

## IFRS Update 2011

### Guiding you through IFRS

Ralph ter Hoeven  
Martijn Hengeveld  
Dingeman Manschot  
*Rotterdam IFRS Center of Excellence*

17 November 2011



# Agenda



## Introduction & IFRS developments

Ralph ter Hoeven

15.00 – 16.00



## Financial instruments update

Martijn Hengeveld

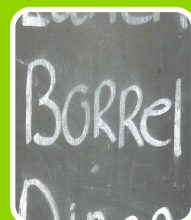
16.00 – 17.30 (break: 16.30 – 17.00)



## IFRS platform changes

Dingeman Manschot

17.30 – 18.30



## Drinks and snacks

18.30

## Polling question (Just testing ...)



### Why do you attend this IFRS Update?

- a) I need the PE credits
- b) I want to stay updated in the field of IFRS
- c) I couldn't refuse the kind invitation of my auditor
- d) Other

## Introduction & IFRS developments Beyond the headlines

Ralph ter Hoeven  
Partner, Leader Rotterdam IFRS Center of Excellence  
+31 88 288 1080



# Overview

# Important developments 2011

- New chairman and vice-chairman
  - All 4 major topics are delayed; promise to G20 is broken
- 
- Publication of new standards (IFRS 10 – 13 + IAS 19R + Amendment to IAS 1)
  - IASB announces agenda consultation project
  - IASB commences post implementation reviews (IFRS 8, IFRS 3)
- 
- Call for Frameworks!!
    - Finishing current Framework of IASB
    - Disclosure and presentation framework (EFRAG/FASB)
    - International Integrated Reporting Framework (IIRC)

# And the European Union?

- IFRS 9 endorsement still postponed (pending full package); still an anti-fair-value-sentiment
- EC proposes a new Directive to replace Accounting and Transparency Derivatives
  - Country-by-Country reporting for oil, gas, mining, logging industries regarding **payments to governments** (e.g. taxes, royalties and bonuses for each country) (large companies + PIEs)
  - 'Cutting red tape' for SMEs (no ground for IFRSs for SMEs in the EU)
  - No obligation to publish quarterly financial information for listed companies



# Agenda consultation

The second decade of the IASB begins:

**Can you please tell us what we should do after  
2012?**

**Suggestions possible until  
30 November 2011**



## Polling question



IFRS is a better reporting platform than Dutch GAAP.

It leads to higher quality financial statements (compared with the application of Dutch GAAP).

**Do you agree?**

- a) Yes
- b) No

# What about the current IASB agenda?

- Still very financial crisis related in cooperation with the FASB
- Some projects show slow progress while differences with FASB remain unresolved:
  - Impairment of financial assets
  - Offsetting of financial assets and liabilities
  - Insurance contracts
- Good progress in revenue recognition and leasing projects

# IASB work plan – current status

Financial crisis related projects	2011 Q4	2012 H1	2012 H2	MoU	Joint
IFRS 9: Financial instruments (replacement of IAS 39)					
▪ Deferral of mandatory effective date of IFRS 9	Target completion				
▪ Impairment		Re-exposure		√	√
▪ Hedge accounting					
▪ General hedge accounting	Review draft	Target IFRS		√	
▪ Macro hedge accounting		Target ED		√	
▪ Assets and liability offsetting	Target IFRS			√	√

# IASB work plan – current status

Memorandum of Understandings projects	2011 Q4	2012 H1	2012 H2	MoU	Joint
Leases		Target ED (Re-expose)	Target IFRS	√	√
Revenue recognition	TED (Re-exposed)		Target IFRS	√	√
Other projects	2011 Q4	2012 H1	2012 H2	MoU	Joint
Insurance contracts		Review draft or revised ED			√
Annual improvements 2009-2001		Target completion			
Annual improvements 2010-2012	Target ED				
Amendments to IFRS 1 (Government loans)	Comment period				
Consolidation – Investment entities	Comment period				√

# IFRS around the world; the move towards global standards



# How countries implement IFRS

- Adoption/Conversion - a switch from local standards to IFRS, without converging them first (Canada)
- Convergence - migration of local standards to being closely aligned with IFRS (US)
- Endorsement – formal endorsement of new or amended IFRS before they become legally binding (EU)
- Condorsement: Endorsement including possible carve-outs, putting additional guidance, alternatives, etc (India, China, US?)
- US may elect a condorsement approach
- Other countries: Japan, China, India?

## Polling question



Listed companies should just comply with full IFRS in their consolidated financial statements (so without condorsement, endorsement, etc.).

**Do you agree?**

- a) Yes
- b) No

## The road to global convergence: adding local flavours to IFRS?

- Increasing reluctance of transferring power to a private organisation (IASB):
  - India (major carve outs proposed)
  - China (CAS; IFRS adopted but differences exist)
  - European Union (endorsement gives political ‘momentum’)
  - United States (probably in future)
    - SEC-staff recently proposed a ‘*condorsement*’ approach
    - Stop issuing new standards, integrate IFRS into US GAAP codification instead
  - Japan? Decision to be taken in 2012. US-GAAP not allowed anymore as per 2016
- Condorsement seems to prefer: IFRSs serve as raw material for local GAAP

Special topics

Project on insurance contracts  
Employee benefits

# Project on insurance contracts

Residual  
margin

- No gains at inception
- Adjust prospectively for changes in estimates of cash flows

Risk  
adjustment

- Include independently measured and updated risk adjustment

Time value  
of money

- Adjust for time value of money using rate that reflects characteristics of liability

Cash flows

- Expected value considering all relevant information
- Includes all direct costs incurred in acquiring the contracts

# IAS 19 Revised

Effective:  
2013

Categories	Components	Financial statements	
Service cost	<ul style="list-style-type: none"> <li>Current service cost net of employee contributions</li> <li>Curtailment loss/gain</li> <li>All past service cost</li> </ul>	Service cost in profit or loss	Recurring cost
Net interest	Time value of money on the net defined benefit liability (asset)	Finance cost in profit or loss	
Remeasurements	<ul style="list-style-type: none"> <li>Actual return net of time value of money on plan assets</li> <li>Non-routine settlement gain/loss</li> <li>Gain/loss on DBO</li> <li>Effect of asset ceiling</li> </ul>	In Other comprehensive income (OCI)	Non-recurring cost

# IAS 19 Revised

**Most important amendment:  
Elimination of unrecognised items on the balance sheet**

## Example

<b>Assets</b>	<b>Balance sheet</b>		<b>Liabilities</b>
Total assets	1,000	Equity	600
		Net defined benefit liability	400
		<i>Unfunded status</i>	700
		<i>Unrecognised actuarial losses</i>	(300)
	<hr/>		<hr/>
	1,000		1,000

# Country specific: the Netherlands – classification

## Clarification of classification

The following two paragraphs have been amended:

### IAS 19R.28

Under defined contribution plans:

- the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund.....
- in consequence, actuarial risk (...) and investment risk (...) fall, in substance, on the employee.

### IAS 19R.29

Examples of cases where an entity's obligation is not limited to the amount that it agrees to contribute to the fund are ... :

- a plan benefit formula that is not linked solely to the amount of contributions and requires the entity to provide further contributions if assets are insufficient to meet the benefits in the plan benefit formula;
- ....

# Country specific: the Netherlands – classification

## Clarification of classification

Consequences of the clarification regarding the classification of a pension plan are:

- The existence of a benefit formula can no longer solely frustrate a classification as defined contribution plan
- The employer should be obliged 'to provide further contributions if assets are insufficient' in order for the pension plan to be classified as defined benefit plan
- Substance of shared risk provisions should be considered

# Country specific: the Netherlands – classification

## Estimated impact

<b>BPF</b>	<b>OPF</b>	<b>Insured plans</b>
High (no ritual dance of request letters; disclosures)	Depending on content administration agreement	Low

# Country specific: the Netherlands – risk sharing

## Risk sharing

IAS 19R acknowledges that part of the pension related risks are shared between the employer and the plan participants, by accounting for:

### a) **Employee contributions**

Present value of the expected future employee contributions should be deducted from the present value of the defined benefit obligation.

### b) **Liability ceiling (the limit on contributions)**

The liability ceiling is determined by the maximum amount an employer is obliged to pay according to the terms of the pension plan and the underlying funding agreement.

# Employee contributions: Deloitte NL methodology

- Employee contributions of the current period are deducted from gross service cost
- Gross service cost are however decreased due to future increases of employee contributions, in line with the treatment of salary increases under PUC.
- Gross service cost (IAS 19):
  - /- Effect of future increases of employee contributions
  - /- Actual employee contributionsNet service cost (IAS 19R)
- Upon payment of the employee contributions:
  - DBO and plan assets are increased
  - Payment does not lead to impact on net defined benefit liability (asset).

# Country specific: the Netherlands – liability ceiling

## Liability ceiling

## Example

Year	Service cost
1	350
2	400
3	450
4	500
5	550
Total	2,250

### Present value of the defined benefit obligation

Defined benefit obligation (before effect of liability ceiling)	2,150
Effect of the liability ceiling	
Defined benefit obligation (after effect of liability ceiling)	<u>2,150</u>

# Questions & answers

## Financial instruments update *Anticipating the unforeseen*

Martijn Hengeveld  
Partner, Financial Services Industry  
+31 88 288 1972



# Overview

# IFRS 9 will replace IAS 39

## Objective of the replacement project

Improve the **decision usefulness** for users of financial statements by **simplifying** the classification and measurement requirements for financial instruments.

