

IFRS Outlook

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When should proposed new IFRS standards be applied?

The IASB and the US FASB are planning to issue a number of new standards by June 2011, covering major areas of accounting including financial instruments, revenue and leases. The impact of these proposals gives rise to the questions of when and how the new standards should be applied. Read about your opportunity to tell the Boards your views on these questions and other related issues.

Our views on the revenue recognition proposals

The recent proposals to change how and when revenue is recognised under both IFRS and US GAAP are likely to have significant consequences for some entities. Read about our views on the proposals.

IFRS monthly update

Find out what's new this month from the IASB and which projects the Board is currently discussing.

Resources

Look here for a list of our recent IFRS publications including Good Mining (International) Limited 31 December 2010 - an illustrative set for financial statements for a fictitious mining company. You may also register for our upcoming webcast on developments in financial instruments.

We welcome your feedback on *IFRS Outlook*. Please contact us at ifrs@ey.com. The next issue will be published in December 2010.

Ruth Picker
Global Leader of IFRS Services

When should proposed new IFRS standards be applied?



The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (collectively the Boards) are planning to issue a number of new standards by June 2011. These projects cover major areas of accounting including financial instruments, revenue recognition and lease accounting and will impact virtually every entity applying IFRS or US GAAP. The impact these changes are likely to bring gives rise to two questions – when should the new standards be applied, and how should entities make the transition?

How the request for views developed

For some years, the Boards have been working on the projects agreed in the Memorandum of Understanding (MoU). In June 2010, the Boards further revised their MoU work plan to reprioritise some projects and have since focused their efforts on key priorities. These include financial instruments, revenue, leases and insurance contracts. The Boards expect to issue standards on these projects by June 2011.

On 19 October 2010, the Boards issued requests for stakeholder input on how the pace and cost of these anticipated changes can best be managed. The Boards are keen to understand the likely overall impact not only on preparers, but also on investors, auditors and regulators. In addition the outreach work as part of the individual projects will also consider the effective date and transition method. Once all of this information has been compiled, the Boards will develop an implementation plan that works for the financial reporting system as a whole and considers the needs of all stakeholders.

In this article, we focus on the request for views paper issued by the IASB. The key differences between the IASB's paper and that of the FASB, are that the IASB considers the impact on first-time adopters of IFRS, whereas the FASB considers the impact of private company reporting in the US.

“Collectively, the standards that are expected to result from these projects will impact almost every entity.”

Table 1 - Standards expected to be issued by June 2011

Project	Status of exposure drafts (ED)
Fair value measurement	EDs published May 2009 and June 2010
Financial instruments (IFRS 9)	Phase 1 (classification and measurement) – completed November 2010 Phase 2 (Impairment) – ED published November 2009 Phase 3 (Hedging) – ED due by end of 2010
Revenue from contracts with customers	ED published June 2010
Insurance contracts	ED published July 2010
Leases	ED published August 2010
Post employment benefits - proposed amendments to IAS 19	ED published April 2010
Presentation of items of other comprehensive income	ED published May 2010

Projects under consideration by the IASB

The IASB paper addresses the projects, listed in Table 1, which are expected to be finalised by June 2011.

The IASB's work plan for IFRS also indicates that new standards on *Consolidation* and *Joint Arrangements* are to be issued by the end of 2010. The transition methods and effective dates of these standards will be separately considered by the IASB. However, the request for views paper also includes consideration of these standards allowing stakeholders to give their views on the effective dates and transition methods.

Collectively, all these standards, when finalised, are expected to impact almost every entity. However, the extent to which each individual entity is impacted is likely to be very different. This will be dependant on the nature of an entity's business.

Request for views items

The IASB poses a number of questions for stakeholders in the request for views paper, which cover the following areas:

- 1. Preparing for transition** – what will be involved, what are the likely costs?
- 2. Effective dates** – should all the standards be adopted at the same time or across a number of years?
- 3. International convergence** – should the IASB and the FASB have the same effective dates?
- 4. First-time adoption** – should the IASB permit different adoption dates for first-time adopters?

The feedback that the IASB receives will help to determine the

implementation plan. Therefore, it is critical that the IASB hears from all different stakeholders including preparers, auditors, regulators, investors and other users of financial statements. Different stakeholders are likely to have different views on how the standards should best be adopted and so we strongly encourage all interested parties to respond.

