

RSM Reporting

**Welcome from
the Editor
Marco Mongiello**

Welcome to the ninth edition of RSM Reporting – the newsletter from RSM International covering technical developments in global accounting and reporting.

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Section 3: Top Ten Topics in IFRS

by Joelle Moughanni

A common theme that emerges from this edition is the variety, diversity and divergence that is still present in international accounting. In fact, in the wake of the first IFRS Annual Conference chaired by Hans Hoogervorst, it becomes questionable whether the effort for a global convergence has perhaps lost some of its momentum.

Constituents seem to represent an ever growing diversity of points of view, to the extent that a number of re-exposures have become needed and the leasing project is still being discussed. Filippo Poli, our guest contributor, reports the personal opinion, which he has formed from his privileged position at the EFRAG.

Diversity is also the main concept emerging from Dan Schwartz's article on how IFRS is perceived in an emerging economy, like Romania, where a principle based framework clashes with the remnants of a regime that used to be normative and authoritarian.

Deirdre Kiely reports on the developments of the Other Comprehensive Income, a topic that has widely highlighted discrepancies between IASB's and FASB's approaches.

Gil Rosenstock and Shlomi Shuv follow up from our previous comments on IFRS for SMEs by presenting the first of a mini-series of articles, where the main challenges of the application of these standards are analysed. Once again, the main theme is the variety of sources that preparers must refer to when adopting the standards.

As usual, Joelle Moughanni closes the edition with her Top Ten Topics, addressing, this time, the contradictory provisions of joint arrangements and some of their not so obvious effects.

Enjoy your reading and please get in touch with the editorial team with any comments you would like to make.

Dr Marco Mongiello ACA
E: m.mongiello@imperial.ac.uk

1 Accounting and reporting this quarter

IASB

>> for further news and updates please visit www.ifrs.org

IASB

June 2011

The IASB's and FASB's joint discussion on insurance contracts gained momentum. Several aspects of accounting for reinsurance were discussed and agreed almost always unanimously by all members of both boards.

The discussion on Leases kept going, as reported by our guest contributor.

The IASB and FASB re-exposed their revised proposals for a common revenue recognition standard in order to provide interested parties with an opportunity to comment on revisions the boards have undertaken since the publication of an exposure draft on revenue recognition in June 2010.

The IASB and FASB issued amendments that will improve and align the presentation of items of other comprehensive income (OCI) in financial statements prepared in accordance with IFRSs and those prepared in accordance with US GAAP. The amendments to IAS 1 Presentation of Financial Statements require companies preparing financial statements in accordance with IFRSs to group together items within OCI that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements.

The IASB completed its project to improve the accounting for pensions and other post-employment benefits by issuing an amended version of IAS 19 Employee Benefits. The amendments are aimed at providing investors and other users of financial statements with a clearer picture of an entity's current and future obligations resulting from the provision of defined benefit plans and how those obligations will affect its financial position, financial performance and cash flow.

July 2011

The IFRS Foundation held its Annual Conference in Zurich, which was for the first time chaired by the newly appointed chairman, Hans Hoogervorst.

The discussion on Insurance Contracts kept going.

The IASB launched for the first time a public consultation to seek broad public input on the strategic direction and overall balance of its future work programme. The consultation document asks deliberately open questions to gather views on the IASB's future work programme from all those involved in or affected by financial reporting.

The IASB and FASB re-exposed their revised proposals for a common leasing standard. Re-exposing the revised proposals will provide interested parties with an opportunity to comment on revisions that the boards have undertaken since the publication of an exposure draft on leasing in August 2010.

August 2011

The IASB published an exposure draft of proposals to adjust the mandatory effective date of IFRS 9 Financial Instruments. The exposure draft proposes an effective date of 1 January 2015 (currently 1 January 2013) for IFRS 9. In publishing the exposure draft, the IASB noted the importance of aligning all phases of the project (both completed and ongoing) to have the same effective date. The comment period of the exposure draft closes on 21 October 2011.

EFRAG

>> for further news and updates please visit www.efrag.org

EFRAG

June 2011

EFRAG has issued an executive summary of the views expressed by European constituents during the outreach meetings on the Revenue Recognition and Leases that were organised jointly with the European National Standard Setters in May 2011.

Revenue Recognition: participants continued to question whether a complete overhaul of the existing standards on the Revenue Recognition was really needed, and some suggested that the direction taken by the IASB in the re-deliberations would bring the proposals quite close to the current requirements.

Leasing: the new proposals on Leases did not receive much support and a large number of participants believed that it would be preferable to keep IAS 17 Leases rather than to proceed with the new model.

EFRAG endorsed the Amendments to IFRS 7 Financial Instruments: Disclosures (issued 7 October 2010).

July 2011

EFRAG finalised its draft endorsement advice and a draft effects study report on IAS 19 Employee Benefits, as revised in 2011, and on the Amendments to IAS 1 Presentation of Items of Comprehensive Income. EFRAG is seeking comments from constituents on these drafts. The comment deadline is 23 September 2011.

EFRAG finalised its draft comment letter to the IASB on the Exposure Drafted Improvements to IFRSs 2009-2011. The draft comment letter supports the amendments proposed in the ED, however, recommends bringing further clarifications to IAS 12 in respect of taxes on distribution to owners. EFRAG is seeking comments from constituents on this draft. The comment deadline is 30 September 2011.

