IFRS News

Welcome to IFRS News – a quarterly update from the Grant Thornton International Ltd IFRS team. IFRS News offers a summary of the more significant developments in International Financial Reporting Standards (IFRS) along with insights into topical issues and comments and views from the Grant Thornton International Ltd IFRS team.

Our third edition of 2013 leads with an analysis of the IASB Exposure Draft 'Leases'. The Exposure Draft proposes that all leases of more than 12 months would be recognised on the lessee's Statement of Financial Position, a proposal that would radically alter the financial position of many companies.

We then discuss several amendments that have been made to existing Standards and Exposure Drafts that have been issued in the last quarter. After this we move on to look at a round-up of IFRS-related news at Grant Thornton, as well as a more general round-up of activities affecting the IASB.

We end with an overview of the proposals that the IASB currently has out for comment, and the implementation dates of newer Standards that are not yet mandatory.

IASB and FASB propose major changes to lease accounting

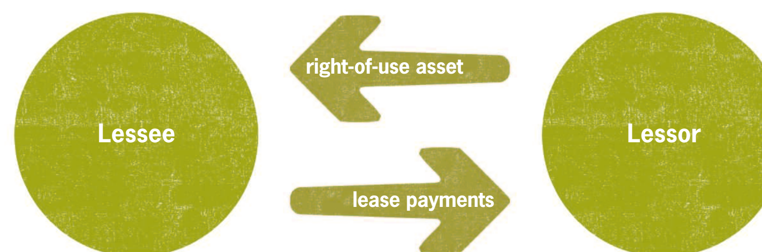
The IASB and the US Financial Accounting Standards Board have published a revised Exposure Draft 'Leases'. The revised Exposure Draft builds on a previous 2010 Exposure Draft and would fundamentally change the current accounting for leases.

Under the current requirements in IAS 17 'Leases', the accounting for a lease depends upon its classification. Classification as an operating lease results in the lessee not recording any assets or liabilities in the Statement of Financial Position (balance sheet). The Exposure Draft proposes to remove this distinction by requiring lessees to recognise assets and liabilities for the rights and obligations created by leases. We discuss the proposals in more detail on the following pages:

Lessee accounting

Under the proposals in the Exposure Draft, a lessee will recognise in the Statement of Financial Position a right of use (ROU) asset and a liability to make lease payments for all leases of more than 12 months.

A lease contract conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration



Commercial implications:

Recognising a ROU asset and a liability to make lease payments for all leases of more than 12 months will have a number of commercial implications for entities, including:

- asset and performance ratios will be affected by the recognition of all leased assets on the balance sheet
- gearing calculations in particular may be affected by the increase in the lessee's reported borrowings. The effect on loan agreements and bank covenants may need to be considered
- entities subject to regulation may need to hold more capital.

Initial measurement

The ROU asset and the liability to make lease payments are recognised at the date the underlying asset is made available to the lessee. The liability is initially measured as the present value of lease payments discounted using the rate charged by the lessor or, if this is not available, the lessee's incremental borrowing rate. To determine the lease payments, an entity will first have to determine the lease term. The lease term will include any optional period to extend the lease, if there is a significant economic incentive for the lessee to exercise the option.

Once the lease term is calculated, the entity will then need to review the lease payments to determine those that are to be included in the initial recognition of the lease liability.

The liability will include:

- fixed payments
- variable payments that depend on an index or rate
- variable payments that are in substance fixed payments
- amounts expected to be paid under residual value guarantees and the exercise price of extension/ termination options if there is a significant economic incentive for the lessee to exercise those options.

Having determined the initial measurement of the liability, the initial measurement of the ROU asset is simply the value of the liability plus any initial direct costs incurred by the lessee plus any payments made to the lessor at or before the commencement of the lease less any lease incentives.

The debate is now whether the new proposals represent a sufficient improvement over current lease accounting standards to justify the cost and disruption of change, and whether they really give users the information they want.

Subsequent measurement

The dual approach

Unlike the 2010 Exposure Draft, the new Exposure Draft does not apply a single lessee accounting model but instead applies a dual approach for lease expenses. This dual approach determines the subsequent accounting for the recognition of the lease expense.

The principle for determining which approach to apply is based on the amount of consumption of the underlying asset. This reflects the IASB's view that there is a difference between a lease for which the lessee pays for consuming a significant part of the underlying asset during the lease term, and a lease for which the lessee merely pays for using the asset.

Leases for equipment/vehicles are Type A unless:

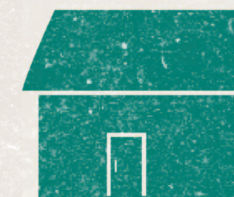
- lease term is insignificant relative to total economic life of asset, or
- present value of lease payments is insignificant relative to fair value of asset

Leases for real estate are Type B unless:

- lease term is major part of remaining life of asset, or
- present value of lease payments is substantially all of fair value of asset

The Exposure Draft applies this concept in a simplified way, distinguishing between 'Type A' and 'Type B' leases. This determination will depend on whether or not the lease is a real estate (property) lease, on the basis that for most leases of real estate the lessee merely uses the underlying asset without consuming more than an insignificant part of it. By way of contrast, the Exposure Draft asserts that a lessee typically consumes a significant part of any equipment or vehicle that it leases.

After initial recognition, the liability for lease payments is accounted for at amortised cost subject to certain adjustments while the ROU asset is recognised at cost less accumulated amortisation and impairment. Classification of the lease as either Type A or Type B affects both the calculation and the presentation of the lessee's lease expense.

