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Audit

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Published for our clients and staff throughout the world

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Closing out 2006

Now that we have stepped off the "stable platform" that applied for December 2005 year ends, there are a number of new and revised Standards and Interpretations that are effective for December 2006 year ends and beyond. These have been issued at various stages over the past couple of years – so we thought that it would be useful to mark the cut-off point with a reminder of where we are, and which of the new developments are effective for current reporting periods.

Deloitte's IFRS model financial statements for December 2006 year ends and our presentation and disclosure checklist, which are available on www.iasplus.com, have been updated to reflect all of the requirements effective for December 2006 year ends – and most of those effective for later periods.

This newsletter by necessity includes a very high level overview of the new and revised Standards and Interpretations – but you will see that, where applicable, we have provided references to past newsletters dealing with the specific Standard or Interpretation in more detail. As always, entities will need to refer to the Standards and Interpretations themselves to identify all of the changes that will impact in their particular circumstances.

In July of 2006, the International Accounting Standards Board (the IASB) acknowledged that entities adopting IFRSs have undergone a period of enormous change in 2005. In order to provide a further period of stability while these changes are fully absorbed by reporting entities, the IASB has made a commitment not to require the adoption of new Standards under development or any major amendments to existing Standards before 1 January 2009. This commitment does not preclude the publication of new Standards before 2009, and entities will generally be permitted to adopt new Standards on a voluntary basis before their effective dates.

Although entities are expected to have some breathing space with respect to the adoption of new Standards for the next few years, we expect that the number of Interpretations issued by the International Financial Reporting Interpretations Committee (the IFRIC) will increase. Such Interpretations, and minor amendments to Standards, may be effective before 2009.

In addition, entities need to be aware of new Standards and Interpretations as they are issued, in order to comply with the requirement included in IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors** to disclose in their financial statements the potential impact of Standards and Interpretations in issue but not yet effective.

Finally, a word of caution regarding early adoption of Standards and Interpretations, and the need to have regard to local endorsement or other legal processes. For example, in the European Union, IFRS 8 and IFRICs 10 to 12 have not yet been endorsed. For further information, refer to the Endorsement Status Report on www.efrag.org.

New and revised Standards and Interpretations

The following is a comprehensive list of new and revised Standards and Interpretations in issue at December 2006, and effective for 31 December year ends and later periods.

Effective for 31 December 2006 year ends		
New Standard		IAS Plus newsletter issued
IFRS 6	Exploration for and Evaluation of Mineral Resources	January 2005
Amendments to Standards		
Amendment to IAS 19	Actuarial Gains and Losses, Group Plans and Disclosures	n/a
Amendment to IAS 21	Net Investment in a Foreign Operation	n/a
Amendment to IAS 39	Cash Flow Hedge Accounting of Forecast Intragroup Transactions	n/a
Amendment to IAS 39	The Fair Value Option	July 2005
Amendments to IAS 39 & IFRS 4	Financial Guarantee Contracts	December 2005
New Interpretations		
IFRIC 4	Determining whether an Arrangement contains a Lease	December 2004
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	December 2004
IFRIC 6	Liabilities arising from Participation in a Specific Market – Waste Electrical and Electronic Equipment (effective for accounting periods beginning on or after 1 December 2005)	September 2005

Available for early adoption for 31 December 2006 year ends			
New Standards		Effective for accounting periods beginning on or after	IAS Plus newsletter issued
IFRS 7	Financial Instruments: Disclosures	1 January 2007	October 2005
IFRS 8	Operating Segments	1 January 2009	December 2006
Amendments to Standards			
Amendment to IAS 1	Capital Disclosures	1 January 2007	October 2005
Revised Guidance on Implementing IFRS 4		1 January 2007	n/a
New Interpretations			
IFRIC 7	Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies	1 March 2006	December 2005
IFRIC 8	Scope of IFRS 2	1 May 2006	January 2006
IFRIC 9	Reassessment of Embedded Derivatives	1 June 2006	March 2006
IFRIC 10	Interim Financial Reporting and Impairment	1 November 2006	August 2006
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions	1 March 2007	December 2006
IFRIC 12	Service Concession Arrangements	1 January 2008	December 2006

