

IFRS outlook

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SEC reaffirms US commitment to IFRS

As more countries base their local accounting standards on IFRS, the US Securities and Exchange Commission (SEC) has issued a timely reiteration of its support for IFRS as the single set of global standards. Find out more about the SEC's statement and our views on this positive development.

Investment companies – consolidate or measure at fair value?

In a significant step towards convergence of IFRS and US GAAP, the IASB tentatively decided that an 'investment company' should no longer need to consolidate investments in entities it controls. Instead it should measure these investments at fair value through profit or loss. Read about the implications of this proposed change on entities in the asset management and private equity sectors, as well as investees of such companies.

The effective date of IFRIC 18 for European entities

For European entities reporting under European Union (EU) IFRS, the interaction between the endorsement date of the Interpretation by the EU and the effective date of IFRIC 18 has caused some confusion. Learn about our view on how European entities should apply IFRIC 18.

Rate-regulated activities – where to next?

In February 2010, the IASB discussed the comment letters received for the *Rate-regulated Activities* Exposure Draft and the next steps on the project. Read about the Board's most recent discussions, and what the potential delay means for regulated entities, particularly in converting countries.

Financial reporting developments

Which International Accounting Standards Board discussions could significantly impact your business? In this issue, we look at tentative decisions on: financial instruments, insurance contracts, financial statement presentation, fair value measurement and leases.

Resources

Register for our webcast on financial instruments on 23 March. Our distinguished panel will discuss the proposals to reform accounting for financial instruments and the potential impacts on businesses. The panel will also offer some insights into application issues around adopting the amendments to IFRS 7.

We welcome your feedback on *IFRS outlook*. Please contact us at ifrs@uk.ey.com. The next issue will be published in April 2010.

Ruth Picker
Global Leader of IFRS Services

SEC reaffirms US commitment to IFRS



The US Securities and Exchange Commission's (SEC) statement on 24 February 2010 reiterated its support for a single set of high-quality global accounting standards and for the continued support for convergence of US Generally Accepted Accounting Principles (US GAAP) and International Financial Reporting Standards (IFRS). The SEC also reaffirmed its backing for IFRS as the single set of global standards.

To aid the SEC in evaluating IFRS, the staff of the Office of the Chief Accountant will prepare a comprehensive Work Plan that addresses specific factors and areas of concern, which will enable the SEC to make a decision in 2011 on whether, how and when IFRS should be incorporated into the US financial reporting system.

The Work Plan will address the following areas of concern that were highlighted in comment letters submitted in response to the SEC's IFRS Roadmap issued in November 2008:

- ▶ Sufficient development and application of IFRS for the US domestic reporting system
- ▶ The independence of the standard setting process
- ▶ Investor understanding and education
- ▶ Examination of the US regulatory environment that would be affected by a change in accounting standards

- ▶ The impact of IFRS on US issuers, both large and small
- ▶ Human capital readiness

As part of the development of the Work Plan, the staff have also been asked to consider the ongoing role of the Financial Accounting Standards Board (FASB) if IFRS were to be incorporated into the US financial reporting system.

Ernst & Young's views

IFRS is quickly becoming the international standard, with 110 countries having already adopted it or in the process of adopting it. The US is the only major capital market that has not yet moved to adopt IFRS. Investors – including those in the US – are increasingly investing in companies that report under IFRS, both in and outside of the US. A perpetual two-GAAP world is not realistic, nor is it best for investors. Therefore, we commend the SEC for reaffirming its belief in a single set of high-quality global accounting standards and we are pleased that the SEC expressed its support for IFRS as that single set of high-quality standards.

We feel that a single standard for all will eliminate arbitrage between standards, level the playing field for companies globally, and lessen the potential for political interference in the standard-setting process.

Investment companies – consolidate or measure at fair value?

An exception to the principle in IFRS that an entity consolidates all controlled investments, which has been previously requested by the asset management and private equity sectors, may be on the horizon. In a joint meeting between the International Accounting Standards Board (IASB) and the US FASB on 17 February 2010, the IASB tentatively decided that an 'investment company' will be required to measure investments in entities that it controls at fair value through profit or loss, rather than consolidating such investments. This tentative decision is a significant step towards converging IFRS and US GAAP with respect to this issue. Representing a significant change from the IASB's proposal in the Exposure Draft (ED) 10 *Consolidated Financial Statements*, it is likely that the IASB will re-expose this tentative decision for public comment.

Background

Currently, IAS 27 *Consolidated and Separate Financial Statements* requires an entity to consolidate all entities that it controls. This principle applies regardless of the nature of the investor and the reason that it controls the underlying investment. ED 10 *Consolidated Financial Statements*, which will replace IAS 27 when issued, proposes to repeat this principle, but with a changed definition of 'control'.

While this requirement works in practice for most entities, many parties believe that when the investor is an 'investment company', consolidating the controlled investment does not provide useful decision-making information in the financial statements. Rather, many respondents to the ED (such as those in Box 1) commented that an investment company should recognise its controlled investment at fair value (through profit or loss), because that information is more useful to the users of the financial statements.

