

Joint Project Watch

IASB/FASB joint projects from an IFRS perspective

February 2011

Keeping up to date with the standard-setting activities of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (collectively, the Boards) on their many joint projects can be challenging. But with several major projects in active stages, it's important to start thinking about the potential effects of new standards on your company. The Boards plan to complete work on many of these projects by the end of the second quarter of 2011.

This publication is designed to provide a snapshot of key developments from an IFRS perspective each month, along with our observations about the potential implications for companies. We also include references to other Ernst & Young publications that provide more background and detail on the projects and proposals. These publications can be downloaded at www.ey.com/ifrs.

The following sections are based on our observations of the standard setter meetings. The Boards are actively redeliberating many of these projects, making tentative decisions that may be different from earlier decisions and those in the exposure drafts (EDs). At this point, the Boards' decisions and our observations are all subject to change.

Joint projects

Financial instruments.....	1
Revenue recognition.....	5
Leases.....	6
Fair value measurement.....	7
Insurance contracts.....	8
Consolidation.....	9
Other joint projects.....	10
Presentation of other comprehensive income.....	10
Reporting discontinued operations.....	10
Emissions trading schemes.....	11
Financial instruments with characteristics of equity.....	11
Financial statement presentation.....	11
Joint projects timeline.....	12

Financial instruments

Overall Project Background

The financial instruments project addresses classification and measurement, impairments, hedging and offsetting. Except for offsetting, the Boards initially deliberated these topics separately, resulting in different conclusions on similar issues and separate proposals. The IASB issued a final standard on classification and measurement (IFRS 9) and separate proposals on impairment and hedging, whereas the FASB issued one comprehensive ED.

Financial instruments – classification and measurement

Background

IFRS 9 *Financial Instruments* requires entities to classify financial assets on the basis of the objective of the entity's business model for managing the financial assets and the characteristics of the contractual cash flows. While the FASB's proposal would require fair value measurement for many financial assets and financial liabilities, IFRS 9 permits more use of amortised cost.

Key developments to date

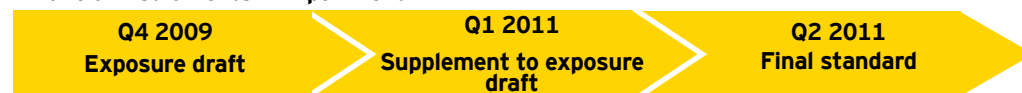
IFRS 9 was first published in November 2009 for financial assets and updated in October 2010 for financial liabilities. For more details of IFRS 9, refer to our publications on this topic.

References

- ▶ [Supplement to IFRS Outlook Issue 89: IASB completes phase 1 of IFRS 9: Financial Instruments - Classification and Measurement \(November 2010\)](#)
- ▶ [Implementing phase 1 of IFRS 9: Financial instruments \(June 2010\)](#)
- ▶ [Supplement to IFRS Outlook Issue 60: IASB publishes IFRS 9: phase 1 of the standard to replace IAS 39 \(November 2009\)](#)

Financial instruments continued

Financial instruments – impairment



Background

Although their original proposals on impairment differ significantly, the Boards recently issued a supplement to their exposure drafts (Supplementary Document) proposing a joint model. In that document, the Boards also asked for feedback on approaches to impairment that they have developed separately.

February 2011

- ▶ The Boards discussed the definition of the term “write-off”. Currently, this is not defined in IFRS and US GAAP. The Boards decided that the term write-off will be defined as “a direct reduction of the amortised cost of a financial asset resulting from uncollectibility”.
- ▶ The Boards also clarified that a financial asset is considered uncollectible when the entity has no reasonable expectation of recovery. In such circumstances, the asset should be written off.
- ▶ Separately, the IASB redeliberated several disclosure requirements that were originally proposed in its ED on amortised cost and impairment. The IASB’s tentative decisions include:
 - ▶ Disclosure of the entity’s write-off policy, including discussion of whether assets written off are still subject to enforcement activity, would be required. Disclosure of the nominal amount of assets written off, but for which the entity is still pursuing collection, would also be required.
 - ▶ Disclosure of a reconciliation of changes in certain assets that are more than 90 days past due would be required.
 - ▶ Disclosure of stress testing information and other information showing the year of origination and the year of maturity of assets, as originally proposed in the ED, would not be required.

