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OIC Update

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IFRS Foundation

IFRS Foundation review in progress

Under the Trustees' examination are the accountability and the independence of the Foundation

In the last few months, the Trustees of the IFRS Foundation have launched two initiatives to review the strategic and operational aspects of the Foundation. Indeed, two consultations have been initiated, one involving the IFRS *Interpretation Committee* and the other the *Strategy Review*. In both cases, the aim is to verify whether the IFRS Foundation, as it is currently structured and funded, is able to develop high-quality accounting standards for global-level adoption and, at the same time, to ensure accountability and independence in the standard setting process.

Consultation on the IFRS *Interpretation Committee*

The first consultation commenced in September 2010 and was concluded in January 2011.

The aim was to assess whether the IFRS *Interpretation Committee* (hereafter IFRS IC) is doing its work in an effective and efficient way. To this end, various aspects were examined, including, among others, the ambit of the IFRS IC's activities, its operating procedures and the criteria used to evaluate interpretation requests for inclusion in its agenda.

The OIC has highlighted an especially critical aspect concerning the way in which the decision not to include an issue in the agenda (so called rejections) is communicated regarding both cases where the question is referred to the Board for possible clarification of existing accounting standards and in cases where, in examining the issue, the Committee explains why it does not believe it necessary to give an interpretation.

Regarding the former, in some cases where the issue has been referred to the Board, the IFRS IC has given guidance as to the accounting treatment to be followed. In so doing, it is as if it has anyway given an interpretation of the question.

> The reasons for rejections should not contain interpretative statements

On the other hand, in the latter case, in explaining its reasons for not proceeding with an interpretation request, the IFRS IC tends not to limit its comments to the provisions of the international accounting standards that clarify the doubt concerning the interpretation. Often, the referral to the IFRS provisions is accompanied by interpretative statements that anyway change the existing regulatory framework.

The issue is especially sensitive for the European endorsement system because, as is well known, changes to accounting policies relating to new accounting standards and official interpretations (IFRIC) follow the standard due process while interpretative statements cause changes to accounting policies in the IFRS system without following the same due process.

Consultation on the *Strategy Review*

The second consultation, which commenced in November 2010 and was concluded at the end of February 2011, focused not only on aspects relating to the due process of the Foundation but also on strategic issues and questions of governance. The matters considered in this second consultation were:

- ⇒ the mission, which currently consists in developing, in the public interest, high-quality and globally accepted accounting standards;
- ⇒ governance, with particular reference to the role of the Trustees and the Monitoring Board;
- ⇒ the due process for approval of international accounting standards issued by the IASB;
- ⇒ the ways of funding the Foundation.

In its contribution to the second consultation, the OIC highlighted, among other things, that one of the most sensitive issue concerns the ways in which the Foundation is financed.

Indeed, the IFRS Foundation requires more stable funding to enable it, on the one hand, to ensure continuity in its work and, on the other, to achieve the financial independence that is essential for its accountability and the independence of the standard setting process.

Currently, its funding comes in part from direct contributions made by private entities and in part through a funding mechanism, the so-called *National Financing Regimes*, adopted in some countries by governmental bodies, standard setters and stock exchanges. The OIC is an example of this type.

It is clear that *National Financing Regimes* enable greater stability and independence because they avoid direct financing by private entities. This type of contribution still accounts for a significant share, about 34% of the financial resources of the IFRS Foundation.

Financial independence is essential for ensuring the accountability of the Foundation and the independence of the standard setting process

The OIC pointed out that the contribution mechanism should principally be funded by countries that adopt IFRSs, given the significant regulatory impacts that they have accepted they should have in their systems.

Another significant aspect of the consultation concerns the Foundation's due process. The aim is to ascertain to what extent the current standard setting process enables the development of high-quality standards and to identify the work priorities, in addition to considering those aspects concerning the uniform application of the standards.

In the opinion of the OIC, much has been done in recent years to improve the due process to make it more efficient and transparent. However, some aspects could be further clarified or developed. For example, the current due process provides for the undertaking of impact analyses and field testing but does not specify how they should be conducted (regarding this point, see the following paragraph of the Discussion Paper "Considering the Effects of Accounting Standards"). Such impact assessments constitute fundamental step towards improving the evaluation of proposals and their practical implications, thereby responding to the aim of developing standards of high quality. For this reason, before launching a new project, the IASB should define the impact analysis that it intends to undertake and the ways in which it intends to involve the interested parties. Similarly, during the development of the project, it should determine the way in which the impact assessments should be conducted in order to verify the soundness of the decisions taken.

