Day 1—Wednesday 27 June 2012

**Special Interest Sessions (pre-conference)**

**Registration**

09:00

09:30–12:00 Register for one of:

- Implementing IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Interests in Other Entities*
- Implementing IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*
- Implementing IFRS 13 *Fair Value Measurement*

**Conference Programme**

12:00 **Registration**

Light buffet and refreshments

13:00 **Welcome**

*Ian Mackintosh, Vice-Chairman, IASB*

13:10 **IFRS Foundation update**

*Michel Prada, Chairman of the Trustees, IFRS Foundation*

13:40 **Bank preparer’s perspective**

*Clemens Börsig, former Chairman of the Supervisory Board, Deutsche Bank AG and Trustee, IFRS Foundation*

14:10 **IASB update: progress and plans**

- Update on IASB’s future agenda consultation
- Current agenda projects
- Recently issued standards
- Interpretations and annual improvements
- Post-implementation reviews

*Presenters:*

- *Ian Mackintosh, Vice-Chairman, IASB*
- *Philippe Danjou, Member, IASB*
- *Jan Engström, Member, IASB*
- *Wayne Upton, Chairman, IFRS Interpretations Committee and Director of International Activities, IASB*
- *Alan Teixeira, Senior Director, Technical Activities, IASB*

15:00 Coffee break

15:30 **IASB update: progress and plans (continued)**

(including 15–30 minutes Q&A)

17:15 **Regulator’s perspective**

*Dr Elke König, President, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)*

17:45 Close day

18:00–19:00 **Cocktail reception**
Day 2 — Thursday 28 June 2012

09:00  **Technical update: financial instruments**  
Replacement of IAS 39, including:  
- Effective date  
- Impairment  
- General hedge accounting  
- Macro hedge accounting  
- Asset and liability offsetting  

*Chair: Ian Mackintosh, Vice-Chairman, IASB*  

*Presenters:*  
- Stephen Cooper, Member, IASB  
- Darrel Scott, Member, IASB  
- Sue Lloyd, Senior Director, Technical Activities, IASB  
- Martin Friedhoff, Associate Director, IASB  

11:00  Coffee break  

11:30  **Break-out sessions:**  
*conducted by IASB members and staff*  
*Choose one of the following – the sessions are repeated after lunch so you can attend two sessions:*  

1. **Revenue recognition**  
   - Ian Mackintosh, Vice-Chairman, IASB  
   - Henry Rees, Associate Director, IASB  

2. **Leases: Lessee (Part 1)**  
   - Philippe Danjou, Member, IASB  
   - Patrina Buchanan, Technical Principal, IASB  

3. **Insurance Contracts**  
   - Darrel Scott, Member, IASB  
   - Andrea Pryde, Technical Principal, IASB  

4. **Measurement myths**  
   - Joan Brown, Senior Research Manager, IASB  
   - Wayne Upton, Chairman, IFRS Interpretations Committee and Director of International Activities, IASB  

5. **Conceptual Framework**  
   - Stephen Cooper, Member, IASB  
   - Michael Wells, Director, IFRS Education Initiative, IASB  

13:00  Lunch  

14:00  **Break-out sessions:**  
*conducted by IASB members and staff*  
*Choose one of the following:*  

1. **Revenue recognition (repeated)**  
   - Darrel Scott, Member, IASB  
   - Henry Rees, Associate Director, IASB  

2. **Leases: Lessor (Part 2)**  
   - Philippe Danjou, Member, IASB  
   - Patrina Buchanan, Technical Principal, IASB  

3. **Emissions trading schemes**  
   - Ian Mackintosh, Vice-Chairman, IASB  
   - Allison McManus, Technical Manager, IASB  

4. **Measurement myths (repeated)**  

5. **Conceptual Framework (repeated)**  

15:30  **End of Conference**
Welcome

IAN MACKINTOSH
Vice-Chairman
IASB
IFRS Conference
Wednesday 27th June 2012
Frankfurt Marriott Hotel, Germany

IFRS Foundation update

MICHEL PRADA
Chairman of the Trustees
IFRS Foundation
Michel Prada, Chairman of the IFRS Foundation Trustees

IFRS Foundation conference, Frankfurt

27 June 2012

Thank you Ian for your opening comments and your kind introduction.

Good afternoon, Ladies and Gentlemen.

It’s a great pleasure to participate in this important event here in Frankfurt. I’m happy to have the opportunity to update you on recent and future developments at the IFRS Foundation, six months after I had the honour of being elected Chairman of the Foundation Trustees.

I deliberately use the word ‘honour’ because I am fortunate to be following in the footsteps of some quite remarkable people, among them Paul Volcker and my good friend Tommaso Padoa-Schioppa, who sadly passed away at the end of 2010.

As you may know, the Trustees are responsible for the governance of the organisation and oversight of the IASB. We are, inter alia, responsible for designing the strategy, providing the financing and resourcing of the organisation, and, most importantly, protecting the IASB’s technical independence while ensuring that their standard-setting activity follows an open, inclusive, thorough and robust due process.

Among my fellow Trustees, we have former Finance Ministers, Presidents of Central Banks, business executives, securities commissioners and academics from around the world, all united in our shared commitment to the goals of the Foundation. I am delighted that my friend and fellow Trustee Clemens Börsig will be speaking after I finish.

As a former Chairman of the Autorité des Marchés Financiers (AMF), the French securities regulator, and former Chairman of the Technical Committee of IOSCO, I was myself involved at the inception of the organisation in May 2000, when IOSCO endorsed the core set of International Accounting Standards (IASs) developed by the IASB’s part-time predecessor, the International Accounting Standards Committee. I served on the committee that selected the first set of Trustees, and it is fortuitous, but also extremely rewarding, to return to Chair the current group of Trustees.

**The path towards global standards**

When we set out on the path towards global standards for accounting and financial reporting more than a decade ago, we could not have imagined the level of success achieved in the following 10 years. Back then, no major economies used international accounting standards. In fact, at that time, if you wanted to use an internationally-recognised, high quality accounting standard, the only game in town was US GAAP.
Nonetheless, the globally interconnected nature of financial markets meant that a national approach to financial reporting was no longer considered appropriate.

As Paul Volker, the first Chairman of the Foundation used to say: “international accounting standards are needed but can’t be drafted in Connecticut”.

Investors seeking diversification and growth wanted to compare and contrast investment opportunities on an equal basis. Multinational companies wanted to eliminate the burden of a multitude of local reporting requirements and they sought the freedom to raise capital anywhere in the world. Meanwhile, as securities regulators, we were well aware of the headache of protecting domestic investors when they are investing internationally and have to deal with different and sometimes contradictory standards.

Indeed, several events came together to confirm the relevance of this strategy, to accelerate the work of the IASB and to highlight its importance to the global financial system.

Firstly, after several decades of failed attempts to develop a pan-European set of accounting standards, Europe decided in 2002 to switch tack and instead adopt, from 2005, the fledgling IASs, now known as International Financial Reporting Standards or IFRSs, for the consolidated accounts of listed companies on regulated markets. Overnight, this transformed the IASB from an interesting but somewhat obscure accounting think-tank into Europe’s accounting standard-setter.

Secondly, in the United States a series of accounting scandals challenged the infallibility of US GAAP, which led the US Financial Accounting Standards Board (FASB) to consider its own fundamental reform of its standards. It made perfect sense for the IASB and the FASB, under the Norwalk Agreement of 2002, to reform IFRSs and US GAAP in parallel, and so began a decade of work to improve the respective standards and bring about their convergence.

Thirdly, the rapid growth experienced by emerging economies meant that they too needed high quality, internationally-recognised financial reporting standards. Many of these economies have well-developed capital markets that are home to major multinational companies. Most have the ambition of developing their own global financial centres, and the use of IFRSs is increasingly seen as a prerequisite for such financial centres to exist.

Finally, the global financial crisis that began in 2007 and continues today provided a very clear illustration of the globally connected nature of financial markets and the pressing need for a single set of high quality global accounting standards. That is why repeated G20 communiqués, including the one that was issued at the recent G20 Summit in Los Cabos, have supported the work of the IASB and called for a rapid move towards global accounting standards.
Thanks to the achievements of the last decade, IFRSs are firmly on the path to becoming those global standards.

Today, companies in more than 100 countries are required or permitted to report using IFRSs. From this year, more than two-thirds of G20 members are required to use IFRSs, including, in the last two years, Brazil, Canada, Korea, Mexico and Russia. Almost half of Global Fortune 500 companies now report using IFRSs.

In those remaining economies yet to fully adopt IFRSs, we continue to see substantial progress being made.

I recently visited China and Japan to better understand their own preparations towards adoption of IFRSs.

China has already substantially reformed its own financial reporting standards through what they call “a continuous convergence process”, which they understand as a process for incorporation and the differences between those standards and IFRSs appear now to be very small. China’s commitment to IFRSs is hugely impressive and it is easy to understand why a country with 14 million accountants is going to take some time to complete its full transition to IFRSs. China is also actively involved in the organisation and already provides the secretariat for the IASB’s Emerging Economies Group and I have no doubt that China will play a full role in the future development of IFRSs.

I was also fortunate enough to spend some time in Japan, meeting with all relevant stakeholders.

Once again, there is no doubt in my mind of Japan’s long-term commitment to IFRSs. Japan has continued to support the work of the IFRS Foundation and works in very close co-operation with the IASB throughout the standard-setting process.

Japan already permits the voluntary use of IFRSs for domestic companies. The number of Japanese companies electing to report using IFRSs is expected to increase rapidly over the next few years. Regardless of a formal Japanese decision to transition to IFRSs, once you have the largest, internationally-focused Japanese companies using the standards, then you have de facto adoption of IFRSs.

Later this year I will visit India. The Trustees stand ready to support our Indian colleagues in their own transition to IFRSs.

Also later this year, the IFRS Foundation will open an Asia-Oceania liaison office in Tokyo. This first office outside of London is a clear indication of our desire to support jurisdictions across the Asia-Oceania region in their transition to IFRSs, as well as those economies that have already adopted the standards.
Last, but not least, one of the most anticipated decisions is whether and how the United States will incorporate IFRSs into its own financial reporting regime. The IASB and the FASB have spent 10 years since the Norwalk agreement laying the groundwork for this decision through a dedicated and fruitful effort of convergence. Recognising this work, in 2007, the US Securities and Exchange Commission (SEC) permitted foreign companies with a US listing to report using IFRSs and began to consult on the possibility of also adopting IFRSs for domestic companies. Today, the SEC oversees more than 100 companies listed on US markets that report using IFRSs.

We await with interest the SEC’s final staff report on a pathway towards IFRS adoption and look forward to a positive outcome to the SEC’s deliberations.

This is truly remarkable progress in little over 10 years. During the remainder of the conference you will hear about the many challenges facing the organisation, including the completion of the remaining convergence projects and our work to encourage those remaining jurisdictions to come fully on board. While recognising these challenges, I also ask you to keep in mind this remarkable progress that I have described. Along historical trends, the glass is most definitely more than half-full!

**Becoming the global accounting standard-setter**

So what does the future hold for the IFRS Foundation? How do we consolidate the achievements of the last decade? What steps need to be taken to support the transition from international to truly global financial reporting standards? And in turn, what steps need to be taken for the IASB to become the globally recognised accounting standard-setter?

In 2010 the Trustees, as well as the IFRS Foundation Monitoring Board, to whom the Trustees report, both set out to answer these questions by initiating independent but co-ordinated reviews.

The Monitoring Board brings together public authorities and provides political legitimacy and accountability to our organisation. It set out to address institutional aspects of the governance of the IFRS Foundation, including its own composition and the relationship between the three tiers of the organisation—the IASB, the Trustees and the Monitoring Board—that are today the basis of a well-accepted architecture.

The Trustees began a far-reaching strategy review that looked at the IFRS Foundation’s mission, standard-setting process, governance and financing.

Both the Monitoring Board and Trustees consulted widely, and in February 2012 we jointly published the conclusions of our respective studies.

These opening remarks do not provide sufficient time to describe the 24 pages of the Monitoring Board’s governance review or the 25 pages of the Trustees’ strategy review.
If you are interested in the future direction of financial reporting, I strongly encourage each of you to download these reports from the website, because they map out our respective activities for the coming years.

However, I would like to signpost what I consider to be the three most important conclusions of the Trustees’ strategy review.

First, it was clear from the feedback we received that there are efficiencies to be gained in the way that IFRSs are developed. Over the last few years, the Trustees have overseen a substantial increase in the number of the IASB’s technical staff. At the same time, we have seen a corresponding increase in the depth and breadth of the IASB’s consultation and outreach activities.

However, as the IASB adapts to become the global accounting standard-setter, we must also recognise that no single organisation can do this on its own.

Standard-setting has long been a collaborative exercise. The quality and robustness of many recently developed standards owe a great deal to the many organisations and individuals who offer advice and guidance to the IASB throughout the life cycle of the standard-setting process. Perhaps the best example of this is the interaction between the IASB as an international standard-setter and those national and regional organisations with an interest in accounting standard-setting.