Key developments to date

- ▶ The Boards are seeking input from stakeholders on a joint impairment model.
- ▶ Under the joint model, credit losses would be based on all available information, including historical data, current economic conditions and supportable forecasts of future economic conditions. This proposal expands on the IASB’s original proposed guidance for estimating losses in its ED. It is a change from the original FASB proposal under which only past events and current conditions could be considered.
- ▶ The joint model would require full recognition of all expected losses in the “bad book” (e.g., those loans that management identifies as doubtful of collection), plus recognition of losses in the “good book” at the higher of either of the following:
 - (a) The time-proportional expected credit losses of the portfolio (i.e., expected losses are recognised ratably over the expected term of the loans)
 - (b) The credit losses expected to occur in the foreseeable future (no less than 12 months) (the floor)
- ▶ The Boards are also seeking constituent feedback on approaches they have been developing separately. The IASB’s separate approach is essentially the same as the joint approach except that the good book does not include the floor. The FASB’s separate approach would require an entity to recognise immediately all credit losses expected to occur in the foreseeable future.

What’s next

- ▶ The Boards will continue to discuss issues from their original EDs that are outside the scope of the Supplementary Document.
- ▶ Comments on the Supplementary Document are due by 1 April 2011.

References

- ▶ [Supplement to IFRS Outlook Issue 95: IASB and US FASB propose a joint approach to accounting for credit losses \(February 2011\)](#)
- ▶ [IFRS Outlook: Impairment of financial assets - where is it heading? \(July 2010\)](#)
- ▶ [Supplement to IFRS Outlook Issue 61: New proposals for financial instruments at amortised cost \(November 2009\)](#)

Financial instruments continued

Financial instruments – hedging



Background

The IASB's hedging model would better align the accounting for hedging activities with risk-management practices and would simplify certain aspects of hedge accounting. The FASB model would make it easier to qualify for hedge accounting. The basic US GAAP framework, including what constitutes eligible hedge relationships, would not be significantly adjusted.

Key developments to date

- ▶ Under the proposed approach in the IASB ED, there would be a better link between an entity's risk management strategy, the rationale for hedging and the impact of hedging on the financial statements. Hedge accounting would be permitted for components of financial and non-financial items, provided the risk component that is being hedged can be separately identified and measured.
- ▶ There would be no bright line tests under the IASB's hedging model for hedge effectiveness assessments. Hedge effectiveness testing would only be required prospectively using a methodology that is driven by the entity's risk management policies.
- ▶ In February 2011, the FASB issued a discussion paper (DP) that seeks comments from its constituents on the IASB's hedging model.

What's next

- ▶ Comments on the IASB ED are due by 9 March 2011.
- ▶ The deadline for responses to the FASB DP is 25 April 2011.

References

- ▶ [Hedge accounting under IFRS - a closer look at the changes and challenges \(February 2011\)](#)
- ▶ [Supplement to IFRS Outlook issue 91: Hedge accounting under IFRS - all set for change \(December 2010\)](#)

Financial instruments continued

Financial instruments – balance sheet offsetting



Background

The Boards recently issued a joint proposal on the offsetting criteria for financial instruments, in an effort to eliminate a significant difference between IFRS and US GAAP.

Key developments to date

The Boards issued a joint proposal that would amend and converge the requirements for balance sheet offsetting under both IFRS and US GAAP.

- ▶ The proposal would replace the current IFRS requirement for financial assets and financial liabilities.
- ▶ Offsetting of assets and liabilities would be required when an entity has both an unconditional, legally enforceable right of set-off and intends to settle either on a net basis or simultaneously. The realisation of a financial asset and the settlement of a financial liability are considered to be simultaneous only when they are settled at the same moment.
- ▶ The proposal is similar to the existing IFRS requirements except as described below:
 - ▶ The proposal would clarify that the right of set-off must be legally enforceable in all circumstances (i.e., in the normal course of business, as well as on the default, insolvency or bankruptcy of a counterparty).
 - ▶ It is likely that contracts executed with a clearing house would no longer be deemed to constitute simultaneous settlement. Consequently, an entity would be able to set-off financial assets and financial liabilities entered into with a clearing house only if the realisation/settlement occurs at the same moment. This does not necessarily happen in practice due to processing constraints.

