Deloitte Luxembourg IFRS Newsletter

Welcome to this edition of the IFRS Newsletter of Deloitte Luxembourg prepared by the Deloitte Luxembourg IFRS Centre of Excellence with contributions from the professionals of our firm.

So far our newsletter includes the summaries of new and revised Standards and Interpretations, Exposure Drafts and discussion documents, including summaries of the documents and consideration of the principal amendments/proposals, this edition also includes articles which have an actuality in Luxembourg, and which present topics tailored to the Luxembourg economic environment.

In this issue:

Recent change in the organization of our IFRS Centre of Excellence in Luxembourg

We are very pleased to announce that three excellent persons within our firm become new team members of our IFRS Centre of Excellence in Luxembourg.

Exposure Draft published on Annual Improvements to IFRSs 2010 - 2012 Cycle

The International Accounting Standards Board (IASB) has published on May 3, 2012, an exposure draft (ED) of proposed amendments to eleven IFRSs under its annual improvements project. The IASB uses the annual improvements project to make necessary, but non-urgent, amendments to IFRSs that will not be included as part of another major project.

Amendment issued on IFRS 1 regarding government loans

On March 12, 2012, the IASB has issued Government Loans (Amendments to IFRS 1). This amendment addresses how a first-time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRSs.

Impacts of revised Exposure Draft on Revenue from Contracts with Customers on the insurance industry

This newsletter highlights aspects of the recently issued revised exposure draft *Revenue from Contracts with Customers*, the interaction of the proposals with the insurance project and the potential effects of the proposals on the insurance industry.

Modernisation of Accounting Law in Luxembourg

Draft Law 6376 issued in January 2012 reforms the *Commission des normes comptables* (CNC – Accounting Standards Commission) and amending various provisions relating to companies' accounting and annual accounts and to the consolidated accounts of certain types of companies.

Final Endorsement Advice on new IFRS on business combinations issued by EFRAG

Based on the European requirements on the application of international accounting standards, EFRAG provided on March 30, 2012 its opinion on IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. In particular, EFRAG recommends the mandatory effective date of the Standards to be 1 January 2014 with early adoption permitted.

IASB/FASB discussions on the application of an expected credit loss model to trade receivables

In April 2012, the boards discussed whether an expected credit loss model should be applied to trade receivables. The boards tentatively agreed that an expected loss model should be applied to trade receivables that do not have a significant financing component (as defined in the Exposure draft on *Revenue from Contracts with Customers*), including a practical expedient that a provision matrix can be used.

IASB and FASB agree on lease accounting approach

In the framework of the convergence between IFRS and US GAAP standards, the IASB and the FASB agreed on the approach for accounting for leases expenses. This joint IASB-FASB project seeks to improve the accounting for leases by developing an approach that is more consistent with the conceptual framework definitions of assets and liabilities.The Boards intend to issue a re-exposure draft in 2012 which will result in a replacement of IAS 17 *Leases* expected in 2013.

For additional information on these topics and on services we could provide to your entity, contact us at **ifrs@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.

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Audit Partner
IFRS Leader
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Exposure Draft published on Annual Improvements to IFRSs 2010 - 2012 Cycle

The IASB has published on 3 May 2012 an exposure draft (ED/2012/1) of proposed amendments to eleven IFRSs under its annual improvements project. This project is aimed to make useful amendments related to the clarification or correction of IFRS standards. The following topics are addressed by these amendments:

- IFRS 2 Share-based Payment: clarification of the definition of ‘vesting conditions’ by separately defining a ‘performance condition’ and a ‘service condition’.
- IFRS 3 Business Combinations: clarification of certain aspects of accounting for contingent consideration in a business combination.
- IFRS 8 Operating Segments: proposition to require entities to disclose those factors that are used to identify the entity’s reportable segments when operating segments have been aggregated.
- IAS 1 Presentation of Financial Statements: clarification of the definition of non-current liability.
- IAS 7 Statement of Cash Flows: clarification of the classification of capitalised interest payments.
- IAS 12 Income Taxes: clarification of the recognition of the tax effect of a deductible temporary difference as a deferred tax asset in combination with other deferred tax assets.
- IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets : clarification of the requirements for the revaluation to address concerns about the computation of the accumulated depreciation at the date of the revaluation.
- IAS 24 Related Party Disclosures: clarification of the identification and disclosure requirements for related party transactions that take place when key management personnel services are provided by a management entity that is not otherwise a related party of the reporting entity.
- IAS 36 Impairment of Assets: clarification of the disclosure requirements that are applicable to fair value less costs of disposal when there has been a material impairment loss or impairment reversal in the period.

The proposed effective date for the amendments is for annual periods beginning on or after 1 January 2014. Early adoption is proposed to be permitted for all of the amendments.

The comments on the ED and the Basis for Conclusions received before September 5, 2012.

Amendment issued on IFRS 1 regarding government loans

The amendment, dealing with loans received from governments at a below market rate of interest, provides guidance in accounting for these loans to first-time adopters of IFRSs. This guidance is in line with the one provided to existing preparers of IFRS financial statements.

