IFRS LINK

Contents

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CHARTERED ACCOUNTANTS

Publications of IFRS Rules by the IASB

The publications presented below relate to the period from April 2013 up to and including July 2013.

Exposure Draft on regulatory deferral accounts

On 25 April 2013, the IASB issued the Exposure Draft ED/2013/5 Regulatory Deferral Accounts in connection with accounting for rate-regulated activities. While many countries already have specific guidelines for recognising assets and liabilities for an entity operating in a rate-regulated environment, there are not yet any IFRS regulations in relation to this issue. Until such time as the IASB will have concluded the long-term project on rate-regulated activities, the interim Standard ED/2013/5 aims to give entities the possibility to also account for the effects of rate regulation under IFRS. According to the exposure draft, users can continue to apply national accounting regulations for the recognition and measurement of regulatory deferral accounts in the IFRS financial statements. The exposure draft provides for special recognition requirements and disclosures in the notes for such cases.

The background to the project is the fact that numerous entities – in the transport and utilities industries in particular – are subject to rate regulation, which has a significant impact on the income of an entity. The regulated rates that an entity can charge may result in economic benefits or disadvantages for the entity, which entities have so far accounted for in different ways (either as deferrals or as income/expenses). In accordance with the exposure draft, there will be new items in the statement of financial position called Regulatory deferral account debit balances and Regulatory deferral account credit balances which will be presented in separate lines in the statement of financial position and changes to these items will be shown in the income statement and in the statement of comprehensive income.

In addition, entities have to make disclosures concerning the risk and cash flows of the rate-regulated activities as well as the content and reversal of the deferral accounts.

In order for the entities to be able to apply the Standard, certain prerequisites must be met. One of these is an authorised body that regulates the price that the entity can charge its customers for goods and services. The other is that the regulated rate must cover the entity's allowable cost of providing the goods or services.

The proposed Standard is only relevant for entities that are first-time adopters of IFRS; the regulation must be applied at the same time as IFRS 1. ED/2013/5 therefore does not apply to entities operating in a rate-regulated environment that already apply IFRS.

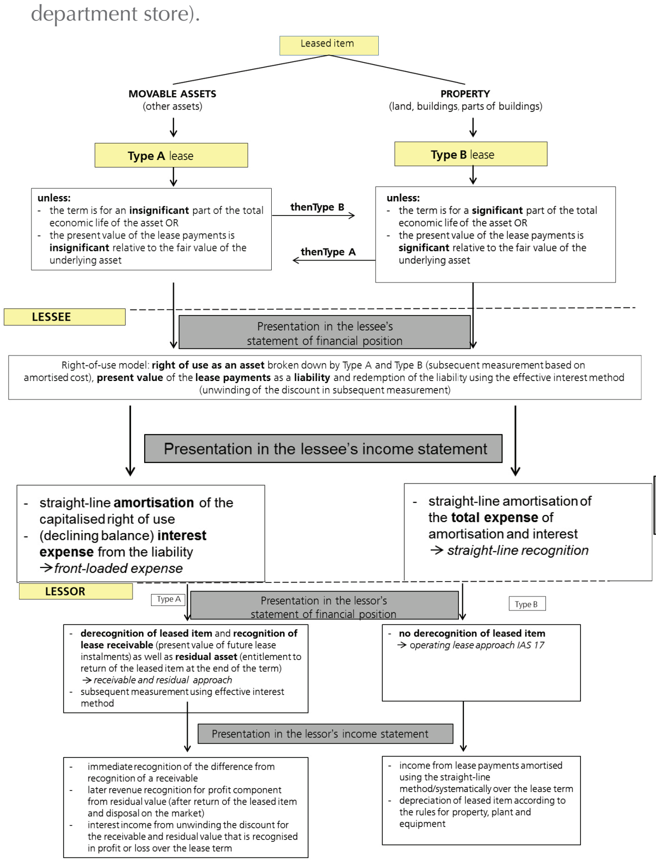
Exposure Draft on leases

As part of their joint project on leases, the IASB and FASB issued the second exposure draft (ED/2013/6) Leases on 16 May 2013. After a two-year discussion phase, this second exposure draft incorporates the responses to the first exposure draft ED/2010/9. One of the criticisms was the front-loading of expense recognition in the lessee model which resulted in a lack of useful information for decision-making. The second exposure draft aims to reduce this front-loading of the expense recognition for certain leases. A definitive Standard would replace the applicable provisions of IAS 17 Leases. The revised second exposure draft defines a lease as a contract that conveys the right to use an identifiable asset for a period of time in exchange for consideration.