Key developments to date (continued)

- ▶ The proposal would require extensive disclosures of the effect of rights of set-off and related arrangements, such as collateral agreements, on an entity's financial position.
- ▶ The proposal would eliminate the exception in US GAAP that allows offsetting for some arrangements in which the right of set off is conditional (e.g., upon bankruptcy, insolvency or default of a counterparty) and there is no intention to set off, or such intention is conditional. This would have a significant effect on the balance sheets of many financial institutions and other entities in the US that have large portfolios of derivative contracts.
- ▶ The proposal would also eliminate the separate guidance in US GAAP for offsetting repurchase agreements and reverse repurchase agreements, as well as certain offsetting practices within the broker dealer, construction and depository and lending institutions.

What's next

Comments on the ED are due on 28 April 2011. A final standard is expected to be issued by the end of June 2011. The proposal does not specify an effective date.

References

- ▶ [Supplement to IFRS Outlook Issue 94: Offsetting of financial instruments: Is convergence on the horizon? \(February 2011\)](#)

Revenue recognition

Q2 2010
Exposure draft

Q4 2010
Roundtables

Q2 2011
Final standard

Background

Both Boards have a strong interest in developing a single, common revenue recognition model that can be applied to a wide range of industries and transactions. IFRS is perceived as lacking necessary application guidance, whereas US GAAP has been criticised for the complexity of its guidance on revenue recognition. The joint proposal of the IASB and FASB would use a contract-based asset and liability approach. Revenue would be recognised when an entity satisfies its obligations to customers, which occurs when control of an asset is transferred to the customer.

References

- ▶ [Revenue recognition under IFRS: What do respondents think of the proposed changes? \(December 2010\)](#)
- ▶ [Revenue from contracts with customers: The road to convergence - what the revenue proposals mean in practice \(October 2010\)](#)
- ▶ [IFRS practical matters: Revenue - will your key performance measure change? \(September 2010\)](#)
- ▶ [Supplement to IFRS Outlook Issue 75: IASB and FASB propose a single revenue recognition model \(June 2010\)](#)

February 2011

- ▶ Building on their decision made in January 2011 to treat goods and services separately, the Boards agreed to criteria to help an entity determine whether a performance obligation constitutes a good or a service.
- ▶ Whether a good or service is “distinct” is a key determination in identifying separate performance obligations under the proposed model. In a change from the ED, the Boards tentatively agreed that an entity’s commitment to provide multiple goods and services as a single integrated item represents a single performance obligation. Otherwise, the determination is based on whether the entity sells the good or service separately or the customer can use the delivered item on its own or with readily available resources.
- ▶ The proposed accounting for warranties would change, with the Boards concluding that many warranties should be accounted for as a cost accrual, while other warranties represent a separate performance obligation to which transaction consideration should be allocated.
- ▶ To determine whether an onerous performance obligation exists, all remaining performance obligations within the contract would be evaluated in the aggregate. This is a change from the proposal that required each individual performance obligation to be separately evaluated.
- ▶ Incremental costs incurred as a result of acquiring a contract would be capitalised to the extent these costs are expected to be recovered. This is also a change from the proposal that indicated such costs should be expensed as incurred.
- ▶ The effects of breakage (rights that are not exercised by the customer) that can be reasonably estimated would be recognised as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, the revenue is not recognised until the likelihood of the customer exercising its remaining rights becomes remote. While not addressed in the proposal, this tentative conclusion is similar to current practice.

Key developments to date

- ▶ The Boards continue to believe that revenue should be recognised upon the transfer of goods and services to the customer, but have tentatively decided to treat goods and services differently. While goods are transferred when the customer obtains control (consistent with the original proposal), the Boards decided that services are transferred as the entity performs the agreed-upon services. These revisions make it clear that continuous revenue recognition for some services, including those typically provided by the construction industry, is appropriate.

What’s next

While the Boards’ redeliberations to date have addressed a number of issues, there are still quite a few to address, including: determining and allocating the transaction price; fulfillment costs; licences and rights of use; implementation guidance; scope; disclosures; and transition. These topics are scheduled to be addressed in March and April 2011. The Boards plan to complete the project in June 2011.

Background

Although current requirements under IFRS and US GAAP are similar, the Boards consider this a priority project due to the need for significant improvement in the accounting for leases.

The joint IASB and FASB proposal would create a single model that would be applied to most leases and require the recognition of lease-related assets and liabilities on the balance sheet. The proposed model also would require entities to make a number of estimates and periodically reassess those estimates in accounting for leases. As proposed, the standard would affect existing leases at transition and no leases would be grandfathered.