Phase 1	Phase 2	Phase 3	Additional
<b>Classification &amp; measurement</b>	<b>Impairment</b>	<b>Hedge accounting</b>	<b>Offsetting</b>
Final standard issued	Exposure Draft (ED)	ED for Micro Hedge Accounting, Macro Hedge Accounting still outstanding	Exposure Draft (ED)

# Polling question



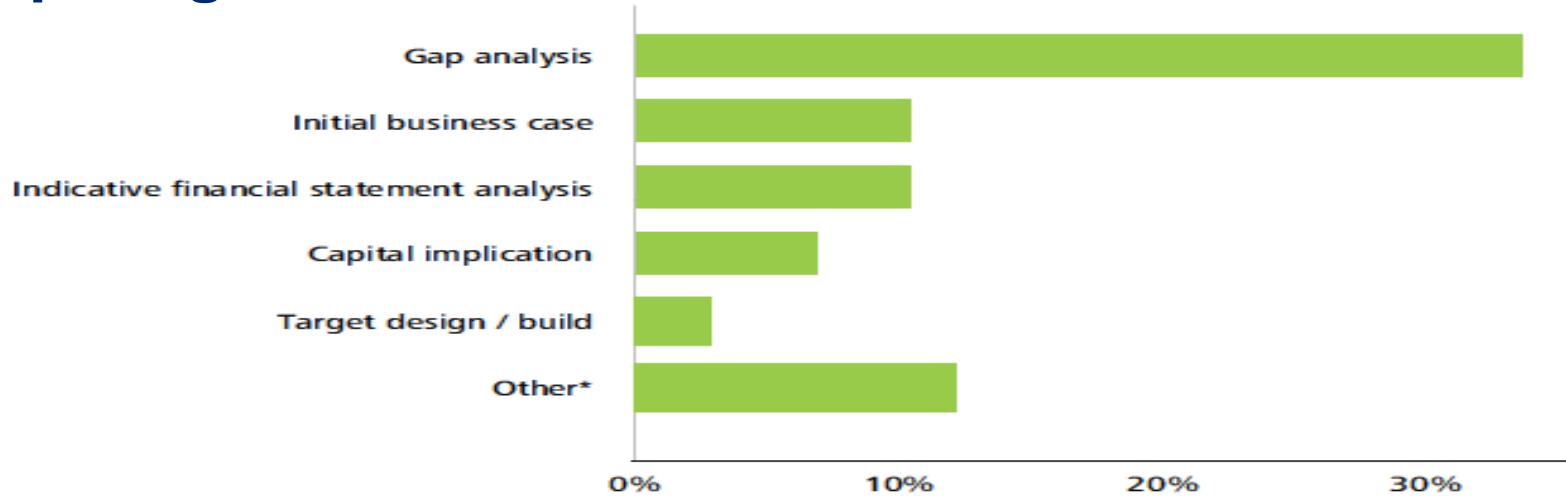
## When do you expect to start?

- a) Already started in 2010
- b) In 2011
- c) In 2012
- d) Waiting for final standard / later

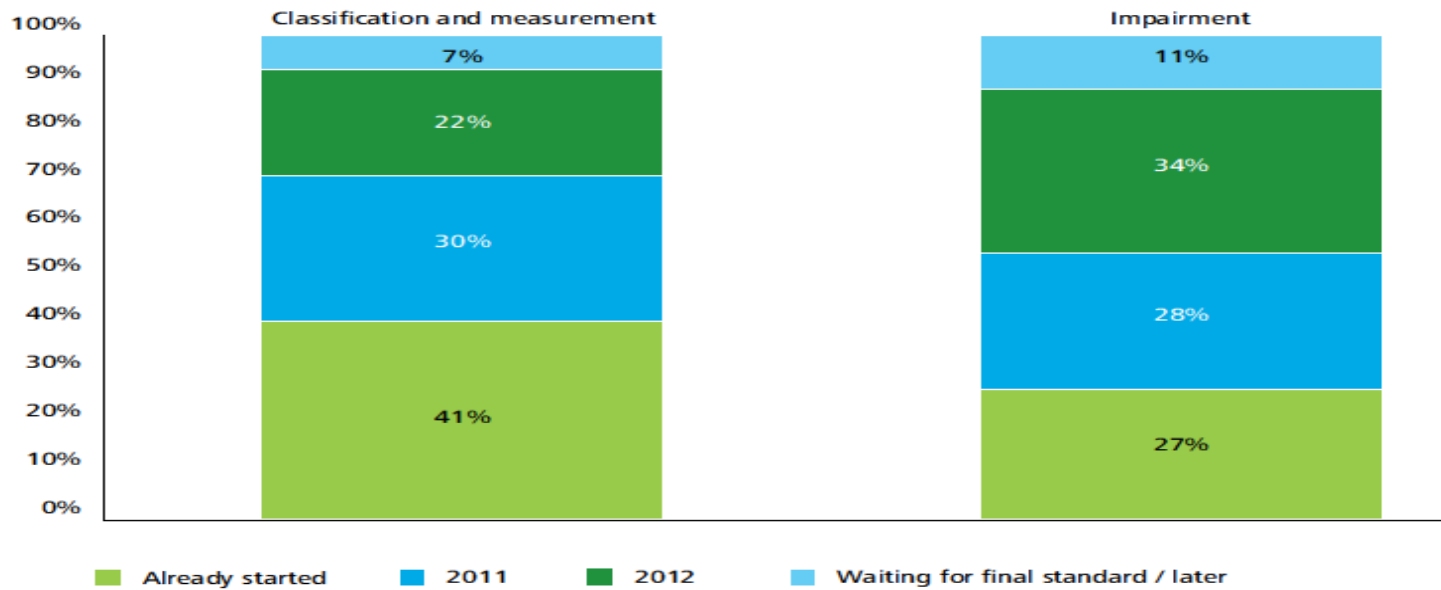
## What have you done so far?

- a) Gap analysis
- b) Initial business case
- c) Indicative financial statement analysis
- d) Capital implication
- e) Target design / build

# Preparing for IFRS 9



## When do you expect to start your IFRS 9 project?



# Classification & measurement

## Phase 1: Classification and measurement

Reduction to two asset categories, no significant changes for liabilities

Business Model and Cash Flow Characteristics as driver for asset classification

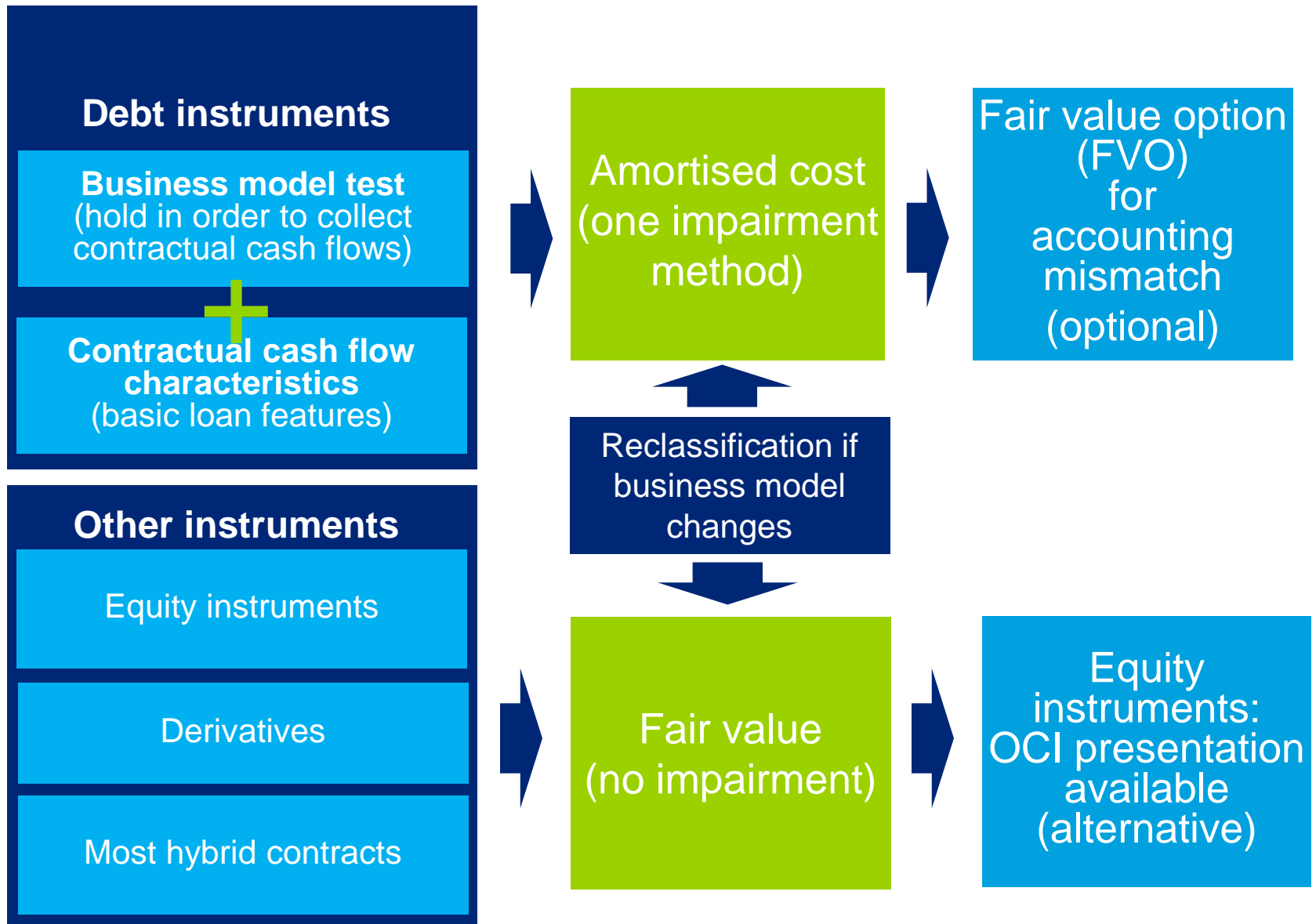
Measurement changes will have impacts on balance sheet and P&L