What remains unchanged compared with the first exposure draft ED/2010/9 is that the lessee must account for all leases using the right-of-use model (recognition of an asset as a right to use the leased item and recognition of a liability from the obligation to pay the lease instalments). There is an exception for leases with a term of less than 12 months; for these short-term leases, the new Standard provides an option regarding recognition in the statement of financial position. Additionally, the distinction between finance leases and operating leases – as made in IAS 17 to date – will be removed.

- **Important changes in the new Exposure Draft ED/2013/6:**

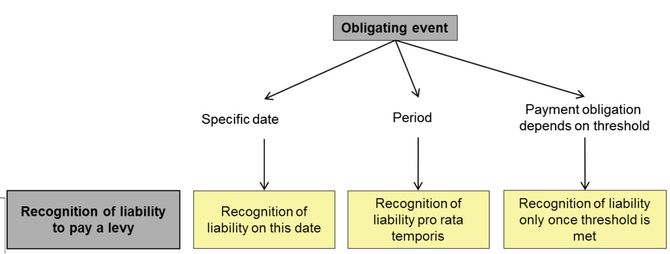
The major change in the new exposure draft is the dual accounting model both for lessees and for lessors (in particular the dual recognition of the lease expense for the lessee) and the related classification model for leases. The classification as a Type A lease or Type B lease is based on the type of leased item and the length of the lease term in relation to the useful life. Provided that the leased item is not property, the lease is treated as an acquisition financed by a loan. For Type B leases it is assumed that the financing aspect is not a priority. The lease term is defined as the non-cancellable period for which a lessee has the right to use an underlying asset, together with periods covered by an option to extend the lease and periods covered by an option to terminate the lease if the lessee has a significant economic incentive to exercise or not exercise the option respectively. Lease payments do not include contingent lease payments that depend on utilisation or performance (e.g. air miles travelled within an airplane or revenue earned of a department store).



The new classification rules lead to major changes in particular for lessors that lease movable assets such as vehicles and for lessees if these agreements were previously classified as an operating lease. One critical point is seen in relation to potential discretionary decisions in classifying the economic useful life as well as in assessing the "significant part" with regard to the term and the present value of the lease payments, while another relates to the fundamental distinction that a lease on property is an operating transaction whereas in other areas it primarily relates to financing. What is certain, however, is that lessees in particular must present all leases (with the exception of short-term leases) in the statement of financial position. This will have to entail more in-depth evaluation of existing contracts for the entities.

Interpretation on accounting for obligations to pay levies

On 20 May 2013, the IASB issued the Interpretation IFRIC 21 Levies, which clarifies the timing for the recognition of provisions pursuant to IAS 37 Provisions, Contingent Liabilities and Contingent Assets as well as of liabilities for levies. These relate to levies imposed by governments in accordance with legislation. In Germany, the main area of application for IFRIC 21 involves financial institutions with the so-called bank levy. The Interpretation was issued in response to the predominance of different accounting used in practice with respect to the date of recognising obligations for payment. Accounting differences resulted in particular in cases where obligations to make payments arise on the basis of prior-year figures (such as revenue or units produced) in a fiscal year or only when certain thresholds are met. The scope of application of IFRIC 21 does not apply to payment obligations that fall under the scope of other standards, such as IAS 12 Income Taxes as well as penalties and fines.
According to IFRIC 21, an "obligating event" leads to recognition of a liability to pay a levy. An "obligating event" is an event identified by the legislation which triggers the payment of the levy. There are three basic scenarios:



If a levy is due as soon as an entity becomes active on a market for the first time and if the levy is not profit based, the fee must be recognised as a liability in full on the date of initial market entry. If the fee is profit based, the liability must be recognised pro rata temporis. In the case of profit-based levies in interim financial statements, only those expenses are recognised that relate to profit recorded between the last cut-off date and the date of interim reporting.

Examples for the recognition of payment obligations:

• **Duty to pay a levy based on past revenue**
Entity E is obliged by law to pay a levy as soon as it records revenue in a fiscal year. The levy amounts to 3% of the prior-year revenue figure. In the prior year, 2012, entity E recorded revenue of EUR 2,000 k. In 2013, E records its first revenue on 4 January.

No liability has to be recognised in the 2012 financial statements, as the triggering event for the duty to pay the levy is the first recording of revenue on 4 January 2013. This means that the payment obligation arose in the interim financial statements as of Q1 2013 and a liability of EUR 60 k (3% of EUR 2,000 k) has to be recognised in those financial statements. As a general rule: no amounts are deferred for the following fiscal year on the cut-off date if the event triggering the levy does not take place until after the cut-off date. This applies even if it is already certain as of the reporting date that activities will be carried out in the next reporting year which will trigger a duty to pay a levy.