At a national level, the IASB has continued to work in close co-operation with the FASB, the Accounting Standards Board of Japan (ASBJ) and many other national standard-setting bodies, such as those that exist in Europe.

At the same time, we have seen the emergence of other regional bodies with an interest in standard-setting.

Some of these are well-resourced organisations such as the European Financial Reporting Advisory Group (EFRAG), while others are less formal regional groupings such as the Asia-Oceania Standard Setters Group (AOSSG) or the Group of Latin American Standard Setters (GLASS).

Each of these national and regional bodies has a great deal to contribute to the IASB’s standard-setting activities. The Trustees’ strategy review and the completion of the convergence programme with the FASB present an opportunity to give further consideration to the future relationship between the IASB and national and regional bodies.

The Trustees’ strategy review foresees new ways of working with these groups. It calls on the IASB to establish more structured and formal relationships with the standard-setting community around the world and to engage these bodies early in the process of standard-setting. The benefit will be better integration of the global perspective into the standard-setting process and perhaps a reduction in the risk of non-endorsement of a new standard.
The review also describes possible ways to more fully integrate the activities of these organisations into the IASB’s formal standard-setting process. This work, led by Yael Almog, our recently appointed Executive Director, is now in progress and we are starting to discuss its details in the next few months.

Second, the Trustees’ strategy review recognises that the goal of global accounting standards will be illusory if those standards are not endorsed and enforced on a globally consistent basis. That means everyone adopting the same set of standards, and those standards being applied in the same way.

The IASB is not a regulator and does not have enforcement capacities. Neither has it the resources or the expertise to monitor global adherence to the standards. Thankfully, there is an existing organisation, the International Organization of Securities Commissions, or IOSCO, that does and deals with investor protection and quality of financial information.

The IOSCO has recently completed a restructuring of its leadership and operational activities. As a former Chairman of the IOSCO Executive and Technical Committees, this is an organisation that I know well and which can play a leading role in monitoring the implementation of global accounting standards.

We have already begun discussions with IOSCO about how we can deepen our co-operation. Last month, Yael and I travelled to Beijing to attend the annual IOSCO conference, where I had the privilege of joining a panel discussion on international standards. The newly appointed Chairman of the IOSCO Board is Masa Kono, who also serves as Chairman of the IFRS Foundation Monitoring Board. At a technical level, IOSCO’s new policy committee on accounting, auditing and financial reporting is well placed to work in close co-operation with the IASB when considering consistent application of the standards. The IOSCO network is also well placed to provide extremely valuable practical input on how IFRSs are working in different parts of the world, which in turn will benefit the work of the IFRS Interpretations Committee and the IASB’s post-implementation review of major new Standards.

There is a great opportunity to move forward and I have high hopes of a very successful ongoing partnership with IOSCO.

Finally, the Trustees’ strategy review recommended a series of further enhancements to the IASB’s standard-setting process. These enhancements build on the already impressive due process framework and include recommendations on the transparency of the IASB’s agenda-setting process, the development of an agreed methodology for field visits and effect analysis and more rigorous oversight of due process through the Trustees’ Due Process Oversight Committee, or DPOC.

The Trustees have already started to put these recommendations in place. For example, last month we appointed David Loweth, a former Technical Director of the United Kingdom Accounting Standards Board (ASB), to the position of Director for Trustee Activities.
David’s appointment provides the DPOC with its own dedicated resource and further enhances the separation of Trustee oversight from the work of the IASB.

I have described three of the main findings of the strategy review. The Trustees are committed to implementing all of the recommendations of both reviews in full. We have already published for public comment the revised IASB Due Process Handbook and will shortly publish revisions to the IFRS Foundation Constitution.

**Conclusion**

Ladies and gentlemen, in the brief time permitted I am pleased to report that we are continuing to make substantial progress. The IFRS Foundation annual report provides a fuller description of the topics that I have touched upon today.

As a Trustee, I am not supposed to deal with the technicalities, but I am fully aware, like my fellow Trustees, of the difficult questions that the IASB has to deal with and of the quasi philosophical discussions that take place worldwide when designing global standards.

A few days ago Hans Hoogervorst, Chairman of the IASB and also a former securities regulator, delivered a speech in Amsterdam to address this challenge and I encourage you to read this speech on the website. His words remind us of the fundamental objective and of the intrinsic complexity of accounting and financial reporting: to provide those market participants who do not have direct access to basic data with a true and fair representation of the situation and performance of companies that they invest in or deal with.

This is a difficult task that has to deal with the rule of relativity of value and to confront different views and business models.

The governance and strategy reviews build upon a decade of achievement and chart a course for the IFRS Foundation to master these complexities with full transparency and in cooperation with all parties involved, and for the IASB to be recognised as the truly global accounting standard-setter.

The formalisation of the IASB’s relationship with national and regional bodies with an interest in accounting standard-setting will increase the effectiveness of our work. The greater focus on the implementation of our standards, in part through an enhanced relationship with IOSCO and other international organisations, will help us to achieve the goal of truly global accounting standards. In addition, the enhancements to the IASB’s due process will further enhance confidence in the standard-setting process and will in turn improve the robustness of the Standards.

I thank you for your attention, I wish you a very successful conference and I now pass you to my fellow Trustee, Clemens Börsig.
Bank preparer’s perspective

CLEMENS BÖRSIG
Former Chairman of the Supervisory Board
Deutsche Bank AG
and Trustee
IFRS Foundation
Deutsche Bank is a leading global investment bank with a substantial private clients franchise. Its businesses are mutually reinforcing.

- Deutsche Bank AG competes to be the leading global provider of financial solutions, creating lasting value for its clients, shareholders, people and the communities in which it operates.
- We engage in business in more than 70 countries.
- Over 100,000 employees from more than 140 nations are the basis for our success.

Deutsche Bank applies IFRS for Group Financial Statements since 2006.
Journey towards one single global accounting standard

Accounting rules and the financial crisis

- Critics of accounting rules in the financial crisis particularly claimed that:
  - Existing accounting rules did not provide sufficient transparency to anticipate the crisis and respond timely.
  - Accounting rules fuelled the crisis due to
    - their high degree of complexity,
    - the pro-cyclical effects from fair value accounting for financial instruments when markets are distorted, and
    - the delayed recognition of impairments on the basis of the incurred loss model.
Journey towards one single global accounting standard
The political reaction

- Increased public and political pressure to improve existing rules and accelerate work on a single set of high-quality, global standards.

“We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process.”

G20 Pittsburgh Communiqué, 2009

Journey towards one single global accounting standard
Financial Crisis Advisory Group formed

- Financial Crisis Advisory Group (FCAG) considered improvements in financial reporting necessary to restore investor confidence.

FCAG report (2009) concluded:
- Accounting standards were not root cause of the financial crisis.
- Nevertheless:
  Weaknesses in accounting standards and their application reduced the credibility of the financial reporting.
Journey towards one single global accounting standard
IASB’s response to the financial crisis

- New standards for the scope of consolidation (IFRS 10) and the measurement of fair value (IFRS 13)
- Overhaul of accounting rules for financial instruments (replacement of IAS 39 by IFRS 9, ongoing)
- Joint FASB/IASB projects currently in process for key areas (e.g., revenue recognition, leases)

Arrangement IASB/FASB in 2002 ("Norwalk Agreement")
- Aim: Eliminate differences between IFRS and US GAAP.
- Good progress made so far.

Reconciliation requirement abolished by the SEC in 2007.
- With regard to convergence, foreign registrants using IFRS are no longer required to reconcile to US GAAP.

Financial crisis emphasized the need to press on with and even accelerate convergence efforts.
- Avoid regulatory arbitrage.
- Restore investor confidence by increasing the transparency and comparability of financial statements.
Journey towards one single global accounting standard
IFRS/US GAAP Convergence Work (2 of 2)

- Extension of the completion date (originally June 2011)
  - Enabling of further work and consultations in accordance with the G20 recommendations.
  - Completion in 2012 unlikely, given due process requirements.

- Before the publication of standards the boards will consider whether
  - a re-exposure is required (already decided for the leasing, revenue recognition and the classification and impairment parts of the financial instruments projects) and
  - the breadth of consultation was sufficient to ensure that standards function and bring about improvements.

- The boards point out that the effective date of new standards will leave enough time for preparers to implement the changes.

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Agenda

1. Journey towards one single global accounting standard
2. Benefits for global institutions such as Deutsche Bank
3. Ensuring the sustainability of global accounting standards
Benefits for global institutions such as Deutsche Bank

From a general perspective
- One set of global financial accounting standards is shareholder-friendly as it helps to provide
  - comparability of performance and the same level of transparency,
  - relevant information about the respective company as well as the industry.
- Addressees and users of the financial statements can better identify risks and chances of the respective preparer.
- Thus resources (risk and reward) are more efficiently allocated including governance.
- One single set of high quality global standards
  - minimizes potential for piecemeal changes to accounting standards, especially in times of financial crisis,
  - minimizes opportunities for regulatory arbitrage.

Benefits for global institutions such as Deutsche Bank

From an individual perspective
- Deutsche Bank can deliver globally accepted and comparable financial statements that are accepted by various stakeholders:
  - Shareholders
  - Supervisors
  - Rating agencies
- The necessity to deliver additional information for individual addressees (e.g. 20F) ceases to exist.
- The implementation of one global set of financial accounting standards
  - is more cost-efficient,
  - pools the know-how,
  - reduces the time of discussion of transactions’ accounting treatments.
Ensuring the sustainability of global accounting standards

Global acceptance of IFRS

- High-quality standards to be applied globally
  - More than 100 countries already permit or require IFRS or are in the process of implementing them, at least for group financial statements.
  - This includes the majority of the G20 members.
  - Remaining G20 are called upon to adopt the IFRS.
  - India and Japan to decide shortly whether and how they will incorporate IFRS.
  - High acceptance is also underlined by the fact that multiple companies plan and steer based on IFRS.

- Adoption of IFRS by the US, a key capital market, is a major step towards gaining global acceptance of IFRS.
Ensuring the sustainability of global accounting standards

- **Credibility**
  - Independence of standard setter is key.
  - Robust due process which allows adequate time for analysis/review of proposals.
  - Clarity in writing is essential; vague or unnecessarily complex standards diminish quality and create potential for misinterpretation.

- **Capital market oriented design**
  - Consideration of all stakeholders, but focus on information requirements of investors.
  - Convergence with US GAAP should be a key consideration, however it must not be at the cost of quality or authenticity.

Ensuring the sustainability of global accounting standards

- **Effective and consistent IFRS enforcement through worldwide organizations is key.**
  - A single set of standards is useless without effective enforcement mechanisms which enhance consistency in application.
  - IFRS Trustees' recent strategy review emphasized the need for a more formal network of standard setters, securities / audit regulators and others to foster greater consistency in the application of the standards.
Challenges for 2012

- Convergence: Convergence and the overarching aim of coming to one set of global accounting standards need to be balanced.
- G20: The initial request for a new transparent standard for financial instruments to replace IAS 39 needs to be achieved timely.
- Politics / companies: A global set of accounting standards requires a partial abandonment of national sovereignty and needs the willingness to compromise without sacrificing fundamental quality features of accounting standards.
- IASB: The due process needs to respect both the external process but also the principle based approach of the IFRS.
IASB update: progress and plans

IAN MACKINTOSH  
*Vice-Chairman*  
IASB

PHILIPPE DANJOU  
*Member*  
IASB

JAN ENGSTRÖM  
*Member*  
IASB

WAYNE UPTON  
*Chairman*  
IFRS Interpretations Committee  
*and Director of International Activities*  
IASB

ALAN TEIXEIRA  
*Senior Director, Technical Activities*  
IASB
International Financial Reporting Standards

IASB update progress and plans

IASB members
Ian Mackintosh | Philippe Danjou | Jan Engström

IASB Staff
Alan Teixeira | Wayne Upton

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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IFRS technical update

- Recently issued standards
- Active projects
- Interpretations and annual improvements
- Agenda consultation
- Post-implementation reviews
**International Financial Reporting Standards**

**Recently issued IFRSs**

**Recent IFRSs**

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<tr>
<th>IFRS</th>
<th>Description</th>
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<tr>
<td>IAS 1</td>
<td>Revised OCI presentation requirements</td>
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<td>IFRS 10</td>
<td>Consolidated Financial Statements</td>
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<td>IFRS 11</td>
<td>Joint Arrangements</td>
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<td>IFRS 13</td>
<td>Fair Value Measurement</td>
<td>1 January 2013</td>
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<td>IFRIC 20</td>
<td>Stripping Costs in the Production Phase of a Surface Mine</td>
<td>1 January 2013</td>
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<td>Post-employment benefits</td>
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<td>IAS 32</td>
<td>Clarified offsetting amendments</td>
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<td>IFRS 7</td>
<td>New offsetting disclosures</td>
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<td>IFRS 9</td>
<td>Financial Instruments</td>
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<td>Amendments to IFRS 1</td>
<td>Government Loans</td>
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Active projects

