

# Beyond the GAAP

N°22 – April 2009

## Editorial

Ready ! Steady ! Go ! Yet the IASB and the FASB started a long run in order to issue an exposure draft on financial instruments by the end of the year 2009. The Financial Crisis Advisory Group supported their initiative. Many respondents expected the Board to modify IAS 39 before year-end but the IASB denied this too ambitious schedule. Now the IASB has no choice but comply with the timeframe and propose relevant changes to the current requirements. This project ranks first in the Board's agenda. Thus, Summer should be busy for everyone interested in this project. Before we are able to tell you more about financial instruments, BEYOND the GAAP highlights the main issues in the 2009 Improvements vintage. We are pleased as well to provide you with the draft changes of IAS 12 'Income tax' for you to identify the potential issues.

Happy reading!

Michel Barbet-Massin

Jean-Louis Lebrun

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### Free access to IFRS standards

As announced in our January issue, standards and interpretations are now freely accessible on the website of the IASB: <http://www.iasb.org/IFRSs/IFRS.htm>. The standards available are those from the 2009 bound volume. Previous versions of the standards translated into Dutch, French, German and Italian are available on: <http://www.iasb.org/IFRSs/Official+Unaccompanied+IFRS+Translations.htm>

### Nomination of a Brazilian financial regulator at the IASB

Mr Amaro Luiz de Oliveira Gomes, currently Head of the Financial Regulation Department at the Bank of Brazil, has been appointed as a member of the IASB. His 5 years mandate will begin on 1 July 2009.

During his career at the Brazil Central Bank, Mr Gomes has played an active role in the adoption of the IFRS standards in Brazil. He has overseen the application of the IFRS standards by regulated financial institutions and was involved in the convergence of prudential regulation in Brazil towards IFRS.

## IFRS news

### ➤ IASB round tables on the consolidation and derecognition of financial instruments

On 21 April 2009, the IASB announced three public round tables on the exposure drafts Consolidated Financial Statements and Derecognition, published in December 2008 and March 2009 respectively.

The IASB hopes that these round tables will provide an opportunity to identify other views on the consolidation proposals. The meetings will also offer scope for discussion of the interactions with the exposure draft on derecognition, in particular securitisation and the use of structured vehicles.

The debates will complement the work of the IASB which aims to publish a new standard on consolidation by the end of 2009 and a new standard on derecognition in the first half of 2010.

The round tables will take place in Toronto on 1 and 2 June, in Tokyo on 8 and 9 June and in London on 15 and 16 June. Interested parties may register through the IASB's website on [www.iasb.org](http://www.iasb.org).

### ➤ Review of IAS 39 - Financial Instruments

Despite the recommendations from the regulators (IOSCO, Basel Committee, CESR etc.) and the EFRAG, the IASB has unanimously decided to pursue its work on the replacement of IAS 39 *Financial Instruments: Recognition and Measurement*, in order to publish an exposure draft by the end of 2009. Therefore, no changes are expected to be applicable at the closing of accounts for 2010.

As part of this project, the IASB will question the basis of the "expected losses" model that may lead to the accounting of expected losses on initial recognition.

More broadly, the IASB will discuss the "dynamic provisioning" issue. The Board will hold additional meetings outside the monthly schedule (including in August) in order to finalise its proposals as soon as possible.

In a letter to the G20 on 29 April, the Financial Crisis Advisory Group (FCAG) expressed its support to the IASB's projects. It considered that the proposed schedule (with an exposure draft to be published by the end of 2009) was incompatible with some amendments to the standards on financial instruments effective in 2009 financial statements.

### ➤ Finalisation of IAS 37 - Provisions

Once again, Board members were divided on the issue of how to measure non-financial liabilities. The scope of application of the future revised IAS 37 appears quite difficult to assess.