EFRAG has issued an Invitation to Comment relating to the endorsement for use in the EU of the Amendments to IAS 1 Presentation of Items of Other Comprehensive Income. It is consulting both on its assessment of the Amendments against the technical criteria for the endorsement in the EU and on its initial assessment of the costs and benefits that would arise from their implementation and application in the EU. Comments are requested by 23 September 2011.

EFRAG has issued an Invitation to Comment relating to the endorsement for use in the EU of the IAS 19 Employee Benefits (as amended in 2011). Comments are requested by 29 September 2011.

2 The point of view of ...

Guest Contributor



Filippo Poli

... on the IASB's Proposals on Lease Accounting¹

The views expressed in this article are those of Filippo Poli, the author. They do not purport to represent the views of EFRAG or the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission.

As the IASB and FASB have recently voted to re-expose the new proposals for accounting for Leases, it is timely to reflect back and see what the Boards intend to achieve with this project. The well-known distinction between operating and finance leases is bound to disappear and be replaced by a single accounting model - at least on the lessee's side². This new model requires lessees to recognise a right-of-use asset and a liability to pay rentals for all lease arrangements.

The right-of-use is an interesting concept that fits well in a business world where the dividing line between tangible and intangible, machine and application is blurring. When files are stored in a virtual space that can be accessed from any device - any PC, Smartphone or tablet - it may be more informative to recognise this resource is available to the entity rather than focusing on whether the entity substantially owns the piece of equipment. But this new direction in financial accounting requires a rigorous explanation of the rationale, which would improve the quality of the Standard and make it more acceptable for those who will have to use it.

The recognition of additional liabilities (and assets) by lessees will have a number of implications:

- » It will impact key ratios such as EBIT, net debt³ and return on asset
- » It will affect financial covenants
- » It will accelerate the recognition of costs from arrangements that were previously accounted for as operating leases
- » As a consequence, it will likely create new tax temporary differences, as in many jurisdictions these costs are deducted on a straight-line basis

One main reason why the IASB decided to change the way lease arrangements are accounted for, was the perception that the existing rules set an artificial bright line between these two categories of leases. There was concern that slightly different economic terms resulted in totally different accounting outcomes.

However, the proposed changes have now emphasised another dividing line; the one between service arrangements and lease arrangements. Service arrangements are not recognised on the balance sheet, although an entity has an unavoidable commitment to pay cash in future. Many have challenged the IASB to clarify why lease arrangements should be on the lessee's balance sheet, but other executory contracts should not.

The IASB's view is that a lease ceases to be an executory contract after the lessee has been granted access to the asset. At that point in time, the lessor cannot prevent the lessee from continuing use of the asset. However, the lessee's entitlement to the future use of the asset is not unconditional but it is contingent on continuing to pay the rentals. So what is the difference between a lease (which gives the right to use an asset, provided the lessee pays the rentals) and a purchase order which gives the right to the delivery of goods, provided that the client makes the payment?

The IASB stated that they do not intend to have service contracts recognised on the balance sheet, so one key element of the new proposals is the identification of a lease arrangement. If one arrangement contains both a lease and other service components the lessee shall split the contract for accounting purposes. The lessee shall allocate part of the rentals to the services, and account for this portion on an accrual basis. This requirement to identify separate components is also consistent with the IASB's direction in the Revenue Recognition project.

What are the conditions that an arrangement must satisfy to be identified as a lease? It is proposed that for an arrangement to contain a lease:

- » Fulfilment of the contract depends on the use of a specified asset; and
- » The arrangement conveys the right to control the use of the asset

These conditions are not new, and indeed are the same that are found in Interpretation IFRIC 4 Assessing whether an Arrangement contains a Lease; however, the Boards have spent considerable time and effort to try to clarify them. Still, a degree of judgment cannot be eliminated (when the proposals are finalised there should be appropriate field testing to identify any major application issues).

Will the Boards move to a single accounting model also for lessors? So it seems, according to the tentative decision recently reached in July. It is acknowledged that consistent accounting is advisable. Different approaches could create significant distortions, even more so when the same entity leases an asset and then sub-leases part or all of it. Many support a single partial derecognition model for lessors - under which the lessor recognises a receivable, derecognises a portion of the asset and records a gain for any difference⁴.

Some are concerned about extending such a model to all leases. These concerns in part refer to the problem of how to determine the portion of the carrying amount that should be derecognised. Assume the following example:

Entity A owns a 10-storey building for a carrying amount of £10,000. The useful life of the building is assessed as 40 years. Entity A leases out 2 stories for a 6-year period.

In a partial derecognition model, the lessor is required to determine how much of the carrying amount of £10,000 should be immediately derecognised. One way to determine it is to assess the fair value of the leased portion expected at the end of the term. This amount discounted back at the appropriate rate is compared to the current fair value of the leased portion and the resulting ratio is applied to its carrying amount.

The problem is that entities may not have information on fair value of portions - in the example, could it be simply assumed that the fair value of the 2 story is 20% of the fair value of the whole building? The assessment may become quite complex and affects the amount of a gain that the lessor immediately recognises. Some feel that in many circumstances the amount is subject to significant uncertainty and would therefore not allow its immediate recognition; at least there should be cases where the gain is deferred over the lease term.

Others have a more fundamental objection to the partial derecognition model - they argue that the lessor's performance is satisfied during the lease term rather than fully at the start of the contract. In other words, the lessor's performance is to provide continuous access to the asset. Therefore, the lessor should recognise revenue over that period as it happens under operating lease accounting.