• Active projects
  – Financial crisis projects
  – Projects that are part of the IASB-FASB Memorandum of Understanding (MoU)
  – Other projects

• IASB work plan
Active projects

Financial crisis
• Financial Instruments (FI)
  • Classification and Measurement—review
  • Impairment
  • Hedge Accounting

MoU
• Leases
• Revenue Recognition

Other
• Insurance Contracts
• Investment Entities
• Annual Improvements
• Transition Guidance (proposed amendments to IFRS 10)
• Effective date and transition (proposed amendments to IAS 8)

IASB Work plan – as of 14 June 2012
IASB Work plan as of 14 June 2012
continued

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<th>Memorandum of Understanding projects</th>
<th>2012 Q2</th>
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Other Projects

| Insurance contracts                 | Review draft or revised ED | ✓ |
| IAS 8 - Effective date and transition methods | Target ED | |
| Annual improvements 2010-2012        | Target completion | |
| Annual improvements 2011-2013        | Target ED | |
| Consolidation-Investment entities    | Target IFRS | ✓ |
| Transition Guidance (Proposed amendments to IFRS 10) | Target amendment to IFRS | |

IASB Work plan as of 14 June 2012
continued

<table>
<thead>
<tr>
<th>Post-implementation reviews</th>
<th>2012 Q2</th>
<th>2012 Q3</th>
<th>2012 Q4</th>
<th>2013 Q1</th>
<th>MoU</th>
<th>Joint</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 8 Operating Segments</td>
<td>Request for Information</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>IFRS 3 Business Combinations</td>
<td>Intiate review</td>
<td></td>
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</tr>
</tbody>
</table>
Financial crisis projects

FI: Classification and measurement-review

IFRS 9 is sound and operational—but:

- Address specific application issues
- Consider the interaction of IFRS 9 and insurance project
- Seek to reduce key differences with the FASB’s classification and measurement model
  - Both are mixed measurement models
  - Both consider characteristics of the instrument and business model
  - Joint deliberations but separate exposure drafts
FI: Classification and Measurement-review continued

• **Scope**
  - Clarified the contractual cash flow characteristics test
  - Reconsidered the need for bifurcation of financial assets
  - Addressed some interaction with the insurance project and align with the FASB model (through FVOCI category)
  - Knock on effects, eg interrelated issues for financial liabilities

• **Timing**
  - Finalise redeliberations mid 2012
  - Target exposure draft Q4 2012

FI: Impairment of financial assets-overview

Guiding principle: Reflect general pattern of deterioration and improvement of credit quality of financial assets

- Joint project
- Move from an incurred loss to an expected loss (EL) model
- Responsive to changes in information that impact credit expectations
- Inappropriate to recognise full lifetime losses on initial recognition of financial assets priced at market
- Deterioration in credit quality leads to recognition of lifetime losses
- Robust disclosures to support principle and support comparability
Impairment: ‘Three-bucket’ approach

Bucket 1: 12 months expected loss allowance

All financial assets are initially categorised in this bucket*

Bucket 2: Lifetime expected loss allowance

Evaluation performed on groups of financial assets

Bucket 3: Lifetime expected loss allowance

Evaluation performed on individual financial assets

→ symmetrical model

Move out of Bucket 1* when:
1. more than an insignificant deterioration in credit quality since initial recognition; AND
2. likelihood of default such that at least reasonably possible that all or some contractual cash flows may not be collected.

* Except for purchased credit-impaired assets and some lease and trade receivables.

FI: Hedge Accounting

General model

• Exposure Draft (ED) in 2010
  • extensive outreach
  • generally well received
• Review draft in mid-2012
• Target IFRS in 2012

Accounting for macro hedges

• Risk management practices for open portfolios not covered by 2010 ED
• Discussion paper before ED
• Keep portfolio hedge accounting in IAS 39 in the mean time
Revenue recognition

- **Objective** – to develop a single, principle-based revenue standard for IFRSs and US GAAP
- **Revised exposure draft published November 2011**
  - Comment period ended 13 March 2012
- **Feedback generally supportive, but**
  - Requests to clarify and refine some proposals (e.g., separate performance obligations)
  - Practical difficulties in applying some proposals (e.g., time value of money)
  - Disagreement with some proposals (e.g., disclosure, transition)
- **Summary of feedback presented in May 2012, redeliberations begin in July 2012**
Overview of revised revenue proposals

Core principle:

Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Steps to apply the core principle:

1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue when a performance obligation is satisfied

Leases - overview

- The FASB and IASB have developed a common model
  - Right-of-use (ROU) lessee model with subsequent measurement of ROU asset depending on whether lessee acquires a more than insignificant portion of the underlying asset
  - Lessor accounting also depends on whether lessee acquires a more than insignificant portion of the underlying asset
- Re-exposure expected Q4 2012
**Redeliberations—lessee model**

<table>
<thead>
<tr>
<th>Balance sheet</th>
<th>Type of lease</th>
<th>Income statement</th>
</tr>
</thead>
</table>
| Dr. ROU asset**  
Cr. Lease liability* | Lessee acquires more than insignificant portion of leased asset | Amortisation expense  
Interest expense |
| Lessee does not acquire more than insignificant portion of leased asset | Rent expense |

* Measured at present value of lease payments  
** Initially measured at same amount as liability, plus initial direct costs

---

**Redeliberations—lessor model**

<table>
<thead>
<tr>
<th>Asset subject to lease</th>
<th>Type of lease</th>
<th>Lessor accounting approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lessee acquires more than insignificant portion of leased asset</td>
<td>Receiveable and residual approach</td>
<td></td>
</tr>
<tr>
<td>Lessee does not acquire more than insignificant portion of leased asset</td>
<td>Approach similar to operating lease accounting</td>
<td></td>
</tr>
</tbody>
</table>

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June 2012 Project update and the future work plan
Insurance contracts

- Joint project with FASB
- IASB and FASB due process steps not aligned
  - IASB has issued an ED, FASB has not
- Have reached different conclusions on some important issues
- Decision whether to re-expose outstanding – a due process document is expected in the second half of 2012
**Investment entities**

- Captures entities solely in the business of investing
- Proposal to create a scope exception to IFRS 10 *Consolidated Financial Statements*
  - Fair value through P&L instead of consolidation
- Joint project with FASB
- ED comment period ended January 2012
- Final amendments expected by end of 2012

**Effective date and transition—Proposed amendments to IAS 8**

- Stakeholders raised concerns about disclosures required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when there is a change in accounting policy
- Items being deliberated:
  - Delete disclosure on effect of change in accounting policy in current period when applying IFRSs
  - Disclose the potential effect of new IFRSs not yet effective that are issued by end of current period
- Deliberations on-going, ED targeted by end of 2012
Transition Guidance - Proposed amendments to IFRS 10

- ED published December 2011, comment period ended March 2012
  - Proposals well received
  - Stakeholders requested more relief
- Final amendments expected by end of June 2012
  - Clarify the date of initial application of IFRS 10 Consolidated Financial Statements
  - Provide additional transition relief from certain comparative information
  - Extend relief to IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities

International Financial Reporting Standards

Interpretations and Annual Improvements
Annual improvements

• 2009-2011 cycle of amendments published in May 2012
  – six amendments to five IFRSs
  – effective 1 January 2013

• 2010-2012 cycle of proposals published in May 2012
  – proposed amendments to eleven IFRSs
  – comment period ends September 2012

• 2011-2013 cycle of proposals expected to be published in Q3 2012
IASB agenda consultation

- Public review of the IASB’s technical programme every three years
- Helps the IASB establish a broad strategic direction for its work plan:
  - Establish a balance between:
    - improvements (new IFRSs); and
    - maintenance (implementation)
  - Determine whether to return to projects that have been deferred
  - Identify areas where improvements are needed

The Board’s initial thinking

- Development of financial reporting
  - Investing in researching key strategic issues
  - Completion of the conceptual framework
  - Completing MoU projects
  - Selected standards-level projects
- Maintenance of existing IFRSs
  - Post-implementation reviews
  - Responding to implementation needs
- Expansion of research function
Consultation

2010-2011
IASB discusses the agenda consultation with the IFRS Advisory Council

July 2011
Request for views published

July – November
Extensive and focused consultation with investors – interviews and surveys. Public forums.

November 2011
Comment deadline – 246 comment letters received

December – January
The IASB hosts four public round table discussions

Consultation

January 2012
Comment summary presented to Board

February 2012
Feedback received discussed with the Advisory Council

May 2012
The Board considers, and endorses, a summary of the feedback received and a draft strategy and initial identification of project priorities.

Mid-2012
The IASB will publish a Feedback Statement, including a statement of priorities for the coming three years.
Feedback

• **Common views**
  - Complete the four current projects
  - Focus on maintenance over development of IFRSs in the near future
  - Utilise research from national-standard setters and academics
  - Complete the Conceptual Framework

International Financial Reporting Standards

Strategic focus
Technical Programme

- Conceptual Framework
- Post-implementation Reviews
- Implementation and Maintenance
- Major projects
  - Research programme
  - Standards-level programme

Conceptual Framework

- Priority will be given to five chapters of the framework
  - Elements
  - Measurement
  - Presentation (including OCI)
  - Disclosure (including interim reporting)
  - Reporting Entity
- Working methods
  - IASB-led projects
  - Developed together
  - Informed by standards-level problems
Research programme

- A broad research and development programme
- Emphasis on defining the problem
  - Identify whether there is a financial reporting matter that justifies an effort by the IASB
  - Evidence based
- Discussion Papers
  - IASB staff papers
- Research Papers
  - Commissioned from others in the IFRS network
- Leads to project proposals, or recommendations not to develop an IFRS

Priority research projects

- Prepare project proposals
  - Agriculture – the bearer asset problem
  - Rate-regulated activities
  - Separate financial statements – the equity method
- Begin analysis – with a discussion paper being the most likely next step
  - Emissions trading schemes
  - Business combinations under common control
Priority research projects

• Analysis – with others
  • Discount rates
  • The equity method of accounting
  • Extractive activities | Intangible assets | Research and Development activities
• Financial Instruments with the Characteristics of Equity
• Foreign Currency Translation
• Liabilities – amendments to IAS 37
• Hyperinflation, and high inflation

Standards-level Programme

• Major projects feed from the research programme
• Narrower scope improvements feed from the interpretations committee and the other implementation outreach
• More focused and disciplined development of standards
• Priority projects
  • FI, Revenue recognition, Leases, Insurance contracts
  • Investment entities
  • Annual improvements
Other activities

- Disclosure forum
- Implementation of the Interpretations Committee review
- Consultative Group on effect analysis
- Formalising the IFRS networks
- Developing a research capability
- Due Process handbook

International Financial Reporting Standards

Post-implementation Reviews
Post-implementation reviews

- The IASB now reviews each new IFRS or major amendment
- Scope
  - contentious issues identified during development of the standard or that have arisen since publication
  - unexpected costs or implementation problems encountered
- Timing of the review
  - Too early or too late?
- The first - IFRS 8 Operating Segments

Example - Comparison of IFRS 8 with IAS 14

**IFRS 8**
- Segment operations on the basis of internal reporting
- Each reported item is measured on the basis used for management reporting
- Reported items are not defined
- Segment totals will need to be reconciled

**IAS 14**
- Segment operations by goods and services or by geography
- Each reported item is measured on the basis used in IFRS
- Reported items are defined
- Segment reporting agrees with financial statements
Investors

Expected benefits

• Convergence with US GAAP
• ‘Management eyes’ perspective improves investors’ ability to predict
• Highlights risks management think are important

Contentious issues

• Usefulness of a management perspective
• Inconsistent segments between entities
• Frequent reorganisations - lose the trend
• Geographical analyses not available
• Non(IFRS measures not understood - not reliable?

Preparers

• Expected benefits to preparers of applying IFRS 8
  – management perspective means little incremental costs
  – timely information – interim reporting
• Issues for investigation include:
  – identification of a single chief operating decision maker
  – subjectivity and complexity of segment aggregation criteria
  – commercial sensitivity - effect on smaller entities
  – costs of implementation
  – others being collated
Steps

• Phase A: develop the work plan
  – Reviewed the concerns that were expressed when IFRS 8 was developed
  – Consulted with standard-setters, auditors, users and others

• Phase B: investigate the issues
  – Request for information (July 2012)
  – Workshops with investors and non-investors
  – Additional sources
    – academic research
    – other outreach

• Phase C: reporting
  – our analysis of the issues and our responses to them (2013)

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.
Regulator’s perspective (Speech)

ELKE KÖNIG
President
Bundesanstalt für Finanzdienstleistungsaufsicht
(BaFin)
Technical update: financial instruments

IAN MACKINTOSH
Vice-Chairman
IASB

STEPHEN COOPER
Member
IASB

DARREL SCOTT
Member
IASB

SUE LLOYD
Senior Director, Technical Activities
IASB

MARTIN FRIEDHOFF
Associate Director
IASB
IFRS 9 Effective date amendment

- IFRS 9 effective date deferred to 1 January 2015
  - Early application permitted

- Restatement of comparative financial statements not required
  - Enhanced disclosures on transition
Limited modifications to IFRS 9: Why?