1. Preparing for transition

The IASB is seeking information on which of the expected standards resulting from the projects (shown in Table 1) are likely to require more time to understand the new requirements, train staff, plan for and otherwise adapt to the changes as well as the types of costs that are likely to be incurred. Although this may primarily affect preparers (as they will have to implement the standards), auditors, regulators and investors will also need time to educate themselves on the impacts of the changes.

The extent of preparation required will vary for different entities. For example, those in the financial services and insurance industries are likely to see major impacts from IFRS 9 and the new insurance contracts standard. However, entities in industries that do not have significant financial instruments or leasing contracts may find the changes more straight forward to implement.

The IASB is also asking constituents whether they agree with the proposed methods of transition for each project.

When should proposed new IFRS standards be applied? *continued*

2. Effective dates for the new requirements

With so many new standards planned for issue, the IASB is looking at whether they should adopt a 'big bang' approach (that is, all the new standards become effective on the same date) or a sequential approach (where different standards would become effective at different dates). Stakeholders need to consider the likely costs and the advantages and disadvantages of each approach. Whichever approach is preferred, stakeholders also need to consider when the standards should be required to become effective.

In addition to the effective date, the paper raises the question of whether early adoption of some or all of the standards should be permitted. Whilst allowing a range of adoption dates may reduce comparability across entities, it is likely to provide the most flexible approach to adoption.

3. International convergence

Most of the projects listed in Table 1 are joint projects with the FASB that are either MoU projects or were prioritised in response to the financial crisis. Therefore, both Boards are keen to understand constituents' views of the importance of aligning the effective dates and transition methods for the equivalent standards under IFRS and US GAAP.

4. First-time adoption

A number of jurisdictions have committed to adopting IFRS in the coming years, or are considering a future date of adoption. If the adoption dates of the proposed standards are different from the date of applying IFRS for the first time, this may mean entities in these jurisdictions will be subject to multiple significant accounting changes in the years proceeding adoption. Consequently, the IASB is asking constituents for their views on the impact on first-time adopters and whether there should be any additional considerations.

Next steps

Due to the far reaching consequences of some of the new standards expected in 2011, all stakeholders should consider how the process and timing of adoption can be best managed. Comments are due to the IASB by 31 January 2011.

Our views on the revenue recognition proposals

The current proposals to change how and when revenue is recognised under both IFRS and US GAAP are likely to have far reaching consequences for some entities. In this article we highlight our views of the proposals, as expressed in our recently submitted comment letter to the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (collectively, the Boards).

The Revenue project

The Boards have been working on their projects to improve the existing standards for revenue for a number of years. Revenue is now one of the key projects in the Memorandum of Understanding (MoU) between the Boards to achieve convergence between IFRS and US GAAP. In June 2010, the Boards issued their joint exposure draft (ED) *Revenue from Contracts with Customers*. The comment letter period ended on 22 October 2010 and the Boards have received more than 900 comment letters on the proposals.

The ED proposes a single model for all revenue transactions arising from contracts with customers. Revenue is recognised upon transfer of control over the goods or services to the customer, rather than upon transfer of risk and rewards. The accounting for some transactions is not likely to change significantly, although it is likely that all entities will be affected to some extent by the proposals. However, in other cases, such as long-term construction contracts, the proposals, may fundamentally change the timing and measurement of revenue recognition.

The model is based on a five step approach:

1. Identifying the contract with the customer
2. Identifying separate performance obligations
3. Identifying the transaction price
4. Allocating the transaction price to the separate performance obligations
5. Recognising revenue when satisfying each performance obligation

What is our view?

We fully support the intention of the Boards to develop a converged revenue recognition standard including the principle of recognising revenue when the entity has satisfied individual performance obligation to its customers. We also support the five-step approach outlined in the ED as we believe it will help entities to apply the principle in practice.

The Boards have engaged in significant outreach activities and we commend the Boards for their efforts. However, we believe that further field testing is needed to ensure that the model is operational and the accompanying application guidance supports different types of revenue across industries and provides decision-useful information for users of financial statements. To allow for further outreach and field testing across industries and jurisdictions, we have asked the Boards to reconsider the timeline (the final standard is scheduled to be finalised in June 2011) for the project. Constituents need more time to consider the proposals and test them on different types of revenue transactions in our view.

Our views on the revenue recognition proposals *continued*

Where does the model need more consideration?

In our comment letter, we raised a number of significant issues and expressed our concerns on key elements of the proposals that the Boards need to resolve. We explore some of those issues in more detail here.