Parallel processing for IAS 39 and IFRS 9 in comparison period(s) is challenging

## Phase 2: Impairment

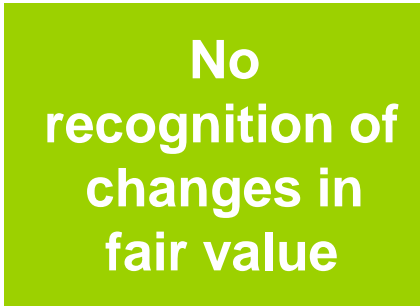
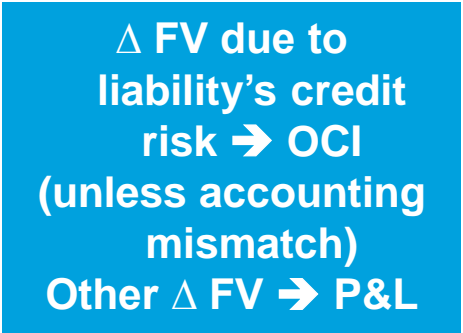
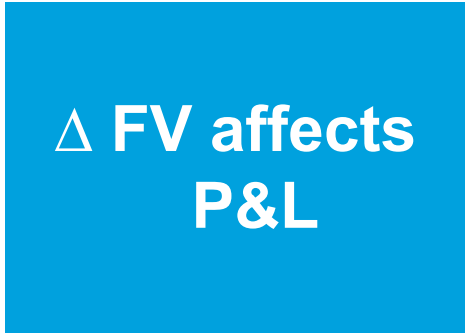
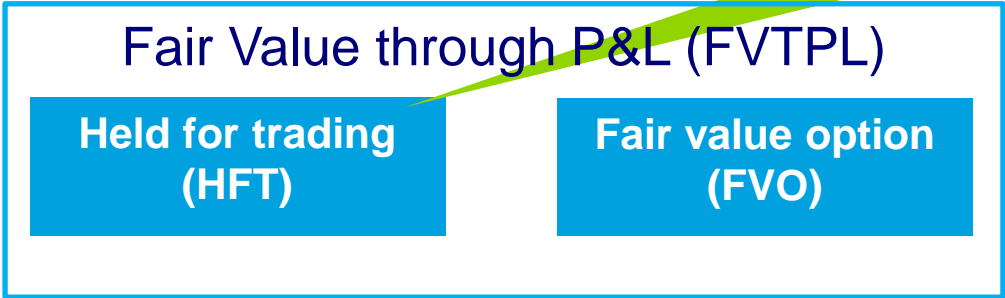
## Phase 3: Hedge accounting

# Financial assets



# Financial liabilities

including bifurcated embedded derivatives



Major IFRS 9 Change

Impairment

## Phase 1: Classification and measurement

## Phase 2: Impairment

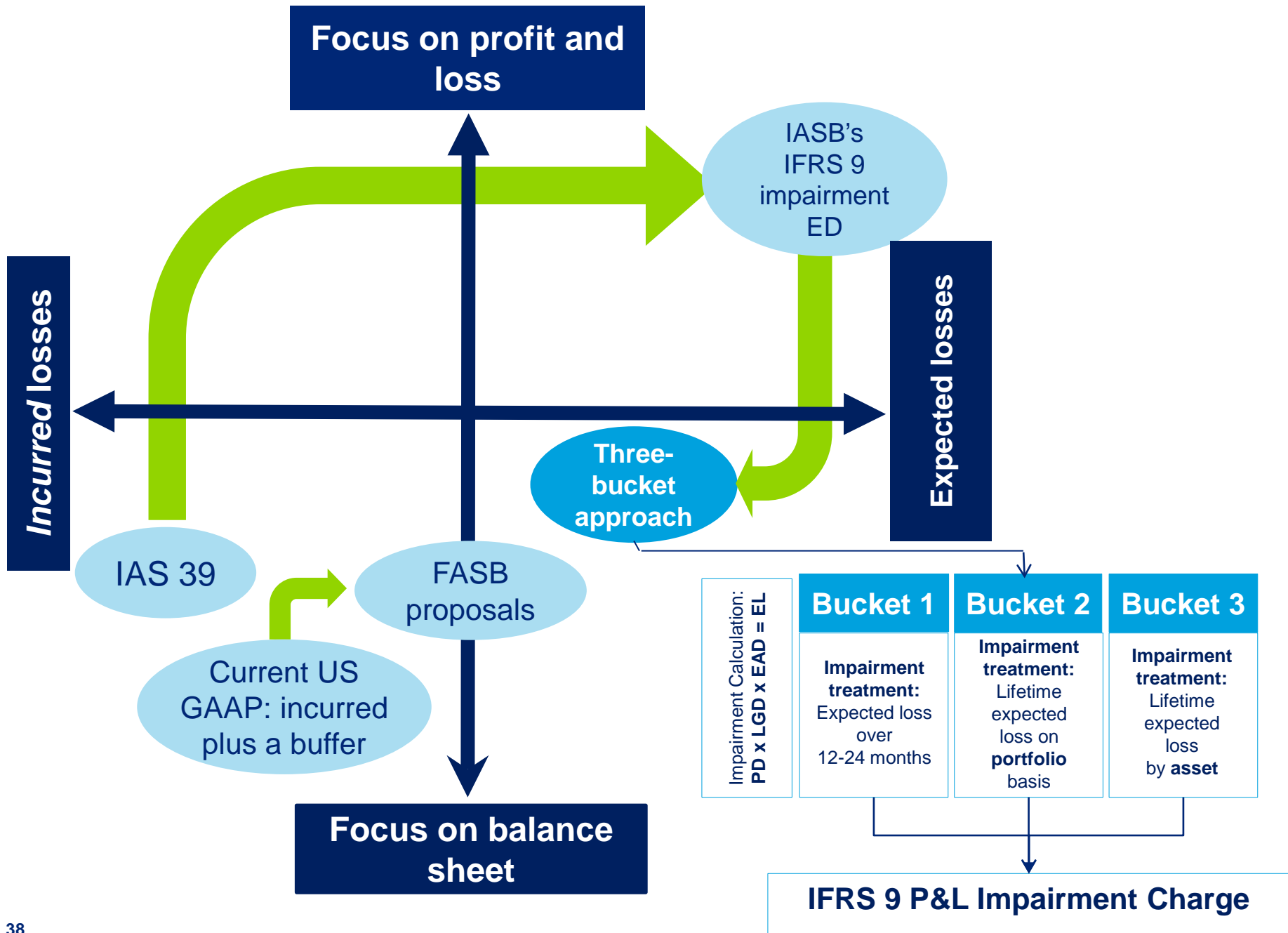
Significant simplifications compared to the first exposure draft

Stronger link between Risk Management (Basle II) and impairment calculations expected

