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 continue to move forward. The Boards have issued new standards or amendments to existing standards or exposure drafts on several projects and continue to re-deliberate others. We encourage you to actively follow the Boards’ progress and to respond to requests for comment.

This publication provides a snapshot of key developments from an IFRS perspective, 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 are available at www.ey.com/ifrs.

The following sections are based on our observations of the standard-setter meetings. During re-deliberations, the Boards make tentative decisions that may differ from earlier decisions and those in the exposure drafts (EDs).

At this point, the Boards’ decisions and our observations are all subject to change.
Overall project background
The financial instruments project addresses the following: classification and measurement; impairment; hedging; and offsetting. The Boards' overall objective is to simplify, improve and converge the accounting for financial instruments. Except for offsetting, the Boards initially deliberated these topics separately to accommodate different timelines and priorities, resulting in separate proposals. The IASB issued a final standard on classification and measurement (IFRS 9 Financial Instruments) and separate proposals on impairment and hedging, whereas the FASB issued one comprehensive ED. In December 2011, both Boards issued amendments to their respective standards related to the disclosures associated with offsetting; the IASB also issued clarifying amendments to IAS 32 Financial Instruments: Presentation related to offsetting.

Q1 2012
• The Boards discussed elements of the cash flow characteristics test and decided to make minor amendments to the application guidance in IFRS 9. The amendments would clarify that an instrument with modifying features can only be classified as at amortised cost if the difference between the cash flows of such an instrument and the cash flows of a similar instrument without modifying features is not “more than insignificant”.
• The FASB tentatively decided to replace its previous tentative characteristics of the instrument test with the IASB's cash flow characteristics test.

Previous key developments
• IFRS 9 for financial assets was first published in November 2009. It was later updated in October 2010 to include financial liabilities.
• The IASB issued Mandatory Effective Date of IFRS 9 and Transition Disclosures (Amendments to IFRS 9 Financial Instruments and IFRS 7 Financial Instruments: Disclosures), to move the mandatory effective date of both the 2009 and 2010 versions of IFRS 9 from 1 January 2013 to 1 January 2015. The amendments continue to permit early application. The amendments require additional disclosures on transition instead of restating comparative information.
• The IASB reached a tentative decision to consider making limited improvements to IFRS 9. While limiting the scope of the review, the IASB seeks to address the interaction between this standard's classification and measurement model and the accounting for insurance contract liabilities. The IASB also seeks to address specific application issues in IFRS 9 and consider possible alignment between IFRS 9 and the FASB's proposed classification and measurement model.

What's next
The Boards will discuss the need and basis for bifurcation of financial assets, the appropriateness of a category for debt instruments measured at fair value through other comprehensive income (FV-OCI) and any related issues. We expect the FASB to fully re-expose the model, most likely in the second half of 2012.
Financial instruments — impairment

### References
- IFRS Practical Matters: Impairment — assessing the impact of the new proposal (March 2012) EYG no. AU1104
- IFRS Developments Issue 21: Impairment — a major step forward in achieving convergence (December 2011) EYG no. AU1056
- IFRS Developments Issue 11: New credit impairment approach takes shape (July 2011) EYG no. AU0913
- IFRS Developments Issue 9: A new approach to credit impairment is in the works (June 2011) EYG no. AU0895

### Background
The Boards initially proposed different impairment models, but are now developing a joint approach to credit impairment based on variations of their previous proposals. Under the joint approach, financial assets that are debt instruments would be split into three buckets, based on their underlying credit risk characteristics and the unit of evaluation.

### Previous key developments
- The three-bucket approach is intended to reflect the general pattern of the deterioration in the credit quality of financial assets.
  - All financial assets (except for purchased assets with an explicit expectation of credit losses at acquisition) would initially be included in Bucket 1, regardless of credit quality. The allowance for financial assets in Bucket 1 would capture losses expected in the next 12 months (e.g., the 12-month probability of default multiplied by the loss given default). The expected losses refer to shortfalls in all cash flows related to loss events expected over the next 12 months, not simply the cash shortfalls expected in the next 12 months.
  - Assets would move into Bucket 2 or 3 when: (1) there has been a “more than insignificant” deterioration in credit quality; and (2) the likelihood of default is such that it is at least “reasonably possible” that the contractual cash flows may not be recoverable.
  - For items in Buckets 2 or 3, the allowance would capture lifetime expected losses, but the unit of evaluation would differ. Financial assets evaluated on a group basis would be in Bucket 2, while items evaluated on an individual basis would be in Bucket 3.
  - Measurement of impairment would be based on expected losses rather than incurred losses. Entities would use the best available and supportable information at the date of estimation (historical, current and forecast).

