

# IFRS Outlook



## In this issue ...

**Lease accounting is entering a second phase of public consultation – the impact on lessees** 2

**Reviews of two key IASB bodies throw light on underlying dynamics of IFRS** 5

**SEC publishes Staff Paper on incorporating IFRS into the US Financial Reporting System – our views** 7

**IFRS update** 9

**Resources** 10

### **Lease accounting is entering a second phase of public consultation – the impact on lessees**

The IASB and the FASB have announced their intention to re-expose the revised proposals on accounting for leases. Read about the tentative decisions that the Boards have made during their redeliberations and how the lease accounting model for lessees has changed from the proposals in the original Exposure Draft (ED).

### **Reviews of two key IASB bodies throw light on underlying dynamics of IFRS**

The governance and strategy reviews carried out by the oversight bodies of the IASB are more than just process reviews. In this article, we outline the institutional relationships surrounding the IASB and discuss the fundamental issues about the creation and implementation of IFRS.

### **SEC publishes Staff Paper on incorporating IFRS into the US Financial Reporting System – our views**

In May this year, the SEC staff issued a paper for public consultation, outlining a possible approach for incorporating IFRS into the US financial reporting system. Read about the potential impact of this approach on US issuers and our views on the proposed 'condorsement' approach.

### **IFRS update**

Find out which projects the IASB and the IFRS Interpretations Committee are currently discussing.

### **Resources**

Look here for an up to date list of our recent publications.

We welcome your feedback on *IFRS Outlook*. Please contact us at [ifrs@ey.com](mailto:ifrs@ey.com).

Ruth Picker  
Global Leader - IFRS Services, Global Professional Practice

# Lease accounting is entering a second phase of public consultation – the impact on lessees



As the IASB<sup>1</sup> and the FASB<sup>2</sup> prepare for the release of a second ED of their new joint standard on lease accounting following an extensive public consultation – and rigorous redeliberations on the original exposure draft – we take stock of the project's underlying aims and impact, as well as highlight which key concerns from the public consultation on the original ED have been addressed during the Boards' redeliberations.

Almost a decade has passed since Sir David Tweedie – recently retired chairman of the IASB – joked with a dinner audience that no-one in the room had ever flown on an airplane that appeared on the airline's balance sheet.<sup>3</sup> His comments signalled the standard-setters' intentions of accounting reform, aimed at bringing the rights and obligations associated with a lease onto the lessee's balance sheet as assets and liabilities.

Although Sir David retired in June of this year, the work remains part of the IASB's and FASB's joint projects on improving certain accounting standards. In August 2010, the proposed joint accounting standard on leases was exposed for public consultation. After a very active feedback round, the Boards have tentatively decided to make significant changes to the original proposals. The revised proposals based on the Boards' tentative decisions will be re-exposed for a second round of consultations later in the year.<sup>4</sup>

Much of the work that has gone into amending the original proposals was intended to address the following key concerns of companies: the proposed model would be too complex; the extensive use of estimates would result in subjectivity and reduced comparability; and there are conceptual issues with the scope of the ED and the definition of a lease. Although we support the Boards' effort to improve lease accounting, we can also sympathise with those concerns. Ernst & Young was an active contributor to the first round of consultation, suggesting areas where the standard could be simplified and the use of subjective estimations, in particular, could be reduced.

## What is the real impact?

It is not difficult to understand the IASB's and the FASB's underlying aims. The problems with the current leasing model are not limited to material assets and obligations arising from operating leases not being recognised on the balance sheet. Economically similar lease transactions can result in different accounting results, while financial estimates used at the beginning of a lease are not re-assessed during the remainder of its life. Placing obligations from operating leases on to the balance sheet would affect key metrics such as leverage and capital ratios, as well as net income. Some of the metrics impacted, such as EBITDA and operating cash flows, would be positively affected.

<sup>1</sup> International Accounting Standards Board

<sup>2</sup> US Financial Accounting Standards Board

<sup>3</sup> Speech by Sir David Tweedie, Sydney 15 August 2002: [www.frc.gov.au/speeches/tweedie\\_speech.asp](http://www.frc.gov.au/speeches/tweedie_speech.asp)

<sup>4</sup> According to the IASB's work plan, which can be accessed on [www.ifrs.org](http://www.ifrs.org), the second ED is planned to be published in the fourth quarter of this year. Also refer to our *IFRS Developments issue 10 Boards to re-expose leases, and propose a new approach for lessors*.

