Deloitte.

Deloitte Luxembourg IFRS Newsletter

Welcome to this edition of the IFRS Newsletter of Deloitte Luxembourg.

The International Accounting Standards Board ("IASB") advanced with its projects this year, resulting in the issuance of several standards, amendments, exposure drafts and other developments. Although not all due dates have been met by the IASB, there are significant developments, which will be discussed in this is issue:

Amendments to IAS 19 Employee Benefits

The IASB issued amendments to IAS 19 Employee Benefits, introducing new requirements on the accounting for employee benefits, with one fundamental change, the removal of the 'corridor approach`.

Presentation of Items of Other Comprehensive Income - Amendments to IAS 1 Presentation of Financial Statements

The IASB has amended IAS 1 as it relates to the presentation of the statement of other comprehensive income. Companies will continue to have the option of presenting one statement or two separate statements. Most importantly, items of other comprehensive income must be separately grouped into items that will or will not be subsequently reclassified to (recycled through) profit or loss and related taxes must be grouped similarly.

Exposure Draft of Improvements to IFRSs 2011

The IASB has released an exposure draft for improvements to be carried out during 2011. The proposed improvements, which are generally minor and clarifying in nature, would affect IFRS 1, IAS 1, IAS 16, IAS 32, and IAS 34 if approved by the IASB.

To be issued soon: Updated exposure drafts on Leases and Revenue recognition

With the publication of exposure drafts in 2010, the IASB introduced significant changes to existing accounting practice resulting in severe criticisms from all sectors. In order to reflect the feedback received from the comment letters in the standards, the Board overhauled the initial exposure draft and will now re-issue an updated version in the coming months, since decisions taken to date were sufficiently different from those published in the initial exposure drafts, even if the deliberations haven`t completed yet.

Effective date of IFRS 9

In August the IASB issued an exposure draft to propose changing the mandatory effective date of IFRS 9, so that entities would be required to apply it for annual periods beginning on or after 1 January 2015 rather than being required to apply it for annual periods beginning on or after 1 January 2013.

Asset and liability offsetting - reconsidered

Today, financial assets and financial liabilities may be presented in an entity's statement of financial position as two separate amounts, or as a single net amount, depending on whether the entity reports using IFRSs or US GAAP. These accounting differences result in the single largest quantitative difference in reported numbers in statements of financial position prepared in accordance with IFRSs or US GAAP.

In response to stakeholders` concern the IASB and FASB decided to jointly address differences in their respective standards on balance sheet netting of derivative contracts and financial instruments, so in January 2011 they issued an exposure draft. In June 2011, in the light of feedback received on the ED, the boards decided to move forward with different offsetting models, but will require information to be provided in the financial statements to help reconcile differences in the offsetting requirements between IFRSs and US GAAP.

Holdings of Eurozone sovereign debt

The decline in creditworthiness of some Eurozone countries has become evident in the recent months. The need for transparent disclosures on Eurozone sovereign debt exposures will also be critical to understanding the financial position and performance for those entities that have material exposures.

Specifically, this relates to holdings of debt (or other loans) issued by the sovereign states subject to a current plan, i.e. Greece, Portugal, Spain, Italy and Ireland, but may also be relevant to holdings or other sovereign states where recent market sentiment has raised doubt about their credit quality.

For additional information on these topics and on services we could provide to your entity, contact us at **luifrsdesk@deloitte.lu**. Deloitte has a range of tools and publications to assist in implementing and reporting under IFRS.

We hope you find this issue useful. As always, we value and welcome your comments and feedback.

Eddy R. Termaten
Audit Partner
Leader of IFRS Centre of Excellence
Luxembourg

Amendments to IAS 19 Employee Benefits

The IASB issued an amended version of IAS 19 Employee Benefits. The amended standard will eliminate some presentation options, improve comparability, clarifying requirements and improve disclosure about the risks arising from defined benefit plans.

Prior to the amendment, IAS 19 permitted choices on how to account for actuarial gains and losses on post-employment benefits (pensions – defined benefit plans and similar items), including the so-called 'corridor approach' which resulted in the deferral of actuarial gains and losses. The most significant amendment to IAS 19 eliminates the use of the corridor approach and instead mandating all actuarial gains and losses of post-employment benefits to be recognized directly in other comprehensive income ("OCI").

An entity that currently is using the corridor approach may have to recognize a larger liability (or smaller asset) in the statement of financial position. On an on-going basis, there will be greater volatility in the statement of financial position and OCI due to the immediate recognition of actuarial gains and losses. The profit or loss impact of amortising gains and losses will no longer occur, separating those changes from changes that many perceive to be the result of an entity's day-to-day operations.

