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September 2009 – Quarterly edition

# iGAAP Newsletter
## Beyond the standards

Published for our clients and staff in the UK

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# Upfront

As promised in our June quarterly newsletter, the International Accounting Standards Board (IASB) has progressed with its project to replace IAS 39 with the release of an exposure draft on classification and measurement of financial instruments. In this issue, we focus on the main features of the proposals and how they seek to remedy some of the perceived shortcomings of the existing financial instruments standard. We await with interest the proposals on impairment and hedge accounting, due by the end of the year.

Our interview is with someone at the heart of these developments. John Smith is a leading figure in financial instruments accounting and has been a board member of the IASB since 2002.

Another development impacting many listed companies for the first time in their June 2009 interim reports and December 2009 annual reports is the change to segmental reporting brought about by the introduction of IFRS 8. This quarter's practical issue highlights some of the key questions to be asked when applying this Standard for the first time.

The extension of IFRS guidance to include something suitable for privately owned and subsidiary companies is a development whose effects will be felt more and more in the coming years. 'IFRS for SMEs', issued by the IASB in July, provides a simplified version of IFRS which is intended for use by a broad spectrum of non-publicly accountable entities. In the UK, the Accounting Standards Board (ASB) has already issued proposals to adopt IFRS for SMEs for use by many UK companies. We will discuss these proposals in more detail in our next newsletter.

Deloitte LLP
September 2009

# Practical issue: Operating segments

Segmental information is a vital tool for management of a business and is consistently identified as the disclosure which is of most value and interest to users of financial statements. It allows the nature and financial effects of the individual business activities in which the entity engages and the economic environments in which it operates to be monitored and evaluated.

These disclosures have previously been governed by IAS 14 'segment reporting', but that Standard has now been replaced by IFRS 8 'Operating segments'. December year end entities will be adopting IFRS 8 in 2009 since IFRS 8 is mandatory for accounting periods beginning on or after 1 January 2009.

### Why the change?

IAS 14 had quite a prescriptive approach to segments. An entity had to give extensive disclosures either by class of business or geography (whichever was deemed to be the more fundamental to the business) and more limited disclosure to whichever one wasn't.

IFRS 8 aims for a more flexible, "through the eyes of management" approach, with segments identified by reference to the information reviewed by the Chief Operating Decision Maker ('CODM'). In this way, it is hoped that segment disclosures will give investors a window into the decision making processes of a business and allow them to make similar value judgements to management.

In addition, IFRS 8 aligns IFRS with US GAAP in this area, assisting comparison between US companies and those from elsewhere in the world.

This article looks at some of the practical issues and questions that have been seen in entities applying IFRS 8 for the first time.

### Who is my CODM?

As the starting point for segment reporting under IFRS 8 is the information used by the CODM, it follows that identification of the CODM is a fundamental point.

In IFRS 8, the term 'Chief Operating Decision Maker' identifies a function, not an individual within the entity who has that specific title. While the CODM is usually an individual, sometimes the function is performed by a group, perhaps a board or executive committee. Critically, the CODM will be identified as the person or group that determines the allocation of resources and assesses the performance of the operating segments. This can be demonstrated in the following scenarios:

- Entity A is a publicly traded manufacturer of various electronic instruments used in aerospace, medical, and consumer products. There is a chief executive for each of the aerospace, medical, and consumer product units, each of whom is responsible for operating, budgeting, and reporting aspects of its respective unit, as well as for overseeing senior management personnel within the unit. The chief executives of the units report to the group CEO regarding, among other things, resource allocation recommendations for their respective units. The group CEO evaluates the performance of each unit on the basis of various management reports and is responsible for entity-wide resource allocation decisions.

- Entity B is a similar publicly traded manufacturer governed by a management committee comprising each of the unit chief executives and the group CEO. The management committee makes all key operating decisions, determines the allocation of resources, and assesses performance. No one individual on the management committee, or elsewhere at the entity, has the ability to override the management committee (except for the board of directors, when acting in its role of overseeing the management committee).

Looking at the key criterion noted above, in the first scenario the group CEO may be identified as the CODM, whilst in the second it is the management committee.

### Will my segments change?

Adoption of IFRS 8 may or may not change the operating segments an entity previously reported under the previous standard. If under IAS 14 an entity's primary segments mirrored the reports reviewed by the CODM, these might become the 'operating segments' for the purposes of IFRS 8.

The identification of components of an entity that represent an operating segment will be determined by looking at the reports reviewed by the CODM and the information used to determine the allocation of resources. In some entities the extent of information received by the CODM will be limited and the identification of operating segments may be readily apparent. In other entities the CODM may receive significant amounts of information and it may be more difficult to determine the level of information that is being used to assess performance and allocate resources. In some cases resource allocation strategy will be determined by reference to one level of information, but more detailed information may be provided, perhaps on a temporary basis, to enable detailed plans to be made of how to implement the strategy.

Even if the segments indentified for disclosure do not change, the figures disclosed for each segment might. In contrast to IAS 14, IFRS 8 does not require segment information to be prepared in conformity with the accounting policies adopted for the entity's financial statements. Under the new Standard, segment information is disclosed as it is presented to the CODM, with reconciliation to statutory figures given only in aggregate. If the CODM's reports do not include, for example, derivatives, pension costs or share-based payment charges then neither will the IFRS 8 information. Consider, for example that management of foreign exchange exposure is at an entity wide level, not a segment level. So foreign exchange hedging instruments are not included in the segment information reported to the CODM. The information disclosed for each segment will therefore not include the effect of hedging and this should give investors more of an insight into how management make their decisions.