Ernst & Young was an active contributor to the first round of consultation, seeking areas where the standard could be simplified and the use of subjective estimations, in particular, could be reduced.

Many companies expressed concerns about using estimates to calculate lease payments based on expected payments as the calculations are complex and the impact of these estimates and their revisions could be significant. Some of their concerns have now been addressed by the Boards.

### **The changes so far**

The Boards have gone a long way to simplify their proposed lease accounting model with the aim of avoiding unnecessary subjectivity. As we look at some of the changes the Boards have made to the proposals in the original ED, we discuss how the Boards have tentatively decided to address these concerns.

- ▶ In the original ED, the Boards proposed that a company should recognise and measure assets and liabilities by taking into account expected payments, including contingent payments. This entailed reporting figures that could be speculative and might not represent present obligations on the balance sheet. In the redeliberations, the Boards instead suggested that contingent payments based on performance and usage be recognised as expenses as they are incurred – which also reduced the amounts recognised on the balance sheet.
- ▶ The level of estimation and judgement proposed in the original ED on the measurement of lease term and lease payments risked reducing comparability among companies in the same industry. This is because companies may have used different assumptions to drive asset and liability amounts for similar types of assets. Although the redeliberations have not led the Boards to remove such judgements completely, we feel the revised definition of 'lease term' (see below) and revised treatment for variable lease payments have the effect of removing some of the judgement and uncertainty.
- ▶ The ED proposed to use existing guidance to determine if an arrangement contains a lease and set a high threshold that would need to be met to separately account for services included in a lease arrangement. As all leases would be recognised on the balance sheet, companies provided feedback that additional guidance was needed and that the threshold for separating services was too restrictive. In the redeliberations, the Boards

clarified what is meant by a 'specified asset' and the 'right to control the use of a specified asset', which would help companies to distinguish between leases and non-lease arrangements. They also agreed to separate lease and non-lease components of a given contract in order to record only the lease element on the balance sheet, rather than the full cost of the contract.

- ▶ Among the themes identified by constituents that were provided as feedback to the Boards, those which we feel have been taken into account in the redeliberations are as follows:
  - ▶ The definition of the lease term in the original ED was the longest possible lease term that has more than a 50% probability of occurring. This is now defined as the non-cancellable period plus any options where there is a significant economic incentive to extend or maintain the lease arrangement – typically shortening the lease term and reducing the amount recognised on the balance sheet.
  - ▶ Purchase options were not to be included in the amounts recognised for leases because arrangements with bargain purchase options were excluded from the scope of the original ED and other purchase options were accounted for only when exercised. However, the redeliberations resulted in a decision to include purchase options if the lessee has a significant economic incentive to exercise them. In such a case, the exercise price is included in the measurement of the lease liability and the right of use of the asset. This provides for consistent treatment of purchase options and lease renewal options.
  - ▶ The original ED required lessees to recognise all leases on the balance sheet and allowed for some simplifications for short-term leases. The Boards have now tentatively decided to allow companies to apply current operating lease accounting to short-term leases. Therefore, companies would not be required to recognise lease-related assets and lease liabilities for short-term leases.

# Lease accounting is entering a second phase of public consultation – the impact on lessees *continued*

## What's next?

The Boards aim to issue the second exposure draft in the fourth quarter of this year and to publish a final standard in 2012. We encourage readers whose companies will be affected by the new standard to become active participants in the second exposure draft.

Companies will need to be ready for the implementation of the incoming standard – not only for the reasons outlined above, but also because the new standard could result in changes to key decisions about whether to buy or lease significant assets. Other areas where change could be required are debt structuring, business processes and information management.

The *World Leasing Yearbook 2010* identified global leasing exposures in 2008 as \$640bn.<sup>5</sup> This figure is not limited to firms with obvious large exposures to big-ticket items such as property and aircraft. It also includes large accumulated exposures to much smaller items such as vehicles and office equipment. It is anticipated that the proposals will have widespread impact for companies. We therefore encourage companies to consider the issues we have discussed, assess the impact that the proposal could have on existing leasing arrangements and business operations, and consider formulating responses to the Boards' second exposure draft.