### Q1 2012
- Financial assets that were initially classified in Bucket 1 (i.e., all originated loans and purchased financial assets with no explicit evidence of credit deterioration) and have been transferred to Bucket 2 or 3 would move back into Bucket 1 if the criteria requiring transfer out of Bucket 1 are no longer satisfied.
- Purchased financial assets with explicit evidence of credit deterioration would follow a modified three-bucket approach. These assets would be captured in Bucket 2 or 3 without an initial impairment loss and are not eligible to move into Bucket 1, regardless of any credit improvement. The purchase price would accrete to the expected cash flows using the credit adjusted effective interest rate at the time of purchase. Favourable and unfavourable changes in expected cash flows would be recognised immediately in profit and loss as adjustments to impairment expense.
- For trade receivables with a significant financing component, entities could make a policy choice to either: (1) fully apply the three-bucket model; or (2) use a simpler approach that would require initial and subsequent classification of the receivables in Bucket 2 or 3.

### What’s next
The Boards will consider how to apply the approach to lease receivables, loan commitments and trade receivables that do not have a significant financing component. The Boards will also discuss appropriate methods for estimating expected values, the definition of purchased credit impaired assets, and presentation and disclosure requirements. The Boards plan to expose this approach in the second half of 2012.
**Financial instruments continued**

**Financial instruments – hedge accounting**

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**Previous key developments**
- When hedging a credit exposure using a credit derivative, an entity could, at any time, elect to account for the loan or loan commitment (i.e., the hedged item) at fair value through profit or loss. The difference between the fair value and the carrying amount when the election is made would be recognised in profit or loss immediately.
- The IASB identified two specific areas for which they proposed that a retrospective application would either be required (when accounting for the time value of options) or permitted (when accounting for the forward points of a forward contract).
- For hedging relationships with frequent de-designation and re-designation, the disclosure of the terms and conditions of the hedging instruments would not be required. Instead, the risk management approach must be described in more detail.
- In a change to the ED, the IASB would permit the forward points of a foreign exchange forward contract (i.e., the forward premium or discount compared to the spot rate) that exist at the inception of a hedging relationship to be recognised in profit or loss over time on a rational basis. The subsequent changes in the fair value of the forward contract would be recorded in other comprehensive income (OCI).
- In another change to the ED, for a cash flow hedge of the foreign currency risk of a net position, the offsetting items in the hedged net position would not be required to affect the profit or loss in the same reporting period. However, the initial hedge documentation would need to describe how such items (within the net position) will affect profit or loss.
- Hedge accounting would be permitted for equity investments measured at fair value through OCI. However, hedge accounting would not be allowed for other exposures that affect OCI, such as defined benefit obligations.
- In a change to the ED, the current accounting for fair value hedges would continue to apply.
- 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 reliably measured.
- There would be no bright line tests for hedge effectiveness assessments. A prospective hedge effectiveness test would be required based on the quantity of the hedged item that an entity actually hedges and the quantity of the hedging instrument that is actually being used to hedge that quantity of the hedged item. In addition, there must be an economic relationship between the hedged item and the hedging instrument, and the effect of credit risk must not dominate the changes in value that result from that relationship.
- The IASB decided that, after the inception of a hedging relationship, rebalancing would be required when an entity adjusts the quantities of the hedging instrument, or the hedged item in response to changes in circumstances that affect the hedge ratio.
- The IASB affirmed the ED’s proposal that a hedge relationship may be discontinued only when it no longer meets the qualifying criteria. Voluntary discontinuation would be prohibited if the risk management objective remains unchanged.

**Background**
Although the hedge accounting project is intended to be a joint project, each of the Boards has issued separate EDs. The IASB’s proposed hedging model is designed to align the accounting for hedging activities more closely with risk management practices and to simplify certain aspects of hedge accounting. The FASB’s proposal would simplify hedge accounting while leaving the basic framework intact, including what constitutes eligible hedge relationships.

**References**
- IFRS Outlook: Hedge accounting moves closer to risk management practices (January 2012)
- IFRS Developments Issue 16: Hedge accounting – summary of redeliberations (September 2011) EYG no. AU0965
- IFRS Developments Issue 14: A step forward in hedge accounting (August 2011) EYG no. AU0926
- Hedge accounting under IFRS – a closer look at the changes and challenges (February 2011) EYG no. AU0765

**What’s next**
- The IASB finished its re-deliberations on general hedge accounting in September 2011, no new developments occurred in Q1 2012. The IASB expects to make a draft of the final standard available on its website in the second quarter of 2012. It will be available on the website for about 90 days. The final standard is expected in the second half of 2012.
- The IASB is developing proposals on macro hedge accounting and intends to issue a separate ED in the second half of 2012.
Revenue recognition

Q1 2012
- The comment period on the Boards’ revised joint revenue recognition proposal ended on 13 March 2012. Over 300 comment letters were submitted. The Boards engaged in extensive industry outreach efforts during the comment period.