IFRS 9 is sound and operational—but…

• Address specific application issues
• Consider the interaction of IFRS 9 and insurance project
• Seek to reduce key differences with the FASB’s classification and measurement model
  – Both are mixed measurement models
  – Both consider characteristics of the instrument and business model
  – Joint deliberations but separate exposure drafts

Limited modifications to IFRS 9: Scope

• Clarify the contractual cash flow characteristics test
• Reconsider the need for bifurcation of financial assets
• To address interaction with the insurance project and align with the FASB model, consider:
  – Introducing a third business model
  – Whether some debt instruments should be remeasured through OCI
• Knock on effects, eg interrelated issues for financial liabilities
Limited modifications to IFRS 9: Scope

- Business model test
- Contractual cash flow characteristics

All other instruments:
- Equities
- Derivatives
- Some hybrid contracts
- ...

Amortised cost (one impairment method) → FVO for accounting mismatch (option)

FVOCI (same impairment method)

Reclassification required if business model changes

Fair Value (No impairment) → Equities: OCI presentation available (alternative)

Cash flow characteristics assessment

- Joint tentative decision February 2012
- Affirms the principle in IFRS 9
  - If cash flows are not solely principal and interest (P&I), measure at FVPL
  - If cash flows are solely P&I, measurement depends on the business model
- Minor change to IFRS 9 to clarify the application of the principle
  - Introduces the notion of modified relationship between P&I
  - Determine by comparing with a benchmark instrument
Contractual cash flow characteristics
Amortised cost

Contractual cash flow characteristics → Contractual terms that give rise to solely payments of

Principal → Interest

Tentative decision:
‘Modified’ P&I satisfies test IF
• Compared with a benchmark instrument, difference not more than insignificant

Interest = Consideration for
• time value of money
• credit risk

Bifurcation

• IFRS 9
  – Eliminated for financial assets
  – Retained for financial liabilities

• FASB model
  – Retained for financial assets and liabilities

• Joint tentative decisions April 2012
  – Noted the effect of the revised cash flow test
  – No bifurcation of financial assets
  – ‘Closely related’ bifurcation of financial liabilities
  – No change to IFRS 9
Business model/strategy

The starting point(s)...

• IFRS 9 business models
  – Held to collect contractual cash flows (amortised cost)
  – Other (FVTPL)

• FASB business strategy
  – Lending business (amortised cost)
  – Investing business (FVOCI with recycling and impairment)
  – Trading business (FVTPL)

Business model/strategy

Tentative decisions April 2012

• Amortised cost is based on the notion of holding to collect contractual cash flows

• Clarification of when sales are consistent with the ‘hold to collect’ notion

• Application guidance to support classification at amortised cost
Business model/strategy

IASB tentative decisions **May 2012**

- Introduce a ‘third’ business model: FVOCI

- Accounting for FVOCI:
  - Interest revenue: effective interest method
  - Impairment: use amortised cost model
  - Gain/loss: recycle to P/L on derecognition
  \[ \Rightarrow \text{P/L same as for amortised cost} \]

Business model/strategy

Joint tentative decisions **May 2012 (continued)**

- Classification as FVOCI if:
  - Debt instrument passes the contractual cash flow characteristics test **and**
  - Business model objective: both to hold to collect contractual cash flows and to sell

- Defining FVOCI results in FVPL as the residual category

- Reclassification: like under IFRS 9 (ie change of business model)
**Business model/strategy**

Tentative decisions *May 2012 (continued)*

- **Contractual cash flow characteristics**
  - Business model
    - Hold to collect
    - Both hold to collect and sell
  - Residual category

Reclassification: like under IFRS 9 (ie change of business model)

---

**June Board Meeting**

- Fair value option
  - Availability for changing FVOCI to FVPL?

- FVOCI: contractual cash flow characteristics
  - FVOCI always requires that the contractual cash flow characteristics test is met—should it?
Impairment of Financial Instruments

Three-bucket approach: general overview

Guiding principle: Reflect general pattern of deterioration and improvement of credit quality of financial assets

- Joint project
- Expected loss (EL) model
- Responsive to changes in information that impact credit expectations
- Inappropriate to recognise full lifetime losses on initial recognition of financial assets priced at market
- Deterioration in credit quality leads to recognition of lifetime losses
- Robust disclosures to support principle and support comparability
‘Three-bucket’ approach

Bucket 1: 12 months expected loss allowance
- All financial assets are initially categorised in this bucket*

Bucket 2: Lifetime expected loss allowance
- Evaluation performed on groups of financial assets

Bucket 3: Lifetime expected loss allowance
- Evaluation performed on individual financial assets

→ symmetrical model

Move out of Bucket 1* when:
1. more than an insignificant deterioration in credit quality since initial recognition; AND
2. likelihood of default such that at least reasonably possible that all or some contractual cash flows may not be collected.

* Except for purchased credit-impaired assets and some lease and trade receivables.

Purchased credit-impaired assets

• Scope
  – Assets purchased with an ‘explicit expectation of credit losses’
  – Same population as IAS 39 today (IASB)*

• Always outside Bucket 1

• Use credit-adjusted effective interest rate
  – No day 1 allowance balance
  – No day 1 impairment loss recognised

• Allowance balance represents changes in lifetime loss expectations

* FASB will consider whether scope should be broadened.
Trade receivables

• **Without** a significant financing component (short term):
  – Measure receivable at invoice amount
  – Always recognise lifetime expected losses (ie categorise outside Bucket 1)
  – Provision matrix as a practical expedient

• **With** a significant financing component (long term):
  – Policy election either:
    – apply general ‘three.bucket’ model or
    – always recognise lifetime expected losses

Lease receivables

• Lease receivables: similar to trade receivables

• Accounting policy choice:
  – apply general ‘three.bucket’ model or
  – always recognise lifetime expected losses

• New impairment model would also apply to leases under IAS 17 (if applicable—depending on effective dates)
Modifications

- Applying the impairment model to modifications
  - Model is symmetrical
  - Impairments can reverse => can get back to Bucket 1

- Effect of modifications:
  - Relative criterion: compare credit quality of restructured debt with original credit quality
  - Absolute criterion: assess collectibility of modified cash flows
  - Agreed reduction of cash flows results in reduction of gross carrying amount => implications for interest revenue

Discount rate for credit losses

- Credit-impaired purchased asset
- EIR (calibration includes EL) ➔ Integrated EIR
- All other assets (including lease receivables)
- EIR (calibration excludes EL) ➔ Risk free rate ➔ Range of rates that facilitates ‘decoupling’ ➔ chosen rate must be consistent over time
Open topics and timeline

- Loan commitments, financial guarantee contracts, revolvers
- Interest revenue recognition when asset has significantly deteriorated
- Disclosures
- Transition
- Re-exposure draft in H2 2012
Components of the general hedge accounting model

Objective

Risk management objective:
Seeks to link risk management and financial reporting (top down)

Accounting objective:
Seeks to manage timing of recognition of gains or losses (bottom up)
Hedged items

Qualifying hedged item

Entire item

Component

Risk component (separately identifiable and reliably measurable)

Nominal component or selected contractual CFs

Hedged items: risk components

IAS 39

Fixed element

Variable element

Benchmark (eg interest rate or commodity price)

Benchmark (eg interest rate or commodity price)

New model

Fixed element

Variable element

Benchmark (eg interest rate or commodity price)

Benchmark (eg interest rate or commodity price)
Hedged items: aggregated exposures

Aggregated exposure—combination of: (a) another exposure and (b) a derivative

First level relationship

Second level relationship

<table>
<thead>
<tr>
<th>Hedging instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedged item</td>
</tr>
<tr>
<td>[non-derivative] exposure</td>
</tr>
</tbody>
</table>

Example 1: hedging commodity price & FX risk

Customer

Commodity futures contract

FX forward contract

Miner

Aggregated exposure

Not an eligible hedged item under IAS 39

US$
Hedged items: aggregated exposures

Example 2: hedging FX & interest rate risk

- Debt holder
- Cross-currency Interest rate swap
- Interest rate swap
- US$
- €

Issuer

Aggregated exposure
Not an eligible hedged item under IAS 39

Hedged items: groups of items

Groups

- Gross positions
- Net positions

Fair value hedge: all risks
Cash flow hedge: only FX risk

Requirements for income statement presentation
Hedging instruments

Qualifying hedging instruments

Entire item
Partial designation

FX risk component
• Intrinsic value
• Spot element

Proportion of nominal amount

Costs of hedging

Costs of hedging

Time value of options
Forward element of forward contract

Transaction related hedged item
Time period related hedged item
Feedback on ED: accounting requirement for time value of options and forward points should be consistently applied

<table>
<thead>
<tr>
<th>Time value of options</th>
<th>Forward points (IAS 39)</th>
<th>Forward points (decision in redeliberations)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction related hedged item</td>
<td>Defer</td>
<td>Can 'in substance' defer**</td>
</tr>
<tr>
<td>Time period related hedged item</td>
<td>Amortise</td>
<td>Profit or loss (Amortise)</td>
</tr>
</tbody>
</table>

** Can be deferred by the “forward rate method” (other than for FX financial assets/liabilities)

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**Hedge effectiveness**

Hedge effectiveness test:
1. Economic relationship
2. Effect of credit risk
3. Hedge ratio

Measuring and recognising hedge ineffectiveness

Discontinuation

Rebalancing
Disclosures

- Hedge accounting disclosures
  - Risk management strategy
  - Amount, timing and uncertainty of future cash flows
  - Effects of hedge accounting on the primary financial statements
  - Specific disclosures for dynamic strategies and credit risk hedging

Alternatives to hedge accounting

- Alternatives
  - ‘Own use’ scope exception in IAS 39
  - Credit derivatives
    - Elective FVTPL
      - At initial recognition or subsequently
      - At discontinuation: amortisation
  - Eligible for FVO in IFRS 9
Transition

Prospective transition with limited exceptions

• Retrospective application
  – Required for time value of options
  – Permitted for accounting for forward elements (if elected, applies to all such hedging relationships)

• Practical expedients
  – Allowed to consider the moment IAS 39 ceases to apply and the moment from which the new model applies as one point in time
  – For rebalancing, the starting point will be the hedge ratio used under IAS 39 (any gains or losses will be recognised in profit or loss)

• Hedging relationships that qualified under IAS 39 and qualify under the new model will be treated as continuing hedging relationships

Open topics and timeline

• All decisions have been taken
• No open topics

• Review draft (on website)
• Timing: mid 2012 (for ≈ 90 days)

• Issue as final (= part of IFRS 9)
• Timing: H2 2012
Accounting for Macro Hedging

Status of the project

<table>
<thead>
<tr>
<th>Project status</th>
<th>Fact finding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sept 2011</td>
<td>Common themes</td>
</tr>
<tr>
<td>Nov 2011</td>
<td>Implications for accounting model</td>
</tr>
<tr>
<td>[current]</td>
<td>Design of accounting model</td>
</tr>
<tr>
<td></td>
<td>Interest rate risk</td>
</tr>
<tr>
<td></td>
<td>Other risks</td>
</tr>
</tbody>
</table>

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.
Insights from the project so far

### Asset Liability Management (ALM)

- Margin (Bid-Offer Spread of Transfer Prices)
- Repricing Risk / Yield Curve Risk / Basis Risk
- Use of Risk Limits for Management
- Volatility in net profit and loss due to:
  - Differences in timing of cash flows
  - Basis differences
  - Amount differences (vintage)
  - Open positions
- Impairment Risk / Prepayment Risk / Market Rate Risk
- Volatility in profit or loss due to:
  - Uncertainty regarding impairment and prepayment (model risk)
- Margin for new transactions dependent on market forces

### Consumer Loans
- Mortgage Loans
- Commercial Loans

- Margin:
  - Contractual market rate vs. internal transfer price
  - Impairment Risk / Prepayment Risk / Market Rate Risk
  - Volatility in profit or loss due to:
    - Differences in timing of cash flows
    - Basis differences
    - Amount differences (vintage)
    - Open positions

### Internal Transactions (Derivatives)

- Influence on risk limit and target cash flow profile

### Equity

- Management within predefined risk limits.
- Trading Unit takes and manages the counterparty risk of the entire derivative position.

### Treasury
- Trading Unit

### Demand Deposits

### Time Deposits

### Other Liabilities

### Discussion of interest rate risk using 11 Steps

#### Full fair value measurement – Step 1

- Step 2 - Limit valuation to interest rate risk
- Step 3 - Net margin as hedged risk
- Step 4 - Valuation on the basis of a (closed) portfolio
- Step 5 - Open portfolios as unit of account
- Step 6 - Timing difference of cash flows (bucketing)

#### Interim Step: Summary of discussion

- Step 7 - Multi-dimensional risk management objectives
- Step 8 - Floating leg of derivatives
- Step 9 - Counterparty risk
- Step 10 - Internal derivatives
- Step 11 - Risk limits

Risk Management
Mechanics of the valuation approach

Accounting alternatives and financial reporting objectives

Simple solutions support transparency when not oversimplifying.