References

- ▶ [Supplement to IFRS Outlook Issue 96: Lease term and variable lease payments simplified \(February 2011\)](#)
- ▶ [Proposed accounting for leases \(November 2010\)](#)
- ▶ [IFRS practical matters for financial services: What do the proposed lease accounting changes mean for financial institutions? \(September 2010\)](#)
- ▶ [IFRS practical matters for the C-suite: Leases - what do the proposed lease accounting changes mean for you? \(August 2010\)](#)
- ▶ [Supplement to IFRS Outlook Issue 79: Proposed accounting changes for leases \(August 2010\)](#)

February 2011

- ▶ The definition of lease term would be revised to include optional periods only when there is a significant economic incentive for the lessee to extend or not terminate the lease (e.g., renewal rates priced at a bargain, penalty payments, and significant customisation or installment costs). The revised definition would result in shorter lease terms and smaller lease-related assets and liabilities than the definition included in the ED.
- ▶ Certain variable lease payments would be included in recognised lease-related assets and liabilities using a higher threshold than had been originally proposed. The lessee's liability and lessor's receivable would include variable lease payments that: (1) depend on an index or rate; (2) have variability that lacks commercial substance; or (3) meet a high recognition threshold (such as reasonably certain). The high recognition threshold would result in some performance- and usage-based contingent rents being excluded from lease-related assets and liabilities.
- ▶ The Boards discussed allowing straight-line recognition of lease income and expense for leases that do not have a significant financing element, and will investigate how to distinguish between leases that contain a significant financing element and those that do not. Many comment letters expressed concern that the front-end loaded recognition of lease income and expense did not reflect the underlying economics of many leases.

Key developments to date

- ▶ The Boards have not concluded whether to change lessor accounting as part of the current leases project. The Boards plan to consider developments in other projects, such as the joint revenue recognition project, before making a final decision.

What's next

The Boards will seek feedback from selected constituents on changes to the proposal and continue to redeliberate additional topics including the definition of a lease; the separation of service elements from a lease; short-term leases; transition and other measurement issues.

Fair value measurement

Q2 2010
Exposure draft

Q1 2011
Final standard

Background

The IASB proposal, in combination with a proposal from the FASB, would generally converge the IFRS and US GAAP requirements for how to measure fair value and the related disclosures. The IASB's new standard would establish a single source of guidance for fair value measurements, when fair value is required or permitted by IFRS. The FASB's proposals, while not intended to result in significant changes to practice, would clarify certain of the existing fair value principles under US GAAP and amend others.

References

- ▶ [Supplement to IFRS Outlook Issue 80: IASB staff draft on fair value measurement \(August 2010\)](#)
- ▶ [Supplement to IFRS Outlook Issue 77: Limited re-exposure of fair value measurement disclosures \(June 2010\)](#)

Key developments to date

- ▶ The new standard would not change when an entity is required to use fair value, but instead, would provide guidance on how to measure fair value under IFRS when fair value is required or permitted by IFRS.
- ▶ Fair value would be defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date". It would be an exit price.
- ▶ A fair value measurement would assume that the transaction to sell the asset or transfer the liability takes place either in the principal or in the most advantageous market (in the absence of the principal market).
- ▶ Market participants would be defined as the "buyers and sellers in the principal (or most advantageous) market for the asset or liability".
- ▶ The new standard would apply both to determining fair value for financial assets and liabilities and non-financial assets and liabilities.
- ▶ When determining fair value, management would be required to use a fair value hierarchy that classifies the inputs used to measure fair value into three levels. An entity would be required to measure fair value using the valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs.
- ▶ The concepts of "highest and best use" and "valuation premise" would not be relevant for financial instruments and liabilities. The Boards have clarified that if the unit of account for the item being measured is not clear from other standards, entities should assume that market participants would transact in a way that maximises value.
- ▶ Measuring financial assets and liabilities with offsetting risks on a portfolio basis would be allowed as an exception to fair value principles, if certain criteria are met.
- ▶ The application of a "blockage factor" would be prohibited on all levels of the fair value hierarchy. The Boards clarified that other premiums/discounts (e.g., control premiums) may be applied when they would be considered by market participants based on the unit of account for the item being measured when the unit of account is not clear.
- ▶ New fair value disclosures would be required.