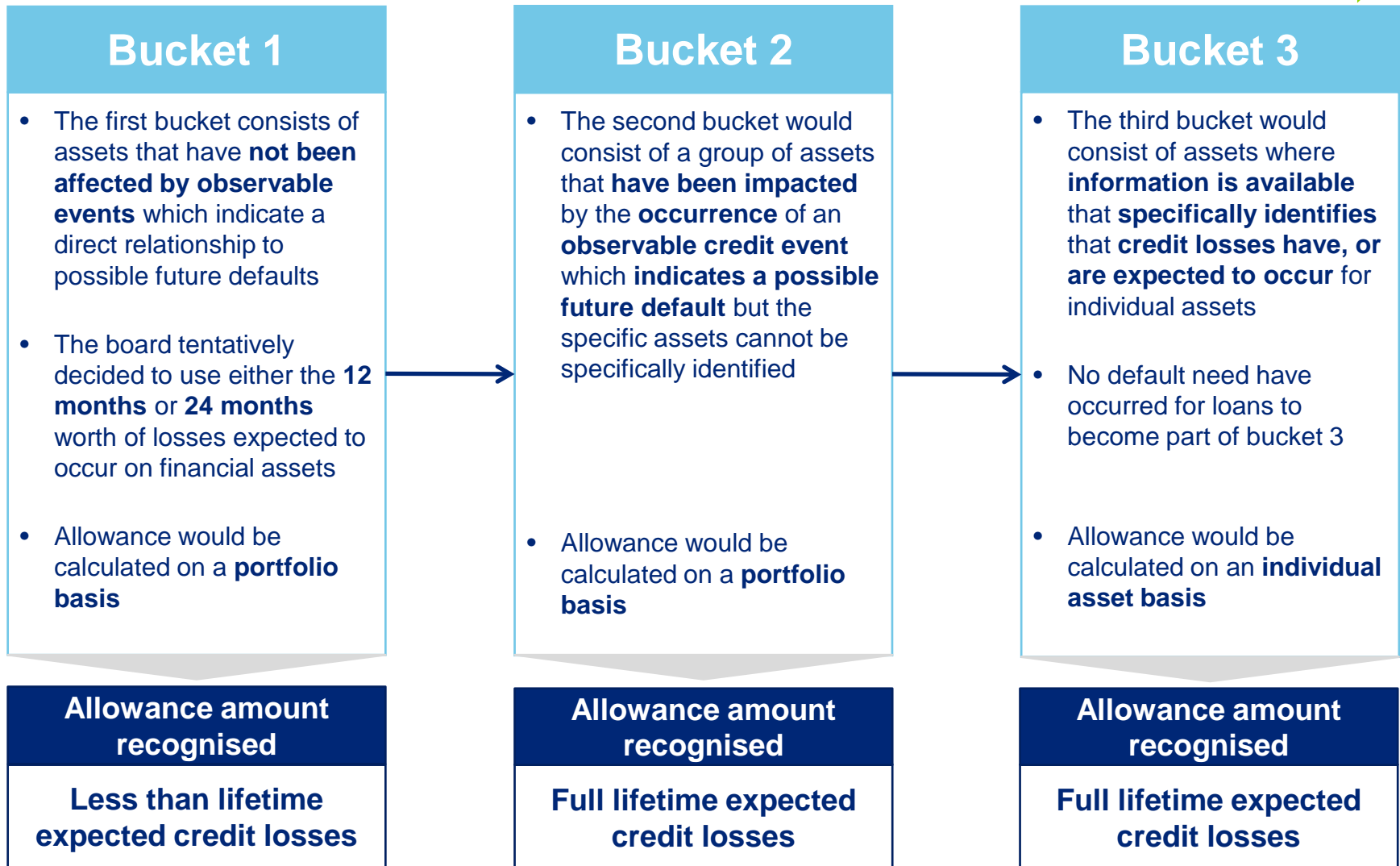
Different methods/ buckets depending on the probability of default

New ED addressed for Q4 2011 / 2012, expected for Q1 2012

## Phase 3: Hedge accounting



# Transfer based on internal credit risk management



# Hedge accounting

# Phase 1: Classification and measurement

# Phase 2: Impairment

# Phase 3: Hedge accounting

Simplification of hedge accounting rules

Stronger link between risk management and accounting

New approaches to address practical issues

Revision of IAS 39 regulations while keeping the general principle intact

**Phase 3A:  
General  
hedge accounting model**

Final standard expected for Q4 2011

**Phase 3B:  
Portfolio / macro hedging  
(is still being discussed)**



Draft expected in Q4 2011 / 2012

# Hedge accounting

Designation

<b>Stronger link to risk management activities</b>	No more need to verify the 80% - 125% hedge effectiveness retrospectively	Instead the assessment of hedge effectiveness can be done based on a qualitative analysis	No permission to voluntarily de-designate a hedging relationship
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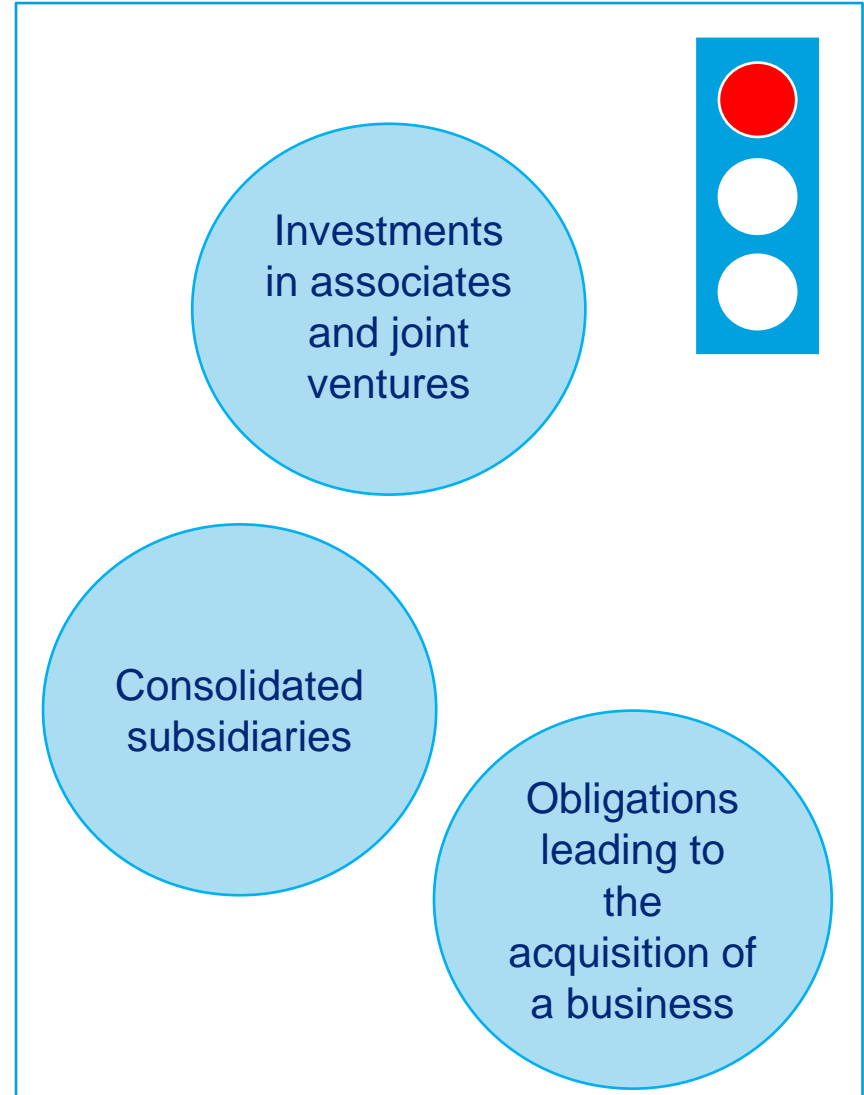
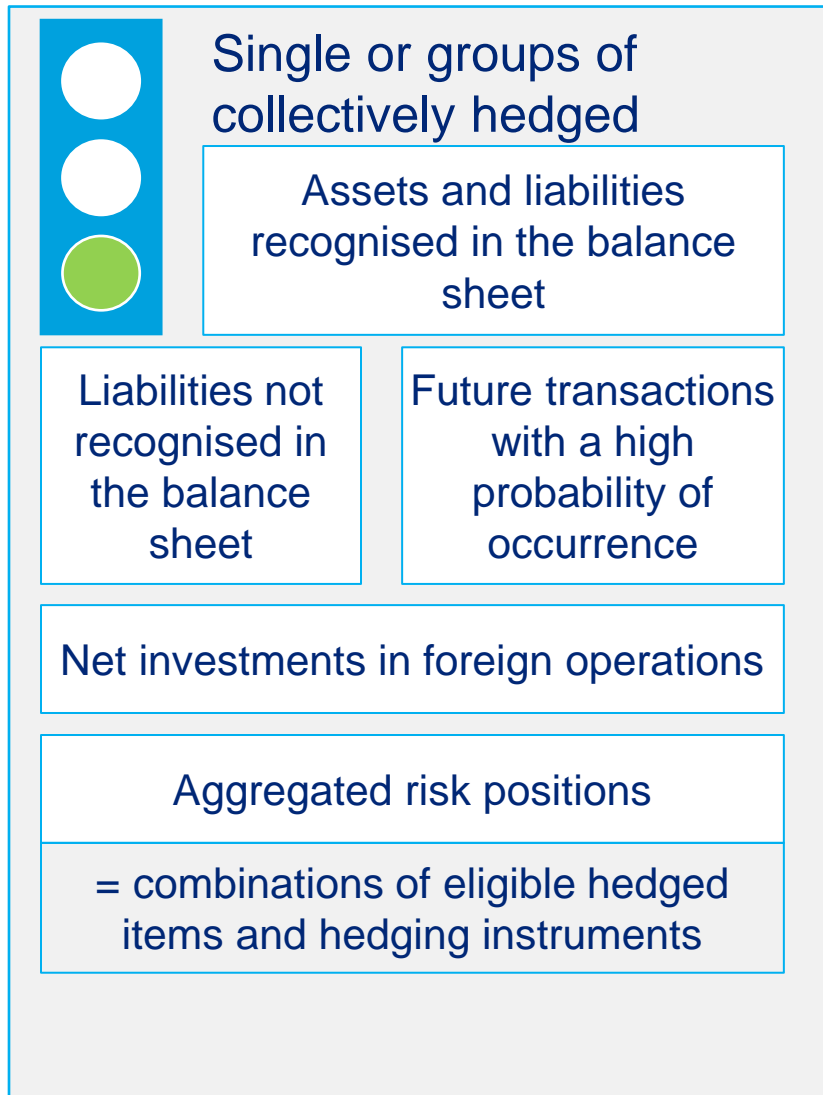
Hedged items

Financial instruments with contractual cash flow characteristics		Derivatives	Equity instruments designated as FV through OCI		Portfolio hedge accounting
Proportional notional amounts / risk components		One-sided risks			