The author notes that the conceptual premise for the right-of-use model is that the lessee incurs the obligation for the whole contract upon gaining access to the asset. It seems contradictory to accept this and reject a partial derecognition model for lessors on the basis that the lessor discharges its obligation over the lease term. It is true that the practical application of the model becomes tricky when the underlying asset can be leased out several times over its useful life (or leased out in portions) and the arrangement include options to extend the term or contingent rentals. But these arguments justify having some practical expedients, not having substantially different approaches for the two parties in the transaction.

Leasing is high on the convergence agenda, but first and foremost the IASB needs to ensure high quality, principle-based standards that enhance transparency to investors and other users of financial statements. There is a lot of expectation to see if the Board has achieved that.

Guest Contributor: Filippo Poli

Filippo Poli is a project manager at EFRAG, the independent advisor on the technical quality of IFRS to the European Commission. Filippo is an Italian chartered accountant and before joining EFRAG had extensive experience in advising Italian and European companies about implementation of IFRS as part of PricewaterhouseCoopers' Global ACS.

¹ While there is no explicit definition in the IFRS literature, markets normally use "Net debt" to refer to financial assets and liabilities. The lease liability is clearly a financial liability, but the "right of use" asset is not. This is confirmed by other sources - see for instance the notion of "Net indebtedness" in the CESR recommendation 05-054b issued in 2005. It is the notion of "net assets" that include both financial and non-financial items. Therefore the recognition of additional liabilities will indeed impact the "net debt" of the lessees, although their "net assets" will stay the same.

² Editor's note: we started to address this matter in Issue 2 of this newsletter; the most recent contribution being published in the last edition. We will keep covering it until an established position is reached. As the author noted, this text reflects the IASB's discussions up to and including the end of July 2011.

³ The Boards has recently reached a tentative decision on the lessor's accounting treatment.

⁴ Assume a present value of the rentals of 1,000 and a carrying value of the portion of 700, the resulting gain is 1,000 - 700 = 300.

2 The point of view of ...



Deirdre Kiely

... on Amendments to Presentation of Items of Other Comprehensive Income

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) recently took a further small step in the project to create a common set of high quality global accounting standards by jointly introducing amendments to the presentation of items of other comprehensive income (OCI).

The IASB issued amendments to IAS 1 Presentation of Financial Statements and the FASB issued ASU No. 2011-05 an update to Topic 220: Presentation of Comprehensive Income in an attempt to bring US GAAP into alignment with IFRSs for the presentation of OCI. While the amendments may result in improved consistency and clarity in the presentation of items in OCI, differences between the standards still remain. In particular, the IASB did not address the fundamental questions of the underlying reasons why some items should be recognised in OCI and why some of the items in OCI are reclassified through profit or loss. This contributes to the further issue of persisting differences in reporting comprehensive income which will affect the comparability of financial statements prepared under IFRS and US GAAP.

Prior to the amendments

IAS 1 required entities to present a Statement of Comprehensive Income setting out all items of income and expense (i.e. all non-owner changes in equity). The standard allowed a choice on whether to present the comprehensive income within a single statement or in two statements. A single statement contains all items of income and expense while a two statement approach required items of comprehensive income to be divided between a separate income statement and a separate statement of comprehensive income. By contrast, US GAAP allowed reporting entities three alternatives for presenting components of other comprehensive income, which were: (i) in a statement that reports results of operations (ii) in a separate statement of comprehensive income that begins with net income or (iii) in a statement that presents the components of OCI as part of the statement of changes in stockholders' equity.

Under IAS 1 income and expense items were typically presented in the profit or loss section of the Statement of Comprehensive Income unless an IFRS required it to be presented in OCI. Examples of items that IFRSs require or permit to be presented in OCI are:

- » Revaluation gains (and losses to the extent that they reverse previous gains - IAS 16 and IAS 38)
- » Gains and losses on re-measuring available-for-sale financial assets (IAS 39)
- » Gains and losses on hedging instruments that are effective cash flow hedges (IAS 39)
- » Foreign currency exchange gains and losses arising on translation of the net investment in a foreign operation (IAS 21)
- » Fully recognised actuarial gains and losses on defined benefit pension schemes (IAS 19)
- » Current and deferred tax charges or credits in respect of items taken to OCI (IAS 12)

US Topic 220 on the other hand was more prescriptive in setting out what items should be included in OCI.

Reasons for the amendments

The IASB held the view that there was a lack of distinction between different items in the OCI and an absence of agreement among users and preparers about which items should be presented in OCI and which should be part of profit or loss. Presently, some items in OCI could have considerable impact on the financial performance of the entity if they were reclassified through profit or loss.

The reasons espoused by the FASB for change were to increase the prominence of OCI and improve comparability, consistency and transparency of financial reporting.

Amendments

Amendments to IAS 1 require OCI to present separately items that would be reclassified to (or recycled through) profit or loss at a later date if certain conditions are met from those that would never be reclassified to profit or loss. The amendments did not change the option to present items in OCI either before or net of tax.

Examples of OCI items that can or must be reclassified to profit or loss are:

- » Gains and losses on re-measuring available-for-sale financial assets (IAS 39)
- » Gains and losses on hedging instruments that are effective cash flow hedges (IAS 39)
- » Foreign currency exchange gains and losses arising on translation of the net investment in a foreign operation (IAS 21)

Examples of OCI items that would never be reclassified to profit or loss are:

- » Revaluation gains and losses (IAS 16 and IAS 38)
- » Recognised actuarial gains and losses on defined benefit pension schemes (IAS 19)

There is no change to the existing option under IAS 1 to present profit or loss and OCI in two statements. There is a change to the title of the Statement of Comprehensive Income to the Statement of Profit or Loss and Other Comprehensive Income, however, an entity is still permitted to use other titles.