After much discussion, a majority endorsed the measurement of such liabilities on the basis of transfer pricing. Transfer pricing will be measured directly when a market can be identified. Otherwise, the entity should estimate the transfer pricing on the basis of the costs it would incur for an equivalent service, adding the consideration it would receive for a service rendered to a third party. In addition, the Board has taken into account the extension of the scope of the revised standard to non-financial liabilities with fixed amounts and maturities. An additional safety margin to cover uncertainty will therefore not be required on a regular basis.

Although the Board finally achieved a qualified majority on a principle for the measurement of non-financial liabilities, it will examine the potential for applying this principle to provisions for litigation at a future meeting.

### ➤ Management commentary

The IASB approved the publication of an exposure draft on a "best practice recommendation" for the preparation of management reports. The period for comments will run from the date of publication (expected in June 2009) until February 2010.

## ➤ First meeting of the Monitoring Board

The IASCF Monitoring Board (see the January 09 issue of Beyond the GAAP) held its first meeting on Wednesday 1 April 2009 in London. At this meeting, the Monitoring Board:

- elected its first Chairman, Mr Hans Hoogervorst, the current Chairman of the Dutch financial markets regulator, on a two years mandate,
- adopted the statutes establishing the rules of operation for the Monitoring Board (organisation, membership, meeting schedule, voting methods etc.)
- approved a Memorandum of Understanding (MOU) defining the role of the Monitoring Board and its relationship with the IASCF.

According to the MOU, the main objective of the Monitoring Board is to promote cooperation between regulators (the financial market authorities) and the IASCF. It aims to:

- help regulators to protect investors and ensure market integrity;
- strengthen the public image of the IASCF as a transparent and responsible body;
- promote the continuing development of IFRS as global, high quality standards.

## ➤ National standard setters come together

Against the background of close cooperation between the IASB and the FASB, the EFRAG and national standard setters aim to offer suggestions and solutions to the IASB in order to influence the review of international standards.

The first meeting of 2009 was held in Johannesburg, South Africa. As usual, discussions were held in public in the presence of an IASB delegation chaired by David Tweedie and representatives of the FASB.

The main items on the agenda included the conditions for a potential review of IFRS 2 - *Share-based Payments*, a project monitored by the CNC/ ANC. Another significant issue was the discussion of a future "tax" standard if IAS 12 were to be abandoned. The project is sponsored by the German and UK standard setters.

Apart from the technical issues, it is worth noting the UK initiative on the conditions for carrying out an analysis of the impact of new accounting regulations. Finally, since the beginning of the financial crisis the meetings of national standard setters have provided an opportunity to note the trend of the measures taken or planned by the IASB. On this occasion all the participants expressed support for the IASB project for reviewing IAS 39 – *Financial Instruments*.

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## Improvement to IFRS standards – 2009 version

Details of the exposure draft were published in the September and November 2008 issues of Beyond the GAAP.

To keep you posted on these topics, Beyond the GAAP presents below a list of the main differences between the 2009 Annual Improvements and the exposure draft, and explains the amendments in the final publication issued on 16 April.

### ➤ Changes since the exposure draft was issued

Three subjects which were not previously addressed have been added to the final version:

- the current/non-current classification of convertible instruments,
- the classification of leases of land and buildings, and
- the treatment of loan prepayment penalties as closely related embedded derivatives.

However, two topics related to financial instruments included in the exposure draft were not finalised in the 2009 version:

- the application of the fair value option to financial instruments with embedded derivatives
- the assessment of embedded derivatives in contracts denominated in a foreign currency.

Finally, changes were made to the following interpretations:

- IFRIC 9 Reassessment of embedded derivatives
- IFRIC 16 Hedges of a Net Investment in a Foreign Operation.

### ➤ IFRS 2 - Share-based Payments – Scope

The current wording of IFRS 2 excludes from its scope transactions related to business combinations within the scope of IFRS 3 *Business Combinations*. However, the new version of IFRS 3 published in 2008 changed the definition of a business combination and now focuses on obtaining control. Common control transactions and joint ventures for which control is not relevant are therefore no longer explicitly included in the definition of business combinations under revised IFRS 3.