### Entity-wide disclosures

The primary focus of IFRS 8 is on disclosure of segment assets and liabilities and profit or loss as presented to the CODM. However, the Standard is not intended to deny users of financial statements key information because of an entity's limited internal reporting, and leave them without the ability to compare similar organisations. Therefore, certain 'entity-wide disclosures' are required whether they are viewed by the CODM or not:

- External revenue for each group of similar products and services.
- Foreign and domestic external revenues and non-current assets, including material revenues and assets from individual countries.
- 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.

### So this is just a disclosure issue?

This may not be the case. Under IAS 36 'Impairment of assets', goodwill may not be tested for impairment at any level larger than an operating segment. If an operating segment under IFRS 8 is smaller than a segment under IAS 14, then goodwill may need to be tested at a lower level too.

**Example:** Entity A is a publicly-traded manufacturer operating in the UK, Europe and the US. Following an acquisition in Europe in 2005, goodwill of €1,000,000 was recognised.

Under IAS 14, Entity A determined that its primary segments were the three geographical locations; the UK, Continental Europe and the US. Management monitored goodwill at this segment level and therefore tested goodwill on the 2005 acquisition at a European level.

On adoption of IFRS 8, Entity A's operating segments have changed as the chief operating decision maker receives information and makes resourcing decisions on some of the principal European locations. Under IFRS 8, the operating segments are identified as the UK, US, France, the Netherlands and the Rest of Europe.

Management must reallocate the goodwill across the operating segments and test for impairment at this lower level. The reallocation is performed using a relative value approach as at the date of acquisition (similar to that used when an entity disposes of an operation within a cash-generated unit), unless the entity can demonstrate that some other method better reflects the goodwill associated with the IFRS 8 operating segments.

This could result in a situation where the change in identified segments, and therefore in the level at which goodwill is tested for impairment, results in an impairment that would not have been recognised had Entity A still been applying IAS 14.

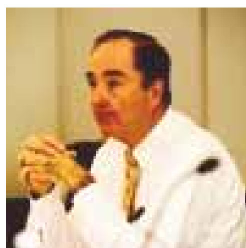
In our example, the carrying amount, new allocation of goodwill and recoverable amount of each of the European segments for the current year is detailed below. This shows that the change in segments will give rise to an impairment charge for France, that would not have arisen if the operating segment had remained as Continental Europe.

| | Net assets €'000 | Allocated goodwill €'000 | Recoverable amount €'000 | Headroom/(Impairment) €'000 |
|---|---|---|---|---|
| France | 3,000 | 800 | 3,500 | (300) |
| Netherlands | 1,000 | 100 | 1,200 | 100 |
| Rest of Europe | 500 | 100 | 1,000 | 400 |
| **Total Continental Europe** | **4,500** | **1,000** | **5,700** | **200** |

The adoption of IFRS 8, together with the consequential change to the requirements of IAS 36, is a change in accounting policy that needs to be adopted retrospectively. It is therefore necessary to consider whether any impairment at a lower level than was previously tested existed in previous years.

Further guidance on IFRS 8 can be found in the Deloitte publication *iGAAP 2009: IFRS Reporting in the UK*.

# A coffee with … John Smith



John Smith was a partner in the US member firm of Deloitte when he became a part-time IASB Board member in 2002. After 35 years with Deloitte, John retired from the firm in 2007 to be a full-time Board member.

**How does accounting practice and standard setting compare?**

From the perspective of time management, standard setting is more straight-forward. At Deloitte I was partner in charge of policies and standards so I was following what the old-IASC was doing plus I was active in the IAS 39 Implementation Guidance Committee, also the equivalent committee in the US, and the US Emerging Issues Task Force. I was therefore doing a lot more standard setting work compared to a normal audit partner but also responding to consultations. As a standard setter, I have much better control of my time than I did as an audit partner at Deloitte. In public accounting it was difficult to plan your activities. The phone would ring and someone wanted a question answered immediately on his or her important client, that request had priority over whatever else you had planned. Time is more controlled in standard setting because we follow a due process.

**How do you stay focussed on the technical challenge when there are so many political and regulatory initiatives?**

I think the technical side is the real focus. Because of my background in public accounting I focus on operational issues and the challenge is "how can I find a loophole to get around the guidance" which some standard setters would typically say is not our job. My view as a standard setter is to make sure that the answers you get from applying the standards are answers that are consistent with the principles set out. You can't leave the standards wide open and hope that the spirit of the standard will be applied.

**Compared to 2002, when you started, are you spending a lot more time dealing with regulatory or political issues?**

I would say no. When I started, Europe was being exposed to IAS 39 which was controversial then and remains so now. We get accused, when we are on the Board for a while, of not listening and so part of our job is no different than your job as an auditor. You have to understand your client's view but you also have to convince a client, when they don't like the answer you are coming up with, why it is the answer that you believe is appropriate. So that is a part of politics. A difficulty we face is how to deal with political pressure. There is no training course here that helps us decide what to do and each board member probably has a different view as to how to respond. That said, we are in the business of improving financial reporting and we have tried to respond to those pressures in a manner that will in fact improve financial reporting.

**The number of Board members is increasing from 14 to 16. How will a larger Board help?**

I'm not sure. A larger Board is probably not going to improve the technical quality of our standards. I don't think you need a large Board to do that. As a matter of fact you might be able to be more efficient with a smaller Board. But where a larger Board will be helpful is in the out-reach activities. We are being pulled in many directions all of the time to interface with constituents, go to meetings, make presentations, and with more and more countries now interested in moving towards IFRS, they like to see us. Only with a larger group can you accommodate that.