Box 1: Excerpt from a Comment Letter on ED 10

"We think that structures that hold controlling interests in other entities for investing, rather than operating, purposes should report those investments at fair value. Reporting the fair value of these investments is appropriate because users make their investment decisions based on the fair value of the investments held, and not based on how the individual assets and liabilities held by each entity are utilized. The investments are managed and financed independently and value will be derived by the entity directly realizing the investment. From our experience, consolidated financial statements of these types of investment companies would be useless because they would exclude information that would affect decisions users make. Therefore, we think that the fair value of controlling interests held in other entities is the most decision useful information about investment companies."

*User Advisory Council of the
Accounting Standards Board of Canada*

The IASB appears to have been persuaded more by the feedback from analysts and preparers this time around than when it previously deliberated this topic when it revised IAS 27 in 2003 and when it issued ED 10. The IASB tentatively agreed to grant an exception to consolidation for controlled investments, whereby an investment company measures controlled investments at fair value. Because a similar concept already exists in US GAAP, and there is significant pressure to issue a converged standard in this area, this tentative decision is likely to be regarded favourably by US markets.

Investment companies – consolidate or measure at fair value? *continued*

Definition of ‘investment company’

The focus of the joint board meeting then turned to which companies should be included within the definition of ‘investment company’ under IFRS. Under US GAAP¹, an investment company is one that meets all four of the following criteria:

- ▶ **Investment activity** - the investment company’s primary business activity involves investing its assets, usually in the securities of other entities not under common management, for current income, appreciation, or both
- ▶ **Unit ownership** - ownership in the investment company is represented by units of investments, such as shares of stock or partnership interests, to which proportionate shares of net assets can be attributed
- ▶ **Pooling of funds** - the funds of the investment company’s owners are pooled to provide owners with professional investment management
- ▶ **Reporting entity** - the investment company is the primary reporting entity

The IASB tentatively decided that these criteria should be the basis for developing the attributes of an ‘investment company’ under IFRS. Therefore, the next step is for the IASB staff to remove any US-specific references and make the definition fit for international users.

Based on a preliminary analysis by the IASB staff, if IFRS adopts a definition of ‘investment company’ similar to that under US GAAP, entities such as mutual funds, hedge funds, unit investment trusts and common collective trusts would measure their investments at fair value, rather than consolidate such investments.

Venture capital and private equity funds

There was considerable discussion at the joint board meeting between the members of the IASB and the FASB regarding whether venture capital (VC) and private equity (PE) funds should be included within the definition of an ‘investment company’. Currently, under US GAAP, these entities measure their investments at fair value, not because they meet the criteria, but rather because a ‘rule’ in US GAAP includes such VC and PE funds in the definition of an ‘investment company’. In contrast, under current IFRS, such entities already consolidate their investments.

Some board members differentiated between funds that actively manage investments that they control, versus the controlled investments for which they are passive investors. They noted that when a VC or PE fund takes an active management role in the investee, it fails the ‘investment activity’ criterion, because there is ‘common management’. They felt that when a fund takes an active management role in the investee, the fund should consolidate its investment.

Other board members believe that whether or not the fund actively manages the investment is irrelevant and that such entities should be ‘investment companies’ and measure their investments at fair value.

The IASB did not reach any tentative decisions on these points, but will discuss them in more detail at a future meeting.

¹ Pursuant to US FASB Accounting Standards Codification (ASC) Topic 946-10-15-2 (formerly the AICPA Investment Company guide).



Other issues

As a separate issue, the boards will discuss whether a fund manager should consolidate an investment fund. Future discussions are expected to focus on how to determine whether a fund manager is acting as a principal or an agent with respect to the fund.

The Boards discussed at the joint meeting whether to provide guidance on the use of this exception by an investor or parent of an investment company, but did not reach any tentative decisions. Use of this exception in the accounting by a group is expected to be discussed in more detail at a future meeting.

Disclosures

The Boards discussed at the joint meeting whether to require the following disclosures:

- ▶ Fair value for each material controlled (but not consolidated) investment (including the methodology and inputs used to determine fair value)
- ▶ Key financial information about controlled (but not consolidated) investees, including assets, debt, liabilities other than debt, revenues and earnings results (e.g., profit or loss)

No tentative decisions were reached, including whether the measures above are required to be prepared in accordance with IFRS or could be prepared in accordance with some other local GAAP. In the past, the IASB required disclosures of financial information of investees (such as those required for associates and joint ventures) to be in accordance with IFRS. Disclosures will be discussed in more detail at a later meeting.

