Conference Documentation

IASC Foundation

IFRS® Conference: London

2010

A one-and-a-half-day conference for senior financial executives & other interested parties
IASC Foundation
IFRSs Conference
Wednesday 23 and Thursday 24 June 2010 – Hilton London Metropole (UK)

Day 1 – Wednesday 23 June 2010

Conference Programme

08:30  Registration - Light buffet and refreshments

09:00  Introduction
      Sir David Tweedie, Chairman, IASB

09:15  Consolidation and derecognition
      Bob Garnett, Member, IASB
      Warren McGregor, Member, IASB

10:45  Coffee break

11:15  Financial statement presentation
      Patricia McConnell, Member, IASB

11:45  Implementation update: progress and plans
      Michael Stewart, Director of Implementation Activities, IASB

12:30  Keynote speaker
      Fernando Restoy, Chairman CESR’s (Committee of European Securities Regulators) Corporate Reporting Standing Committee (CESR-Fin)

13:15  Lunch

14:15  Break-out sessions:
      conducted by IASB members and staff
      Choose one of:
      Conceptual Framework
      • Warren McGregor, Member, IASB
      • Alan Teixeira, Director of Technical Activities, IASB
      Revenue recognition
      • Prabhakar Kalavacherla, Member, IASB
      • April Pitman, Technical Manager, IASB
      Financial instruments with characteristics of equity
      • Jan Engström, Member, IASB
      • Joanna Yeoh, Technical Manager, IASB

15:45  Break-out sessions:
      conducted by IASB members and staff
      Choose one of:
      Leases
      • Patricia McConnell, Member, IASB
      • Rachel Knubley, Technical Principal, IASB
      Emissions trading schemes
      • Philippe Danjou, Member, IASB
      • Allison McManus, Technical Manager, IASB
      Hedge Accounting
      • Bob Garnett, Member, IASB

17:15-18:15  Cocktail reception

Day 2 – Thursday 24 June 2010

Conference Programme (cont’d)

08:30  Registration - Light buffet and refreshments

09:00  IASB update: 2011 and beyond
      Sir David Tweedie, Chairman, IASB

09:30  Financial instruments: replacing IAS 39
      Stephen Cooper, Member, IASB
      Sue Lloyd, Associate Director, IASB

11:00  Coffee break

11:30  Panel discussion: replacing IAS 39
      • Sylvie Matherat, Director, Financial Stability Banque de France and Member, Basel Committee (Chair Accounting Task Force)
      • Dennis Jullens, European Head of Global Accounting and Valuation Group, UBS Investment Bank
      • Charlotte Jones, CFO, EMEA, Deutsche Bank AG

13:00  Lunch

Special Interest Sessions (post-conference)

14:00–16:30  Choose one of:

1.  Regulatory Update
    Chair: Amaro Gomes, Member, IASB

2.  IFRS for Small and Medium-sized Entities
    Chair: Gilbert Gelard, Member, IASB

3.  IFRS for Extractive Activities
    Chair: Bob Garnett, Member, IASB

4.  IFRS for Insurance Contracts
    Chair: Warren McGregor, Member, IASB

16:30  End of conference
Special Interest Session

**Regulatory Update**

To provide a comprehensive service for those with a special interest in recent regulatory developments the IASC Foundation will hold an intensive half-day session immediately after its IFRS conference, on the afternoon of 24 June 2010.