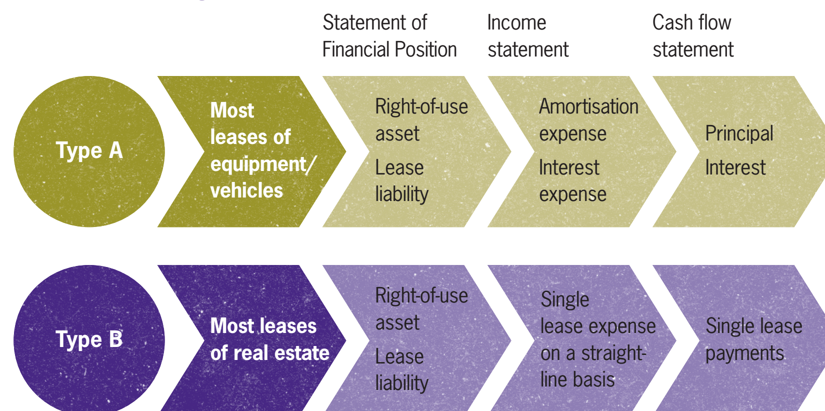


Subsequent measurement

Type A leases

For Type A leases, a finance charge for the unwinding of the discount on the lease liability will be recognised separately from an amortisation charge for the ROU asset. The unwinding of the lease liability will be measured using the effective interest method. The ROU asset will be amortised on a straight line basis unless another basis is more representative of the pattern in which the lessee expects to consume the ROU asset's future economic benefits. As a result, the lessee's total cost for a Type A lease will be higher in the earlier years of the lease and lower in later years (so-called 'front loading'). Most current non-property operating leases are expected to become Type A leases.

Lessee accounting overview



Type B leases

Type B leases will result in a straight-line total lease cost in each year of the lease. The total lease cost will combine both the unwinding of the discount on the lease liability and the amortisation of the ROU asset. The unwinding of the discount on the lease liability will be calculated using the effective interest method. The amortisation of the ROU asset will be a balancing figure to ensure the total lease expense is recognised straight line over the lease term.

Lessor accounting

For practical purposes, the Exposure Draft would have only a minor impact on the accounting by lessors for finance leases. Under IAS 17, lessors recognise a lease receivable and derecognise the underlying asset. These leases would be Type A under the proposed model and lessors would apply the 'receivable and residual' model described below. However, the residual asset would be relatively small.

For leases that are considered operating leases under IAS 17 the extent of change would depend on whether the underlying asset is property or equipment. A lessor would distinguish between most property and most equipment leases in the same way that a lessee would under the proposals. Operating leases of property would be Type B leases and the proposed lessor accounting model would be essentially unchanged. Operating leases of equipment or vehicles, would typically be Type A and, for these, the changes proposed are significant.

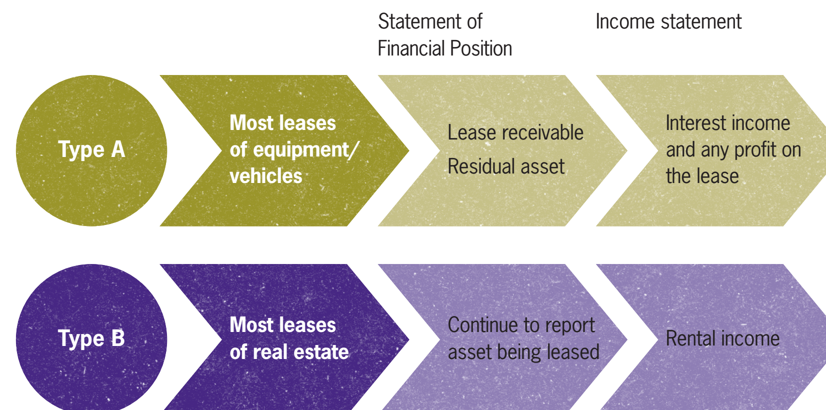
A lessor of most equipment or vehicles leases would apply the 'receivable and residual approach' and would:

a) recognise a lease receivable and a retained interest in the underlying asset (the residual asset), and derecognise the underlying asset; and

b) recognise interest income on both the lease receivable and the residual asset over the lease term.

A manufacturer or dealer lessor might also recognise profit on the lease when the underlying asset is made available for use by the lessee.

Lessor accounting overview



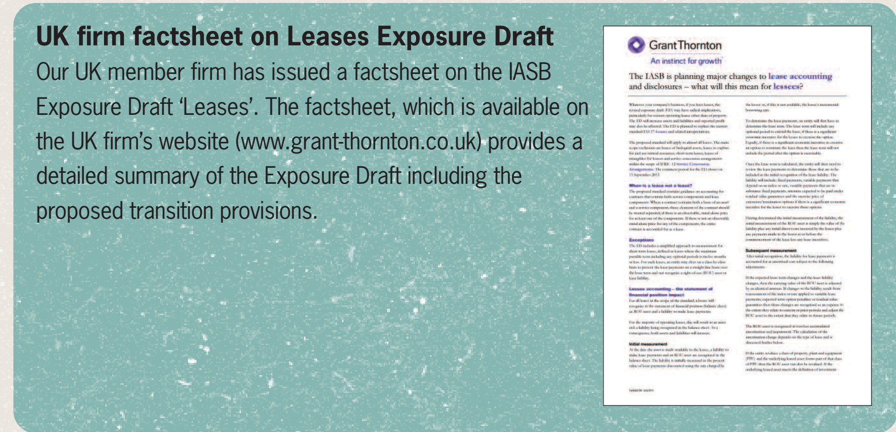
Exceptions

The Exposure Draft would permit simplified accounting for short-term leases, defined as leases where the maximum possible term (including any option periods) is 12 months or less. For such leases, an entity may elect on a class by class basis to account in essentially the same way as for operating leases in accordance with IAS 17.