Logically, IFRS 2 should therefore be applicable to transactions relating to business combinations of this type. However, this conclusion does not reflect the intention of the Board, that changed the scope of IFRS 2 to maintain the exclusion of contribution of a business on the formation of a joint venture and common control transactions.

The application date for this provision has been harmonised with the application date for IFRS 3, i.e. 1 July 2009. As it maintains an existing exception, this change will have no impact.

## ➤ IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations –Disclosures

A large number of notes to the financial statements present and explain the amounts of assets and liabilities in the balance sheet, as required by most IFRSs. However, the standards did not state whether these notes had to be reconciled with balance sheet items, disposal groups included or excluded.

The new wording addresses this uncertainty and states that the notes required by the standards (excluding IFRS 5) are not applicable to disposal groups or to discontinued operations, unless the standards require disclosures:

- specific to this type of asset or operation, or
- about measurement of assets and liabilities within a disposal group that are not within the scope of IFRS 5; such disclosures should not be repeated if they are already provided in the other notes to the financial statements.

The change is applicable to accounting periods beginning on or after 1 January 2010. Earlier application is permitted.

## ➤ IFRS 8 – Operating Segments – Disclosures

The Board aims to eliminate a difference with the US standards on the presentation of segment disclosures. Currently, the assets of each segment must be systematically presented while the liabilities are disclosed only when the amount is monitored on a regular basis by the chief operating decision maker. The change introduced in April requires the same disclosures for both assets and liabilities.

The application of this change is mandatory for annual periods beginning on or after 1 January 2010. Companies which opted for early application of IFRS 8 should be aware of this change, as the interim provisions require a retreatment of the comparative years.

## ➤ IAS 1 - *Presentation of Financial Statements* – classification as current or non-current items

The change aims to provide clarification on the classification of the liability component of a convertible asset as current or non-current: this component should not be classified as a current liability simply because it may be settled at any time at the option of the holder.

Conversion into equity instrument has no impact on the cash position of an entity, and does not contribute to assessing its solvency. As potential conversion within twelve months (of an instrument whose maturity exceeds twelve months) does not result in a cash movement, the liability component should not be classified as a current liability.

The change is applicable to annual periods beginning on or after 1 January 2010 and potentially requires a reclassification of the relevant instruments in the year-end financial statements of the comparative years.

## ➤ IAS 7 - Statement of Cash Flows – classification as investing activities

The Board states that only expenditure that results in the recognition of an asset are eligible for classification as investing activities in the statement of cash flows. For example, expenditure on advertising and promotional activities, training, and research and development should not be classified as investing activities but as operational flows.

The issue was initially raised by extraction and exploration groups, which were allowed under IFRS 6 – *Exploration for and Evaluation of Mineral Resources* to choose whether to recognise exploration and evaluation expenditures as assets or expenses. The exception to the general principles for the recognition of assets under IFRS 6 applies to the recognition and measurement of assets and not to their presentation, in the statement of cash flows in particular.

The change aims to ensure consistency between the statement of financial position and the statement of cash flows.

This clarification is effective for annual periods beginning on 1 January 2010 and potentially requires a reclassification of the relevant cash flows in the statement of cash flows for the comparative years.

## ➤ IAS 17 – Leases – classification of leases

When a lease includes both land and building elements, the standard required the classification of the land element as an operating lease, unless title is expected to pass to the lessee by the end of the lease term.

However, in some cases, the length of the lease is such that, in substance, title passes to the lessee at the end of the lease term. With the new classification, these leases may be classified as finance leases.

The transitional provisions require retrospective application on the basis of the information available at the date of signature of the contract. However, to simplify matters in the absence of earlier information, the entity should define the nature of the lease at the date of adoption of the new provisions, and measure both the asset and the liability at fair value at this date. Any difference between these fair values should be recognised in equity.

The change is effective for annual periods beginning on or after 1 January 2010.

One Board member dissented from the amendment, arguing that whatever the length of the lease title cannot in substance pass to the lessee, namely because any appreciation in the land value does not accrue to the lessee.