**When you started the IAS 39 replacement project with the discussion paper on reducing complexity, the long term aim of the Board was for all financial instruments to be at fair value. Do you think you will ever see that day?**

Not in my lifetime! When you say that was our aim, I would say it was a view conceptually that everything should be at fair value. The board never undertook a process for eliminating mixed measurement attributes. The cut we are proposing between fair value and amortised cost in our recent exposure draft focuses on variability of cash flows and the business model. If it's a basic lending instrument and you are looking to get interest and repayment of principal then amortised cost seems appropriate. Under the current IAS 39, we have some things at cost, some at fair value and some at amortised cost, but that approach does not tell you the underlying cash flow variability or risk. Our proposed model will help in that regard.

**The replacement to IAS 39 was always a joint project with the US FASB yet the IASB produced their proposed model and the FASB are going to separately propose theirs. Why has this happened?**
It is not unusual for the two boards to start out in different places and seek to converge on a single common standard. FASB, at least preliminarily, has a view that all financial instruments should be at fair value because users believe that that information is important. We have taken a different view. We believe a mixed measurement model can provide very useful information provided we make a reasonable cut at what is at fair value and what isn't. That said, both Boards are committed to trying to resolve these differences and to move forward and to eventually get to one model. We are hopeful we can achieve that.

**Do you think it is realistic for a December year-end to be able to apply the new classification and measurement proposals this year?**
Yes, if you like the answer! Last October we were asked to make a change to IAS 39 to permit reclassification of financial assets. Very quickly it was endorsed around the world, very quickly companies took advantage of it. Practically, particularly the larger banks, I think they will want to study and understand the impact of the final standard before they decide.

**Do you think it's crucial for the IASB that Europe endorses the new financial instrument standard?**
If we issue the standard, we would hope it would be endorsed, if its not, it's a question then of why not? Does it need more time, what's the reason it didn't get endorsed within a normal period? Right now to me it's too difficult to tell and to start looking at the what-if game. I think we have to start from the point that we have a model, which we think is pretty good, and let's get input from constituents. Let's understand where FASB is on theirs and see if we cannot get together. We are currently engaged in a large program of outreach activities – joint round tables with the FASB, webcasts to thousands of people, meetings with groups of investors, policymakers, the profession – to capture their feedback so that there will hopefully be no surprises on either side when we publish the final standard.

**Do you think that the financial crisis has helped the IASB accelerate the bigger projects?**
Yes. Financial instruments was always on the agenda of both Boards but it wouldn't have been as urgent if it wasn't for the crisis. We are both moving together on consolidation and derecognition, but as a result of the crisis we decided we would accelerate those projects and hopefully that will lead to convergence quickly.

**How critical do you think it is for the long-term success of the IASB that US companies can choose or are required to adopt IFRS?**
Well obviously if they were required, that would be a giant step in promoting IFRS around the world. Europe took our standards and that clearly was a catalyst for others. A few years later when the US got rid of the US GAAP/IFRS reconciliation that reinforced the initiative around the world and so the next piece would be the US either allowing or requiring IFRS. In the meantime they have got a lot to think about and a lot to consider. We have agreed to get certain things done as part of the memorandum of understanding and so our focus is to keep to our end of the bargain and hopefully we will have done the things necessary that would allow the US to move to IFRS. The G20, which includes the US, has called for an acceleration of global standards. We are working hard to deliver against that goal.

| Good, bad, or ugly | |
|---|---|
| The expected loss model for loan impairments | Ugly |
| All financial instruments at fair value | Bad |
| The EU endorsement process | Ugly |
| Convergence with US GAAP | Good |
| Industry specific accounting standards | Hard to justify unless really different |
| Financial Stability Forum and G20 recommendations on accounting | Some good, but if it gets too political, then bad |

# Topic of focus: Financial instruments

### Comprehensive project to replace IAS 39

Accounting for financial instruments under IAS 39 *Financial Instruments: Recognition and Measurement* has long been regarded as complex and, in some cases, not intuitive due to its focus on rules instead of principles. Added to this the standard has been criticised for the number of variations in accounting that can exist for the same instrument, reducing comparability amongst reporters. Such criticisms intensified in the current financial crisis especially in relation to the different values determined for impaired financial assets depending on their IAS 39 classification. As a result the IASB accelerated its existing project to replace IAS 39 with a commitment to have a new simplified standard finalised by the end of 2010.

### Classification and measurement

The IASB reached a significant milestone in this ambitious project in June 2009 when it issued an exposure draft (ED) of a new model for classification and measurement of financial instruments. This brings the IASB one step closer to completing phase one of the project which it has broken down into three phases: (1) classification and measurement; (2) impairment and (3) hedge accounting. Replacing the derecognition rules of IAS 39 is formally part of a separate project, for which an ED was issued in April 2009.

One reason why the IASB began its project by proposing a revised model for classification and measurement of financial instruments is that these are considered to form the foundation of a standard on reporting financial instruments. Another reason is because many of the shortfalls of IAS 39 highlighted in the financial crisis concerned classification and measurement.

### Available-for-sale

The new model proposes the removal of the available-for-sale (AFS) classification; a source of significant complexity with its split recognition of gains and losses, part in equity and part in profit or loss, the classification was further exposed in the downturn for its perceived shortfall in measuring and recognising impairment losses.