Programme

13.00 Registration
14.00 Introduction
   Amaro Gomes
   Member
   IASB
14.05 European Commission
   Jeroen Hooijer
   Head of Unit of Financial Reporting Policy, DG Internal Market and Services, European Commission
14.30 CESR-fin
   Sophie Baranger
   Chief Accountant, French Autorite des Marches Financiers and Chair of the IFRS Project Group, CESR
14.55 United Kingdom
   Richard Thorpe
   Accounting and Audit Policy Sector Leader and Head of Accounting and Audit Policy Department, UK Financial Services Authority
15.20 United States of America
   Julie Erhardt*
   Deputy Chief Accountant, US SEC
15.45 Round-table Q&A
   Chair:
   Amaro Gomes, Member, IASB
   Panellists:
   Jeroen Hooijer, Head of Unit of Financial Reporting Policy, DG Internal Market and Services, European Commission
   Sophie Baranger, Chief Accountant, French Autorite des Marches Financiers and Chair of the IFRS Project Group, CESR
   Richard Thorpe, Accounting and Audit Policy Sector Leader and Head of Accounting and Audit Policy Department, UK FSA
   Julie Erhardt, Deputy Chief Accountant, US SEC*
16.25 Concluding comments
   Amaro Gomes
   Member
   IASB

Special Interest Session

**IFRSs for Extractive Activities**

The extractive activities project is a comprehensive research project that forms the first step towards the development of an acceptable approach to resolving accounting issues that are unique to upstream extractive activities.

The ultimate objective of this project is to develop an IFRS on accounting for extractive activities. This IFRS will supersede IFRS 6 Exploration and Evaluation of Mineral Resources, which the Board released in December 2004 as an interim measure pending completion of the comprehensive project.

This special interest session will help you to consider financial reporting issues associated with reserves and resources (including the exploration for reserves and resources) and other IASB projects that are of particular interest in the extractive industries.

Programme

13.00 Registration
14.00 Introduction
   Bob Garnett
   Member
   IASB
14.05 Technical update
   Accounting issues including:
   • Extractive activities project
   • Joint arrangements
   • Deferred stripping
   • Other developments
   Glenn Brady
   Senior Technical Manager
   IASB
15.00 Mining preparer’s perspective
   Laura Barbrook
   Deputy Controller
   Rio Tinto
15.25 Oil and gas preparer’s perspective
   Svetlana Pereverzeva, Head of Accounting Policy - E&P
   BP
15.45 Round-table Q&A
   Chair:
   Bob Garnett, Member, IASB
   Panellists:
   Glenn Brady, Senior Technical Manager IASB
   Laura Barbrook, Deputy Controller, Rio Tinto
   Svetlana Pereverzeva, Head of Accounting Policy - E&P, BP
16.25 Concluding comments
   Bob Garnett, Member, IASB

* Subject to confirmation

Register Today
Tel: +44 (0)20 7017 5509
Fax: +44 (0)20 7017 7824
Email registration@iascfconference.org
Web www.iascfconference.org
Special Interest Session
Insurance Contracts

The IASB’s project to improve requirements for accounting for insurance contracts is split into two phases:

- Phase I of this project was aimed at addressing the most urgent issues. It was finalised in 2004 and resulted in IFRS 4 Insurance Contracts, an interim standard that permits a wide variety of accounting practices for insurance contracts. Many of these practices differ from those used in other sectors and make it difficult to understand insurers’ financial statements.

- The IASB is currently undertaking Phase II of the project. In this phase the Board intends to develop a standard that will replace the interim standard and that will provide a basis for consistent accounting for insurance contracts on the longer term.

This intensive workshop will provide you with a special focus on Phase II of the IASB’s insurance contracts project.

Programme

13.00 Registration

14.00 Introduction
Warren McGregor
Member IASB

14.05 Technical update
Peter Clark
Director of Research
IASB

14.35 Preparer’s perspective
Hugh Francis
Director of External Reporting Developments
AVIVA

15.10 Analyst’s perspective
Rob Jones
Managing Director
Standard & Poor’s

15.45 Round-table Q&A
Chair: Warren McGregor, Member, IASB
Panellists: Peter Clark, Director of Research, IASB
Hugh Francis, Director of External Reporting Developments, AVIVA
Rob Jones, Managing Director, Standard & Poor’s

16.25 Concluding comments
Warren McGregor, Member, IASB

Special Interest Session
IFRS for Small and Medium-sized Entities

Published by the IASB in July 2009, the IFRS for SMEs is a self-contained standard designed to meet the needs and capabilities of small and medium-sized entities, which are estimated to account for over 95 per cent of all companies around the world.