What's next

- ▶ A final IFRS and final amendments to US GAAP are expected shortly. However, the Boards still need to determine when their respective guidance will become effective.
- ▶ The Boards decided not to finalise certain of the proposed disclosures related to the measurement uncertainty analysis at this time, but instead are conducting more outreach, and have deferred these proposed disclosures into a project that will be finalised separately.

Insurance contracts



Background

The IASB's ED contains a proposal for a comprehensive model on the accounting for insurance contracts. The FASB issued a DP to solicit input on its preliminary views and the IASB's ED. The proposals are far-reaching and would have a significant effect on insurers.

References

- ▶ [Insurance Accounting Alert: IASB and FASB begin re-deliberations \(February 2011\)](#)
- ▶ [Insurance Accounting Alert: Insurance Working Group meets to discuss the IASB Insurance Exposure Draft \(November 2010\)](#)
- ▶ [Insurance Accounting Alert \(special edition\): Proposal for accounting for insurance contracts \(July 2010\)](#)

February 2011

- ▶ Certain acquisition costs related to a portfolio of insurance contracts would be included in the cash flows of the insurance liability. This is a change from the ED/DP proposal that provided that acquisition costs be identified at a contract level. The Boards will continue discussing which acquisition costs should qualify for inclusion.
- ▶ The standard will not prescribe a particular method for determining the discount rate (e.g., top-down or bottom-up approach), but the rate should reflect the characteristics of the liability. The ED/DP prescribed a discount rate based on a risk-free rate plus a liquidity adjustment (i.e., bottom-up approach). The Boards will also explore permitting the use of a specified rate (e.g. a rate that is based on the interest rates of high quality corporate bonds) to discount insurance obligations as a practical expedient.
- ▶ The requirement to use an expected value of fulfilment cash flows refers to the mean. The Boards clarified that practical implementation would depend on circumstances and there is no need for all possible scenarios to be identified and quantified to calculate the mean, provided that the insurer is satisfied that the estimate is consistent with the objective of expected value.
- ▶ The Boards confirmed their view that no gain would be recognised at the inception of a contract while a loss at issue must be recognised.
- ▶ The IASB is developing the insurance model on the assumption that financial assets are measured in accordance with IFRS 9. It stated that it has no current plan to change the classification and measurement requirements in IFRS 9.

What's next

The IASB plans to continue redeliberating jointly with the FASB over the next several months. It expects to publish a final standard in June 2011.

Consolidation



Background

Under the IASB proposal, which includes a single consolidation model applicable to all entities, more judgement would be required to determine whether one entity controls another.

References

- ▶ [Supplement to IFRS Outlook Issue 84: Consolidated financial statements \(October 2010\)](#)
- ▶ [IFRS Outlook: Investment companies - consolidate or measure at fair value \(March 2010\)](#)

Key developments to date

- ▶ Control would exist when the reporting entity is exposed, or has rights, to variable returns from its involvement with another entity and has the ability to affect those returns through its power over that other entity.
- ▶ After hearing from constituents, the FASB decided not to develop a single consolidation model for all entities and will not converge with the IASB's proposal at this time. Accordingly, some of the significant IFRS and US GAAP differences with respect to the concept of *de facto* control and consideration of potential voting rights will not be eliminated. However, the FASB has tentatively decided to amend its principal/agent guidance for variable interest entities (VIEs) and its guidance on kick-out rights for voting interest entities.
- ▶ The Boards plan to issue EDs with largely converged proposals related to the definition of an investment company and the measurement requirements for its investments (i.e., fair value).
- ▶ The IFRS on consolidation would be effective for annual periods beginning on or after 1 January 2013.

What's next

- ▶ The IASB plans to issue a new standard that will replace portions of its current standards on consolidation in Q1 2011.
- ▶ The IASB also expects to issue another new standard that will include disclosure requirements about subsidiaries, joint arrangements, associates as well as unconsolidated structured entities in Q1 2011.
- ▶ The FASB plans to propose amendments to the principal/agent guidance in Q1 2011.
- ▶ The Boards plan to issue their proposals for investment companies in Q2 2011.

Other joint projects

Presentation of other comprehensive income



Background

The goal is to make the components of other comprehensive income more transparent and make IFRS and US GAAP more comparable.