Volatility provides information—none or too much lacks transparency.

“Derivatives at cost”

“Designation of a bottom layer of a gross position (for accounting purposes) to address the dynamics easier than with current hedge accounting approach. The layer is derived from the actual net risk position.”
Accounting for macro hedging: timetable

- After initial discussions in September/November 2010, the Board’s deliberation began in September 2011
- The Board is first developing a model for interest rate risk (H1 2012) and plans to address other risks thereafter
- Targeting issue of a Discussion Paper in H2 2012

Decoupling accounting for macro hedging from IFRS 9

Why create a separate accounting standard?

- Developing something very new => extra research and input needed
- Postponing the entire financial instruments standard for one issue relevant to entities that do macro hedging is not appropriate
- Demand for IFRS 9 and for a stable accounting basis => IFRS 9 should be available as soon as possible
Road map

• Continue with IFRS 9 as planned but exclude accounting for macro hedging from its scope
• Progress accounting for macro hedging as a separate project with the objective to prepare a Discussion Paper
• Interim solution:
  – Preparers can keep current accounting for macro hedging strategies
  – Adopt IFRS 9 for all purposes except macro hedge accounting
  – Maintains status quo for those using macro hedge accounting
Offsetting

Offsetting (netting):

- Presentation of two or more financial assets and financial liabilities as a single net amount (the difference between them) in the B/S
  => not the same as derecognition

- Criteria for offsetting: the entity…
  1. currently has a legally enforceable right to set off the recognised amounts; and
  2. intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously

---

Offsetting

- Application of criteria was clarified in Dec 2011 (amendment to IAS 32)

- Interpretation of currently has a legally enforceable right
  - must not be contingent on a future event
  - must be legally enforceable in:
    (i) the normal course of business;
    (ii) the event of default; and
    (iii) the event of insolvency or bankruptcy of the entity and all of the counterparties
Offsetting

- Interpretation of *simultaneous settlement*
  - outcome must be, in effect, equivalent to net settlement
  - gross settlement mechanism must have features that:
    - eliminate or result in insignificant credit and liquidity risk; and
    - will process receivables and payables in a single settlement process or cycle
  \(\rightarrow\) relates to clearing processes and stock exchanges

Offsetting disclosure requirements

- Respond to investors’ need for information about gross and net exposures
- Provide information about exposures in normal course and in times of stress
- Do not reconcile IFRSs and US GAAP but allow entities to be compared on a like basis

<table>
<thead>
<tr>
<th>Offsetting disclosures</th>
</tr>
</thead>
</table>
| **Scope** | Limited to:  
|  
| - Instruments offset in balance sheet and  
| - Instruments subject to a master netting agreement or similar arrangement  
| **Excludes:** |  
| - Non-financial collateral  
| - Instruments with only collateral rights  
| - Loans and deposits with the same institution (unless set off)  
| **Class** | Disclosures by type of financial instrument or by counterparty  
| **Effective date** | Disclosures do not change offsetting requirements  
|  
| - No effect on other requirements in IFRS 9  
| - As soon as possible to promote comparability |
Offsetting disclosure requirements

- Disclosures include:
  - the gross amounts of financial assets and financial liabilities (a);
  - the amounts of financial assets and financial liabilities offset and the net amount in the statement of financial position (b) & (c);
  - the effect of rights of set-off enforceable/exercisable in bankruptcy, default, or insolvency of either party not already offset in the statement of financial position (including collateral) (d); and
  - net amount (e).

- Columns d and e could be shown by category of instrument or by counterparty.

<table>
<thead>
<tr>
<th>Category</th>
<th>a. Gross carrying amounts (before offsetting)</th>
<th>b. Gross amounts offset</th>
<th>c. Net amount presented in statement of financial position (a-b)</th>
<th>d. Amounts available to be offset (but not set off in SFP) (i.e. in bankruptcy or default)</th>
<th>e. Net amount (c-d) [same for all entities]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivatives</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
<tr>
<td>Repos/similar arrangements</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
<tr>
<td>Other</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
<td>(X)</td>
<td>X</td>
</tr>
</tbody>
</table>

Questions or comments?

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Technical break-out sessions:

Revenue recognition

IAN MACKINTOSH
Vice-Chairman
IASB

HENRY REES
Associate Director
IASB
Revenue from Contracts with Customers

June 2012

Agenda

• Project objective and status
• Overview of the revised proposals
• Feedback received
• Possible directions
Project objective

Objective: To develop a single, principle-based revenue standard for IFRSs and US GAAP

- The revenue standard aims to improve accounting for contracts with customers by:
  - Providing a more robust framework for addressing revenue recognition issues
  - Increasing comparability across industries and capital markets
  - Requiring better disclosure

Project status

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>June 2010: Exposure draft, Revenue from Contracts with Customers, 974 comment letters</td>
</tr>
<tr>
<td>2011</td>
<td>November 2011: Revised exposure draft, Re-exposure of Revenue from Contracts with Customers, 358 comment letters</td>
</tr>
<tr>
<td>2012</td>
<td>March 2012: Comment letter deadline, April 2012: Roundtables, May 2012 onwards: Redeliberations</td>
</tr>
<tr>
<td>2013</td>
<td>H1 2013: Expected IFRS X Revenue from Contracts with Customers, Effective date to be determined</td>
</tr>
</tbody>
</table>
Overview of revised proposals

Core principle:
Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Steps to apply the core principle:
1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue when a performance obligation is satisfied

Overview of feedback

Generally support the project objective and the proposals, but...

- Requests to clarify and refine the proposals
  - Identifying separate performance obligations
  - Determining revenue over time
- Difficulties in practically applying proposals
  - Time value of money
  - Retrospective transition
- Disagreement
  - Disclosure requirements
  - Onerous performance obligations
  - Application to the telecommunications industry
## Proposed timeline for redeliberations

<table>
<thead>
<tr>
<th>Month</th>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2012</td>
<td>- Identifying separate performance obligations (Step 2)</td>
</tr>
<tr>
<td></td>
<td>- Determining revenue over time (Step 5)</td>
</tr>
<tr>
<td></td>
<td>- Contract combinations and modifications (Step 1)</td>
</tr>
<tr>
<td></td>
<td>- Application guidance on licences</td>
</tr>
<tr>
<td></td>
<td>- Onerous performance obligations</td>
</tr>
<tr>
<td>September 2012</td>
<td>Constraining the cumulative amount of revenue recognised (Step 5)</td>
</tr>
<tr>
<td></td>
<td>- Collectibility (customer credit risk)</td>
</tr>
<tr>
<td></td>
<td>- Time value of money (Step 3)</td>
</tr>
<tr>
<td>October 2012</td>
<td>- Scope (e.g., definition of a customer, collaborative arrangements and interaction with other projects)</td>
</tr>
<tr>
<td></td>
<td>- Contract acquisition costs</td>
</tr>
<tr>
<td></td>
<td>- Allocation of the transaction price (Step 4)</td>
</tr>
<tr>
<td></td>
<td>- Applying the proposals to transfers of non-financial assets</td>
</tr>
<tr>
<td>November 2012</td>
<td>- Disclosures – interims and annuals</td>
</tr>
<tr>
<td></td>
<td>- Transition, effective date and early adoption</td>
</tr>
<tr>
<td>December 2012</td>
<td>- Sweep issues</td>
</tr>
</tbody>
</table>

## Step 1: Identify the contract(s)

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Feedback</th>
</tr>
</thead>
</table>
| Combine contracts with the same customer and entered into at or near the same time if specified criteria are met | - Contract combinations criteria is too restrictive—can only combine contracts with the same customer  
|                                                                         |   - How to account for contracts that are economically linked (e.g., sales through a distribution channel with promises to ultimate customer)? |
| Contract modifications:                                                 | - Much improved from the 2010 ED                                          |
| - Some are accounted for as a separate contract                         |   - However, some think that the guidance is complex and difficult to understand |
| - Otherwise, re-evaluate remaining performance obligations               |                                                                         |
### Step 2: Identify the separate performance obligation(s)

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td>A good or service is distinct if either:</td>
<td>• Support for identifying a separate performance obligation on the basis of whether the good or service is distinct</td>
</tr>
<tr>
<td>• The entity regularly sells it separately</td>
<td>• ‘Distinct’ criteria has improved from 2010 ED, but:</td>
</tr>
<tr>
<td>• The customer can benefit from the good or service on its own or together with other readily available resources</td>
<td>• Two-step approach is confusing</td>
</tr>
<tr>
<td>However, it is not distinct if:</td>
<td>• Some concepts should be clarified (eg significant integration service)</td>
</tr>
<tr>
<td>• It is part of a bundle of goods or services that are highly interrelated so that a significant ‘integration service’ is required</td>
<td>• Difficulties in applying the criteria to some contracts (eg software customisation contracts)</td>
</tr>
<tr>
<td>• That bundle is significantly modified or customised to fulfil the contract</td>
<td></td>
</tr>
<tr>
<td>As a practical expedient, two or more distinct goods or services may be treated as a single performance obligation if they have the same pattern of transfer</td>
<td>• Viewed as an accounting policy choice</td>
</tr>
<tr>
<td></td>
<td>• Unclear whether repetitive services would have the same pattern of transfer</td>
</tr>
</tbody>
</table>
Step 4: Allocate the transaction price

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocate to each separate performance obligation the amount to which the entity expects to be entitled</td>
<td>• Some disagreement with the proposed basis for allocating the transaction price—a common view among those in the telecommunications industry</td>
</tr>
</tbody>
</table>
| Allocating on a relative standalone selling price basis will generally meet the objective  
  • Estimate selling prices if they are not observable  
  • Residual estimation techniques may be appropriate | • Additional guidance requested on allocating the transaction price when more than one good or service has a selling price that is highly variable or uncertain |
| Discounts and contingent amounts are allocated entirely to one performance obligation if specified criteria are met | • Some request greater flexibility |

Step 5: Recognise revenue

**Objective:** To recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service

**Performance obligations satisfied over time**
A performance obligation is satisfied over time if:
- The entity’s performance creates or enhances an asset (e.g., WIP) that the customer controls as the asset is created or enhanced; or
- The criteria in paragraph 35(b) are met (see following slide)

Revenue is recognised by measuring progress towards complete satisfaction of the performance obligation

**Performance obligations satisfied at a point in time**
All other performance obligations are satisfied at a point in time

Revenue is recognised at the point in time when the customer obtains control of the promised asset.
Indicators of control include:
- Present right to payment
- Legal title
- Physical possession
- Risks and rewards of ownership
- Customer acceptance
Step 5: Recognise revenue

An overview of the paragraph 35(b) criteria

• A performance obligation is satisfied over time if:
  – The entity’s performance does not create an asset with alternative use to the entity; and
  – At least one of the following three criteria is met:
    – The customer benefits as the entity performs, or
    – Another entity would not need to re-perform work to date (other entity would not have benefit of any WIP), or
    – The entity has a right to payment for work completed to date

• An entity is reasonably assured only if:
  – The entity has experience with (or has other evidence about) similar types of performance obligations, and
  – The entity’s experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled

• Various factors might indicate that the entity’s experience is not predictive

Constraint: When the consideration is variable, the cumulative amount of revenue recognised is limited to the amount to which an entity is reasonably assured to be entitled
Step 5: Recognise revenue

Feedback
- Support for the criteria for revenue over time
  - Generally captures appropriate contracts, but some concerns about consistency with control principle
- Suggestions to clarify the criteria in paragraph 35, such as
  - Meaning of ‘alternative use’, and the relevance of contractual restrictions
  - Whether ‘no need to substantially re-perform’ criterion should apply only to service contracts
  - Additional guidance on determining whether an entity has a ‘right to payment for work performed to date’
- Constraining cumulative revenue recognised
  - Clarify interpretation of ‘predictive experience’
  - Clarify principles to address royalties (¶85)

Contract costs and onerous POs

Costs of obtaining a contract
Recognised as an asset if they are incremental and are expected to be recovered (eg sales commissions)

Feedback:
Some agree but others prefer to expense

Costs of fulfilling a contract
Recognised as an asset if they:
- Relate directly to a contract
- Relate to future performance
- Are expected to be recovered (eg pre-contract or setup costs)

Onerous performance obligations
Recognise a loss if the least cost of settling the performance obligation satisfied over time exceeds the amount of transaction price allocated to that performance obligation

Feedback:
Disagree with scope and applying to individual performance obligations
Disclosure

Feedback

• Near unanimous divide between users and others
  – Users: seems appropriate (or require more)
  – Others: excessive, overly prescriptive and requires information not used by management

• Interim disclosures conflict with the principles of interim reporting

Transition and effective date

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retrospective application with some practical expedients</td>
<td>• Users mostly agree&lt;br&gt;• Others think costs would outweigh benefits&lt;br&gt;• Strong support to allow prospective application</td>
</tr>
<tr>
<td>Effective date no earlier than annual reporting periods beginning on or after 1 January 2015 (but depends on when standard issued)</td>
<td>• Retrospective application requires longer time between issuance and effective date</td>
</tr>
</tbody>
</table>
More information

Additional information about the revised proposals and the revenue recognition project is available at www.ifrs.org and www.fasb.org.