### Summary of key changes from the original ED

- ▶ Less use of subjective estimations
- ▶ Contingent payments based on usage and performance to be expensed as incurred
- ▶ Clearer distinction between lease and non-lease arrangements
- ▶ Consistent treatment of purchase options and renewal options
- ▶ Simplified treatment of short-term leases

<sup>5</sup> *The World Leasing Yearbook 2010* can be accessed on [www.euromoney-yearbooks.com](http://www.euromoney-yearbooks.com)

# Reviews of two key IASB bodies throw light on underlying dynamics of IFRS

The IFRS Foundation Trustees and the Monitoring Board Working Group on Governance Review both opened consultations starting in 2010. Far from being mere process reviews, these provide the opportunity to re-examine some fundamental questions underlying the development and implementation of IFRS. In this article, we outline the institutional relationships surrounding the IASB, summarise some of the key questions raised by the two consultations, and give our responses.

## Governance of the IASB

The IASB was established in 2001 following a strategy review undertaken by its predecessor body – the International Accounting Standards Committee. It is an independent, privately-funded body with responsibility for setting international accounting standards to provide cross-border transparency to investors of mainly publicly-listed companies. Its oversight body is the IFRS Foundation, which is governed by a Board of Trustees that appoints the 15 IASB members.

In 2009, an additional layer of governance was added with the creation of the Monitoring Board, made up of certain national and multilateral public-market securities regulators. The Monitoring Board's remit is intended to be exclusively one of governance and oversight – it does not have a mandate to set the technical agenda of the IASB beyond an agreed mechanism by which it can suggest items for the IASB to consider for its agenda. Its mandate is instead to ensure that the IFRS Foundation Trustees fulfil their duties appropriately in line with the IFRS Foundation Constitution, along with approving the appointment or re-appointment of Trustees. At the same time, however, the Monitoring Board provides a crucial link between the development of IFRS and the users of IFRS. This is because its members are the capital-markets regulators who represent the primary users of IFRS in different jurisdictions – i.e., investors.

Indeed, in our comment letter to the IFRS Foundation Trustees, Ernst & Young stated that the Monitoring Board should be actively involved in discouraging divergent views or interpretations by individual countries and regulatory bodies.

As more countries consider joining the 100+ that have already implemented IFRS, the IFRS Foundation and the Monitoring Board have begun to carry out their own reviews of the organisation's overall governance and strategy. These reviews are meant to address the challenges the IFRS Foundation faces in the areas of convergence and adoption, quality and implementation of the standards, and governance and accountability.

They are, however, more than just process reviews. The respective consultations bring to light some fundamental questions surrounding the creation and implementation of IFRS. This article will focus on three such issues – the implementation of a single set of accounting standards that are not subject to local interpretation and the role of national regulators in that process; the underlying purpose and beneficiaries of accounting standards; and the financing of the IASB.

## A single standard for all

Top of the list of the IFRS Foundation's Trustees Strategy Review is affirming that "the IFRS Foundation must remain committed to the long-term goal of the global adoption, in its entirety and without modification, of IFRS as developed by the IASB". Although this would seem implicit in the very purpose of the IASB, the practice of implementing IFRS in local jurisdictions has – up to the present moment – sometimes diverged in subtle ways from the stated aim of achieving a single standard. A useful analogy is the difference between the official form of a language and its local dialects. IFRSs are supposed to provide a 'global language' for accounting. Yet even if the main form of the language is the same in different jurisdictions, the risk remains of local 'dialects' appearing in different jurisdictions. We therefore believe that the Monitoring Board as well as the Trustees should play a role in encouraging the adoption, without modification, of IFRS as issued by the IASB, as well as the uniform implementation of IFRS around the world.

Indeed, in our comment letter to the IFRS Foundation Trustees, Ernst & Young stated that the Monitoring Board should be actively involved in discouraging divergent views or interpretations by individual countries and regulatory bodies.

A related issue is that of convergence. We believe that the Trustees struck a good balance in their Strategy Review between encouraging convergence where possible as a step towards full adoption as the ultimate objective – rather than allowing convergence to become an 'endless pursuit' in itself.