The Exposure Draft also proposes a number of scope exceptions that are broadly in line with IAS 17's (for example, leases of intangible assets and leases to explore for or use mineral resources and similar non-regenerative resources).

The link between the leasing model and IAS 40 'Investment Property' also remains important. Under the ED:

- a lessee would be obliged to apply IAS 40 in measuring ROU assets that are investment property, and can choose IAS 40's cost or fair value model. This would change the current position under which a lessee with an operating lease interest in investment property can choose to apply IAS 40 but must use fair value if it does
- a lessor that owns an investment property and leases it under a Type B lease would apply IAS 40 to the asset.



UK firm factsheet on Leases Exposure Draft

Our UK member firm has issued a factsheet on the IASB Exposure Draft 'Leases'. The factsheet, which is available on the UK firm's website (www.grant-thornton.co.uk) provides a detailed summary of the Exposure Draft including the proposed transition provisions.

Grant Thornton
An instinct for growth

The IASB is planning major changes to lease accounting and disclosures – what will this mean for lessees?

Grant Thornton International Ltd comment

Our view remains that reform of lease accounting is long overdue and sorely needed. Leasing is a very useful and flexible financing tool that offers many legitimate tax and legal advantages but the operating versus finance accounting model has led to too much emphasis on structuring leases to arrive at a desired accounting treatment. As a result companies' balance sheets too often present an incomplete and non-transparent picture and many investors make their own adjustments to fix this. Any reform will have a major impact given the huge scale of leasing – annual volume of US$1.9trillion for US listed companies alone. Another measure is a recent Grant Thornton survey that revealed, globally, companies have an average of 20 leases.

The Boards' previous proposal was for a single, on-balance sheet model for all leases – the so-called 'right-of-use' model. While many supported an on-balance sheet model, several aspects of the proposal came under fire – including the 'front-loading effect' on the lessee's expense profile, the definition of a lease and how the model would work for more complex leases such as those with contingent rent or option periods.

The new proposal would still bring most operating leases on balance sheet, but the subsequent accounting would be dependent on the Type A and Type B distinction. This, and many other changes proposed by the Boards, are intended to reduce controversy and make the final Standard easier to apply. However, they also raise conceptual questions, add to the complexity of the text, result in new bright lines and perhaps even create new structuring opportunities. The debate is now whether the new proposals represent a sufficient improvement over current lease accounting standards to justify the cost and disruption of change, and whether they really give users the information they want.

Novation of derivatives and continuation of hedge accounting

IASB provides relief from discontinuing hedge accounting on novation of derivatives

Grant Thornton International Ltd comment
We welcome the Amendments to IAS 39. We believe these amendments will provide more useful information to users of financial statements given the legislative changes taking place in many jurisdictions.

The IASB has published 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)', containing narrow-scope amendments to IAS 39 'Financial Instruments: Recognition and Measurement'.

The narrow-scope amendments provide relief from IAS 39's normal requirements on discontinuing hedge accounting. Specifically, they allow hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation, if certain conditions are met.

The relief has been introduced in response to legislative changes across many jurisdictions that would lead to the widespread novation of over-the-counter derivatives. These legislative changes were prompted by a G20 (Group of 20) commitment to improve transparency and regulatory oversight of over-the-counter derivatives in an internationally consistent and non-discriminatory way.

Similar relief will be included in IFRS 9 'Financial Instruments'.

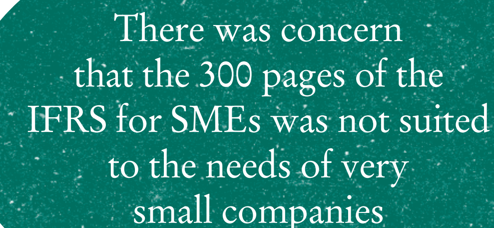
Guidance for micro-sized entities on applying the IFRS for SMEs

The IASB has issued guidance to help micro-sized entities apply the IFRS for Small and Medium-sized Entities (IFRS for SMEs).

The 'Guide for Micro-sized Entities Applying the IFRS for SMEs (2009)' does not modify the requirements of the IFRS for SMEs and does not constitute a separate Standard for micro-sized entities. Instead it is intended to assist such entities who are currently applying the IFRS for SMEs and to make that Standard more accessible for those considering applying it in the future.

The IASB was conscious that in a number of the 80+ jurisdictions around the world that have adopted the IFRS for SMEs, the Standard was being used by very small companies with just a few employees. There was concern that the 300 pages of material in the IFRS for SMEs was not suited to the needs of such companies.

The IASB has therefore extracted from the IFRS for SMEs those requirements that are likely to be necessary for a typical micro-sized entity, placing them in the Guide without modifying any of the IFRS for SMEs' principles for recognising and measuring assets, liabilities, income and expenses. In a few areas, it also contains further guidance and illustrative examples to help a micro-sized entity apply the principles in the IFRS for SMEs.



IASB issues narrow-scope amendments to IAS 36 Impairment of Assets

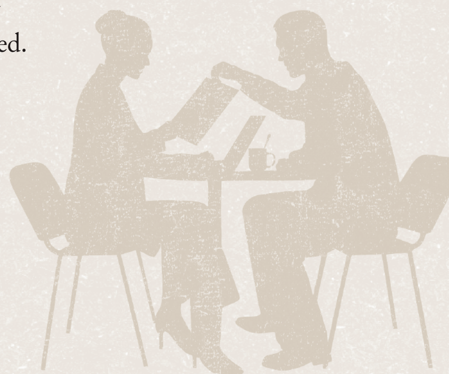
The IASB has published 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)'. These amendments address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal.

When developing IFRS 13 'Fair Value Measurement', the IASB decided to amend IAS 36 'Impairment of Assets' to require disclosures about the recoverable amount of impaired assets. The IASB noticed however that some of the amendments made in introducing those requirements resulted in them being more broadly applicable than the IASB had intended.

