



# IFRS News

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

Our July edition leads with an article on the International Accounting Standards Board's (IASB) latest plans for convergence with its counterpart in the United States, the Financial Accounting Standards Board (FASB). We then look at some recent changes that have taken place and some that are expected to occur in the near future as well as commenting on the effect the credit crisis may have on the future reporting of financial instruments.



# Convergence moves a step closer

## Update to the Memorandum of Understanding between the IASB and the US FASB to set out steps needed to facilitate mandatory adoption of IFRS in all major capital markets

Following the elimination of the US GAAP reconciliation requirement for SEC-registered foreign companies that use IFRS, the IASB and FASB have discussed the need to update their 2006 joint Memorandum of Understanding (MoU). With the reconciliation milestone achieved, the Boards have set their sights on adoption of IFRS in all of the world's major capital markets by 2013. The Boards also acknowledge that a stable period will be needed ahead of that date.

The revised MoU is not yet final, but the Boards have discussed its major themes. The most significant outcome is an expected reordering of the IASB's priorities and work plans between now and 2011. That is the target date by which 'major deficiencies' in IFRS will

need to be addressed if the ambitious 2013 goal is to have a realistic chance of success. The projects falling into the 'major deficiencies' category are:

- **Revenue recognition** – the Boards regard existing guidance in IAS 18 'Revenue' as incomplete, insufficient, and internally inconsistent. Preparers who do not find a ready answer in IAS 18 often resort to the detailed guidance provided in US GAAP. The Boards therefore intend to develop a single model of revenue recognition in time for the 2013 deadline.
- **Fair value measurement** – IFRS currently lacks a consistent/robust definition of fair value, and this has been identified as a significant issue for US investors. The Boards therefore aim to complete a project on this matter by mid-2011 by; limiting the objective of the project to amending existing IFRSs to replace the various measurement terms used with references to either

entry or exit prices; and including a definition of exit prices that is identical to the one used in the US standard dealing with fair value measurement.

- **Consolidation policy** – the Boards have identified the need for improved guidance relating to effective control and special-purpose entities as being critical issues that need to be addressed, particularly in light of the current credit crisis. The intention is to complete a consolidation policy standard that embraces the idea of effective control by 2011.
- **Derecognition** – the Boards view both IAS 39 'Financial Instruments: Recognition and Measurement' and the US derecognition standard as being flawed and have therefore identified a need for a replacement standard to be developed which will adequately address securitisation issues.

In addition, the Boards have identified projects that address areas for which there is a significant need for improvement in IFRS, which include financial statement presentation, post-retirement benefits and lessee accounting. The MoU discussions have provided some clear pointers on the Boards' current views on what should be done in these areas.

Inevitably, this prioritisation exercise means that other projects will be pushed back. Any other projects not specifically mentioned in the MoU can be expected to be relegated to the longer term agenda. The project on insurance is likely to fall into this category.

# IASB acts to reduce obstacles preventing companies from adopting IFRS

## Amendments to IFRS 1 and IAS 27 aim to encourage greater use of IFRS in separate financial statements

The IASB has issued amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' and IAS 27 'Consolidated and Separate Financial Statements', entitled 'Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate'.

These changes affect only the separate financial statements of a parent entity or investor. In some jurisdictions, parent entities apply IFRS in their consolidated financial statements but continue to use local GAAP in their separate (or 'Company-only') financial statements. The changes aim to remove one of the problems which have discouraged the use of IFRS in separate financial statements.

The main changes are:

- the introduction of a 'deemed cost' exemption into IFRS 1 for first-time adopters of IFRS when measuring the cost of an investment in a subsidiary, jointly controlled entity or associate, and
- the removal of IAS 27's requirement to deduct dividends paid from pre-acquisition profits from the cost of such an investment in the investor's separate financial statements.

Previously parent entities recognised income from investments in subsidiaries only to the extent that dividends were paid out of post-acquisition accumulated profits; distributions received out of pre-acquisition profits were regarded as a recovery of the investment and were deducted from its cost. In future, dividends receivable will be recorded as income. However, IAS 36

'Impairment of Assets' has also been amended to include a dividend in excess of the investee's comprehensive income for the period as an indicator of possible impairment of the investment.

The changes also include new requirements on accounting by a parent that reorganises its group by forming a new parent entity without affecting the interests of shareholders.