# Reviews of two key IASB bodies throw light on underlying dynamics of IFRS *continued*

## Who are IFRSs for?

An even more fundamental question is that of identifying who IFRSs are supposed to serve – and remaining true to that purpose. Our comment letter to the Trustees reaffirmed that this should be the primary users of financial statements – namely investors and the securities regulators that represent them. The main interest of these users is transparency – which we believe is the faithful representation of transactions underlying the financial statements and a clear understanding of related accounting policies. We also believe that transparency is the best response to a criticism often aimed at IFRS – that of accounting volatility – which can result from the use of fair value measurement for certain items.

Non-primary users – central banks and prudential regulators, for example – have different fundamental aims, such as economic stability or controlling inflation. These aims should not obscure the fundamental purpose of IFRS which is to serve investors with better information about the underlying transactions in a business. Indeed, we believe that transparency is in the best interests of long-term investor confidence and ultimate financial stability.

This is reflected in the IFRS Foundation Trustees Review Report's statement that "there should be a clear statement of the Foundation's commitment to providers of capital as the primary, but not exclusive, users of financial statements" – itself bringing the Foundation into line with the IASB's Conceptual Framework, first published in 1989 and most recently revised in 2010.

Our comment letters to both the IFRS Foundation Trustees and to the Monitoring Board Working Group made clear that non-primary users should have the opportunity to provide their input to existing due-process requirements – such as public comment and roundtables – or by being given an observer role on the Monitoring Board. More broadly, we believe that consultation and outreach should be with an appropriate number of varied interest groups in order that the views presented to the IASB are as balanced as possible and to avoid the risk of being unevenly weighted.

## Who pays for it?

A third area is the financing of the IASB. The IASB has no official, repeat funding channels but is, instead, reliant on voluntary contributions collected using differing arrangements in different countries. We believe this system should be superseded by a transparent and non-voluntary funding mechanism that is clearly linked to the capital markets that are supported by and use IFRS. This may mean that it varies between jurisdictions – as mechanisms can vary between jurisdictions – but all differing arrangements would be united in pursuing public interest and being overseen by the Monitoring Board and Trustees. Furthermore, this would ensure that the footprints of those using IFRS and those paying for the development of IFRS are more closely aligned, helping to prevent possible concerns about undue influence from the countries or bodies that make a greater financial commitment. The proposals in the Trustees' Strategy Review were not conclusive as to how the funding mechanism would operate. However, they did propose that funding should be organised on a longer-term basis and be publicly-sponsored.

Overall, this is an important time for the IFRS Foundation and for the development of IFRS. With a large number of jurisdictions now using or moving towards adoption of IFRS, we feel that the IASB and its related bodies are making good progress. The development of various joint standards such as those being developed with the US FASB on leasing and revenue recognition, combined with continued convergence projects in other key areas are positive steps. The two consultation processes described here are aimed in large part at balancing the Board's independence in standard-setting with accountability to a broad group of stakeholders, with a view to encouraging adoption for a broader range of jurisdictions.

The two consultation processes described here are aimed in large part at balancing the Board's independence in standard-setting with accountability to a broad group of stakeholders, with a view to encouraging adoption for a broader range of jurisdictions.

# SEC publishes Staff Paper on incorporating IFRS into the US Financial Reporting System – Our views

In May this year, the SEC<sup>1</sup> staff issued a paper<sup>2</sup> outlining a possible approach for incorporating IFRS into the US financial reporting system, which was followed by a consultation period. This article outlines that approach, examines its impact on US issuers, and presents our views on it.

Under the approach outlined in the Staff Paper, the SEC has explored a possible method for the US to move towards IFRS using a transitional process – known informally as ‘condorsement’ – whereby the US FASB would incorporate newly-issued IFRSs into GAAP<sup>3</sup> following their own endorsement protocol. According to the paper, this objective would be to allow US companies eventually to assert compliance with IFRS following the condorsement process. Under the approach, the FASB’s role would also provide input and support to the IASB in developing standards – bringing it into line with the role played by national standard-setters in countries that have already adopted IFRS. The overall timeframe for completion of this process was not specified, but five to seven years was given as an example. The FASB would retain sovereignty over US accounting standard-setting yet – importantly – would not develop separate new US standards, except for rare modifications to protect US public interest and investors.