Compared with full IFRSs (and many national GAAPs), the IFRS for SMEs is less complex in a number of ways.

This intensive half-day session is designed to assist companies and accounting practitioners in applying the standard. It will include updates from various perspectives including the UK and Ireland’s adoption proposal, the IASC Foundation’s implementation support activities, the South African implementation experience and the European Federation of Accountants and Auditors of SMEs.

Programme

13.00 Registration

14.00 Introduction
Gilbert Gélard, Member, IASB

14.05 Implementation update
Paul Pacter, Chairman of the SME Implementation Group and Director of Standards for SMEs, IASB

14.35 Perspectives
- UK & Ireland plans
  Ian Mackintosh, Chairman, ASB
- South African experience
  Bruce Mackenzie, Managing Partner, W Consulting
- Preparer’s and auditor’s perspective
  Geoffrey Britton, President, European Federation of Accountants and Auditors of SMEs

15.50 Round-table Q&A
Chair: Gilbert Gélard, Member, IASB
Panellists: Geoffrey Britton, President, European Federation of Accountants and Auditors of SMEs
Ian Mackintosh, Chairman, ASB
Bruce Mackenzie, Managing Partner, W Consulting
Paul Pacter, Chairman of the SME Implementation Group and Director of Standards for SMEs, IASB

16.25 Concluding comments
Gilbert Gélard, Member, IASB

Register Today
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Email registration@iascfconference.org  Web www.iascfconference.org
Introduction

SIR DAVID TWEEDIE  
Chairman  
IASB
Consolidation and derecognition

BOB GARNETT
Member
IASB

WARREN Mcgregor
Member
IASB
Reasons for proposals

<table>
<thead>
<tr>
<th>Criticisms: Current accounting</th>
<th>Solution: Proposed accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inconsistencies in practice</strong></td>
<td>• Develop a single control model for all entities</td>
</tr>
<tr>
<td>• Tension between IAS 27 (control) and SIC-12 (risks and rewards)</td>
<td>• Provide clearer principles of control and additional application guidance</td>
</tr>
<tr>
<td>• Concerns that they are not being applied consistently</td>
<td>• SIC-12 performed well but proposals giving more guidance on consolidation of SPEs</td>
</tr>
<tr>
<td><strong>Financial crisis</strong></td>
<td>• Enhanced disclosure – particularly for unconsolidated structured entities</td>
</tr>
<tr>
<td>• Was guidance for structured entities sufficient?</td>
<td></td>
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<tr>
<td>• Should reputational risk be a basis for consolidation?</td>
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<tr>
<td>• Concerns disclosure was inadequate?</td>
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</table>
Where are we now?

- ED10 Published 12/08
- Public consultation – comment letter process & round tables (June 2009)
- Board deliberations (joint with FASB from Nov 2009) Began July 2009
- IASB draft of consolidation standard Aug/Sept 2010
- IASB final consolidation standard Q4 2010
- IASB draft of disclosure standard Aug/Sept 2010
- IASB final disclosures standard (incl JVs and associates) Q4 2010
- IASB investment entity ED Q4 2010

Additional input from: Users, preparers, firms, special interest groups, local standard setters and regulators during the comment period, at round table meetings in June 2009 and on ongoing basis

The control model – overview

Definition of control

A reporting entity controls another entity when the reporting entity has the **power** to direct the activities of that other entity to generate **returns** for the reporting entity

- Single consolidation model for all entities, including structured entities
- Consolidation based on control – ‘power so as to benefit’ model
- Controller must have some exposure to risks and rewards. Exposure is an indicator of control but is not control of itself
- Power arises from contractual rights—voting rights (either majority or less than a majority), potential voting rights, other contractual arrangements, or a combination thereof.
Assessing control of an entity

Questions:

1. Are a reporting entity’s rights sufficient to give it power, i.e., the current ability to enforce its will in directing the activities of an entity that significantly affect the returns?