## ➤ IAS 18 - Revenue – Determining whether an entity is acting as a principal or as an agent

It is not always easy to determine whether an entity is acting “on behalf of...” or “on its own”. IAS 18 was previously somewhat obscure about this. At stake is the presentation of revenue: does the activity result in commissions (first case) or gross income from negotiated transactions?

An example was added to the appendix to the standard, illustrating the indicators reflecting exposure to the risks and rewards of the operations concerned (inventory risk, credit risk etc.) which should be taken into account in determining the nature of the relationship between the entity and its counterparty.

## ➤ IAS 36 - Impairment of Assets – allocating goodwill to cash-generating units

The application of IFRS 8 for annual periods beginning on or after 1 January 2009 could have an impact on the determination of operating segments. This determination may lead to a revision of the allocation of goodwill to cash-generating units (CGU). Under IAS36, CGU should not be larger than an operating segment.

Under certain conditions IFRS 8 allows the aggregation of segments with similar economic characteristics. IAS 36 did not state whether the relevant segments for goodwill allocation should be considered before or after the combination. As a consequence, IAS 36 has been amended and states that the relevant segments for the allocation of goodwill are those existing before the aggregation.

This amendment applies prospectively to annual periods beginning on or after 1 January 2010.

## ➤ IAS 38 – Intangible assets – measurement in a business combination

The standard has undergone two changes.

The first aims to ensure consistency with the changes to IFRS 3 regarding the measurement of acquired intangible assets. The amendment states that all identifiable intangible assets (without exception) may be reliably measured at fair value and therefore be recognised separately. In other words, an identifiable intangible asset acquired within a business combination should be recognised separately from the goodwill.

The second change states that no specific fair value measurement techniques be required to be used for the measurement of intangible assets when no active market exists.

These amendments apply prospectively from the date of application of IFRS 3, i.e. 1 July 2009.

## ➤ IAS 39 – Financial instruments – recognition and measurement – scope, cash flows hedges and embedded derivatives

Additional guidance was seen as necessary.

Forward contracts resulting in obtaining control of an entity were previously excluded from the scope of IAS 39, without any further guidance. This lack of guidance resulted in divergent interpretations. The amendment now states that only firm forward contracts with a determined price, the finalisation of which does not depend on the future actions of one or another party, are excluded from the scope of IAS 39. For example, purchase options (whether exercisable or not) which may result in obtaining control of the acquired entity when exercised are considered as derivatives and should be measured at fair value.

As regards cash flow hedges, the Boards clarified the reclassification to profit or loss of amounts recognised in equity. The amounts recognised in equity should be reclassified to profit or loss in the same period (or periods) during which the hedged cash flows affect profit or loss.

Finally, the Board explained in which cases prepayment options should be recognised separately from the host contract. In the future, the application guidance on IAS 39 requires separate recognition unless the option exercise price compensates the lender for the loss of interest income because the loan was repaid early. The changes will apply prospectively to unexpired contracts for annual periods beginning on or after 1 January 2010.

## ⇒ IFRIC 9 – Reassessment of embedded derivatives – scope of application

The change states that embedded derivatives in contracts acquired in a business combination, a combination of entities under common control or the formation of a joint venture are excluded from the scope of IFRIC 9. The assessment of the separate recognition of these embedded derivatives should therefore be made at the date when the entity acquires the contracts. This amendment results from the changes made in 2008 in the definition of a business combination under IFRS 3.

The amendment will be applied prospectively from the date of application of IFRS 3, i.e. for annual periods beginning on or after 1 July 2009.

## ⇒ IFRIC 16 – Hedges of a net investment in a foreign operation - consensus

IFRIC 16 currently states that the hedging instrument of a net investment in a foreign operation may be held by any entity within a group, except the hedged entity. The amendment from the IASB eliminates this restriction. The amendment is effective for annual periods beginning on or after 1 July 2009.