For debt instruments the AFS classification combines fair value measurement in the balance sheet with an amortised cost and effective interest rate (EIR) method for recognising interest in profit or loss. While for pure amortised cost debt instruments the effective interest rate remains the same before and after any impairment, for AFS debt instruments the effective interest rate changes after impairment.

For AFS equity investments it has long been challenging to assess whether a decline in fair value below its cost is 'significant or prolonged' – the criteria for recognising impairment – resulting in divergence in practice.

The rules on reversing impairment charges through profit or loss, which will become increasingly relevant in a recovery, are also unpopular, especially for equity investments where no reversals are permitted.

### Held-to maturity

Another classification proposed to disappear is held-to-maturity (HTM), although a broader classification is proposed in its place that results in the same amortised cost measurement, but without the unpopular restrictions (such as the tainting rules that can force all HTM assets to be reclassified to AFS if they are sold before maturity and the restrictions on hedging such assets). However, the criteria for classifying an instrument at amortised cost are different to that for HTM and therefore there is no guarantee that all current HTM assets will be measured on the same basis under the new model.

## The new model

The ED proposes a three classification model applicable to all financial assets and financial liabilities in the scope of IAS 39. The classifications available for an instrument depend on a combination of the characteristics of the instrument, the entity's business model and elections made by the entity at initial recognition of the instrument. The model is summarised below by type of non-derivative instrument showing the classifications currently permitted by IAS 39 against the proposed permissible classifications in the ED. This shows the reduction in possible measurement and recognition bases with the resulting single requirement for measuring and recognising impairment applicable only to debt instruments measured at amortised cost. The proposals introduce further simplification by prohibiting reclassifications after initial recognition.

| Instrument | IAS 39 classifications | Impairment testing required? | New classifications | Impairment testing required? |
|---|---|---|---|---|
| Equity investments | Available-for-sale<br>Cost less impairment<br>Fair value through profit or loss | Yes<br>Yes<br>No | Fair value through profit or loss<br>Fair value through other comprehensive income | No<br>No |
| Debt instruments – assets | Available-for-sale<br>Loan and receivable<br>Held-to-maturity<br>Fair value through profit or loss | Yes<br>Yes<br>Yes<br>No | Fair value through profit or loss<br>Amortised cost | No<br>Yes |
| Debt instruments – liabilities | Amortised cost<br>Fair value through profit or loss | n/a<br>n/a | Fair value through profit or loss<br>Amortised cost | n/a<br>n/a |

## Equity investments

Of the proposed three classifications, one introduces a new measurement and recognition basis that is permitted, by election on initial recognition, for equity investments that are not held for trading. This classification, called fair value through other comprehensive income (FVTOCI) results in an equity investment being measured at fair value on the balance sheet with all fair value gains or losses (including dividend income and impairment losses) recognised in equity with no recycling to profit or loss, even on disposal. This classification provides an alternative to the otherwise mandatory classification of fair value through profit or loss (FVTPL).

The ED also proposes no relaxation of the fair value requirement currently available for some unquoted equity investments – all must be recorded on balance sheet at fair value. This change is another simplification, however, some have commented that the cost of producing fair value information that may in some cases not be sufficiently reliable will outweigh the benefit.

## Debt instruments

For debt instruments, both assets and liabilities, the model requires all those with non-basic loan features or those that are not managed on a contractual yield basis to be recorded at FVTPL. All other debt instruments will be held at amortised cost unless the fair value option, available if FVTPL significantly reduces an accounting mismatch, is elected on initial recognition. The ED provides some necessary guidance on identifying 'basic loan features' and instruments 'managed on a contractual yield basis'.

Basic loan features are terms that result in the payment of principal and interest on the principal outstanding. Examples cited include single, unleveraged market rates of interest (eg UK LIBOR), fixed rates of interest and combinations of the two such as floating rates with caps, floors or fixed margins.

Managed on a contractual yield basis includes those instruments whose performance, at a portfolio level, is managed and reported to key personnel on a contractual yield basis, and excludes those instruments that are held for trading.

### Embedded derivatives

The criteria for amortised cost accounting sound pretty straight forward, however, the challenge will be in the practical application. Are the principles clear enough to result in consistent application or will significantly more application guidance be needed as is currently the case for non-closely related embedded derivatives? The lack of a clear principle and an excessive number of examples could undo the work done in the ED on simplifying the accounting for embedded derivatives in financial hybrid contracts.

The ED proposes an end to the separate accounting of non-closely related embedded derivatives from financial host contracts. Instead the entire hybrid contract is assessed to determine the classification and measurement basis for the entire instrument, such that, if it contains non-basic loan features it must be recorded at FVTPL in its entirety. As a result, most non-closely related embedded derivatives in financial hybrid contracts will still be recorded at FVTPL but as part of the whole instrument, which is unlikely to be assessed as having only 'basic loan features'.

### Derivatives

The accounting of derivatives is not impacted by the proposals except derivatives over certain unquoted equity instruments that are physically settled, that would be required to be held at fair value instead of cost as currently permitted.

### Transition

One third of the ED's main paragraphs are devoted to transition. The general principle is retrospective application with some exceptions. The complexity of transition will vary amongst entities depending on the changes in classification that arise. Most challenging will be determining amortised cost retrospectively for debt instruments with incurred impairment losses that are currently FVTPL, although this is where some practical relief is available. Entities that reclassified instruments as part of the October 2008 reclassification amendment to IAS 39 are not likely to find transition any easier. However, they will have an opportunity to reclassify debt instruments that were previously designated at FVTPL (under the fair value option) to amortised cost (if the criteria are met) – a reclassification that did not qualify under the October 2008 amendment.