The Amendments to IAS 36 therefore clarify the IASB's original intention that the scope of those disclosures is limited to the recoverable amount of impaired assets that is based on fair value less costs of disposal.

Grant Thornton International Ltd comment

We welcome the Amendments to IAS 36. We believe they will result in the disclosure of more useful information about impairments in accordance with IAS 36 and are uncontroversial in nature.



IASB issues IFRIC Interpretation 21: Levies

The IASB has published IFRIC Interpretation 21 'Levies' (IFRIC 21). It considers how an entity should account for liabilities to pay levies imposed by governments, other than income taxes, in its financial statements. A number of such levies were raised following the global financial crisis, particularly on banks. As these levies were not based on taxable profits, they fell outside the scope of IAS 12 'Income Taxes'.

IFRIC 21 is an interpretation of IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'. It addresses the accounting for a liability to pay a levy that is within the scope of that Standard, in particular when an entity should recognise a liability to pay a levy. It also addresses the accounting for a liability to pay a levy whose timing and amount is certain.

Under IFRIC 21, the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. Where the activity that triggers the payment of the levy occurs over a period of time, the liability to pay a levy is recognised progressively. For example, if the obligating event is the generation of revenue over a period of time, the corresponding liability is recognised as the entity generates that revenue.

IFRIC 21 also clarifies that an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period.

Grant Thornton International Ltd comment

We agree that diversity in practice existed in how entities were accounting for the obligation to pay certain levies and that guidance was therefore needed in this area. We also consider IFRIC 21 to be a correct interpretation of the requirements of IAS 37 and therefore welcome its publication.

Despite this support, we note that IFRIC 21 will result in some levies being recognised as expenses on a specific date rather than over an accounting period. Some commentators may find this counter-intuitive, but the IFRIC consider that it follows from IAS 37's obligating event model.

Insurance

New proposals look to reduce the current diversity of accounting practices

The IASB has published a new Exposure Draft of proposals for the accounting for insurance contracts. The new Exposure Draft builds upon a 2007 Discussion Paper and a 2010 Exposure Draft that followed it.

IFRS does not currently have a comprehensive standard for insurance contracts. When the IASB began its preparatory work for the adoption of IFRS by the European Union and others in 2005, it did not have a Standard on insurance contracts. The IASB therefore decided to introduce IFRS 4 'Insurance Contracts' as an interim standard until a more comprehensive review of the accounting for insurance contracts could be completed.

IFRS 4 permitted entities to continue with their existing accounting policies for insurance contracts if those policies met certain minimum criteria. As a result there has been and continues to be considerable diversity of accounting practices in how to account for insurance. In the current low-interest environment in much of the western world, particular criticism has been aimed at the out-dated assumptions that many insurance companies rely on when measuring their liabilities. Some for example use interest rates from many years ago.

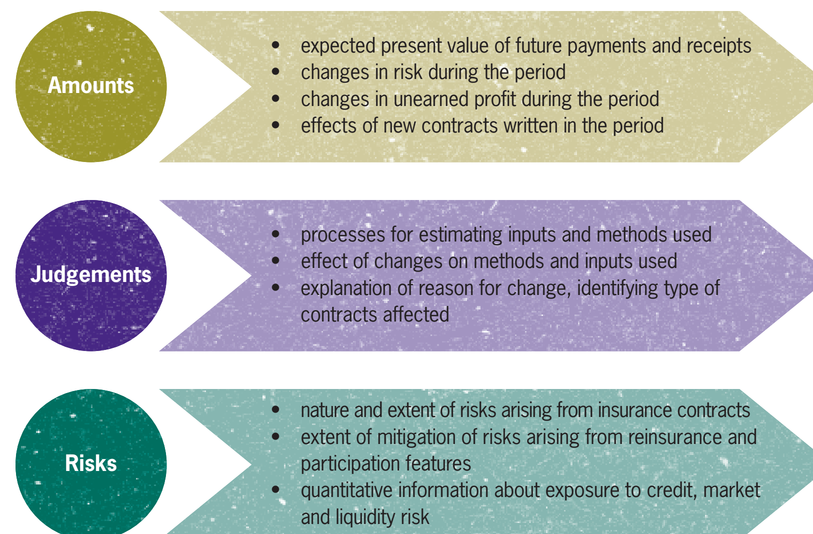
The new Exposure Draft, which is a joint project with the US Financial Accounting Standards Board, aims to increase comparability and transparency in accounting for insurance. The table sets out some of the issues that are perceived as being problems under IFRS 4 and how the Exposure Draft proposes to address them:

Perceived problems
- variety of accounting treatments depending on the type of contract and type of company that issues the contracts
- estimates for long duration contracts not updated
- discount rate based on estimates of investment returns does not reflect economic risks of insurance contract
- lack of discounting for measurement of some contracts
- little information about economic value of embedded options and guarantees

Proposed improvement
- consistent accounting for all insurance contracts issued by all companies (not just insurance companies)
- estimates updated to reflect current market-based information
- discount rate reflects characteristics of the cash flows of the contract
- measurement of insurance contract reflects discounting where significant
- measurement reflects information about full range of possible outcomes

Given the complexity of accounting for insurance, disclosure is also considered vital for a proper understanding of an entity's results and financial position. The Exposure Draft reflects this by emphasising the importance of disclosure in the following key areas:

Proposed disclosures



criticism has been aimed at the out-dated assumptions that many insurance companies rely on

When the IASB began its preparatory work for the adoption of IFRS by the European Union and others in 2005, it did not have a Standard on insurance contracts.

