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Technically Speaking
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Accounting & Auditing - External

Nita Ranchod

Welcome

Dear Colleagues

Welcome to our fourteenth edition of Technically Speaking!

This edition includes articles on the following topics:

What is Heading Your Way?
With many International Financial Reporting Standards (IFRS) changes coming in the near future, this article provides an overview of when the new standards are effective and some of the potential issues in implementing the standards.
Adoption of International Financial Reporting Standards by the United States of America
The international community has been waiting and watching for a decision by the Securities Exchange Commission (SEC) on the adoption of International Financial Reporting Standards (IFRS) by the United States of America (US). This article explores the latest developments in the US around the adoption of IFRS.
Update on the leases project
The International Accounting Standards Board (IASB) has been working on a project to revise the way in which leases are accounted for. This article provides an update on the latest developments in the leases project.
Draft interpretation on put options over non-controlling interests
The IFRS Interpretations Committee (IFRIC) has released a draft interpretation on how to account for put options over non-controlling interests.
Draft Interpretation on Liabilities to Participate in a specific market
A draft interpretation has also been released on how entities should account for liabilities incurred in order to participate in a specific market.
Non-permanent workforce
Labour legislation in South Africa is changing with regards to how non-permanent employees should be treated. This article provides insight into the latest developments and potential impact on employers.
New ISA 610 issued
The International Auditing and Assurance Standards Board (IAASB) has issued a new standard, which provides guidance on how the work of internal audit can be used during the external audit process.

Please continue to send and alert your clients to the external version of Technically Speaking.

We look forward to your comments on this publication. Please feel free to contact our editor Amy Escott if you have any questions or suggestions for future issues.

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Kind Regards

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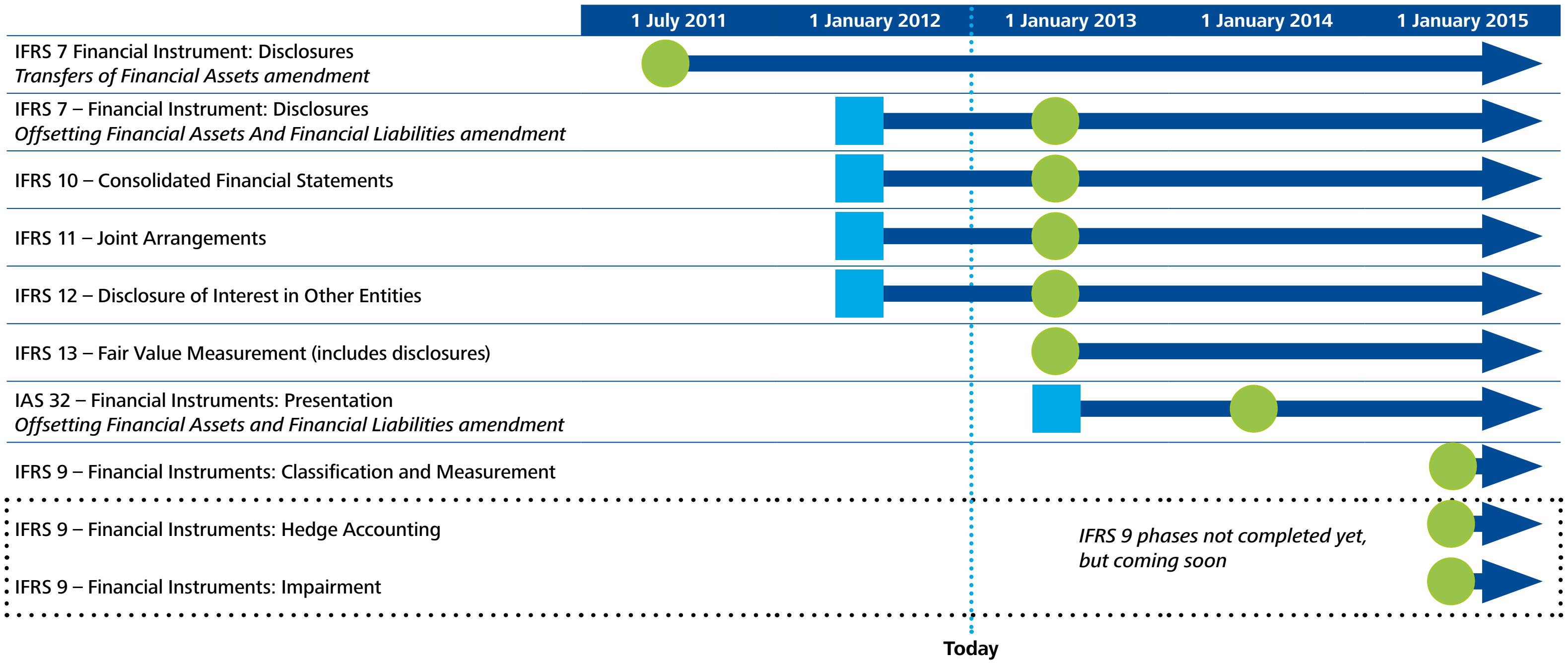
What is heading your way?