Business impact

Entities in the asset management and private equity sectors should carefully monitor developments with respect to these proposals and are strongly encouraged to comment on the proposals if they are issued for re-exposure. In particular, management should consider:

- ▶ Measuring such investments at fair value might result in increased volatility in profit or loss
- ▶ Preparing the disclosure requirements (once tentatively agreed upon) might negate any potential benefits achieved from not consolidating
- ▶ Making this change (if the IASB requires investment companies to measure controlled investments at fair value) might call into question whether such entities should still be able to choose whether to measure joint ventures and investments in associates at fair value (or be required to do so)
- ▶ Modifying current processes for the guidance and disclosure requirements for the standard on *Fair Value Measurements*, which is expected in the third quarter of 2010, might take additional time and effort

In addition, the decisions by the IASB might significantly affect entities that are outside the asset management and private equity sectors, but that are investees of such companies, particularly in countries converting to IFRS. For example, if the IASB continues to require a private equity fund that actively manages its investments to consolidate such investments, the investees will be required to prepare financial statements in accordance with IFRS, or to reconcile from the investee's local GAAP to IFRS. However, even if the IASB grants this exception, disclosures might have to be prepared in accordance with IFRS. Therefore, investees will still have to decide whether to convert to IFRS to prepare disclosures, or reconcile from their local GAAP to IFRS. Given that conversion to IFRS can be time-consuming, management of both the investor and the investee should prepare for both outcomes.

The effective date of IFRIC 18 for European entities



In December 2009, the European Union (EU) endorsed the use of IFRIC 18 *Transfers of Assets from Customers* for European entities reporting under EU IFRS. However, the endorsement date differs from the date on which the IFRIC became effective, which is causing some confusion as to how entities transition to the new Interpretation. This article clarifies how we believe the EU endorsement date and the effective date of IFRIC 18 interact.

Article 2 of the endorsement states:

'Each company shall apply IFRIC 18 and the amendments to IFRS 1, as set out in the Annex to this Regulation, at the latest, as from the commencement date of its first financial year starting after 31 October 2009.'

Paragraph 22 of IFRIC 18 (included without amendment within the endorsed interpretation) states:

'An entity shall apply this Interpretation prospectively to transfers of assets from customers received on or after 1 July 2009. Earlier application is permitted provided the valuations and other information needed to apply the Interpretation to past transfers were obtained at the time those transfers occurred. An entity shall disclose the date from which the Interpretation was applied.'

As an example, assume Entity A has CU 100,000 of transfers of assets from customers between 1 July 2009 and

31 December 2009 and CU 300,000 of transfers of assets from customers between 1 January 2010 and 31 December 2010. How does Entity A apply IFRIC 18 when it begins applying it from 1 January 2010?

The EU endorsement dictates when EU companies should adopt IFRIC 18 – for years commencing on or after 1 November 2009. The endorsement, however, did not alter the transition requirements or the transactions to which the IFRIC should be applied. This means the endorsed Interpretation applies to transfers of assets on or after 1 July 2009. Therefore, we believe that there is no conflict between the EU endorsement and the effective date of IFRIC 18. The correct application for Entity A is to adopt IFRIC 18 as of 1 January 2010 with a restatement of the 2009 results for the transfers received on or after 1 July 2009.

If Entity A is also required to report compliance with IFRS as issued by the IASB, then it must adopt IFRIC 18 for transfers after 1 July 2009 during the 2009 reporting cycle. An entity that does not adopt IFRIC 18 for transfers on or after 1 July 2009 during the 2009 reporting cycle will not be in compliance with IFRS as issued by the IASB going forward.

As European entities complete their 2009 annual reporting process and enter into their first reporting cycle for 2010, they must consider the transfers made on or after 1 July 2009 and restate their comparatives, if material.

Rate-regulated activities – where to next?

In July 2009, the IASB issued an ED, *Rate-regulated Activities* to address the recognition of regulatory assets and regulatory liabilities under IFRS. The IASB and preparers had hoped that the ED would finally clarify the accounting for the effects of regulation under IFRS. In February 2010, the IASB discussed the comment letter responses, which show that the debate is far from over. In this article, we discuss the Board's February discussions, what they mean for regulated entities and the potential paths forward for the project.

February IASB discussions

The IASB received 155 comment letters on the ED. Overall, those in the utility industry (preparers, regulators and associations) broadly supported the proposals. Conversely, other respondents, such as accounting firms, standard setters and accountancy bodies, were more divided on the issue. Paramount amongst their concerns is that regulatory assets and regulatory liabilities do not meet the current definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements* (Framework). In addition, most respondents expressed concerns about the scope, recognition, measurement and disclosure aspects of the ED.

In our December 2009 issue of IFRS *outlook*, we noted that we did not believe the current asset and liability definitions were met in the ED. We believe, however, that the economic impact of regulation should be reflected in the financial statements of regulated entities. Therefore, we expressed support for a separate standard for rate-regulated activities in order to provide decision-useful information for investors and stakeholders.

Given the diversity in views as to whether regulatory assets and regulatory liabilities meet the definitions in the Framework, the IASB staff presented only one technical issue at the February meeting: do regulatory assets and regulatory liabilities exist in accordance with the current Framework and consistent with other current IFRSs?