The Amendments are effective for annual periods beginning on or after 1 January 2009.

### Comment

The previous requirement to treat dividends paid out of pre-acquisition profits as a reduction of the cost of investment in a subsidiary, joint venture or associate created practical problems for many companies and no doubt was a factor behind some of them continuing to use local GAAP rather than IFRS in their separate financial statements.

The IFRS 1 changes are perhaps more pragmatic than principle-based. However, they are not inconsistent with other exceptions contained in IFRS 1 and should encourage wider adoption of IFRS in separate financial statements. We pressed for these changes and therefore welcome their publication.



# IASB completes its first annual improvements project

## Minor problem areas in standards addressed by IASB amendments

The IASB has completed its first round of annual improvements by publishing 'Improvements to IFRSs' ('the 2008 Improvements'). These make minor amendments to a number of International Financial Reporting Standards.

This process is intended to deal with non-urgent (but necessary) minor amendments. These could be matters referred to the International Financial Reporting Interpretations Committee (IFRIC) or suggestions from practitioners. Rather than making piecemeal changes during the year, the process streamlines the improvement activity through publication of changes in a single, annual document.

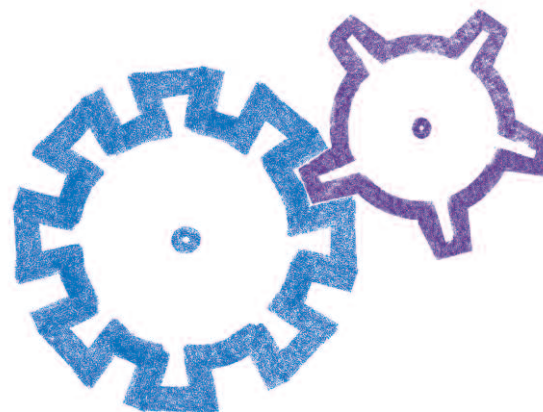
The 2008 Improvements are divided into two parts, with the first part including amendments that result in accounting changes for presentation, recognition or measurement purposes while the second deals with amendments that are terminology or editorial changes only, which the IASB expect to have no or minimal effect on accounting.

In most (but not all) cases the amendments apply for annual periods beginning on or after 1 January 2009, with early adoption permitted.

## Comment

When the Exposure Draft containing the proposed amendments to IFRS were published last year, we raised concerns that some proposals amidst the 40-plus changes originally put forward could have far-reaching implications. An example was the proposed broadening of the definition of a derivative (including embedded derivatives) which we felt was likely to capture many contracts currently outside the scope of IAS 39 'Financial Instruments: Recognition and Measurement'. This and certain other proposals did not seem to fall into the 'minor but necessary' category.

We are therefore pleased that the IASB has removed most of the more controversial changes from the 2008 Improvements. One controversial issue that the Board did include concerns accounting for advertising and promotional activities. An entity incurring costs on promotional goods such as catalogues will need to expense these costs when it has a 'right to access' the goods. Companies that previously recognised catalogues and brochures as assets will therefore need to review their accounting policies in the light of the 2008 Improvements.



# IAS 1 Revised: Implementation draws nearer

Although IAS 1 'Presentation of Financial Statements' (Revised 2007) does not become effective until reporting periods beginning on or after 1 January 2009, preparers of accounts should be thinking now about the changes that it will bring. The new requirements are retrospective so companies adopting them in 2009 will need comparative information for 2008.

Perhaps the most important change is the requirement to present all items of income and expense recognised in the period in either a single "statement of comprehensive income" or in two separate statements (an "income statement" and a "statement of comprehensive income"). 'Comprehensive income' includes normal profits and losses along with other gains and losses that are reported outside profit or loss in accordance with

IFRS. These items of other comprehensive income include revaluation surpluses, actuarial gains and losses and changes in the fair value of available-for-sale financial assets. These items, previously charged or credited to equity, will in future be reported separately from owner transactions such as dividends and changes in share capital.

The new requirements will focus attention on comprehensive income as a performance indicator in addition to the more traditional net income sub-total, and could result in a change in the way analysts read the financial statements.