Questions or comments?

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Technical break-out sessions:

Leases: Lessee (Part 1)

PHILIPPE DANJOU
Member
IASB

PATRINA BUCHANAN
Technical Principal
IASB
We will be considering...

- assets and liabilities measured by reference to future cash flows

- where future cash flows are uncertain:
  - range of possible outcomes
  - possible outcomes must be estimated.
Myth 1

Everyone knows what ‘best estimate’ means

Some IFRSs refer to ‘best estimate’

- **IAS 39**: Impairment loss measured at **best estimate** within range of possible outcomes.
- **Old IAS 19** (will be deleted effective 1/1/2013): “In the long term, actuarial gains and losses may offset one another. Therefore, estimates of post-employment benefit obligations may be viewed as a range (or ‘corridor’) around the **best estimate**.”
- **IAS 37**: “The amount recognised as a provision should be the **best estimate** of the expenditure required to settle the present obligation at the end of the reporting period.”
What does ‘best estimate’ mean?

- **Most likely outcome?**
- **Median outcome?**
  - < 50% chance of higher cash flows
  - < 50% chance of lower cash flows
- **Expected value?**
  - Average (mean) of range
- **Whatever amount feels ‘best’?**

Alternatives to ‘best estimate’

<table>
<thead>
<tr>
<th>Expected value (aka Mean)</th>
<th>Probability-weighted sum of the outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum amount that is more likely than not to occur (aka Median)</td>
<td>The outcome that separates the higher and lower halves of a distribution of outcomes</td>
</tr>
<tr>
<td>Most likely outcome (aka Mode)</td>
<td>‘Best estimate’ is often interpreted to mean ‘most likely outcome’</td>
</tr>
</tbody>
</table>
Myth 2

The IASB prefers fair value

The IASB does not always prefer fair value

- provisions
- impairment of property, plant, equipment, intangibles
- revenue recognition
- insurance contracts
- leases
Myth 3

The IASB prefers expected value

Expected value might be best...

- if objective is to measure current value of asset or liability
- if transactions recur frequently
- if users are concerned about extreme outcomes (outliers)
- if expected value is as easy to estimate as other measures
- if the timing of cash flows is uncertain
But most likely or median outcome might be better...

- if objective is to predict future cash flows
- if transactions do not recur frequently
- if outliers are less important or more uncertain than central outcomes
- if expected value is more difficult to measure

Revenue recognition proposals

- Estimate transaction price at either **expected value** or **most likely outcome**
- Select method that **better predicts** the amount of consideration
  - **Expected value** may be appropriate for large number of contracts with similar characteristics
  - **Most likely outcome** may be appropriate if contract has only two possible outcomes.
- Apply consistently
Myth 4

Expected value needs accurate data about *all* outcomes

Measuring expected value

Some IFRSs suggest consider ‘all’ possible outcomes

- **IAS 37**: Where the provision being measured involves a large population of items, the obligation is estimated by weighting *all possible outcomes* by their associated probabilities. The name for this statistical method of estimation is ‘expected value’.

- **IAS 36**: “…expected present value of the future cash flows, ie the weighted average of *all possible outcomes*”.

Measuring expected value

‘All possible outcomes’, continued...

– **IAS 39**: The amount of loss in a large population of items can be estimated on the basis of experience and other factors by weighting **all possible outcomes** by their associated probabilities.

‘All’ is a bit daunting, to put it mildly

– What are ‘all possible outcomes’ to a lawsuit?

---

Measuring expected value

• We do **not** mean identify and assign a probability to every single possible outcome.

• use any suitable technique for estimating weighted average (mean) of range

• if identifying range of possible outcomes:
  – use same data as would use to identify most likely or median outcome
  – include everything you know
  – but don’t make up what you don’t know...
Measuring expected value

We have evidence that...
Most likely outcome is 100 currency units (CU)

We have no evidence that...
Distribution is other than normal (bell-shaped)

We would estimate expected value to be...
cu 100

---

Measuring expected value

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Estimated outflows</th>
<th>Relative likelihood</th>
</tr>
</thead>
<tbody>
<tr>
<td>Best case</td>
<td>cu 100</td>
<td></td>
</tr>
<tr>
<td>Most likely outcome</td>
<td>cu 200</td>
<td>About twice as likely as best case</td>
</tr>
<tr>
<td>Worst case</td>
<td>cu 1,000</td>
<td>Unlikely, but possible</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Estimate of expected value</th>
</tr>
</thead>
<tbody>
<tr>
<td>cu 100 x 30% cu 30</td>
</tr>
<tr>
<td>cu 200 x 60% cu 120</td>
</tr>
<tr>
<td>cu 1,000 x 10% cu 100</td>
</tr>
<tr>
<td>cu 1,000 x 10% cu 250</td>
</tr>
</tbody>
</table>
Measuring expected value

Future standards will explicitly acknowledge that it is not necessary to identify all possible outcomes

- **Revenue exposure draft**: ‘consider all the information (historical, current and forecasted) that is reasonably available to the entity and … identify a reasonable number of possible consideration amounts.’

- **Insurance exposure draft**: ‘the objective is not necessarily to identify every possible scenario but rather to incorporate all relevant information …’

---

Myth 5

**Expected values take account of risk**
**Expected values may need risk adjustments**

<table>
<thead>
<tr>
<th>Probability</th>
<th>Inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>cu 500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Probability</th>
<th>Inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>50%</td>
<td>cu 250</td>
</tr>
<tr>
<td>50%</td>
<td>cu 750</td>
</tr>
</tbody>
</table>

- Expected value is cu 500 for each asset
- But risk averse entity would put lower value on asset 2

---

**Myth 6**

Risk always increases discount rates
Risk adjustments for liabilities

- Risk = variability of outcome
- Risk aversion typically increases transaction prices for uncertain liabilities
- Therefore, a risk adjustment increases the amount at which a liability is measured

How to take risk into account in making an estimate

1. Could intentionally introduce a bias by:
   - increasing estimates of cash outflows, or
   - adjusting estimates of probabilities, or
   - reducing rates at which cash outflows are discounted to present value, or
2. Could use an explicit risk adjustment
   - Adjusting discount rate doesn’t always work
The IASB encourages its members and staff to express their individual views.

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Technique break-out sessions:

Conceptual Framework

STEPHEN COOPER
Member
IASB

MICHAEL WELLS
Director, IFRS Education Initiative
IASB
The Conceptual Framework for Financial Reporting

IFRS Foundation IFRS conference: Frankfurt

Stephen Cooper, IASB member
Michael Wells, Director, IFRS Education Initiative, IASB

Role of the Conceptual Framework

- Conceptual Framework sets out agreed concepts that underlie financial reporting
- IASB uses Conceptual Framework to set standards
  - enhances consistency across standards
  - enhances consistency over time as IASB members change
  - provides benchmark for judgments
- IFRS Interpretations Committee uses Conceptual Framework to interpret IFRSs
- Preparers use Conceptual Framework to develop accounting policies when there is no explicit IFRS requirement—IAS 8 hierarchy
If no specific IFRS requirement…

• use judgement to
  – develop a policy that results in relevant information that faithfully represents (i.e. complete, neutral and error free)
  – Hierarchy:
    1st IFRS dealing with similar and related issue
    2nd Conceptual Framework definitions, recognition crit. etc
    Can also in parallel refer to GAAPs with similar framework

Objective of financial reporting

Provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity

Note:
• other aspects of the Conceptual Framework flow logically from the objective (CF.OB1)
• Conceptual Framework sets out the concepts that underlie IFRS financial statements and assist the IASB in the development of future IFRSs and in its review of existing IFRSs (CF.Purpose and Status)
Objective of financial reporting

- Investors’, lenders’ and other creditors’ expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity.
  - Decisions by investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, eg dividends, principal and interest payments or market price increases.
  - Decisions by lenders about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect.

Objective of financial reporting

- To assess an entity’s prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about:
  - the resources of the entity;
  - claims against the entity; and
  - how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources
    - eg protecting the entity’s resources from unfavourable effects of economic factors such as price and technological changes
Qualitative characteristics

• If financial information is to be useful, it **must** be **relevant** and **faithfully represent** what it purports to represent (ie fundamental qualities).
  – Financial information without both relevance and faithful representation is not useful, and it cannot be made useful by being more comparable, verifiable, timely or understandable.

• The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable (ie enhancing qualities—less critical but still highly desirable)
  – Financial information that is relevant and faithfully represented may still be useful even if it does not have any of the enhancing qualitative characteristics.

Fundamental qualitative characteristics

• **Relevance**: capable of making a difference in users’ decisions
  – predictive value
  – confirmatory value
  – materiality (entity-specific)

• **Faithful representation**: faithfully represents the phenomena it purports to represent
  – completeness (depiction including numbers and words)
  – neutrality (unbiased)
  – free from error (ideally)

Note: faithful representation replaces reliability
Enhancing Qualitative Characteristics

• **Comparability**: like things look alike; different things look different
• **Verifiability**: knowledgeable and independent observers could reach consensus, but not necessarily complete agreement, that a depiction is a faithful representation
• **Timeliness**: having information available to decision-makers in time to be capable of influencing their decisions
• **Understandability**: Classify, characterise, and present information clearly and concisely

Pervasive constraint

• Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.
  • Benefits include more efficient functioning of capital markets and a lower cost of capital for the economy.
  • Costs include collecting, processing, verifying and disseminating financial information and the costs of analysing and interpreting the information provided.
• In applying the cost constraint, the IASB assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information. Those assessments are usually based on a combination of quantitative and qualitative information.
Elements

**Asset**
- resource controlled by the entity
- result of past event
- expected inflow of economic benefits

**Liability**
- present obligation
- arising from past event
- expected outflow of economic benefits

**Equity** = assets – liabilities

**Income**
- recognised increase in asset/decrease in liability in current reporting period
- that result in increased equity except...

**Expense**
- recognised decrease in asset/increase in liability in current period
- that result in decreased equity except...

Examples: elements

**Are the following assets?**
- fish in the sea (from a fish harvester’s perspective)
- firm order to acquire gold, settle net in cash
- firm order to acquire gold, cannot settle net
- ‘right’ to recover past costs incurred increased future prices in a rate regulated activity
- lessee—short-term car rental agreement

**Are the following liabilities?**
- lessee—short-term car rental agreement
- participant in a cap and trade emission trading scheme
Recognition

- Recognise item that meets element definition when
  - **probable** that benefits will flow to/from the entity
  - has cost or value that can be measured **reliably**

What does probable mean?
The meaning of probable is determined at the standards level. Therefore, inconsistent use across IFRSs

What does measure reliably mean?
To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions.
Examples: recognition

**Recognise the asset?**

- a hospital’s backup backup generator (expect never to use it)
- research and development expenditure
- internally generated brand
- lessee—short-term car rental agreement
- firm order to acquire gold, cannot settle net

Derecognition of assets

- Derecognition of an asset refers to when an asset previously recognised by an entity is removed from the entity’s statement of financial position
  - derecognition requirements are specified at the standards level
  - for example, PPE is derecognised: (a) on disposal; or (b) when no future economic benefits are expected from its use or disposal (IAS 16.67)
  - note: derecognition of PPE does not necessarily coincide with the loss of control of the asset
Elements and recognition/derecognition

• How can we improve the definitions?
  – What does expected mean? Is it different from probable?
  – Why focus on future inflow/outflow of economic benefits, rather than present position?
  – Why do we need to identify past transactions?
  – What does control mean in the asset definition?
  – How does liability definition apply to non-contractual obligations?

• Should we define equity? If so, how?

Elements and recognition/derecognition

• Working asset definition: An asset of an entity is a present economic resource to which the entity has a right or other access that others do not have.
  – Present means that on the financial statement date the economic resource exists and the entity has the right or other access that others do not have.
  – Economic resource is scarce and capable of producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources. Economic resources that arise from contracts and other binding arrangements are unconditional promises and other abilities to require provision of economic resources, including through risk protection.
  – Right or other access that others do not have enables entity to use the economic resource and its use by others can be precluded or limited. It is enforceable by legal or equivalent means.
Elements and recognition/derecognition

• Working liability definition: A liability of an entity is a present economic obligation for which the entity is the obligor.
  – Present means that on the financial statement date the economic obligation exists and the entity is the obligor.
  – Economic obligation is an unconditional promise or other requirement to provide or forgo economic resources, including through risk protection.
  – An entity is the obligor if the entity is required to bear the economic obligation and its requirement to bear the obligation is enforceable by legal or equivalent means.

• Are these improvements?