Under US GAAP, ASU No. 2011-05, an entity has the option to present the total of comprehensive income, the components of net income and the components of OCI either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both choices, an entity is required to present each component of net income along with total net income, each component of OCI along with a total for OCI and a total amount of comprehensive income. Regardless of whether an entity chooses to present comprehensive income in a single continuous statement or in two separate but consecutive statements, the entity is required to present on the face of the financial statements reclassification adjustment for items that are reclassified from OCI to net income. The amendments eliminated the option to present the components of OCI as part of the statement of changes in stockholder's equity.

Missed Opportunity

Unfortunately the IASB did not address the rationale of the nature of the items that should be recognised in OCI and the determination as to whether items in OCI are reclassified through profit or loss in future periods. Reference must still be made to other IFRSs to make this determination. The IASB acknowledged that it has not addressed these matters but stated that they were outside the scope of the project which focused on presentation. However, the board did state that these matters may be addressed as part of a future work programme.

Effective Date and Transition

The amendments to IAS 1 shall apply for annual periods beginning on or after 1 July 2012. Early adoption is permitted provided the entity discloses that fact.

The amendments in ASU No. 2011-05 apply for public entities for fiscal years, and interim periods within those years beginning after 15 December 2011, and for non-public entities the amendments apply for fiscal years ending after 15 December 2012 and interim and annual periods thereafter.

**Deirdre is Head of Audit,
Advisory and Assurance in
RSM Farrell Grant Sparks, Ireland**

**T: +353 1 4182088
E: deirdre.kiely@rsmfqs.ie**

2 The point of view of ...



Gil Rosenstock and Shlomi Shuv

... on IFRS for SMEs - Hierarchy to establishing accounting policy (1 of 3)

In July 2009, the IASB published the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).

This article is the first of three on how an entity shall apply, in practice, an accounting treatment in a situation where the IFRS for SMEs does not address the specific transaction or event.

The IFRS for SMEs is intended to be a stand-alone document, where concise guidance can be found to deal with accounting issues or many typical SMEs. Thus, the IFRS for SMEs does not have any mandatory requirement to look to full IFRSs, although it does include one option for an entity to choose to follow full IFRS, which is the option to use IAS 39 Financial Instruments: Recognition and Measurement.

Hierarchy to establishing accounting policy

When the IFRS for SMEs does not specifically address a transaction, other event or condition, an entity's management shall use its judgment in developing and applying an accounting policy that results in information that is relevant and reliable.

In making that judgment, management shall refer to, and consider the applicability of, the following sources:

- (a) the requirements and guidance in the IFRS for SMEs dealing with similar and related issues; and
- (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in the IFRS for SMEs

Management may also consider the requirements and guidance in full IFRSs dealing with similar and related issues.

Following are a number of cases, for which the IFRS for SMEs does not describe a specific accounting treatment, and the proposed accounting solutions for those cases, in the authors' view, based on the hierarchy as established in the IFRS for SMEs.

- » Transfer of a property to, or from, investment property
- » Classification of gains from sale of assets held for rental
- » Accounting-policy choice for the recognition of actuarial gains and losses

Transfer of a property to, or from, investment property

IAS 40 Investment Property requires an entity to transfer a property to, or from, investment property when, and only when, there is a change in use.

The IFRS for SMEs requires an entity to transfer a property to, or from, investment property only when the property first meets, or ceases to meet, the definition of investment property.

In light of the fact that the definition of Investment Property includes characteristics related to the reporting entity's intentions ("Property held to earn rentals or for capital appreciation or both"), the transfer dates required by the IFRS for SMEs may occur before the transfer dates required by IAS 40.

In the authors' view, in this case an entity shall not turn to full IFRSs to determine the date of a transfer to, or from, investment property. This is because wherever there is a specific guidance in the IFRS for SMEs addressing a transaction, other event or condition, the entity is required to follow the specific guidance, rather than applying the hierarchy and turning to full IFRSs.

Thus, for example, for a transfer from investment property to owner-occupied property (Property, Plant and Equipment), IAS 40 requires an actual commencement of owner-occupation. On the other hand, in the authors' view, under the IFRS for SMEs an entity shall transfer the property from investment property to owner-occupied property at the date when it assigns the property to its own use, even though it has yet to begin actually using the property.

In another example, for a transfer from inventories to investment property, IAS 40 requires an actual commencement of an operating lease to another party. In contrast, in the authors' view, under the IFRS for SMEs an entity shall transfer the property from inventories to investment property at the date when the entity assigns the property to be leased to another party, even though the leasing period has yet to begin, and the other party has yet to be found.

Classification of gains from sale of assets held for rental

IAS 16 Property, Plant and Equipment prohibits classification as revenue of gains arising from derecognition of items of property, plant and equipment. However, an entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others shall transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets shall be recognised as revenue.

The IFRS for SMEs prohibits an entity from classifying a gain on the derecognition of an item of property, plant and equipment as revenue. However, no guidance exists in the IFRS for SMEs regarding an entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others.

In the authors' view, an entity shall not turn to full IFRSs to transfer the aforementioned assets to inventories, and subsequently classify the proceeds from their sale as revenue. Even though such a transfer better reflects the actual operations of those entities, SMEs are prohibited from straying from the unequivocal instruction in the IFRS for SMEs, according to which it is not permitted to classify a gain on the derecognition of an item of property, plant and equipment as revenue, including the implications on the Statement of Cash Flows.