Control model

The ED proposes a single model for all types of revenue arising from contracts with customers (i.e., contracts for goods, services, licences, fees, etc.). The model is based on transfer of control, which is defined as “when the customer has the ability to direct the use of, and receive the benefits from, the good or service”. Whilst applying this may be straightforward for the supply of goods, we believe further clarity is needed on how to apply this principle to services and long-term construction contracts.

For example, consider a construction company that builds an office tower on land that is not owned but is leased by the customer under a 99-year lease. In this scenario, if legal ownership over the partially constructed asset does not transfer to the customer as the construction progresses, we believe it is difficult to argue that control over the asset, as it is constructed, is transferred to the customer before the building is completed. Consequently, revenue would be recognised when the contract is completed. We do not believe that application of a pure control model in such a situation provides decision-useful information. The Boards have addressed this to some extent by introducing the concept of ‘continuous transfer of control’. However, it is not clear under what circumstances continuous transfer can be demonstrated. Box 1 shows four indicators given in the ED to help determine whether control has transferred to the customer.

Box 1

Indicators that control has transferred to the customer:

1. The customer has an unconditional obligation to pay
2. The customer has legal title
3. The customer has physical possession
4. The design or function of the good or service is customer - specific

None of the indicators listed in Box 1 is determinative of whether control has transferred. All of the indicators need to be assessed based on the facts and circumstances of the contract. We have particular concerns about the fourth criterion as we believe it is difficult to apply. In our comment letter, we urged the Boards to make explicit that continuous transfer of control is an exception to the pure control model and to provide guidance on how and when to apply this exception to provide decision-useful information.



Measurement of revenue

The proposed model requires variable consideration to be included in the transaction price if it can be reasonably estimated. For example, a music studio may enter into a contract with a distributor that entitles the studio to receive additional revenue consideration dependent on the sales volumes of the distributor. Assessing the probable future outcome for such agreements will involve significant estimation and management judgement. We have requested that the Boards engage in further field testing to ensure that preparers can derive these estimates, auditors can gather sufficient evidence to audit them, and users can derive decision-useful information, all at a cost that does not exceed the benefit.

The proposed approach to estimating the variable consideration is to use a probability-weighted outcome approach. We are concerned this may not always result in decision-useful information. For example, consider an entity that may receive an additional CU100 if the product is delivered by a certain date. The entity estimates there is a 30% probability of achieving this deadline (and therefore a 70% probability that no additional consideration will be received). The probability-weighted outcome approach would result in revenue of CU30 being initially measured, even though this outcome will never occur, and it is less than likely any additional consideration will be received at all. We believe this may not be decision-useful and so have suggested to the Boards to reconsider this decision. As an alternative, we have suggested that a best estimate approach, with supplemental disclosures about the inherent uncertainties, may be more feasible.

Allocation of the transaction price to separate performance obligations

The ED proposes that, within a contract, the separate performance obligations must be identified. This issue of multiple element arrangements was not previously addressed under IFRS (similar guidance to the proposed model, however, was provided under US GAAP¹). The model proposes that the transaction price is then allocated to the different performance obligations based on their relative standalone selling price.

Preparers applying US GAAP had been applying a residual method to allocate the transaction price when a standalone selling price could not be determined for all elements in a multiple element arrangement. This option is no longer available under US GAAP and is not permitted under the ED. In our comment letter, we point out that there are likely to be significant practical difficulties for preparers to implement the requirements and to estimate standalone selling prices for all performance obligations.

Further complexity is added when the transaction price of a good differs depending on the bundle of goods supplied or the customer to which it is sold. For example, a telecommunications provider gives away a free handset when the customer enters into a two-year contract, or there is a charge of CU100 for the same handset when the customer selects a pay-as-you-go agreement. The proposals will require entities to track different prices for the same product, which may prove to be onerous for most IT systems. Therefore, we believe the Boards should consider some form of residual method to reduce complexity for such transactions.

Product warranties

The ED proposes that an entity should distinguish between two types of product warranty:

- ▶ A warranty that provides a customer with coverage for latent defects in the product (this does not give rise to a separate performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract).
- ▶ A warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer (this gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract).

While we understand the principle of deferring revenue related to warranties that have not expired, we question the benefit of distinguishing between two types of warranty and applying different recognition and measurement criteria to each of the types. Many entities offer both types of warranty within one contract and we have concerns about an entity's ability to distinguish between quality assurance and insurance warranties, and the cost of doing so.

