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Responding to the financial crisis

With the Monitoring Board of the International Accounting Standards Committee Foundation now in place, we spoke to Hans Hoogervorst, the Monitoring Board's first chairman. Learn about the role of the Monitoring Board, as well as Hans' thoughts on the current economic crisis.

Private equity funds – accounting for investments

With a new consolidation standard on the horizon, private equity funds should be aware of the potential impact on their businesses. Ernst & Young recently hosted roundtables in Luxembourg and London to discuss the requirement for private equity funds to consolidate their investment portfolio. Find out about the roundtable discussions and the IASB's initial reaction to the issues raised.

Borrowing costs and the role of foreign currency exchange gains or losses

IAS 23 *Borrowing Costs* is now effective, and entities no longer have a choice as to how they account for such costs. However, entities borrowing amounts in foreign currencies still have to exercise judgment in accounting for the impact of foreign currency exchange gains or losses. Learn about the effect foreign currency borrowings may have on your entity and the alternative treatments available.

Financial reporting developments

Find out more about the Board's discussions that could significantly impact your business: tentative decisions on financial instruments, leases, revenue recognition and annual improvements.

Resources

Our recent publications on the impact of the proposed revenue recognition model and the amendments to IFRS 2 *Share-based payment* may be of interest to members of your finance staff.

We welcome your feedback on *IFRS outlook*. Please contact us at ifrs@ey.com. The next issue will be published in August 2009.

Ruth Picker
Global Director of IFRS Services

Responding to the financial crisis

An interview with Hans Hoogervorst



Hans Hoogervorst has recently been appointed as chairman of the Monitoring Board to the International Accounting Standards Committee Foundation. He is also co-chair of the Financial Crisis Advisory Group of the IASB and Chairman of the Dutch Securities Regulator, Autoriteit Financiële Markten (AFM). Prior to that, he was Dutch Minister of Finance and Minister of Health, Welfare and Sport.

“Financial reporting only played a minor part in the current credit crisis,” Hans Hoogervorst clarified upfront. “The crisis was caused by a combination of poor management by banks and insufficient oversight. However, financial reporting can be improved and also the role of the auditors as gatekeepers to the system may have to be looked at.”

As co-chair of the Financial Crisis Advisory Group (FCAG) of the IASB and the FASB, Mr Hoogervorst and his committee have spent a considerable amount of time over the last couple of months discussing and analysing the root causes of the crisis, the role of financial reporting, the relationship with prudential regulators and the steps needed to improve financial reporting and accounting standard-setting.

The FCAG will release its report later this month and plans to meet again in December 2009 to discuss subsequent developments and conclude whether there is a more permanent role for a committee like this. “The FCAG has proven to be a valuable bridge between the accounting and regulatory world.”

The FCAG’s report will remain high-level, although it will also contain a couple of detailed proposals for improving financial reporting, the relationship between prudential regulators and accounting standard-setting.

Mr Hoogervorst commented “for example, we recommend that the Boards change the current requirement to take into account their own credit risk when fair valuing liabilities. Recognising a gain in the income statement due to a deterioration of own credit standing is counterintuitive and potentially undermines to the credibility of financial reporting.

We also urge the two Boards to work together and converge their standards. We support an expected loss model for loan loss provisioning by banks, where part of the interest rate margin is set aside to cover expected losses. We have also addressed the pro-cyclicality of financial reporting. However, we want the loan loss model to be transparent and not unduly influenced by prudential regulatory requirements.

“Financial reporting only played a minor part in the current credit crisis”

Accounting standard-setting must remain independent from regulatory and political interference. It is not for the politicians to discuss detailed technical accounting issues. This is a matter for the experts. However, those experts should not operate in a vacuum; they must be fully accountable for their work. Standard-setting should not be an ivory tower exercise, rather, it should be embedded in the society it is intended to serve, taking account of the role financial reporting plays in a wider sense.”

The growing interest in financial reporting and the recent political pressures from the US Congress (on the FASB) and the European Union (on the IASB) are among the reasons why a Monitoring Board was set up earlier this year by the IASC Foundation.

“Last September, the IASB gave in to EU demands to change its standard on financial instruments, bypassing normal due process. This has set a dangerous precedent. To achieve our goal of global accounting standards, it is absolutely key that the IASB remains an independent accounting standard-setter. As soon as the US or Asia have the impression that the IASB is dominated by Europe or capitulating to EU demands, they will lose interest.”