IASB proposes interim standard on rate regulation

The IASB has issued the Exposure Draft 'Regulatory Deferral Accounts' containing proposals for an interim standard that would address the current lack of guidance in IFRS on accounting for rate-regulated activities.

Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. The requirements of some national accounting standard-setting bodies permit or require entities that are subject to certain types of rate regulation to capitalise and defer expenditures (or income) that would otherwise be recognised as expenses (or income) in the statement of profit or loss and other comprehensive income by non-rate-regulated entities. These amounts are often referred to as 'regulatory deferral' (or 'variance') accounts. As a result, the IASB has come under pressure to develop guidance in this area from jurisdictions that have not yet adopted IFRS and that currently recognise such regulatory items.

The Exposure Draft proposes an interim Standard that would allow entities that adopt IFRS for the first-time to preserve the existing accounting policies that they have in place for rate-regulated activities with some modifications designed to enhance comparability (see diagram). A longer term project would then address the more difficult question of whether regulatory deferral account balances meet the definitions of assets and liabilities in the 'Conceptual Framework'.

Grant Thornton International Ltd comment

We support the Board's objective in developing an interim solution pending the completion of a comprehensive project on rate regulation.

While experience suggests that 'interim' standards, such as IFRS 4 'Insurance Contracts' and IFRS 6 'Exploration for and Evaluation of Mineral Resources', can remain in force for many years, we recognise that the current lack of clarity as to whether IFRSs permit or require the recognition of regulatory assets and liabilities in particular circumstances is unsatisfactory and has proved to be a barrier to the adoption of IFRSs by rate-regulated entities in some jurisdictions. We consider that the proposals are a pragmatic response to this situation.

Interim solution proposes:

Recognition and measurement
Permits first-time adopters of IFRS to continue to recognise regulatory balances in accordance with their existing local GAAP.

Presentation and disclosure
Isolates the impact of recognising regulatory balances by requiring
- regulatory deferral account balances and movements on those balances to be presented as separate line items
- specific disclosures to identify clearly the nature of, and risks associated with, the rate regulation

Bearer plants

The IASB has issued the Exposure Draft 'Agriculture: Bearer Plants (Proposed amendments to IAS 16 and IAS 41)'.

IAS 41 'Agriculture' requires all biological assets that are related to agricultural activity to be measured at fair value less costs to sell based on the principle that their biological transformation is best reflected by fair value measurement. However, there is a class of biological assets, known as bearer plants, that, once mature, are held by an entity solely to grow produce over their productive life. Examples include grape vines, rubber trees and oil palms.

Constituents have told the IASB that IAS 41's fair value model is not appropriate for mature bearer plants that are no longer undergoing significant biological transformation as the way they use these assets is more similar in nature to manufacturing. Accordingly, the Exposure Draft proposes to account for bearer plants like property, plant and equipment in accordance with the requirements in IAS 16 'Property, plant and equipment', rather than in accordance with IAS 41.

Under the proposals an entity could elect to measure bearer plants at cost although the produce growing on the plants would continue to be measured at fair value less costs to sell in accordance with IAS 41.

Grant Thornton International Ltd comment

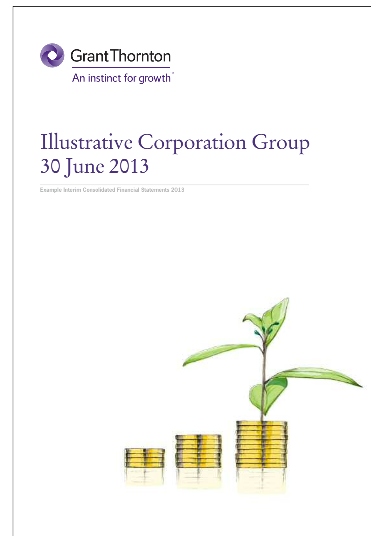
We support these proposals, which respond to feedback received from the IASB's constituents. We believe they would simplify the measurement of bearer plants for preparers and provide information that is arguably more useful to investors.

New Grant Thornton International Ltd example interim IFRS financial statements released

The Grant Thornton International Ltd IFRS team has published an updated version of its IFRS 'Example Interim Consolidated Financial Statements'.

The previous version has been reviewed and updated to reflect changes in IFRSs that are effective for the year ending 31 December 2013. In particular, the publication reflects the application of IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 13 'Fair Value Measurement' and the revised version of IAS 19 'Employee Benefits'.

To obtain a copy of the publication, please get in touch with the IFRS contact in your local Grant Thornton office.



Grant Thornton International Ltd's Executive Director of IFRS appointed to IFRIC

Congratulations to Andrew Watchman, Grant Thornton International Ltd's Executive Director of International Financial Reporting, on being appointed to the IFRS Interpretations Committee (the IFRIC) for a three year term starting 1 July 2013.

The IFRIC is the interpretative body of the IASB and is responsible for reviewing widespread accounting issues arising in the application of IFRSs and issuing authoritative guidance (IFRICs) on such issues.

Comment letter on expected credit losses

The Grant Thornton International Ltd IFRS Team has submitted a comment letter on the IASB Exposure Draft 'Expected Credit Losses'.

In our letter, we recognise the need to implement a more forward-looking model for recognising impairment on financial assets. We also express the view that the proposals in the Exposure Draft achieve a suitable balance between the objectives underlying the earlier 2009 ED and the simplifications necessary to ensure the final Standard is operational and delivers benefits commensurate with its costs, and that they would therefore be an improvement on the existing incurred loss-based model.

That said, we are not convinced that the three-stage model proposed in the ED strikes the most appropriate balance, our principal concern being that we do not believe the recognition of a loss on initial recognition of a debt instrument (a 'day-one' loss) to be representative of the economics of lending activities.