Effective dates that you need to think about

Over the last two years, the International Accounting Standards Board (IASB) has completed a range of significant projects resulting in new accounting and disclosure requirements. The effective dates for these requirements are fast approaching and now is the time to plan for implementation. The chart below details these dates and whether or not the requirements apply retrospectively.



● Effective date ■ Retrospective application (assuming one year of comparatives required), however preparation needs to start earlier.

The following tables provide a summary on each amendment or new IFRS, what the requirements are and the key things to think about when preparing to implement the changes. While this is not intended as a comprehensive planning toolkit, it may help you think about the revised accounting implications and kick start your planning process if you have not already started.

Amendments and new standards	Effective date	What is this about?	Things to think about
IFRS 7 – Transfer of Financial Assets	1 July 2011 No comparative disclosure required	• Disclosures about financial assets that are transferred but not derecognised • Disclosures about continuing involvement in transferred financial assets that have been derecognised • The scope of 'continuing involvement' disclosures are broader than continuing involvement accounting used for measuring certain derecognition transactions	• Consider arrangements for collecting information required and controls around completeness • Consider how information will be aggregated and presented in the financial statements and the overall messaging to users of the accounts • Consider how historic information can be collated for transactions that led to full derecognition in the past
IFRS 7 – Offsetting Financial Assets and Financial Liabilities*	1 January 2013 Comparative disclosures are required	• Disclosures about the rights of set-off and related arrangements on an entity's financial position	• Consider arrangements for collecting information required on first time adoption and on-going • Consider how information will be aggregated and presented in the financial statements and the overall messaging to users of the accounts

Amendments and new standards	Effective date	What is this about?	Things to think about
IFRS 10 – Consolidated Financial Statements	**1 January 2013 The new standard applies retrospectively**	• Replaces IAS 27 Consolidation and Separate Financial Statements and SIC 12 Consolidation – Special Purpose Entities • A single model for consolidation based on a control model (as opposed to a risk and reward model such as SIC-12)	• Consider de facto control and new control definition • Consider arrangements for collecting information required on first time adoption and on-going • Consider how information will be aggregated and presented in the financial statements and the overall messaging to users of the accounts
IFRS 11 – Joint Arrangements	**1 January 2013 The new standard applies retrospectively**	• Replaces IAS 31 Interests in Joint Ventures and SIC 13 Jointly Controlled Entities – Non-Monetary Contributions by Venturers • Establishes principles applicable to all jointly controlled entities	• Perform assessments to determine classification of any jointly controlled entities • Consider joint arrangements that were accounted for using proportionate consolidation that must now apply equity accounting and prepare journals for first time adoption • Consider knock-on effects of using equity accounting over proportional consolidation (e.g. effect on ratios, KPIs, hedge accounting, etc)
IFRS 12 – Disclosure of Interest In Other Entities	**1 January 2013 The new standard applies retrospectively (comparative disclosures required)**	• Disclosures about interests in: – Subsidiaries – Joint ventures and associates – Unconsolidated structured entities	• Collecting information to prepare the disclosures as required for first time adoption and on-going arrangements for collecting information • Consider controls for completeness of the disclosures of interests in other entities • Consider how information will be aggregated and presented in the financial statements and the overall messaging to users of the accounts

