

# Beyond the GAAP

No.55 – April 2012

Financial instruments were in the spotlight in April! The two Boards continued their progress on the proposed "expected loss" impairment model for financial assets (Phase II of IFRS 9/Impairment), and in particular clarified how the expected loss estimate should be determined. The Boards also reached an agreement on the definition of a business model which would permit measuring financial assets at amortised cost, and on bifurcation of embedded derivatives (Reopening of Phase I of IFRS 9/ Classification and measurement).

At the beginning of May, the IASB published an exposure draft of proposed amendments to eleven IFRSs under its Annual Improvements project (cycle 2010-2012). The comment period is open until 5 September 2012.

Enjoy your reading!

Michel Barbet-Massin

Eduard Fossat

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#### Editors in chief:

Michel Barbet-Massin, Eduard Fossat

#### Columnists:

Vincent Guillard, Egle Mockaityte, Arnaud Verchère and Mathieu Vincent.

#### Contact us:

Mazars  
Exaltis, 61, rue Henri Régnault  
92 075 – La Défense – France  
Tel.: + 33 (0)1 49 97 60 00  
[www.mazars.com](http://www.mazars.com)

## News

### Trustees publish report on efficiency and effectiveness of IFRS Interpretations Committee

On 2 May 2012, the Trustees of the IFRS Foundation published a report on their review of the efficiency and effectiveness of the IFRS Interpretations Committee (formerly IFRIC).

The review, which began in 2010, took the form of a questionnaire that requested comments from interested parties and the Committee members themselves.

The Trustees' primary recommendations are as follows:

- Use a broader range of 'tools', to enable the Committee to be more responsive;
- Revise the criteria used to determine which issues the Committee should take action on;
- Improve communications on issues which the Committee decides not to address;
- Expand the Committee's outreach activities and the transparency surrounding the Committee's decisions regarding which issues to address.

The report can be accessed on the IASB's website via the following link:

<http://www.ifrs.org/Alerts/PressRelease/IC+review+May+2012.htm>

### ➤ Exposure draft on annual improvements to IFRS: 2010-2012 cycle

On 3 May 2012, the IASB published an exposure draft on its improvements to IFRS for the 2010-2012 cycle. The comment period is open until 5 September 2012.

The amendments proposed by the IASB (11 in total) pertain to the following standards and issues:

- IFRS 2 – *Share-based Payment*: definition of 'vesting condition';
- IFRS 3 – *Business Combinations*: accounting for contingent consideration in a business combination;
- IFRS 8 – *Operating Segments*: aggregation of operating segments;
- IFRS 8 – *Operating Segments*: reconciliation of the total of the reportable segments' assets to the entity's assets;
- IFRS 13 – *Fair Value Measurement*: short-term receivables and payables;
- IAS 1 – *Presentation of Financial Statements*: current/non-current classification of liabilities;
- IAS 7 – *Statement of Cash Flows*: interest paid that is capitalised;
- IAS 12 – *Income Taxes*: recognition of deferred tax assets for unrealised losses;
- IAS 16 – *Property, Plant and Equipment* and IAS 38 – *Intangible Assets*: revaluation method – proportionate restatement of accumulated depreciation;
- IAS 24 – *Related Party Disclosures*: key management personnel;
- IAS 36 – *Impairment of Assets*: harmonisation of disclosures for value in use and fair value less costs of disposal.

It is proposed that these amendments shall be mandatory for financial periods commencing on or after 1 January 2014, except for the amendments to IFRS 3 and IFRS 9 which shall be mandatory for financial periods commencing on or after 1 January 2015.

Beyond the GAAP will examine the content of this exposure draft in more detail in a future issue. In the meantime, the exposure draft can be accessed via the following link:

<http://www.ifrs.org/Current+Projects/IASB+Projects/Annual+Improvements/ED+May+2012/Exposure+draft+and+comment+letters.htm>

### ➤ SME Implementation Group publishes two new Q&As

The SMEIG (SME Implementation Group) has published two new Q&As, detailed below. This forms part of its remit to support the IASB on the implementation of the *IFRS for SMEs* by publishing guidance on implementing this standard in the form of Q&As and by making recommendations for amendments to the standard.