The staff believed that the answer to this question was the key to determining the way forward for the project. The following potential paths were presented to the Board:

- ▶ Finalise a stand-alone IFRS with appropriate changes
- ▶ Incorporate the project as amendments to current IFRS
- ▶ Issue a disclosure only standard
- ▶ Defer the project
- ▶ Cancel the project

The Board did not select one of the proposed paths. Rather, it instructed the staff to continue their research and analysis on this project, to focus on the key issues of whether regulatory assets and regulatory liabilities exist in accordance with the current Framework and whether recognition would be consistent with other current IFRS. Meanwhile, the Board tentatively decided to finalise the transition relief for first-time adopters. The exemption allows entities with rate-regulated activities to use the carrying amount of their property, plant and equipment and intangible balances from their previous GAAP (which include amounts that would not be permitted for capitalisation under IAS 16 *Property, Plant and Equipment*, IAS 23 *Borrowing Costs* and IAS 38 *Intangible Assets*) as its deemed cost upon transition to IFRS. The transition relief is expected to be included in the omnibus *Improvements to IFRSs*, due to be issued in April 2010.

Rate-regulated activities – where to next? *continued*

Ultimately, the fate of the project will be determined by the technical analysis the staff have been asked to perform. However, the Board's decision to conduct further analysis means that it is highly unlikely that an IFRS will be issued in 2010. In fact, the staff's revised timeline presented in the February 2010 staff paper indicates a final IFRS will not be issued until the second half of 2011. This timeline includes re-exposure of an ED, which is likely to be required if the Board selects any of the first three paths forward listed above.

What does the delay mean?

Regulatory assets and regulatory liabilities are recognised in very limited circumstances by regulated entities currently reporting under IFRS. As a result, the delay in the project timeline is not likely to have a significant impact on them, as they will continue with their current reporting until the IASB makes a final decision on the project. However, the delay is significant for regulated entities in countries converting to IFRS in the near term that have historically looked to US GAAP FASB ASC Topic 980 – *Regulated Operations*.

Below we discuss some key issues that entities are currently addressing in their conversion plans and how they might react to the changes in the projects' timeline:

Allowance for funds used during construction (AFUDC) and overhead costs capitalised in construction projects: Certain regulators allow the capitalisation of certain costs for rate setting purposes that are not capitalised in accordance with IFRS. In some jurisdictions, AFUDC represents capitalisation of interest and includes a component that capitalises the cost of equity on construction projects. Similarly, many regulators permit the capitalisation of overhead costs that are calculated on a fully

allocated basis. These amounts are then recovered in rates in future periods. Over time, these regulatory practices have become generally accepted under certain national GAAPs, allowing regulated entities to use their regulatory balances for external reporting.

The IASB's tentative decision to provide relief for first-time adopters in this area eliminates the need for entities to restate their historical balances. However, the ED had also proposed this exemption be provided on a prospective basis (paragraph 16 of the ED). Given the status of the project, it is uncertain as to whether this prospective exemption will be provided. As a result, entities should be evaluating necessary systems and reporting changes such that the property, plant and equipment and intangible balances reported externally only include amounts permitted by IAS 16, IAS 23 and IAS 38 after adoption of IFRS.

Asset retirements: Many regulators also prescribe the accounting for asset retirements. For example, in the United States, the full cost of the asset is charged to accumulated depreciation, together with any related cost of removal. Any salvage is credited to accumulated depreciation. Depreciation rates are periodically adjusted for any differences that may be created by this accounting. Again, these amounts are collected through rates charged to customers. IAS 16 does not allow such treatment and requires a gain or loss to be recorded upon disposal, with the cost of removal being expensed as incurred and all assets to be depreciated at a component level. For first-time adopters, the relief proposed exempts past transactions from being restated, but is not prospective in nature. Therefore, entities should be continuing with system and reporting changes to ensure that gains and losses, salvage costs and depreciation are in accordance with IAS 16.



Contributions in aid of construction: A common occurrence in the industry is receiving contributions to aid construction. These contributions arise from developers contributing property, customers paying for line extensions or underground service and governments seeking line relocations. Many regulators require or permit these contributions to be recorded as a reduction in the cost of the asset. In January 2009, the IFRIC issued IFRIC 18 *Transfer of Assets from Customers* which addresses such transactions. IFRIC 18 requires that these assets transferred be recognised as assets by the recipient and revenue recognised for the related service. For first-time adopters, the relief proposed exempts past transactions from being restated, but is not prospective in nature. Therefore, entities should be continuing with system and reporting changes to comply with IFRIC 18.

Investor relations and contractual compliance: Investors in regulated entities that have looked to ASC 980 are accustomed to the recognition of regulatory assets and regulatory liabilities. As a result of transitioning to IFRS and not reporting the effects of regulation as separate regulatory assets and regulatory liabilities, an entity's financial results will generally exhibit more volatility, which may impact compliance with existing contracts, such as debt covenants. Entities should be educating investors and other stakeholders now on the financial reporting effects that may result from a restriction on the ability to recognise regulatory assets and regulatory liabilities.

Conclusion

The issue of whether regulatory assets and regulatory liabilities should be recognised under IFRS has been lingering since 2004 when it was first presented to the IFRIC. We applaud the IASB for tackling the issue in a formal project and issuing the ED. Whichever path the IASB chooses, we believe it must be one that puts an end to the debate. Simply delaying or deferring resolution of the issue will only lead to diversity and confusion in practice.