Key developments to date

- ▶ Preparers reporting under IFRS would continue to be permitted to present net income and other comprehensive income either in a single continuous statement or in two separate statements. The option in US GAAP to present other comprehensive income in the statement of changes in stockholders' equity would be eliminated.
- ▶ Reclassification adjustments would be required to be presented separately on the statement of comprehensive income.
- ▶ Items of other comprehensive income subject to reclassification to profit or loss in the future would be presented separately from items that will never be reclassified.
- ▶ There is no change to how earnings per share is calculated or reported.

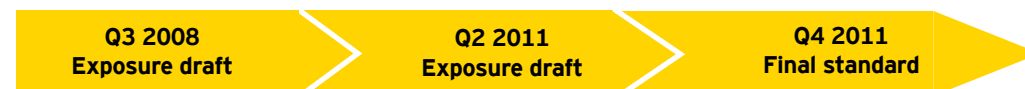
What's next

A final standard is expected in March 2011.

References

- ▶ [Supplement to IFRS Outlook Issue 74: Proposed changes to the presentation of other comprehensive income \(May 2010\)](#)

Reporting discontinued operations



Background

The Boards plan to align their definition of discontinued operations and related disclosures.

Key developments to date

- ▶ Discontinued operations would continue to be presented in a separate section on the face of an entity's financial statements.
- ▶ A discontinued operation would be defined as a component that has either been disposed of, or is classified as held for sale, and meets any one of the following criteria:
 - ▶ Represents a separate major line of business or major geographical area of operations
 - ▶ Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations
 - ▶ Is a business that meets the criteria to be classified as held for sale on acquisition
- ▶ Disclosures about continuing involvement in the discontinued operation after the disposal date would be required.

What's next

The Boards will re-expose the proposals.

Other joint projects continued

Emissions trading schemes

Background

The Boards have acknowledged this area as increasingly important, as more countries adopt allocation and trading systems to control emissions.

What's next

The Boards will continue discussions after June 2011.

Financial instruments with characteristics of equity

Background

The project to distinguish equity instruments from those that are assets or liabilities responds to criticism of both IFRS and US GAAP requirements. The existing guidance is complex and inconsistent.

What's next

The Boards will continue discussions after June 2011.

Financial statement presentation

Background

The proposed model would significantly change the way that entities present their statements of financial position, comprehensive income and cash flows. It would also require more disaggregation of information within the primary financial statements.

What's next

The Boards will continue discussions after June 2011.

References

- ▶ [Supplement to IFRS Outlook Issue 78: IASB staff draft of new presentation model for financial statements \(July 2010\)](#)

Joint Project Timeline

		2010		Q1 2011	Q2 2011	Q3 2011	Q4 2011
Statement of comprehensive income	Joint	ED		Final			
Fair value measurement	Joint	ED ¹		Final ²			
Financial Instruments	IASB	ED ⁵	Final ⁶	SD ³	Final		
	FASB	ED	RT	SD/DP ³	Final ⁴		
Balance sheet offsetting	Joint			ED	Final		
Revenue recognition	Joint	ED	RT		Final		
Leases	Joint	ED	RT		Final		
Consolidation	Joint ⁷				ED		
	IASB	Staff Draft		Final			
	FASB	RT		ED ⁸		Final ⁸	
Financial statement presentation	Joint	Staff draft					
Reporting discontinued operations	Joint				ED		Final
Financial instruments with characteristics of equity	Joint ⁹						
Insurance contracts	IASB	ED	RT		Final		
	FASB	DP	RT				
Emissions trading schemes	Joint ⁹						
Effective dates and transition	Joint	DP/RV ¹⁰					

ED - Exposure Draft RT - Roundtable SD - Supplementary document DP - Discussion paper RV - Request for views

1 The FASB's ED includes various amendments and implementation guidance to achieve convergence. The IASB re-exposed one new disclosure requirement.

2 The disclosures related to measurement uncertainty will be finalised separately from the main project.

3 The Boards issued a Supplementary Document on impairment in January 2011. The FASB issued a discussion paper requesting input on the IASB's hedging proposal.

4 The FASB's deliberations on proposed hedging requirements will begin in Q2 2011. The FASB indicated that a final standard including the credit impairment model will be issued in 2011.

5 IASB ED related to the hedging portion of its project.

6 IASB's final IFRS on classification and measurement for liabilities.

7 IASB and FASB project related only to consolidation by investment companies.

8 FASB amendments to principal-agent guidance.

9 The Boards will continue discussions after June 2011.

10 FASB discussion paper and IASB request for views.

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