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### **Is there a future for rate regulated assets and liabilities under IFRS?**

The provision and pricing of essential services such as electricity, natural gas and water are subjects close to the hearts of many stakeholders from customers, governments in their respective jurisdictions through to the companies that supply these services. Similarly, the accounting applied to companies that provide such services, be they those already reporting under IFRS or those converting to IFRS, is an area of intense interest. The IASB recently added the Rate-Regulated Activities project to its agenda. Find out about their plans and how they may impact the industry.

### **Convertible instruments - why you should look at anti-dilution provisions**

Convertible instruments can often be a more cost effective means of raising capital as they usually carry lower interest rates than non-convertible instruments. But the terms and conditions of convertible instruments may inadvertently impact whether the conversion feature should be accounted for as equity, or as a derivative liability with fair value changes taken to profit and loss. Learn about what these considerations are and how they can impact the accounting for convertible instruments.

### **Financial reporting developments**

At its recent meeting, the Board discussed the objectives of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. It also considered an aspect previously not addressed in the *Revenue Recognition* Discussion Paper and made tentative decisions about financial instruments with characteristics of equity, emission trading schemes, and post employment benefits.

We welcome your feedback on *IFRS outlook*. Please contact us at [ifrs@uk.ey.com](mailto:ifrs@uk.ey.com). The next issue will be published in May 2009.

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# Is there a future for rate regulated assets and liabilities under IFRS?



Many governments have established regulatory mechanisms and bodies to govern the provision of essential services such as natural gas, water, electricity and related services. For the consumer, the effect of this regulation is nothing more than rate adjustments on their invoices. However, these regulatory mechanisms have created significant accounting issues for the service providers that have been hotly debated by the power and utilities industry in countries already reporting under IFRS and those converting to IFRS.

After much deliberation, the International Accounting Standards Board (IASB or Board) added a Rate-Regulated Activities project to its agenda in December 2008. This article discusses the issues surrounding the recognition of rate-regulated assets and liabilities, the Board's tentative decisions to date, as well as some of the challenges the project will face.

## **How regulatory mechanisms work**

One of the key aims of these mechanisms is to provide price protection to consumers while maintaining a balance between that protection and allowing entities to earn a fair return. To meet these aims regulators often set prices in advance, based on estimated volumes and commodity prices as well as a target rate of return. After delivery, the regulator and entity determine the actual costs and volumes, and the entity can recover benefits (or must return costs) through future rate increases (or decreases). This gives rise to rights or obligations which may qualify as assets or liabilities - often referred to as rate-regulated assets or liabilities. Box 1 outlines two examples that may give rise to rate-regulated assets or liabilities.

“It has been estimated that in the US electricity industry alone, regulatory assets and liabilities of \$675 billion and \$450 billion, respectively, have been reported in 2007.”

## Box 1

### Example: Change in future rates due to infrastructure damage

Entity A is a regulated electricity transmitter. It incurred significant damage to its infrastructure during a major storm. Its regulator allows Entity A to recover the storm damage costs from ratepayers. However, to avoid a significant increase in rates in the next annual period, the regulator allows costs to be recovered over the three subsequent annual periods.

### Example: Change in future rates due to forecast volumes

Entity B is a distributor and supplier of natural gas. The regulator does not allow distributors to make a profit or loss on the sale of natural gas. Entity B charges its customers two rates - one for the natural gas and a separate rate for distribution services. In December 2007, the regulator stipulates that natural gas will be billed at \$1 per therm from 1 January 2008 to 31 December 2008. This estimate is based on consumers purchasing a specific volume, which is based on an average temperature for each season.

After rates were set, unseasonably warm weather in 2008 resulted in lower demand for natural gas, so consumption was significantly lower than forecast. Therefore, Entity B was unable to take advantage of volume discounts which were considered during the rate setting process.

## Accounting practices

Many legacy GAAPs allow entities to recognise rate-regulated assets and liabilities in the situations noted above. For example, under US GAAP, FAS 71 *Accounting for the Effects of Certain Types of Regulation* (FAS 71) sets out the required accounting in this area, and many other national GAAPs have looked to FAS 71 for guidance. Using the examples in Box 1, those that believe that rate-regulated assets and liabilities should be accounted for would recognise the storm damage costs in example 1 as an asset, and in example 2, recognise an asset of \$0.10 per therm of natural gas as it is sold. Conversely, if the cost of natural gas in example 2 was \$0.90, a liability of \$0.10 per therm of natural gas would be recognised as it is sold. While these are relatively simple examples, the amounts involved are often very significant. For example, it has been estimated that in the US electricity industry alone, regulatory assets and liabilities of \$675 billion and \$450 billion, respectively, have been reported in 2007.<sup>1</sup>

Conversely, under IFRS, there is no equivalent standard that addresses the accounting for rate-regulated activities. In 2005, the International Financial Reporting Interpretations Committee (IFRIC) was asked to provide guidance on accounting for operations subject to regulation. The IFRIC concluded that regulatory assets and liabilities can only be recognised if they qualify under the IASB's *Framework*. They also noted that the US GAAP recognition criteria were not fully consistent with IFRS and could not be applied by analogy.