Our preferred solution would be the implementation of a single-stage model that avoids the recognition of such a day-one loss and that is capable of being applied to all financial assets within the ED's scope. We believe an approximation of the yield adjustment that was a feature of the 2009 ED (which was considered technically pure but not operational) could be made without introducing excessive or insurmountable operational challenges by adopting a 'gross-up' approach, using current methods of amortising loan origination costs for these premiums.

Grant Thornton's international expert groups meet

In May, the Grant Thornton International Ltd IFRS Interpretations Group (pictured) met in Raymond Chabot Grant Thornton's Montreal office.

During the meeting they were joined by Jean Paré, who is a member of both IFRIC and the Canadian Accounting Standards Board.

The Grant Thornton International Ltd IFRS Interpretations Group consists of a representative from each of our member firms in the United States, Canada, Singapore, Australia, South Africa, India, the United Kingdom, France, Sweden and Germany as well as members of the Grant Thornton International Ltd IFRS team. It meets in person twice a year to discuss technical matters which are related to IFRS.

Later in May, the Grant Thornton Financial Instruments Working Group (FIWG) met in Grant Thornton International Ltd's London office. The Group discussed a number of issues relating to financial instruments, including Grant Thornton International Ltd's response to the Exposure Draft 'Expected Credit Losses' (see separate article). The FIWG consists of a representative from each of our member firms in Germany, Greece, France, and the United Kingdom, the United States, Canada, New Zealand, the Philippines and India as well as members of the Grant Thornton International Ltd IFRS team.

US partner featured in Private Equity Manager magazine

Gary Illiano, a partner at Grant Thornton LLP, our US member firm, was featured in 'Private Equity Manager' magazine. Gary was commenting on the odds on how likely, or in what fashion, the US will make its decision to adopt international financial reporting standards.

Commenting on the prospect that the US Securities and Exchange Commission (SEC) will not make a formal decision on the adoption of IFRS at all but continue to sit on the fence when it comes to convergence, Gary noted that "the economy is still shaky, and until it stabilises, the fear is that mid-size businesses won't have the resources to migrate their accounting systems to international standards".

Separately, an article by Gary looking at principles-based and rules-based standards, and the way they interact with litigation risk in the US was featured in the French financial magazine 'Echanges'. The article notes that given the prohibitive cost of litigation in the US, people's preference for rules or principles will be influenced by their approach to managing litigation risk. It notes that while plaintiffs are more likely to allege violations under a principles-based system, they have more trouble proving their case.

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par
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Expertises

DE L'ÉTRANGER

THOUGH ACCOUNTING STANDARDS ARE GENERALLY CATEGORIZED AS PRINCIPLES- OR RULES-BASED, THAT'S AN OVERSIMPLIFICATION. IFRS AND U.S. GAAP ARE OFTEN VIEWED AS STARK EXAMPLES OF EACH SYSTEM, BUT THE ANALYSIS IS FREQUENTLY FRAMED, UNFORTUNATELY, IN EITHER/OR TERMS.

Are CFOs Better Served with Principles-Based Accounting Standards?

We all live with uncertainty. Because reducing uncertainty gives us a measure of comfort, we look for ways to bring order to our complex and chaotic world. To help reduce uncertainty, one thing we do to help is agree to follow certain rules.

For example, we agree on what will happen when we approach an intersection that has a traffic light. If the light is green we keep going; if the light is red, we stop. Generally, this works well, until someone runs the red light, either intentionally or by mistake.

We also have rules for intersections without traffic lights, but since those rules are less clear-cut, we are required to use more judgment. We consider whether other cars are approaching, who arrives first, who is on the right and so on. Most likely, we approach those intersections thoughtfully and, perhaps, more warily.

At first blush, accounting systems — which represent agreement on the way transactions, events and circumstances are reported — seem designed to reduce uncertainty in the financial world. Balance sheets balance. Income statements have a bottom line. In fact, young people tell us that they choose to study accounting because they like the notion that you get a certain answer, unlike the law where there is always another argument or a reversal on appeal. But you don't have to study it for very long before you discover that even in accounting certainty can be elusive. What is a fair value? How much should be included in bad-debt reserves? Is an event more likely than not to occur?

We quickly learn that accounting involves estimates and judgments, which means that accounting, too, involves uncertainty. Accounting standards are often categorized as being either principles-based or rules-based, but that is an oversimplification. International Financial Reporting Standards (IFRS) are held as an example of a principles-based system, and U.S. generally accepted accounting principles (U.S. GAAP) are held as an example of a rules-based system. Unfortunately, the analysis is frequently framed in either/or terms.

AND THE EVIDENCE SHOWS ...

Actually, both systems are based on sound principles; both systems have plenty of rules. The principles versus rules analysis is better represented as a continuum, with a pure rules system on one end and a pure principles system on the other. No accounting system today sits completely at either extreme. On the continuum, both U.S. GAAP and IFRS are somewhere in the middle, with the U.S. standards slightly closer to the rules end and IFRS slightly closer to the principles end.

There is some academic research on principles versus rules that suggests there are benefits to rules-based standards. A study published in the July 2012 issue of The Accounting Review, reports results that suggest rules-based standards are associated with lower litigation risk. The authors, Dain C. Donelson, John M. McInnis and Richard D. Mergenthaler, considered litigation risk in the context of the likelihood of being sued, having the suit dismissed and settling the suit.

The evidence in the study indicates that rules can be prophylactic if applied correctly, but if not they can be devastating if simple and helpful if complex. In a system with principles-based standards you may be more likely to be sued, but less likely to suffer an overall adverse consequence.

For a rules-based system, the study discusses two theories of litigation risk: the Complexity view and the Specificity view. The Complexity view holds that rules-based standards are more complex than principles-based standards, which benefits the defendant. Complexity allows for an "innocent mistake" defense, on the grounds that the complex rule was misunderstood, which runs counter to any notion of scienter, or willful intent to deceive. Under the Complexity view, a rules-based system both prevents lawsuits from being brought in the first place and facilitates their early dismissal, as those decisions most often hinge on the issue of scienter.