Amendments and new standards	Effective date	What is this about?	Things to think about
IFRS 13 – Fair Value Measurements	1 January 2013 The new standard applies prospectively	• Defining fair value measurements • Provides guidance on how to apply a fair value measurement concept where IFRSs use the term 'fair value' • Provides a measurement exception for items managed on a portfolio level as well as permitting mid-market pricing more generally • Disclosure requirements related to fair value and assumptions used when measuring fair value	• Consider whether the new guidance changes current valuation inputs, assumptions and methodologies • Consider knock-on effects of changes in valuation (e.g. effect hedge accounting, regulatory reporting, etc) • Consider how disclosures will be aggregated and presented in the financial statements and the overall messaging to users of the accounts • Consider controls over fair value measurement
IAS 32 – Offsetting Financial Assets and Financial Liabilities*	1 January 2014 Amendment applies retrospectively	• Clarify the meaning of "currently has a legal enforceable right of set-off" • Clarify that some gross settlement systems would be considered equivalent to net settlement if they eliminate or result in insignificant credit and liquidity risk and process receivables and payables in a single settlement process cycle	• Consider accounting policies and whether amendments change the application of offsetting under IAS 32 (e.g. for transactions with clearing houses)
IFRS 9 – Classification and Measurement	1 January 2015 The new standard applies retrospectively	• Classification and measurement requirements for financial instruments based on a combined business model and contractual cash flow test • Derecognition requirements for financial instruments	• Consider classification and measurement of financial instruments in terms of the business model within which they sit and the contractual terms of their cash flows (for example, consider the appropriate classification of liquidity portfolios between amortised cost or FVTOCI) • Determine accounting policy choices and process for decision making

Amendments and new standards	Effective date	What is this about?	Things to think about
IFRS 9 – Hedge Accounting[1]	**1 January 2015** **The new standard will be applied prospectively**	• New hedge accounting model (does not include portfolio hedge accounting) • Increases items eligible for designation as hedged items • New hedge effectiveness testing requirements (no more 80-125% effectiveness test)	• Evaluate risk management practice to consider wider application of hedge accounting • Prepare hedge accounting documentation and designations ahead of application date • Evaluate new systems requirements to run hedge accounting modules alongside accounting application software (or integrated)
IFRS 9 – Impairment[2]	**1 January 2015** **As yet unclear what transitional provisions may apply**	• Change from an incurred loss model to expected loss model	• Consider system requirements to measure, track and account for expected losses • Consider integration with other regulatory change projects

[1] It is expected that the final standard will be published in December 2012.

[2] The IASB plans to publish an new exposure draft on impairment later this year. Even though this is just an exposure draft, the IASB plans to finalise the requirements so that IFRS 9 (including all phases) will be ready for application for periods beginning 1 January 2015. Consequently, this is also something to plan for.

Will the IASB tire of accommodating the US standard setter?

The on-going debate around IFRS adoption in the US

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Since February 2010, the Securities and Exchange Commission (SEC) has been evaluating the implications of incorporating International Financial Reporting Standards (IFRS) into the financial reporting system for US companies. On 13 July, 2012, the SEC issued its final staff report.

The report indicates that before making a decision, the SEC must further analyse and consider "the fundamental question of whether transitioning to IFRS is in the best interests of the US securities markets generally and US investors specifically."

The following significant themes have been identified by the SEC staff. These seem to reflect the significant hurdles of IFRS adoption to US preparers:

- The IFRS framework does not have guidance for extractive, insurance, and rate-regulated industries.

- The IFRS Interpretations Committee (IFRIC) has been criticised for not responding to constituent requests for guidance on the application of IFRS to specific transactions on a timely basis. The IFRIC and its predecessor body have issued 30 current interpretations of IFRS. United States Generally Accepted Accounting Practice (US GAAP) has over 100 interpretations on revenue alone. Although recent changes to the committee's process may address this concern, it is not yet known whether the changes will be effective.

- The staff identified diversity in the application of IFRSs globally and suggested that regulators in various jurisdictions need to work cooperatively to foster consistent application and enforcement of IFRS.

- The staff expressed concern about the IFRS Foundation's ability to access funding and about existing funding sources, including the reliance on large accounting firms to provide funding.

The IASB and US accounting standard setter (FASB) have been working on several joint projects since the financial crisis in 2008. In many instances, the Boards have concluded on divergent treatments, and one could conclude that the FASB are not amenable to progressing onto IFRS in the short-to-medium term.

The SEC staff have not set timelines to following up on the report. This leaves the IASB uncertain about convergence and may cause some frustration for constituents as the IASB continues to accommodate the FASB within the IASB's work programme.

Is the leases project on a road to nowhere?