The role of the Monitoring Board is to observe and reinforce the public interest oversight function of the IASC Foundation, while preserving the independence of the Board. Mr Hoogervorst was appointed as the first chair of the Monitoring Board when it was established earlier this year. The Monitoring Board’s Charter states that the members are representatives from two committees of IOSCO, the European Commission, the Financial Services Agency of Japan and the US SEC. “The European Commission has not yet signed up to the Monitoring Board as the European Parliament wants to see concessions from the IASB in the area of fair value accounting first,” explained Mr Hoogervorst. “It may have been one of the reasons why someone with a political background like me was asked to chair the Monitoring Board.” Mr Hoogervorst was Minister of Finance and Minister of Health, Welfare and Sports in the Netherlands before he was appointed as chairman of the Dutch Securities Regulator in 2007.

Mr Hoogervorst finished by discussing the recent developments in financial instruments. “It is clear that the current financial reporting requirements for financial instruments need to be simplified. The rules are patchy, very complex and hardly understandable for users. It should not come as a surprise that IFRS is criticised for this and politicians weigh in. I welcome very much the current steps by the IASB to work together with the FASB on reducing complexity in the standard on financial instruments.”

Private equity funds - accounting for investments



Private equity funds often make significant investments in numerous companies, with the aim of generating returns via capital growth, rather than generating returns from synergies between the underlying businesses. However, their investments are often large enough that they have the power to govern the financial and operating policies of those entities, even if this is not their intention. As a result, this gives them control. When applying IFRS, private equity funds, therefore, must consolidate their controlled investments, but many in the industry do not believe that this provides decision-useful information.

In May and June 2009, Ernst & Young hosted two client roundtables - in Luxembourg and London - attended by representatives from over fifty private equity entities. The purpose was to discuss the requirement for private equity funds to consolidate their investment portfolio and to that end, the London event was also attended by Jan Engstrom and Patrina Buchanan from the IASB.

An outstanding Exposure Draft issued by the IASB proposes a new consolidation standard that incorporates a new definition of control. When it issued the Exposure Draft, the Board retained its previous decision that no scope exemption would be given for venture capital businesses. However, attendees at both roundtable events expressed concerns about this decision, and an interactive discussion took place about the needs of users of their consolidated financial statements, and whether they provide decision-useful information.

The attendees cited examples whereby funds that prepare consolidated financial statements also provide an additional set of financial statements in which the investments are carried at fair value. The attendees noted that, once the reports were issued, there were never any queries on the consolidated financial statements - rather all of the queries arose from the supplemental information. They believe that this illustrates their argument that consolidated financial statements are of little use to users.

While the IASB attendees acknowledged the concerns and understood the arguments, there are no plans to give an industry exemption. Instead, a principles-based approach needs to be considered that could be applied across all jurisdictions and to all entities applying IFRS. The attendees effectively tasked the industry with the challenge of proposing an appropriate set of principles that support non-consolidation of investments in which a controlling interest is held.

To hear more about the matters discussed at this roundtable listen to the podcast *Private Equity and Consolidation: a Changing Landscape*, which summarises the event. This podcast can be found at www.ey.com/ifrs.

Borrowing costs and the role of foreign currency exchange gains or losses

The revised standard for accounting for borrowing costs, IAS 23 *Borrowing Costs*, is now effective. Entities no longer have a choice as to how they account for such costs – rather all borrowing costs incurred on borrowings undertaken to construct a ‘qualifying asset’ are now capitalised as part of the cost of constructing the asset. For many entities this has resulted in a significant change in their processes and information systems. However, the current economic turmoil has focused attention on other issues affecting the amount of borrowing costs to be capitalised, primarily accounting for the effects of changes in foreign currency exchange rates, where borrowings are undertaken in a foreign currency, and derivative instruments to hedge foreign currency exposures or interest rate risk. In this article, we take a closer look at how foreign currency borrowings impact the borrowing costs to be capitalised and the areas of concern where management judgment is required.