The main argument against recognising these rights and obligations as assets and liabilities under IFRS is that their recovery or payment is based only on future sales, over which the entity has no control or present obligation. Only in situations where there is a guarantee given to the entity would an asset exist, for example, in certain circumstances in Spain.

The Board's decision to take this on as a separate project is a positive step for the industry, for both converting and converted countries.

<sup>1</sup> Source: July 25, 2008 letter from the Edison Electric Institute to the IASB.

# Is there a future for rate regulated assets and liabilities under IFRS? *continued*

## **The Board's discussions to date**

The IASB staff have put forward many arguments supporting the recognition of certain rate regulated assets and liabilities. These are based on reference to the new definitions of assets and liabilities arising from the joint IASB/FASB conceptual framework project.

With respect to asset recognition the staff noted that:

- ▶ Interpretation of 'control': in Phase B of the conceptual framework project (Phase B), the IASB and the FASB noted that constituents interpret control as the power to obtain benefits by having access to a resource and being able to limit others' access to it.
- ▶ Power to control customers: the staff drew parallels to customer relationships recognised in business combinations, where the acquiring entity can recognise an asset in the absence of obtaining the power to control its customers.

As a result, the IASB and the FASB have agreed to remove the misunderstood notion of control and to focus the definition of an asset on whether the entity has some rights or privileged access to the economic resource.

With respect to liability recognition, the IASB and the FASB agreed, during Phase B, that their current respective definitions over-emphasise the need to identify both the specific past event and the future outflow of economic benefits. Instead, a definition should focus on the economic obligation that presently exists.

## **The Board's decisions to date**

### *Proposed scope*

The only decision the Board has made to date is the proposed scope of the project. Two scope criteria were tentatively agreed at the February meeting, as follows:

- ▶ That a regulated entity's rates are established or are subject to approval by an authorised body. This body need not be independent from the regulated entity, if the price decision is binding; and
- ▶ The rate regulation takes the form of cost-of-service regulation - whereby rates are set to recover the specific entity's costs of providing the regulated good or service, plus a specified rate of return on invested assets.

The Board also believes that only costs incurred by the entity (including costs that must be estimated, e.g. pension costs) are in scope. Regulated prices based on targeted or assumed costs are not. For example, if the rates are set based on average costs for the entire industry and not each entity's specific costs, this would not be included in the scope of any eventual standard.

However, one of the difficulties is that if an asset is recognised, what type of asset is it - a financial asset or an intangible asset? Similarly, what type of liability is it? The Board asked the staff to clarify the nature of the asset, and if it is an intangible asset, the Board asked the staff to determine whether it can be distinguished from the entity's operating licence.



#### **Differences between FAS 71 and IFRS considered to date**

During its discussions, the Board considered whether the project's scope is aligned with US GAAP. FAS 71 has three scope criteria. Two of these are consistent with those in the Board's project. The third criterion requires that it is reasonable to assume that rates set by the regulator will be sufficient to recover the enterprise's costs and can be charged to and collected from the customers. This criterion requires that the entity considers changes in levels of demand and competition during the expected recovery period. The staff intend to address this when they consider recognition at the April Board meeting. However, they do not believe that transactions within the scope of the project will differ from FAS 71.

#### **The challenges ahead**

The IASB intends to publish an Exposure Draft in July 2009. We fully support the Board's intention to consider the accounting for regulated activities under IFRS. However, any decisions that the Board makes will be closely scrutinised by entities both within and outside the industry as it will move the goal posts for asset and liability recognition. If the Board concludes that an obligation does exist, there are other consequences that it will need to consider. For example, in IFRIC 6 *Liabilities arising from Participation in a Specific Market - Waste Electrical and Electronic Equipment*, the obligating event for recording a liability under IAS 37, is participation in the market place during the measurement period and not the manufacture or sale of the related good. If the IASB concludes that the obligating event for recording a liability for rate-regulated activity is the time of the sale, IFRIC 6 will need to be revisited to ensure that consistent approaches are taken to determining the existence of a liability.