Another example concerns issues related to the application of the IFRSs. This is the field in which the IASB will presumably be most involved in the coming years; this also in view of the fact that, in coming years, new countries will adopt the IFRSs, and new standards, also particularly complex ones, will be coming into effect. In this context, the role of national accounting bodies will be significant as they can bring forward national issues and contribute to the undertaking of the impact assessments of new proposals.

Next Steps

Once the analysis of the comments received has been completed, at the end of March, the Trustees will issue a report, which they will distribute for discussion, on the actions that they intend to take.

In the light of the conclusions that will be reached, the constitution of the Foundation will be modified as necessary.

For further details on the views of the OIC, readers may refer to:

- OIC comment letter on *Status of Trustees Strategy review*
- OIC comment letter on *Review of the operational efficiency and effectiveness of the IFRS Interpretation Committee*

New EFRAG projects

The EFRAG and ASB publish the Discussion Paper "Considering the Effects of Accounting Standards"

This attempts to analyse how an accounting entity should address the issue of the "impacts" arising from the issuing of a new standard

In January, the EFRAG and the UK standard setter, the Accounting Standards Board — ASB, published the Discussion Paper (DP) *Considering the Effects of Accounting Standards*. The document was developed within the framework of the support activities of the EFRAG and the other European standard setters relating to the IASB. Its aim was to analyse how a standard setter should address the issue of the "impacts" arising from the issuing of a new standard.

There were a number of reasons that led the EFRAG to undertake this project.

First, the *Due Process Handbook for the IASB* establishes that there should be an analysis of the anticipated effects of adopting a new standard, however without exploring in depth how such an analysis should be conducted. The importance of an adequate effects analysis in due process of the IASB has been stressed by the both the European Commission and by the community of users of financial statements prepared in accordance with the IFRSs.

> The Discussion Paper should assist the IASB in defining an effects analysis procedure within its own due process

In addition, the financial crisis, which has fuelled an intense debate about the potential effects of accounting regulations on the stability of the financial system, has generated widespread awareness of the need for the IASB to adopt effects analysis procedures that are as rigorous as those applied by any other regulatory body.

The DP, appropriately modified and supplemented also on the basis of comments received during the consultation period, should assist the IASB in defining an effects analysis procedure within its own due process.

What the Discussion Paper proposes

Concerning content, after defining the effects analysis as *'a systematic process for considering the effects of accounting standards as those standards are developed and implemented'*, the document sets out some general criteria that should typify the way it is undertaken:

- ⇒ The effects analysis should be a mandatory phase in the due process that leads to the development of a standard in order to contribute to the transparency of the due process and the work of the standard setter and, consequently, to contribute to developing improved standards.
- ⇒ Responsibility for the effects analysis should remain with the standard setter that develop the accounting standards.
- ⇒ The analysis should cover the whole life cycle of the principle, but the due process should in any case establish that there be a mandatory verification once the standard has been in effect for a certain period of time.
- ⇒ The effects analysis should be undertaken for all new standards and for amendments to standards; however, its level of detail should be proportionate to the significance of the innovation (in terms of potential effects) and the time available.

The effects analysis is wider in scope than the cost-benefit analysis to which current IFRS literature refers. The proposal in the DP is follow a procedure that is structured into some key phases. The first is the preliminary explanation, by the standard setter, of the expected consequences of adopting the new accounting standard. Following this first statement, the standard setter should commit itself to promoting the gathering of comments and any objections that the various stakeholders may raise concerning the merits of amending the *standards* (or of publishing radically new ones).

> The effects analysis should be a mandatory part of the due process and be undertaken both in the developmental phase of a new standard and once it has come into force

Once this information has been obtained, the standard setter is in a position to then provide sufficient evidence that the new standard or the proposed amendment will improve the information provided by entities for the users of financial statements and, thus, can then move forward with the process of writing the new standards.

It is clear that the DP sees that at the heart of the new due process there should be close collaboration between the IASB and the national standard setters, as these are able to make a significant contribution (both in the study phase and in the application phase) to the analysis of the effects that the new standards are expected to have within their jurisdiction.
The publication of the document marks an important stage in the process of reviewing and improving the rules of governance of the IASB and, once again, confirms Europe's desire to contribute in a "pro-active" way to its renewal.
Consultations on the DP will close on 31 August 2011.