The requirements of IAS 23 *Borrowing Costs*

When IAS 23 was revised in 2007, the IASB added no new guidance on how to implement the capitalisation method. Rather, the changes were limited to removing the option to expense borrowing costs, bringing the accounting broadly in line with US GAAP. However, one aspect of the standard that did not change, and remains different from the approach taken in US GAAP, is the treatment of foreign currency exchange differences on foreign currency borrowings. As shown in Box 1, foreign currency exchange differences are included in the determination of borrowing costs to be capitalised, but only to the extent that they are an adjustment to the interest cost on the borrowing. No further guidance is given within the standard itself about how this is determined. Indeed in US GAAP, no such requirement exists, hence, there is no guidance.

When the matter was referred to the IFRIC, it concluded that ‘how an entity applies IAS 23 to foreign currency borrowings is a matter of accounting policy requiring the exercise of judgment’¹.

Box 1 Summary of key requirements of IAS 23

- ▶ Borrowing costs are capitalised when they are directly attributable to the construction or acquisition of a qualifying asset. These are borrowing costs that would have been avoided if the expense on the qualifying asset had not been made.
- ▶ Qualifying asset:
 - ▶ Any asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
 - ▶ Does not include assets routinely manufactured or produced in large quantities on a repetitive basis.
- ▶ Borrowing costs comprise:
 - ▶ Interest expense calculated using the effective interest rate method.
 - ▶ Finance charges on finance leases.
 - ▶ Foreign exchange differences on foreign currency borrowings to the extent they are an adjustment to interest cost.
- ▶ Specific borrowings:
 - ▶ Borrowing costs capitalised are the actual borrowing costs incurred on the borrowing, less investment income from temporary investment of excess funds.
- ▶ General borrowings:
 - ▶ Borrowing costs capitalised is calculated by determining a capitalisation rate to apply to the capital expenditure incurred, based on all borrowings other than those that are specific for the construction or acquisition of a qualifying asset.

¹ IFRIC Update January 2008

Borrowing costs and the role of foreign currency exchange gains or losses *continued*



The effect of foreign currency borrowings

In theory, foreign exchange rates and interest rates are related and, as such, it is fair to assume that any changes in foreign exchange rates reflect changes in the interest rate. On this basis, all of the foreign exchange gain or loss on foreign currency borrowings would be considered as part of the borrowing costs on the borrowing. But recently, this argument has not been holding true, with many other factors impacting the relationship between foreign exchange rates and interest rates. Accordingly, it is not necessarily safe to assume that all of the foreign exchange gains or losses on foreign currency borrowings are an adjustment to income. Take the following two examples:

Entity A's functional currency is euro, and it borrows £1,000 on 1 January 2009 for one year at a fixed interest rate of 5% to fund the construction of an asset. The spot exchange rate at this date is €1.5:£1. At 31 December 2009, the exchange rate is €1.1:£1. The entity has incurred a foreign currency gain of €400, while interest costs (assuming they were paid throughout the year at the then spot rate) amount to €65. How much of the foreign exchange gain is included in the borrowing costs eligible for capitalisation?

Entity B's functional currency is euro, and it borrows US\$1,000 on 1 January 2009 for one year at a fixed interest rate of 3% to fund the construction of an asset. The spot exchange rate at this date is €1:US\$1. At 31 December 2009, the exchange rate is €1.4:US\$1. The entity has incurred a foreign currency loss of €400, while interest costs (assuming they were paid throughout the year at the then spot rate) amount to €36. How much of the foreign exchange loss is included in the borrowing costs eligible for capitalisation?

A number of possible approaches exist:

1. Determine, at the date of entering into the loan, the equivalent interest rate on a local currency borrowing and use this as the borrowing cost to be capitalised. Let's assume that, for both of the above examples, the interest rate on a €1,500 borrowing at 1 January 2009 is 7% (entity A), and the interest rate on a €1,000 borrowing at 1 January 2009 is 4% (entity B). The amount of borrowing costs eligible to be capitalised by entity A would be €105, regardless of the movement in the foreign exchange rate. Entity B would be eligible to capitalise €40 as borrowing costs. However, this ignores the reason for entities borrowing in a foreign currency i.e., that they expect it to be less expensive. In this case, the movement in the exchange rates has effectively generated an additional gain for entity A, which is also counter-intuitive.
2. Establish a 'cap and floor' for the amount of foreign exchange gains or losses to be included in borrowing costs. The floor may be up to the amount that reduces the borrowing cost to nil. We do not believe that a net gain can be capitalised. In the above example, entity A would include €65 of foreign currency gains as an element of borrowing costs, resulting in a net nil borrowing cost. The cap may be the interest on a local currency borrowing at inception, as this reflects the relationship between foreign currency and interest at that time. In the above example, entity B would therefore include €4 of the foreign currency losses as borrowing costs, resulting in a net borrowing cost of €40.



