

Accounting Alert

Special update



In this issue:

- IASB Proposes Changes to Financial Instruments Accounting
- Discussion Paper on Credit Risk in Liability Measurement
- IASB Invites Comments on Expected Loss Model for Impairment of Financial Assets
- Exposure Draft on Income from Non-exchange Transactions
- IASB issues IFRS for SMEs
- Exposure Draft on Management Commentary
- Group Cash-settled Share-based Payment Transactions – Amendments to IFRS 2
- IPSASB Issues Proposed Improvements to Public Sector Standards

This Accounting Alert provides you with information about a number of recent developments in financial reporting, including the release by the IASB of the much anticipated exposure draft on classification and measurement of financial instruments as part of the IASB's project to replace IAS 39.

IASB Proposes Changes to Financial Instruments Accounting

The IASB has released an Exposure Draft which proposes new rules for the classification and measurement of financial instruments. The Exposure Draft entitled *Financial Instruments: Classification and Measurement* is part of the first phase of the IASB's project to replace the current financial instruments standard, IAS 39. This project is intended to reduce complexity in accounting for financial instruments and to make it easier for investors to understand the information presented in financial statements relating to financial instruments. The project is being completed in three phases - Classification and Measurement, Impairment and Hedge Accounting.

Key proposals in the current Exposure Draft include:

- Replacement of the IAS 39 classification categories with two measurement categories – fair value and amortised cost.
 - All equity instruments would be carried at fair value, however gains and losses (including dividends) for equity instruments meeting certain criteria could be presented in other comprehensive income.
 - Debt instruments with basic loan features

which are managed on a contractual yield basis would be measured at amortised cost. While this category is similar to the 'held to maturity' category in the existing IAS 39, there are no 'tainting provisions' comparable to those in IAS 39 that would prohibit an entity from measuring a financial asset at amortised cost if it has recently sold other financial assets measured at amortised cost before maturity. However, special disclosures would be required for derecognition of a financial asset or financial liability measured at amortised cost.

- All other debt instruments would be carried at fair value with gains and losses recognised in profit or loss.
- The Exposure Draft would retain IAS 39's 'fair value option' by which an entity may elect at initial recognition to measure any financial asset or financial liability at fair value through profit or loss, but only if such designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch').
- The Exposure Draft would prohibit subsequent reclassification of financial assets and financial liabilities between the amortised cost and fair value categories.
- Elimination of the exemption available under IAS 39 which allows entities to record certain equity investments at cost where their fair value cannot be reliably determined.

- Elimination of the existing IAS 39 requirements to account separately for an embedded derivative and the host contract where the host contract is a financial instrument. The Exposure Draft proposes that a hybrid contract with a host that is within the scope of the proposed IFRS must be classified in its entirety in accordance with the proposed classification approach. Embedded derivatives in non-financial host contracts will continue to be accounted for in accordance with the current requirements of IAS 39.

The IASB has also recently issued a discussion paper requesting comments on including consideration of an entity's own credit risk in measuring its financial and non-financial liabilities. The feedback received on the discussion paper will be considered along with the feedback on the Exposure Draft. The IASB intends to finalise the proposals on classification and measurement of financial instruments in time for non-mandatory application in December 2009 annual financial statements.

As a precursor to this, the IASB intends to publish an Exposure Draft on financial instruments impairment in October 2009 as part of phase two of the financial instruments project. The IASB has issued a Request for Information on the feasibility of adopting an expected cash flow approach. An Exposure Draft proposing improvements to hedge accounting is expected in December 2009. The full project to replace IAS 39 is expected to be completed in 2010 with mandatory adoption from 2012.

Download the [Press Release](#) and [Exposure Draft](#) from the IASB website.

Comments on the Exposure Draft are due to the IASB by **14 September 2009**.

Discussion Paper on Credit Risk in Liability Measurement

The IASB has issued a discussion paper entitled *Credit Risk in Liability Measurement* which considers the pros and cons of including consideration of the entity's own credit risk in the measurement of its financial and non-financial liabilities. The discussion paper acknowledges that there is inconsistency between existing standards in the extent to which an entity's own credit risk is included in the measurement of its liabilities. For example, a debt instrument measured at fair value under IAS 39 reflects the risk of non-payment while a pension liability measured under IAS 19 is discounted using a high quality bond rate that does not reflect the credit risk of the entity holding the liability. The discussion paper is accompanied by a staff paper that

describes the most common arguments for and against including credit risk in measuring liabilities.