Also, limiting the scope of the project to cost-of-service regulation, while consistent with FAS 71, will be subject to much discussion. Entities that do not operate under a cost-of-service regulation are likely to take issue with the fact that they are outside the scope of this project, even though there is a history of allowing cost recovery through future rate increases. We believe that the Board should clarify the accounting for such costs as well.

When considering recognition issues, we believe that the Board will also need to consider whether an asset or liability can be recognised where the regulatory approval for the specific matter is anticipated but has not been formally received, as formal approval is obtained after recognition of the asset or liability, and can sometimes take years.

Whatever standard is finally issued, an assessment of the facts and circumstances of each regulatory mechanism will be required, as each jurisdiction is unique. As a result, regulators should pay close attention to this project to understand how their mechanisms affect the results of the rate regulated enterprises in their jurisdiction.

# Convertible instruments - why you should look at anti-dilution provisions



The terms of a financial instrument may often be structured so that it contains both equity and liability components that need to be accounted for separately - otherwise called a compound instrument. A convertible bond is a classic example. In this article, we explore why anti-dilution provisions within convertible instruments may result in either an equity or liability classification.

## What are anti-dilution provisions?

From time to time, entities, particularly larger listed companies, may need to restructure their equity and this may take a number of forms, including:

- ▶ Structural changes in the issuer's ordinary shares (e.g. stock splits, reverse share splits, combinations or reclassifications of the outstanding ordinary shares of the issuer)
- ▶ Repurchases of shares
- ▶ Distributions of reserves or premiums, by way of extraordinary dividend
- ▶ Bonus share or rights issues

Anti-dilution provisions are often built into convertible instruments (usually referred to as 'conversion price adjustments'), in order to protect the holder of the instrument against a dilution of its interest arising from such events. For example, a convertible bond may typically include an adjustment formula so that the bondholder maintains the same percentage ownership in the entity before and after the event. Therefore, the effect of anti-dilution provisions is that a bondholder will usually be indifferent to converting immediately before or immediately after the event.

## Why do entities issue convertible instruments?

Large corporates often issue convertible instruments because they are cheaper to issue, i.e., they carry lower interest rates compared with non-convertible instruments, due to the potential appreciation of value in the future or the lower upfront cash cost. For medium-sized or start-up ventures, convertible preference shares are an easier way to raise capital from private equity houses or venture capitalists.

## Accounting implications

IAS 32 *Financial Instruments: Presentation* does not specifically deal with conversion price adjustments. However, IAS 32 provides a general notion that, except for certain puttable instruments, a contract or embedded derivative that will be settled by exchanging a 'fixed amount of cash or another financial asset for a fixed number of its own equity instruments' is an equity instrument or component. This is commonly known as the 'fixed-for-fixed criterion'.

On one hand, if the conversion price adjustment meets the fixed-for-fixed criterion, then the conversion component will be classified as equity. On the other hand, when a conversion price adjustment fails to meet that criterion, the component will be classified as a derivative liability, with fair value changes reported in profit or loss.



Many conversion price adjustments for bonus issues, share splits extraordinary dividends, etc, are fairly straightforward. They are usually not viewed as breaching the fixed-for-fixed requirement, as the conversion price adjustment feature ensures that the bondholders' risks are more closely aligned to those of the shareholders and so the instrument is, in substance, more 'equity like'. However, a wide range of more complex conversion price adjustment features exist, often expressed as mathematical formulae, in which the position of the bondholders does not necessarily track that of the existing shareholders. Even if the entity has no history where the conversion price adjustment provision was triggered in the past, and the entity does not intend to apply this adjustment in future, the mere existence of such an adjustment feature by itself could, in some cases, cause the component, or even the instrument as a whole, to fail the equity classification.

In the following two scenarios, we consider whether the conversion feature would result in the conversion component being classified as either equity or a derivative liability:

- (i) If an entity issues shares at less than the prevailing market price, the conversion price is adjusted by application of a formula to reflect the dilution arising from the subscription price for the additional shares.
- (ii) If an entity issues shares at less than the prevailing market price, the conversion price is adjusted based on an amount determined by an investment bank, but the quantum of the adjustment is not specified in the instrument.

In scenario (i) above, the conversion price adjustment feature is designed to make good the bondholder for the dilutive effect of the new issue of shares at less than their fair value (ie, the event). There are different types of adjustment, some of which make a dollar-for-dollar reduction in the conversion price, which would normally fail the fixed-for-fixed criterion (the bondholder, in effect having no equity price risk in this event). Others make a proportionate adjustment to the conversion price, through which the effect of the new issue below market rates is weighted by the relative increase in the number of shares in issue. While these give the bondholders an advantage over the existing shareholders, the effect of the conversion price adjustment is to maintain the bondholders position relative to all of the shareholders, new and old, taken together. Such features are more likely not to fail the fixed-for-fixed criterion, since although the conversion price is not fixed, the adjustment does not violate the substantive equity characteristics of the component.