¹ ASC 605-25, after reflecting the effects of the ASU 2009-13, previously EITF 00-21

Our views on the revenue recognition proposals *continued*

Effective date and transition

The ED proposes full retrospective application of the requirements when the standards is first applied. Although this may enhance comparability, we are concerned that entities that have a number of long-term contracts, for example licensing agreements over several years, will be unable to apply this retrospectively. We have urged the Boards to perform additional outreach activities to assess the practicability of this proposal.

The effective date of the new standard has not yet been determined as the Boards are requesting feedback from constituents separately on the issue of when to apply a number of new standards expected to be issued in 2011. The article on page 2 of this edition of *IFRS Outlook*, 'When should proposed new IFRS standards be applied?' addresses this subject in more detail.

Overall conclusion

We agree that this project is important to convergence and to reducing inconsistencies in practice arising from the number of standards and interpretations currently applied. We support the principle of the joint project and believe the Boards have made good progress in their objective. However, in our view, the model needs significant further work to make it operational, including further field testing. As such, we consider that the timeline for the project should be revisited to allow for this.

The Boards now need to analyse the concerns of the constituents raised in the comment letters and make sure that the model, its implications and practicability are fully understood and operational.

IFRS monthly update

What's new this month?

The following table shows new publications issued by the IASB (the Board).

Projects	Publication	Status
Effective dates and transition	<p>The IASB and the US FASB have issued separate documents seeking input on the effective dates and transition methods for several new standards expected to be issued by June 2011.</p> <p>View the IASB's <i>Request for Views</i> at www.iasb.org.</p> <p>Our first article in this November 2010 edition of <i>IFRS Outlook</i> provides details of the documents issued.</p>	Open for comment until 31 January 2011
Financial instruments	<p><i>Classification and measurement – financial liabilities</i></p> <p>The IASB has issued requirements for accounting for financial liabilities. The requirements will be incorporated in IFRS 9 and complete the classification and measurement phase of the financial instruments project.</p> <p>Further details can be found at www.iasb.org.</p> <p>The Ernst & Young <i>Supplement to IFRS Outlook Issue 89</i> contains details of the requirements and can be downloaded at www.ey.com/ifrs.</p>	Effective for annual periods beginning on or after 1 January 2013 (early adoption permitted)

Current discussions

The IASB held meetings from 19 to 22 October 2010 and on 27 October 2010. Some of these meetings were held jointly with the FASB.

Tentative decisions were made on a number of projects including hedge accounting, fair value measurement and post-employment benefits. The Board also tentatively decided that, due to a shortage of resources, exposure drafts on financial statement presentation and financial instruments with characteristics of equity will not be issued in the near term. The Boards will return to these projects when they have available capacity, which is not expected to be before June 2011.

IASB work plan

The IASB work plan outlines all of the projects the Board is currently working on, and includes projected publication dates. Further details of all the ongoing projects can also be accessed at www.iasb.org/current+projects.

SEC issues progress report on IFRS work plan

The Securities and Exchange Commission's (SEC) staff has issued its first progress report on its work plan related to the possible move to a set of global accounting standards. The purpose of the work plan is to help the SEC make a well-informed decision about whether, when and how IFRS should be incorporated into the US financial reporting system. The SEC expects to make a decision in 2011 upon successful completion of its work plan and the convergence projects of the FASB and the IASB. The staff will continue to report periodically on the status of the work plan in 2011.

Further information can be obtained from the SEC website at www.sec.gov/news/press/2010/2010-207.

Resources

The publications below are all available at www.ey.com/ifrs.

Refining IFRS – IASB extractive activities project – the responses are in ...

In 2004, the IASB set up an international project team to undertake a detailed assessment of the accounting for extractive activities. The project team's findings and recommendations were presented in the staff Discussion Paper - *Extractive Activities* (DP), in April 2010, prior to the IASB making any decisions on the standard. Preparers, users and regulators were subsequently invited to comment on the DP. This publication provides a high-level overview of the responses to the DP, focusing on key themes, trends and issues raised, and some insights from Ernst & Young.

Please note: as this publication impacts both the Mining and Metals and Oil and Gas sectors, each sector elected to issue the same paper using their individual IFRS newsletters, being: Mining and Metals: *Refining IFRS*; and Oil and Gas: *Exploring IFRS*

IFRS Insurance Accounting Alert November 2010: Insurance Working Group meets to discuss the IASB Insurance Exposure Draft

The IASB Insurance working Group (IWG) meet in London on 11 and 12 November to discuss the exposure draft *Insurance Contracts*. The IASB had released a series of discussion papers ahead of the IWG meeting. The papers, which the IASB prepared together with FASB, outline a series of questions proposed for discussion at the meeting. While these questions are closely aligned to those in the ED, the agenda is deliberately focused on issues where the IASB is still considering a variety of accounting options. This document provides a useful overview of the discussions and should be of interest to clients and technical staff following the insurance project.