With a short comment period of 60 days ending on 14 September 2009 there will not be a long wait to see how well the new model is received – as with IAS 39 it's unlikely to please everyone.

# Activities of the IASB

The following amendments can be downloaded from the IASB's website at www.iasb.org

Deloitte (Global) has published special editions of the IAS Plus newsletter summarising each amendment. You can find them at www.iasplus.com

**IASB issues IFRS for SMEs**

The IASB has issued the IFRS for SMEs. This is the first set of international accounting requirements developed specifically for small and medium-sized entities (SMEs). It has been prepared on IFRS foundations but is a stand-alone product that is separate from the full set of International Financial Reporting Standards (IFRSs). The IFRS for SMEs has simplifications that reflect the needs of users of SMEs' financial statements and cost-benefit considerations. Compared with full IFRSs, it is less complex in a number of ways:

- Topics not relevant to SMEs are omitted.
- Where full IFRSs allow accounting policy choices, the IFRS for SMEs allows only the easier option.
- Many of the principles for recognising and measuring assets, liabilities, income and expenses in full IFRSs are simplified.
- Significantly fewer disclosures are required.
- The standard has been written in clear, easily translatable language.

To further reduce the reporting burden for SMEs, revisions to the IFRS will be limited to once every three years. It is suitable for all entities except those whose securities are publicly traded and financial institutions such as banks and insurance companies.

The 230-page standard is a result of a five-year development process with extensive consultation of SMEs worldwide. Accompanying the standard is implementation guidance consisting of illustrative financial statements and a presentation and disclosure checklist. The IFRS for SMEs is available for any jurisdiction to adopt whether or not it has adopted the full IFRSs. It is up to each jurisdiction to determine which entities should use the standard. In the UK, the ASB has issued proposals to adopt the IFRS for SMEs for use by UK entities (see page 14 for details).

Deloitte has issued an iGAAP newsletter covering this topic in more detail, which is available at http://www.iasplus.com/uk/0908ias39revnewsletter.pdf

**Exposure Draft on Financial Instruments: Classification and Measurement**

The IASB has published an exposure draft (ED) on Financial Instruments: Classification and Measurement as the first part of its three-phase project to replace IAS 39 Financial Instruments: Recognition and Measurement. The Board decided to address classification and measurement of financial assets and financial liabilities first because they form the foundation of a standard on reporting financial instruments. Moreover, many of the concerns about IAS 39 that have been expressed during the financial crisis relate to its classification and measurement requirements.

The IASB plans to finalise the classification and measurement proposals in time for non-mandatory application in 2009 year-end financial statements. The other two phases of the IAS 39 project are addressing Impairment and Provisioning and Hedge Accounting.

Additionally, the Board's project on Derecognition of Financial Instrument will also result in amendments to IAS 39. The IASB plans to complete the replacement of IAS 39 during 2010, although mandatory application will not be before January 2012.

The commend period for the ED on Classification and Measurement closed on 14 September 2009.

### Exposure Draft on rate related activities

The IASB has invited comment on proposals on the accounting for rate-regulated activities. The objective of the proposals is to establish whether and how assets and liabilities resulting from rate-regulated activities should be recognised and measured under International Financial Reporting Standards (IFRSs). If adopted, the proposed IFRS would:

- define regulatory assets and regulatory liabilities;
- set out criteria for their recognition;
- specify how they should be measured; and
- require disclosures about their financial effects.

The IASB was asked for guidance on the issue from many jurisdictions. Clarifying the accounting for rate regulation is of particular importance for jurisdictions that are in the process of adopting IFRSs and where accounting for the effect of rate regulation is in place for some sectors. In those cases entities are currently recognising sometimes significant 'regulatory' assets and liabilities by reference to an existing US standard, and current IFRS would appear not to permit the recognition of such assets and liabilities.

Comments on the ED are due by 20 November 2009.

### Exposure Draft on classification of rights issues

The IASB has invited comment on an exposure draft (ED) of an amendment to IAS 32 Financial Instruments: Presentation on the classification of rights issues.

The proposals seek to clarify the accounting treatment when rights issues are denominated in a currency other than the functional currency of the issuer. Current practice appears to require such issues to be accounted for as derivative liabilities. The proposals state that if such rights are issued pro rata to an entity's existing shareholders for a fixed amount of currency, they should be classified as equity regardless of the currency in which the exercise price is denominated.

The short comment period on ED classification of rights issues ran until 7 September 2009 and the IASB plans to issue the final amendment before the end of 2009 with early application permitted. If adopted the amendment will apply retrospectively.

### IFRIC proposal on debt extinguishments

The International Financial Reporting Interpretations Committee (IFRIC) has published a draft Interpretation, IFRIC D25 Extinguishing Financial Liabilities with Equity Instruments.

The proposal addresses the appropriate accounting under IFRSs when a creditor agrees to accept an entity's shares or other equity instruments to settle the financial liability fully or partially. IFRIC D25 proposes that:

- An entity's equity instruments are part of any 'consideration paid' to extinguish a financial liability.
- The equity instruments should be measured at either their fair value or the fair value of the financial liability extinguished, whichever is more reliably determinable.
- Any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments should be included in the entity's profit or loss for the period.

Comments on the proposal are due by 5 October 2009.

### Exposure draft on improvements to IFRSs

The IASB's latest annual improvements exposure draft proposes amendments to 11 IFRSs. These amendments are principally intended as clarification of existing requirements, although some changes are proposed (for example, to the significant events required to be disclosed in an interim financial report and to the circumstances under which an asset should be reclassified out of investment property).