- Determine a forward foreign exchange rate at the date of entering into the borrowing and use this to determine the amount of foreign exchange gains or losses that are eligible for capitalisation. Let's assume in the above examples, the one year forward foreign exchange rates as at 1 January 2009 are €1.4: £1 and €1.1:US\$1. The amount of foreign currency gains on the borrowing that entity A includes as borrowing costs is €10¹, regardless of the movement in the foreign exchange rate. Entity B includes €10² of foreign currency losses on the borrowings as borrowing costs. While this approach provides a consistent assessment of the relationship between foreign exchange rates and interest rates, it is by no means a perfect approach. There are many factors affecting the relationship between foreign exchanges rates and interest rates that cannot be adequately measured.

Management will need to carefully consider which approach they apply to best reflect the relationship between foreign exchange rates and interest rates. However, the approach selected needs to be applied consistently and disclosed within the financial statements. Each approach also requires an appropriate information system to be in place to collect the relevant information.

The effect of derivatives

It is also common for entities to enter into derivative instruments that are designed to hedge against either foreign exchange gains or losses arising from foreign currency borrowing or changes in interest rate. IAS 23 itself does not address the treatment of derivative instruments, and therefore the general principle of determining if the derivative financial instrument is directly attributable to the acquisition or construction of a qualifying asset applies. This is further complicated when considering the impact of IAS 39 *Financial instruments: Recognition and Measurement*, which requires that derivative financial instruments are carried at fair value, with all changes being recognised in the income statement unless they are in a designated hedging relationship. Again, the IFRIC discussed this matter and concluded that this was also 'a matter of accounting policy requiring the exercise of judgment'. Management must consider the potential affect the accounting for the derivative has on the amount of borrowing costs eligible for capitalisation. Let's take the following example:

Entity C enters into a loan of €5,000 on 1 January 2009 to construct a building. Interest is paid at EURIBOR plus 1%. At the same date, the entity enters into an interest rate swap with the same notional amount and the same interest payment dates, whereby it receives interest at EURIBOR plus 1% and pays a fixed rate of 9%.

Two possible approaches exist:

- The entity may determine that the inter-relationship between IAS 39 and IAS 23 is such that the derivative instrument is directly attributable to the acquisition or construction of an asset only if it is designated as a hedge in accordance with IAS 39. Therefore, in the above example, to include the effects of the derivative in borrowing costs to be capitalised, the derivative instrument must have been designated as a hedge of the interest rate risk. In this case, the borrowing costs eligible will be the interest costs paid on the loan plus the net interest paid/received on the swap. If it is not designated as a hedge, the borrowing costs eligible will only comprise the interest costs paid on the loan.
- Alternatively, the entity may determine that the inter-relationship between IAS 39 and IAS 23 is irrelevant, and consider that the derivative instrument may be directly attributable to the acquisition or construction of an asset, even if it is not designated as a hedge under IAS 39. This again would be based on the cash costs of the swap rather than the changes in fair value. Therefore, the borrowing costs eligible for capitalisation would be the interest costs paid on the loan plus the net interest paid/received on the swap. It will, however, be necessary for management to set up an approach to establish that it is directly attributable to the acquisition or construction of an asset. This is likely to be more difficult the more the terms of the swap and loan differ.

Concluding comments

The standard requiring borrowing costs to be capitalised in the cost of assets has limited application guidance. As such, significant judgment is required about what to include in this calculation. The extent to which foreign exchange differences are a component of borrowing costs is particularly troublesome and will require management to evaluate a number of alternative approaches to determine an appropriate policy. Disclosure of managements' judgment will therefore become important. Other areas within the standard also require judgment and we plan to address these in future articles.

¹ Difference between spot at time of entry and forward rate is €0.1 (1.5 - 1.4). Therefore giving FX gain of €10.

² Difference between spot at time of entry and forward rate is €0.1 (1 - 1.1). Therefore giving FX loss of €10.

