

# IFRS news

Emerging issues and practical guidance\*

Issue 82 – March 2010



## Update on rate-regulated activities project

David Humphreys, the current PwC practice fellow at the IASB, provides an update on status of the Board's rate-regulated activities project. He explains that the Board is moving forward with transition relief for first-time adopters while pausing for thought on the technical aspects of the project.

The good news is that the Board agreed to transition relief for first-time adopters; this will be included in the April 2010 'Improvements to IFRSs'. The IASB staff was directed to continue working on the key technical question of the project: do regulatory assets and regulatory liabilities meet the criteria for recognition in accordance with IFRSs and the Framework?

### Mixed response to proposals

The Board was last month given an overview of the number of responses and the breadth of views expressed by respondents. The proposals received most support from North America and a mixed response from other jurisdictions, with some raising concerns as to whether the regulatory assets and regulatory liabilities meet the criteria for recognition in IFRSs and the conceptual framework. The majority of the total respondents were from the utilities industry, specifically preparers.

Some commentators were concerned that the exposure draft did not include sufficient arguments to explain how the Framework definitions of assets and liabilities were met. As a result, the Board requested that the staff prepare further analysis which is expected to include:

- Arguments for and against the recognition of regulatory assets and regulatory liabilities included in the comment letters;
- Guidance in the current Framework and any potential impact of the 'Conceptual Framework' project; and
- The rationale for recognising assets and liabilities under current IFRSs in comparison with other IASB projects.

### Project timetable and paths forward

#### History

- The exposure draft on rate-regulated activities was published in July 2009.
- Transition to IFRS in Canada was partly responsible for the question of regulatory assets and regulatory liabilities coming before the Board.
- 155 comment letters were received.
- The Board is considering responses and next steps.

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The original project was planned to accommodate the IFRS transition timeline in Canada. Canadian utility companies had hoped for a final standard in Q2 2010 to facilitate transition to IFRS in 2011. The breadth of the responses and the Board's need to address some of the matters below may have a significant impact on the project timetable.

- The nature and extent of the Board's re-deliberations on whether regulatory assets and regulatory liabilities exist in accordance with current IFRSs, including the Framework.
- Scope of the project (for example, should the scope be adjusted to have a more principles-based approach or should it be defined more narrowly at the risk of being perceived as an 'industry-specific' standard).
- The measurement model to be used (for example, should a cost accumulation or 'best estimate' approach be used

instead of the proposed 'expected present value' model).

- The path forward chosen by the Board. This could include addressing the issue of regulatory assets and liabilities by:
  - finalising a standalone IFRS;
  - amending current IFRS (for example, guidance in IAS 38 'Intangible assets', or IAS 18, 'Revenue');
  - issuing a disclosure-only standard; or
  - choosing to significantly defer or even cancel the project.

Interested parties should look for transition relief guidance to appear in the April 2010 'Improvements to IFRSs' and monitor developments to track the future direction and timing of the project.

## Cannon Street Press

### IASB decides measurement of financial liabilities

The IASB and FASB last month discussed the measurement of financial liabilities (part of the IASB's project to replace IAS 39). The IASB's tentative decisions effectively retain the measurement requirements in IAS 39, 'Financial instruments: Recognition and measurement', for financial liabilities, except for proposed changes to the fair value option.

The IASB tentatively decided that financial liabilities should be measured at amortised cost if they are not held for trading, and if they do not have embedded derivative features that would require bifurcation under IAS 39. Financial liabilities held for trading should be measured at fair value through profit or loss. The existing bifurcation requirements in IAS 39 would be retained for financial liabilities that are held to pay contractual cash flows and contain embedded derivatives. This tentative decision responds to issues raised about recognising gains or losses arising from changes in an entity's own credit risk.

The IASB tentatively decided to retain the fair value option and carry forward the eligibility conditions in IAS 39. However, to respond to issues raised about recognising gains or losses arising from changes in an entity's own credit risk, it tentatively decided that for all financial liabilities designated under the fair value option, an entity should:

- recognise the total fair value change in profit or loss; and
- recognise the portion attributable to changes in own credit risk in other comprehensive income (with an offsetting entry to profit or loss).