IFRS adopted by the European Union

EU Regulation 149/2011 on adoption of "Improvements to IFRS"

The European Commission adopts *Improvements to IFRS,* issued in May 2010. The Regulation is published in the EU gazette

The European Commission has adopted the amendments introduced to the international accounting standards by the *Improvements to IFRSs*. On 19 February 2011, the *Official Journal of the European Union* published Regulation No. 149/2011, which adopts the document issued by the IASB in May 2010.
As specified in the Regulation, the amendments are part of the annual improvement process that aims to simplify and clarify the international accounting standards. Most of them are clarifications or minor corrections to the existing IFRSs, or amendments stemming from changes previously made to the IFRSs.
The accounting standards that have been amended are IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 34 and IFRIC 13, in addition to amendments relating to IAS 27.
The changes thereby introduced are summarized below.

IFRS 1

The amendments to the standard concern three aspects and are to be applied for accounting periods beginning on or after 1 January 2011.

Changes in accounting policies for first-time adoption of IFRSs and interim financial reports

The amendment to IFRS 1 clarifies that the first-time adopter of the IFRSs that changes its accounting policies after the publication of the first interim financial report must explain these variations in the presentation of the effects stemming from the first application of the international accounting standards.

Deemed cost

Under IFRS 1, the first-time adopter has the option to use, as deemed cost, the fair value as measured for an event such as a privatisation or an initial public offering (IPO) at a date at or before transition to the IFRS.
The IASB has decided to modify IFRS 1 to allow the first-time adopter to use, as deemed cost, the fair value measured at the date of such events that occurred after the date of transition to the IFRSs but within the period covered by its first IFRS financial statement. The revaluation can only be made at the measurement date and comparative amounts does not include those fair value amounts.

Use of deemed cost for operations subject to rate regulation

An entity that operates in sectors under rate regulation may be carrying costs or charges for property, plant and equipment or intangible assets in its pre-IFRS financial statements that do not qualify for capitalization in accordance with IFRSs. Under IFRS 1, an entity shall recalculate those values as if it had applied the IFRSs from the outset or use the exemption of fair value as deemed cost.
The IASB has noted that, for a first-time application, it is not always easy to recalculate values that comply with the IFRSs and that this task may be particularly burdensome. Therefore, it has decided to allow such entities to use the carrying amounts for plant and intangible assets as determined on the basis of previous accounting standards as deemed cost at the date of transition to the IFRSs.

IFRS 3

The amendments to the standard concern three aspects and are to be applied for accounting periods beginning on or after 1 July 2010.

Transitional requirements for contingent consideration from a business combinations that occurred before the effective date of the revised version of IFRS 3 (IFRS 3R)

The introduction of IFRS 3R has created possible conflicts over how to measure the effect of the contingent consideration from a business combinations that occurred before the effective date of IFRS 3R. Indeed, as is well known, IFRS 3R provides that changes in the fair value of the contingent consideration should always be recognised in the income statement, whereas under the earlier IFRS 3 such changes were recognised against goodwill.

The IASB has clarified that, consistent with the prospective application of IFRS 3R, contingent consideration from a business combinations whose acquisition preceded the effective date of IFRS 3R are to be accounted for on the basis of the provision contained in the earlier version of IFRS 3, and therefore through changes to goodwill.

Awards held by the acquiree's employees exchanged for acquirer share-based payment awards

The IASB has addressed the case where in a business combination the acquirer decides voluntarily to exchange the stock options held by the acquiree's employees with its own. Indeed, currently, IFRS 3R only covers the stock options schemes that the acquirer is contractually obliged to exchange for its own shares as part of a business combination.

The IASB has clarified that the accounting treatment should be the same in both cases.

Measurement of non-controlling interests

Currently, IFRS 3R sets that non-controlling interests shall be measured initially at fair value or on the basis of the proportionate share in the recognized amounts of the acquiree's identifiable net assets. This provision could lead to cases where some "potential" non-controlling interests are included in the concept of non-controlling interests under IFRS 3R, but being without a corresponding proportionate share of the net assets are measured at zero in equity. One can think of the case where the acquirer considers that also the equity component of a convertible debt instrument is a non-controlling interest. In this case, as the bondholders have no immediate claim on the entity's net assets, that share of the non-controlling interest could be measured at zero in the post-combination accounts.