• **Duty to pay a levy based on meeting threshold values**
Entity E must pay a levy if it records revenue of more than EUR 2,500 k. The levy amounts to 3% of the revenue figure. The entity reaches accumulated revenue of EUR 2,500 k on 15 July. Accumulated revenue totals EUR 3,000 k as of the end of Q3, and amounts to EUR 4,000 k as of 31 December 2013.

Entity E does not have to recognise any liability in the interim financial statements for Q1 and Q2, as the threshold triggering the duty to pay the levy had not yet been exceeded. An obligation of EUR 90 k must be recognised for Q3 (3% of EUR 3,000 k), which must be increased to EUR 120 k (3% of EUR 4,000 k) as of the end of the year.

Standards amendment on disclosures in the notes for the measurement of the recoverable amount

On 29 May 2013, the IASB issued the amendments to IAS 36 Impairment of Assets – Recoverable Amount Disclosures for Non-Financial Assets.

According to the new rules, the duty to disclose information about the recoverable amount has been relaxed; the disclosure of the recoverable amount is only required for assets and cash-generating units if an impairment loss was recorded or reversed in the current period. Previously, it was necessary to disclose the recoverable amount of every cash-generating unit that had significant goodwill or significant intangible assets with indefinite useful lives pertaining to it, even if no impairment loss was recorded or reversed. This amendment (as a result of the new IFRS 13) was broader than intended by the IASB.

The amendments also include further disclosure requirements if an asset is impaired and the recoverable amount was determined on the basis of the fair value less costs of disposal. Among other things, an entity must disclose which valuation technique was used and at which of the three levels described in IFRS 13 fair value measurement took place. In the case of Level 2 and 3 measurements, the key assumptions and the discount rate used must be disclosed.

Exposure Draft on accounting for insurance contracts

On 20 June 2013, the IASB issued the revised Exposure Draft ED/2013/7 Insurance Contracts, having already issued the first Exposure Draft ED/2010/8 on accounting for insurance contracts in July 2010. The aim of the exposure draft is to provide a consistent basis for accounting for insurance contracts for all entities and thus to improve comparability. The exposure draft is to replace the currently applicable IFRS 4 Insurance Contracts, as the latter permits some local accounting practices. The exposure draft also aims to improve the understanding of the nature, amount and timing as well as the uncertainty of cash flows resulting from insurance contracts. Like the previous exposure draft, a measurement model is proposed that comprises four components: estimating cash flows, discounting to reflect the time value of money, risk adjustment as well as the contractual service margin, which represents the unearned profit of the insurer for the service to be provided as part of the insurance contract.

The following five core topics have changed significantly compared to the first exposure draft:

1. Treatment of measurement changes in OCI
Unlike the recognition in profit or loss of all effects from updating the discount rate (difference between the actual market interest rate on the measurement date and the historical discount rate from initial recognition) provided for in the first exposure draft, the second exposure draft provides for these effects to be shown in Other Comprehensive Income (OCI). This applies to all cases in which the cash flows presented are independent of the development of the underlying capital investment.

2. Adjustment of the contractual service margin (unlocking)
Changes in cash flows for future services are no longer recognised immediately in profit or loss, but offset instead against the contractual service margin (unearned profit) without an effect on income. However, changes in cash flows that are larger than the service margin are still recognised in profit or loss (because the service margin cannot be negative).

3. Mirroring
In the case of insurance contracts with profit participation or tied to a fund, the future payments to the policyholder depend on the returns on the underlying capital investment.
According to the new exposure draft, the contractual payments

must be broken down to allow for a distinction between those cash flows that depend directly on returns on the capital investment and those that do not (such as fixed payments and guarantees), as the accounting is based on this factor. For the share of the obligation which has cash flows that vary directly with returns on the capital investment, the accounting mirrors the book value of the underlying capital investment. For the share of the obligation which has cash flow changes reported in OCI, measurement is performed in accordance with the component approach contained in the exposure draft.

4. Volume information by disclosure of income and expenses from insurance contracts
Income in the statement of comprehensive income is now presented based on information on volume. The insurer must distribute the income over the individual periods in accordance with the expected payments over the period of cover. This means that the payments must be split into a portion that relates to future coverage (this is added to the service margin) and a portion that stems from old claims to damages that have not yet been fulfilled and that was recognised as an insurance expense.

5. Transition provision for first-time adoption
The new exposure draft requires retrospective application to insurance contracts that are in the portfolio upon transition; however, it does provide for some simplifications in determining the individual components.

Exposure Draft on fruit-bearing plants in agriculture

On 26 June 2013, the IASB issued the Exposure Draft (ED/2013/8) Agriculture: Bearer Plants, proposing amendments to IAS 16 Property, Plant and Equipment and IAS 41 Agriculture. Pursuant to the exposure draft, bearer plants should in future fall under the scope of IAS 16 Property, Plant and Equipment.