Comments are due by 24 November 2009. Most of the amendments are intended to be effective for periods beginning on or after 1 January 2011, with earlier adoption permitted.

### IASB proposes guidance on 'management commentary'

The IASB has issued an exposure draft (ED) of proposed non-mandatory guidance for preparing and presenting a 'management commentary' – sometimes called 'management's discussion and analysis' or 'operating and financial review'. In a management commentary, which normally accompanies but is not part of the financial statements, management explains how the entity's financial position, financial performance and cash flows relate to management's objectives and its strategies for achieving those objectives.

The proposals in the ED draw on international best practice in the preparation and presentation of management commentary. The IASB believes that providing non-mandatory guidance will improve the consistency and the comparability of management commentary across jurisdictions. The ED Management Commentary is open for comment until 1 March 2010.

### Draft discussion paper on Extractive Activities

The IASB has posted on its website a working draft of a discussion paper Extractive Activities. The draft was prepared by a project team comprising staff of the national accounting standard-setters in Australia, Canada, Norway, and South Africa. The paper addresses financial reporting issues associated with exploring for and finding minerals, oil, and natural gas deposits, developing those deposits, and extracting the minerals, oil, and natural gas.

The paper notes that an absence of comprehensive IFRS literature on the subject has contributed to a divergence in practice under IFRSs. The paper reviews the issues and presents the recommendations of the project team. It is posted for information only and comments are not requested.

The IASB plans to invite comments on the project team's proposals in the first quarter of 2010. The project is not yet on the IASB's active agenda. The IASB has agreed that if it adds the extractive activities project to its agenda, it will regard the discussion paper as the first stage in its due process. In that case, the IASB would publish an exposure draft as the next phase of such a project.

### Exposure Draft on employee benefits discount rate

To address issues arising from the global financial crisis, the IASB proposes to eliminate the current requirement to use yields on government bonds in the scenario where there is no deep market on high quality corporate bonds. Instead, entities would estimate the yield on high quality corporate bonds. If adopted, the amendments would ensure that the comparability of financial statements is maintained across jurisdictions, regardless of whether there is a deep market for high quality corporate bonds.

Comments are due by 30 September 2009 and the IASB intends to permit entities to adopt the amendments that arise from this exposure draft in their December 2009 financial statements.

### IASB amends IFRS 1 on first-time adoption

The IASB has amended IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

The amendments address the retrospective application of IFRSs in two particular first-time adoption situations:

- Full-cost oil and gas assets. The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets. An entity electing this exemption will use the carrying amount under its old GAAP as the deemed cost of its oil and gas assets at the date of first-time adoption of IFRSs.

- Determining whether an arrangement contains a lease. If a first-time adopter with a leasing contract made the same type of determination of whether an arrangement contained a lease in accordance with previous GAAP as that required by IFRIC 4 Determining whether an Arrangement Contains a Lease, but at a date other than that required by IFRIC 4, the amendments exempt the entity from having to apply IFRIC 4 when it adopts IFRSs.

The amendments are effective for annual periods beginning 1 January 2010, with earlier application allowed.

# UK GAAP round up

Deloitte has issued a publication highlighting the issues entities will need to address in considering these proposals (see page 16 for details).

**ASB seeks views on proposals for the future reporting requirements for UK and Irish entities**
Now that the IASB has issued the IFRS for SMEs, the ASB has issued a consultation paper 'Policy Proposal: the future of UK GAAP', which sets out its proposals for the future reporting requirements for UK and Irish entities.

The Board's proposals envisage a differential reporting regime based on public accountability, broadly in line with the IASB's definition in the IFRS for SMEs, which states that entities do have public accountability if they:

(a) trade their debt or equity instruments in a public market; or

(b) hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses.

The Board is proposing a three-tier approach to developing UK GAAP converged with IFRS as follows:

- Tier 1 – publicly accountable entities would apply IFRS as adopted by the EU ('EU-adopted' IFRS).
- Tier 2 – all other UK entities other than those who can apply the Financial Reporting Standard for Smaller Entities (FRSSE) could apply the IFRS for SMEs.
- Tier 3 – small entities could choose to continue to apply the FRSSE.

Entities within Tier 2 and Tier 3 would have the option of using EU-adopted IFRS if they wished, and those in Tier 3 would have the option of using the IFRS for SMEs.

Comments on the proposals are due by 1 February 2010.

**Proposals for amendments to UITF 42 and FRS 26**
The Accounting Standards Board (ASB) has issued a Financial Reporting Exposure Draft (FRED) on Embedded Derivatives proposing amendments to UITF Abstract 42 (IFRIC 9) 'Reassessment of Embedded Derivatives' and FRS 26 (IAS 39) 'Financial Instruments: Recognition and Measurement'. The proposed amendments clarify the treatment of embedded derivatives when an entity reclassifies a financial asset out of the fair value through profit or loss category.

The proposed amendments are a consequence of the International Accounting Standards Board (IASB) issuing 'Embedded Derivatives – Amendments to IFRIC 9 and IAS 39' on 12 March 2009.

The amendments to IFRIC 9 and IAS 39 require an entity to assess whether an embedded derivative is required to be separated from a host contract when an entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category. The assessment is made on the basis of the circumstances that existed on the later date of:

(i) when the entity first became a party to the contract; and

(ii) a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract. If the fair value of the embedded derivative that is to be separated cannot be reliably measured then the entire financial instrument must remain in the fair value through profit or loss category.