Effective for 31 December 2006 year ends

IFRS 6 – Exploration for and Evaluation of Mineral Resources

IFRS 6 does not require or prohibit any specific accounting policies for the recognition and measurement of exploration and evaluation assets. Rather, it permits entities to continue to use their existing accounting policies provided that they comply with the requirements of paragraph 10 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors – i.e. that they result in information that is relevant to the economic decision-making needs of users, and that is reliable.

Paragraphs 11 and 12 of IAS 8 specify the various sources of authoritative requirements and guidance that should generally be considered in developing an accounting policy for an item if no IFRS specifically applies. There had been concern that requiring entities to apply those paragraphs when assessing their existing accounting policies for exploration and evaluation assets would highlight areas of uncertainty. To avoid the potential costs and disruption that such uncertainties could cause, IFRS 6 grants a temporary exemption from applying paragraphs 11 and 12 of IAS 8 until the Board addresses these issues as part of a comprehensive project.

IFRS 6 requires entities to assess any exploration and evaluation assets for impairment when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount. The recognition of impairment in respect of such assets is varied from that in IAS 36 Impairment of Assets but, once an impairment loss has been identified, it is measured in accordance with IAS 36.

Amendment to IAS 19 – Actuarial Gains and Losses, Group Plans and Disclosures

The amendments to IAS 19 Employee Benefits introduce an option to recognise actuarial gains and losses arising from a defined benefit plan in full in the period in which they occur, outside profit or loss, in a statement of recognised income and expense. Entities that currently spread their actuarial gains and losses do not need to change their approach, but they can change their accounting policy to follow this new treatment. Whichever policy is selected, it should be consistently applied for all defined benefit plans.

The amendments also:

- introduce additional disclosure requirements that provide information about trends in the assets and liabilities in a defined benefit plan and the assumptions underlying the components of the defined benefit cost (and bring the disclosures in IAS 19 closer to those required by US Generally Accepted Accounting Principles);
- specify how group entities should account for defined benefit group plans in their separate or individual financial statements; and
- clarify the accounting treatment for a contractual agreement under a multi-employer plan that determines how a surplus is distributed (or deficit funded).

Amendment to IAS 21 – Net Investment in a Foreign Operation

The amendments to IAS 21 The Effects of Changes in Foreign Exchange Rates deal with circumstances in which a loan from one entity to another entity within the same group may be regarded as part of the net investment in a foreign operation (if settlement is neither planned nor likely to occur in the foreseeable future) and, therefore, whether the exchange differences arising on such a loan are recognised in profit or loss or reclassified to a separate component of equity in the consolidated financial statements.

The revisions specify that where an entity has a monetary item that forms part of its net investment in a foreign operation, the accounting treatment in the consolidated financial statements should not be dependent upon the currency of the monetary item nor upon which entity within the group conducts the transaction with the foreign operation. In other words, exchange differences arising on such monetary items (denominated in a currency other than the functional currency of the reporting entity) are always reclassified to a separate component of equity in the consolidated financial statements.

Amendment to IAS 39 – Cash Flow Hedge Accounting of Forecast Intragroup Transactions

The amendments to IAS 39 Financial Instruments: Recognition and Measurement:

- permit the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in a cash flow hedge in the consolidated financial statements, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect the consolidated financial statements; and
- specify that if the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised directly in equity in accordance with the hedge accounting rules in IAS 39 should be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.