Up until now, biological assets related to agricultural activity (including bearer plants) have been accounted for at fair value less costs to sell under IAS 41, as the prevailing opinion is that the fair value best reflects the biological transformation process of such biological assets.

However, in the case of plants that have reached maturity (e.g. vines or cotton plants), significant biological transformation is no longer assumed, as they generate produce up until the end of their useful life. Consequently, the Exposure Draft ED/2013/8 proposes that mature bearer plants be accounted for as property, plant and equipment in accordance with the rules of IAS 16, provided that the following conditions are met:
• the plant is used in the production of agricultural produce
• the plant has an expected useful life of more than one period
• the plant itself will not be sold or harvested as agricultural produce.

Plants that do not meet these conditions will continue to be accounted for as consumable biological assets according to IAS 41. Pursuant to the transition provision, it is to be possible to use the carrying amount measured to date in line with IAS 41 as deemed cost.

Standards amendment on novation of derivatives

On 27 June 2013, the IASB issued the standards amendment Financial Instruments – Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39 and IFRS 9). The amendments aim to improve transparency and simplify regulatory oversight of over-the-counter (OTC) derivatives. The amendments were prompted by a commitment by the G20 States to introduce more stringent regulation and oversight of OTC derivatives, which includes a clearing duty for these derivatives. The EU subsequently issued the "Regulation on OTC derivatives, central counterparties and trade repositories" which took effect on 26 August 2012.

A major part of the amendments is the creation of a central counterparty that has to be the contractual partner to a standardised OTC derivative in order to reduce default risk. The exposure draft aims to avoid the new regulatory framework having an influence on the hedge accounting recognised by an entity as a result of derecognition of the derivative.

According to the rules in IAS 39 to date, a change in the counterparty to a derivative automatically led to derecognition of the derivative. This also led directly to discontinuation of the hedge accounting. However, any resulting need to redesignate the hedge generally led to greater ineffectiveness, as the fair value of the derivative underlying the novation was only equal to zero in exceptional circumstances. This consequence is to be avoided by means of the published amendments to IAS 39, which were also transferred to IFRS 9. In the event of a novation due to a change in the counterparty, a derivative does not have to be derecognised if the following conditions are cumulatively met:
• the novation takes place due to laws or regulations
• the novation results in a central counterparty becoming the counterparty to both of the original contractual partners
• adjustments to the contractual terms and conditions are limited to those that are necessary for transfer to the central counterparty.

The scope of the admissible adjustments to the contractual terms and conditions is narrow: such adjustments are only permissible to the extent that they reflect the conditions currently applicable for the derivative. If, for example, the nominal value or the term of the original derivative is changed, the exception no longer applies and the derivative would have to be derecognised and again recognised based on the novation.

Discussion paper on the review of the conceptual framework

On 18 July 2013, the IASB issued the Discussion Paper (DP/2013/1) Review of the Conceptual Framework for Financial Reporting. As part of the agenda consultation in 2011, many of those queried were in favour of returning to the process of reviewing the conceptual framework that commenced in 2010 but which had ground to a halt.

In view of problematic applications in practice, the IASB proposes among other things additional guidance for defining assets and liabilities, an improved wording to define equity as well as the introduction of regular measurement of equity entitlements, the introduction of derecognition rules, guidelines to distinguish the income statement from other comprehensive income and the provision of a framework for presentation and disclosure in the notes. The IASB asks for comments until 14 January 2014.

Adoption of IFRS standards by the EU

Standards adopted

In the Official Journal dated 5 April 2013, the European Union issued Regulation (EU) No. 313/2013 of 4 April 2013 amending Regulation (EC) No. 1126/2008 which adopts certain international accounting standards in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council. By way of this regulation, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities (Transition Guidance) are adopted for application in the EU.

Update of standards not yet adopted

On 22 July 2013, the EFRAG (European Financial Reporting Advisory Group) issued the current EU endorsement status report.

As of 22 July 2013, the following 5 IASB pronouncements have not yet been endorsed for adoption in Europe:

New Standards

IFRS 7 and IFRS 9	Financial Instruments (12 November 2009) and subsequent amendments to IFRS 9 and IFRS 7 (16 December 2011)

Amendments to Standards

IFRS 10, IFRS 12 and IAS 27	Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27) (31 October 2012)
IAS 36	Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36) (29 May 2013)
IAS 39 and IFRS 9	Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39 and IFRS 9) (27 June 2013)

Interpretations

IFRIC 21	Levies (20 May 2013)

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