## Exposure Draft on Income Tax: part one

On 31 March 2009, the IASB published the exposure draft entitled *Income Tax* putting forward a new standard on the treatment of income tax. Comments can be submitted to the IASB until 31 July 2009.

Below, we set out an overview of the general principles proposed by this document and the main amendments to the current standard under consideration. The May issue of *Beyond the GAAP* will further analyse some of the complex or controversial provisions contained in this exposure draft.

### ➤ A long debated issue

This topic was on the IASB agenda as early as September 2002. The draft comes in response to the many requests for clarification received by the IASB on various aspects of IAS 12. It also fits more generally into the convergence process between the international and the US standard setters.

The FASB had initially planned to publish proposals to amend FAS 109 in accordance with the decisions taken within this joint project. However, it revised its strategy in September 2008 and will issue an invitation to comment on the exposure draft published by the IASB. Following this process, the FASB will decide whether or not to adopt this standard.

### ➤ General principles of the exposure draft

#### Maintenance of the temporary difference approach

IAS 12 and the US FAS 109 standard share a common approach to accounting for income tax, i.e. the temporary difference approach. This approach aims to recognise the tax that would be payable or receivable if the entity's assets and liabilities were recovered or settled at their present carrying amount. The IASB did not consider reviewing this approach. As a result, the general principles of accounting for income tax are not amended in this exposure draft.

However, the IASB has decided to eliminate most of the exceptions to the temporary difference approach included in IAS 12. In addition, the document published by the IASB aims to provide a more consistent structure to the provisions on the recognition of income tax in order to achieve a "clearer, more principle-based standard that will make the accounting requirements on income tax easier to understand and apply and will also result in more consistent reporting" (Sir David Tweedie, Chairman of the IASB).

#### An eight-step approach

The outcome of this approach is a methodology in eight steps for the recognition of deferred tax:

1. Recognise current tax, measured by taking into account the effect of the possible outcome of a review by the tax authorities.
2. Identify the assets and liabilities that may generate deferred tax (i.e. the assets and liabilities which would affect the taxable profit if they were recovered or settled at their carrying amount according to the expectations of the entity).

3. Determine the tax basis of the assets and liabilities resulting from step 2, as well as the other items not recognised as assets or liabilities but having a tax basis. The tax basis is determined on the hypothesis of a sale of the assets or a settlement of the liabilities at their carrying amount.
4. Compute any temporary differences (i.e. any differences between the carrying amount and the tax basis of the items determined in steps 2 and 3), unused tax loss and unused tax credits.
5. Measure the deferred tax assets and liabilities resulting from all the amounts computed in step 4 at an amount taking into account the possible outcomes of a review by the tax authorities; use tax rates that, on the basis of substantively enacted tax law at the end of the reporting period, are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.
6. Recognise a valuation allowance against deferred tax assets so that the net amount equals the highest amount that is more likely than not to be realisable against taxable profit.
7. Allocate current and deferred tax to the related components of comprehensive income and equity; classify tax assets as either current or non-current on the basis of the related non-tax asset or liability.
8. Disclose the required information in the notes to the financial statements

## ➔ Principal amendments to the current standard

While the general principles for the recognition of income tax in the current standard and the exposure draft remain the same, the draft nevertheless proposes a number of amendments to IAS 12, as shown below.

Topic	Provisions in the current IAS 12 standard	Provisions in the exposure-draft
Tax basis	Determine the tax basis according to the entity's expected manner of recovery or settlement of asset or liability of the carrying amount of the asset (sale or use).	<p>* Introduce an initial step in determining deferred tax assets and liabilities so that no deferred tax arises in respect of an asset or liability if there will be no effect on taxable profit when the entity recovers or settles its carrying amount.</p> <p>* Determine the tax basis assuming a <u>sale</u> of the assets or a settlement of the liabilities at their carrying amount.</p>
Applicable tax rate: sale or use?	Measurement of the tax assets and liabilities according to the rate applicable to the expected manner of recovery (sale or use).	Measurement of the tax assets and liabilities according the rate applicable to a sale, unless the entity plans to use the asset and the tax basis is the same whether the asset is sold or used.