Paragraph 10A of IAS 20 Accounting for *Government Grants and Disclosure of Government Assistance* requires the benefit of government loans advanced either interest free or at a below-market rate of interest to be treated as a government grant, measured as the difference between the initial carrying amount of the loan determined in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* (or when applied, IFRS 9 Financial Instruments) and the proceeds received.

IAS 32 requires first-time adopters to classify the loan as a financial liability or an equity instrument at the transition date.

The amendment permit first-time adopters of IFRSs to apply prospectively the requirements in paragraph 10A of IAS 20 only to new loans entered into after the transition date. In other words, the benefit of a government loan at a below-market rate of interest existing at the date of transition shall not be recognised as a government grant.

However, entities may choose to apply retrospectively, on a loan by loan basis, the requirements of IFRS 9 and IAS 20 to government loans provided that the information needed to do so have been obtained at the time of initially accounting for that loan.

The amendments are mandatory for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Impacts of revised Exposure Draft on Revenue from Contracts with Customers on the insurance industry

On November 14, 2011, the IASB and the US FASB jointly issued a re-exposure draft Revenue from Contracts with Customers (hereafter “the revised ED”) – which develops an entirely new revenue recognition standards. The period for comments ended on March 13, 2012 and the effective date of the proposed standard will not ne earlier than for annual reporting periods beginning on or after January 1, 2015- with early application allowed.

The section below briefly highlights the aspects of the revised ED which might affect insurance entities. A good point to keep in mind is that the Boards have aligned certain aspects of the insurance contract project with those of the revenue recognition project – ensuring the more parallels are created than diverging points.

The revised ED core principles is that “an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services”. The revised ED shall apply to ALL contracts with customers other than those within the scope of the leasing, insurance or financial instruments standards (please note that consequences for insurance industry are discussed below).

The revised ED enounces five key steps for entities to follow in recognising revenue from customers contracts within the revised ED's scope:

(i) Identify the contract with the customer

(ii) Identify the separate performance obligations in the contract

(iii) Determine the transaction price (iv) Allocate the transaction price to the separate performance obligations in the contract, and

(iv) Recognize revenue when (or as) the entity satisfies a performance obligation.

In addition the revised ED contains several other changes compared to the current IFRS, especially in terms of disclosure of qualitative and quantitative information.

Impact of revised ED for the insurance industry:

(i) Scope exceptions: under certain contracts, a provider charges its customers a fixed-fee in exchange for the agreement to provide services to them if an uncertain future event occurs. These contracts meet the actual definition of an insurance contract, however the Boards agreed to exclude fixed-fee arrangements from the scope of the insurance contracts standard. The scope exception apply to contracts which exhibits the following characteristics: (i) contract is not priced with respect to the risk associated to it (ii) non-cash compensation (ii) risk transferred merely relates to the frequency of services . Entities will therefore account for such contracts in accordance with the revenue recognition guidance.

Example of contracts that may meet the scope exception: capitation and fixed-fee medical service arrangements, fixed-fee prepaid maintenance and repair contracts and traditional roadside assistance programs.

(ii) **Points in common:** The Boards were mindful to ensure that the revenue and insurance contracts projects have common issue. The common feature include the consideration of the time value of money, the treatment of acquisition costs and onerous contracts). Accordingly, various points of intersections have emerged, as follows:

a) Unbundling obligations to deliver goods and services hosted in an insurance contract: it was tentatively concluded that the unbundling of goods and services from the insurance component is possible.

b) Identifying separate performance obligations: Under the revised ED, entities must identify separate performance obligations. Under the insurance contracts project, only obligations to deliver goods or services that are distinct would be unbundled, all the other obligations would be measured as part of the insurance contract. Complexities might arise to allocate cash flows from an insurance contracts between the different components.

(iii) **Asset management fees**: the revised ED might impact the timing of recognition of asset management fees. While the revised ED is not expected to affect significantly the recognition of based management fees, in case of performance-based fees (variable considerations), revenue shall only be recognized once reasonably assured. Entities will therefore have to ensure their management fee recognition policy is appropriate under the basis of the revised ED – leading to a potential deferral of the recognition of contingent management fees.

(iv) **Acquisition costs**: The revised ED proposes that incremental acquisition costs (necessary in obtaining a new contract with a customer) should be recognized as an asset if it is expected that these costs will be recovered. Costs that would have been incurred regardless of whether the contract was obtained shall be expensed as incurred.

> Capitalised expensed shall be amortized “on a systematic basis consistent with the pattern of transfer of the goods and services to which the asset relates”. Insurers have asked the Boards to clarify whether the concept of incremental acquisitions costs might include fee paid to third-parties to distribute insurance products – which is a frequent feature of the distribution mode for insurance products.

The final revenue standard shall be issued during the first quarter of 2013 and the timeline of the insurance contracts project has been extended (with a re-exposure due during the second half of 2012). On such basis, the final insurance standard’s effective date is likely to be aligned with that of the other standards being under revision…we wait and see.