Financial reporting developments

The IASB (the Board) met in London on 2 and 10 February 2010 and again on 15-19 February 2010. The meetings on 2 and 10 February and 16-18 February were held jointly with the US Financial Accounting Standards Board (FASB) (collectively, the Boards). The table below summarises the main decisions reached at these meetings. In the following pages, you will find more detailed information about the highlighted items in the table.

Projects	Key discussion points	Status
Financial instruments with characteristics of equity	<p>The Boards continued their deliberations on the proposals to include in the ED, and tentatively made (or affirmed) decisions in respect to the following:</p> <ul style="list-style-type: none"> ▶ Scope ▶ Instruments to be classified as equity ▶ Ability to issue equity instruments ▶ Contracts to repurchase own shares ▶ Convertible debt ▶ Puttable shares ▶ Presentation of freestanding written put options ▶ Classification of subsidiary instruments in consolidated financial statements 	ED expected Q2 2010
Classification and measurement – financial liabilities	<p>The Boards continued their deliberations on the proposals to include in the ED, and made tentative decisions with respect to measurement of financial liabilities.</p>	ED expected Q1/Q2 2010
Hedge accounting	<p>The Board tentatively decided to permit hedging by risk component (i.e., bifurcation-by-risk) for financial items and indicated a leaning toward permitting bifurcation-by-risk for non-financial items.</p> <p>The Board also tentatively decided to explore a new criterion for the purpose of determining risk components eligible for designation as hedged items.</p>	ED expected Q2 2010
Derecognition of financial instruments	<p>The Board discussed the feedback received on the ED and made tentative decisions on a number of topics.</p>	IFRS expected Q4 2010

ED = Exposure Draft, Q1 2010 = First quarter of 2010, Q2 2010 = Second quarter of 2010, Q3 2010 = Third quarter of 2010, Q4 2010 = Fourth quarter of 2010, H1 2010 = First half of 2010, H2 2010 = Second half of 2010



Projects	Key discussion points	Status
Revenue recognition	<p>The Boards tentatively decided that the proposed standard would apply to contracts with customers, except for:</p> <ul style="list-style-type: none"> ▶ Lease contracts within the scope of IAS 17 <i>Leases</i> or FASB ASC Topic 840 <i>Leases</i> ▶ Insurance contracts within the scope of IFRS 4 <i>Insurance Contracts</i> or FASB ASC Topic 944 <i>Financial Services–Insurance</i> ▶ Contracts within the scope of IFRS 9 <i>Financial Instruments</i>, IAS 39 <i>Financial Instruments: Recognition and Measurement</i> or FASB ASC Topic 825 <i>Financial Instruments</i> ▶ Guarantees (other than product warranties) within the scope of IFRS 4, IAS 39 or FASB ASC Topic 460 <i>Guarantees</i> <p>These transactions will continue to be covered by the respective IFRSs and not the proposed standard. Although it must be noted that all of these areas are current projects of the Board where significant changes may still be expected.</p>	ED expected Q2 2010
Consolidation	<p>The Boards tentatively decided that an investment company must measure investments in entities it controls at fair value and provide additional disclosures. See "Investment Companies – consolidate or measure at fair value?" on page 3 for further discussion and insights on this decision.</p>	IFRS expected Q4 2010
Rate-regulated assets	<p>The Boards tentatively decided to finalise the transition relief for first time adopters (to be included in the omnibus Improvements to IFRS due to be issued in April 2010) while conducting further research on this matter. See "Rate-regulated Activities – where to next?" on page 7 for further discussion and insights on this project.</p>	IFRS expected 2011
Insurance contracts	<p>The Boards continued their deliberations on proposals to include in the ED, and made tentative decisions on the following topics:</p> <ul style="list-style-type: none"> ▶ Reinsurance contracts ▶ Unbundling ▶ Unit-linked contracts 	ED expected Q2 2010
Financial statement presentation	<p>The Boards continued their deliberations on the proposals to be included in the EDs, and made tentative decisions on the following topics:</p> <ul style="list-style-type: none"> ▶ Comprehensive income ▶ Definition of remeasurement and related guidance ▶ New categories for 'financing arising from operating activities' and for 'assets and liabilities arising from equity' ▶ Statement of cash flows for financial service entities 	ED on Comprehensive Income expected March 2010

ED = Exposure Draft, Q1 2010 = First quarter of 2010, Q2 2010 = Second quarter of 2010, Q3 2010 = Third quarter of 2010, Q4 2010 = Fourth quarter of 2010, H1 2010 = First half of 2010, H2 2010 = Second half of 2010