However, in the conversion price adjustment feature in scenario (ii) above, the adjustment will vary depending on the bank valuation and is more likely to fail the fixed-for-fixed criterion, since the intent of the adjustment is more likely to be the elimination of the equity price risk of the event.

Determining whether or not a certain anti-dilutive provision meets the fixed-for-fixed criteria is a question of judgment and will depend on the specific facts and circumstances.

#### **Other practical considerations**

Conversion price adjustments are usually contained in convertible debt or convertible preference shares, but are not limited to these types of financial instruments. For instance, they may also be seen as strike price adjustments in options or warrants. They are generally described in the "anti-dilution provisions" of the underlying agreement, but such features may also be included within other sections of the agreement.

Management needs to carefully evaluate the terms of financial instruments in order to identify these provisions. They should not simply rely on the term sheet or other summary documents to identify these adjustment features.

#### **US GAAP**

EITF 07-5 provides guidance for analysing conversion price adjustments and a number of examples. Although the fundamentals of the fixed-for-fixed notion are the same as IFRS, there are several subtle differences between US GAAP and IFRS, and it is not possible to draw a direct parallel between the two.

#### **Summary**

Terms and conditions of convertible instruments can be easily overlooked, resulting in misclassification of instruments and therefore errors in the financial position. Analysing anti-dilutive clauses can be challenging and the accounting implications may not always be clear or simple. Even if the terms are considered "standard anti-dilution provisions" in that they are common to many transactions, this does not mean that they will all comply with the fixed-for-fixed concept, and result in equity classification.

We encourage any entity that has issued, or is contemplating the issue or modification of, convertible or other financial instruments that contain conversion price adjustment features, to carefully evaluate the terms and conditions to ensure not only that the documentation reflects the intent of the agreement, but also that it does not change the expected accounting treatment.

# Financial reporting developments

The IASB (the Board) met in London on 16 - 20 March 2009 and the IFRIC met on 5 March 2009. The Board and the US Financial Accounting Standards Board (FASB) (the Boards) also met for a joint meeting on 23 - 24 March 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
<b>Financial instruments - recognition and measurement</b>	<p>The Boards discussed the objectives of the project to replace IAS 39 <i>Financial Instruments: Recognition and Measurement</i> and the criteria for determining measurement attributes, other than fair value.</p> <p>The Boards also discussed approaches to loan loss accounting, and compared an incurred loss model (that is currently applied in IAS 39) with an expected loss model. No decisions were made. However, staff were asked to further explore the dynamic provisioning model required by the Spanish Central Bank.</p>	Proposals expected Q3 2009
<b>Financial instruments with characteristics of equity</b>	The Board continued deliberations on developing an approach to identify equity instruments and made some tentative decisions on the classification of certain redeemable and puttable instruments.	ED expected H2 2009
<b>Financial instruments - tentative IFRIC agenda decisions</b>	The IFRIC tentatively decided not to add participation rights and the calculation of the effective interest rate, and the classification of failed loan syndications to its agenda.	IFRIC to confirm its tentative decision not to add these items to its agenda at its next meeting
<b>Annual improvements</b>	The Board re-deliberated an issue from the ED <i>Improvements to IFRSs</i> published in August 2008, relating to the scope of IAS 39. Currently, the scope of IAS 39 excludes "contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date". The Board tentatively decided to limit this exclusion to forward contracts that will result in a business combination at a future date. This date should be within a reasonable period necessary to obtain any approvals to complete the acquisition.	Amendments expected April 2009
<b>Consolidation / derecognition</b>	The Board has now published both of its EDs on consolidation and derecognition. The Boards decided that, going forward, they would both debate the responses in comment letters the Board receives on these projects.	Standards expected H2 2009/H1 2010
<b>Conceptual framework</b>	<p>The Conceptual Framework project will focus on the private sector at this point, and the frameworks of both Boards will maintain their current hierarchical status. The Board also tentatively decided to amend IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> to reflect the qualitative characteristics of the revised framework, and made tentative decisions relating to Phases A and D:</p> <p><i>Phase A Objective of Financial Reporting</i></p> <p>Clarify that financial reports may include forward-looking information. This change it will be encompassed within the objective and characteristics outlined in the relevant chapter.</p> <p><i>Phase D Reporting Entity</i></p> <p>Only the concept of control should be discussed in the framework, and should take into account responses to ED 10 <i>Consolidated Financial Statements</i>.</p>	<p>Phase A final chapter due Q2 2009</p> <p>Phase D ED due H2 2009</p>