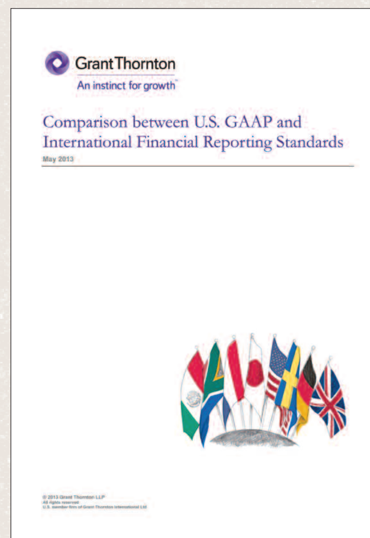
The other theory in a rules-based system, the Specificity view, holds that litigation risk either increases or decreases depending on how successfully the potential defendant applies the rules. If they are unsuccessful, the rule provides a roadmap for the plaintiff. Lawsuits are more likely to be brought, withstand dismissal and result in higher settlements. On the other hand, if the rule is applied successfully, defendants enjoy "safe harbor" protection, with a low likelihood of adverse results.

In a principles-based system, I suspect that

US GAAP IFRS Comparison guide updated

Our US member firm, Grant Thornton LLP, has updated its publication ‘Comparison between US GAAP and International Financial Reporting Standards’. The publication is intended to help readers identify the major areas of similarity and difference between current US GAAP and IFRS. It will also assist those new to either US GAAP or IFRS to gain an appreciation of their major requirements.

The 2013 edition of the publication has been updated for standards issued up to May 2013. The guide can be downloaded from Grant Thornton LLP’s website (www.grantthornton.com).



Grant Thornton partner appointed to Egypt's most prestigious accounting and audit association

Tarek Youssef, principle partner, Grant Thornton Egypt, has been appointed as a Board member of the Egyptian Society for Accountants and Auditors (ESAA). Members of the ESAA account for 15% of the total accounting and auditor experts in Egypt, so have a significant voice on the direction of the profession in Egypt. Grant Thornton now has representation on this Board with Tarek Youssef being appointed to complete a six year term.

Grant Thornton representative appointed to UK GAAP Technical Advisory Group

Robert Carroll from Grant Thornton's UK member firm has been appointed to the Financial Reporting Council's UK GAAP Technical Advisory Group.

The UK GAAP Technical Advisory Group was established in June 2013. It will provide advice on accounting (and related company law) for entities applying UK accounting standards. Its initial focus will include the implementation of FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland', and the future of the Financial Reporting Standard for Smaller Entities.

Round-up

IASB indicates how it may address disclosure overload

Towards the end of May the IASB published a Feedback Statement summarising the discussions that took place during the forum hosted by the IASB on financial information disclosure in January of this year.

As well as summarising those discussions, the Feedback Statement sets out the recommended actions resulting from them. With reference to its own responsibilities, the IASB intends to take action in three main areas:

1. amendments to IAS 1 'Presentation of Financial Statements' – the IASB intends to make narrow scope amendments to IAS 1 to address perceived impediments to preparers exercising their judgement in presenting their financial reports
2. materiality – the IASB will seek to develop educational material on materiality with input from an advisory group
3. a separate project on disclosure – the IASB will consider as part of its research agenda the broader challenges associated with disclosure effectiveness.

A few weeks later, IASB Chairman, Hans Hoogervorst, expanded on these intentions in a speech in Amsterdam. During his speech, Mr Hoogervorst unveiled a ten-point plan designed to make disclosures more effective. He indicated that the IASB will look to:

1. clarify in IAS 1 that the materiality principle does not only mean that material items should be included, but also that it can be better to exclude nonmaterial disclosures
2. clarify that a materiality assessment applies to the whole of the financial statements, including the notes
3. clarify that if a Standard is relevant to the financial statements of an entity, it does not automatically follow that every disclosure requirement in that Standard will provide material information
4. remove language from IAS 1 that has been interpreted as prescribing the order of the notes to the financial statements
5. make sure IAS 1 gives companies flexibility about where they disclose accounting policies in the financial statements
6. add a net-debt reconciliation requirement
7. create either general application guidance or educational material on materiality
8. use less prescriptive wordings for disclosure requirements when developing new Standards
9. begin a research project to undertake a more fundamental review of IAS 1, IAS 7 'Statement of Cash Flows' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' during the second half of 2013
10. undertake a general review of disclosure requirements in existing Standards once the review of the above Standards has been completed.

EFRAG field-tests on insurance and leases proposals

The European Financial Reporting Advisory Group (EFRAG) in conjunction with a number of national standard setters in Europe is conducting a field-test in order to evaluate how the IASB's proposals on insurance accounting (see earlier article) will affect European companies applying IFRSs.

To aid in the process, EFRAG has developed a questionnaire which participants are requested to complete. Workshops will also be held in Brussels in which IASB staff will participate.

A similar field-test is being conducted on the IASB proposals on leases.

IFRS Foundation charts progress towards global adoption of IFRSs

The IFRS Foundation has completed the first phase of its initiative to assess the progress towards global adoption of IFRSs. The initiative is intended to provide a central source of information that permits interested parties to chart jurisdictional progress towards the achievement of that goal.

The completion of the first phase of this project sees the publication of IFRS profiles for all G20 (Group of 20 major economies) jurisdictions, as well as profiles for a further 46 jurisdictions who responded to a survey of national and regional bodies with overall responsibility for accounting standards within their jurisdiction.