Accounting-policy choice for the recognition of actuarial gains and losses

IAS 19 Employee Benefits currently allows an accounting-policy choice for the recognition of actuarial gains and losses, as follows:

- » Immediate recognition in profit or loss
- » Recognition in other comprehensive income and immediate recognition in retained earnings
- » Using the corridor approach
- » Using the accelerated corridor approach⁵

Under the IFRS for SMEs, an entity is required to recognise all actuarial gains and losses in the period in which they occur, while choosing an accounting policy to either recognise all actuarial gains and losses in profit or loss, or to recognise all actuarial gains and losses in other comprehensive income. Neither the corridor approach nor the accelerated corridor approach is permitted.

In respect of the option where actuarial gains and losses are recognised in other comprehensive income, the IFRS for SMEs does not specifically state that those gains and losses are to be recognised immediately in retained earnings.

Thus, in the authors' view, an entity is not required to turn to full IFRSs for the immediate recognition in retained earnings, but rather is allowed to choose as its accounting policy either one of the following options, and apply it consistently:

- » Immediate recognition in retained earnings
- » Immediate recognition in reserve with no recognition in retained earnings

This article will continue in the next two editions, where further aspects of IFRS for SMEs will be covered.

Gil Rosenstock, C.P.A. IFRS Consultant
Head of Professional Practice in
Shiff, Hazenfratz & Co, Israel

T: +972 (3) 791 9111
E: gil_r@shifazen.co.il

Shlomi Shuv, C.P.A. IFRS consultant,
Vice Dean at the School of Business (IDC)
Herzliya, Israel

T: +972 (9) 952 7655
E: shuvs@idc.ac.il

⁵ The corridor approach has recently been eliminated for annual periods beginning on or after 1 January 2013.

2 The point of view of ...



Dan Schwartz

... on the Proposed amendments to IAS 1

This article addresses the debate on the amendments to IAS 1 in the context of former communist economies, using the experience of our profession in Romania.

In June, the IASB passed and published an exposure draft called Improvements to IFRSs (proposed amendments to IFRS) with the aim of informing accountants and users of IFRSs about the manner in which the Standards will be applicable starting January 2013, however, the Board encourages earlier application of the Standards. Comments on, and suggestions for, improvements to the proposals are welcomed, the final aim of the Board being to supply all those interested with well drafted accounting standards.

The IFRS and IAS subject to amendments as presented in the exposure draft are IFRS 1, IAS 1, IAS 16, IAS 32 and IAS 34. I have chosen to analyse and provide my personal comments on the amendments to paragraphs 7 and 9 of IAS 1 from the perspective of a professional working in Romania, a former communist country that made the transition to capitalism only twenty years ago. I believe that opinions and comments similar to those presented in this article are likely to be shared by accountants from other former communist countries and states with emerging economies, such as China, Russia, India and Brazil.

The proposed amendments to paragraph 7 of IAS 1

The new text proposed for paragraph 7 is as follows (the new text is underlined and the deleted text has been struck through):

7 Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The Conceptual Framework for Financial Reporting 2010 ~~The Framework for the Preparation and Presentation of Financial Statements states in paragraph QC32-25 that "Financial reports are prepared for users who are assumed to have a reasonable knowledge of business and economic activities and accounting and who review and analyse a willingness to study the information with reasonable diligence diligently."~~ Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.*

...
[*Footnote deleted]

The most important change to this paragraph is, in my opinion, the elimination of the word "accounting" from the text. Although the stated aim of eliminating this word is to reflect the Conceptual Framework for Financial Reporting 2010, the proposed change succeeds in making IAS 1 more consistent with the Conceptual Framework only in form rather than substance. Moreover, in my opinion, the proposed wording of paragraph 7 requires that accountants be able to translate accounting jargon into a layman's terms sufficiently comprehensible to users with no knowledge of accounting. In a perfect world, this would probably work, but in our times when accountants have been accused by laymen of provoking financial crisis and economic downturns and especially in countries where the market economy is still relatively young, it is, in my view, highly unrealistic to expect the laymen to have the minimum knowledge of accountancy required to understand firms' accounts.

In my practical experience, it has often been difficult to explain to entrepreneurs (in their capacity as investors and creditors) how to read and understand financial statements. The reason for this is the lack of a minimum economic and accounting culture that still can be found among these very important users of financial information.

Taking into account the above, I believe that to expect users to have reasonable knowledge of accounting and consequently to keep the word "accounting" within the text of paragraph 7 (and, if necessary, to change the wording of QC 23 of the Conceptual Framework accordingly) would make IAS 1 more suitable for both accountants and users of financial statements in countries with emerging economies and in the constituencies that have turned to the market economy in the last two decades.

The proposed amendments to paragraph 9 of IAS 1

IASB has proposed the deletion of Paragraph 9 of IAS 1, its replacement with two new paragraphs. (9A and 9B), and the amendment of the heading before paragraph 9 (as a result of the new amendment, the heading becomes "Objective of financial reporting"). The wording of paragraph 9B is copied almost identically from the former paragraph 9.

The text proposed for paragraph 9A is as follows:

9A The objective of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's resources and claims against the reporting entity. General purpose financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions about providing resources to an entity.