Assessing the latest proposals for lessee accounting

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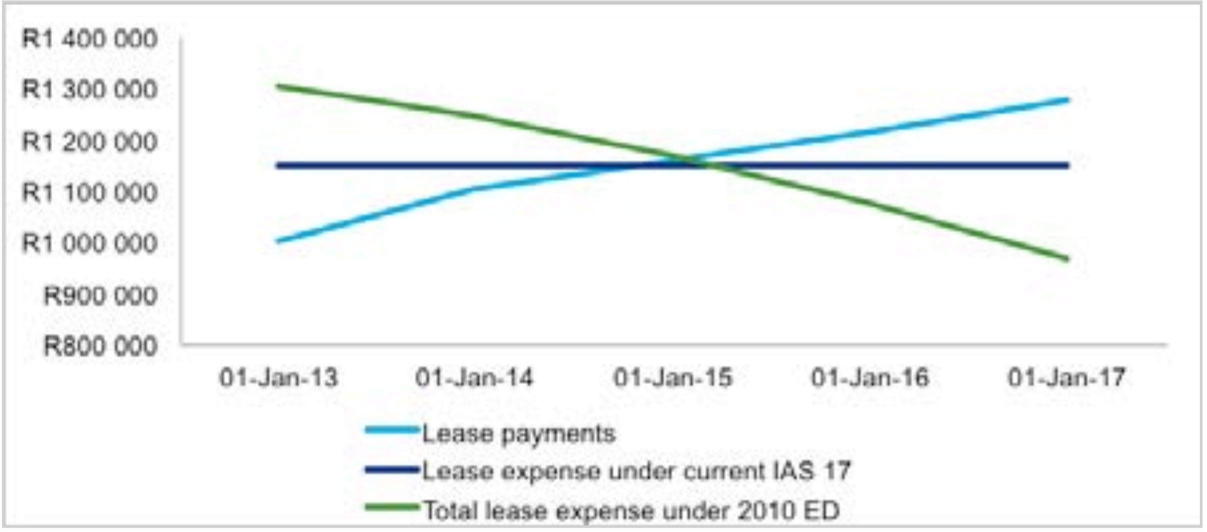
The International Accounting Standards Board and the Financial Accounting Standards Board (the Boards) issued the exposure draft in 2010 (2010 ED). The proposals would result in finance lease accounting for all leases, including leases classified as operating leases under the current requirements of IFRS.

Many respondents to the 2010 ED maintain that the finance lease treatment does not reflect the way that their businesses are managed and evaluated. The 2010 ED would increase the debt position of many preparers, with the retail industry being most significantly impacted. The pattern of profit or loss recognition over the term of the lease is the most contentious issue.



The 2010 ED is based on the premise that a commitment has been made to pay amounts due under the lease and, in return, receive the right to the use the asset over the lease term. The right-of-use asset would be amortised, generally resulting in a straight line amortisation charge over the lease term. Interest would be recognised on the liability to make payments under the contract while lease payments would reduce the liability. It follows therefore, that the interest charge will be highest at the beginning of a lease and be reduced over time as the lease liability is reduced by lease payments. This issue is referred to as "front loading".

The Boards have debated a potential solution to the front loading problem for over a year. The current proposal is to separate lease contracts into two types similar to the current operating and finance lease classifications in IFRS.

The classification will not impact the balance sheet, in other words, the Boards still propose the recognition of a liability and an asset on commencement of the lease.

For leases where the lessee does not consume all of the economic benefits of the underlying asset over the lease term (similar to current operating lease classification), the profit or loss charge would be smoothed over the lease term. This would result in a similar profit or loss charge over the lease term as currently recognised in terms of IAS 17 Leases. The interest charge would be recognised on the financial liability on the same basis as described in the 2010 ED, while the amortisation charge will reflect the balancing number between the smoothed charge and the interest charge. The smoothed charge would also be reflected as a rental charge, and excluded from other amortisation and interest recognised by the entity.

Year	0	1	2	3
Liability	1 966	1 556	923	-
Asset	1 966	1 456	823	-
Interest expense		590	467	277
Amortisation		510	633	823
Total expense		1 100	1 100	1 100

The traditional finance lease approach will be applied for leases where the lessee consumes all of the economic benefits of the underlying asset over the lease term.

It is likely that the current proposals will be published by the Board as the re-exposure of the leases standard in the first quarter of 2013.

Interpretations committee issues draft interpretation on accounting for put options over non-controlling interests

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During May 2012, the IFRS interpretations committee (IFRIC) released a draft interpretation on accounting for put options written on non-controlling interests (NCI). This occurs when the NCI shareholders in a partly owned subsidiary have the right to put their minority shareholding back to the majority shareholders and to receive cash in return.

