nation and are comparable for investor analysis.

Bruce Aust, executive president of the NASQUE Corporate Client Group showed his support of this new rule by commenting that the rule *"removes unnecessary costs and steps that create barriers to attracting international companies. The SEC clearly communicates that the US markets are dedicated to wringing the cost and inefficiency out of doing business in the US".*

This new rule bids farewell to a foreign private issuer's US GAAP reconciliation from financial statements covering years ended after 15 November 2007.

For more information, please contact your client service partner.



XBRL – Evolution in Business Reporting

by Theodore de Jager

eXtensible Business Reporting Language (XBRL) is changing how the business world communicates. By updating the way business and financial data is transferred and reported globally, **XBRL** will significantly affect accounting, our firm, and our clients.

What is XBRL?

XBRL is an electronic language that can be thought of as a barcode for business data. Much as cash registers read barcodes, your computer reads XBRL-coded documents and extracts information. It is fast, accurate, and enables you to gather data from many different sources.

What benefits will XBRL bring?

XBRL's many advantages include:

- *Greater accuracy:* More reliable analysis and exchange of financial information, because your computer application accesses data directly. The possibility of human error is therefore reduced.
- *Better data management:* XBRL gives you the power to systematically manage and check data. Information is monitored in real time, enhancing validation.
- *Timesaving:* You can sit at your desk and collect information in-house or from the other side of the world. This increases productivity and you can file regulatory reports more easily.
- *Reusing data:* XBRL-tagged reports allow organisations to share and reuse data in business reports, both internally and externally. Applications take advantage of XBRL tags to process information for further reporting and analysis.
- *Easier document reading:* XBRL taxonomies enable your computer to read any document. If you speak Chinese, you can collect and reassemble data from documents written in Finnish if they are XBRL-tagged.

XBRL South Africa

The SAICA XBRL Steering Committee is currently leading the way in the development, implementation and marketing of XBRL within the South African environment. This committee comprises of the major auditing firms, various regulatory bodies and business and is mandated with the development and review of South African specific taxonomies.

In future communication, we will provide you with Deloitte's response to XBRL and the implications that XBRL could have on business.

For more information about XBRL in SA, please contact your client service partner.

In Closing

In closing

Dear reader,

*Thank you for reading the fourth edition of our externally focused technical publication, "**Technically Speaking**", which we hope you enjoyed.*

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We welcome your comments and suggestions, which can be e-mailed to technicallyspeaking@deloitte.co.za.

Kind regards

Nicci

Nicolette Meadows

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Client Service Centre - Telephone: +27 (11) 209 8999, Email: clientservicecentre@deloitte.co.za

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