2. Does the reporting entity have the ability to benefit from that power?

Main changes from IAS 27 / SIC-12

1. “De facto” control

Current IFRS:

• In practice, often no consolidation with less than 50% of voting rights

ED10:

• Entity can control with less than 50%
• Feedback: operationality issues
“De facto” control

Boards’ tentative decisions:
• Entity can control with less than 50%. Factors to consider include:
  – Size of the holding rights relative to the size and dispersion of other vote holders
  – Voting patterns at previous shareholders meetings
  – Potential voting rights (see below)
  – Other contractual rights
• If those indicators are not conclusive consider additional indicators of power (eg appointment of management, etc)

Main changes from IAS 27 / SIC-12

2. Potential voting rights

Current IFRS:
• Currently exercisable potential voting rights give the holder power

ED10:
• Potential voting rights can give the holder power (examples listed)
Potential voting rights

Boards’ tentative decisions:

• Substantive potential voting rights can give the holder power

• Determining whether potential voting rights are substantive requires judgement. Consider the terms and conditions of the instrument, including:
  – Whether the rights are currently exercisable
  – Whether exercise of the rights would be beneficial to the holder

Main changes from IAS 27 / SIC-12

3. SPEs / structured entities

Current IFRS:

• Indicators of control of an SPE:
  – purpose of SPE
  – decision-making powers
  – rights to majority of benefits
  – exposure to majority of risks

ED10:

• Apply general control definition—specific guidance included
SPEs / structured entities

Boards’ tentative decisions:

• Apply general control definition

• Additional application guidance added to address:
  – the purpose and design of an entity
  – the activities that significantly affect the returns
    (including multiple parties involved)
  – rights that are available when particular events happen
  – participating and protective rights
  – agency relationships (see next slide)

Main changes from IAS 27 / SIC-12

4. Agency relationships

Current IFRS:

• No specific guidance regarding agent/principal relationships

ED10:

• Removal rights and remuneration are indicators of an agency relationship
Agency relationships

Boards’ tentative decisions:
• Consider all of the following factors:
  – scope of the decision-making authority
  – rights held by other parties
  – remuneration of the decision-maker
  – the decision-makers’ exposure to variability of returns because of other interests that it holds in the entity
• List of examples of non-contractual agency relationships (related parties)

Main changes from IAS 27 / SIC-12

5. Investment entities

Current IFRS:
• An investment entity consolidates investments in entities that it controls

ED10:
• No change to current requirements
• Feedback from users: fair value provides the best information
• Input from the industry: proposals to define an investment entity
Investment entities

Boards’ tentative decisions:

• An investment entity is required to measure investments in entities that it controls at fair value through profit or loss
• An investment entity is one that meets all of the following criteria:
  - Express business purpose
  - Investment activity
  - Unit ownership
  - Pooling of funds
  - Fair value
  - Reporting entity

• Parent of an investment entity consolidates all entities that it controls, including controlled investees of an investment entity subsidiary.

Main changes from IAS 27 / SIC-12

6. Disclosures

Current IFRS:
• Limited disclosures for both consolidated entities and unconsolidated SPEs

ED10:
• Extensive disclosures for unconsolidated structured entities
• Feedback from users: generally agreed with proposals
• Feedback from others: generally, proposals were excessive
Disclosures

Boards’ tentative decisions:

• Develop a disclosures standard for a reporting entity's involvement with other entities, including subsidiaries, joint ventures, associates and unconsolidated structured entities

• Carry-over the disclosures in ED10, but give preparers more freedom to tailor disclosures according to their needs

International Financial Reporting Standards

Derecognition of Financial Assets and Liabilities

Bob Garnett, IASB member
Agenda

• Project overview
• Derecognition approach for financial assets
  – Description
  – Comparison to ED, IAS 39 and US GAAP
• Derecognition approach for financial liabilities
• Disclosures
• Next steps