Amounts recognised in other comprehensive income would never be recycled into profit or loss.

The IASB is expected to continue its deliberations on financial liabilities in March.

### Boards discuss recognising investment at fair value

The IASB and FASB are discussing radical changes to investment company accounting for controlled subsidiaries. The key issue is whether an investment entity should account for its controlled investments in the same way as a multinational group accounts for its subsidiaries.

ED 10, 'Consolidated financial statements', proposes that all controlled subsidiaries should be consolidated in full. The latest proposals from the Boards may allow funds to recognise subsidiary investments as assets at fair value.

#### What is the issue?

Investment companies acquire interests in other entities – these maybe a controlling stake or not – with a view to realising these investments in the near to medium term – generally five years or less. They do not integrate these interests, even where controlled, into their own operations. The investments are generally managed on a fair value basis.

Users of the financial statements of these investment companies claim that the most useful information is the fair value of the investments; consolidated financial statements are not meaningful for evaluating the company's performance.

The Boards have tentatively decided that there should be an exception to the normal consolidation basis for investment companies. Their investments should be accounted for as single assets at fair value, with fair value changes recognised in profit or loss. The IASB therefore tentatively agreed to amend the current wording in ED 10. The FASB agreed to develop similar guidance for the US GAAP part of the joint consolidation project. An investment company that measures its investments at fair value would be required to provide additional disclosures.

The term 'investment company' is a known expression in US accounting practice but is not defined in IFRS. The Boards agreed that guidance will be added to identify which entities should be considered investment companies. Such guidance is expected to include the characteristics of the reporting entity and the relationship between the (primary) reporting entity – which is the investment company – and its investments. Key attributes of an investment company would be:

- Primary business activity involves investing in assets for capital appreciation and investment income.
- Ownership is represented by units to which proportionate shares of net assets can be attributed.
- Structure exists to pool the investor's funds to avail owners of professional investment management services.

#### Who is affected?

IFRS reporters that are mutual funds, unit investment trusts, hedge funds and private equity funds may be considered investment companies. Accounting for subsidiaries as investments at fair value through profit or loss would give very different information compared to full consolidation. The amount of work involved in preparing consolidated financial statements could also be greatly reduced.

#### What does management need to do?

The Boards will be discussing this issue further at future meetings, and interested parties should monitor developments in that discussion. Should the issue be re-exposed for comment, it will be important for preparers and users to assess whether the proposals are practical and will lead to better financial information, and to respond to the exposure draft explaining their point of view.

### 'Full ED' of IAS 37 replacement now out

The Board has published the entire working draft of the standard to replace IAS 37, 'Provisions, contingent liabilities and contingent assets'. This draft is based on proposals published for comment in 2005, amended for decisions the IASB has taken in the light of comments it received. It includes revised measurement proposals that the IASB published

separately for comment in January this year (see *IFRS news*, February 2010).

The Board has published the entire working draft to enable interested parties to see the revised measurement proposals in the context of the IFRS as a whole.

## New appointments at the board

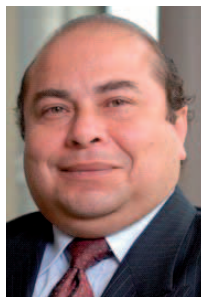
The board has announced the appointment of two new members. Dr Elke König, CFO of Hannover Re Group in Germany, and Darrel Scott, CFO of the FirstRand Banking Group in South Africa, take up their five-year terms from July and October 2010 respectively. They replace Bob Garnett and Gilbert Gélard, who retire at the end of June. The search continues for a replacement for Jim Leisenring, who also retires at the end of June.



**Dr König** was CFO of reinsurance group Hannover Re from 2002 to 2009. She was a member of the senior management of Munich Re before that, with responsibility for the group's accounting and controlling activities. She is currently non-executive chairperson of investment bank Hannover Finanz GmbH and a member of the supervisory board of mortgage bank Deutsche Hypothekbank Aktiengesellschaft. Dr König has also been a member of the European Insurance CFO Forum, where she was involved in the IASB's project on insurance contracts.