Financial reporting developments *continued*

Projects	Key discussion points	Status
Fair value measurement	<p>The Boards continued to work jointly on the key elements of the converged fair value measurement guidance and made tentative decisions on the following topics:</p> <ul style="list-style-type: none"> ▶ Role of premiums and discounts ▶ Disclosures when the highest and best use differs to the way an asset is used ▶ Valuation premise for non-financial assets ▶ Measuring the fair value of financial instruments 	IFRS expected in Q3 2010
Leases	<p>The Boards continued their deliberations on proposals to include in the ED, and made tentative decisions on the following topics:</p> <ul style="list-style-type: none"> ▶ Definition of a lease ▶ Accounting for changes in contingent rentals ▶ Scope 	ED expected Q2 2010
Post-employment benefits	<p>The Board tentatively approved a package of disclosures to include in the ED and tentatively decided the disclosure requirements proposed for inclusion in the Fair Value Measurements standard will not be required for plan assets.</p>	ED expected in Q1 2010
Annual improvements	<p>The Board tentatively decided to accept the proposals made by the IFRIC in January 2010 to finalise six of the proposed improvements and remove three amendments without finalising them. For more details, please refer to the February 2010 <i>IFRS outlook</i>.</p>	Amendments expected in April 2010

ED = Exposure Draft, Q1 2010 = First quarter of 2010, Q2 2010 = Second quarter of 2010, Q3 2010 = Third quarter of 2010, Q4 2010 = Fourth quarter of 2010, H1 2010 = First half of 2010, H2 2010 = Second half of 2010



Financial instruments with characteristics of equity

In January 2010, the Boards decided to explore an amendment to IAS 32 *Financial Instruments: Presentation* (the “modified IAS 32 approach”). In February 2010, the Boards continued to pursue the modified IAS 32 approach and tentatively made (or affirmed) the following key decisions.

Scope

- ▶ Instruments currently accounted for within IFRS 2 *Share-based Payment* are not within the scope of this project.

Instruments to be classified as equity

- ▶ The following types of instruments are to be classified as equity (assuming there is no contractual interest obligation):
 - ▶ Perpetual instruments issued by entities without specified limits on their lives.
 - ▶ A perpetual instrument (i.e., ordinary and preferred shares) issued by an entity that has a specified life, or that must be liquidated at the option of an instrument holder.
 - ▶ Mandatorily redeemable and puttable instruments that meet either of the following criteria:
 - ▶ The instrument’s terms require, or permit the holder or issuer to require, redemption to allow an existing group of shareholders, partners or other participants to maintain control of the entity when one of them chooses to withdraw.
 - ▶ The holder must own the instrument in order to engage in transactions with the entity or otherwise participate in the activities of the entity, and the instrument’s terms require, or permit the holder or issuer to require, redemption when the holder ceases to engage in transactions or otherwise participate.

- ▶ Contracts that require or may require an entity to issue a specified number of its own perpetual equity instruments for a specified price. For this purpose, the specified number must be either fixed or vary only so that the counterparty will receive a specified percentage of the total shares that were outstanding on the issuance date for a specified price. The specified price must be fixed in the reporting entity’s currency unless the domestic currency or functional currency of the shareholder that holds the derivative is different from the currency in which the issuing entity issues equity instruments to domestic shareholders. In that case, the price may be specified in the currency of the shareholder instead of the currency of the issuer.
- ▶ Contracts that require an entity to issue, for a specified price or for no future consideration, a specified number of puttable or mandatorily redeemable instruments that will be equity in their entirety when issued.
- ▶ Contracts that require an entity to issue, for a specified price or for no future consideration, a specified number of derivatives that will require the entity to issue a specified number of instruments that will be equity in their entirety when issued.
- ▶ Preferred shares that are required to be converted into a specified number of perpetual equity instruments.
- ▶ Preferred shares that are required to be converted into a specified number of puttable or mandatorily redeemable instruments that will be equity in their entirety when issued.

Financial reporting developments *continued*

Ability to issue equity instruments

- ▶ An entity's ability to issue its own perpetual equity instruments to settle share-settled instruments classified as equity should be assessed at the date that each instrument is issued and at each reporting date thereafter. If, at any time, the entity does not have enough authorised shares to settle a share-settled instrument classified as equity, that instrument should be reclassified as a liability and left there for the remainder of its life.

Contracts to repurchase own shares

- ▶ Contracts that require an entity to repurchase its own shares on a specified date or on the occurrence of an event that is certain to occur should be separated into a liability representing the amount to be paid with an offsetting debit to equity.

Convertible debt

- ▶ A bond (or other debt instrument) should be separated into a liability component and an equity component if it is convertible at the option of the holder into a specified number of instruments that will be equity in their entirety when issued. All other convertible debt instruments should be classified as liabilities in their entirety.

Puttable shares

- ▶ Puttable shares that are not classified as equity in their entirety should be separated into liability and equity components. The liability component, which represents a written put option, should be accounted for as a freestanding written put option.

Presentation of freestanding written put options

- ▶ A freestanding written put option should be presented net as a liability in its entirety.

Classification of subsidiary instruments in consolidated financial statements

- ▶ Equity classification in a subsidiary's financial statements should be carried forward into consolidated financial statements, unless the nature of the instrument changes on consolidation because of arrangements between the instrument holder and another member of the consolidated group. If the nature of the instrument changes on consolidation, classification should be reconsidered in the consolidated financial statements.

Classification and measurement - financial liabilities

When the Board issued phase 1 of IFRS 9 *Financial Instruments* in November 2009, it excluded financial liabilities and limited the scope to the classification and measurement of financial assets only. The Board has subsequently discussed the accounting for financial liabilities. In the February joint meeting, the Boards affirmed their previous tentative decisions that financial liabilities that are not held to pay contractual cash flows should be measured at fair value through profit or loss.