## Will the approach result in compliance with IFRS?

We support the approach as a thoughtful and balanced way of moving closer to the ultimate goal of a single set of high quality, globally-accepted standards. However, we do not believe that the SEC staff’s approach would enable US companies to assert compliance with IFRS as issued by the IASB for the following reasons:

- ▶ We believe certain differences between IFRS and US GAAP – for example, LIFO<sup>4</sup> inventory accounting and accounting for contingencies – will be difficult to reconcile. Even if the FASB initially agreed to eliminate all significant differences under a transition protocol, some US constituents are likely to strongly oppose the elimination of some of these. As a result, the FASB and SEC would be forced to seriously consider such opposition. In addition, there may be US political or regulatory pressures to maintain certain elements of current US GAAP.

- ▶ The approach described in the staff paper that the FASB may make modifications to the IASB standards. Although the staff has indicated that this would only be in rare cases, we are already seeing a number of areas where the Boards are diverging – e.g., consolidations, financial instruments and the balance sheet off-setting projects. It is possible that such differences would not be eliminated, even when evaluating the international standards under a transition protocol. We therefore support a well-developed and pre-established endorsement and incorporation protocol, with a high threshold for modifying the international standards. That threshold should focus on the acceptability of the specified international standard in the US, not necessarily the preferences of the FASB. Ultimately, we hope such a protocol would result in fewer deviations from IFRS as issued by the IASB, and recognise that differences may be necessary in certain circumstances to protect US public interest and investors.
- ▶ The SEC also does not require the implementation of IFRS 1, the ‘bridge’ standard that allows a company to transition from previous GAAP to IFRS – in many cases by requiring retrospective restatement. Without requiring the application of IFRS 1, we question how US constituents could assert compliance with IFRS as issued by the IASB.

In light of these issues, we believe it is unlikely that every major difference between US GAAP and IFRS would be eliminated under the method described in the Staff Paper. This, in turn, could lead to the development of a ‘local flavour’ to US IFRS. We believe it is important for participants in the US capital markets, as well as global capital markets, to understand this likely outcome before committing to the process. While complete convergence may not be achieved by the end of the transition period, we hope that investors would be able to understand any remaining substantive differences between US GAAP and IFRS. We also hope that remaining differences would not represent a major impediment to cross-border capital flows.

Without requiring the application of IFRS 1, we question how US constituents could assert compliance with IFRS as issued by the IASB.

<sup>1</sup> US Securities and Exchange Commission.

<sup>2</sup> Exploring a possible method of incorporation issued 26 May 2011 [www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf](http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf).

<sup>3</sup> Generally Accepted Accounting Principles.

<sup>4</sup> Last In-First Out.

# SEC publishes Staff Paper on incorporating IFRS into the US Financial Reporting System – Our views *continued*

## **Closer alignment while avoiding 'perpetual change'**

We recognise that the SEC cannot and should not abdicate its responsibility for financial reporting for US issuers, and we support its continued oversight of US GAAP for public companies. We therefore support the continuing role of the FASB as the US national standard-setter and would support its active participation in the IASB's standard-setting process, becoming broadly consistent with the role of other national standard-setters. Indeed, it would be particularly critical for the perspectives of US constituents to be heard and considered throughout the IASB's standard-setting processes. The FASB's role, as described in the Staff Paper, would be instrumental in providing that input and support to the IASB. We agree that this would be a different role from that which is currently played by FASB, and we support this possible approach because it aligns the FASB more closely with other national standard-setters. Adopting this framework would result in the closer alignment of US and international financial reporting standards while maintaining the ultimate standard-setting and regulatory authority for those standards in the US. However, the SEC would have to exercise its authority by providing its input during the standard-setting process, rather than unilaterally creating or revising US GAAP, for this approach to more successfully converge US GAAP and IFRS.

The transition process is also important. We are mindful of not creating a state of 'perpetual change' for US companies by continual alteration to US GAAP, mainly in order to avoid serious disruption to the US financial-reporting system. Notwithstanding our overall support for the Staff Paper, we remain concerned about the emergence of an environment in which the FASB continually makes changes to US GAAP – including the incorporation of IFRS into US GAAP – over an extended period. While we understand some change is unavoidable during the transition period envisaged by the framework, frequent changes over an extended period would have the potential to significantly disrupt the financial reporting system in the US.