- **Recycling of cumulative exchange differences on disposal of a subsidiary (Q&A 2012/04)**: this Q&A stipulates that the cumulative amount of any exchange differences arising on translation of a foreign subsidiary into the group's presentation currency, and recognised in other comprehensive income, shall not be recycled into profit and loss on disposal of the subsidiary.
- **Fallback to IFRS 9 Financial Instruments (Q&A 2012/03)**: this Q&A stipulates that the option for SMEs to apply the recognition and measurement provisions of IAS 39, rather than those given in the *IFRS for SMEs*, applies solely to IAS 39. SMEs are not permitted to apply IFRS 9.

These publications are available on the IASB's website via the following link:

<http://www.ifrs.org/Alerts/SME/sme+qa+april+2012.htm>

## European matters

### ➤ EFRAG launches field-test on general hedge accounting

On 19 April 2012, the EFRAG announced that it will conduct a field-test of the Review Draft on General Hedge Accounting, in partnership with National Standard Setters in Europe who are interested in participating in the study. The EFRAG stated that so far, the ANC, ASB, ASCG and OCI have signed up.

For EFRAG, the review draft on general hedge accounting will introduce significant changes to current general hedge accounting requirements, and therefore it is necessary to do more than simply identifying any fatal flaws in the review draft.

The aims of the field-test on the proposed general hedge accounting standard are as follows:

- to test the operationality of proposals by applying them to actual transactions or instruments, and to determine whether the standard operates as intended;
- to gather information that will help to:
  - assess the quality and effects of the future accounting standard;
  - assess the usefulness of the information that will result from applying the proposals; and
  - estimate the effort required to implement and apply the proposals.

The EFRAG states in its press release that the results will:

- be used as input to the drafting of any endorsement advice on the future general hedge accounting standard; and
- be shared with the IASB.

For more details on the request for field-test participants, see the EFRAG's press release at the link below:  
<http://www.efrag.org/Front/n1-932/Field-test-for-preparers-on-the-general-hedge-accounting-Review-Draft.aspx>

### ➤ ESMA questions IFRS Interpretations Committee on restructuring of Greek government bonds

On 17 April 2012, ESMA sent a letter to the IFRS Interpretations Committee (formerly IFRIC), raising several questions relating to the accounting of the restructuring of Greek sovereign bonds.

The questions focused particularly on the appropriate accounting treatment of the exchange transaction (should it be treated as debt restructuring or as a derecognition of existing financial assets and concomitant recognition of new financial assets?) as well as on the accounting treatment of securities linked to Greece's Gross Domestic Product (GDP) which are issued in the context of this exchange.

These issues will be addressed at the Committee's next meeting on 15 May 2012.

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## IFRS 9: the two Boards make progress on impairment, classification and measurement

At April's plenary meeting, the two Boards continued their discussions on the IFRS 9 project, focusing particularly on impairment (Phase II of IFRS 9/Impairment) and on classification and measurement of financial instruments (reconsideration of Phase I of IFRS 9/ Classification and measurement). In this article, Beyond the GAAP presents a summary of the major tentative decisions taken by the Boards on these issues.

### ➤ Impairment of financial assets (Phase II of IFRS 9/ Impairment)

At the plenary meeting on 18 April, the two Boards continued work on the proposed "expected loss" impairment model for financial instruments.

#### Principles for calculating impairment amount (applicable to all buckets)

The Boards stipulated that the following principles should be applied to calculate expected credit losses, which will form the basis for the proposed impairment model:

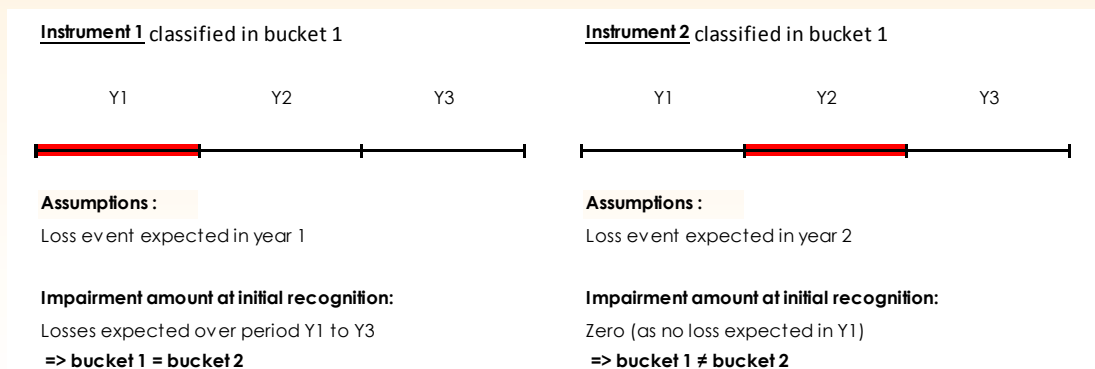
- Preparers of financial statements shall take into account all reasonable and supportable information when making the estimate.
- A range of reasonable possible outcomes and the likelihood of each outcome shall be considered when making the estimate. An estimate based solely on the most likely outcome is not sufficient.
- Finally, estimates shall take into account the time value of money.