The amended standard requires entities to segregate changes in the net defined liability (asset) into the following different components:

- Service cost: recognised in profit or loss
- Net interest: recognised in profit or loss
- Remeasurement of the defined benefit liability/asset: recognised in OCI

Various other changes were also incorporated into the amended standard as for example enhanced disclosure requirements for defined benefit plans.

The amended standard is effective for annual periods beginning on or after 1 January 2013. Early adoption is permitted. Although entities applying IFRS as adopted by the EU should exercise caution regarding early adoption, since it is not an option till endorsement by the European Union.

Accounting for employee benefits, particularly pensions and other post-retirement benefits, has long been a complex and difficult area. Deloitte pension – IAS 19 specialists may assist you in providing further clarity regarding the accounting for post-employment benefits and the implications of the amended standard for your organization.

Presentation of Items of Other Comprehensive Income - Amendments to IAS 1 Presentation of Financial Statements

Since May 2010, the IASB undertook a project on the presentation of items of other comprehensive income (OCI). The presentation of items of OCI is becoming more important as the Board has decided in various projects that entities should present particular items of income and expense in OCI (e.g.: IFRS 9 Financial Instruments; IAS 19 Employee Benefits).

In this context IASB issued on 16 June 2011 new amendments to IAS 1.

The amendments require companies preparing their financial statement in accordance with IFRSs to present items for OCI amounts by nature and to group together, within OCI, items that may be reclassified to profit or loss (items that are potentially re-classifiable to profit or loss subsequently) and items that will not be reclassified.

Regarding the income tax on items presented in OCI, it has to be allocated between items that might be subsequently reclassified to profit or loss and those that will not be reclassified, if those items are presented before tax. The amendment also retains the flexibility in the presentation of income tax on OCI items that IAS 1 allows. Items in OCI could therefore be presented either before tax or net of tax.

Also, the amendment has introduced few name changes. The statement of comprehensive income will be referred as:

- the statement of profit or loss and other comprehensive income if presented as one statement and the profit or loss section of the statement of profit or loss and other comprehensive income must be presented first;
- the statement of profit or loss and statement of comprehensive income if presented as two statements. In this case the statement of profit or loss must immediately precede the statement of other comprehensive income.

By requiring items of OCI to be grouped and presented on this basis, their potential effect on profit or loss in future periods will be clearer.

Although, these changes do not address which items should be presented in OCI or which and when items should be recycled through profit or loss. The IASB acknowledged the need to develop guidance on OCI and may it to its future agenda.

The amendments to IAS 1 are effective for annual periods beginning on or after 1 July 2012, with early adoption permitted under the condition of a disclosure. Although for European entities it is not an option till endorsement by the European Union. The European Financial reporting Advisory Group (“EFRAG”) held its preliminary discussion about the assessment of the Amendments against the technical criteria for endorsement in the EU and did not raise any significant comments. These changes also have an impact on several other standards.

Exposure Draft of Improvements to IFRSs 2011

The IASB has released an exposure draft for improvements to be carried out with effective date of 1 January 2013, including the following changes:

IFRS 1 First-time Adoption of International Financial Reporting Standards: The proposal clarifies that an entity is required to apply IFRS 1 if it's most recent financial statements did not contain an explicit and unresolved statement of compliance with IFRS, even if the entity previously applied IFRS. Additionally, the IASB proposed to clarify that any borrowing costs which were capitalized under a previous GAAP, may be carried forward without adjustment upon adoption of IFRS.

IAS 16 Property, Plant and Equipment: The proposal clarifies that equipment used in providing services should be classified as property, plant and equipment when it is used during more than one period and as inventory in all other cases.

IAS 32 Financial Instruments: Presentation: The proposal clarifies that income taxes related to distributions to holders or equity instruments or transaction costs should accounted for in accordance with IAS 12.

IAS 34 Interim Financial Reporting: The proposal clarifies that segment assets must only be presented in interim financial statements if such amounts are regularly provided to the chief operating decision maker and there has been a material change in segment assets from the amounts listed in the most recent annual financial statements.

To be issued soon: New exposure draft on Leases and Revenue recognition

Leases re-exposed

In August 2010, the IASB issued an exposure draft on lease accounting introducing important changes to the existing rules. Following this publication, the IASB received a significant number of comments from lessees and lessors across all industries expressing concerns about a number of changes, including the accounting model for lessors, the definition of a lease and the impact of these changes on the key performance indicators.