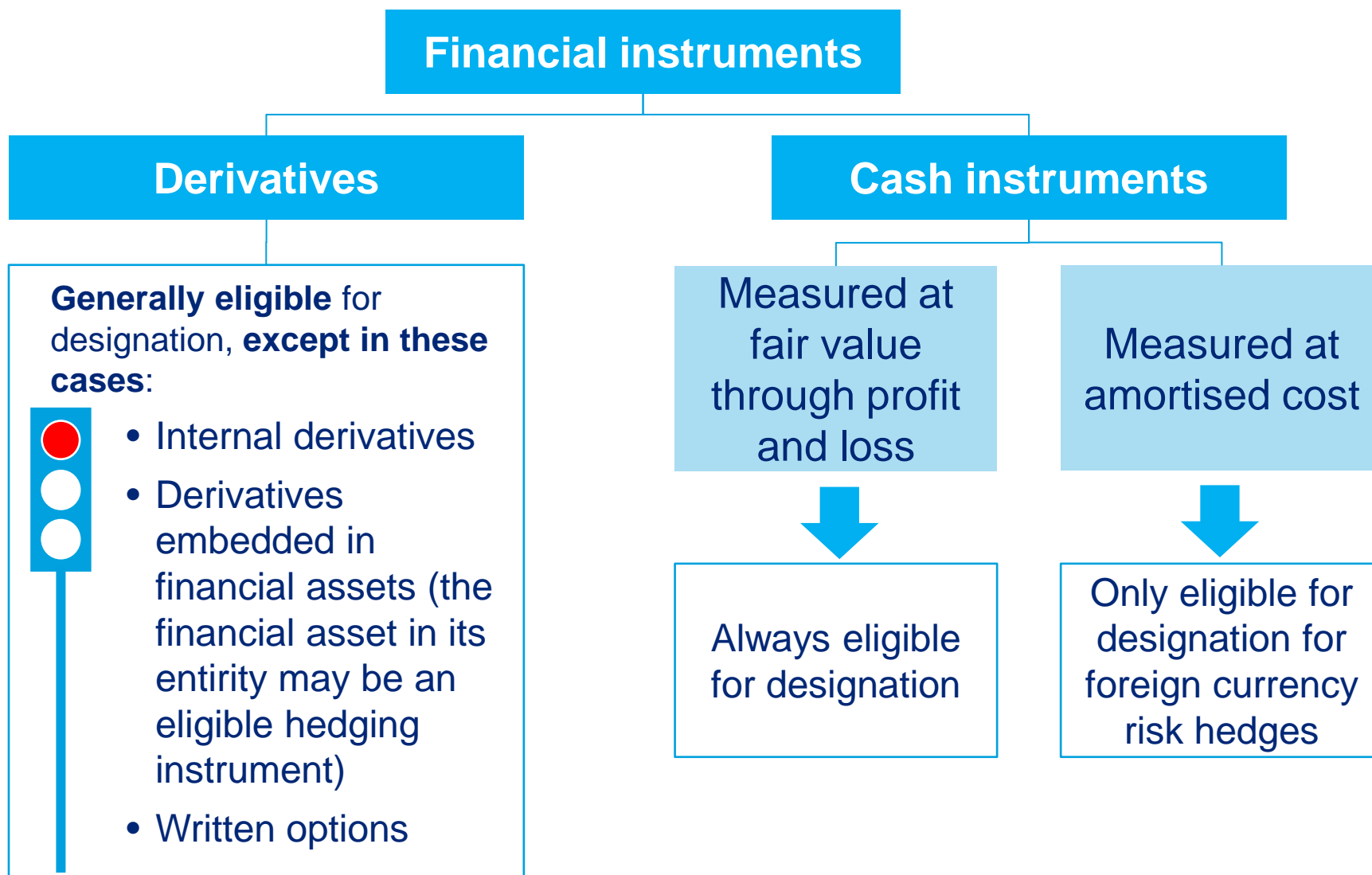
Hedging instruments

	Cash instruments measured at fair value through profit and loss	Stand-alone derivatives		Embedded derivatives	Internal derivatives
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# Hedged items

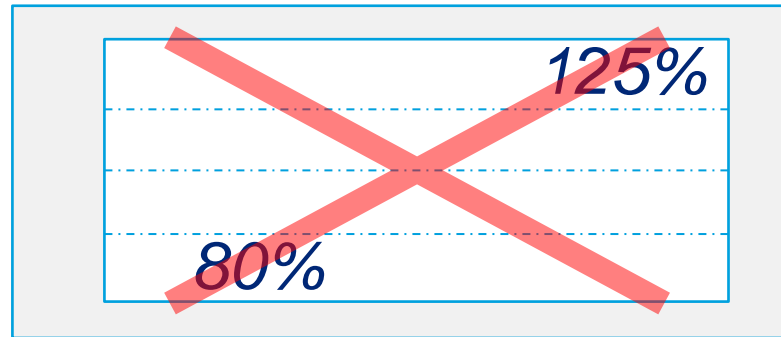


# Hedging instruments



# Hedge effectiveness

'no more  
bright line'



- **No “bright line” threshold for hedge effectiveness**
- **The characteristics of each hedging relationship** determine whether a **qualitative assessment** of hedge effectiveness is sufficient or if a **quantitative analysis** is needed
- **Forward looking assessment of hedge effectiveness** (at the time of designation and at each reporting date)
- A **retrospective assessment of hedge effectiveness** is **no longer necessary** in all cases, but ineffectiveness have to be measured and immediately recognised in P&L

Impact

# Impact

## Accounting policies

- New guidelines for Classification & Measurement, Impairment, Hedge accounting
- Potentially, amended guidelines for Management Accounting – depending on the decision how far IFRS 9 should be reflected

## Markets / Front office

- Consideration of Business Model impacts as well as Cash Flow Characteristics on IFRS 9 classification, adjusted NPP\*
- Consideration of IFRS 9 impacts on pricing, e.g. for loans

## Processes

- Links Risk and Finance processes, especially regarding impairment
- Adjusted processes for Classification and Hedge accounting
- Adjusted NPP

## Governance

- Clarification of future IFRS 9 responsibilities of Finance, Risk and Controlling necessary
- Set-up of IFRS 9 project governance

# Impact

## IT Systems

- IFRS 9 will have impacts on all IT layers, e.g. new attributes, new evaluation functions, adjusted booking rules, adjusted reporting
- Parallel processing for comparison year(s) is challenging

## Finance, Risk and IT staff

- IFRS 9 will require significant internal support during project time
- Releasing staff from regular tasks through external support should be considered
- Know How on ongoing basis necessary

## Budgets

- IFRS 9 will at least have impacts on 2012 and 2013 budgets
- Gap analysis for enabling reliable budget estimation should be started soon

## Polling question

**Where do you expect the largest impact from IFRS 9?**

- a) Accounting policies
- b) Markets / front office
- c) Processes
- d) Governance
- e) IT systems
- f) Budgets / management information
- g) Risk systems



# Areas affected by IFRS 9 impairment

Criteria of allocation

Methods of loss provisioning

Trigger for transfers

Booking rules

Disclosure and reporting

IT and processes

## Operative influence of IFRS 9 Impairment

Accounting	Controlling	Risk	Regulatory reporting	Asset allocation	IT
<ul style="list-style-type: none"> <li>• Adjustment of loss provisioning</li> <li>• Impact on P&amp;L</li> <li>• Effect on accounting ratios</li> <li>• Setup of accounts</li> <li>• Disclosure of the development of loan loss provisions</li> </ul>	<ul style="list-style-type: none"> <li>• Modification of investment planning</li> <li>• Review of profit planning</li> <li>• Profit distribution</li> <li>• Management Reporting</li> </ul>	<ul style="list-style-type: none"> <li>• Lifetime EL estimation: PD, LGD, EAD computation/adjustment</li> <li>• Implementation of methods</li> <li>• Definition and monitoring of risk factors</li> <li>• Portfolio building</li> </ul>	<ul style="list-style-type: none"> <li>• Adjustment of disclosures</li> <li>• Disclosure of the development of loan loss provisions</li> <li>• Modification of regulatory reporting</li> </ul>	<ul style="list-style-type: none"> <li>• Modification of limit systems</li> <li>• Additional data requirements for debt instruments</li> <li>• Portfolio building</li> <li>• Investment reallocation</li> </ul>	<ul style="list-style-type: none"> <li>• System compatibility and interface adjustments towards accounting, risk and asset allocation</li> <li>• Adjustment of data base</li> <li>• Implementation of new methods, expected loss calculations and other modifications</li> </ul>

○ No impact

→ ● Very high impact

# Questions & answers

## IFRS platform changes 2013

Be prepared!