Projects	Key discussion points	Status
<b>Emissions trading schemes</b>	The Board made tentative decisions about emission allowances received for free.	ED due H2 2009
<b>IFRS for NPAs</b>	A final standard will be issued without re-exposure. A plan is to be established that addresses how issues arising upon adoption of the standard will be dealt with and how the standard will be updated in the future.	Final standard due Q2 2009
<b>Post-employment benefits</b>	The Board made several tentative decisions about the upcoming ED that will address recognition and presentation of changes in the defined benefit obligation and in plan assets and disclosures.	ED due H2 2009
<b>Revenue recognition</b>	The Board began discussing measurement of the transaction price – an aspect not addressed in the DP released in December.	ED due H1 2010
<b>Compliance costs for REACH</b>	The IFRIC continued discussions on whether to add to its agenda a project on accounting for costs incurred under the European Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH). Further research has been requested before making a final decision	IFRIC to decide whether it will be added to their agenda
<b>IAS 7 Statement of Cash Flows - Determination of Cash Equivalents</b>	The IFRIC tentatively decided that shares in a money market fund must be convertible to a known amount of cash on initial investment to be classified as a 'cash equivalent'. The existence of a readily determinable market value is not sufficient to satisfy that requirement. Rather, the risk of this value changing in the future must be insignificant. To make this assessment an entity could understand the fund's investment policy or identify the nature of the underlying investments.	IFRIC to consider whether to propose amendments to the Board
<b>IAS 28 Investments in Associates - Partial Use of Fair Value Through Profit or Loss</b>	The IFRIC was asked to consider the application of the venture capital (VC) exemption in IAS 28 in the consolidated financial statements when: part of the investment is held by a subsidiary that applies the VC exemption in its separate financial statements; recognises the investment at fair value; and the rest of the investment is accounted for using the equity method.  The IFRIC considered whether the VC exemption should only be applied to the entire investment, or whether it could be applied to each portion of the investment.  No decision was reached, and further analysis is requested for the discussion at the May meeting.	IFRIC to decide whether it will be added to their agenda
<b>IFRIC post-implementation revisions</b>	Constituents agreed with the Board's proposals to amend IFRIC 9 Reassessment of Embedded Derivatives to exclude from its scope derivatives in contracts acquired in common control transactions and the formation of joint ventures. They also agreed with proposed amendments to IFRIC 16 Hedges of a Net Investment in a Foreign Operation to remove the restriction that the hedging instrument cannot be held by the foreign operation whose net investment is being hedged.  The Board agreed to proceed with the amendments as proposed, but agreed to revise the effective date of the amendment to IFRIC 16 to annual periods beginning on or after 1 July 2009.	Amendments expected in April 2009
<b>Other IFRIC tentative agenda decisions</b>	The IFRIC tentatively decided not to add classification of tonnage taxes, disclosure of idle assets and construction in progress, accounting for sales costs and the discount rate assumption used in fair value calculations for agriculture to its agenda.	IFRIC to confirm its tentative decision not add these items to its agenda at its next meeting

ED = Exposure Draft, DP = Discussion Paper, Q2 2009 = Second quarter of 2009, H1 2009 = First half of 2009, H2 2009 = Second half of 2009, H1 2010 = First half of 2010.

# Financial reporting developments *continued*

## **IFRIC - items not taken onto the IFRIC's agenda**

*IAS 28 Investments in Associates - Potential effect of IFRS 3R and IAS 27 consolidated and Separate Financial Statements as amended in 2008 (IAS 27R) on equity method accounting*

IAS 28 provides explicit guidance on the following topics and the IFRIC and does not expect divergent practice:

- ▶ Assessing impairment of an indefinite-lived intangible asset of an equity accounted investment.
- ▶ Accounting for a change from the equity to the cost method.

*IAS 32 Financial Instruments: Presentation - classification of puttable and perpetual instruments*

The IFRIC was asked to provide guidance on classification of puttable instruments that are subordinate to all other classes of instruments when the entity also has perpetual instruments classified as equity. The IFRIC noted that an instrument is first classified as equity or a liability in accordance with the general criteria in IAS 32. If this results in a liability classification because it is puttable, an assessment is then made as to whether it is the most subordinate class of instruments. IAS 32 already specifies that the instrument's priority in liquidation determines its level of subordination. Therefore, the existence of the put option does not necessarily imply that the puttable instrument is less subordinate than the perpetual instrument. The IFRIC did not expect significant diversity to arise in practice and did not add this issue to its agenda.