Amendment to IAS 39 – The Fair Value Option

The amendments restrict the use of the option to designate any financial asset or any financial liability as at fair value through profit and loss (the 'fair value option') to avoid inappropriate use. The option is therefore limited to those financial instruments designated upon initial recognition into one of the following categories:

- those that are classified as held for trading;
- where the fair value option designation eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains or losses on them on different bases;
- those that are part of a group of financial assets, financial liabilities, or both that are managed, and their performance is evaluated by management, on a fair value basis in accordance with a documented risk management or investment strategy; or
- those that contain one or more embedded derivatives, except if the embedded derivative does not modify significantly the associated cash flows or it is clear with little or no analysis that separation is prohibited.

Amendments to IAS 39 & IFRS 4 – Financial Guarantee Contracts

The amendments specify that any financial guarantee contract issued by an entity is included within the scope of IAS 39. However, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IAS 39 or IFRS 4 Insurance Contracts to such financial guarantee contracts. The issuer may make the above election on a contract by contract basis, but the election for each contract is irrevocable. The accounting treatment and disclosures for such contracts will vary according to whether IAS 39 or IFRS 4 is being applied.

IFRIC 4 – Determining whether an Arrangement contains a Lease

IFRIC 4 addresses arrangements that do not take the legal form of a lease but which convey rights to use assets in return for a payment or series of payments (e.g. outsourcing arrangements). The Interpretation specifies that an arrangement that meets the following criteria is, or contains, a lease that should be accounted for in accordance with IAS 17 Leases, both from the lessee and lessor's perspective:

- the fulfillment of the arrangement depends upon a specific asset (either explicitly or implicitly identified in the arrangement); and
- the arrangement conveys a right to control the use of the underlying asset. IFRIC 4 provides further guidance to identify when this situation exists.

IFRIC 5 – Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

IFRIC 5 requires that if an entity recognises a decommissioning obligation under IFRSs and contributes to a fund to segregate assets to pay for the obligation, it should determine whether the decommissioning fund should be consolidated, proportionately consolidated or accounted for under the equity method.

When a fund is not consolidated, proportionately consolidated, or accounted for under the equity method, and that fund does not relieve the contributor of its obligation to pay decommissioning costs, the contributor should recognise:

- its obligation to pay decommissioning costs as a liability; and
- its rights to receive reimbursement from the fund as a reimbursement under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The Interpretation also requires a right to reimbursement to be measured at the lower of:

- the amount of the decommissioning obligation recognised; and
- the contributor's share of the fair value of the net assets of the fund.

IFRIC 6 – Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective for accounting periods beginning on or after 1 December 2005)

Under the European Union's directive on Waste Electrical and Electronic Equipment, the obligation to contribute to waste management costs is allocated proportionately to producers of the relevant type of equipment who participate in the market during a specified period (the measurement period). The IFRIC was asked to determine what constitutes the obligating event for the recognition of a provision for the waste management costs.

The IFRIC decided that the event that triggers liability recognition is participation in the market during a measurement period (and not the production of the equipment, nor the actual incurrence of waste management costs).

Available for early adoption for 31 December 2006 year ends

Note that where Standards or Interpretations are adopted in advance of their effective dates, disclosure of that fact is generally required. Where the Standards and Interpretations discussed below are not adopted for December 2006 year ends, preparers will need to have regard to the requirements of IAS 8.30, i.e. the requirement to consider and disclose the potential impact of Standards and Interpretations in issue but not yet effective.

Preparers will also need to have regard to local endorsement or other legal processes (see introduction to this newsletter).

IFRS 7 – Financial Instruments: Disclosures — Effective 1 January 2007

IFRS 7:

- adds new disclosures about financial instruments to those currently required by IAS 32 *Financial Instruments: Disclosure and Presentation;*
- replaces the disclosure requirements currently imposed on financial institutions by IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions;* and
- puts all of those financial instrument disclosures together in a new combined Standard.