Under normal circumstances, these arrangements meet the definition of a derivative and would be measured at fair value through profit or loss. However, IFRS requires these arrangements to be recognised as a financial liability equal to the present value of the redemption amount instead of at the fair value of the put option.

The draft was issued in a response to a divergence in practice on the presentation of remeasurements to the NCI put liability. This was due to uncertainty as to whether the measurement should be accounted for as a transaction between owners in their capacity as owners and accounted for in equity or as an adjustment to a financial instrument within the scope of IAS 39 Financial Instruments: Recognition and Measurement.

The draft states that all subsequent measurements of the liability arising from the NCI put should be recognised under profit and loss effectively adopting the financial instrument methodology. The basis of this methodology is that the transaction does not amount to a transaction with owners in their capacity as owners as the remeasurement of the put option does not alter the relative shareholding interests in the subsidiary held by the parent or non-controlling interest shareholder.

The draft does not apply to NCI puts that were accounted for as contingent consideration as part of a business combination as these remeasurements are considered within the ambit of IFRS 3 and the standard provides sufficient guidance on these arrangements.

NCI puts within a Group

The Interpretation would only apply to the financial statements of the parent entity who has written the option in favour of the NCI shareholders of one of its subsidiary companies. These instruments are not always written by the parent and may be written by a fellow subsidiary within the Group. If not amended, there is still leeway for the Group to present the remeasurement of the NCI put directly in equity.

The double knock theory

If the put option is exercisable at fair value, any increase in the current or expected future profits available to the NCI shareholders of the subsidiary should increase the value of the NCI put liability and raise a consequential debit to profit and loss. Simultaneously, the Group will attribute profits to the non-controlling interest in accordance with normal consolidation principles resulting in another debit against the profits of the Group. This double debit is criticised by proponents to the methodology outlined in the Interpretation.

This unusual accounting treatment is mirrored in the balance sheet where the NCI put is reflected within the liability section of the balance sheet while the equity section reflects the current attribution of equity reserves to the non-controlling interest based on their current voting rights.

The debt equity classification

Constituents have been encouraging the IASB to reconsider the fundamental principles behind the debt and equity classifications. Due to capacity limitations, the IASB has put this project temporarily on hold. This Interpretation provides guidance on the subsequent presentation of movements in a put option liability when the IASB should be considering whether the principles behind the recognition of NCI puts as financial liabilities is the appropriate accounting treatment.

Puts and forwards

The draft does not provide guidance on to how to account for similar forward contracts or mirroring call options relating to NCI shareholders. There is no clear rationale why these arrangements, which have similar accounting treatment on initial recognition, are not within the scope of the Interpretation.

Draft Interpretation on Levies Charged by Public Authorities on Entities that Operate in a Specific Market

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During May 2012 the IFRS Interpretations Committee issued a draft interpretation (IFRIC) on Levies Charged by Public Authorities on Entities that operate in a specific market, for example the payment of a levy to operate in a specific industry if the entity generates revenue in a particular period. In the South African context entities operating in the gaming industry often have to pay a levy based on revenue generated. The legislation mandates that the levy is continuous and does not require a revenue target to be met. If a threshold was required to be met, this would be outside the scope of this draft IFRIC.

The draft Interpretation reaches a consensus that the obligating event, that gives rise to the liability to pay the levy, is the activity that triggers the payment of the levy as identified by the legislation. In the gaming industry, the payment of the levy is triggered by the generation of revenue and therefore a liability should be accrued when revenue is generated. The levy should be recognised as an expense and should be recognised progressively if the obligating event occurs over time. The same recognition principles should be applied to the interim financial statements as are applied to the annual financial statements.

Some further examples include:
Company B operates in a market where a levy is charged for operating in that market. The levy is payable as soon as the entity starts operating or starts generating revenue in a particular financial year (e.g. the levy is raised as soon as the entity starts generating any revenue in the current financial year and is based on revenues earned in previous years) The levy will be raised in full as soon as any revenue is generated during the current financial year. Therefore, at an interim stage the full liability will be provided for.

Company C operates in a market where a levy is charged for operating in that market. The levy is triggered if the entity is operating in that specific market at the end of the financial year. At an interim stage, no liability is required to be raised even if the entity has the full intention or requirement to carry on operating in that particular industry for the rest of the financial year. This is because the action that triggers the payment of the liability is the entity being in operation in that market at the end of the reporting period. The liability is not recognised progressively over the financial year as the trigger event has not yet occurred.