**Mr Scott** is CFO of the FirstRand Banking Group. He has responsibility for statutory and regulatory financial reporting under the Basel II Accords. He also serves on the group's governance, risk, operation and strategic committees. He is a member of the IFRIC but will resign his membership when he becomes an IASB member. He is also a former member of the IASC Foundation's Standards Advisory Council (SAC).



## The adoption of IFRS in South America

**Luis W Montero, partner in PwC's Accounting Consulting Services group in Peru, looks at the path to IFRS in his country and gives an overview of the progress being made in the move towards IFRS in the rest of South America.**

When I was a student of the accounting faculty of the University of Lima (Peru), by the end of the 1970s, a young professor introduced his students to a new accounting framework, the International Accounting Standards issued by the International Accounting Standards Committee. As students, we had to acquire the updated version of such accounting standards, the text of which I still keep in my library as a treasured antique. Reviewing the content of this book makes me think how far the accounting profession in Peru has come; just recall that, by that time, the IASB had only issued 13 standards.

The Peruvian Institute of Public Accountants (IPA) recommended the application of IAS during the mid 1980s as the accounting principles to be applied in Peru. However, because the accounting in Peru is established by law and by the government's standard setter, the National Accounting Board (NAB), financial statements were usually prepared applying tax rules and following the legal form of the transactions rather than the accounting principles recommended by the IPA. It was not rare to see financial statements showing pre-operating expenses, research expenses, internally generated goodwill – among other expenses – as assets. Furthermore, it was common for an entity that had to account for a complex transaction, such as a reverse acquisition, to look for the advice of legal counsellors rather than accountants. In other words, accounting was supported on the principle 'legal form over substance'.

But things changed in 1989. The 'New Corporate Law' (still in force) introduced a different concept for the preparation of financial statements. It establishes that financial statements must be prepared in accordance with applicable laws on the matter (none existing then nor today) and local generally accepted accounting principles. Immediately after the law was issued, the NAB issued a Resolution ruling that the local generally accepted accounting principles referred to in the Corporate Law are IAS (today IFRS) as approved by Resolutions issued by the NAB.

This change in the Peruvian rules was revolutionary. From 1989, companies in Peru began to apply IAS for the preparation of their financial statements. It was not an easy task to explain to management the impacts of the change in their accounts. Major concerns arose from the accounting treatment of business combinations, goodwill, depreciation, intangibles, deferred income tax, and leases, among others. The information shown in the financial statements changed significantly.

Is it fair to say today that the financial statements in Peru are prepared according with IFRS? The answer still is no. Peruvian rules establish that the local accounting principles are those endorsed by the NAB. Despite the efforts made by this entity, the Peruvian accounting framework today has not endorsed any standard, interpretation or revisions made by the IASB since 2005.

The accounting profession, the auditor's big firms and the regulators are working together preparing a rule that will obligate public companies to be in full compliance with IFRS by 2011. The project also contemplates permitting the adoption of IFRS for small entities by those non-public entities that comply with the small entities' definition in the standard.

Below is a snapshot of IFRS adoption in the rest of the region.

### Argentina

IFRS is mandatory in Argentina for public companies (except banks and other financial institutions) for accounting periods beginning on or after 1 January 2012. Early adoption is permitted for years beginning on or after 1 January 2011. Non-public companies continue to follow Argentinean GAAP.

### Bolivia

The Association of Auditors and Accountants of Bolivia (CACB) has for several years been preparing a local standard framework convergent with IFRS, with the support of the International Bank of Development.

The technical body of the CACB, the Technical Council of Auditors and Accountants of Bolivia, performed the steps necessary for Bolivia to fully converge with IFRS from 1 January 2010. The CACB in December 2009 issued a draft of the 15 standards that must be approved in the near future by the Authority of Fiscalisation and Social Control of Enterprises of Bolivia (government accounting standard setter) before their mandatory application. These standards are IASs 1, 2, 8, 10, 16, 17, 18, 21, 23, 27, 29, 37 and 41, and IFRSs 5 and 7. It is expected that, in 2010, the CACB jointly with the government accounting standard setter will issue and approve the rest of the IFRSs issued internationally.

## Brazil

IFRS is mandatory for the consolidated financial statements of listed entities, including banks and insurance companies, from 1 January 2010. However, a number of options permitted under IFRS have been eliminated by local regulators.