Financial reporting developments

The IASB (the Board) met in London on 15 - 19 June 2009. The table below summarises the main issues discussed. In the following pages, you will find more detailed information and insights about the shaded items in the table.

Projects	Key discussion points	Status
Financial instruments - recognition and measurement	<p>The Board made several tentative decisions about the classification and measurement of financial instruments as part of the project to replace IAS 39.</p> <p>The Board also discussed an alternative approach to classification and measurement of financial instruments that have basic loan features and are managed on a contractual yield basis.</p>	ED expected July 2009
Impairment of financial assets	<p>The Board held two education sessions on impairment of financial assets, and requested information on the feasibility of an expected cash flow approach to impairment. The Board will use the input received in developing an Exposure Draft on impairment. Refer to Supplement to <i>IFRS Outlook</i>, Issue 47: <i>IASB seeks input on a new impairment model</i>.</p>	ED expected Q4 2009
Financial instruments with characteristics of equity	<p>The Board made several tentative decisions relating to the measurement of equity instruments.</p>	ED expected Q4 2009
Insurance contracts	<p>The Board discussed candidate measurement approaches for insurance contracts and tentatively decided to:</p> <ul style="list-style-type: none"> ▶ Include an approach based on an updated model being developed in the project to amend IAS 37, discussed below (modified to exclude day one gains). ▶ Remove the fulfilment value approach that includes residual and risk margins. ▶ Remove a current exit price approach. 	ED expected Q4 2009
Joint ventures	<p>The Board tentatively decided to include accounting by investors in joint arrangements that do not have joint control in the arrangement, as follows:</p> <ul style="list-style-type: none"> ▶ If it is a joint operation, account for its share of any assets, liabilities, revenues and expenses arising from the operation. ▶ If it is a joint venture, account for its interest in accordance with IAS 39 or IAS 28 (if it has significant influence in the joint venture). <p>It also tentatively decided that parties with interests in a joint asset should recognise their share of the joint asset.</p>	IFRS expected Q4 2009



Projects	Key discussion points	Status
Leases	The Board made a number of tentative decisions about some of the unresolved issues relating to lessee accounting.	ED expected H1 2010
Liabilities - amendments to IAS 37	The Board made tentative decision about liabilities arising from litigation, stand-ready obligations, reimbursement rights and disclosure.	IFRS expected Q4 2009
Rate-regulated activities	<p>The Board tentatively decided:</p> <ul style="list-style-type: none"> ▶ Regulatory assets and liabilities existing at the date of transition would apply the standard with adjustments arising recognised in the opening balance of retained earnings. ▶ First-time adopters can elect to include regulatory assets determined under the entity's previous GAAP, in the carrying amounts of property, plant and equipment or intangible assets, provided they meet the conditions of this standard. ▶ Self-constructed property, plant and equipment or internally generated intangible assets would include all costs permitted by the regulator. 	ED expected Q3 2009
Revenue recognition	<p>The Board made tentative decisions about:</p> <ul style="list-style-type: none"> ▶ Revenue to be recognised when other parties are involved in providing goods and services to the customer ▶ Revenue arising from combination and modification of contracts ▶ Non-cash consideration 	ED expected H1 2010
Annual improvements 2009	<p>The Board made tentative decisions about:</p> <ul style="list-style-type: none"> ▶ The revaluation basis as deemed cost for a first-time adopter ▶ Accounting policy changes in the year of adoption of IFRS ▶ Contingent consideration of an acquiree in a business combination ▶ Venture capital consolidations and partial use of fair value through profit or loss ▶ Impairment of investments in associates 	ED expected Q3 2009

ED = Exposure Draft, DP = Discussion Paper, Q3 2009 = Third quarter of 2009, Q4 2009 = Fourth quarter of 2009, H1 2010 = First half of 2010.

Financial reporting developments *continued*

Financial instruments – recognition and measurement

The classification and measurement approach being developed will measure almost all financial assets and financial liabilities at either amortised cost (those instruments with “basic loan features” and “managed on a contractual yield basis”) or fair value.

Hybrid contracts

If the host contract is within the scope of IAS 39 (that is, it is a financial instrument), the Board tentatively decided that the proposed classification approach would apply to the entire contract and the host contract would not be separated from the embedded derivative(s). If the host contract of a hybrid contract is not within the scope of IAS 39, the existing requirements for embedded derivatives in IAS 39 are to be applied (pending a review of the scope of IAS 39 in a later phase of this project).