To help minimise this disruption, we hope the FASB would make changes to its legacy standards only to converge with IFRS. In addition, we would hope that the FASB would carefully consider which changes are necessary to its legacy standards to achieve substantial convergence. We would expect the FASB to be judicious in making those changes, focusing on the major areas of difference between US GAAP and IFRS that are viewed to be of particular concern to investors and other users of US GAAP financial statements. After the FASB decides what changes should be made to legacy standards, we also would encourage the Board to explore approaches to adoption that would ease the transition burden for US issuers. For example, requiring preparers to adopt new accounting standards each year during the transition period would be unduly burdensome. After the transition period, we would also expect changes to US GAAP to follow corresponding changes made to IFRS by the IASB. We would therefore expect new differences between US GAAP and IFRS to be "rare", as described in the Staff Paper.

## **Is this the "end game"?**

We currently are not in a position to form a view as to whether the possible incorporation method described in the Staff Paper should represent the final stage in the consideration of the full adoption of IFRS by US issuers. It is possible that, after the successful implementation of the framework, the environment may be more conducive to the adoption of full IFRS, especially if the majority of the significant differences between US GAAP and IFRS have been eliminated. But we accept that this may not be the case. Ideally, we would like to see a single set of high-quality accounting standards used throughout the world, including the US, without modification. However, as discussed, we are not convinced that this goal can be practically achieved in the US at this time. Nonetheless, we believe that the framework described in the Staff Paper is a reasonable alternative that, while not ideal, could help address US political, regulatory and other concerns, at the same time, moving us closer toward a reasonably converged set of global accounting standards.

# IFRS update

## What's new?

The following table shows new publications issued by the IASB.

Projects	Publication
<b>Annual Improvements</b>	<p>The IASB has issued ED/2011/2 <i>Improvements to IFRSs</i> which is proposing amendments to five IFRSs under its annual improvements project:</p> <ul style="list-style-type: none"><li>▶ IFRS 1 <i>First-time adoption of International Financial Reporting Standards</i></li><li>▶ IAS 1 <i>Presentation of Financial Statements</i></li><li>▶ IAS 16 <i>Property, Plant and Equipment</i></li><li>▶ IAS 32 <i>Financial Instruments: Presentation</i></li><li>▶ IAS 34 <i>Interim Financial Reporting</i></li></ul> <p>The comment period of the ED closes 21 October 2011. The ED can be accessed at <a href="http://www.ifrs.org">www.ifrs.org</a>.</p>
<b>Financial Instruments</b>	<p>The IASB has published ED/2011/3 <i>Amendments to IFRS 9 Financial Instruments (November 2009) and IFRS 9 Financial Instruments (October 2010): Mandatory Effective Date</i> which proposes to adjust the mandatory effective date of IFRS 9 <i>Financial Instruments</i> from 1 January 2013 to 1 January 2015. The comment period of the ED closes on 21 October 2011. The ED can be accessed at <a href="http://www.ifrs.org">www.ifrs.org</a>.</p>
<b>Agenda consultation 2011</b>	<p>The IASB has launched a public consultation to seek broad public input on the strategic direction and overall balance of its future work programme. The consultation document is seeking feedback on how the IASB should balance the development of financial reporting with the maintenance of IFRSs and with consideration of time and resource constraints those areas of financial reporting that should be given the highest priority for further improvement. The consultation period on the IASB's future work programme closes on 30 November 2011. The agenda consultation document can be accessed at <a href="http://www.ifrs.org">www.ifrs.org</a>.</p>
<b>IFRS Taxonomy 2011 interim release</b>	<p>The IFRS Foundation has published the IFRS Taxonomy 2011 interim release for IFRS 12 <i>Disclosure of Interests in Other Entities</i> and IFRS 13 <i>Fair Value Measurement</i>. IFRS Taxonomy interim releases contain additional taxonomy concepts that reflect new IFRSs and improvements to IFRSs published by the IASB, thereby allowing entities wishing to report electronically using the latest IFRSs to do so without the need for these entities to create their own taxonomy concepts. The IFRS Taxonomy can be accessed at <a href="http://www.ifrs.org">www.ifrs.org</a>.</p>

## Current discussions

In recent months, the IASB has focused its discussions on key projects that are intended to result in the issue of exposure drafts for public consultation in the next coming months.