The IASB decided to discuss the major issues identified from the comment letters with professionals from all industries and a significant number of decisions were taken in order to reflect their conclusions in the standard.

In this context, the IASB updated the definition of a lease as a contract whose fulfilment depends on the use of a specified asset and which conveys the right to control the use of this specified asset for a period of time. If a contract meets these criteria, the lessee has to recognize the right to use the asset as well as the corresponding liability. Only short term leases, which have a maximum period of 12 months including renewal periods, are exempt from this requirement and would not be recognized on the lessee's statement of financial position.

As a result of a number of comment letter received, the IASB also revised its definition of a lease term which shall now only include renewal periods if the exercice of the renewal option represents a significant economic incentive for the entity and is therefore probable to be exerciced. The draft proposal provides additional guidance on when a contract is considered to represent a significant economic incentive. The same concept is retained for purchase options which are separately recognized and amortized if it provides a significant economic benefit.

While the feedback to the accounting for a lessee was very positive, the IASB agreed to amend the lessor accounting to allow only the 'receivable and residual approach' as this is a mirror of the lessee accounting. As for the lessee accounting, this also excludes short-term leases.

Further amendments with respect to variable lease payments, lease incentives and sale-and-lease back transactions are expected in the new exposure draft which will be issued by the end of 2011.

Revenue recognition re-exposed

Since the publication of the exposure draft on revenue recognition in June 2010 and our brief overview of its amendments in the October edition of our newsletter, the whole project has undergone significant changes. Concerns expressed by the professionals from all sectors related to the identification of separate performance obligations, capitalization of contract costs and the distinction between goods and services and were subsequently amended by the IASB. An updated exposure draft on revenue recognition is now expected to be issued in the third quarter 2011 summarizing the decisions taken by the Board.

The exposure draft published in June 2010 required entities to account for contracts as a single item if they were entered into at the same time with the same party and either characteristics or prices of the goods and services provided under this contract are interrelated or if they were negotiated as a package with a single commercial objective. In the new version of the exposure draft, the Board now removed the obligation to account for contracts as a single one because they would be performed either concurrently or consecutively.

With regards to the identification of performance obligations, the Board clarified that goods and services can be aggregated to one performance obligation in case they are integrated in one single item which is sold to the customer. They shall, however, be split into separate performance obligations if the pattern of transfer of these goods and services is different or if they represent distinct functions, meaning that they can either be sold or used separately.

As a result of numerous remarks from the comment letters, the IASB added further guidance regarding transfer of control taking into account the different characteristics of services and goods. While they added the condition of 'transfer of risks and rewards' for the recognition of revenue on sale of goods, the Board will provide a set of criteria in the new exposure draft to determine when services are satisfied continuously and how to measure their revenues.

Beside these amendments, the Board also agreed to lighten the requirements for the capitalization of contract costs allowing entities to expense costs incurred on short term contracts and to limit the obligation to identify onerous contracts to long-term service contracts. Further changes are expected to affect the method prices are allocated to performance obligations and disclosure requirements.

Due to the re-issuance of the exposure draft, the initial timetable for the application of the final standard was delayed and this standard is only expected to be effective as from 2015.

Effective date of IFRS 9

In response to feedback received from constituents regarding the adoption of IFRS 9 Financial Instruments, the IASB published, on 4 August 2011, an exposure draft proposing to push back the mandatory effective date of IFRS 9 from 1 January 2013 to 1 January 2015. The proposed deferral would only change the date when IFRS 9 would be mandatory. Entities could still elect to use IFRS 9 before 2015, although European entities would only do that when the European Union has endorsed it.

IFRS 9, as currently drafted, is required to be applied for annual periods beginning on or after 1 January 2013 including the presentation of comparative figures.

The move to 2015 for IFRS 9 mandatory effective date will permit:

- the IASB to align the effective dates for all phases of the project (both completed and ongoing) and to have sufficient time to fulfil its prior intention to expose the FASB's final standard on classification and measurement of financial instruments for comment by its constituents ;
- the European Union to help to address concerns about the delay of endorsement of phase 1 of IFRS 9 (classification and measurement);
- entities to have sufficient time to make the necessary system changes and to prepare adequately for transition, as well as to implement all the phases of the IAS 39 replacement project concurrently.

Asset and liability offsetting - reconsidered

Seeking a common approach to offsetting financial assets and financial liabilities in the statement of financial position, the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) have issued, in January 2011, a joint exposure draft "Offsetting Financial Assets and Financial Liabilities" which proposed changes to address the differences between the two accounting standards.