Project overview
The **what, the why and the how**…

<table>
<thead>
<tr>
<th>Objective (what?)</th>
<th>Why?</th>
<th>Addressed how?</th>
</tr>
</thead>
<tbody>
<tr>
<td>To improve derecognition guidance</td>
<td>IAS39 is internally inconsistent (two principles)</td>
<td>One principle (with limited exceptions)</td>
</tr>
<tr>
<td>To reduce complexity</td>
<td>Many practice issues (IFRIC)</td>
<td></td>
</tr>
<tr>
<td>To improve transparency</td>
<td>Users’ and regulators’ concerns</td>
<td>Improved disclosures</td>
</tr>
<tr>
<td>To bring to convergence IFRS + US GAAP</td>
<td>MoU</td>
<td>New approach closer to US GAAP</td>
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</tbody>
</table>

**Chronology**

- **2005-2006**
  - Apr 05: Added to research agenda
  - Feb 06: Included in MoU

- **2007-2008**
  - Apr 08: Updated MoU
  - Jul 08: Added to active agenda

- **2009-2010**
  - Mar 09: Published ED (two views)
  - Oct 09: Selected one view
  - Jul 09: Comment letter period ended
Derecognition approach for financial assets – Description

Focus: Rights and obligations after transfer

- **Asset definition** *(Framework)*
  - Existence of future economic benefits
  - Control of the future economic benefits

- **Control**
  - Present ability to:
    - Obtain (access) the future economic benefits
    - Restrict others’ access to those benefits

- **Criteria for assessing control**
  - Does an entity cease to have present access, for its own benefit, to all economic benefits of the financial asset?
Implication 1:

Transfer rights to some ECs

=  Derecognise entire asset + Recognise economic benefits retained:

Proportionate benefits (eg 10% CFs)

Recognise as part of old asset
• Allocate carrying amount of old asset to part retained on basis of relative FVs
• Subsequently measure part retained using measurement attribute applied to old asset

Disproportionate benefits (eg first/last 10% CFs)

Recognise as new asset
• Initially measure at FV
• Subsequently measure according to IFRS 9

To address earnings manipulation concerns

Exceptions:

Repos and securities lendings

EXCEPTION: Seller accounts for repos and securities lendings as secured borrowings...

...even though seller no longer controls all the economic benefits of the asset.

Entitled and obliged to repurchase same, or substantially same, asset on or before maturity of asset
+ Entered into in contemplation or contemporaneously
+ Applies to agreements between two parties only
Interaction with consolidation

Order of application does not affect outcome

Focus is on control. But: Control of asset ≠ Control of entity

<table>
<thead>
<tr>
<th>Derecognition (Asset/Liability level)</th>
<th>Consolidation (Entity level)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Ability to obtain the future economic benefits</td>
<td></td>
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<tr>
<td>- Not a risk/rewards model</td>
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<tr>
<td>- Power to direct activities of another entity to generate returns</td>
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<tr>
<td>- Must have some exposure to risk/rewards</td>
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</table>

Why is the Board pursuing this approach?

Because it is the only sustainable approach.
Don’t believe us? Look at the benefits:

Principle based (with only limited exceptions)...Single concept (control)...Risks appropriately reflected in measurement...Resolves ‘stickiness’ issue (ie ‘history’ does not matter)...Results in recognition of assets and liabilities that are consistent with IASB Framework...Much simpler to apply in practice

Many respondents preferred this approach
Derecognition approach for financial assets – Comparisons

Comparison to alternative approach in ED/2009/3

<table>
<thead>
<tr>
<th>ED</th>
<th>Now</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repos and securities lendings = sale + forward derivative</td>
<td>Repos and securities lendings = secured borrowing</td>
</tr>
<tr>
<td>Proportionate interest retained = new asset</td>
<td>Proportionate interest retained = part of old asset</td>
</tr>
</tbody>
</table>
| Scope of ‘transfer’ definition too broad and not clear enough | • Removed ‘transfer’ definition  
  • Derecognition principle addresses concerns |
| Meaning of ‘economic benefits’ in derecognition principle not clear enough | Clarified meaning |
Comparison to IAS 39