Tentative decisions were made regarding a number of projects, including: leases, insurance contracts, impairment of financial assets, hedge accounting, offsetting financial assets and financial liabilities. In addition, the IASB and the FASB have elected to formally expose their joint leases proposals for a second time because they have made significant changes to the model they proposed last year, as discussed in this issue of *IFRS Outlook*. Their decision will give constituents a chance to comment on the changes.

The IFRS Interpretations Committee met on 7 and 8 July 2011. The Committee voted and confirmed that there was consensus on the Interpretation for *Stripping Costs in the Production Phase of a Surface Mine*, subject to its final review of drafting changes, and submitted the Interpretation to the Board for ratification at the Board's meeting in September 2011. The Committee continued

discussions on the use of IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment* by analogy, and made agenda decisions on sales proceeds from cost of testing an asset before commercial production and defined contribution plans with vesting conditions. Tentative decisions were made on business combinations involving newly formed entities, business combinations under common control, acquirer in a reverse acquisition, and group reorganisations in separate financial statements. The Committee has directed the staff to do further analysis on – the definition of a business, and acquisition of interest in a joint operation for their next meeting in September. The Committee also considered the application of the aggregation criteria and the identification of the chief operating decision maker in IFRS 8 *Operating Segments*. The Committee decided that it would be best to recommend that the IASB consider these issues as part of a future post-implementation review of IFRS 8.

Updates from Board meetings and the Interpretations Committee meetings can be found at [www.ifrs.org/Updates](http://www.ifrs.org/Updates).

# Resources

The publications below are all available at [www.ey.com/ifrs](http://www.ey.com/ifrs).

## **IFRS Developments (formerly Supplements to IFRS Outlook) Issues 8 – 14**

### **Issue 8: Proposed improvements to IFRS**

The IASB has proposed seven necessary, but non-urgent, improvements to IFRS as part of its annual improvements project. The amendments are intended to clarify existing IFRS, typically where ambiguity exists. The comment period for the ED closes on 21 October 2011.

IFRS Developments issue 8 summarises what you need to know about these developments.

### **Issue 9: A new approach to credit impairment is in the works**

The IASB and the FASB received mixed feedback on their previous proposals for credit impairment and have now decided to develop a new approach. This new approach considers splitting loans into three buckets based on their underlying credit risk characteristics and the information available.

The model would represent a significant change from current practice under both US GAAP and IFRS. In addition, this will raise some new practical challenges for preparers of financial statements.

### **Issue 10: Boards to re-expose leases, and propose a new approach for lessors**

The IASB and the FASB decided to re-expose their joint leases proposal for a second time, because they have made significant changes to the model they proposed last year. They also decided that lessors should apply a “receivable and residual” approach to all leases, with a few exceptions. This represents a significant change from current lease accounting and the proposals in last year’s ED.

IFRS Developments Issue 10 summarises what you need to know about these developments.

### **Issue 11: New credit impairment approach takes shape**

The IASB and FASB continued their discussion about the three-bucket approach for impairment of financial assets. The new three-bucket approach captures different phases of deterioration in credit quality of financial assets. All financial assets subject to impairment would be initially classified in Bucket 1. Any subsequent transfers to Buckets 2 and 3 would be based on changes in credit loss expectations. While the Boards have decided that the impairment allowance for Buckets 2 and 3 would be based on full expected lifetime losses, they have yet to decide whether the allowance for Bucket 1 would be based on 12 months or 24 months of expected credit losses.

IFRS Developments Issue 11 summarises what you need to know about these developments.

### **Issue 12: IFRS 9 mandatory effective date to move to 2015**

On 22 July 2011, in response to feedback received from constituents and its prior intention to allow entities to adopt IFRS 9 *Financial Instruments* in one package, the IASB tentatively decided to move the mandatory effective date of IFRS 9 to annual periods beginning on or after 1 January 2015, with earlier application permitted.

The IASB plans to publish the proposed change in an ED, which will have a comment period of 60 days.

IFRS Developments issue 12 highlights the impact of the proposed change on reporting entities.

### **Issue 13: Accounting for waste removal costs in surface mines**

The IFRS Interpretations Committee considered the near final Interpretation on accounting for waste removal costs during the production phase of a surface mine at its July 2011 meeting.