IFRS 7 deals with the disclosure requirements in relation to all risks arising from financial instruments (with limited exemptions), and applies to any entity that holds financial instruments. The level of disclosure required depends on the extent of the entity's use of financial instruments and its exposure to financial risk. The Standard retains many of the disclosure requirements currently within IAS 32 and IAS 30. However, there have been some editorial changes to the existing requirements as well as some additional disclosure requirements added. The overriding objective is that preparers should provide disclosures that enhance a user's understanding of the entity's exposures to financial risks and how the entity manages those risks. To this end, IFRS 7 requires an entity to disclose:

- information on the significance of financial instruments to the entity's financial position and performance;
- the nature and extent of risk exposures arising from financial instruments (quantitative disclosures); and
- the approach taken in managing those risks (qualitative disclosures).

IFRS 8 – Operating Segments — Effective 1 January 2009

IFRS 8 replaces IAS 14 Segment Reporting. IFRS 8 requires an entity to report financial and descriptive information about its reportable segments, which are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

Upon adoption of IFRS 8, the identification of an entity's segments may or may not change, depending on how the entity has applied IAS 14 in the past. IAS 14 required an entity to identify two sets of segments (business and geographical), using a risks and rewards approach, with the entity's "system of internal financial reporting to key management personnel" serving only as the starting point for the identification of such segments. If under IAS 14 an entity identified its primary segments on the basis of the reports provided to the person whom IFRS 8 regards as the chief operating decision maker, those might become the 'operating segments' for the purposes of IFRS 8.

IFRS 8 requires the amount reported for each segment item to be the measure reported to the chief operating decision maker for the purposes of allocating resources to that segment and assessing its performance. In contrast to IAS 14, IFRS 8 does not define segment revenue, segment expense, segment result, segment assets and segment liabilities, nor does it require segment information to be prepared in conformity with the accounting policies adopted for the entity's financial statements. As a consequence, entities will have more discretion in determining what is included in segment profit or loss under IFRS 8, limited only by their internal reporting practices.

Under IFRS 8, additional entity-wide disclosures are prescribed that are required even when an entity has only one reportable segment. These include information about each product and service or groups of products and services.

Analyses of revenues and certain non-current assets by geographical area are required – with an expanded requirement to disclose revenues/assets by individual foreign country (if material), irrespective of the identification of operating segments.

IFRS 8 also introduces a requirement to disclose information about transactions with major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of the entity's revenues, the total amount of revenue from each such customer and the segment or segments in which those revenues are reported must be disclosed.

Amendment to IAS 1 – Capital Disclosures — Effective 1 January 2007

IAS 1 Presentation of Financial Statements was amended in conjunction with the release of IFRS 7. The amendments impose additional requirements for disclosure of:

- the entity's objectives, policies and processes for managing capital;
- quantitative data about what the entity regards as capital;
- whether the entity has complied with any capital requirements; and
- if it has not complied, the consequences of such non-compliance.

Revised Guidance on Implementing IFRS 4 Insurance Contracts — Effective 1 January 2007

This revised guidance applies only from when an entity has adopted IFRS 7. IFRS 7 amends and supersedes the disclosures about risk that were previously required by IAS 32. These changes necessitate consequential amendments to IFRS 4, which previously required disclosure of the information about interest rate risk and credit risk that IAS 32 would require if the insurance contracts were within the scope of IAS 32.

IFRIC 7 – Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies — Effective 1 March 2006

IAS 29 *Financial Reporting in Hyperinflationary Economies* requires that the financial statements of an entity that reports in the currency of a hyperinflationary economy should be stated in terms of the measuring unit current at the balance sheet date. Comparative figures for prior period(s) should be restated into the same current measuring unit. IFRIC 7 contains guidance on how an entity would restate its financial statements in the first year it identifies the existence of hyperinflation in the economy of its functional currency, including specifically the restatement of deferred tax in the opening balance sheet.