Topic	Provisions in the current IAS 12 standard	Provisions in the exposure-draft
Taking into account the distribution rate	Measurement of the payable and deferred tax assets and liabilities with the applicable rate when there is no distribution.	Measurement of the current and deferred tax assets and liabilities with the entity's expected applicable rate, including the effect of the entity's expectations of future distributions.
Initial measurement of assets and liabilities whose tax basis is different from their initial carrying amount.	No deferred tax assets or liabilities.	Takes into account the difference between the tax basis and the carrying amount on initial recognition.
Temporary differences resulting from investments in subsidiaries, branches and joint ventures.	Exception to the recognition of deferred tax assets or liabilities when: * The parent or venturer is able to control the timing of the reversal of the temporary difference; and * It is probable that the temporary difference will not reverse in the foreseeable future.	Exception to the recognition of deferred tax assets or liabilities only for investments in <u>foreign</u> subsidiaries, joint ventures or branches that are essentially permanent in duration.
Temporary differences resulting from investments in associates	Exception to the recognition of deferred tax assets or liabilities when: * The investor is able to control the timing of the reversal of the temporary difference; and * It is probable that the temporary difference will not reverse in the foreseeable future.	No exception to the recognition of deferred tax assets or liabilities.
Recognition and impairment of deferred tax	Recognition of the portion of the deferred tax asset for which realisation is probable.	Recognition of deferred tax assets in full, less, if applicable, a valuation allowance to reduce the net carrying amount to the highest amount that is more likely than not to be realisable against taxable profit.

Topic	Provisions in the current IAS 12 standard	Provisions in the exposure-draft
Uncertain tax positions	Not addressed	Mandatory measurement of current and deferred tax assets and liabilities using the probability-weighted average amounts of possible outcomes, assuming that the tax authorities will examine the amounts reported to them by the entity and have full knowledge of relevant information.
Allocation of income tax to the components of comprehensive income and equity	<p>* Allocation of income tax to the components of comprehensive income and equity using a reasonable pro-rata allocation.</p> <p>* Tax recognised in equity when it relates to items directly recognised in equity <u>in a previous year</u>.</p>	<p>* Adoption of the SFAS 109 requirements for the allocation of income tax to the components of comprehensive income and equity.</p> <p>* Tax recognised in equity when it relates to items directly recognised in equity in <u>a previous year</u> (excluding any change in valuation allowance of deferred tax assets resulting from transactions with equity holders).</p>
Classification of deferred tax assets and liabilities in the statement of financial position	Classification as non-current.	Classification as either current or non-current on the basis of the related non-tax asset or liability.

# Events and FAQ

## Events/publications

### Seminars on "Current developments in IFRS"

Mazars' Technical Department will host a number of seminars throughout 2009 dedicated to current developments in IFRS. These seminars are organised by Francis Lefèbvre Formation. Sessions will be held on 19 June, 25 September and 18 December 2009.

Registration forms can be obtained from Francis Lefèbvre Formation, 13-15 rue Viète, 75017 Paris.

## Frequently asked questions

### IFRS standards

- Implementation of the debt/equity distinction to a loan;
- Treatment of bonuses granted to first-time participants in on-line gambling;
- Post-closure event: consequences of changes to a disposal plan for a discontinued operation;
- Disposal of future receivables and maturity of a liability;
- Provisions for the first application of the revised IAS 23;
- What accounting treatment for a public service concession: implementation of IFRIC 12?

## Upcoming meetings of the IASB, IFRIC and EFRAG

### IASB

18 - 22 May 2009  
15 - 19 June 2009  
20 - 24 July 2009

### IFRIC

7 - 8 May 2009  
9 - 10 July 2009  
3 - 4 September 2009

### EFRAG

4 - 5 June 2009  
8 - 10 July 2009  
7 - 9 September 2009

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