*IAS 39 Instruments: Recognition and Measurement - Fair value measurements of financial instruments in inactive markets: determining the discount rate*

The IFRIC received a submission containing a proposal for measuring fair value in an inactive market using a valuation technique where some inputs are not observable.

The IFRIC noted that: the Board has already published a report on valuing instruments in inactive markets; the IASB/FASB discussed similar subjects at the round-table meetings in November and December 2008; and that guidance should be provided by the IASB/FASB as part of the fair value measurements project. Consequently, it did not add this issue to its agenda.

## **Financial instruments - recognition and measurement**

The Boards decided that:

- ▶ The objective of the project is for each Board to replace its respective financial instruments standards with a single, common standard which simplifies the accounting.
- ▶ Three potential measurement methods will be considered: fair value (being an exit price); a re-measurement method based on discounted cash flows; and amortised cost.

The Boards discussed possible criteria to consider which measurement method should be applied to an instrument, without making any decisions.

## **Financial instruments with characteristics of equity**

The Board tentatively decided that the following instruments are equity:

- ▶ An instrument redeemable at the option of the issuer; and
- ▶ An instrument puttable or mandatorily redeemable only upon the holder's retirement (including resignation and termination) or death. For example, many partnership interests are automatically redeemed when a partner dies or retires and such features are designed to maintain control of the business, or to restrict membership.

An instrument which is mandatorily redeemable on a specific date, dates or an event that is certain to occur (other than retirement or death), is a liability as it creates an unconditional obligation to deliver cash or another financial asset.

## **Financial instruments - tentative IFRIC agenda decisions**

The IFRIC tentatively decided not to add the following items onto its agenda:

*IAS 39 Instruments: Recognition and Measurement - Participation rights and the calculation of the effective interest rate*

Guidance had been requested on how to account for a fixed rate financial liability (measured at amortised cost) that gives the holder the right to share in the profits and losses of the issuer. It was assumed that the instrument does not contain any embedded derivatives. The IFRIC noted that AG6 and AG8 of IAS 39 already provide the applicable guidance for measuring liabilities at amortised cost.



#### *IAS 39 Instruments: Recognition and Measurement - Classification of failed loan syndications*

When an entity originates a loan with the intention of syndication but a part, or the whole of the loan fails syndication, the IFRIC was asked whether the retained portion of the loan must always be classified as held for trading, or only if held with trading intent.

The IFRIC noted that the classification is dependent on whether the "loans and receivables" or "financial asset at fair value through profit or loss" definitions are met and not the entity's intent. The IFRIC did not expect significant diversity in practice.

#### **Emissions trading schemes**

Emission allowances received for free are assets to be recognised and measured at fair value. Receipt of such assets gives rise to an obligation for the entity to reduce emissions below the level of the allowances received. Accordingly, a liability should also be recognised, measured at the fair value of the allowances received.

#### **Post-employment benefits**

##### *Presentation*

The Board tentatively decided in previous meetings that all changes in plan assets and obligations of defined benefit plans must be recognised in the income statement. Consequently, changes in the net defined benefit asset or liability should be separately presented as follows:

- ▶ Service cost (including any gain or loss on settlement and the effect of the asset ceiling in the remeasurements component).
- ▶ Interest cost on the obligation (as for other finance costs).
- ▶ "Remeasurements" including total return on plan assets and actuarial gains/losses on the defined benefit obligation (including any gain or loss on curtailment).

##### *Other issues*

Other miscellaneous topics that are within the scope of the project were discussed. One of these was the definition of the term 'deep market' used when determining discount rates. The Board considered replacing it with the definition of an 'active market' when the Board finalises its project on fair value measurement.

#### **Revenue recognition**

The Board began discussing three aspects of measurement of a transaction price and tentatively decided that:

##### *Time value of money*

- ▶ The net contract position includes the effect of the time value of money, if material.
- ▶ The discount rate is the one that the entity and the customer would have used had they entered into an independent financing transaction.
- ▶ Its impact is presented separately from revenue arising from other goods and services.

##### *Uncertain consideration (other than for customer credit risk and contract modifications)*

- ▶ At inception, the transaction price is the probability-weighted estimate of customer consideration, if the amount is uncertain.
- ▶ After inception, the measurement of contractual rights must be updated to reflect changes in transaction price. These amounts must be allocated to performance obligations. If the amount relates to an obligation already satisfied, the revenue is recognised immediately.

##### *Non-cash consideration*

- ▶ Any non-cash consideration is measured at fair value. If this is not possible, the entity refers to the fair value of the promised goods and services. However, no revenue is recognised if the transaction lacks commercial substance.