IFRS Developments Issue 13 summarises what you need to know about these developments.

### **Issue 14: A step forward in hedge accounting**

At its July meetings, the IASB made a significant step towards releasing a new standard on hedge accounting. The tentative decisions taken by the Board at these meetings are consistent with its intention to link an entity’s risk management strategy with the rationale for hedging and the impact of hedging on the financial statements. This will allow many entities, both financial institutions and corporations, to apply hedge accounting to more of their common hedging strategies.



### **IFRS Practical matters: Lease accounting proposals – simplified, but not simple**

This edition, Lease accounting proposals - simplified, but not simple, complements our recent IFRS publications (*Applying IFRS: Lessee model comes together as leases project progresses* and *IFRS Developments: Boards to re-expose leases, and propose a new approach for lessors*) on the changes to last year's ED on lease accounting, and further highlights how the revised proposals for leases will still have a significant impact on many organisational functions, including financial, tax, IT systems, and business processes. The publication also indicates how Ernst & Young may be able to help a company with its initial assessment of the proposal through to eventual adoption.

### **Applying IFRS: Lessee model comes together as leases project progresses**

The IASB and the FASB have made significant changes to their proposed leases model to address conceptual and operational concerns constituents raised about their original proposal. Like the ED, the revised proposal (i.e., ED adjusted for subsequent deliberations) would require most leases to be recognised on the balance sheet. This would also require a number of judgements, as well as periodic reassessment.

This publication from our *Applying IFRS* series, *Lessee model comes together as leases project progresses*, summarises the revised leases proposal for topics the Boards have redeliberated through June 2011. These decisions are primarily lessee-related, and this publication compares the revised proposal with current accounting. All of the decisions made by the Boards to date are tentative and will not be finalised until they approve a final standard.

### **Joint Project Watch – July 2011**

Keeping up to date with the standard-setting activities of the IASB and FASB on their many joint projects can be challenging. The Boards are actively redeliberating many of their projects and, as a result, they are making tentative decisions that may be different from earlier decisions and those in the exposure drafts. This issue of Joint Project Watch provides a snapshot of the key developments through July 2011 from an IFRS perspective, together with our observations on the potential implications for companies.

### **IASB Projects – A pocketbook guide – June 2011**

The IASB continues to move forward with its standard-setting activities and the ability to stay one step ahead in a sea of change is critical. This June 2011 edition of the *IASB Projects: A pocketbook guide* summarises the key features of the various IASB projects, many of which are joint projects with the FASB as part of ongoing efforts to converge IFRS and US GAAP. This guide also includes some of the potential financial and business implications of the proposed accounting changes, together with Ernst & Young's views on the projects.

### **Second edition of Implementing Phase 1 of IFRS 9**

*Implementing Phase 1 of IFRS 9* (2nd edition), is an update of the first edition that we issued in June 2010. In this edition, we have addressed additional questions that are being asked about implementing IFRS 9 *Financial Instruments*, recognising that some aspects of the standard are still unclear. The new standard is principles-based, with less extensive rules and application guidance than IAS 39 *Financial Instruments: Recognition and Measurement*. Therefore, its application will require the careful use of judgment. This publication should be utilised by entities that are currently preparing for or contemplating an early adoption of IFRS 9, to enable these entities to analyse the impact of the new standard.

### **Insurance Accounting Alert July 2011**

At a joint meeting on 13-15 June, the Boards discussed the residual margin, acquisition cost and presentation of the statement of comprehensive income.

### **Insurance Accounting Alert August 2011**

At a joint meeting on 21 July, the Boards discussed the premium allocation approach (previously known as the modified approach) to measurement of liability for remaining coverage (previously known as pre-claims liabilities) of certain types of contracts.

**About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com)

© 2011 EYGM Limited.  
All Rights Reserved.

EYG no. AU0934

**About Ernst & Young's International Financial Reporting Standards Group**

The move to International Financial Reporting Standards (IFRS) is the single most important initiative in the financial reporting world, the impact of which stretches far beyond accounting to affect every key decision you make, not just how you report it. We have developed the global resources – people and knowledge – to support our client teams. And we work to give you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our work worldwide. It's how Ernst & Young makes a difference.

In line with Ernst & Young's commitment to minimise its impact on the environment, this document has been printed on paper with a high recycled content.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.