Separately, the Board also made the following tentative decisions:

- ▶ Financial liabilities should be measured at amortised cost if they are not held for trading and do not have embedded derivative features that would require bifurcation under IAS 39 *Financial Instruments: Recognition and Measurement*.
- ▶ Financial liabilities that are held to pay contractual cash flows and contain embedded derivative features that would require bifurcation should be bifurcated into a host and the embedded features. Those components would be separately measured in accordance with the current measurement requirements in IAS 39.



- ▶ The three eligibility conditions in IAS 39 would remain, for entities that choose to use the fair value option for financial liabilities. However, for financial liabilities designated under the fair value option, an entity would be required to:
 - ▶ Recognise the total fair value change in profit or loss; and
 - ▶ Recognise the portion attributable to changes in own credit risk in other comprehensive income (OCI) (with an offsetting entry to profit or loss).
- ▶ Amounts recognised in OCI would never be recycled into profit or loss.

Derecognition of financial instruments

In October 2009, the Board decided to further develop the alternative approach in the ED on derecognition of financial assets. Under the alternative approach, a financial asset is derecognised when the transferor does not have present access, for its own benefit, to all of the cash flows or other economic benefits of the transferred asset.

The Board made the following tentative decisions at this meeting:

- ▶ Not provide a definition of 'transfer', but to provide application guidance.
- ▶ The term 'economic benefits' used in the alternative derecognition approach encompasses the benefits associated with both the financial and non-financial components of a contract within the scope of IAS 39, provided that the economic benefits associated with the non-financial component of the contract have not been recognised separately. As a result, if an entity sells the non-financial right (for instance, transfers the right to exercise the voting power of an equity instrument), it will derecognise the entire financial asset and will then recognise a new asset representing a right to only the economic benefits arising from the financial component retained.

- ▶ To make an exception to the derecognition criteria for sale and repurchase agreements and similar transactions. Consequently, any sale of a financial asset that entitles and obligates the entity to repurchase the asset before maturity of the asset should be accounted for as a secured borrowing.

Insurance contracts

The Boards reached the following tentative decisions:

Reinsurance contracts

- ▶ The recognition and measurement approach for reinsurance contracts (for the reinsurer) is to be the same as the approach for insurance contracts (for insurers).
- ▶ The reinsurance asset is to be recognised and measured on the same basis as the underlying insurance contract although further research is needed on the consequences. The balances cannot be offset.

Unbundling

- ▶ Further research is to be conducted on an approach where unbundling for recognition and measurement will not be required if the components are significantly interdependent.

Unit-linked contracts

- ▶ The assets and liabilities associated with unit-linked contracts would be reported as the insurer's assets and liabilities.

Financial statement presentation

The Boards reached the following tentative decisions:

Comprehensive income

- ▶ An entity must present a continuous statement showing clearly and separately either profit or loss, or net income and other comprehensive income. This effectively removes the choice for an entity to produce two statements.

Financial reporting developments *continued*

Definition of a remeasurement and related guidance

- ▶ Previously, the Boards had decided that 'remeasurement items' within the statement of comprehensive income should be prominently disclosed in the notes to financial statements.
- ▶ The Boards decided that a remeasurement should be defined as an amount recognised in comprehensive income that reflects the effects of a change in the net carrying amount of an asset or liability, and that is a result of a change in one of the following:
 - ▶ A change in (or transacting at) a current price or value;
 - ▶ A change in an estimate of a current price or value; or
 - ▶ A change in any estimate or method used to measure the carrying amount of an asset or liability.

New categories for 'financing arising from operating activities' and for 'assets and liabilities arising from equity'

- ▶ The Boards proposed further changes to the categorisation within the financial statements.
 - ▶ Financing arising from operating activities will be included in a new subcategory in the operating category of the statements of financial position and comprehensive income, rather than its own category within the business section.
 - ▶ Assets and liabilities that arise from transactions involving an entity's own equity will be separately included within the debt category (and separate from borrowings).

Statement of cash flows for financial service entities

- ▶ Require presentation of a direct method statement of cash flows.
- ▶ Require cash flows from loans to customers and collections to be presented gross rather than net.
- ▶ Require an entity with funds held on deposit to present cash flows with depositors as if they were settled by external funds.

Fair value measurement

The Boards reached the following tentative decisions:

- ▶ A blockage factor differs from other types of discounts and may not be applied to any level of the fair value hierarchy. The final standard will describe what this is and explain why it is different to other discounts.
- ▶ The objective of a fair value measurement of an individual asset (other than a financial instrument) is to determine the price for a sale of that asset alone, not for a sale of that asset as part of a group of assets or business.
- ▶ Entities will not be required to separate the fair value of an asset group into two components when an entity uses an asset in a way that differs from its highest and best use. Although additional disclosure will be required.
- ▶ When the highest and best use of an asset is to be used as part of a group of assets, the fair value measurement of that asset presumes that the sale is to a market participant that has or can obtain, the "complimentary assets" and "complimentary liabilities".
- ▶ The concepts of 'highest and best use' and 'valuation premise' are relevant only for non-financial assets. That is, they are not relevant for financial assets or liabilities.