Arguments for including credit risk in the measurement of liabilities include:

- **consistency at initial recognition** – the initial measurement of a loan reflects the borrower's credit risk as it is recorded at fair value. This is inconsistent with subsequent measurement at amortised cost which excludes consideration of credit risk and is also inconsistent with certain other liabilities which are measured at amounts that do not reflect credit risk.
- **wealth transfer** – equity holders are generally not required to make any additional investment to cover losses incurred by the entity. As the value of an entity's assets decrease, and the likelihood of default increases, the change in the fair value of the liabilities may be considered to be a transfer of wealth from the liability holders to the equity holders, and thus may be reasonably recorded as a gain in profit or loss.
- **accounting mismatch** – the measurement of assets reflects the probability of non-payment, so excluding credit risk from the measurement of liabilities may lead to an accounting mismatch.

Arguments against including credit risk in the measurement of liabilities include:

- **counter-intuitive results** – when an entity measures a liability at fair value and there is a decline in the credit quality of the liability, the entity will record a gain in profit or loss which may be considered misleading.
- **realisation** – an entity is rarely able to benefit from a gain that arises from a decrease in its own credit standing.
- **accounting mismatch** – including credit risk in the measurement of liabilities may increase rather than decrease accounting mismatches as many assets are not measured at fair value and the decline in credit risk may reflect change in the value of these assets or of assets not recognised on the balance sheet, such as internally generated goodwill.

The IASB is requesting comments on whether, and to what extent, the measurement of a liability should incorporate the price of credit risk inherent in the liability. Further information on the proposals presented in the discussion paper can be found in the Deloitte IAS Plus Newsletter: [IASB seeks views on the role of credit risk in liability measurement](#).

Download the [Discussion Paper](#) from the IASB website.

Comments on the discussion paper are due to the FRSB by **12 August 2009** or to the IASB by **1 September 2009**.

IASB Invites Comments on Expected Loss Model for Impairment of Financial Assets

As part of the second phase of the project to replace IAS 39, the IASB has issued a Request for Information on the feasibility of using an expected loss approach for measuring the impairment of financial assets carried at amortised cost. IAS 39 currently requires an incurred loss approach, which does not permit the recognition of impairment for losses which are expected to arise from future events. The expected loss model would require an entity to make an ongoing assessment of expected credit losses, which may require earlier recognition of credit losses than the incurred loss model. Proponents of the expected loss model argue that this would better reflect the way that financial assets are priced and the way that some companies manage their business. The IASB has requested information on the practical implications for entities of adopting the expected loss model. The IASB will consider the feedback as it develops the exposure draft on financial instruments impairment that is expected to be released in October 2009.

Download the [Request for Information](#) from the IASB website.

Comments are due to the FRSB by **10 August 2009** or to the IASB by **1 September 2009**.

Exposure Draft on Income from Non-exchange Transactions

The Financial Reporting Standards Board (FRSB) and the Australian Accounting Standards Board (AASB) have issued a joint exposure draft entitled *Income from Non-Exchange Transactions (Taxes and Transfers)* which proposes guidance on accounting for grants, donations, bequests, and other non-exchange transactions. The FRSB and AASB based this exposure draft on International Public Sector Accounting Standard IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. The resulting Standard is expected to apply to Public Benefit Entities (PBEs) in New Zealand that have adopted New Zealand Equivalents to International Financial Reporting Standards.

Key proposals in the exposure draft include:

- Assets acquired in a non-exchange transaction are measured on initial recognition at fair value, except for financial assets which are measured in accordance with NZ IAS 39.
- Stipulations relating to transferred assets may be either *conditions* or *restrictions*.

- Where there is a *condition* attached to a transferred asset meaning that the entity must consume the economic benefits of the asset as specified or return the asset to the transferor, the entity records a liability for the present obligation and recognises revenue only when that present obligation is satisfied. The liability is measured at the best estimate of the amount required to settle the obligation at reporting date, except that financial liabilities are measured in accordance with NZ IAS 39.
- Where there is a *restriction* attached to the asset meaning that there is no enforceable requirement that an entity consume the economic benefits of the asset in the manner specified by the transferor, the entity records revenue when it takes control of the asset.
- An entity recognises an asset in respect of taxes when the taxable event has occurred and the asset recognition criteria have been met. The asset is measured at fair value, being the best estimate of the resources that will flow to the entity.
- Advance receipts are distinguished from other liabilities and are measured at the amount received.
- An entity is permitted, but not required to recognise revenue in relation to services in kind.

There are no differential reporting concessions proposed in the exposure draft.

Download the [Exposure Draft](#) and the [Media Release](#) from the NZICA website.

Comments on the exposure draft should be submitted to the FRSB or AASB by **30 November 2009**.