Dingeman Manschot  
Director, Rotterdam IFRS Center of Excellence  
+31 88 288 2913



IFRS 10, 11 & 12

# Overview standards relating to interests in other entities

	Standard	Accounting	Disclosures	Separate financial statements
Subsidiaries	IFRS 10	Consolidation	IFRS 12	IAS 27 (2011)
Associates	IAS 28 (2011)	Equity method		
Joint ventures	IFRS 11			
Joint operations	IFRS 11	Contractual rights to assets and contractual obligations		IFRS 11
Unconsolidated structured entities	IFRS 9	As financial instruments		IFRS 9

IFRS 10

Consolidated financial statements

# IFRS 10 Consolidated financial statements

Key  
changes

Single model

***“Based on control”***

De facto control

***“Consider de facto circumstances”***

Substantive potential voting rights ***“Consider all potential voting rights”***

Concept of delegated power

***“Agent or principal”***

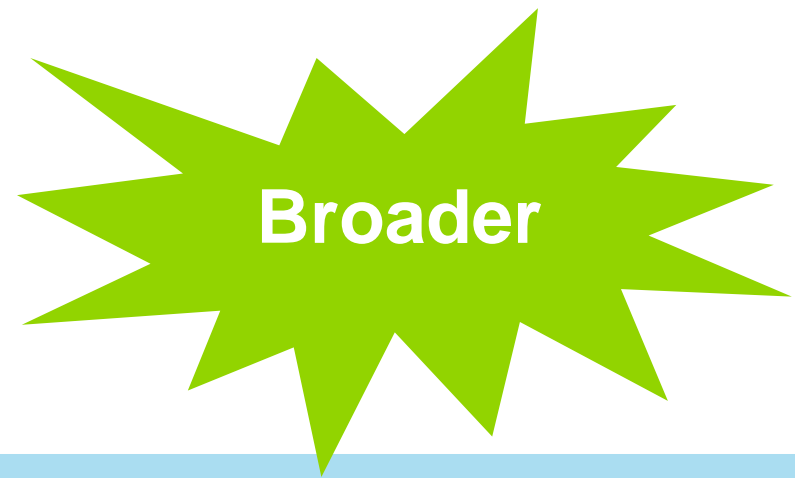
Concept of silos

***“Specified assets instead of legal entity”***

Protective rights

***“Definition of protective rights”***

# Definition of control



Power



Exposure (rights) to variable returns



Ability of the investor to affect its returns through its power

Substantive rights to direct « relevant activities »

Potential variability to positive or negative returns (broad definition of returns)

Need to determine whether the « decision-maker » is an agent of another investor

# Project on investment entities

**ED published  
in AUG 2011**

The project objective is to define an investment entity and to require that an investment entity should not consolidate investments in entities that it controls, but to measure those investments at fair value, with changes in fair value recognised in P&L.

## Polling question



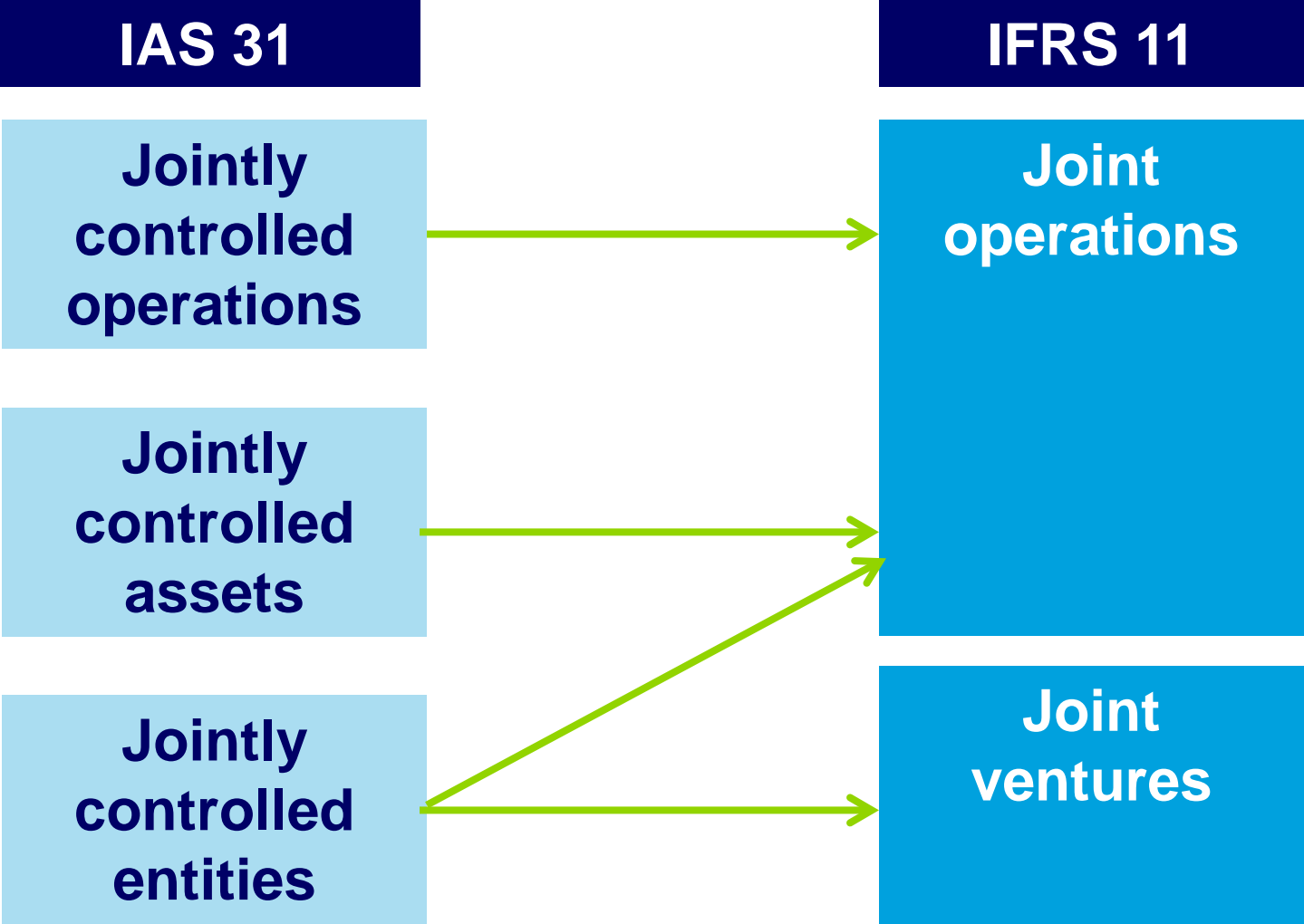
**What impact do you expect from the application of IFRS 10?**

- a) More interests in other entities will qualify as subsidiaries
- b) Less interests in other entities will qualify as subsidiaries
- c) No impact

# IFRS 11

## Joint arrangements

# IFRS 11 Joint arrangements



# Recognition and measurement

## Joint operations

A party to a joint arrangement recognises its contractual rights to assets and contractual obligations for liabilities in accordance with applicable standards

## Joint ventures

A venturer would recognise its right to a share of the outcome expected to be generated from a group of assets and liabilities subject to joint control using the **equity method**

## Polling question



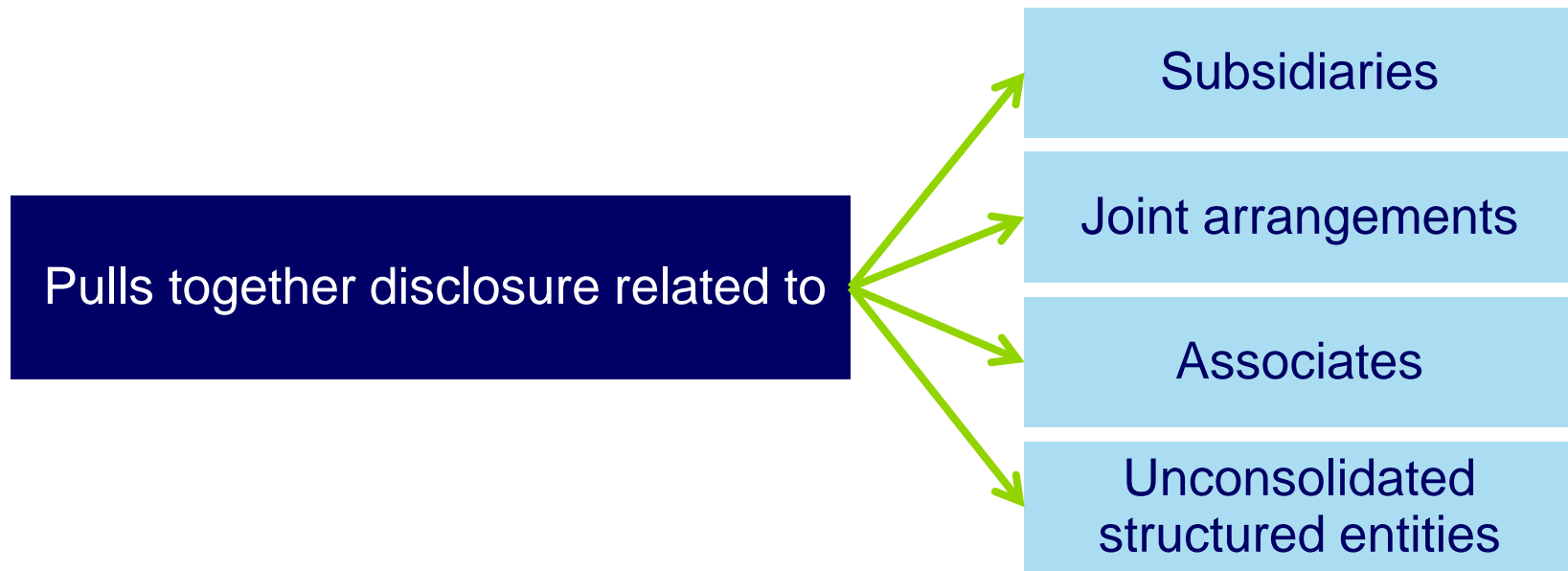
**What impact do you expect from the application of IFRS 11?**

- a) From proportionate consolidation to equity method for joint ventures
- b) No impact, because we already account for joint ventures using the equity method
- c) Some jointly controlled entities will classify as joint operations

IFRS 12

Disclosure of interests in other  
entities

# IFRS 12 Disclosure of Interests in Other Entities



## Objective

Establish the information necessary to evaluate

- Nature of, and risks associated with, interests in other entities
- Effects of those interests on the financial position, financial performance and cash flows

# IFRS 13 Fair value measurement

# IFRS 13 Fair value measurement

**How? Not  
when!**

Single source of guidance for all fair value measurements

Clarify the definition of fair value and related guidance

Enhance disclosures about fair value measurements

Increase the convergence of IFRS and US GAAP

# Examples of fair value in IFRS



# Out of scope IFRS 13

Scope

Share-based payments (IFRS 2)

Leasing transactions (IAS 17)

Measurements that have some similarities to fair value:

- net realisable value in IAS 2
- value in use in IAS 36

# What is fair value?

**'exit price'**

The price that would be received ***to sell an asset*** or paid ***to transfer a liability*** in an ***orderly transaction*** between ***market participants*** at the ***measurement date***.