#### **Other IFRIC tentative agenda decisions**

The IFRIC was asked about the following issues and tentatively decided not to add them onto its agenda:

##### *IAS 12 Income Taxes - Classification of tonnage taxes*

Whether a tax based on tonnage transported or tonnage capacity is an income tax as per IAS 12. IFRIC has previously noted that IAS 12 applies to taxes that are based on taxable profit, which implies a net amount. Tonnage capacity or tonnage transported is based on gross amounts and, therefore, not an income tax under IAS 12.

# Financial reporting developments *continued*

## *IAS 16 Property, Plant and Equipment - Disclosure of idle assets and construction in progress*

To provide more guidance on the extent of the disclosures required for property, plant and equipment (PP&E) which is temporarily idle, or assets under construction when additional construction has been postponed. The IFRIC considered that disclosure of idle assets may be relevant in the current environment and that entities may want to provide additional disclosure for such assets. Therefore, they propose that the Board reviews those disclosures which are encouraged and confirm whether they are required or should be removed.

## *IAS 38 Intangible Assets - Accounting for sales costs*

To clarify how a real estate developer should account for initial selling and marketing costs incurred during construction of a specific real estate construction project. The IFRIC noted that these costs cannot be capitalised if the real estate units are inventory or PP&E, unless they are directly incurred for preparing the asset for use. IAS 11 *Construction Contracts* also excludes such costs from contract costs. The IFRIC noted that other standards do allow recoverable costs directly associated with a customer contract to be capitalised, however, in very narrow circumstances. The IFRIC did not expect diversity in practice

## *IAS 41 Agriculture - Discount rate assumption used in fair value calculations*

To provide guidance on determining a discount rate when using the present value of expected net cash flows to determine fair value of biological assets. The fair value guidance in IAS 41 is consistent with other standards and reference should be made to the recent guidance provided by the Board about estimating fair values for assets without readily observable prices in active markets.

## New documents issued

Project	Effective date
<i>IASB seeks views on FASB's FSPs on fair value measurement and impairment of financial instruments</i>	Open for comment until 20 April 2009
<i>DP of Leases - Preliminary Views</i>	Open for comment until 17 July 2009
<i>ED of Derecognition - Proposed Amendments to IAS 39 and IFRS 7</i>	Open for comment until 31 July 2009
<i>ED of Income Tax</i>	Open for comment until 31 July 2009
<i>Amendments to IFRS 7 Financial Instruments: Disclosures</i>	Applicable for annual periods ending on or after 1 January 2009
<i>Embedded Derivatives (amendments to IFRIC 9 and IAS 39)</i>	Applicable for annual periods ending on or after 30 June 2009

# Resources

## Supplements to *IFRS outlook*: Issues 33 - 38

### Issue 33 - Embedded derivatives: amendments to IFRIC 9 and IAS 39:

Pursuant to the amendments to IAS 39, issued in October 2008, the IASB has held a series of round-table meetings with the US FASB. As a result, the IASB has issued proposed amendments to IFRIC 9 and IAS 39 that would require an entity to assess whether an embedded derivative must be separated from a host contract when it reclassifies a hybrid financial asset out of the fair value through profit or loss.

### Issue 34 - Reclassification of financial assets:

This supplement replaces *Supplement to IFRS outlook* Issue 23, summarising the amendments the IASB has made to IFRS regarding the reclassification of certain financial assets from held for trading to the held to maturity, available for sale, or loans and receivables categories including the recent amendments to IFRIC 9.

### Issue 35 - Leases project preliminary views:

This supplement summarises the proposals in the Discussion Paper *Leases*, issued by both the IASB and FASB. This DP is the output of a joint project to develop a common lease accounting standard to ensure that the assets and liabilities arising from lease contracts are recognised in the statement of financial position. Under the proposed new model, which would eliminate operating leases, lessees would record an asset representing their right to use the leased asset during the term of the lease and a liability for their obligation to make rental payments.

### Issue 36 - ED Income Tax - Proposal to replace IAS 12:

The IASB has issued an ED to replace IAS 12 Income Taxes. The most important changes include definitions of 'tax basis' and 'temporary difference', exceptions to the 'temporary difference' approach, allocation of tax components to comprehensive income or equity, uncertain tax positions, and transitional and first-time adoption provisions. We encourage you to read this publication as almost all tax-paying entities will need to assess the potential effects of the proposed amendments given the pervasiveness of income tax items on financial statements.

### Issue 37 - Derecognition of financial instruments - proposed amendments to IAS 39 and IFRS 7:

This publication summarises the ED which proposes to improve the derecognition provisions included in IAS 39 for financial instruments. The ED also proposes changes to IFRS 7 introducing new qualitative and quantitative disclosure requirements related to derecognition of financial instruments. The proposed derecognition requirements for financial assets, which are based on an assessment of control, are simpler than those in the current IAS 39, while the proposals for derecognition of financial liabilities retain similar requirements to those currently in IAS 39.