Good Mining (International) Limited Illustrative financial statements for the year ended 31 December 2010

This publication contains an illustrative set of consolidated financial statements of Good Mining (International) Limited, a fictitious mining company for the year ended 31 December 2010. These illustrative financial statements have been prepared in accordance with IFRS in issue as at 31 August 2010.

Supplements to IFRS outlook Issues 87 - 89

Issue 87: Proposed amendment to IFRS 1 - Severe hyperinflation

The IASB has published an exposure draft, *Severe Hyperinflation: Proposed amendment to IFRS 1* (ED), which is applicable to entities that have stopped presenting IFRS financial statements after a period when they were unable to comply with IFRS due to their functional currencies being subject to severe hyperinflation. The ED proposes that such entities are treated as first-time adopters and may elect to use the proposed IFRS 1 exemption. The ED is open for comment until 30 November 2010.

Issue 88: IASB and FASB request input on when new standards should become effective

In an effort to assist users and preparers of financial statements by reducing the burden of adopting new financial reporting standards, as well as helping stakeholders to manage both the pace and cost of change, the IASB and the US FASB have published documents seeking views on when new standards should become effective.

Issue 89: IASB completes Phase 1 of IFRS 9 Financial Instruments: Classification and Measurement

In November 2009, the IASB issued the first part of Phase 1 of IFRS 9 dealing with the classification and measurement of financial assets. On 28 October 2010, the IASB issued amendments to IFRS 9 to address financial liabilities. Furthermore, these amendments also incorporate the current derecognition principles of IAS 39 into IFRS 9.



Archived webcast

IFRS 2010 update: implications for real estate

Following our hugely successful IFRS update for real estate webcast in January, Ernst & Young's Global Real Estate group held the second webcast of the year. In response to feedback, the webcast was extended to 1.5 hours and George Yungmann from NAREIT joined a panel of Ernst & Young professionals to share their views and experiences. With year-end reporting upon us, the panel discussed the following topics for the real estate sector:

- ▶ The latest IFRS developments and their implications for the real estate sector, including changes to investment property, revenue recognition and leasing
- ▶ Major convergence projects and the implications for US GAAP
- ▶ What you should anticipate for the reporting season
- ▶ How these new standards and interpretations may affect your business

As well as George, our panel included Ad Buisman, Ernst & Young Accountants LLP, Global Real Estate Assurance and IFRS Leader, Matt Williams, Ernst & Young LLP, Director, Real Estate Assurance and co-author of International GAAP. To listen to this archived webcast, go to www.ey.com/ifrs.

Coming soon

IFRS Thought Center webcast

The webcasts are aimed at CFOs, finance directors, audit committee members and controllers, from both financial and non-financial institutions who take a proactive approach to addressing the impact of new standards and pronouncements under IFRS.

Wednesday, 8 December 2010: Financial instruments: a sea of change

We are offering this global webcast twice in 24 hours to account for global time zones. Please go to www.ey.com/ifrs for details and register for the webcast that best fits your scheduling needs.

Date:	Wednesday, 8 December 2010
Live Broadcast:	9:00 a.m.-10:00 a.m. London, 10:00 a.m.-11:00 a.m. Paris
Replay Date:	Wednesday, 8 December 2010
Time:	11:00 a.m.-12:00 p.m. New York

Join John Smith, a member of the IASB, and our panel of Ernst & Young professionals to discuss the ongoing development of IFRS 9 *Financial Instruments*, which will eventually replace IAS 39 *Financial Instruments: Recognition and Measurement*. The panel will discuss the expected impact of changes to hedge accounting and the latest developments in other aspects of the financial instruments project.

Since our last webcast on this topic in March, there have also been significant developments around the classification and measurement of liabilities, hedge accounting, impairment and derecognition. With the benefit of insights into the IASB's thinking, the panel will discuss how entities should respond to the changes now under consideration.

Our panellists include:

- ▶ John Smith, member of the IASB
- ▶ Tony Clifford, Ernst & Young LLP, Co-Chairman, Ernst & Young IFRS Financial Instruments Working Group
- ▶ Franciane Rays, Ernst & Young et Associés, Ernst & Young representative on the IASB Expert Advisory Panel

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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.

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