In order to be consistent with the Conceptual Framework, the proposed text of paragraph 9A limits both the number of potential users of financial statements and the decisions that can be made based on information collected from financial statements. One very important category of users that has been excluded is that of traders who buy/sell stocks from/to each other on stock exchanges. The aim of many of these traders is not to keep their resources invested in a given entity, but merely to make capital gains from trading the shares of the respective entity. If the proposed text of paragraph 9A remains as it is in the exposure draft, then for these people, who are important to the very survival of the market economy and the capitalist system, financial statements will no longer be announced as a source of information. Consequently, they will either make incorrect financial decisions or be obliged to look for other sources of information. This represents a source of frustration for such traders, especially in economies that are still relatively new to capitalism, who were under the expectation that the financial statements would provide sufficient information for them to take decisions.

Another radical change of mindset, which is entailed by the transition to market economy, is that there must be a division of roles between standard setters and regulators. A question that would arise, applying the now abandoned regimes is: *if financial statements are not prepared with the additional objective of supplying regulators with information on the way the rules have been followed during the preparation of financial reports, how can the regulatory bodies keep a watch over the regulated entities?* In the new European democracies and in countries like Russia or China, as a reminiscence of the communist system, regulators have been used to having a very autocratic and centralised attitude towards the accounting profession.

Consequently, the national GAAP in these countries still are full of strict rules that limit the scope of professional judgment, one of the most important concepts promoted by IFRS and IASB. If regulators must take into consideration the IFRS substance when they design local accounting rules, the IFRS approach of accountancy will also be implemented into national accounting standards. On the other hand, to exclude regulators from the object of IAS 1 could still be considered as a limitation to the accountants' freedom of performing their profession.

Taking into consideration the above, I suggest that paragraph 9A be redrafted as follows (the suggested new text is underlined):

9A The objective of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors, in making decisions about providing resources to the entity and to regulators and other users that might be interested in making economic decisions in relation to the reporting entity. General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's resources and claims against the reporting entity. General purpose financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions about providing resources to an entity.

For consistency, the Conceptual Framework should have been worded accordingly.

Please note that the rewording of paragraph 9A is merely a proposal suggested by the author of this article and not part of the exposure draft issued by IASB in June.

Conclusions

Even though they seem to be an improvement compared to the old wording, the exposure draft has put forward new texts of IFRS and IAS to which objections might be raised. Therefore, they are likely to generate questions and debate. The more proposals and comments from accountants and users are made, the easier it will be to apply the IFRS. So, please, go ahead!

Dan Schwartz, MBC, EC, AF, CF
is Managing Partner in
Scot & Company Consulting SRL,
Romania

T: +40 21 318 9150
E: danschwartz@scot.ro

3 Top Ten Topics in IFRS



Joelle Moughanni
Joint Arrangements

Although not appearing on our list of Top Ten Topics, this is one of the hottest topics at the moment. On 12 May 2011, the IASB issued IFRS 11 Joint Arrangements (which supersedes IAS 31 and SIC-13), as part of a 'package of five' new or revised standards (IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Involvement with Other Entities, IAS 27 Separate Financial Statements (revised 2011) and IAS 28 Investments in Associates and Joint Ventures (revised 2011)).

With IFRS 11, US GAAP and IFRSs are more closely aligned (though not fully, mainly due to the large amount of industry-specific requirements for joint arrangements under US GAAP).

Joint arrangements are quite a common practice worldwide to leverage diversification and globalisation (e.g. for infrastructure companies). Entities with existing joint arrangements or that plan to enter into new joint arrangements need to start assessing their arrangements to determine whether they have invested in a joint operation or a joint venture. Entities that have been accounting for their interest in a joint venture using proportionate consolidation will no longer be allowed to use this method; instead they will account for the joint venture using the equity method. In addition, some entities that previously equity-accounted for investments may need to account for their share of assets and liabilities now that there is less focus on the structure of the arrangement.

The new accounting may have a significant impact on entities' financial results and financial position, which should be clearly communicated to stakeholders as soon as possible. Management should also carefully consider the planned timing of their adoption. If they wish to retain the current accounting for existing arrangements, now is the time to consider how the terms of these arrangements can be reworked or restructured to achieve this.

This article explains in 10 Q&As, how IFRS 11 brings major change to accounting for joint ventures.

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1. Why is IFRS 11 perceived as an improvement on IAS 31?

IFRS 11 addresses two weaknesses of IAS 31: the structure of the arrangement is the only driver for the accounting and an entity has a choice of accounting treatment for interests in jointly controlled entities, together resulting in practical inconsistencies. In practice, arrangements that entitle the parties to similar rights and obligations are accounted for differently and, conversely, arrangements that entitle the parties to different rights and obligations are accounted for similarly.

IFRS 11 improves the accounting for joint arrangements by introducing a principle-based approach where a party to a joint arrangement recognises its rights and obligations arising from the arrangement, reflecting the arrangement's substance (instead of its form) and by eliminating the existing policy choice of proportionate consolidation for jointly controlled entities.

2. What are the practical consequences of eliminating proportionate consolidation?

IFRS 11 removes proportionate consolidation as defined in IAS 31. However, it does not prevent a party to a joint arrangement from recognising individual assets and liabilities and the related revenue and expenses when that party has rights to them.

Actually, application of IFRS 11 will result, in some instances (i.e. joint operations), in parties recognising assets, liabilities, revenues and expenses relating to their arrangements.