Hybrid contracts containing an embedded derivative that is a basic loan feature (e.g., interest rate cap, floor or collar that combines a fixed interest and variable interest rate) would qualify for amortised cost classification (if managed on a contractual yield basis).

Fair value

The Board tentatively decided to retain a fair value option. Entities can elect to measure at fair value financial instruments that qualify for amortised cost measurement if the use of that option eliminates or significantly reduces a measurement or recognition inconsistency. (The other criteria for the fair value option in IAS 39 will be unnecessary as a result of the Board’s other proposals).

Fair value changes on equity instruments within the scope of IAS 39, other than investments that are held for trading, would be presented in other comprehensive income (OCI). This election can be made separately for each holding of an instrument at initial recognition and is irrevocable. The amounts recognised in OCI (including dividends) will not be recycled to profit or loss in any circumstances (including disposal). Impairment testing will not be necessary for these assets.

Application guidance will be developed on the classification approach for investments in structured investment vehicles with a ‘waterfall’ feature. The Board’s initial thinking on this issue is that only the most senior tranche of a securitisation will qualify for amortised cost accounting.

The existing requirements in IAS 39 on the treatment of ‘day 1 differences’ and the measurement requirements for financial guarantee contracts, loan commitments and financial liabilities with demand features will be retained.

The meaning of “managed on a contractual yield basis” is still to be determined.

Transition

The Board reaffirmed its tentative decision to propose retrospective application but decided to introduce specific transition provisions in some areas. The following is to be proposed as of the “initial application date”:

- ▶ The assessment of whether an instrument is ‘managed on a contractual yield basis’ (reflecting the circumstances at that date).
- ▶ Designation or de-designation of any financial instruments into or out of the fair value categories (provided the eligibility criterion is met).
- ▶ If retrospective application of the impairment requirements in IAS 39 is impracticable, the fair value of the instruments will be their deemed cost less impairment allowance.
- ▶ For unquoted equity instruments and related derivatives that were previously measured at cost, the fair value measurement requirements will be applied prospectively (any differences at the initial application date will be recognised in retained earnings).



It also reaffirmed that any required de-designations of hedge accounting are accounted for as a discontinuation of hedge accounting. There will be no ability to retrospectively designate any new hedging relationships for assets reclassified to amortised cost. Limited additional disclosures will be required for entities electing to apply the new standard early. The option in IFRS 1 *First time Adoption of International Financial Reporting Standards*, which allows entities to designate on either initial recognition or the date of transition, will be retained.

As a result of this project, the Board revisited related annual improvement topics and tentatively decided to:

- ▶ Defer finalising the amendment on the effective interest rate (paragraphs AG7, proposed AG7A and IG B24 of IAS 39)
- ▶ Finalise an amendment on the separation of an embedded foreign currency derivative (AG33 of IAS 39).

Alternative approach

An alternative approach to the classification and measurement of financial instruments was also discussed. The Board tentatively decided that the Exposure Draft will describe and ask questions about that approach. This approach has the following features:

- ▶ Instruments that are assets classified as loans and receivables under IAS 39 and financial liabilities would be eligible for measurement at amortised cost.
- ▶ Instruments that are assets that are not loans and receivables would be measured at fair value in the statement of financial position. For basic debt instruments managed on a contractual yield basis, amortised cost information would be presented in the profit or loss (including impairment) and movements over and above this would be recognised in OCI.
- ▶ There would be no recycling between OCI and profit or loss.
- ▶ A variation of this alternative approach is for the amounts that would be recorded in OCI to be recorded in a separate line of the income statement.

Financial instruments with characteristics of equity

The Board made the following tentative decisions:

- ▶ To expense all transaction costs or fees arising from the issue of an equity instrument or equity hybrid instrument.
- ▶ Freestanding equity instruments are initially measured at their transaction price and are not subsequently remeasured. Similarly, an equity component of a hybrid instrument that the entity cannot be required to redeem, is initially measured at its transaction price and is not remeasured after initial recognition.
- ▶ A separated equity hybrid instrument is initially measured as follows: the liability or asset component is measured first at fair value as if it were a free-standing liability or asset; the remainder of the transaction price is allocated to the equity component.
- ▶ Equity instruments with a redemption requirement are subsequently measured at the current redemption value, which is the value obtained from applying the redemption formula as if redemption was required at the measurement date. Changes in this value are presented as a transfer between the redeemable equity instrument or component and another equity account.

