

Accounting Alert

Special update



In this issue:

- Exposure Draft Measurement of Liabilities in IAS 37
- Proposed Amendments to NZ IAS 26 for Retirement Benefit Plans
- Securities Commission Cycle 10 Results
- Other Topics of Interest

The latest IASB work programme issued in November 2009 indicates a busy year to come. Exposure drafts or finalised standards are expected covering topics of financial instruments (hedging, impairment, derecognition), consolidation, lease accounting, revenue recognition, financial statement presentation, insurance, liabilities, equity and more. If you also consider interpretations, annual improvements and any other fast tracked projects, there is a very challenging year ahead for all of us!

This Accounting Alert provides you with information about a number of recent developments in financial reporting, including exposure drafts issued by the IASB and FRBSB. We will continue to keep you apprised of developments as they occur, so watch this space...

Exposure Draft Measurement of Liabilities in IAS 37

Revising the accounting for non-financial liabilities has been on the IASB's work programme for a while, with an exposure draft issued in 2005. The IASB has been debating issues raised by respondents and decided to issue another exposure draft on its refinement of the proposed measurement requirements for liabilities in the scope of IAS 37: *Provisions, Contingent Liabilities and Contingent Assets*. IAS 37 applies to liabilities not covered by other accounting standards, including liabilities to decommission assets, environmental liabilities, obligations under onerous contracts, and liabilities arising from legal disputes. The exposure draft makes the following proposals:

- The revised exposure draft does not have a test of 'probability of outflows' in order to record a liability. Any uncertainty in cash flows is reflected in the

measurement of expected value using a probability weighted average of the outflows, using a range of possible outcomes.

- Measurement of liabilities within the scope of IAS 37 would be the amount the entity would rationally pay at the measurement date to be relieved of the liability. This would normally be an estimate of the present value of the resources required to fulfil the liability, taking into account the expected outflows of resources, the time value of money, and the risk that the actual outflows might ultimately differ from the expected outflows.
- If the liability is to pay cash to a counterparty (for example to settle a legal dispute), the outflows would be the expected cash payments plus any associated costs, such as legal fees.
- If the liability is to undertake a service (for example, to decommission plant) at a future date, the outflows would be the amounts that the entity estimates it would pay a contractor at the future date to undertake the service on its behalf. If there isn't a market for contractors, then the entity determines what it would charge another party at the future date to undertake the service – based on the costs the entity is expected to incur and the profit margin it would require.

Six of the fifteen members of the IASB dissented on issuing the exposure draft on the basis that including a hypothetical profit margin leads to inappropriate financial performance information. Submissions are therefore expected on this point.

Illustrative Example

Entity A is defending a legal claim by a customer for \$1 million. Based on legal advice, management estimate that there is a 40% likelihood that the claim will be successful requiring Entity A to pay \$1 million to the customer. The likelihood that Entity A will defend the claim and not be required to pay anything to the customer is 60%.

Under the existing requirements of NZ IAS 37, no provision would be recognised in these circumstances because an outflow of resources is not considered probable (i.e. more likely than not). The legal claim meets the definition of a contingent liability and appropriate disclosures should be made in accordance with NZ IAS 37.86.

Under the current proposals, a provision of \$420,000 would be recognised, measured at expected value using a probability-weighted average of the outflows for the range of possible outcomes, as follows:

Outcome (present value)	Probability	Amount
\$1,000,000	40%	\$400,000
Nil	60%	\$0
		\$400,000
	Risk adjustment (5%)	\$20,000
	Total provision	\$420,000

The exposure draft also includes an illustrative example demonstrating how an entity might measure an obligation to dismantle an asset.

The IASB is expecting to finalise the revised standard later this year. As the revised standard would lead to more liabilities being recorded on the statement of financial position, we recommend that you consider early what impact the revised standard might have on banking covenants, future profitability and market reactions. Submissions on this exposure draft are due to the FRSB by 19 March 2010, and to the IASB by 12 April 2010.