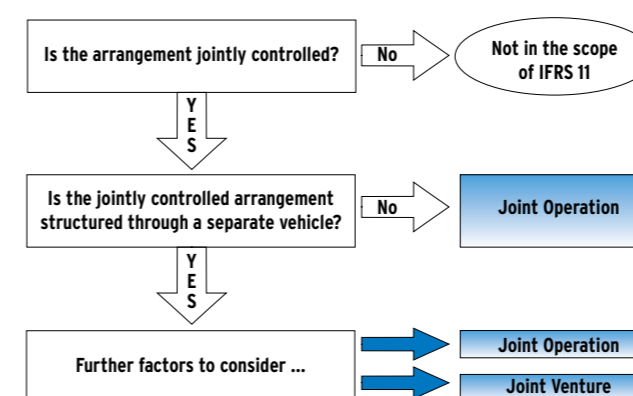
In the majority of cases, such accounting gives the same outcome as proportionate consolidation would have done, however, with two differences. First, under IFRS 11 assets, liabilities, revenues and expenses of the joint operation are recognised as specified in the contractual arrangement rather than based on the ownership interest that the entity has in the joint operation. Second, there is no difference between amounts recognised in the parties' separate and consolidated financial statements, whereas in IAS 31 the parties' interests in jointly controlled entities in their separate financial statements are represented by an investment (measured at cost or in accordance with IFRS 9/IAS 39).

3. "IFRS 11 is principle-based"...What is the core principle of IFRS 11?

IFRS 11 establishes a principle-based approach for accounting for all joint arrangements (i.e. any arrangement where two or more parties contractually agree to share control): all parties to a joint arrangement must recognise their rights and obligations arising from the arrangement with focus on how rights and obligations are shared by the parties to the joint arrangement (not on legal structure of the arrangement).

Application of this principle requires two main assessments, often involving judgement. An entity must first assess whether parties to the arrangement (all or a group of them) have joint control of the arrangement. In the absence of joint control, the arrangement is outside the scope of IFRS 11; otherwise, a second assessment is needed for classifying the joint arrangement (based on an analysis of the parties' rights and obligations arising from the arrangement).

This classification will determine the accounting to be applied; gross accounting for a joint operation or equity method for a joint venture. This is summarised in the following chart:



4. What is joint control and how is it assessed?

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about activities that significantly affect the returns of the arrangement (the relevant activities) require the unanimous consent of the parties sharing control (i.e. any party with joint control of the arrangement can prevent any of the other parties from making unilateral decisions about the relevant activities without its consent).

First, an entity determines whether the parties (all or a group of them), considered collectively, are able to direct the relevant activities (i.e. they control the arrangement collectively, based on definition of control in IFRS 10). After concluding that the parties (all or a group of them) control the arrangement collectively, the entity assesses whether it has joint control of the arrangement.

5. How is the classification of a joint arrangement determined (joint venture vs joint operation)?

Joint arrangements are established for a variety of purposes and use different structures and legal forms, sometimes involving the establishment of a separate vehicle, but not necessarily. Regardless of the purpose, structure or form of the arrangement, the classification of a joint arrangement as a joint operation or a joint venture depends upon the parties' rights and obligations arising from the arrangement in the normal course of business.

In the absence of a separate vehicle, the parties to the joint arrangement have direct rights and obligations to the assets and liabilities of the arrangement and hence the arrangement is clearly classified as a joint operation.

A joint arrangement in which the assets and liabilities are held in a separate vehicle (i.e. a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality) can be either a joint venture or a joint operation, depending on all relevant facts and circumstances. The existence of a separate vehicle is a necessary, but not sufficient, condition for a joint arrangement to be considered a joint venture (this is a significant change from IAS 31 which treats the establishment of a separate legal vehicle as the key factor in determining the existence of a jointly controlled entity).

Not all jointly controlled entities will be classified by IFRS 11 as joint ventures. Some jointly controlled entities will be classified as joint operations because of the parties' related rights and obligations.

6. What is a joint operation and how is it identified?

A joint operation is a joint arrangement that gives parties to the arrangement direct rights to the assets and obligations for the liabilities, as in all of the following situations:

- » The arrangement is not structured through a separate vehicle
- » The arrangement is structured through a separate vehicle but the legal form of the separate vehicle does not cause it to be considered in its own right (i.e. assets and liabilities placed in the separate vehicle belong to the parties)
- » The arrangement is structured in a separate vehicle that can be considered in its own right but the terms agreed by the parties in their contractual arrangement modify the features of the legal form and cause the assets and liabilities held in the separate vehicle to belong to the parties
- » The arrangement is structured through a separate vehicle that can be considered in its own right and the terms of the contractual arrangement do not confer on the parties rights to the assets and obligations for the liabilities, but the arrangement has been designed in such a way that the parties have rights to substantially all the economic benefits of the assets placed in the separate vehicle and the arrangement is continuously dependent on the parties for settling the liabilities relating to the activity conducted through the arrangement

7. What is a joint venture and how is it identified?

A joint venture is a joint arrangement that gives parties to the arrangement rights to an investment, i.e. to the net assets or outcome (profit or loss) of the activity undertaken by the arrangement.

Joint ventures are arrangements structured in separate vehicles whose legal form together with the contractual terms agreed by the parties do not confer on the parties rights to the assets and obligations for the liabilities of the activities carried out and those

Touching base two years on

separate vehicles have been designed to have a trade on their own (thus facing directly the risks arising from activities such as demand, credit or inventory risks). It is possible that an investment that previously met the definition of a jointly controlled entity under IAS 31 will be a joint operation under IFRS 11.

In assessing its rights and obligations in a joint arrangement structured in a separate vehicle, an entity should consider the legal form of the arrangement, the terms agreed by the parties in the contractual arrangement, and other facts and circumstances (if relevant).

Other facts and circumstances include consideration of whether the parties designed the arrangement so that its trade is substantially only with its parties (i.e. the parties have rights to substantially all the economic benefits of the assets placed in the separate vehicle), with the result that the arrangement continuously depends on the parties for settling the liabilities relating to the activity conducted through the arrangement.