The proposals in the exposure draft were based on the existing offsetting criteria in IAS 32 Financial Instruments: Recognition and Measurement. It stated that the offsetting should be applied when the right of set-off is enforceable at all times (including default and bankruptcy), the ability to exercise that right is unconditional (does not depend on a future event), and the parties intend to settle net or settle the gross amounts simultaneously. In other words, a company that meets the proposed criteria must offset the related assets and liabilities in its statement of financial position. It would not have the choice to show the amounts either gross or net.

In practice, companies with large derivative activities (e.g. large financial institutions) and reporting in accordance with US GAAP would have been specially affected. Generally, IFRS preparers should not be significantly affected by the proposals.

Based on June and July 2011 meetings, The IASB tentatively decided not to proceed with the proposals in the exposure draft, and instead retain IAS 32 offsetting model and supplementing it with additional guidance. This decision may result in less implementation efforts and resolve some of the practice issues identified during the project.

However, the Board has tentatively decided to retain the original disclosure objective proposed in the exposure draft but to modify the scope of the disclosure requirements to apply only to instruments under an enforceable master netting agreement or similar arrangement and to clarify that the entity would not need to provide the required disclosures if the entity has no financial assets or financial liabilities subject to a right of set-off at the date of the reporting date.

The Board discussed the effective date and transition requirements for the revised offsetting disclosures. The staff recommended that the revised disclosure requirements should be applied retrospectively and be effective for annual and interim reporting periods beginning on or after 1 January 2013.

Holdings of Eurozone sovereign debt

Impairment Assessment — Holdings of Greek Debt

In the second quarter of 2011, Greece's difficulty in meeting its debt obligations became increasingly apparent. On July 21, 2011, European Union member states and private bondholders (represented by the Institute of International Finance Inc. ("IIF")) agreed to a proposed restructuring of Greek Government Bonds ("GGBs").

The proposed restructuring is for GGBs that mature before and including 2020 and involves an exchange for new bonds (with a maturity of either 15 or 30 years) or a rollover to new bonds (with a maturity of 30 years). As part of this restructuring, the IIF estimated that private bondholders will suffer an economic loss of 21 percent of par.

Our initial assessment is that GGBs and other loans issued by the Greek state held by IFRS-applying entities could be impaired as of June 30, 2011. Paragraph 59 of IAS 39 includes indicators of impairment of which three are relevant in this instance (significant financial difficulty of the obligor, the lender granting a concession to the borrower, and the disappearance of an active market for the asset because of financial difficulties).

If there is evidence of impairment, IAS 39 requires an impairment loss to be recognized in profit or loss. The measurement will depend on how the impaired asset is classified:

- Available-for-sale (AFS) investments: the cumulative fair value loss at period-end is recognized in earnings. This applies to assets currently classified as AFS as well as those assets reclassified from AFS in previous periods in which an amount continues to be recognized in other comprehensive income.
- Loans and receivables and held-to-maturity investments: the difference between the carrying value and the sum of the best estimate of the recoverable cash flows discounted by the effective interest rate will be recognized as an impairment loss in earnings.

There could be different views on the required accounting for sovereign debt therefore we recommend that you consult with a professional adviser.

Disclosure of Eurozone sovereign debt exposures

For entities with an annual reporting date ended 30 June 2011, additional disclosure will be required including all the credit risk disclosures in IFRS 7 Financial Instruments: Disclosure.

Disclosures should include, by sovereign state, the gross carrying value, the cumulative impairment provision, net carrying value, fair value, how the financial assets are classified, as well as the impact in profit or loss in the period. Disclosure of key judgements used in estimation uncertainty (e.g., impairment assessment and measurement) will also be critical.

To the extent credit risk is mitigated through holdings of credit default swaps or purchased financial guarantee contracts over direct sovereign exposures, the nominal amount of the credit protection by sovereign and maturity should be disclosed, along with the carrying value of those instruments that mitigate credit risk

The IFRS Desk

Contacts - Deloitte Luxembourg IFRS leasdership team

Specialists per industry

Funds
Justin Griffiths
jugriffiths@deloitte.lu

Private Equity
John Psaila
jpsaila@deloitte.lu

Consolidation
Karine Thil
kthil@deloitte.lu

Banks
Raphaël Charlier
rcharlier@deloitte.lu

Securitization and Real Estate
Jan van Delden
jvandelden@deloitte.lu

Insurance
Jérôme Lecoq
jlecoq@deloitte.lu

Deloitte Luxembourg and IFRS

Luxembourg IFRS leaders

Eddy R. Termaten (Partner)
edtermaten@deloitte.lu

Monika Tasi-Mota (Manager)
mtasi@deloitte.lu