The profiles describe each jurisdiction's decision regarding use of IFRSs. They also cover, where applicable, each jurisdiction's process for adopting or endorsing IFRSs under local law or regulations, as well as the process (if any) for translating IFRSs into the local language.

IASB Survey on Classification and Measurement of Financial Assets

The IASB has launched a survey for financial statement users on its November 2012 Exposure Draft 'Classification and Measurement: Limited Amendments to IFRS 9 (Proposed amendments to IFRS 9 (2010))'.

The IASB asks analysts and investors to provide input on the proposals in the Exposure Draft, in particular the proposed third category for the classification of financial assets (the 'Fair Value through Other Comprehensive Income' category). The survey, which is targeted at users of financial statements, is part of the IASB's programme of outreach activities.

EFRAG feedback statement on goodwill

EFRAG has issued a feedback statement on the findings of the survey it conducted last year on the subsequent measurement of goodwill.

The results of the study indicate that information on goodwill is used in many different manners and that there are many different views on how to measure goodwill after initial recognition. This diversity resulted in some respondents going so far as to claim that they did not use the information presented on goodwill at all.

EFRAG report on how IFRS 9 would affect the classification and measurement of financial assets

EFRAG has issued a report summarising the findings received from participants in its field-test on how IFRS 9 'Financial Instruments' would affect the classification and measurement of financial assets.

The field test was focused on the practical application of the new requirements and was intended to gather solely facts and objective data, by way of a questionnaire, rather than views and opinions. Findings from it included the following:

- more financial assets would be measured at 'fair value through profit or loss' under IFRS 9 because they fail the contractual cash flow characteristics assessment
- investment strategies and/or the level at which the business model test is performed could change when implementing IFRS 9 to achieve a particular accounting measurement.

Effective dates of new standards and IFRIC interpretations

The table below lists new IFRS Standards and IFRIC Interpretations with an effective date on or after 1 January 2011. Companies are required to make certain disclosures in respect of new Standards and Interpretations under IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

New IFRS Standards and IFRIC Interpretations with an effective date on or after 1 January 2011

Title	Full title of Standard or Interpretation	Effective for accounting periods beginning on or after	Early adoption permitted?
IFRS 9	Financial Instruments	1 January 2015	Yes (extensive transitional rules apply)
IAS 39	Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)	1 January 2014	Yes
IAS 36	Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)	1 January 2014	Yes (but only when IFRS 13 is applied)
IFRIC 21	Levies	1 January 2014	Yes
IFRS 10, 12 and IAS 27	Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)	1 January 2014	Yes
IAS 32	Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)	1 January 2014	Yes (but must also make the disclosures required by Disclosures – Offsetting Financial Assets and Financial Liabilities)
IFRS 10, 11 and 12	Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance – Amendments to IFRS 10, IFRS 11 and IFRS 12	1 January 2013	Yes
Various	Annual Improvements 2009-2011 Cycle	1 January 2013	Yes
IFRS 1	Government Loans – Amendments to IFRS 1	1 January 2013	Yes
IFRS 7	Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)	1 January 2013	Not stated (but we presume yes)

Effective dates of new standards and IFRIC interpretations

New IFRS Standards and IFRIC Interpretations with an effective date on or after 1 January 2011

Title	Full title of Standard or Interpretation	Effective for accounting periods beginning on or after	Early adoption permitted?
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	1 January 2013	Yes
IFRS 13	Fair Value Measurement	1 January 2013	Yes
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013	Yes
IFRS 11	Joint Arrangements	1 January 2013	Yes (but must apply IFRS 10, IFRS 12, IAS 27 and IAS 28 at the same time)
IFRS 10	Consolidated Financial Statements	1 January 2013	Yes (but must apply IFRS 11, IFRS 12, IAS 27 and IAS 28 at the same time)
IAS 28	Investments in Associates and Joint Ventures	1 January 2013	Yes (but must apply IFRS 10, IFRS 11, IFRS 12 and IAS 27 at the same time)
IAS 27	Separate Financial Statements	1 January 2013	Yes (but must apply IFRS 10, IFRS 11, IFRS 12 and IAS 28 at the same time)
IFRS Practice Statement	Management Commentary: A framework for presentation	No effective date as non-mandatory guidance	Not applicable
IAS 19	Employee Benefits (Revised 2011)	1 January 2013	Yes
IAS 1	Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)	1 July 2012	Yes
IAS 12	Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12)	1 January 2012	Yes

Effective dates of new standards and IFRIC interpretations

New IFRS Standards and IFRIC Interpretations with an effective date on or after 1 January 2011

Title	Full title of Standard or Interpretation	Effective for accounting periods beginning on or after	Early adoption permitted?
IFRS 1	Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendments to IFRS 1)	1 July 2011	Yes
IFRS 7	Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)	1 July 2011	Yes
Various	Annual Improvements 2010	1 January 2011 unless otherwise stated (some are effective from 1 July 2010)	Yes
IFRIC 14	Prepayments of a Minimum Funding Requirement – Amendments to IFRIC 14	1 January 2011	Yes
IAS 24	Related Party Disclosures	1 January 2011	Yes (either of the whole Standard or of the partial exemption for government-related entities)

Open for comment

This table lists the documents that the IASB currently has out to comment and the comment deadline. Grant Thornton International aims to respond to each of these publications.

Current IASB documents

Document type	Title	Comment deadline
Exposure Draft	Regulatory Deferral Accounts	4 September 2013
Exposure Draft	Leases	13 September 2013
Exposure Draft	Insurance Contracts	25 October 2013
Exposure Draft	Agriculture: Bearer Plants (Proposed amendments to IAS 16 and IAS 41)	28 October 2013
Discussion Paper	A Review of the Conceptual Framework for Financial Reporting	14 January 2014

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