In many cases, the rights and obligations agreed to by the parties in their contractual arrangements are consistent, or do not conflict, with the rights and obligations conferred on the parties by the legal form of the separate vehicle in which the arrangement has been structured. In other cases, the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured.

8. How are joint arrangements reflected in the parties' financial statements?

In relation to its interest in a joint operation, a joint operator recognises, in accordance with the relevant IFRSs:

- » Its assets, including its share of any assets held jointly
- » Its liabilities, including its share of any liabilities incurred jointly
- » Its revenue from the sale of its share of the output of the joint operation
- » Its share of the revenue from the sale of the output by the joint operation; and
- » Its expenses, including its share of any expenses incurred jointly

Accounting for joint operations under IFRS 11 is consistent with the current treatment in IAS 31 of jointly controlled operations and jointly controlled assets.

In separate financial statements, joint operations are accounted for in the same manner as in the consolidated financial statements (i.e. the investor recognises directly its shares of assets, liabilities, revenues and expenses related to the joint operations). Joint ventures, like investments in associates and in subsidiaries, are accounted for in the separate financial statements of the venturer either at cost or under IFRS 9/IAS 39 (in accordance with amended IAS 27).

A joint venturer recognises its interest in a joint venture as an investment using the equity method in accordance with IAS 28 (revised 2011, though the mechanics of equity accounting, as detailed in current IAS 28, have not changed). Entities can no longer account for an interest in a joint venture using the proportionate consolidation method.

9. What disclosures are required for joint arrangements?

The disclosure requirements for entities involved with joint arrangements are established in IFRS 12 (a comprehensive disclosure standard for subsidiaries, joint arrangements, associates and unconsolidated structured entities). The required disclosures aim to include information that helps users of financial statements to evaluate the nature, extent and financial effects of an entity's interests in joint arrangements, and the nature of the risks associated with those interests.

The main disclosure requirements consist of a list of all individually material joint arrangements, summarised financial information about each material joint venture and separate disclosure of commitments and contingent liabilities relating to joint ventures.

10. When and how does IFRS 11 become applicable?

IFRS 11 is effective for annual periods beginning on or after 1 January 2013, with early application permitted (so long as IFRS 10, IFRS 12, IAS 27 (2011) and IAS 28 (2011) are adopted at the same time). When adoption of IFRS 11 requires a change in accounting, the impact of the change is calculated as at the beginning of the earliest period presented (i.e. 1/1/12) and the comparative periods are restated. However, special transitional provisions are available and they vary depending on how an interest is classified under IAS 31.

The main transition requirements affect arrangements that were accounted for proportionately under IAS 31. Some of these arrangements will now need to be accounted for using the equity method (joint ventures) while others will have to recognise assets, liabilities, revenues and expenses (joint operations). In the first case, the entity will not have to adjust retrospectively any differences between the proportionate consolidation and equity method, but should instead aggregate the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated into a single line investment as at the beginning of the earliest period presented. In the second case, when changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, the entity must derecognise the investment at the beginning of the earliest period presented and recognise its share of each of the assets and the liabilities in respect of its interest in the joint operation. In this case, an entity would recognise its share of each of the assets and the liabilities relating to the joint operation at their carrying amounts on the basis of the information used by the entity in applying the equity method (deemed cost), instead of remeasuring its share of each of those assets and liabilities at the date of transition.

Joelle Moughanni is a Technical Consultant in the RSM International Executive Office
T: + 44 (0)207 601 1089
E: joelle.moughanni@rsmi.com

Our first edition was published in the summer of 2009. This is a brief account of the highlights and the guest contributors who have shared their expertise with us.



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- » Revenue Recognition
- » Income Tax

*Guest contributor
 Paul Klumpes, Professor at Imperial College, London



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- » Defined Benefit Pension
- » Borrowing Costs
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*Guest contributor
 Denise Gomez Soto, Project Manager at IASB



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 Francesco Bellandi, writer



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*Guest contributor
 Mike Wells, Education Initiative Leader at IASB



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*Guest contributors
 Michael Izza and Marianne Mau, CEO and Technical Manager at ICAEW



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*Guest contributor
 Mike Brooks, writer



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*Guest contributors
 Chris Chapman, Professor at Imperial College, London



In Issue 8:

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- » IFRS 10 and IFRS 12: Consolidation

*Guest contributor
 David Cairns, Financial Reporting Review Panel, World Bank Centre for Financial Reporting Reform

Global Contacts

Americas

Bob Dohrer
T: +1 919 645 6819
E: robert.dohrer@mcgladrey.com

Middle East

Chandra Sekaran
T: +965 2245 2680
E: chandra.sekaran@albazie.com

Europe

C.M. (Kees) Roozen
T: +31 (0)30 24 28 505
E: kroozen@rsmnederland.nl

Africa

Simon Fisher
T: +254 20 4451747/8/9
E: sfisher@ke.rsmashvir.com

Asia Pacific

Jane Meade
T: +61 2 8226 9518
E: jane.meade@rsmi.com.au

RSM Global Executive Office - UK

Ellen Costa
T: +44 (0)20 7601 1080
E: ellen.costa@rsmi.com

Editor

Dr Marco Mongiello ACA
Director MSc Management and MSc Innovation & Entrepreneurship
Principal Teaching Fellow in Accounting
Imperial College Business School
T: +44 (0)20 7594 9686
E: m.mongiello@imperial.ac.uk

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