Modernisation of Accounting Law in Luxembourg

On 20 December 2011, the draft Law 6376 was published, reforming the *Commission des normes comptables* (CNC – Accounting Standards Commission) and amending various provisions relating to companies’ accounting and annual accounts and to the consolidated accounts of commercial companies. It introduced several revised procedures governing the use of the fair value method.

Other amendements introduced by the draft law are further developed in our January 2012 publication entitled “**Modernisation of accounting Law and reform of the CNC**”, available on our website.

EFRAG Final Endorsement Advice on new IFRS on business combinations issued

The European Financial Reporting Advisory Group (EFRAG) provided its opinion regarding the adoption of IFRS 10 “Consolidated Financial Statements”, IFRS 11 “Joint Arrangements”, IFRS 12 “Disclosure of Interests in Other Entities”, IAS 27 “Separate Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures” (the “Standards”), published by the IASB on the 12th May, 2011. It issued the corresponding Endorsement Advice Letter and Effects Study Report for endorsement in the European Union and European Economic Area on 30 March 2012.

IFRS 10 provides a new guidance on the assessment of control, the basis for consolidation for all types of entities. The single consolidation model introduced by IFRS 10 supersedes the consolidation procedures defined in IAS 27 “Consolidated and Separate Financial Statements” and in SIC-12 “Consolidation — Special Purpose Entities”.

IFRS 11 replaces IAS 31 “Interests in Joint Ventures” and SIC-13 “Jointly Controlled Entities—Non-Monetary Contributions by Venturers”. IFRS 11 provides guidance on the financial reporting by parties to a joint arrangement, on the assessment of joint control and on the classification of joint arrangement into joint venture or joint operation.

IFRS 12 provides a broad framework for the disclosures requirements regarding entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities.

IAS 27 and IAS 28 were revised as a result of the introduction of these new IFRS standards. IAS 27 (2011) applies only to separate financial statements. IAS 28 (2011) provides guidance in accounting for interests in associates and joint ventures in accordance with equity method.

EFRAG supports the adoption of the Standards and recommends its endorsement as the Standards meet the endorsement’s criteria. However, based on the conducted field-tests, EFRAG does not support the mandatory effective date of 1 January 2013 for the following reasons:

- Developing a commom understanding of how the standards should be applied and how reliable financial reporting should be produced and disclosed to capital markets would require more time;
- Some institutions believe that gathering additional information about assets, liabilities, revenue and expenses would be challenging;
- Two exposure drafts are being consulted by IASB in order to amend IFRS 10 prior to its effective date.

EFRAG recommends therefore delaying the mandatory effective date of the Standards to 1st January 2014, with early adoption permitted. Given the interaction between the Standards, EFRAG suggests that the mandatory effective date should be the same for all the Standards.

According to the EU endorsement status report as at 6 June 2012, the “Standards” on consolidation are expected to be endorsed in Q4 2012.

IASB/FASB discussions on the application of an expected credit loss model to trade receivables

During the meeting in February 2012, the IASB and the FASB discussed whether an expected credit loss model should be applied to trade receivables that do not have a significant financing component resulting from revenue transactions within the scope of the revenue exposure draft (ED/2011/6 "Revenue from Contracts with Customers").

They discussed separately on how a general expected loss approach would be applied due to the differences in their respective requirements related to initial measurement.

The IASB tentatively decided that a simplified form of the three bucket model should be applied:

- the receivable shall be measured at the transaction price as defined in the Revenue ED (usually the amount of the invoice) on initial recognition in IFRS 9 "Financial Instruments";
- the three bucket model is also affected: the receivables shall be included in Bucket 2 or 3 on initial recognition in order to recognise the lifetime expected losses on initial recognition and throughout the life of the asset. This addresses the operational concerns of corporates.

In contrast, the FASB tentatively decided that the lifetime expected losses throughout their life would be the measurement objective for impairment for all trade receivables that do not have a significant financing component. It was also decided that entities would not be required to track credit deterioration for disclosure purposes.

In the session of April 2012, the staff provided the boards with its evaluation whether an expected loss model would be operational for such trade receivables. Based on that evaluation, the IASB and the FASB tentatively agreed that an expected credit loss model should be applied to trade receivables that do not have a significant financing component. In addition, the boards agreed that trade receivables would be initially be recognised in buckets two or three upon initial recognition.

The standard IFRS 9 will provide a practical expedient that will allow entities to utilise a provision matrix in estimating expected losses on portfolios of trade receivables.

IASB and FASB agree on lease accounting approach

The IASB and the FASB discussed the lessor and the lessee accounting at the 13 June joint meeting.

Alternative approaches to subsequently measuring the right-of-use asset by the lessee were developed while the consequences for lessor accounting resulting from the outcome of the lessee accounting discussions were discussed.

In addition, the Boards proposed to record leases over one year on the balance sheet. They also proposed to recognise evenly the leases representing a relatively small percentage of the life or value of the leased asset over the lease term on the income statement.

The re-exposure of the proposals would be published for public comment in the second quarter of 2012, the aim being to complete the convergence project in 2013.

These tentative decisions are further developed in **Deloitte IFRS Project Insights "Leases – 15 June 2012"**, available on **www.iasplus.com**.

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Do not hesitate to visit our **IFRS webpage**.