Elements and recognition/derecognition

• How many elements? Which ones?
• Is other comprehensive income an element?
  If so, how should it be defined?

<table>
<thead>
<tr>
<th>FASB (10)</th>
<th>IASB (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>Gains</td>
</tr>
<tr>
<td>Liabilities</td>
<td>Losses</td>
</tr>
<tr>
<td>Equity</td>
<td>Revenue</td>
</tr>
<tr>
<td>Investments by owners</td>
<td>Comprehensive Income</td>
</tr>
<tr>
<td>Distributions to owners</td>
<td>Expenses</td>
</tr>
</tbody>
</table>
Elements and recognition/derecognition

- Recognition criteria need clarification
  - probable
  - measured reliably
- There are no derecognition criteria
- Do we need recognition and derecognition criteria?
  - perhaps meeting (or not) the elements definitions and satisfying the qualitative characteristics is sufficient

Elements and recognition/derecognition

- This phase of the project has been deferred
- Board is not trying to fundamentally change what meets current definitions, just trying to clarify and improve
- Has proven to be quite challenging
- Perhaps standards-level projects will provide insights
  - Financial instruments with characteristics of equity
  - IAS 37 (Provisions)
  - Insurance
  - Revenue...
Reporting entity

• *Conceptual Framework* is silent on reporting entity
• These are tentative decisions in CF project to date
• Circumscribed area of economic activity
  – activities are being, have been, or will be conducted
  – activities can be objectively distinguished
  – provides information for users to make decisions
• Legal entity not necessary
  – branch or segment of a legal entity could be a reporting entity
• Consolidated financial statements are general purpose
  – may also be a group of entities under common control
  – parent-only financial statements useful with consolidated financial statements, but not on their own

Measurement concepts

• Measurement is the process of determining monetary amounts at which elements are recognised and carried. (CF.4.54)
• To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The *Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models (CF.OB11)
Measurement ‘concepts’

- Measurement section of Framework is weak—only lists some measurement methods used in practice:
  - **historical cost**: cash/cash equivalents paid or fair value of consideration given at time of acquisition.
  - **current cost**: cash that would be paid if acquired now
  - **realisable (settlement) value**: cash that could be obtained by selling the asset now
  - **present value**: present discounted value of future net cash inflows that the item is expected to generate
  - **market value**: listed but not described in Framework. For fair value see IFRS 13 Fair Value Measurements

Measurement

- **Conceptual Framework** should set forth concepts for determining the most appropriate measurement attribute for a particular asset or liability in a given circumstance
- However, there is little in Conceptual Framework on measurement
  - list of measurements used in standards
  - no concepts or basis for choosing among them
- Large hole in the literature
- Has resulted in ad hoc standards-level decisions in multiple-measurement environment
Measurement

- Current thinking is measurement concepts should be based on objective of financial reporting, qualitative characteristics, and elements definitions
  - objective of financial reporting is the place to start
  - elements tell us what we are trying to measure
  - qualitative characteristics and cost constraint would be measurement selection factors
  - perhaps value realisation connects relevance to the objective of financial reporting

- Board does not think the *Conceptual Framework* should strive to identify a single measurement attribute for all assets and liabilities

Measurement

- One approach being considered
  - Determine view of financial reporting that best meets the objective of financial reporting
    - statement of financial position view
    - income statement view
    - holistic view (statements of financial position and income)
  - Then identify implications of that view and the fundamental qualitative characteristics for historical cost-based and fair value measures

- Is it necessary to expand on relevance and faithful representation in measurement chapter?
  - How and why?
Measurement

- Path of this project phase has taken several turns
  - range from highly conceptual to writing down what is in existing standards
- The measurement phase is highly controversial
  - measuring things in financial statements is fundamental
  - but, there are no concepts to guide the choice of attribute
  - people have firmly held (although often loosely defined) views
  - some fear fair value is the logical answer to applying the objective of financial reporting, qualitative characteristics, and elements definitions
- Regardless, measurement concepts are sorely needed

Classification and presentation

- Financial statements portray financial effects of transactions and events by:
  - grouping into broad classes (the elements, eg asset)
  - sub-classify elements (eg assets sub-classified by their nature or function in the business—PPE, inventory, invest. property)
  - further sub-classifying IFRS classifications of assets (eg PPE) into separate classes—a grouping of assets of a similar nature and use in an entity’s operations
Why classify assets and claims?

- Information about the nature and amounts of a reporting entity’s economic resources and claims can help users to identify the reporting entity’s financial strengths and weaknesses.
- That information can help users to:
  - assess the reporting entity’s liquidity and solvency
  - its needs for additional financing and how successful it is likely to be in obtaining that financing. (CF.OB13)

Why classify assets?

Different types of economic resources affect a user's assessment of the prospects for future cash flows differently.
- Some future cash flows result directly from existing economic resources (e.g., accounts receivable and investment property).
- Other cash flows result from using several resources in combination to produce and market goods or services to customers (e.g., PPE and intangible assets).
  - Although those cash flows cannot be identified with individual economic resources (or claims), users of financial reports need to know the nature and amount of the resources available for use in a reporting entity’s operations. (CF.OB14)
Asset classification

Which IFRS classification of asset are?
• land
• bird breeder’s birds
• birds in a zoo
• gold

How many classes (similar nature and use) of PPE?
• plot on which HQ is built
• vacant plot, about to construct new HQ
• plot that operates as landfill site
• plot on which sales office is built
• 10 plots in different cities each with retail outlet
• vacant plot acquired for an undetermined purpose

Disclosure

• Objective of financial reporting
• Notes provide narrative descriptions or disaggregations of items presented in ‘primary’ statements and information about items that do not qualify for recognition in those statements – the failure to recognise an item cannot be rectified by disclosure
• Application of IFRSs with additional disclosures when necessary results in a fair presentation (faithful representation of transactions, events and conditions)
Conceptual Framework versus standards-level projects

• How can standard setting continue without finishing the Conceptual Framework project first?
  – we have a Conceptual Framework in place today (not perfect)
  – Standards-level projects inform Conceptual Framework project and vice-versa (eg liabilities and equity)
  – Standards need improvement and Conceptual Framework project is likely to take many years; investors cannot wait for better information

• Would a completed Conceptual Framework help standard setting?
  – Yes, particularly measurement
  – Also, disclosure and presentation
Agenda consultation

- Public agenda review every three years
- Will help the IASB establish a broad strategic direction for its work plan:
  - establish a balance between:
    - improvements (new IFRSs); and
    - maintenance (implementation)
  - determine whether to return to projects that have been deferred
  - identify areas where improvements are needed

Agenda Consultation

The IASB's initial thinking

- Development of financial reporting
  - investing in researching key strategic issues
  - completion of the Conceptual Framework
  - completing MoU projects
  - selected standards-level projects
- Maintenance of existing IFRSs
  - post-implementation reviews
  - responding to implementation needs
- Expansion of research function
**Common conceptual misunderstandings**

Michael Wells, Director, IFRS Education Initiative, IASB

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**Common ‘conceptual’ misunderstandings**

<table>
<thead>
<tr>
<th>The Framework does not…</th>
<th>Clarification—the Framework includes</th>
</tr>
</thead>
<tbody>
<tr>
<td>include a matching concept</td>
<td>accrual basis of accounting—recognise elements when satisfy definition and recognition criteria</td>
</tr>
<tr>
<td>include prudence/conservatism concept</td>
<td>neutrality concept</td>
</tr>
<tr>
<td>include an element other comprehensive income (or a concept for OCI)</td>
<td>only the following elements—asset, liability, equity, income and expense</td>
</tr>
<tr>
<td>mention management intent or business model</td>
<td></td>
</tr>
</tbody>
</table>
### Misunderstanding Clarification

<table>
<thead>
<tr>
<th>Misunderstanding</th>
<th>Clarification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uniformity = comparability</td>
<td>Comparability is achieved when like things are accounted for in the same way. Comparability is not achieved when accounting rules require unlike things be accounted for in the same way.</td>
</tr>
</tbody>
</table>

### Misunderstanding Clarification

<table>
<thead>
<tr>
<th>Misunderstanding</th>
<th>Clarification</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is a clear concept for the historical cost of an item</td>
<td>The Framework provides only a vague description—assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition.</td>
</tr>
<tr>
<td></td>
<td><strong>What is cost when:</strong></td>
</tr>
<tr>
<td></td>
<td>- advance/deferred payment?</td>
</tr>
<tr>
<td></td>
<td>- purchased option exercised?</td>
</tr>
<tr>
<td></td>
<td>- contingent purchase price?</td>
</tr>
</tbody>
</table>
### Common ‘conceptual’ misunderstandings continued

<table>
<thead>
<tr>
<th>Misunderstanding</th>
<th>Clarification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principles are necessarily less rigorous than rules</td>
<td>Rules are the tools of financial engineers</td>
</tr>
</tbody>
</table>
| There are few judgements and estimates in cost-based measurements               | Inventory, eg allocate joint costs and production overheads  
PPE, eg costs to dismantle/restore site, useful life, residual value, depreciation method  
Provisions, eg uncertain timing and amount of expected future cash flows          |

### Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenters. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.
Technical break-out sessions:

Leases: Lessor (Part 2)

PHILIPPE DANJOU
Member
IASB

PATRINA BUCHANAN
Technical Principal
IASB
Why a leases project?

- Existing lease accounting does not meet users’ needs
  - accounting depends on classification
  - contractual rights and obligations (assets and liabilities) are off balance sheet
  - users forced to adjust financial statements

- Structuring opportunities
  - lease classification often based on bright lines
  - significant difference in accounting on either side of operating/finance lease line
Where we are

- **March 2009**
  - Discussion Paper
  - Leases: Preliminary Views

- **August 2010**
  - Exposure Draft
  - Leases

- **Q4 2012**
  - Second Exposure Draft
  - Leases

- **TBD**
  - Final Standard
  - Leases

Comment period 4 months
- 786 comment letters received
- Primarily focused on lessee accounting

Re-expose proposals
- Focus on revisions to 2010 proposals
- Will contain proposals for both lessees and lessors

Effective date: TBD
- Will contain guidance for both lessees and lessors

---

**2010 ED – lessor accounting**

Does the lessor retain significant risks or benefits of the underlying asset?

- **No**
  - Derecognition approach:
    - Derecognise underlying asset
    - Recognise residual asset
    - Profit on amount derecognised and interest income

- **Yes**
  - Performance obligation approach:
    - Recognise underlying asset
    - Recognise performance obligation
    - Lease income, depreciation and interest income

Both approaches: recognise lease receivable
Feedback received—main themes

Concerns about lessor model:
- relationship with lessee model
- not representing economics
- little support for PO approach

Concerns about cost and complexity

Concerns about service contracts being captured as leases

Proposed right-of-use model

- A lease contract is one in which the right to control the use of an asset (for a period of time) is transferred to the lessee.
Redeliberations—lessor model

Lessor accounting approach

Type of lease

- Lessee acquires more than insignificant portion of leased asset
  - Receivable and residual approach
- Lessee does not acquire more than insignificant portion of leased asset
  - Approach similar to operating lease accounting

Asset subject to lease

Redeliberations—the rationale

What the lessor provides

- Lessor provides the lessee with the right to use an asset
- Leases vary from those for almost all of the life of leased asset to those for very short portion of the life of leased asset
  - 20-year airplane lease => lessor charges the lessee to recover almost all of the value of the airplane plus interest
  - 3-year real estate lease => lessor charges the lessee only for use of the real estate
- Recognise lease receivable and interest in residual asset when lessor sells a portion of the leased asset
  - No change to accounting for leased asset and recognise straight-line rental income when lessor charges the lessee only for use of the real estate

What the right-of-use represents

How best to reflect those contracts in lessor’s financial statements
Determining type of lease

Lessee acquires more than insignificant portion of leased asset

- Leases of assets other than property unless:
  - Lease term is insignificant relative to economic life of asset
  - PV of lease payments is insignificant relative to FV of asset

Lessee does not acquire more than insignificant portion of leased asset

- Leases of property (land and/or a building) unless:
  - Lease term is major part of economic life of asset
  - PV of lease payments is substantially all of FV of asset

Determining type of lease—examples

As assumed economic life of:
1. Vessel (20 yrs)
2. Truck (4 yrs)
3. Car (3 yrs)
4. Airplane (8 yrs)
5. Vessel (5 yrs)
6. Comm. real estate (10 yrs)
7. Comm. real estate (30 yrs)

1 40 years
2 25 years
3 10 years
4 6 years
## Receivable and residual approach

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Income Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Right to receive lease payments*</td>
<td>X</td>
</tr>
<tr>
<td>Residual asset**</td>
<td>X</td>
</tr>
</tbody>
</table>

*Present value of lease payments, plus initial direct costs  
** Measured at an allocation of carrying amount of leased asset  
*** Interest on residual based on estimated residual value—any profit on the residual asset is not recognised until asset sold or re-leased at end of lease term