The amended version of the Standard also makes changes to the titles of the primary financial statements, with

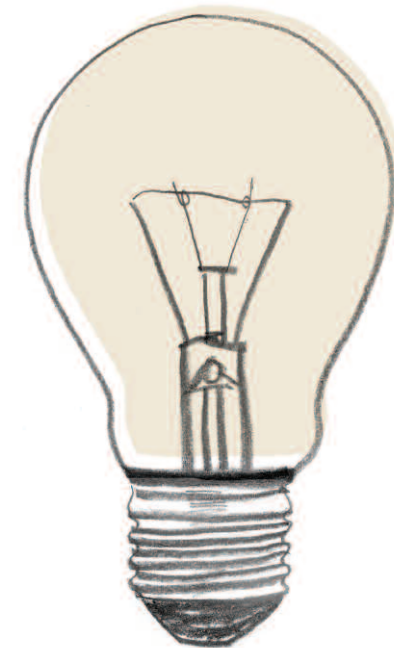
- the term "statement of financial position" replacing "balance sheet";
- "statement of cash flows" replacing "cash flow statement"; and

- "statement of comprehensive income" replacing "statement of recognised income and expenditure" as explained above.

While these changes in title have attracted considerable attention, their use is not mandatory. Instead preparers may be wise to focus on a change that has attracted less attention but could have a major impact – the need to make additional comparative disclosures in particular circumstances.

IAS 1 as amended in 2007 introduces a requirement to present an additional balance sheet (or statement of financial position) as at the beginning of the earliest comparative period in a set of financial statements when the entity retrospectively applies an accounting policy or makes a retrospective restatement, or when it reclassifies items in its financial statements.

Should you find that you need to prepare a third balance sheet, 2009 will suddenly seem not so far away!



# IFRIC Interpretation on Agreements for the Construction of Real Estate

## Interpretation will cause some entities to recognise revenue at a later stage

The International Financial Reporting Interpretations Committee (IFRIC) has published IFRIC 15 'Agreements for the Construction of Real Estate'.

The development of this Interpretation was prompted by the desire to standardise accounting practice among real estate developers for 'off plan' sales of apartments or houses (sales before the construction of the apartments or houses is complete). Up to now, there have been significant differences in the way real estate developers have accounted for such sales, with some recording revenue only when the completed unit is handed over to the buyer, and others recognising revenue as construction progresses in accordance with IAS 11 Construction Contracts.

The IFRIC Interpretation will make it more difficult to argue that this type of agreement falls within the scope of IAS 11. It emphasises that a feature of construction contracts is the buyer's ability to specify major structural components of the design both before and during construction activity. It therefore seems likely that this Interpretation will require changes to revenue recognition policies for some property developers and house-builders. IFRIC 15 is effective for annual periods beginning on or after 1 January 2009, with earlier application permitted.



# IFRIC Interpretation on Hedges of a Net Investment in a Foreign Operation

The International Financial Reporting Interpretations Committee (IFRIC) has published IFRIC 16 'Hedges of a Net Investment in a Foreign Operation'.

The IFRIC clarifies certain issues about the accounting for hedges of foreign currency risk relating to foreign operations (such as subsidiaries and associates whose activities are conducted in a currency other than the functional currency of the reporting entity). The main issues addressed are:

- the type of risk that can qualify for this form of hedge accounting, and
- where within a group the instrument that offsets that risk may be held.

In respect of the first issue, IFRIC 16 concludes that translation risks relating to exchange differences between a foreign operation's functional currency and the reporting entity's presentation currency are not eligible for hedge accounting. This is based on the view that mere translation of currency for presentational use does not represent an economic risk. The economic risk relates to the functional currency exposure between the parent or investor and its foreign operation.

On the second issue, IFRIC clarifies that the hedging instrument can be held by any subsidiary or parent entity within a group regardless of the entity's functional currency.

IFRIC 16 is effective for annual periods commencing on or after 1 October 2008, with earlier application being permitted. However, in recognition of the difficulty that entities would face in preparing adequate information from the inception of the hedge relationship, retrospective application is not required.

# IASB takes first step to revising IAS 19

## Discussion paper aims to increase transparency in the accounting for post-employment benefits

The IASB has issued a Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits' which sets out the IASB's preliminary views on how the accounting for certain types of post-employment benefit, including pensions, could be improved.