The FRED proposes parallel amendments to UITF Abstract 42 (IFRIC 9) and FRS 26 (IAS 39) with the objective of ensuring that UK GAAP remains fully converged with IFRS in this area.

The comment period for the FRED closed on 31 July 2009.

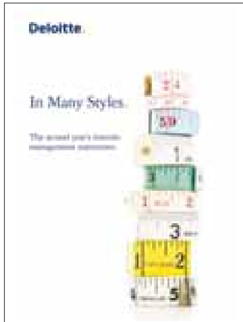
### Amendment to FRS 20 on group cash-settled share-based payment transactions

The ASB has issued an amendment to FRS 20, clarifying both the scope of the standard and the accounting for group cash-settled share-based payment transactions in the separate or individual financial statements of the entity receiving the goods or services when that entity has no obligation to settle the share-based payments transaction.

This amendment corresponds to an amendment to IFRS 2 in June 2009 and maintains equivalence between the two standards. The guidance in UITF 41 'scope of FRS 20' and UITF 44 'Group and Treasury Share Transactions' is now incorporated into FRS 20 and accordingly these abstracts will be withdrawn.

Entities are required to apply the amendments retrospectively for annual periods beginning on or after 1 January 2010, with earlier adoption permitted.

# Publications



**In Many Styles – the second year's interim management statements**
The new Deloitte publication *In Many Styles* is the latest survey in the Firm's corporate reporting series.

The publication considers how UK listed companies have met the requirements for an interim management statement (IMS) in the second year of compliance with the Disclosure and Transparency Rules (DTR).

*In Many Styles* also contains an updated illustrative IMS as well as an enhanced IMS disclosure checklist containing all the requirements.

*In Many Styles* is available at: **http://www.deloitte.com/dtt/cda/doc/content/UK_Audit_In_many_styles.pdf**

**Choosing your GAAP – planning for the proposed removal of UK GAAP**
The UK Accounting Standards Board has recently issued a paper proposing to replace full UK GAAP with the recently-issued IFRS for SMEs.

This will have wide-reaching implications for many companies as it will affect both statutory accounts and tax returns.

The Deloitte guide, *Choosing your GAAP*:

- discusses the planned changes;
- considers the choices available to UK companies;
- provides an overview on the accounting and tax impacts; and
- indicates whether any advance actions should be taken.

*Choosing your GAAP* is available at:
**http://www.deloitte.com/dtt/cda/doc/content/UK_Audit_Choosing_your_GAAP.pdf**

# IFRS issued but not yet effective or endorsed by the EU

| Title | Subject | Mandatory for accounting periods beginning on or after | Endorsed* or when endorsement expected (EFRAG 29 July 2009) |
|---|---|---|---|
| **IAS/IFRS standards** | | | |
| IFRS 1 (revised November 2008) | First-time Adoption of International Financial Reporting Standards | 1 January 2009 | Q4 2009[1] |
| Amendments to IFRS 7 (March 2009) | Improving Disclosures about Financial Instruments | 1 January 2009 | Q4 2009 |
| Amendment to IAS 39 (July 2008) | Eligible Hedged Items | 1 July 2009 | 18 September 2009[1] |
| Amendment to IAS 39 (November 2008) | Reclassification of Financial Assets – Effective Date and Transition | 1 July 2008 | 10 September 2009[1] |
| Amendments to IFRIC 9 and IAS 39 (March 2009) | Embedded Derivatives | Periods ending on or after 30 June 2009 | Q4 2009 |
| Improvements to IFRSs (April 2009) | Improvements to IFRSs 2009 | 1 July 2009 or 1 January 2010 (varies by standard) | Q1 2010 |
| Amendments to IFRS 2 (June 2009) | Group Cash-settled Share-based Payment Transactions | 1 January 2010 | Q1 2010 |
| Amendments to IFRS 1 (July 2009) | Additional Exemptions for First-time adopters | 1 January 2010 | To be confirmed |
| **Interpretations** | | | |
| IFRIC 15 | Agreements for the Construction of Real Estate | 1 January 2009 | 23 July 2009 |
| IFRIC 17 | Distributions of Non-cash Assets to Owners | 1 July 2009 | Q4 2009[1] |
| IFRIC 18 | Transfers of Assets from Customers | 1 July 2009[2] | Q4 2009[1] |

* The critical date when considering endorsement is the date of approval of the financial statements.

Note 1: may be applied prior to endorsement as interpretative only, but transitional relief (i.e. prospective application) will be lost.

Note 2: applies prospectively to transfers of assets from customers received on or after 1 July 2009, or can be applied to earlier transfers provided the valuations and other information needed to apply to the Interpretation to past transfers were obtained at the time those transfers were made.