Brazilian GAAP has significantly changed in the last two years. The changes are being made by the newly established Brazilian accounting standards setter, the Comitê de Pronunciamentos Contábeis, which is replacing previous accounting standards with new standards based on IFRS. Brazilian GAAP is the relevant accounting framework for the financial statements not required to be prepared under IFRS, including large private companies and financial statements of the parent companies.

As the income tax calculation is a quasi-dependent regime, the new local GAAP figures are the initial basis of calculation, but the impact of these new standards has to be adjusted to arrive at taxable income. IFRS for SMEs as adopted in Brazil is available for companies other than those required to present IFRS and the large private companies.

Recently, the Brazilian accounting standards setter and the Brazilian Federal Counsel of Accountants signed a memorandum of understanding with the IASB, which aims to increase the level of convergence between IFRS and Brazilian GAAP, including increased participation from these Brazilian bodies in the development of new standards by IASB.

## Chile

IFRS is mandatory for public companies, for accounting periods beginning on or after 1 January 2009. In addition, Chilean GAAP has converged with IFRS. Insurance companies are required to present full IFRS financial statements in 2010. Banks are required to do the same, with some exceptions (see *IFRS news*, June 2008). Chilean GAAP, now converged with IFRS, is mandatory for unlisted entities, for both consolidated and stand-alone financial statements.

## Colombia

There is a current government initiative to adopt IFRS in the near term. The Superintendencia de Servicios Públicos Domiciliarios issued several rules that require companies under its supervision to initiate the IFRS adoption process from 2010. Other Colombian entities will apply an accounting framework based on an international model; this will be prepared by a task group, which is still to be established.

## Ecuador

Ecuador is also following this path. In November 2008, the Superintendencia de Compañías established a calendar for the adoption of IFRS between 2010 and 2012, depending on the type of entity.

- Entities that come under the local Stock Market Law will adopt IFRS in 2010.

- Entities that have assets totalling more than US\$4 million as at 31 December 2007, including holding companies, public sector business entities and branches of foreign companies, will adopt IFRS in 2011.
- All other entities will adopt IFRS in 2012.

## Paraguay

The National Stock Commission, the Superintendencia de Bancos and the Superintendencia de Seguros, is analysing the future adoption of IFRS (Paraguay must adhere to the standards adopted by the other member countries of Mercosur). It originally planned to adopt IFRS by 2012, but it is more than likely that the adoption will be delayed.

## Uruguay

Local accounting decrees were issued in 1991 and 2004 requiring Uruguayan GAAP to converge with IASs. However, significant differences between the frameworks remained. Another decree in July 2007 declared that the IFRSs internationally in force at July 2007 were mandatory for the accounting periods beginning on or after 1 January 2009. A set of accounting standards was also approved for small entities based on IFRSs (some IFRS such as IAS 39 are not required), from July 2007. However, the first reporting date under full IFRS has not yet been established.

These rules do not apply to Uruguayan banks and other financial institutions. They must follow local GAAP as established by the Central Bank. These accounting rules defer significantly from IFRS.

## Venezuela

IFRS applied for all 'big' companies for annual periods ending on or after 31 December 2008. SMEs and companies reporting under the National Stock Market Regulator rules (Comisión Nacional de Valores) will report under the IFRS for SMEs for annual periods ending on or after 31 December 2010. A current project proposes to push back the application of IFRS for SMEs to periods ending on or after 31 December 2011. The comment period on this ends in March 2010.

The IFRSs applied locally are those as endorsed by the local accountancy body (FCCPV). The current endorsed version approved by the FCCPV does not include the improvements and amendments made by the IASB after 2008. The current version of IFRS adopted in Venezuela also differs slightly from IFRS as issued by the IASB in respect of IAS 29 and IAS 21.

Financial institutions currently report under the rules established by SUDEBAN (the banking regulatory authority). Financial institutions have to report, as 'supplementary' information, a set of financial statements under IFRS accompanying the main financial statements issued according to SUDEBAN rules.

South American countries have recognised the need to adopt a single accounting framework and are convinced that IFRS is, globally, the most accepted accounting framework.



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