Leases

The Board tentatively decided that lessees:

- ▶ Refer to the applicable requirements in IAS 36 *Impairment of Assets* when assessing impairment of right-of-use assets.
- ▶ Expense the initial direct costs for negotiating and arranging leases as they are incurred.
- ▶ Apply the standard applicable to the underlying leased asset to determine whether and how a right-of-use asset may be revalued.

Financial reporting developments *continued*

- ▶ On initial application, recognise and measure all existing lease contracts: measure the obligation to pay rentals at the present value of the lease payments, discounted using the lessee's incremental borrowing rate and measure the right-of-use asset on the same basis as the liability, subject to any adjustments required to reflect impairment.
- ▶ When accounting for sale and leaseback transactions, control-based approach is to be applied consistent with the revenue recognition project to determine whether an asset has been sold and should be derecognised. If the leaseback is not at market terms, the gain is adjusted to reflect this.

Liabilities – amendments to IAS 37

Litigation liabilities

The Board agreed previously to remove an explicit probability threshold (more likely than not) from the recognition criteria. Entities would therefore be required to recognise all obligations that can be measured reliably. At this meeting, the Board tentatively decided not to change or supplement this with guidance on identifying liabilities that cannot be measured reliably.

Reimbursement rights

The Board tentatively concluded that no measurement objective would be specified for reimbursement rights. However, the assumptions used to measure a reimbursement right should be consistent with those used to measure the related liability. The existing 'asset cap' that limits the amount recognised for the reimbursement right to the amount of the related liability is to be removed.

Possible obligations

The Board tentatively decided that disclosure about possible obligations would be required when it is uncertain that a present obligation exists, but the entity has concluded it does not. Unless the possibility of an outflow of economic benefits is remote, disclosure would include: a description of the circumstances; the financial effects; the uncertainties relating to the amount and timing of any outflow of economic benefits; and the possibility of any reimbursement.

Revenue Recognition

Revenues for performance by other parties

The Board tentatively decided that an entity would recognise revenue on a gross basis when the performance obligation is to provide goods and services to customers. If the entity arranges for another party to provide those goods and services, revenue for the fee or commission would be recognised. Alternatively, if the performance obligation is legally transferred to another party, no revenue would be recognised.

Combination and modification of contracts

The Board tentatively decided that if the prices of multiple contracts with the same customer are interdependent, these contracts would be accounted for as a single net contract position. Similarly, if an existing contract is modified but the prices of the original contract are interdependent with those of the modified contract, the entity accounts for the original contract and modification as a single net contract.

Non-monetary exchanges

The Board tentatively decided that no revenue would be recognised from a non-monetary exchange contract if its purpose is only to facilitate a sale to another party (even if the contract has commercial substance).



Annual improvements

IFRS 1 First-time Adoption of International Financial Reporting Standards

Revaluation basis as deemed cost

The Board tentatively decided to revise IFRS 1 to recognise that a revaluation triggered by an event, such as privatisation, that occurs after the date of transition to IFRS but during the period covered by the first IFRS financial statements, is also a valid basis to determine a 'deemed cost'.

Accounting policy changes in the year of adoption

The Board tentatively decided that the requirements of IAS 8 do not apply to an entity that changes its accounting policies, or the IFRS 1 exemptions it chooses to apply during the period covered by its first IFRS financial statements. However, IFRS 1 is to be revised to require an explanation of the changes and an update to the reconciliation of comprehensive income and equity, including those reported for interim periods.

IFRS 3 Business Combinations

Contingent consideration of an acquiree

The Board clarified that pre-existing contingent consideration is an identifiable liability assumed in the subsequent acquisition, and is not contingent consideration in the acquirer's business combination. No revisions to IFRS 3 are proposed.

IAS 28 Investments in Associates

Venture capital consolidations and partial use of fair value through profit or loss

The Board tentatively decided that different measurement bases can be applied to portions of an investment in an associate when part of the investment is held by venture capital organisations or mutual funds and similar institutions. Accordingly, IAS 28 will be revised to require the entity to first measure the portion of the investment to which the scope exclusion of IAS 28 applies at fair value, and account for the remaining investment in accordance with IAS 28.