Previous key developments
- The proposal would apply to most contracts with customers. Leases, insurance contracts, financial instruments, guarantees and certain non-monetary transactions would be excluded from the scope.
- Certain aspects of the proposal would result in a significant change from current practice, including:
  - An entity would account for promised goods or services separately if they are “distinct”. The determination of distinct would include the consideration of both the individual goods and services promised as well as how those goods and services are bundled in the arrangement. An entity would account for a bundle of goods and services as one performance obligation if the goods and services are highly interrelated and to transfer them would require significant integration and modification by the entity.
  - Variable consideration would be estimated based on a probability weighting or the amount most likely to be received, whichever best predicts the amount to be received. Variable consideration would be allocated to performance obligations, but the entity would recognise as revenue only the amounts to which it is reasonably assured to be entitled.
  - A performance obligation would be satisfied continuously if: (1) the entity’s performance creates or enhances an asset that the customer controls as the asset is being created; or (2) the entity’s performance does not create an asset with alternative use to the entity and certain criteria are met.
- The scope of the onerous performance obligation test would be limited to performance obligations satisfied over a period greater than one year (determined at contract inception). Any loss and corresponding liability would be measured using the lesser of the cost to fully satisfy the performance obligation or the cost to exit the contract.
- Allowances for uncollectible amounts would be presented as a separate line item adjacent to revenue in the statement of comprehensive income. Changes in estimated or actual collections would be recognised in the same line item adjacent to revenue.
- For contracts longer than one year, an entity would recognise the incremental costs of obtaining a contract as an asset (capitalisation would be permitted, but not required, for contracts with a duration of less than one year). The costs incurred in fulfilling a contract (e.g., set-up costs) would also be capitalised. Such costs would be recognised in the statement of comprehensive income consistent with the pattern of transfer of the related good or service.
- All entities would apply the standard retrospectively, although some practical relief from full retrospective application would be permitted with appropriate disclosures. A final standard would not be expected to be effective before 1 January 2015.

What’s next
The Boards will continue outreach efforts in roundtable meetings in April and May 2012. Re-deliberations are expected to begin in June 2012.

Background
The Boards want to develop 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, while US GAAP has been criticised for complexity in the revenue recognition area. Under the joint proposal exposed by the Boards in November 2011, revenue would be recognised when an entity satisfies its obligations to customers, which occurs when control of the good or service is transferred to the customer.

References
- IFRS Outlook: More work needed on revenue recognition (March 2012) EYG no. AU1139
- Applying IFRS: Revenue from contracts with customers – the revised proposal (January 2012) EYG no. AU1074
- IFRS Practical Matters: Revenue recognition project: Round 2 for the exposure draft (January 2012) EYG no. AU1087
- IFRS Developments – Issue 18: IASB and FASB issue revised revenue recognition proposal (November 2011) EYG no. AU1008
- A number of sector-specific Applying IFRS publications on this project are also available on www.ey.com/ifrs.
Q1 2012

- In response to concerns raised by constituents, the Boards began considering ways to mitigate the “front loading” of expense recognition for some leases.

Previous key developments

- The Boards decided that they will re-expose the standard because they made significant changes to the model proposed in 2010.
- The Boards clarified the key concepts underlying the definition of a lease to align control concepts with other standards. These changes could scope out certain contracts that are currently accounted for as leases.
- Lessees would be required recognise all leases (other than short-term leases) on the balance sheet.
- For leases other than leases of investment property and short-term leases, lessors would recognise a lease receivable, a residual asset and any profit or loss at the commencement of each lease. Over the term of the lease, the lessor would recognise income related to interest on the receivable and accretion of the residual asset.
- Lessors of investment property would account for those leases as operating leases.
- Both lessees and lessors would be allowed to apply current operating lease accounting to short-term leases.
- The lease term for accounting purposes would 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).
- Variable lease payments based on performance or usage would not be included in the amounts recognised on the balance sheet. Instead, they would be recognised as expense or income when they are incurred or accrued.
- Reassessment of certain key considerations (e.g., lease term, variable lease payments that depend on an index or rate) would be required throughout the life of the lease. The reassessment requirements would vary, as would the offset recorded when the liability to make lease payments or lease receivables is adjusted.
- All non-lease components (including services and executory costs) of contracts containing both lease and non-lease components would be separated from the lease components, except in limited circumstances.
- No unique criteria would exist for sale-leasebacks. The determination of whether sale-leaseback transactions are accounted for as a sale and a lease, or as a financing transaction, would be based on the revenue recognition standard.
- In transition, lessees and lessors could follow either a full retrospective approach or a modified retrospective approach (i.e., an approach that allows certain types of relief that the Boards designed to reduce transition costs).