IAS 19 has been criticised in many quarters for permitting the inclusion of misleading figures in the statement of financial position (balance sheet). The criticisms stem largely from the so-called 'corridor mechanism' which enables companies to defer the recognition of actuarial gains and losses on their defined benefit pension schemes.

The proposal to remove the 'corridor mechanism' is an important one as the pension liabilities of some large companies can sometimes exceed the actual market capitalisation of the companies themselves



The preliminary view expressed in the Discussion Paper is that the options for deferred recognition of gains and losses in defined benefit plans should be removed, thereby improving comparability between companies and reflecting the actual pension scheme exposure more accurately. This proposal is an important one, as the pension liabilities of some large companies can sometimes exceed the actual market capitalisation of the companies themselves.

The Discussion Paper also proposes a new classification of what it refers to as 'benefit promises' into 'contribution-based promises' and 'defined benefit promises'. Some schemes that currently fail the IAS 19 definition of 'defined contribution plans' would fall into the new contribution-based category. The Paper puts forward a new measurement

attribute for contribution-based promises, which would involve a fair value approach assuming that the benefit promise does not change. This would not change the accounting for simple fixed contribution schemes but is intended to clarify and improve the accounting for plans that include a promised return on contributions linked to an asset or an index.

In this respect, the focus of the Discussion Paper is quite narrow: it is principally aimed at addressing the accounting for cash balance pension scheme plans or pension schemes which contain promises linked to contributions with a minimum guaranteed return. Using current terminology, these schemes have some of the characteristics of both defined benefit plans and defined contribution plans.

# Reducing the complexity in reporting financial instruments

The IASB has published a Discussion Paper ‘Reducing the Complexity of Financial Instruments’ as the first step in a project towards developing a less complex and principles-based standard that will replace IAS 39 ‘Financial Instruments: Recognition and Measurement’.

The Discussion Paper considers the main sources of complexity in reporting financial instruments. The authors suggest that a key source of complexity is the multiple methods currently used to measure financial instruments. The Paper argues that the long-term solution to these problems is a move to full fair value, but then explains why this solution is not realistic in the near term. Accordingly, three possible ‘intermediate approaches’ are explored.

The intermediate approaches suggested are:

- amending the current measurement requirements;

- replacing them with alternative requirements; and
- simplifying hedge accounting requirements.

Ways of amending the current measurement requirements include reducing the number of categories of financial assets by, for example, eliminating either the held-to-maturity or the available-for-sale-categories. Alternatively, some of the current measurement restrictions such as the tainting rules for the held-to-maturity category could be eliminated.

**The project is the first step in developing a less complex and more principles-based standard that will replace IAS 39**

Under the second intermediate approach, the existing measurement requirements would be replaced with a fair value measurement principle. Fair value would become the default category for financial instruments but limited, optional exemptions would be made to allow some instruments to be measured at amortised cost. The nature of the exemptions would no doubt be of significant interest – one approach put forward is to base it on the extent of variability of an instrument’s cash flows.

The third intermediate approach is to simplify hedge accounting requirements in some way. This might be accomplished by replacing the current models with a less complex fair value hedging model or simplifying the existing model by changing the requirements for assessing hedging effectiveness or the hedging of portions or partial term hedges.

## Comment

Sadly the project is at present only on the IASB’s research agenda (as opposed to being an active agenda project), so those readers hoping to see a reduction in complexity in the near future are likely to be disappointed.

It is nevertheless a thought-provoking paper for several reasons. It is notable in part for what it does not cover. Some issues, such as derecognition, are covered in separate projects while others, such as IAS 39’s complex language and convoluted structure, or its lack of a clear principle on when an embedded derivative is ‘closely related’, are not addressed at all. More fundamentally, however, should the IASB be seeking to make significant ‘intermediate’ changes to IAS 39 if it has already decided on the long-term solution?

# Conceptual framework – views sought

## IASB and FASB seek views on two consultative documents on the conceptual framework

The IASB and the US Financial Accounting Standards Board (FASB) have published two consultative documents relating to their joint project to develop an improved conceptual framework. The project is an important one as a solid foundation upon which future standards can be based is essential if the boards are to succeed in their aim of developing principles based standards which are consistent with one another.

The first document is an Exposure Draft which seeks views on an improved objective of financial reporting, the qualitative characteristics of information provided by financial reporting and constraints on the provision of that information. It proposes that the objective of financial reporting is to provide financial information that is useful to present and potential equity investors, lenders and other creditors in making decisions as capital providers.