Leases

The Boards tentatively decided that a lease should be defined as a contract in which the right to use a specific asset is conveyed, for a period of time, in exchange for consideration. They also made the following tentative decisions about the accounting for leases:

Accounting for changes in contingent rentals

- ▶ For lessees, changes in amounts payable under contingent rentals arising from current or prior periods are recognised in profit or loss. All other changes are recognised as an adjustment to the lessee's right-of-use asset. The same accounting will be proposed for changes in amounts payable under residual value guarantees.
- ▶ For lessors, changes in the amounts payable under contingent rental arrangements should be treated as adjustments to the original transaction price and be allocated to the lessor's performance obligations. If the performance obligation has been satisfied then the change would be recognised in revenue, otherwise the carrying amount of the performance obligation should be adjusted.

Scope

- ▶ Contracts that are purchases or sales of the underlying assets are not lease contracts.
- ▶ A contract is a purchase or sale if, at the end of the contract, the contract transfers control of the underlying asset or all but a trivial amount of the risks and benefit associated with the underlying asset. The Boards discussed situations that evidence transfer of control which will likely be included in the ED.
- ▶ Very long leases of land are not considered purchases or sales.

New documents issued

Project	Comment period
Proposed IFRS Taxonomy 2010	Open for comment until 22 April 2010
Working draft of proposed IFRS to replace IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	-

Resources

Supplement to *IFRS outlook*

Issue 67: IASB issues complete working draft on proposals to replace IAS 37

The IASB published for comment a revised exposure draft of the measurement section of the replacement for IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. As part of the replacement project, the IASB has issued a working draft of the full standard (including the scope, recognition, measurement and disclosure sections) to enable interested parties to see the revised measurement guidance in the context of the proposed new IFRS as a whole.

Negotiation series: Controlling the effects of a non-controlling interest

The fourth issue in our *Negotiation series* considers the effects of a non-controlling interest on financial statements and the impact of management's choice of how to measure NCI at the acquisition date.

IFRS European Investment Fund Survey 2010

The economic crisis has had a profound impact on the asset management industry and, in particular, hedge funds received considerable criticism. This survey explores the current application of IFRS by investment funds across Europe and shows how views and attitudes have changed since the last time we undertook a similar survey in 2003.

Searching for clarity in uncertain tax positions

This thought leadership paper spotlights uncertain tax positions (UTPs) under IFRS. It provides insights into the diversity of practices that have developed in the financial reporting and disclosure of UTPs, given the lack of direct guidance IAS 12 *Income Taxes* has in this area. The publication also discusses potential future developments and activities at the IASB and other bodies around this hot topic, and leading practices companies may consider.



Coming soon

IFRS for SMEs – Comparison with IFRS

This publication provides a high-level overview of *IFRS for SMEs* which was issued as a stand-alone standard in July 2009 and an appraisal of the similarities and key differences between it and full IFRS. In particular, this guide provides an overview on the recognition and measurement differences between IFRS and *IFRS for SMEs* that are most likely to arise.

IFRS Insights for Asset Management – Application of IFRS 8 to Investment Funds

This publication provides information about the application of IFRS 8 *Operating Segments* to investment funds. It has been designed to help those responsible for preparing financial statements of a fund to apply and understand the new requirements. The publication addresses: the scope of IFRS 8 specific to funds; how to identify reportable operating segments; and provides a summary of the IFRS 8 disclosures which are applicable to funds.

IFRS update for June 2010 reporting

This publication summarises the new and amended IFRS standards and interpretations that are applicable to financial periods beginning on or after 1 July 2009. It also highlights other new and amended IFRS standards and interpretations that have been issued up to 31 March 2010 but are not yet effective.

IFRS webcast series

23 March 2010 – Financial instruments – further insights

The first phase of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement* has been completed, while proposals to reform the accounting for financial instruments continue to be developed. Our panellists will discuss the proposed changes and their potential impacts for businesses and will also offer insights on the key application issues in adopting the amendments to IFRS 7 for the year ending 31 December 2009. This webcast is intended to assist CFOs in understanding the significant practical challenges and the full impact of the proposed changes on their reporting performance.

25 May 2010 – The lessons learned for year-end reporting

Although signs of recovery in the market have been evident since the beginning of 2010, businesses are still facing significant challenges in different areas including valuation for impairment and mark-to-market measurement. A panel of specialists will share their experiences from the 2009 reporting cycle and discuss the trends that are emerging from the released annual reports. This webcast is aimed at CFOs and controllers to enable them to take a proactive approach in the upcoming reporting season.

29 June 2010 – A new accounting model for insurers (subject to issue of Exposure Draft)

The new proposals for accounting for insurance contracts are likely to have a significant effect on all insurance companies as IFRS 4 *Insurance Contracts* is an interim standard that grandfathered accounting standards previously used. Our panel of experts will discuss the key aspects of the proposals and the potential impact these may have on the financial performance of insurers.

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