Impairment of investments in associates

The Board tentatively decided that in the separate financial statements of an investor, the focus is on the performance of the assets as investments. Accordingly, IAS 28 will be revised to require the investor to determine impairment of its investment in an associate in accordance with IAS 39.

New documents issued

Project	Effective date
Request for Information ('Expected Loss Model') - Impairment of Financial Assets: Expected Cash Flow Approach	Responses to be received by 1 September 2009
Discussion Paper of <i>Credit Risk in Liability Measurement</i>	Open for comment until 1 September 2009
Exposure Draft of <i>Management Commentary</i>	Open for comment until 1 March 2010

Resources

Supplements to *IFRS outlook*, Issues 45 – 48

Issue 45: Group cash-settled share-based payment transactions

In an effort to provide guidance on the accounting for cash-settled share-based payment transactions, the IASB recently amended IFRS 2. This supplement looks at the key changes that have been introduced by the Amendment, and includes illustrations of the potential impact of different arrangements between subsidiaries and parents. Businesses need to consider the potential tax accounting consequences of the Amendment for their groups and the separate reporting of each entity involved.

Issue 46: IASB issues Discussion Paper on 'own credit risk'

The IASB published a Discussion Paper on the role of an entity's own credit risk in liability measurement, often referred to as 'own credit risk'. This supplement summarises the arguments presented by the IASB for and against, including own credit risk and also highlights some of the potential implications. Constituents need to consider these arguments and whether this provides decision-useful information. Comments on the DP are due by 1 September 2009.

Issue 47: IASB seeks input on a new impairment model

The IASB issued a Request for Information on the feasibility of an expected cash flow approach to impairment of financial assets as part of its project to replace IAS 39. The adoption of the expected cash flow approach should reduce some of the complexity of the current approach under IAS 39, but businesses may face a challenge in adapting their processes and information systems to obtain relevant cash flow information. This supplement summarises the key aspects of the approach, information the Board has requested and the impact for businesses. Comments on the Request for Information are due by 1 September 2009.

Issue 48: Proposed guidance for management commentary

This supplement considers the key proposals outlined in a new Exposure Draft issued by the IASB containing non-binding guidance for preparing management commentary that is intended to improve the consistency and comparability of management commentary across jurisdictions. Comments on the ED are due by 1 March 2010.



Revenue recognition project preliminary IFRS views

This publication provides an overview of more significant elements of the IASB and FASB's ongoing convergence project on revenue recognition that is intended to improve financial reporting under both IFRS and US GAAP. It contains an analysis of the potential impact of the Discussion Paper entitled *Preliminary Views on Revenue Recognition in Contracts with Customers*, discusses a wide range of topics that may be affected by the proposed standard and the areas that are still unclear or are yet to be developed. It also analyses the impact of the proposed model on 14 industries.

Archived webcast

The lessons learned for year-end reporting

The December 2008 reporting cycle was one of the most challenging for several years, as a result of the deterioration in the economy and uncertainty about the future. In a follow-up to our November 2008 webcast, *Preparing for the year-end in the current environment*, in which we highlighted the critical areas of financial reporting likely to arise during the 2008 year-end reporting season, a panel of specialists discussed the challenges companies faced in the 2008 year-end reporting season, including the trends reflected in annual reports. We looked, in particular, at key areas such as impairment, financial instruments, restructuring and disclosure requirements, as well as some of the new challenges companies are likely to face when implementing some of the new standards in this environment.

This webcast was aimed at CFOs and controllers keen to take a proactive approach to addressing the potential issues and pitfalls in the upcoming reporting season. To listen to this webcast, go to <http://webcast.ey.com/thoughtcenter>

Coming soon

Good Bank (International) Limited - Illustrative financial statements – June 2009 update

This publication contains the financial statements for a fictitious bank, Good Bank (International) Ltd, with subsidiaries incorporated and listed in Euroland for the year ended 30 June 2009. The financial statements are cross-referenced to the source literature and include explanatory notes.

Good Insurance (International) Limited 2009 – Illustrative financial statements

This publication contains the financial statements for a fictitious insurance company, Good Insurance (International) Ltd, with subsidiaries incorporated and listed in Euroland for the year ended 31 December 2009, based on IFRS in issue at 31 March 2009. The financial statements are cross-referenced to the source literature and include explanatory notes.

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