The second document sets out the Boards' preliminary views on the reporting entity concept and related issues. Although the reporting entity concept determines some important aspects of financial reporting, the boards' existing frameworks do not address it specifically.

## A solid foundation is essential if the Boards are to succeed in their aim of developing principles-based standards

Views on the two documents are invited by 29 September 2008. There are eight phases to the overall project, so while the publications dealing with the first two phases are welcome, it will be some while before we see completion of the revised conceptual framework.

# The International Financial Reporting Standard for Private Entities – a better name for the IFRS for SMEs project

## **IASB redeliberations expected to lead to a stand-alone Standard for private entities**

The IASB has begun redeliberating the proposals in the Exposure Draft of a proposed IFRS for SMEs, which has led amongst other things to a change in name for the project.

Some commentators struggled to reconcile the use of the term ‘Small and Medium-sized Entity’ with that project’s scope (it addressed the accounting for all entities which do not have shares issued on a public stock market and which therefore could be any size, big or small). They will be pleased to learn that the IASB has decided to rename the project the ‘International Financial Reporting Standard for Private Entities’ although its scope remains the same.

Other important decisions that were tentatively made by the IASB in its May and June meetings included a resolution that the final standard should be a stand-alone document and that all accounting policy options contained in the full text of IFRSs should be available to private entities. This would mean that topics such as share-based payment and lessor accounting for finance leases will now be addressed directly rather than by cross-reference to full IFRS.

The eventual standard will also reflect the requirements contained in the revised version of IAS 1 ‘Presentation of Financial Statements’ published last year. Amongst other things, this will mean that the final version of the IFRS for Private Entities will use the new titles for financial statements contained in IAS 1 (eg Statement of Financial Position rather than Balance Sheet). As is the case for full IFRS, these titles will not be mandatory. Entities using the IFRS for Private Entities will also be required to present a “statement of comprehensive income”.

The Board will continue to debate the proposals in future meetings before any final standard is developed.

# Credit crisis causes IASB to review its work schedule

'Sub-prime' losses and the wider effects of the global credit crisis are continuing. Unsurprisingly, these events have led to demands for the IASB to review the effectiveness of some of its standards against the backdrop of these extreme market conditions. In April the G7 finance ministers and central banks called for the IASB to take action urgently to improve accounting and disclosure standards for off-balance sheet entities and enhance guidance on fair value accounting. How will the IASB respond?

The IASB has a long-running project to develop a consolidation model applicable both to normal subsidiaries and to special purpose entities. It has recently suggested that it will omit the discussion paper stage and proceed directly to an exposure draft later this year. Around the same time, proposals to improve IFRS 7 'Financial

Instruments: Disclosures' (the Standard dealing with financial instrument disclosures) may emerge. Additional transparency concerning off balance sheet risks and arrangements is likely to be the main theme of any such proposals although refinements in other areas (such as liquidity risks) could also feature. A review is timely in any case, with 2007 being the first year in which IFRS 7 has been applied widely.

**Additional transparency concerning off balance sheet risks and arrangements is likely to be the main theme of proposals to improve IFRS 7**

The IASB is also expected to move ahead with detailed guidance on fair value measurement, along the lines of the (US GAAP influenced) discussion paper it issued in 2007. However, it will surely be less sympathetic to calls to limit or roll-back the use of fair value accounting. Some commentators suggest that fair value is appropriate only when items are held for trading or managed on a fair value basis. Others have gone further, suggesting that fair value accounting may have exacerbated the effects of the credit crisis. Proponents of fair value argue that cost-based alternatives would mask the impact of changing market conditions and, in doing so, would ultimately prolong the difficulties. This debate will continue.

## Comment

The IASB has sensibly acknowledged that standard-setters can learn from the credit crisis. Hence this difficult period may at least provide the impetus for some lasting improvements in financial reporting.

However, a note of realism is also necessary. Forming a workable definition of 'off balance sheet arrangements' is a challenging task in itself, even before deciding how the transparency of such arrangements can be enhanced.

Financial statements should inform users about risks but could not have been expected to foresee a crisis that very few predicted.

