

IFRS news

The clock is ticking – 50 shopping days 'til deadline

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The IASB set itself quite a task when it announced its aim to release final standards in a number of key areas (under the Memorandum of Understanding with the FASB) before several board members – and the chairman, Sir David Tweedie – leave in June 2011.

The scale of the challenge became apparent when many constituents pointed out the risk associated with such an aggressive timetable; the IASB amended its project plan in November 2010, prioritising the projects that were most urgent. These are outlined in the table below.

Project	2011 Q1	2011 Q2
Financial instruments (IAS 39 replacement)		
Impairment (supplement – comments due 1 April 2011)		
Hedge accounting (ED – comments due 9 March 2011)		✓
Asset and liability offsetting (ED – comments due 28 April 2011)		
Consolidation		
Replacement of IAS 27	✓	
Disclosure of interests in other entities	✓	
Fair value measurement	✓	
MoU projects		
Financial statement presentation (presentation of OCI)	✓	
Leases		✓
Revenue recognition		✓
Joint ventures	✓	
Post-employment benefits	✓	
Other		
Insurance contracts		✓

The projects that were delayed in order to make the timetable feasible for the rest are:

- financial statement presentation (the replacement of IAS 1 and IAS 7);
- financial instruments with characteristics of equity;

- emissions trading schemes;
- liabilities (IAS 37 amendments); and
- income taxes.

The Board aims to resume discussing these topics after June 2011. It has also deferred publication of the EDs on investment companies and the annual improvements project.

The Board is also considering staggering the effective dates of the new standards to help management make 'an orderly transition' to the new requirements. It has published a paper outlining ways that this burden could be reduced. The deadline for comments on that paper was 31 January. We await the outcome.

Board discussions on revenue project – update



Andrea Allocco

The IASB and FASB have reached a number of decisions in their revenue recognition project. Andrea Allocco from PwC's Accounting Consulting Services Central Team provides a summary of recent discussions.

The boards addressed two fundamental issues:

- identifying separate performance obligations; and
- determining when control over goods or services is transferred.

They also reached decisions on other key areas. These decisions are tentative and subject to change. A number of issues remain to be redeliberated, including allocation of transaction price, variable consideration, accounting for licences, disclosure and transition.

Identification of separate performance obligations

Performance obligations are promises in a contract to transfer goods or services to a customer. They modified the definition to delete 'enforceable' and clarified that promises implied by an entity's business practices are performance obligations if they create expectations of performance.

The boards also discussed the identification of a 'distinct' performance obligation that should be accounted for separately. They concluded that a distinct performance

obligation exists if the entity regularly sells the good or service separately, or the customer can use the good or service on its own or together with resources readily available to the customer. The boards also decided that a bundle of goods or services should be accounted for together if the entity integrates those goods or services into a single item provided to the customer.

Transfer of goods and services

The boards agreed to modify the indicators for determining when control transfers. They plan to add 'transfer of risks and rewards of ownership' as an indicator of control, and eliminate 'the design or function of the good or service is customer-specific'.

The boards also proposed new guidance for accounting for services. A service is satisfied continuously if the entity creates or enhances an asset that the customer controls. A service might also be satisfied continuously even if performance does not create an asset that the entity can otherwise use if:

- the customer immediately receives a benefit from the tasks the entity performs;
- another entity would not need to reperform tasks already performed if it took on the remaining obligations to the customer; or
- the entity has a right to payment for work performed.

Other significant decisions

- Costs to obtain a contract can be capitalised if they are incremental and expected to be recovered. Costs of fulfilling a contract will be discussed at a future meeting.
- Only warranties that provide a service in addition to quality assurance should be accounted for as a separate performance obligation. Warranties for quality assurance should be accounted for as a cost accrual similar to current guidance.
- Onerous contract provisions will be assessed at the contract level, rather than the performance obligation level. Further debate is expected for contracts that are 'loss leaders' together with costs to be included in the onerous test.
- Interrelated contracts should be combined. Contracts might be interrelated if they are entered into

at the same time, generally with the same party, or if other factors indicate they are interrelated.

The boards' timeline indicates a final standard in June 2011. The boards will continue to redeliberate over the next few months and perform targeted consultation. We anticipate the final standard to have an effective date no earlier than 2014, given the proposed retrospective application of the new model.

Cannon Street Press

Board discussions on leasing project – update

The boards have agreed five key areas that need redeliberation following the comment letter responses and further consultation activities. These are: lease term, variable lease payments, lessor accounting, profit and loss recognition and definition of a lease.

The boards have made one tentative

decision since the redeliberation process began in January, regarding the lease term. They have tentatively agreed to define lease term as the contractual minimum lease term plus any optional periods where there is significant economic incentive to extend. This change is expected to reduce the recognised lease term for

many leases compared to the 'more likely than not' threshold in the original ED.