## Approach similar to operating lease accounting

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Income Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leased asset *</td>
<td>X</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Lessor measures leased asset in accordance with other standards (eg IAS 16, IAS 40)  
** Rental income recognised on a straight-line basis or another systematic basis, if more representative of pattern of earning rentals  
***If property measured at cost, rental income plus depreciation recognised  
**** If property measured at fair value, rental income plus fair value changes recognised
Application example–equipment lease

- Assumptions and workings:

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of leased asset</td>
<td>CU1,000</td>
<td></td>
</tr>
<tr>
<td>Carrying amount of leased asset</td>
<td>CU950</td>
<td></td>
</tr>
<tr>
<td>Lease term</td>
<td>5 years</td>
<td></td>
</tr>
<tr>
<td>Residual (future value)</td>
<td>CU500</td>
<td></td>
</tr>
<tr>
<td>Residual (present value)</td>
<td>CU374</td>
<td></td>
</tr>
<tr>
<td>Rents (annual in arrears)</td>
<td>CU149</td>
<td></td>
</tr>
<tr>
<td>Rate implicit in lease</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>Initial direct costs</td>
<td>none</td>
<td></td>
</tr>
<tr>
<td>PV of lease payments =</td>
<td>Lease receivable</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CU626</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total profit on transaction = FV of UA – CA of UA</th>
<th>1,000 - 950 = 50</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit on ROU = lease rec/FV of UA * Total profit</td>
<td>626/1,000 * 50 = 31</td>
</tr>
<tr>
<td>Unearned income (profit relating to residual) = total profit – profit on ROU</td>
<td>50 – 31 = 19</td>
</tr>
</tbody>
</table>

Application example–equipment lease continued

<table>
<thead>
<tr>
<th>Periods</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance sheet</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivable</td>
<td>626</td>
<td>515</td>
<td>397</td>
<td>273</td>
<td>140</td>
<td>0</td>
</tr>
<tr>
<td>Gross residual asset</td>
<td>374</td>
<td>396</td>
<td>420</td>
<td>445</td>
<td>472</td>
<td>500</td>
</tr>
<tr>
<td>Net residual asset</td>
<td>355</td>
<td>377</td>
<td>401</td>
<td>426</td>
<td>453</td>
<td>481</td>
</tr>
</tbody>
</table>

| **Income statement** | | | | | | |
| Gain on sale | 31 | - | - | - | - | - |
| Interest on receivable | - | 38 | 31 | 24 | 16 | 8 |
| Unwinding interest for residual asset | - | 22 | 24 | 25 | 27 | 28 |
| **Total lease income** | 31 | 60 | 55 | 49 | 43 | 37 |
Reducing complexity and cost

<table>
<thead>
<tr>
<th>Options to extend the lease term (term options)</th>
<th>2010 ED</th>
<th>Post-ED simplifications</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Longest possible lease term more likely than not to occur</td>
<td></td>
<td>• Option period included if lessee has significant economic incentive to exercise</td>
</tr>
<tr>
<td>• Reassessed</td>
<td></td>
<td>• Reassessed other than for market conditions</td>
</tr>
<tr>
<td>Variable lease payments</td>
<td></td>
<td>• Excluded from liability (unless in-subs- stance fixed or based on an index or rate) and accounted for as occurred</td>
</tr>
<tr>
<td>• Included in lease liability on probability-weighted basis</td>
<td></td>
<td>• Reassessed for spot/index</td>
</tr>
<tr>
<td>• Reassessed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short–term leases (lease term ≤ 12 months)</td>
<td></td>
<td>• No liability/asset recognised</td>
</tr>
<tr>
<td>• Liability/asset recognised with no discounting</td>
<td></td>
<td>• Rent expense</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• IAS 17 operating lease model</td>
</tr>
</tbody>
</table>

Redeliberations – definition of a lease

• ‘Contract in which the right to use an asset is conveyed, for a period of time, in exchange for consideration’
  – underlying asset = identifiable (physically distinct)
  – right to control use of underlying asset

• Notion of control changed
  – ‘ability to direct the use’ and receive benefits
  – change from EITF 01-8/IFRIC 4/ED:
    if entity obtains substantially all output ≠ control
  – pricing does not determine control
Redeliberations – lessor other issues

- Impairment
  - financial asset impairment guidance for receivable
  - non-financial impairment guidance for residual asset

- Residual value guarantees
  - not recognised separately
  - considered when assessing residual asset for impairment

- Multi-element contracts
  - separately account for non-lease elements
  - allocate using revenue guidance (selling price)

Redeliberations–lessor presentation

- Balance sheet
  - Receivable on the face or notes
  - Residual on the face or notes
  - Lease assets on the face

- Statement of cash flows
  - cash inflows from leases → operating activities
Redeliberations–lessor disclosure

- Reconciliation of lease receivable and residual asset*
- Maturity analysis
- A table of all lease income, including short-term
- Details of contingent rentals and options
- Details of purchase options
- Details on residual asset risk management including quantitative exposure*
- Similar requirements for leases to which an approach similar to operating lease accounting is applied

* Receivable and residual approach only

Redeliberations – lessor transition*

- Retrospective approach but based on information available at beginning of earliest comparative period
- Reliefs available
  - use of hindsight
  - no evaluation of initial direct costs for contracts before effective date
- No requirement to make adjustments for leases currently classified as finance/capital leases

* Lessor can choose to fully retrospectively apply the new leases standard
What happens next?

- **Q3 2012**: Finalise Redeliberations
- **Q4 2012**: Publish Revised Exposure Draft
- **2012/2013**: Consultation
- **TBD**: Issue Final Standard

<table>
<thead>
<tr>
<th>Stage</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finalise Redeliberations</td>
<td>Q3 2012</td>
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<tr>
<td>Publish Revised Exposure Draft</td>
<td>Q4 2012</td>
</tr>
<tr>
<td>Consultation</td>
<td>2012/2013</td>
</tr>
<tr>
<td>Issue Final Standard</td>
<td>TBD</td>
</tr>
</tbody>
</table>

Some sweep issues
- Comment letter period TBD
- Outreach
- Working group meetings
- Redeliberations

Effective date: TBD

Questions or comments?

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Technical break-out sessions:

Emissions trading schemes

IAN MACKINTOSH
Vice-Chairman
IASB

ALLISON McMANUS
Technical Manager
IASB
International Financial Reporting Standards

Emissions Trading Schemes
Ian Mackintosh, Vice-Chairman
Allison McManus, Senior Technical Manager

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Agenda

1. Background
2. Where are we in the project?
3. Scope of the project
4. Main accounting issues
5. Current practice
6. Next steps
What is an emission trading scheme?

- Emission trading scheme
- Rights and obligations
- Emissions of different gases
- How to account for those rights and obligations??

Growth of emissions trading schemes

- Climate change is a critical issue
- Jurisdictions seeking to reduce emissions
- Emissions trading schemes are a low cost solution
- More jurisdictions implementing some form of scheme

- European Emissions Trading Scheme (EU ETS)
- Tokyo Emissions Trading Scheme
- Regional Greenhouse Gas Initiative (RGGI)
- Carbon Price Mechanism (Australia)
- New Zealand Emissions Trading Scheme
Need for a project on ETS?

Implementation of many schemes internationally

Requests for guidance

No current international guidance

Divergent accounting practices

Agenda

1. Background
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3. Scope of the project
4. Main accounting issues
5. Current practice
6. Next steps
Where are we in the project?

- IASB and FASB put project on hold
- Some tentative decisions
- November 2010
- H2 2011
- Agenda consultation
- Recommendation: add to work plan

ETS and the work plan

- Board will finish work on 4 main projects (revenue, leases, insurance and financial instruments)
- Board supports adding emissions trading schemes to research programme
  - Add as priority research project
  - First milestone: discussion paper?
- Work also to be restarted on conceptual framework
  - Staff to continue to consider interaction with elements phase (primarily the definition of a liability)
Agenda

1. Background
2. Where are we in the project?
3. **Scope of the project**
4. Main accounting issues
5. Current practice
6. Next steps

---

**Scope of the project**

- 2 main types of schemes
  - Cap & trade
  - Baseline and credit

- Related activities
  - Forestry
  - Project-based activities

Rights and obligations under an emissions trading scheme
**Main types of schemes - Cap & trade v Baseline & credit**

<table>
<thead>
<tr>
<th></th>
<th><strong>Cap &amp; trade</strong></th>
<th><strong>Baseline &amp; credit</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall cap</strong></td>
<td>Units of emissions (e.g., tonnes of CO₂) that may be released</td>
<td>Baselines are assigned to</td>
</tr>
<tr>
<td><strong>(emissions target)</strong></td>
<td>within commitment period</td>
<td>individual emitters up to the overall cap</td>
</tr>
<tr>
<td><strong>Implementation of overall cap</strong></td>
<td>Allocation or auction of allowances to individual emitters up to overall cap</td>
<td>Credits issued only if emissions are below baseline at end of the year</td>
</tr>
<tr>
<td><strong>Trading mechanism</strong></td>
<td>Allowances are tradable</td>
<td>Credits are tradable, baseline is not</td>
</tr>
<tr>
<td><strong>Remittance obligation</strong></td>
<td>Allowances covering total emissions</td>
<td>Credits covering emissions in excess of baseline</td>
</tr>
</tbody>
</table>

**Related activities**

- **Forestry**
  - Allowances received for sequestering carbon
  - Only required to return allowances when carbon released

- **Project-based activities**
  - Project developer receives credits (e.g., CERs) for reducing emissions below a specified benchmark
Agenda

1. Background
2. Where are we in the project?
3. Scope of the project
4. Main accounting issues
5. Current practice
6. Next steps

What are the main accounting issues?

• What elements should an entity recognise in its financial statements for emissions trading schemes?
  – Allowances and baselines – are they assets?
  – What are the obligations/liabilities in each scheme? (most contentious issue)
• How do you measure the assets and liabilities?

Initial focus: cap and trade schemes
Assets

‘An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.’ [Conceptual Framework]

Allowances – are they assets?

- Allowances meet the definition of an asset
- How do you measure them?

<table>
<thead>
<tr>
<th></th>
<th>Alternative 1</th>
<th>Alternative 2</th>
<th>Alternative 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchased allowances</td>
<td>Measure the assets initially and subsequently at fair value</td>
<td>Measure the assets based upon their ‘intended use’</td>
<td>Either Alternative 1 or Alternative 2</td>
</tr>
<tr>
<td>Allocated allowances*</td>
<td><strong>Bold:</strong> Measure the assets initially and subsequently at fair value</td>
<td><strong>Bold:</strong> Measure the assets based upon their ‘intended use’</td>
<td>NIL</td>
</tr>
</tbody>
</table>

*received from the scheme administrator for no monetary consideration
Liabilities

'A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.' [Conceptual Framework]

What are the liabilities?

Entity emits → Liability

Entity receives allowances for ‘free’ → A liability?

If not, how to account for credit?
How do you measure the liabilities?

- At fair value of the allowances? (IAS 37)
- At cost of allowances held? What if allowances measured at NIL (ie because they have been received for ‘free’)?

Price

X

Quantity

- Tonnes of emissions?
- Number of allocated allowances received?

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What was the IFRIC 3 approach?

- **IFRIC 3 Emission Rights** was issued in 2004
  - Allocated allowances measured at fair value, not remeasured unless active market, remeasurement (if any) recognised in OCI [IAS 38]
  - Corresponding amount amortised to income [IAS 20]
  - Liability for actual emissions remeasured at fair value, remeasurement recognised in income [IAS 37]
- IFRIC 3 met considerable resistance because of “Mismatch” of asset and liability
- IFRIC 3 was withdrawn in 2005

What is current practice?

2 main approaches for recognition and measurement (cap & trade)

<table>
<thead>
<tr>
<th></th>
<th>Approach 1</th>
<th>Approach 2 (like IFRIC 3)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchased Allowances</strong></td>
<td>Purchase price (ie Cost)</td>
<td></td>
</tr>
<tr>
<td><strong>Allocated Allowances</strong></td>
<td>NIL</td>
<td>Market value. No remeasurement.</td>
</tr>
<tr>
<td>Government grant (deferred revenue)</td>
<td>N/A</td>
<td>Market value of allocated allowances. Amortised</td>
</tr>
<tr>
<td>Liability for actual emissions</td>
<td>Recognise as emissions occur. Measure at carrying amount of allowances on hand (which may be NIL), or market value for excess.</td>
<td>Recognise as emissions occur. Measure at market value of allowances at each reporting date.</td>
</tr>
</tbody>
</table>
Work of the national standard-setters

- France, Italy and Australia have developed accounting proposals for emissions trading schemes
- Approaches vary, but some similarities
  - For example, France and Italy consider the entity’s business model
- Australian scheme also varies significantly (at least initially) from EU ETS

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Next steps

- Restart work on project as part of the research programme
- Consider work of national standard-setters
- Determine first milestone
  - Discussion paper?
- Main challenges in moving forward:
  - Schemes are new and constantly changing
  - Need to find a solution that can be implemented across schemes that vary significantly

Where to get more information

Find out more at:

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Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.
Questions or comments?

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