# Grant Thornton International IFRS guides available

Over the last few months, the IFRS team of Grant Thornton International has developed a number of publications. These include:

## **IFRS Top 20 Tracker**

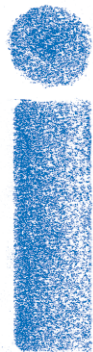
The IFRS Top 20 Tracker takes management through 20 top disclosure and accounting issues identified by Grant Thornton International, based on the experience of member firms within Grant Thornton International.

## **Intangible Assets in a Business Combination – Identifying and Valuing Intangibles under IFRS 3**

This guide reflects collective efforts of the Grant Thornton International IFRS team and member firm IFRS experts and valuation specialists. It includes practical guidance on the detection of intangible assets in a business combination and also discusses the most common methods used in practice to estimate their fair value. Also included in the guide is an overview of IFRS 3 'Business combinations' (January 2008), which summarises the main aspects of accounting for business combinations and draws out a number of practical points to consider.

## **Non-current Assets Held For Sale and Discontinued Operations – Challenges in Applying IFRS 5**

This guide looks into the more problematic aspects of IFRS 5 'Non-current Assets Held For Sale and Discontinued Operations'. It explains IFRS 5's key implementation issues and common approaches to practical application. The guide also includes several examples illustrating the Standard's disclosure and presentation requirements.



# Open for comment

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

## Current IASB documents

Document type	Title	Comment deadline
IASB Discussion Paper	Discussion Paper: Financial Instruments with Characteristics of Equity	5 September 2008
IASB Discussion Paper	Discussion Paper: Reducing Complexity in Reporting Financial Instruments	19 September 2008
IASB Discussion Paper	Preliminary Views on Amendments to IAS 19 Employee Benefits	26 September 2008
IASB Exposure Draft	An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information	29 September 2008
IASB Discussion Paper	Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity	29 September 2008



# Effective dates of new standards and IFRIC interpretations

The table below lists new IFRS standards and IFRIC Interpretations with an effective date on or after 1 January 2007. Companies are required to make certain disclosures in respect of new Standards and Interpretations under IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

**New IFRS Standards and IFRIC Interpretations with an effective date on or after 1 January 2007**

Title	Full title of Standard or Interpretation	Effective for accounting periods beginning on or after	Early adoption permitted?
IAS 1	Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures	1 Jan 2007	Yes
IFRS 7	Financial Instruments: Disclosure	1 Jan 2007	Yes
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions	1 March 2007	Yes
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 Jan 2008	Yes
IFRIC 12	Service Concession Arrangements	1 Jan 2008	Yes
IFRIC 13	Customer Loyalty Programmes	1 July 2008	Yes
IFRS 8	Operating Segments	1 Jan 2009	Yes
IAS 23	Amendments to IAS 23 Borrowing Costs	1 Jan 2009	Yes
IAS 1	Presentation of Financial Statements	1 Jan 2009	Yes
IFRS 2	Amendment to IFRS 2 Share-based Payment: Vesting Conditions and Cancellations	1 Jan 2009	Yes
IAS 32 and IAS 1	Amendments to Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements: Puttable Financial Instruments and Obligations Arising on Liquidation	1 Jan 2009	Yes (but must be applied in conjunction with related amendments to IAS 39, IFRS 7 and IFRIC 2)
IAS 32	Amendments to Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements: Puttable Financial Instruments and Obligations Arising on Liquidation	1 Jan 2009	Yes
IFRS 3	Business Combinations (Revised 2008)	1 July 2009	Yes (but only for periods beginning on or after 30 June 2007)

# Effective dates of new standards and IFRIC interpretations

## New IFRS Standards and IFRIC Interpretations with an effective date on or after 1 January 2007

Title	Full title of Standard or Interpretation	Effective for accounting periods beginning on or after	Early adoption permitted?
IAS 27	Consolidated and Separate Financial Statements	1 July 2009	Yes (but must be applied in conjunction with IFRS 3 Revised 2008)
IFRS 1 and IAS 27	Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements	1 January 2009	Yes
Various	Improvements to IFRSs	1 January 2009 (unless otherwise stated)	Yes
IFRIC 15	Agreements for the Construction of Real Estate	1 January 2009	Yes
IFRIC 16	Hedges of a Net Investment in a Foreign Operation	1 October 2008	Yes

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