**Important!**

## General guidance

- Application to non-financial assets
- Application to liabilities
- Application to an entity's own equity instruments
- Application to financial instruments

# Valuation techniques

'maximising the use of observable inputs'

■ Market approach

■ Income approach

■ Cost approach

'minimising the use of unobservable inputs'

# Disclosures for fair value measurements



Disclosure for each class of assets and liabilities (based on nature, characteristics, risks and the level of the fair value hierarchy)



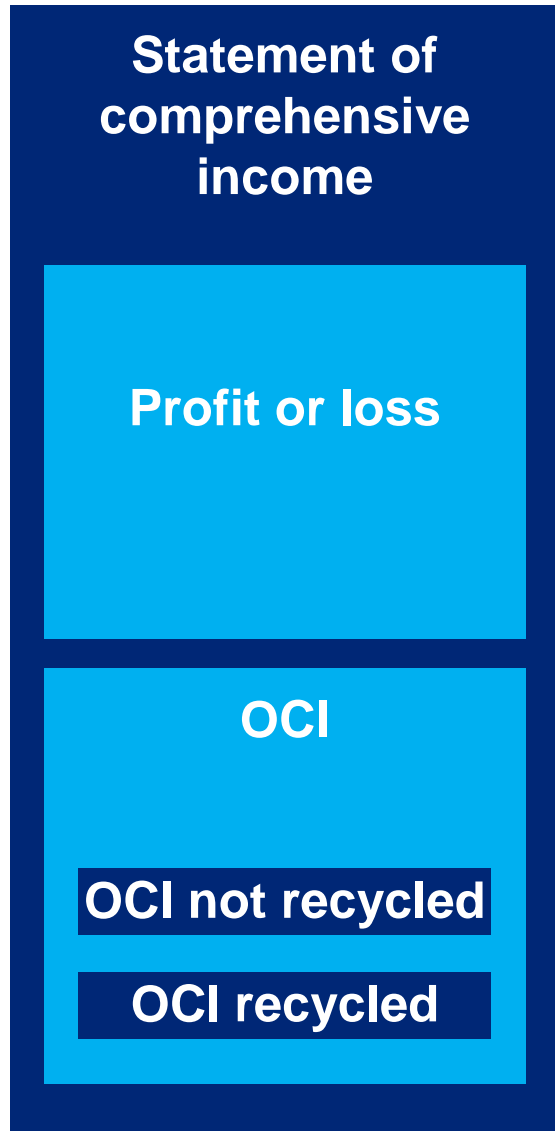
Recurring vs non-recurring fair value measurements



Fair value measurement in balance vs fair value measurement only included in notes