For this reason, the IASB has clarified that, for the purposes of IFRS 3, non-controlling interests are those that currently give a right to a proportionate share of the entity's net assets in the event of liquidation. The other equity components acquired (e.g. the equity component of a convertible debt instrument) that do not fall under this definition must be measured at the acquisition-date fair value unless another measurement basis is required by IFRSs.

IAS 1

The IASB has amended IAS 1 to clarify that entities may present the reconciliations required for each component of other comprehensive income (OCI) in the statement of changes in equity or in the notes where this is deemed excessively burdensome.

The amendments are to be applied for accounting periods beginning on or after 1 January 2011.

IFRS 7

The IASB has decided to intervene so that the quantitative and qualitative information on the nature and extent of the risks related to financial instruments are clearly disclosed in a coherent manner and linked with one another.

Furthermore, the IASB has decided to remove the concept of "materiality" from IFRS 7. Currently, the standard mentions the materiality of information as regards information of a quantitative nature. However, the same requirement is not mentioned for information of a qualitative nature. Therefore, in the opinion of the IASB, this could have led to the providing of qualitative information also in cases where it would not be significant.

The amendments are to be applied for accounting periods beginning on or after 1 January 2011.

IAS 21, IAS 28 e IAS 31

As is known, in January 2008, amendments were made to IAS 27, which were to be applied prospectively. These amendments concerned the changing of the terminology from "minority interest" to "non-controlling interest" and the loss of control of a subsidiary, of the significant influence over an associate and of the joint control of a joint venture.

However, on that occasion, prospective application was not envisaged for the amendments that IAS 27 implied for IAS 21, IAS 28 and IAS 31.

The amendments are to be applied for accounting periods beginning on or after 1 July 2010.

IAS 34

As is known, in March 2009, the IASB amended IFRS 7 regarding the information to be disclosed for financial instruments measured at fair value, introducing, *inter alia*, specific information requirements for the 3 levels of the hierarchy of fair value. With this amendment, the IASB has decided to extend the information requirements also for interim financial statements prepared under IAS 34.
The amendments are to be applied for accounting periods beginning on or after 1 January 2011.

IFRIC 13

As is known, on the basis of IFRIC 13, the award credits for customer loyalty programmes are measured at their fair value or, if this is not directly observable, on the basis of the fair value of the awards for which they could be redeemed.
The intervention of the IASB clarifies that for the measurement of the fair value of the awards available it is necessary to take into account the amount of the discounts or incentives that would normally be offered to customers who purchase the products.
The amendments are to be applied for accounting periods beginning on or after 1 January 2011.

OIC Documents

Publication of OIC Application on "Impairment and goodwill" for the banking sector

It provides clarifications and specific examples for the sector

In December 2009, the Organismo Italiano di Contabilità (OIC) published Application 2 *"Impairment and goodwill"*, which contains some considerations and examples about how to apply IAS 36 *Impairment of Assets* in conducting the impairment test of the goodwill in the industrial and service sectors. In March 2011, the OIC published a supplement to this document intended to cover the characteristics and specific features of the banking sector: Application 2.1. *"Impairment and goodwill"* for the banking sector.
The issuing of a specific document is justified by the presence in the banking sector of some particular issues (in some cases significant) relating to the impairment test in the industrial and service sectors. It should be noted that the new Application supplements those aspects covered in Application 2, which therefore remain valid also for entities in the banking sector.
Among the principal issues addressed in the document are: the definition of cash generating unit (CGU), the carrying amount of the CGU, the measurement of the recoverable value of the CGU, with particular regard for the estimate of the value in use.

Definition of CGU

To identify the level at which it is necessary to test the impairment of goodwill (CGU), the Application establishes that "the internal organization and the methods of management and control of the business are extremely important". In the banking and finance sector, the methods of management and control of the business, and hence the identification of the management policies that determine the cash inflows (revenues), are typically linked to the type of product/service, to the type of client for which the products/services are intended and/or to the physical location.
The aim of the document is to provide guidance on the correct identification of the CGU in relation to the degree of organizational and operational integration that in fact exists.