### Issue 38 - FASB issues FSPs on fair value measurement and impairment of financial instruments:

The FASB issued its final FASB Staff Positions (FSPs) relating to determining fair value when the volume and level of activity have decreased, recognising and measuring impairment of debt securities. In March, the IASB invited comments on the draft proposals. This publication is an update to *Supplement to IFRS outlook* Issue 33 and reflects the text of the final FSPs, which incorporate some significant amendments from the proposals. The IASB consultation period ends 20 April 2009.

# Resources *continued*

## **IFRS disclosure checklist April 2009**

This publication is an update of International GAAP® Disclosure checklist, designed to meet the needs of clients and our client-service teams, contains all of the disclosure requirements for an entity filing either year-end or interim IFRS-based financial statements. The update contains all of the disclosure requirements issued as of 31 March 2009 should an entity wish to early adopt any standards and interpretations approved by the IASB.

## **IFRS 2 *Share-based payment* - the essential guide (updated March 2009)**

This updated guide gives an overview of IFRS 2 and the related interpretations of IFRIC 8 *Scope of IFRS 2* and IFRIC 11 *Group Treasury Share Transactions*. It also encompasses the recent amendments to the standard in respect of and cancellations that became effective on 1 January 2009.

## **Archived webcast**

### **Consolidations and the effect of the new business combinations standard**

When the IASB amended the accounting for a business combination, IAS 27 - *Accounting for consolidations*, it also revised how a parent of a group of companies accounts for certain transactions involving subsidiaries. These changes have a direct impact on the reported results of a group and the amount of equity that is attributed between the parent and subsidiaries. The IASB also intends to amend IAS 27 to change the definition of control and introduce additional disclosures for structured entities. To listen to our panel of professionals discuss the changes in IAS 27 and the potential implications, as well as the proposed changes and their expected impact, go to <http://webcast.ey.com/thoughtcenter>.

## **Coming soon**

### **Good Group (International) Limited - Interim Illustrative financial statements**

This publication contains the interim financial statements for a fictitious company, Good Group (International) Ltd, for the period ended 30 June 2009, based on IFRS in issue at 31 March 2009. The financial statements are cross-referenced to the source literature and include explanatory notes.

### **2008 IFRS update - April 2009 supplement**

Our April supplement to the 2008 IFRS update gives an overview of the upcoming changes in standards and interpretations issued by the IASB since the 2008 IFRS update was published. These changes affect many different areas of accounting, focusing on the effect on years ending in 2009 and beyond.



## IFRS webcast series

### Remuneration packages

Tuesday 28 April 2009

[9.00 - 10.00 London Central European Time, 10:00-11:00 Paris, 17:00-18:00 Hong Kong, 20:00-21:00 Sydney]

In the midst of the economic downturn and tight budgetary constraints, many companies have modified the terms and conditions of their employees' remuneration packages, or they are considering new remuneration schemes. The complexity of applying the accounting standards for share-based payments and pension funds can lead to unexpected and significant impacts on a business's reported performance. Our panellists will discuss the preparation of accounts and the disclosure considerations, with particular emphasis on the modifications and cancellations to employee remuneration packages and the potential implications for businesses in the current economic climate.

This webcast is aimed at CFOs, preparers of financial statements, financial controllers and human resources directors. Join a panel of experienced professionals from Ernst & Young's Global IFRS Services group to discuss the impact that IFRS 2 and IAS 19 may have on accounting for remuneration packages.

To register, go to <http://webcast.ey.com/thoughtcenter>.

### Forthcoming webcasts on IFRS

#### May 2009 - Proposed changes to accounting for income taxes under IFRS

On 31 March 2009, the IASB released its much-anticipated ED to replace IAS 12 *Income Taxes* proposing several changes to the current requirements of IAS 12, including new requirements for the accounting and disclosure of uncertain tax positions, and definitions of a "tax base" and a "temporary difference". Furthermore, the ED proposes a change in the allocation of tax to components of profit or loss or equity ("backward tracing") along with transitional and first-time adoption provisions.

In this webcast, our panel of specialists will discuss several aspects of the ED, with particular emphasis on the changes mentioned above, as well as the potential accounting and business implications thereof. Income taxes are a significant item for all reporting companies and any changes to how they are accounted for can have a fundamental impact on a company's balance sheet and income statement, as well as on disclosures. To register, go to <http://webcast.ey.com/thoughtcenter>

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**EYG no. AU0265**

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