The boards will also consult with constituents on four other areas. The table below summarises the direction the board appear to be taking.

Key issue	Tentative direction of the board
Lessor accounting	Preparers should use IAS 17 as the starting point for lessor accounting and determine whether any proposed changes to lessee accounting should also be reflected as a change for lessor accounting.
Profit or loss recognition	The boards will develop a dual model for lessees: finance leases continue with the front-loading of expenses proposed in the ED; other-than-finance leases result in a straight-line rental expense. A new set of indicators will be developed to distinguish between finance and other-than-finance leases.
Variable lease payments	All variable payments resulting from indices/rates and hidden minimum lease payments should be estimated and included in the obligation to make rental payments. They are also exploring the inclusion of variable payments based on usage or performance where these are reasonably certain.
Definition of a lease	The boards will revise the wording of IFRIC 4, particularly around the assessment of control, to bring it more in line with revenue recognition. They are seeking input from preparers to understand the implications of the wording changes.

FASB seeks comments on IASB hedge accounting ED

The FASB has issued a discussion paper seeking feedback on the IASB's proposed revisions to hedge accounting. The IASB issued its ED on revisions to hedge accounting in December 2010. The FASB issued, in

May 2010, its own proposals on changes to hedge accounting as part of its overall ED on the accounting for financial instruments. The FASB will use the feedback it receives on the discussion paper to help in its

own deliberations about how to improve hedge accounting under US GAAP.

The FASB also raises a number of questions, in addition to those within

the IASB's ED; these relate to the IASB's proposals that would represent changes to US GAAP. The FASB and IASB's current hedging guidance contains many provisions designed to limit abuse. The IASB's proposals are trying to make hedge accounting more friendly: the FASB questions focus on whether the key changes would be understandable, operable and have conceptual merit.

Am I affected?

All entities that prepare their financial statements in accordance with US GAAP and engage in risk management activities, regardless of whether they use hedge accounting today, could be affected. The FASB intends to use the feedback from the discussion paper to help it in its redeliberations of its own hedge accounting proposal.

What's next?

The comment deadline for the discussion paper is 25 April 2011. The deadline for responding to the IASB's exposure draft is 9 March 2011. The IASB will begin its redeliberations after its comment period ends. The FASB plans to participate with the IASB in its discussions and to consider the feedback it has received, in Q2 2011.

IASB's SME Implementation Group publishes draft guidance

The IASB has published its first draft guidance on the IFRS for SMEs in form of question and answers. The draft is open for public comment for 30 days.

Although the SME Standard contains clear principles, there is limited detail or application guidance. There is therefore increased scope for different

interpretation, and there may be a need for further interpretation of some issues. The IASB has created the SME Implementation Group (SMEIG) to support the international adoption of the IFRS for SMEs and monitor its implementation.

The first set of draft Q&As relates to the scope of the SME standard.

Specifically these address whether a parent entity that itself does not have public accountability may present its separate financial statements in accordance with the IFRS for SMEs if it is part of a group that is required (or elects) to present consolidated financial statements in accordance with full IFRSs.

Transition issues from around the world: Brazil



Martin Perrie



Tadeu Cendon

This is the third article in the series about issues affecting countries that are moving to IFRS. This month, Martin Perrie and Tadeu Cendon of PwC's Accounting Consulting Services in Brazil look at accounting for concessions, communications with shareholders and implementation of IFRS by banks.

Q:What's the difference between Brazilian companies applying IFRS for the first time and Brazil hosting the 2014 World Cup?

A: If the IFRS financial statements aren't ready on time, they can't be moved to Germany!

Joking aside, we're about half-way through the reporting season, and it is the first time that most Brazilian entities are publishing IFRS consolidated financial statements. It

has been a challenge, but most Brazilian entities are managing to do what they need to do.

The number of adjustments between former Brazilian GAAP and IFRS has been small for many entities, but it's easy to underestimate the amount of effort required in preparing a full set of IFRS financial statements. The PwC Brazil illustrative financial statements have increased from 63 pages in 2009 to 119 pages in 2010. The Brazilian securities regulator (Comissão de Valores Mobiliários – CVM) last month published the results of its review of the 2009 financial statements and noted at least one problem with 80% of them (some of us were more surprised that there were as many as 20% with no issues). Related parties and financial instruments are the most common areas with problems. It is not just a

change in accounting practice; it is an important cultural change.

Concessions

Accounting for concessions has led to some debate. For example, at a meeting of the large firms, attendees discussed whether an asset should be bifurcated into an intangible or financial asset. They considered what is behind the word 'indemnification' in the concession contracts as follows: "Of course they're going to receive cash; how else could they be compensated? With a truckload of pineapples?"