IFRIC 8 – Scope of IFRS 2 — Effective 1 May 2006

IFRIC 8 clarifies the following:

- IFRS 2 applies to share-based payment transactions in which the entity cannot identify specifically some or all of the goods or services received;
- in the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case IFRS 2 applies;
- if the identifiable consideration received (if any) appears to be less than the fair value of the equity instruments granted or the liability incurred, typically this circumstance indicates that other consideration (i.e. unidentifiable goods or services) has been (or will be) received;
- the entity should measure the identifiable goods or services received (or to be received) in accordance with IFRS 2;
- the entity should measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received);
- the unidentifiable goods or services received (or to be received) should be measured at grant date; and
- for cash-settled transactions in which unidentifiable goods or services are received, the liability should be measured at each subsequent reporting date in order to be consistent with IFRS 2. Subsequent re-measurements of the liability do not affect the measurement of the unidentifiable goods or services received (or to be received) as those are measured at grant date.

IFRIC 9 – Reassessment of Embedded Derivatives — Effective 1 June 2006

IFRIC 9 addresses two questions:

- does an entity have to reconsider its assessment of whether an embedded derivative needs to be separated after the initial recognition of the hybrid contract?
- should a first-time adopter of IFRSs make its assessment of whether an embedded derivative needs to be separated when the entity first became a party to the hybrid contract, or when the entity adopts IFRSs for the first time?

The IFRIC concluded that an entity generally should not reassess its conclusion as to whether an embedded derivative needs to be separated from the hybrid contract after it is initially recognised. Similarly, a first-time adopter of IFRSs should make its assessment on the basis of conditions existing when the entity became party to the hybrid contract, not when it adopts IFRSs. An entity should only revisit its assessment if the terms of the contract change, and the expected future cash flows of the embedded derivative, the host contract, or both, have changed significantly relative to the previously expected cash flows on the contract.

IFRIC 10 – Interim Financial Reporting and Impairment — Effective 1 November 2006

The Interpretation addresses the interaction between the requirements of IAS 34 *Interim Financial Reporting* and the recognition of impairment losses on goodwill under IAS 36 and certain financial assets under IAS 39. The Interpretation concludes that where an entity has recognised an impairment loss in an interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost, that impairment should not be reversed in subsequent interim financial statements nor in annual financial statements.

IFRIC 11 – IFRS 2 – Group and Treasury Share Transactions — Effective 1 March 2007

IFRIC 11 clarifies the application of IFRS 2 **Share-based Payment** to certain share-based payment arrangements involving the entity's own equity instruments and to arrangements involving equity instruments of the entity's parent.

The IFRIC concluded that when an entity receives services as consideration for rights to its own equity instruments, the transaction should be accounted for as equity-settled. This is regardless of whether:

- the entity chooses or is required to purchase equity instruments to satisfy its obligation;
- the entity or its shareholder(s) grants the right; or
- the transaction is settled by the entity or by its shareholder(s).

Where a parent grants rights to its equity instruments to employees of its subsidiary, assuming the transaction is accounted for as an equity-settled share-based payment transaction in the consolidated financial statements, the subsidiary should measure the services received using the requirements for equity-settled transactions in IFRS 2, and should recognise a corresponding increase in equity as a contribution from the parent.

Where a subsidiary grants rights to equity instruments of its parent to its employees:

- the subsidiary has incurred a liability to transfer cash or other assets of the entity to its employees (being a liability to transfer equity instruments of its parent); and
- the subsidiary accounts for the transaction as a cash-settled share-based payment transaction.

IFRIC 12 – Service Concession Arrangements — Effective 1 January 2008

The Interpretation addresses the accounting by private sector operators involved in the provision of public sector infrastructure assets and services, such as schools and roads. The Interpretation does not address the accounting for the government (grantor) side of such arrangements. The Interpretation states that for arrangements falling within its scope (essentially those where the infrastructure assets are not controlled by the operator), the infrastructure assets are not recognised as property, plant and equipment of the operator. Rather, depending on the terms of the arrangement, the operator will recognise:

- a financial asset (where the operator has an unconditional right to receive a specified amount of cash or other financial asset over the life of the arrangement); or
- an intangible asset (where the operator's future cash flows are not specified – e.g. where they will vary according to usage of the infrastructure asset); or
- both a financial asset and an intangible asset where the operator's return is provided partially by a financial asset and partially by an intangible asset.

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