IASB Issues IFRS for SMEs

The IASB has issued the *IFRS for SMEs*. This is the first set of international accounting requirements developed specifically for small and medium-sized entities (SMEs). It has been prepared on IFRS foundations but is a stand-alone product that is separate from the full set of International Financial Reporting Standards (IFRSs). The *IFRS for SMEs* has simplifications that reflect the needs of users of SMEs' financial statements and cost-benefit considerations. Compared with full IFRSs, it is less complex in a number of ways:

- Topics not relevant to SMEs are omitted.
- Where full IFRSs allow accounting policy choices, the IFRS for SMEs allows only the easier option.
- Many of the principles for recognising and measuring assets, liabilities, income and expenses in full IFRSs are simplified.
- Significantly fewer disclosures are required.
- The standard has been written in clear, easily translatable language.

To further reduce the reporting burden for SMEs, revisions to the IFRS will be limited to once every three years. It is suitable for all entities except those with public accountability, such as those whose securities are publicly traded and financial institutions such as banks and insurance companies. The 230-page standard is a result of a five-year development process with extensive consultation of SMEs worldwide. Accompanying the standard is implementation guidance consisting of illustrative financial statements and a presentation and disclosure checklist. The *IFRS for SMEs* is available for any jurisdiction to adopt whether or not it has adopted the full IFRSs. It is up to each jurisdiction to determine which entities should use the standard. It is not clear at this stage whether the IFRS for SMEs will be adopted for use in New Zealand. If adopted, it would likely replace the framework for differential reporting.

Download the [Press Release](#) from the IASB website.

Further information can be found in the Deloitte IAS Plus Newsletter: [Simplified financial reporting - IASB provides relief for SMEs](#).



Exposure Draft on Management Commentary

Up until now, the content and structure of the management discussion and analysis (MD&A) in the annual report (usually in the form of the chairman's and CEO's reports in New Zealand) have largely been at the preparer's discretion. The IASB has issued an Exposure Draft entitled *Management Commentary*, which presents a proposed framework for preparing and presenting both historical and prospective commentary presented in conjunction with financial statements prepared in accordance with IFRS. While the IASB intends to issue the final document as non-mandatory guidance rather than a Standard, the document would be considered to represent 'best-practice' for management commentary. The Exposure Draft proposes that decision-useful management commentary should include information relating to:

- the nature of the business;
- management's objectives and strategies for meeting those objectives;
- the entity's most significant resources, risks, and relationships;
- the results of operations and prospects; and
- performance measures and indicators

The Exposure Draft reinforces the IASB's view, expressed in IFRS 8 *Operating Segments*, that the information that management considers to be important in managing and evaluating the business is the information that should be presented to users of financial statements. The IASB emphasises in the Exposure Draft that commentary should be entity-specific (rather than boilerplate) and should be consistent with the information provided in the financial statements, including segment disclosures.

Download the [Exposure Draft](#) from the IASB website.

Comments on the exposure draft should be submitted to the IASB by **1 March 2010**.

Further information on the proposals presented in the exposure draft can be found in the Deloitte IAS Plus Newsletter: [IASB issues proposals regarding management commentary](#).

Group Cash-settled Share-based Payment Transactions – Amendments to IFRS 2

In June 2009 the IASB issued amendments to IFRS 2 *Share-based Payment* in response to requests to clarify the accounting in the individual financial statements of an entity that enters into a share-based payment arrangement that will be settled by another entity within the consolidated group.

The amendments clarify that:

- an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, and no matter whether the transaction is settled in shares or cash.
- The entity receiving the goods or services will account for the transaction as a cash-settled share-based payment unless it has no obligation to settle the transaction or the arrangement will be settled by issuing its own equity instruments.
- The entity required to settle the transaction will recognise it as a cash-settled share-based payment unless the transaction will be settled by issuing its own equity instruments.

The amendments to IFRS 2 also incorporate guidance previously included in IFRIC 8 *Scope of IFRS 2* and IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*. As a result, these Interpretations have been withdrawn by the IASB.

Further information on the changes to IFRS 2 can be found in the Deloitte IAS Plus Newsletter:

[Clarification of accounting for group cash-settled share-based payment transactions](#).

For more information on these topics and for the latest developments in International Financial Reporting, please visit our global IFRS website www.iasplus.com.

IPSASB Issues Proposed Amendments to Public Sector Standards

The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants has launched an improvements project with the release of Exposure Draft 42 *Improvements to IPSASs*. This Exposure Draft is the first of a proposed series of annual improvements to the IPSASs and is modelled on the annual improvements program developed by the International Accounting Standards Board (IASB). The proposed amendments affect 12 International Public Sector Accounting Standards (IPSASs) and the amendments reflect changes made by the IASB to related International Financial Reporting Standards.

Download the **Exposure Draft** and the **Accompanying Explanation** from the NZICA website.

Comments on the exposure draft are due to the FRSB by **11 September 2009** or to the IPSASB by **30 September 2009**.

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