The non-permanent workforce, what are the risks going forward?

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Business in South Africa has seen a significant increase in the non-permanent workforce over the last decade. It is estimated that approximately 3.9 million people are employed in either a temporary, fixed term or labour brokered relationship. Current employment legislation protects the rights of non-permanent appointees. These protections manifest themselves in provisions regulating:

- The non-renewal of fixed-term contracts where expectations of such renewals exist
- Unfair discrimination between fixed-term and permanent employees on any grounds defined in the employment equity legislation
- Deeming provisions of employment as opposed to independent contracting if certain factors are present to the relationship.

On 20 March 2012, Cabinet approved the Basic Conditions of Employment Amendment (BCEA) Bill and the Labour Relations Amendment (LRA) Bill (the Bills). The Bills are very different to those published in December 2010, but continue to propose significant changes to labour broking and contract work.

Labour broking

- Unlike the 2010 bills, the 2012 bills no longer seek to ban labour broking in general
- In the current LRA - a labour broker is the employer of the resource (employee) provided. The client of the labour broker is not an employer and only jointly and severally liable with the labour broker for breaches of wage determinations, collective agreements that regulate terms and conditions of employment, arbitration awards regulating terms and conditions, and contraventions of the BCEA. These provisions are maintained for employees earning on or above the current BCEA earnings threshold of R183 008 per annum.

- Additional protection is proposed for employees that earn below the BCEA earnings threshold. With reference to these brokered resources a client of a labour broker may:
  - Be deemed to be the employer of a brokered resource if the resource is employed for longer than six months and is not rendering temporary work for the client
  - Be obliged to grant remuneration and benefits to a brokered resource deemed to be its employee, similar to the remuneration and benefits of the clients other employees doing the same work
  - Be liable for the unfair termination of employment and unfair labour practices related to the brokered resource.

Regulating contract work (fixed-term employees)

The Bills introduce additional protection for vulnerable workers and apply only to employees who earn on or below the current BCEA earnings threshold of R183 008 per annum. In addition, the proposed protections will not apply in the following circumstances:

- Employees who ordinarily work less than 24 hours a month
- During the first six months of employment
- An employer that employs less than 10 employees
- An employer that employs less than 50 employees and whose business has been in operation for less than two years, unless the employer conducts more than one business or the business was formed by the division or dissolution for any reason of an existing business.

The proposed amendments will impact the appointment of fixed-term employees protected by the provisions as follows:

- An employer will be permitted to employ an employee on a fixed-term contract or successive fixed-term contracts for up to six months.
- Employees employed on a fixed-term contract for more than six months may be deemed to be permanently employed and must be treated on the whole not less favourable than an employee on an indefinite contract performing the same or similar work, unless there is a justifiable reason for treating the employee differently.

A justifiable reason for different treatment may be:

- Seniority, experience or length of service
- Merit
- Quality or quantity of work performed
- Any other criteria of a similar nature not prohibited by section 6(1) of the Employment Equity Act, 1998.

An employer must provide an employee employed on a fixed-term contract with the same access to opportunities to apply for vacancies as it would provide to an employee employed on an indefinite contract of employment.

Independent contractors

There are no proposed amendments to the employment legislation relating to independent contractors. However, the most common mistake made in independent contracting relationships is to contract out of employment law and tax provisions and regard the relationship as a legitimate exclusion of such provisions. The contractual provisions of independent contracting agreements are simply one of the factors that have to be considered in order to determine whether any employment or tax risks exist from the relationship between the respective parties. More importantly, is the factual relationship that exists between the parties which is determined by the dominant impression test gained from the actual relationship.

The use of the independent contracting label and the perception that the term is an acceptable means of avoiding employment and tax legislation has necessitated the development of strong anti-avoidance measures from a legislative and SARS perspective. The use of contractors in business is a common and necessary practice. However the associated PAYE withholding obligations and employment law consequences can be complex.

In closing
Note from the Editor

Dear Colleagues

I hope you have enjoyed reading this issue of Technically Speaking. I hope that this issue has provided you with a valuable update on the latest development in the accounting and regulatory world.

Please continue to send your comments and suggestions that you may have to improve our future issues to technicallyspeaking@deloitte.co.za

Kind Regards

Amy Escott

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