Carrying amount of CGU

Another aspect that the Application addresses is the definition of the carrying amount of a CGU. Broadly speaking, IAS 36 establishes that liabilities should not be included in the carrying amount of the CGU except where the recoverable value of the CGU can only be estimated by also including specific liabilities. In the case of a banking entity, financial liabilities, in principle excluded under IAS 36, like financial assets, form part of the entity's core business; therefore, it is impossible to identify the cash flows of the CGUs without considering the cash flows associated with the financial assets and liabilities. The latter represent the "goods" that enable development of the business areas and that contribute to the generation of the main cash flows stemming from the development of business.

Estimating recoverable value

Concerning value in use, the Application stresses that, in the case of banking entities, in practice, the measurement models are not applied in an "unlevered" way (as expressly stated in IAS 36) as the debts (deposits, bonds, etc.), as already noted, are of a very different nature compared with other kinds of entities. They do not represent just a way of financing investments, rather they are an integral and preponderant part of banking activity. Therefore, the measurement of the value in use for banks generally uses an "equity side" approach, that is, by using levered models in which the cash flows are considered net of the financing component, and therefore refer to an income flow pertaining to the shareholders.

Value in use determined with an equity side approach

For the purposes of estimating the value in use, the OIC, in addressing the issue, considered the question of the compatibility of the formula of the Dividend Discount Model (DDM) with the provisions of IAS 36. After having activated the international consultation procedure and verified the range of treatments at the global level, the OIC submitted a formal query to the IFRS IC. In November 2010, the IFRS IC said that use of the DDM may be appropriate "*when calculating value in use of a single asset, for example when an entity applies IAS 36 in determining whether an investment is impaired in the separate financial statements of an entity*".

For further details, please refer to the OIC Web page to consult the following documents (available in Italian only):

- Application 2.1. *Impairment and goodwill* for the banking sector
- Comments received during public consultation

New OIC projects

Project for the review of national accounting standards

The OIC has launched a project to update the national accounting standards. With the public consultation phase completed, a first set of 6 accounting standards are now being examined.

Most of the current national accounting standards were written in a period when entities had to prepare their financial statements in accordance with EU directives. Thus, their content reflects the perceived needs of the time for, above all, large entities and especially listed companies to provide information that was clear and exhaustive.

As is known, since 2005, listed companies and other large entities have prepared their financial statements on the basis of the international accounting standards. This reflected a need of the markets driven by the integration of the main financial markets.

This change in the reference scenario has been considerable and, after some years of application of the new discipline, there has been a greater focus on those entities that have not adopted the international accounting standards.

The European Commission has itself launched a series of projects to revise European accounting directives with a view, *inter alia*, to simplifying their discipline, especially at the level of information for small and medium entities. The aim is to lessen the administrative burden for such entities.

It is in this context that the project to update existing national accounting standards is taking place. The aim is to update them also in the light of who the actual users are (mainly small and medium entities) in order to create a set of rules that can address the needs of these parties.

To this end, in the second half of 2010, the OIC opened up a public consultation that drew responses from both the professional associations (ANDAF, ASSIREVI, CNDCEC, SIDREA and local professional orders) and individual professionals and academics. The project drew a general consensus and there were numerous technical suggestions for improving the existing accounting standards.

There were also suggestions as to possible questions to be addressed in new accounting standards or by supplementing existing ones (such as, for example, issues relating to agriculture, derivatives, freely transferable assets and stock options). With the consultation concluded and with the awareness of the magnitude of the task, a special working group was set up comprising expert representatives of the stakeholders. Thus, in 2011, the updating of the individual standards commenced through: a) an evaluation of the comments received with a view to their inclusion; b) an examination of the proposals for improvements and additions; c) the final drafting of the standard for final approval.

The work programme envisions that the following standards should be examined first:

OIC 15 - Credits;

OIC 16 – Tangible assets;

OIC 18 - Accruals and payables;

OIC 19 - Provisions – Severance indemnity for subordinate employment – Debts;

OIC 20 - Securities and Interests;

OIC 29 - Changes to accounting principles, changes to accounting estimates, correcting errors, extraordinary operations and events, events occurring after the end of the accounting period.

The remaining accounting standards will be finalized by the end of 2012. The due process for approval establishes that, as the standards are developed, they should be distributed for public consultation and, once the comments have been examined, sent for final publication.

On the OIC Web page about the project, it is possible to consult:

- the questionnaire distributed for comments;
- the comments received on OIC 15, 16, 18, 19, 20, 29.