No requirement to first apply consolidation
No criteria for what qualifies as part of an asset
No 'transfer' determination step
No explicit pass-through requirements
No risks and rewards test
Control defined broadly (eg practical ability to sell is not the only form of control)
No 'continuing involvement' measurement

Comparison to US GAAP

Main difference:

Legal isolation

Without legal isolation, approach is similar to US GAAP

Smaller differences:
- I/O and P/O strips
- Some puts and calls
- Measurement of some retained interests

Some differences are not substantive (easy to structure around)!
Derecognition approach for financial liabilities

Primary characteristics of a liability:
• Present obligation
• Outflow of resources embodying economic benefits

Derecognition approach:
Derecognise financial liability if:
• Present obligation is eliminated and
• No longer required to transfer economic resources in respect of that obligation
Special guidance for debt modifications

Extinguish liability when existing contract is **substantially modified** (ie if either test if met):

<table>
<thead>
<tr>
<th>Quantitative test:</th>
<th>Qualitative test:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timing, amounts or uncertainty of CFs under new or modified contract are <strong>substantially different</strong> from those under the original contract</td>
<td>Modification changes <strong>nature</strong> of debtor’s obligation or nature of investment that contract represents</td>
</tr>
</tbody>
</table>

Similar to IAS 39, but no threshold!  
New!

Debt modifications (continued)

**Examples of when qualitative test is met:**

- Change in currency in which P+I are denominated
- Addition or removal of contingent interest rate or shared appreciation features
- Change in liquidation preference or ranking of instrument
- Change from variable interest rate to fixed rate or vice versa
- Addition of repayment provisions or prepayment premium clauses
Extinguishment accounting

<table>
<thead>
<tr>
<th>Consideration = Assets or Equity</th>
<th>Consideration = New Liability (debt modification)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Derecognise old liability</td>
<td>Same +</td>
</tr>
<tr>
<td>• Recognise new liability at FV</td>
<td>Allocate to new liability costs that are directly</td>
</tr>
<tr>
<td>(initially)</td>
<td>attributable to that liability</td>
</tr>
<tr>
<td>• Recognise gain or loss equal</td>
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<tr>
<td>to difference between</td>
<td></td>
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<tr>
<td>carrying amount of old</td>
<td></td>
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<tr>
<td>liability and consideration paid*</td>
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<tr>
<td>• Include costs to extinguish</td>
<td></td>
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<tr>
<td>old liability in gain or</td>
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<tr>
<td>loss</td>
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</table>

*Consider whether difference between consideration paid and FV of old liability represents separate asset or liability

When repurchasing part of liability AND also modifying some terms, apply debt modification guidance to entire liability (ie contract as a whole)!

When repurchasing part of liability:

• Allocate carrying amount of existing liability between part derecognised and part not derecognised on basis of relative FVs
• Recognise gain or loss on only part derecognised (amount = carrying amount of that part minus consideration paid*)
Modification accounting

- Continue to recognise old liability
- Adjust carrying amount of liability for any costs incurred
- Amortise adjusted carrying amount over term of liability using original effective interest rate

No change from IAS 39!
Objectives

On-balance sheet disclosures
To help understand the relationship between financial assets that are not derecognised and associated liabilities

Off-balance sheet disclosures
To help evaluate the nature of and risks from continuing involvement in derecognised financial assets

On-balance sheet disclosures

Currently required (IFRS 7)
• Nature of (non derecognised) financial assets
• Nature of risks to which entity remains exposed
• Carrying amounts of assets and associated liabilities

New
• Description of nature of relationship between assets and associated liabilities (incl. restrictions on use of assets)
• If recourse only to assets: FV of assets, associated liabilities and net position
Off-balance sheet disclosures… all new