#### Specific requirements for calculating impairment of bucket 1 assets

This issue was previously discussed in December 2011 (see Beyond the GAAP No. 51, December 2011). The Boards have now specified the time period to be taken into account when calculating the amount of impairment to be recognised on bucket 1 assets<sup>1</sup>, as follows:

- **Expected losses are cash shortfalls expected over the lifetime of the financial asset**, as for assets in buckets 2 and 3;
- **But this applies only to assets for which a "loss event" is expected over the next 12 months**; this is specific to bucket 1.

We will use a simplified example to illustrate our understanding of the proposed accounting treatment for bucket 1 assets:



The Boards have not yet defined the meaning of a "loss event".

<sup>1</sup> For recall, under the proposed general impairment framework all financial assets acquired are initially classified in bucket 1, regardless of their level of credit risk at the acquisition date. Subsequently, they are transferred to bucket 2 (portfolio basis) or bucket 3 (individual basis) when a deterioration of credit risk is identified (for more details on these aspects see previous issues of Beyond the GAAP).

The Boards also stated that other approaches could be used which do not necessarily include the "12-month probability of a loss event" criterion. However, it should be noted that without this criterion, the bucket 1 approach would *a priori* be identical to the approach used for buckets 2 and 3, namely the immediate recognition of all losses expected over the lifetime of the asset. Further clarification will probably be required on this issue.

## Impairment of trade receivables that do not have a significant financing component

The Boards continued with the discussion on trade receivables' impairment initially brought up in February (see Beyond the GAAP No. 53, February 2012), finally deciding that the expected loss model should be applied to such receivables. However, entities will be permitted to make operational simplifications using a provision matrix.

## ➤ Reopening of Phase I of IFRS 9 – Classification and measurement

### Business models permitting the measurement of financial assets at amortised cost

Readers will remember that IFRS 9, as published by the IASB in 2009, stipulated that the following condition (among others) must be met in order to measure debt instruments at amortised cost: "*the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.*" After investigating various alternative definitions, the Boards decided to retain the IASB's current definition. It should be noted that the FASB has opted to align its position with the current requirements of IFRS 9.

The future amendment to IFRS 9 is expected to include examples of business models which could or could not be considered as models with a "hold to collect" objective. In particular, examples will be provided on the frequency and nature of sales which would prohibit financial assets from qualifying for amortized cost measurement. It will be interesting to compare these examples with the current rules on financial instruments "held to maturity".

### Bifurcation of embedded derivatives

After investigating various different approaches to bifurcation of embedded derivatives, the Boards tentatively decided to continue with the IASB's current approach under IFRS 9:

- derivatives embedded in financial assets would not be bifurcated; instead, such hybrid assets would be recognised in one of the measurement categories in their entirety;
- derivatives embedded in financial liabilities would be analysed in line with the rules set out in the current standard IAS 39 (i.e. they might have to be recognised separately if their economic characteristics are not "closely related" to those of the host contract).

Once again, the FASB has chosen to align its measurement model with the current provisions of IFRS 9.

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## ➔ Frequently asked questions

### IFRS

- IFRS 11 stipulates that “other facts and circumstances” shall be taken into account when relevant: what does this mean in the case of a separate vehicle?
- If an entity opts for early application of the revised IAS 19 (subject to adoption by the EU), what will be the impact on the interim financial statements for 2012?
- Attributing licence-related borrowing costs to a qualifying asset.
- Sale-and-leaseback transactions and selling prices below market value.

## Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

### IASB

21 - 25 May 2012  
11 - 15 June 2012  
16 - 20 July 2012

### Committee

15 - 16 May 2012  
10 - 11 July 2012  
18 and 19 September 2012

### EFRAG

9 - 11 May 2012  
20 - 22 June 2012  
23 - 25 July 2012

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