One of the main areas of controversy has been whether a contract is executory or not, and therefore whether the entity needs to recognise an asset and liability at the start of the contract or just recognise payments made in the income statement over the period of the concession. Many in the electricity and toll-road sectors have been scandalised by the requirement to recognise financial liabilities on which interest accrues over the next 20 or 30 years. When the Brazilian Central Bank's reference interest rate is 11.25% (and the annual rate on a credit card is 107%), this really makes a difference. "I'll never be able to pay a dividend again", is a frequent complaint. Various industry groups have been

formed to discuss the implementation of IFRIC 12 – for example, the energy sector (generators and distributors) and toll road operators. The CPC issued application guidance on how to apply IFRIC 12 in Brazil based on these discussions.

Communication with investors

The level of communication with investors has been less timely and less extensive than it might have been – certainly compared with communications made during the European move to IFRS. This has been partly due to changes in the regulatory requirements: at first, listed companies were required to file their quarterly financial information in accordance with IFRS; the CVM later relented and allowed them to file the quarters based on old Brazilian GAAP (but to refile them under IFRS by the time they published their annual financial statements).

PwC Brazil, together with the Brazilian investor relations institute (Instituto Brasileiro de Relações com Investidores – IBRI), published a guide to IFRS for investor relations professionals. Investor reaction has been muted so far – there are occasional surveys of reporting in the financial press. Communication issues

Local background

- The adoption of IFRS in Brazil was agreed following a decision at the end of 2007 to update Brazilian Corporate Law. The change to the law gave the CVM power to issue accounting standards. This led to the setting-up of the Brazilian accounting standards setter (Comitê de Pronunciamentos Contábeis – CPC).
- The CVM allowed Brazilian companies to file consolidated financial statements prepared in accordance with IFRS from 2008 onwards. It now requires the use of IFRS in the consolidated financial statements for 31 December 2010 year ends.
- The change is not restricted to listed Brazilian companies. The CPC has issued the IFRSs and interpretations applicable as of 31 December 2010 as Brazilian GAAP (also known as CPCs); these are all applicable to all Brazilian companies, listed or otherwise (except banks, see below).
- The CPC adopted a phased approach: 14 standards were published during 2008, applicable for 31 December 2008 year-ends; a further 26 were issued in 2009, to be applied for 31 December 2010 year-ends.
- Brazilian companies are also required to apply the CPCs in their parent company financial statements. CPCs applicable to the parent-company financial statements are IFRSs, with the exception that investments in subsidiaries, joint ventures and associates are required to be equity-accounted. In practice, this means that the parent company financial statements are a kind of 'collapsed consolidation' and end up with the same equity and net income as in the consolidated financial statements.
- The CPC also issued a 'CPC for Small and Medium-sized Entities', which is a translation into Portuguese of the 'IFRS for SMEs' but can only be applied by companies with assets and revenues lower than certain limits specified in the Law.

are only really apparent when there are problems. There was one example of a CFO of a sugar producer trying to explain the business performance without being clear on the impact of the movements in the fair value of biological assets. But these communication challenges have been pretty rare.

IFRS for banks

Brazilian banks don't have to apply IFRS until 31 December 2011. The Brazilian Central Bank has permitted them to not present comparative information in their 2010 IFRS consolidated financial statements. Many banks will be taking advantage of this exemption.

Loan-loss provisioning under existing Brazilian Central Bank rules has tended to be conservative; the main question has been to what extent provisioning should be lower when applying IFRS. The banking industry has been applying a pragmatic approach to determining their provisions pending the introduction of IFRS 9; there is no point creating a perfect IAS 39 system for loan loss provisioning when it will be replaced by an IFRS 9 model within a couple of years.

The other significant issue arising in banks has been in relation to derecognition (an ugly word in English; even worse in Portuguese) of financial assets. Many small and

medium-sized banks originate loans that they then sell on to larger banks, while retaining all or most of the credit risk. These 'sales' generally resulted in the loan being derecognised under old Brazilian GAAP but will usually remain on-balance-sheet under IFRS. This is resulting in some significant adjustments, with equity being reduced by over 50% in some cases.

So, we wait to see how the management of entities that are to publish over the next few weeks cope with the stresses and strains of IFRS adoption. Will we get to the beach for *carnaval* the first week of March? Then we can pause for breath till the next phase of IFRS kicks in!

For more information on the transition to IFRS in Brazil, see the English edition of the PwC Brazil weekly IFRS newsletter **Navegador Contábil** (Accounting Navigator) www.pwc.com/br/pt/ifrs-brasil/navegador-contabil/assets/navegador-contabil-e-27.pdf

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