Further information can be found in the Deloitte IAS Plus Newsletter: [IASB refines proposals for the measurement of liabilities](#).

The [Exposure Draft](#) is available on the NZICA website.

Proposed Amendments to NZ IAS 26 for Retirement Benefit Plans

An exposure draft has been issued by the FRSB seeking comment on proposed amendments to NZ IAS 26 *Accounting and Reporting by Retirement Benefit Plans*. The following changes are proposed:

- to align the scope of NZ IAS 26 with the scope of IAS 26. As a result, retirement benefit plans and similar entities will need to consider if they are required to comply with the revised standard.
- to remove the option to present the information required in a statement of net assets available for benefits in a statement of financial position. Therefore, both defined benefit plans and defined contribution plans will have to present a statement of net assets available for benefits.
- to allow defined benefit plans to present the actuarial present value of promised retirement benefits in the statement of net assets available for benefits regardless of when the actuarial valuation was completed.

Comments are due by 30 April 2010.

The [Exposure Draft](#) is available on the NZICA website.



Securities Commission Cycle 10 Results

The Securities Commission has warned company directors to thoroughly review financial statements to ensure that they comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), because if they don't *"they could be failing in their duty to inform investors"*.

These comments were the result of the Securities Commission's ongoing financial reporting surveillance programme, where a mix of listed and unlisted issuer financial reports are reviewed for compliance with NZ GAAP. The full results from the Cycle 10 review were published in December 2009, and covered financial reports published by issuers for periods ending 31 January 2009 – 31 March 2009.

The following specific issues were raised, in addition to some other less widespread matters:

- financial instrument disclosures, particularly in relation to non-disclosure of fair value assumptions, expected maturity of financial instruments and estimates of fair value of collateral held,
- impairment of non-financial assets with poor disclosure of assumptions underlying goodwill and intangibles impairment testing,
- related party information with omissions in key management personnel compensation disclosures and non-disclosure of the terms and conditions of related party transactions,
- valuation of property, plant and equipment disclosures – in particular assumptions underlying the valuation,
- composition of other expenses – with insufficient description of significant amounts of such other expenditure, and
- failure to describe the nature of non-audit services provided.

The Commission stated that *"In this review, the Commission was disappointed to encounter persistently inadequate disclosures in certain critical reporting areas. We have warned issuers that they should make greater efforts to comply in these areas, and that, where necessary, we will take enforcement action."*

The Securities Commission's **Cycle 10 Report** is available on their website (www.sec-com.govt.nz).

Other Topics of Interest

Amendment to IFRS 1

IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been amended to exempt first-time adopters of IFRSs from providing the additional disclosures introduced in March 2009 by *Improving Disclosures about Financial Instruments (Amendments to IFRS 7)*. This gives first-time adopters the same transition provisions that the IFRS 7 amendment gives to current IFRS preparers. The amendment is effective on 1 July 2010. Early adoption is permitted.

International Public Sector Accounting Standards Board Activity

The International Public Sector Accounting Standards Board (IPSASB) has issued the following standards:

- IPSAS 28 *Financial Instruments: Presentation*
- IPSAS 29 *Financial Instruments: Recognition and Measurement*
- IPSAS 30 *Financial Instruments: Disclosures*

These standards are primarily consistent with the equivalent IFRS, but do address some public sector specific issues such as financial guarantee contracts provided for nil or nominal consideration and concessionary loans.

The IPSASB has also issued IPSAS 31 *Intangible Assets*, consistent with the equivalent IFRS and *Improvements to IPSASs* in order to conform to IFRS. Public sector specific guidance on intangible assets will be considered later.

Insurance Accounting Monthly Newsletter

Deloitte continues to issue a monthly newsletter focusing on the joint IASB and FASB project to develop a new global financial reporting standard for insurance.

Issue 10 and **Issue 11** summarise key decisions made at meetings recently held by the IASB and FASB with the insurance standard now taking shape.

Kind Regards,

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