# ASB and IASB timetables

**ASB Current Projects**

| | |
|---|---|
| Convergence | • The ASB and the UITF continually consider what consequential amendments will be needed to UK GAAP once the IASB and IFRIC finalise standards, amendments and interpretations. |
| Retirement benefits | • This project is led by the ASB as part of the PAAinE (Pro-Active Accounting in Europe) initiative – a partnership including EFRAG and European standard setters.<br>• The ASB is currently considering responses to the discussion paper *The Financial Reporting of Pensions*. |
| Financial statement presentation | • The ASB, as part of the PAAinE (Pro-Active Accounting in Europe) initiative, has welcomed the discussion paper Performance Reporting prepared jointly by the staff of the Spanish standards-setter (ICAC) and of EFRAG, but does not necessarily agree with all of the views expressed in the paper. |
| Accounting for Income Tax | • The ASB and Accounting Standards Committee of Germany (DRSC) have a joint project to consider accounting for income tax from first principles. |
| Business combinations | • The ASB, as a result of the IASB issuing a revised IFRS 3 and IAS 27, is reconsidering what action is required to FRED 36, 37 and 39 as part of its overall convergence strategy. |

**IASB Project Timeline – Active Projects**

| | |
|---|---|
| Annual Improvements to IFRSs – 2009-2010 | • ED issued in August 2009.<br>• Final IFRS expected first half of 2010. |
| Common Control Transactions | • Added to agenda December 2007.<br>• Timing not yet determined. |
| Conceptual Framework<br>Eight phases in all | • ED on objectives and qualitative characteristics was issued in May 2008.<br>• Discussion paper (DP) on reporting entity was issued in May 2008. ED is expected in third quarter of 2009.<br>• DP on measurement expected fourth quarter of 2009.<br>• DP on elements and recognition expected in second half of 2010. |
| Consolidation, including SPEs* | • ED issued in December 2008.<br>• Round tables held in June 2009.<br>• Final IFRS expected fourth quarter of 2009. |
| Convergence – Short-term issues, IFRSs and US GAAP* | **IAS 12 Income taxes**<br>• ED issued in March 2009.<br>• Final IFRS expected second half of 2010.<br>**Joint Arrangements – Reconsideration of IAS 31**<br>• ED 9 Joint Arrangements issued September 2007.<br>• Final IFRS expected fourth quarter of 2009.<br>**Impairment**<br>• Staff research has begun.<br>• ED expected fourth quarter of 2009.<br>• Final IFRS expected first half of 2010.<br>**Government Grants**<br>• Work deferred pending revenue recognition, related parties and emissions trading schemes projects. |
| Derecognition* | • ED issued March 2009.<br>• Round tables held June 2009.<br>• Final IFRS expected second half of 2010. |
| Discontinued operations amendment | • ED issued September 2008.<br>• Final amendment expected fourth quarter of 2009. |

| Project | Status |
|---|---|
| Earnings per share amendment | • Exposure draft issued August 2008.<br>• No further discussion expected until 2010. |
| Emissions Trading Schemes | • ED expected first half of 2010.<br>• Final IFRS expected first half of 2011. |
| Fair Value Measurement Guidance | • ED issued May 2009.<br>• Round tables planned for second half of 2009.<br>• Final IFRS expected first half of 2010. |
| Financial Instruments with the Characteristics of Equity* | • DP issued February 2008.<br>• ED expected first half of 2010.<br>• Final IFRS expected first half of 2011. |
| Financial Instruments (replacement of existing standards)* | • Classification and measurement ED issued July 2009, Final IFRS expected 2009.<br>• Impairment and Hedging EDs expected second half of 2009, Final IFRSs expected first half of 2010. |
| Financial Statement Presentation*<br>Phase B: Presentation on the face of financial statements | • DP issued October 2008.<br>• ED expected first half of 2010.<br>• Final IFRS expected first half of 2011. |
| IFRS 1 First-time Adoption of IFRSs – additional exemptions | • ED issued September 2008.<br>• Final IFRS issued July 2009. |
| Insurance Contracts – Phase II | • DP issued May 2007.<br>• ED expected second half of 2009.<br>• Final IFRS expected first half of 2011. |
| Leases* | • DP issued March 2009.<br>• ED expected second half of 2010.<br>• Final IFRS expected first half of 2011. |
| Liabilities (IAS 37 amendments) | • ED issued June 2005.<br>• Revised ED or final IFRS expected fourth quarter of 2009. |
| Management Commentary | • DP issued October 2005.<br>• Output will be best practice guidance, not an IFRS.<br>• ED issued June 2009.<br>• Final guidance expected second half of 2010. |
| Post-employment Benefits (including Pensions)* | • DP issued March 2008.<br>• ED expected fourth quarter of 2009.<br>• Final IFRS expected 2011.<br>• ED on short term amendment relating to the discount rate issued August 2009, final amendment expected fourth quarter of 2009. |
| (IFRS for) Small and Medium-sized Entities | • ED issued February 2007.<br>• Final IFRS published July 2009. |
| Rate-regulated Activities | • ED issued July 2009.<br>• Final IFRS expected first half of 2010. |
| Related Party Disclosures (IAS 24) | • Revised ED issued December 2008.<br>• Final IFRS expected fourth quarter of 2009. |
| Revenue Recognition* | • DP issued December 2008.<br>• ED expected first half of 2010.<br>• Final IFRS expected first half of 2011. |
| Rights issues (classification) | • ED issued August 2009.<br>• Final amendment expected fourth quarter of 2009. |

**IASB project timeline – Research agenda**

| | |
|---|---|
| Extractive activities | • Group of national standard setters conducting research.<br>• DP available on the IASB website August 2009.<br>• Request for views expected first half of 2010. |
| Intangible Assets* | • Decision in December 2007 not to add to agenda but continue as research project. |
| Credit risk | • Discussion paper issued June 2009. |

* IASB projects with milestones agreed in the February 2006 IASB-FASB Memorandum of Understanding on convergence – download the MoU at www.iasplus.com/pressrel/0602roadmapmou.pdf

This timetable is derived from the IASB's published timetable supplemented by decisions and comments made at recent meetings of the Board. You will find details on each project, including decision summaries from each Board meeting, at www.iasplus.com/agenda/agenda.htm

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