References

- IFRS Developments Issue 25: Boards weighing effects of putting leases on the balance sheet (March 2012) EYG no. AU1106
- IFRS Development Issue 17: Operating lease accounting survives for some real estate lessors (October 2011) EYG no. AU0982
- IFRS Practical Matters: Lease accounting proposals – simplified, but not simple (August 2011) EYG no. AU0930
- Applying IFRS: Lessee model comes together as leases project progresses (July 2011) EYG no. AU0905

What’s next

The Boards will perform outreach and research on alternative methods to determine the pattern of lessee expense recognition and consider making changes to the lessor model to achieve consistency with the lessee model.
Insurance contracts

Q1 2012
- The Boards agreed to eligibility criteria for the premium allocation approach (PAA). If the criteria are met, the IASB would permit the use of the PAA and the FASB would require it.
- The IASB reaffirmed that direct acquisition costs associated with both successful and unsuccessful efforts would be included; the FASB would continue to include only direct acquisition costs that relate to successful efforts. The Boards agreed that, for contracts with a coverage period of one year or less, all acquisition costs may be expensed as incurred.
- Cash flow estimates for the building-block approach and onerous contracts test under the PAA should be updated for infrequent, high-severity events as of the balance sheet date.
- The IASB would include investment contracts with discretionary participation features written by insurers in the scope of its proposal. The FASB would not include investment contracts with discretionary participation features.

Previous key developments
- The standard would not prescribe a particular method for determining the discount rate (e.g., top-down or bottom-up approach), but the rate would reflect the characteristics of the liability. The discount rate would be a current rate that is updated each reporting period. The objective of the discount rate is the same for non-participating and participating contracts. However, to the extent that cash-flows depend (wholly or partly) on the performance of specific assets, the insurers would adjust these cash flows using a discount rate that reflects that dependence.
- The IASB decided that the measurement model would contain an explicit risk adjustment and residual margin, while the FASB decided that the measurement of an insurance contract liability would include a single margin. The Boards will evaluate how differences in their approaches might be addressed through disclosures.
- The IASB decided that the residual margin would be adjusted (i.e., unlocked) on a prospective basis for favourable and unfavourable changes in estimates of cash flows and that the margin would be amortised over the coverage period.
- The objective of the risk adjustment in the IASB model is to determine the compensation an insurer requires for bearing the risk that the ultimate cash flows will exceed those expected. In a change from the ED, the IASB decided not to restrict the use of different techniques for estimating the risk adjustment. However, the IASB decided to retain the proposed disclosure of the confidence level equivalent in those estimations.
- The IASB decided not to specify further guidance on the unit of account for the risk adjustment, but instead, reiterated that the risk adjustment would be determined in a manner that achieves the overall objective of that adjustment.
- Under the PAA, an insurance contract would be onerous if the expected present value of the future cash outflows from that contract (plus, for the IASB, the risk adjustment) exceeds the expected present value of the future cash inflows in the pre-coverage period or the carrying amount of the liability for the remaining coverage.
- Fulfilment cash flows relating to policyholder participation features should be measured on the same basis as the underlying items in which the policyholder participates.
- Fixed-fee service contracts would be excluded from the insurance contracts model when certain criteria are met.
- The Boards continue to believe that certain portions of insurance contracts should be separated.

What's next
The IASB plans to continue re-deliberating jointly with the FASB over the next several months. The FASB plans to issue an exposure draft in the second half of 2012. The IASB will issue either a review draft or exposure draft.