# Presentation of OCI (IAS 1)

## Change of presentation OCI



OR



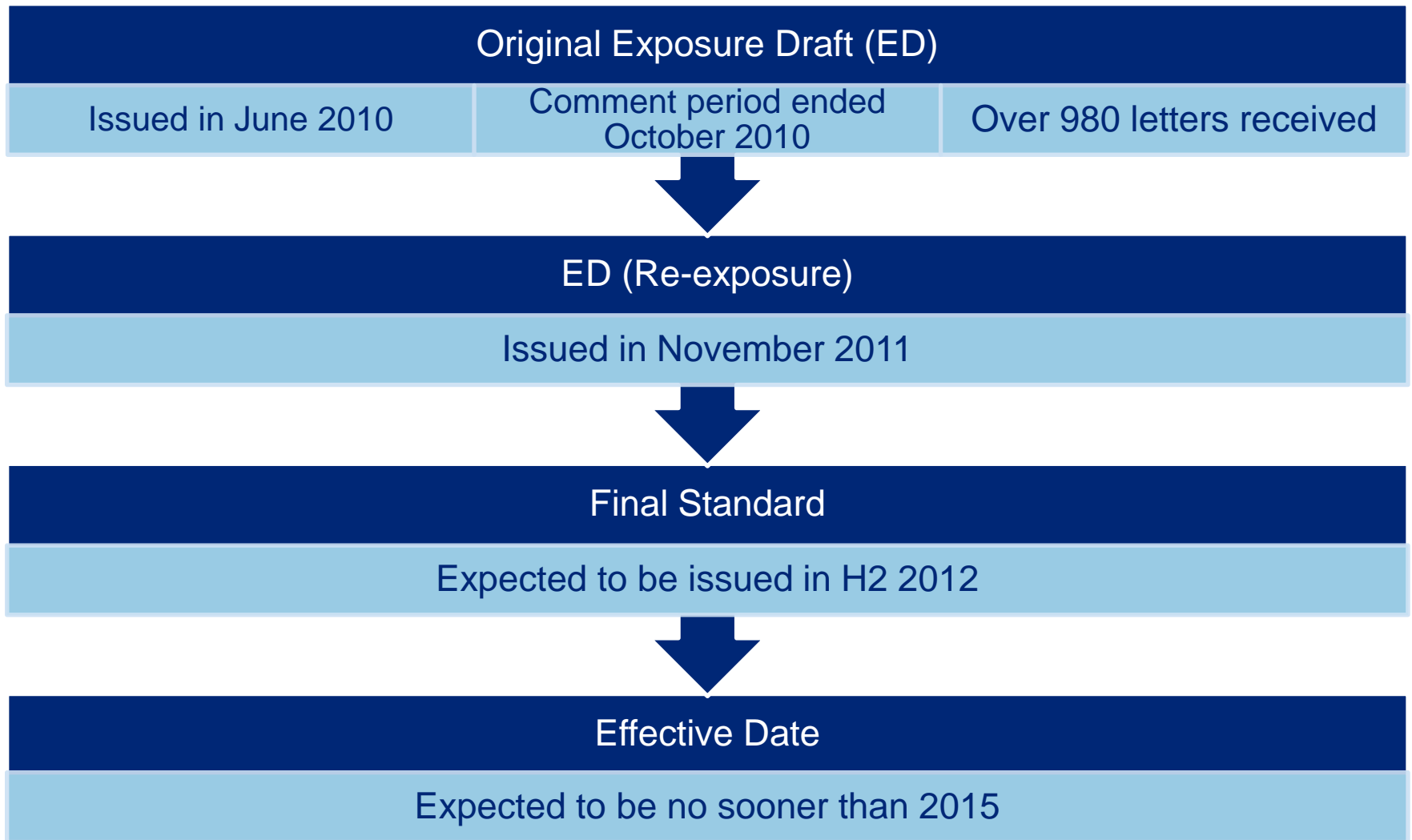
Effective:  
1 July 2012

## Other future platform changes Revenue recognition & leases



# Project on revenue recognition

# Overview & timing project on revenue recognition



# ED (Re-exposure) November 2011

Identifying separate performance obligations

Allocating the transaction price

Accounting for costs of obtaining a contract

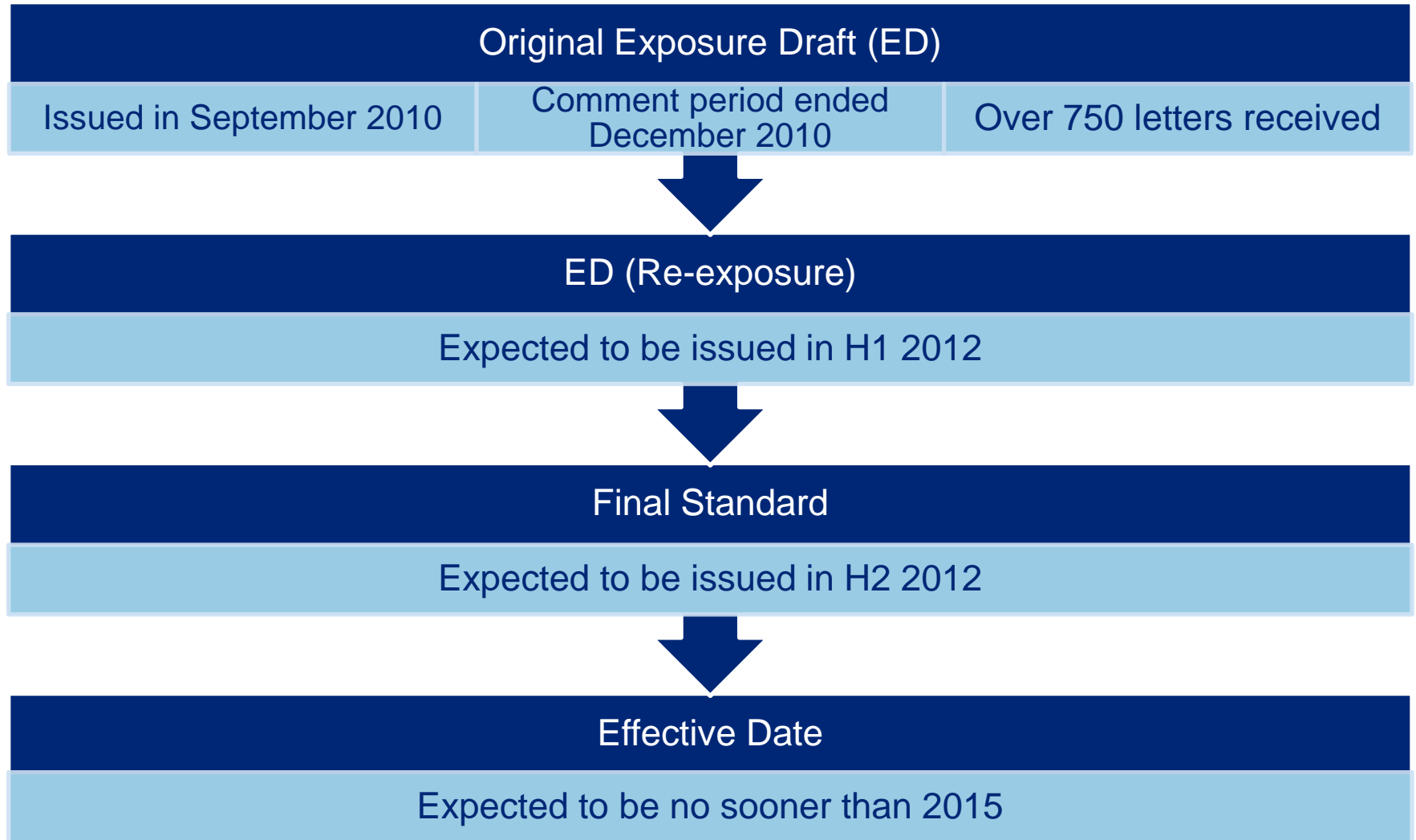
Effect of expected breakage

Accounting for warranties

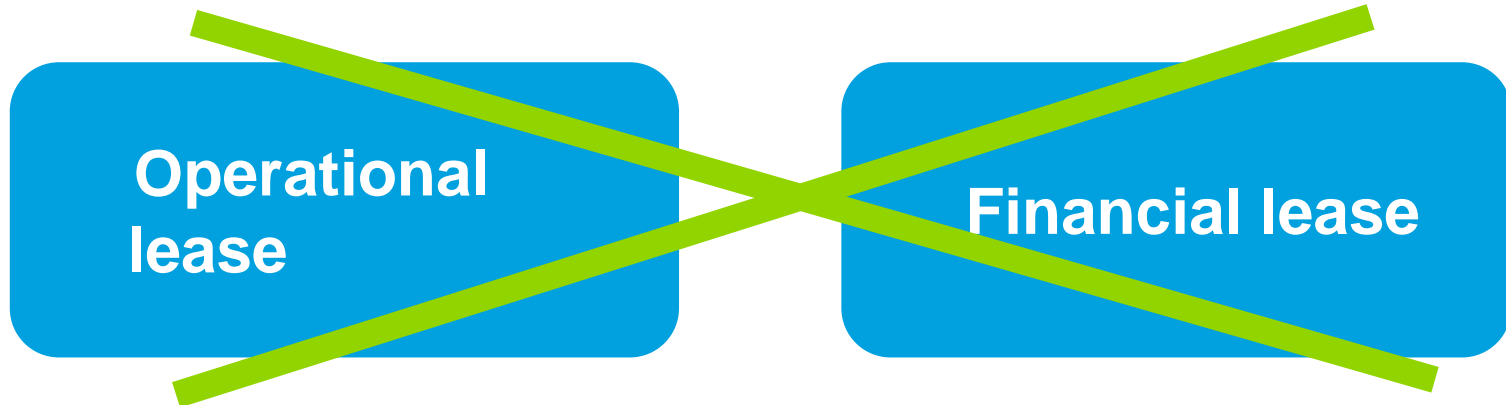
Collectibility

# Project on leases

# Overview & timing project on leases



# New model



**All leases are treated equally**

# Lessee accounting

**Right-of-use  
model**

## Statement of financial position

**Right-of-use asset**

**Liability to make lease payments**

## Statement of comprehensive income

**Amortisation of the right-of-use asset during lease term**

**Interest expense during lease term**

# Lessee – subsequent measurement



IAS 17:  
Operational lease

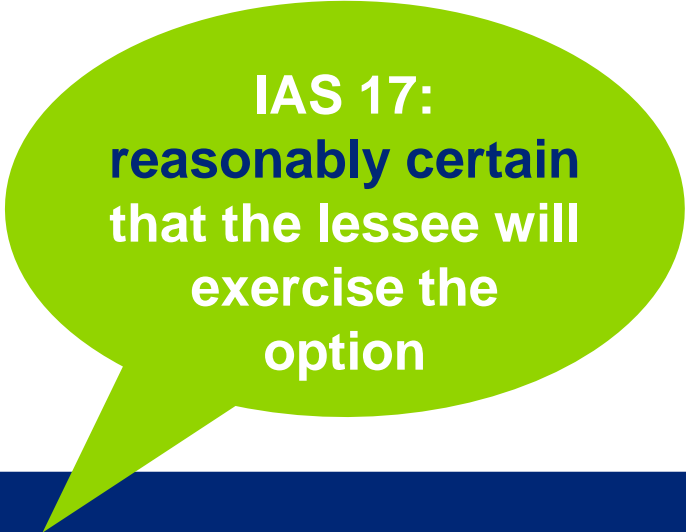
— Straight Line rent expense (old standard)

— Cash Outflow

— Interest and Amortization Expense (proposed standard)

Proposed standard

# Lease term – accounting for renewal options



IAS 17:  
reasonably certain  
that the lessee will  
exercise the  
option

Tentative decisions  
November 2011

The lease term to be the noncancelable period and would only include renewal periods in the lease term if there is a **significant economic incentive** for an entity to exercise an option to extend the lease.

# Lease-term – accounting for renewal options

Tentative decisions  
November 2011

Entities should consider the following factors at lease commencement when evaluating whether they have a **significant economic incentive** to renew:

- Contract-based — Terms included in the lease agreement
- Asset-based — Specific characteristics of the underlying asset
- Market-based — Market rentals for comparable assets
- Entity-specific — The historical practice of the entity, management's intent, and common industry practice

# Expense recognition pattern with and without reassessment of lease term



# Lease payments – variable payments

**IAS 17:  
contingent rents  
should be  
recognised as  
expenses when they  
are incurred**

## **Tentative decisions November 2011**

The initial measurement would only include variable payments:

- based on an index or rate; or
- that are in-substance fixed lease payments (e.g., the lease contains disguised fixed lease payments).

In addition, entities should use the spot rate, rather than a forward rate, to measure variable payments related to an index or rate.

# Purchase options

IAS 17:  
purchase options should  
be taken into  
(if **reasonably certain**)

Tentative decisions  
November 2011

Purchase options should be accounted for similarly to options to renew.

Therefore, purchase options with a “**significant economic incentive to exercise**” will be included in lease payments.

The reassessment guidance for purchase options should be the same as that for lease terms.

# A single model for lessor accounting

**Derecognition  
approach**

## Statement of financial position

Residual asset (rights in the underlying asset that the lessor retains)

Right to receive lease payments

## Statement of comprehensive income

Lease income (present value of the lease payments at the date of commencement of the lease)

Lease expense (cost of the underlying asset that is derecognised at the date of commencement of the lease)

Interest income on the right to receive lease payments during lease term

# Short-term leases

Essentially be treated as an operating lease

IAS 17: short-term leases generally accounted for as operational leases

Tentative decisions  
November 2011

Short-term leases:

maximum possible lease term of 12 months or less, including any options to renew.

Lessee and lessor

Accounting policy election by asset class

# Potential planning activities

## Activities

- Lease survey (customised)
- Interviews/workshops with key personnel to document lease requirements
- Assess location and availability of data elements needed, given lease calculations
- Develop a near-term data repository strategy
- Define long-term business requirements
- Develop detailed project roadmap and high level resource estimates

## Outcomes

- Initial lease landscape
- Data assessment
- Project roadmap (with preliminary timing of resources)
- Accounting issue summary
- Project issue summary

Be aware of ...

## Areas of AFM focus in 2012 (FY 2011)



**Investment property (measurement and disclosures)**



**Impairment of fixed assets (including disclosures)**



**Government bonds (measurement and disclosures)**



**Non-controlling interests (disclosures)**



IFRSs in your pocket



IFRSs and NL GAAP; A pocket comparison



IFRS Model financial statements



IFRS Presentation and disclosure checklist



The Deloitte IFRS in Focus Newsletter



IFRS Update webcasts

[http://www.deloitte.com/view/nl\\_NL/nl/15c4033f69966210VgnVCM100000ba42f00aRCRD.htm](http://www.deloitte.com/view/nl_NL/nl/15c4033f69966210VgnVCM100000ba42f00aRCRD.htm)



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# Questions & answers

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