References
- Insurance Accounting Alert: Boards make decisions on the premium allocation approach (March 2012)
- EYG no. AU1113
- Applying IFRS in insurance: Limited improvements to IFRS classification and measurement – the impact for insurers and next steps (March 2012) EYG no. AU1101
- IFRS Developments for Insurers: Boards debate premium allocation approach (February 2012) EYG no. AU1092
- Insurance Accounting Alert: Boards discuss onerous contract testing and measurement of options and guarantees (December 2011) EYG no. AU1061
- Insurance Accounting Alert: IASB decides to consider limited improvement to IFRS 9: Boards discuss unbundling (November 2011) EYG no. AU1022
- Insurance Accounting Alert: Boards discuss fixed-fee service contracts (October 2011) EYG no. 1006
- Discount rates: one size does not fit all (September 2011) EYG no. AU0970

Joint Project Watch IASB/FASB joint projects from an IFRS perspective — March 2012
Consolidation

Overall project background
The IASB issued IFRS 10 Consolidated Financial Statements, which establishes a single control model applicable to all entities. IFRS 10 results in substantial convergence with the US GAAP on consolidation of variable interest entities and related disclosures. After hearing from constituents, the FASB decided not to move to a single control model for all entities. Instead, the FASB decided to make targeted revisions to the two consolidation models in US GAAP in order to more closely align the models with IFRS. In the second half of 2011, the Boards issued proposals to define an investment entity and to provide an exception to consolidation.

Consolidation - Investment entities

Background
The Boards issued proposals to define an investment entity and to provide accounting guidance for its investments. The concept of an investment entity is new to IFRS. The FASB also has a separate proposal to define an investment property entity (a new term) and how it accounts for investments.

Q1 2012
- The comment period for the IASB’s proposal on investment entities ended on 5 January 2012.
- The FASB and the IASB held joint roundtables in February and March 2012 to discuss their proposals.

Previous key developments
- In October 2011, the FASB issued an ED with largely converged proposals related to the definition of an investment entity and the measurement requirements for its investments (i.e., fair value). However, the Boards diverged on whether an investment entity’s fair value accounting would be retained by a non-investment entity parent. The FASB favours retention of fair value accounting by a non-investment entity parent, whereas the IASB proposals would require the non-investment entity parent to consolidate the investment entity and its underlying investments.

References
- IFRS Developments Issue 15: Proposal for investment entities to measure investments at fair value (August 2011) EYG no. AU0939.

What’s next
The Boards plan to consider the feedback they received at the roundtable sessions and through other outreach efforts during their re-deliberations.

Joint Project Watch IASB/FASB joint projects from an IFRS perspective – March 2012
Joint projects completed in 2011

**Financial instruments – balance sheet offsetting**

*Standards issued in December 2011*

- **IASB**: Amendments to IFRS 7 Financial Instruments: Disclosures and IAS 32 Financial Instruments: Presentation
- **FASB**: ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities

**References**

- IFRS Developments Issue 22: Offsetting of financial instruments (December 2011) EYG no. AU1053

**Presentation of other comprehensive income**

*Standards issued in June 2011 and December 2011*

- **IASB**: Amendments to IAS 1 Presentation of Financial Statements
- **FASB**: ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income
- **FASB**: ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05

**References**

- IFRS Developments Issue 7: Changes to the presentation of other comprehensive income - amendments to IAS 1 (June 2011) EYG no. AU0787

**Fair value measurement**

*Standards issued in May 2011*

- **IASB**: IFRS 13 Fair Value Measurement
- **FASB**: ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs

**References**

- IFRS Developments Issue 2: Fair value measurement guidance converges (May 2011) EYG no. AU0840
Inactive joint projects

**Reporting discontinued operations**

**Background**
The Boards plan to align their definitions of discontinued operations and related disclosures.

**Emissions trading schemes**

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

**Financial instruments with characteristics of equity**

**Background**
The project to distinguish equity instruments from those that are assets or liabilities responds to criticism that the existing IFRS and US GAAP requirements are complex and inconsistent.

**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 above joint projects were reassessed as lower-priority projects. The IASB will consider next steps for these projects as part of its agenda consultation process.
## Joint projects timeline

### 2010 – 2011

(highlights of prior activity)

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**Note:** Timing for some projects is presented based on discussions with staff and may differ from the technical plan on the Boards’ websites.

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1. The IASB’s final IFRS classification and measurement for liabilities. In Q4 2011, the IASB deferred the mandatory effective date of IFRS 9.
2. The IASB’s project is to undertake limited scope changes to IFRS 9.
3. The FASB issued single comprehensive proposal on all three phases of this project. In a February 2011 DP, the FASB sought feedback from its constituents on the IASB’s hedging model.
4. The FASB will, at a minimum, expose the proposed amendments to the Codification, and may decide to fully re-expose the model, most likely in second half of 2012.
5. The FASB is separately considering liquidity and interest rate risk disclosures related to financial instruments and expects to issue an ED in Q2 2012.
6. In 2011, the IASB issued a DP to clarify the transition guidance in IFRS 10. Final amendments are expected in Q2 2012.
7. The FASB deferred certain presentation requirements of ASU 2011-05.
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