QUANTITATIVE disclosures – Part 1

- Carrying amount and FV of continuing involvement
- Maximum exposure to loss from continuing involvement
- FV of derecognised assets in which entity has continuing involvement
- Cash outflows to repurchase assets
- Maturity analysis of future cash outflows
- Sensitivity analysis

Aggregate disclosures when more than one category of continuing involvement with same derecognised assets

Off-balance sheet disclosures … all new

QUANTITATIVE disclosures - Part 2

- Gain or loss at date of derecognition
- Income and expense recognised from continuing involvement
- If transfer activity not evenly distributed in reporting period:
  (a) Total amount of activity and related gain or loss in period and
  (b) When greatest activity within period took place
Off-balance sheet disclosures … all new

QUALITATIVE disclosures

Terms of the transaction or modification that resulted in derecognition of financial assets:

(a) Description of the derecognised assets
(b) Nature and purpose of continuing involvement
(c) Risks to which entity remains exposed:
   (i) How entity manages risk from continuing involvement
   (ii) Whether entity bears losses before other parties + ranking and loss amounts borne by each category of party involved
   (iii) Events/circumstances that would trigger financial support or repurchase of derecognised asset

Next steps
Getting there…

- IASB + FASB discussion/decision?
- Exposure draft?
- Final standard?

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.
Financial statement presentation

PATRICIA McCONNELL
Member
IASB
Disclaimer: The views expressed in this presentation are those of the presenters, not necessarily those of the FASB, the Financial Accounting Foundation, the IASB or the IASC Foundation.

The exposure draft contains the boards’ formal decisions, which are still subject to change after the public comment period. Only the final standard will contain authoritative guidance.

Financial Statement Presentation Update
A joint FASB/IASB project

Patricia McConnell, IASB member

Project timeline

<table>
<thead>
<tr>
<th>Timeline</th>
<th>Event</th>
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<tbody>
<tr>
<td>October 2008</td>
<td>Discussion Paper issued (6 month comment period)</td>
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<tr>
<td>January – June 2009</td>
<td>Field testing</td>
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<tr>
<td>June 2009 – Mar 2010</td>
<td>Deliberations</td>
</tr>
<tr>
<td>June 2010</td>
<td>Exposure Draft issued</td>
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<tr>
<td>Summer 2010</td>
<td>Field testing</td>
</tr>
<tr>
<td>October 29, 2010</td>
<td>Comment letter period ends</td>
</tr>
<tr>
<td>Q4 2010 – Q1 2011</td>
<td>Redeliberations (tentative)</td>
</tr>
<tr>
<td>June 2011</td>
<td>Final standard (tentative)</td>
</tr>
</tbody>
</table>
Project Objective and Scope

• **Objective:** Establish a global standard that will guide the organization and presentation of information in the financial statements
  – Directly affect how management communicates information to users of its financial statements
  – Improve the usefulness of financial statement information to help users in their decision making

• **Scope:**
  – All business entities
  – All financial statements

Core presentation principles

Information should be presented in the financial statements in a manner that:

• Portrays a *cohesive* financial picture of an entity’s activities
  – Relationships are clear, statements are complementary

• *Disaggregates* information so that it explains the components of an entity’s financial position and financial performance
  – Consider disaggregation by function, nature and measurement basis in each financial statement
Structure of the financial statements

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>Business section</td>
<td>Business section</td>
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</tr>
<tr>
<td>Operating category</td>
<td>Operating category</td>
<td>Operating category</td>
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<tr>
<td>Operating finance subcategory</td>
<td>Operating finance subcategory</td>
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<tr>
<td>Investing category</td>
<td>Investing category</td>
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<tr>
<td>Financing section</td>
<td>Financing section</td>
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<tr>
<td>Debt category</td>
<td>Debt category</td>
<td>Debt category</td>
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<tr>
<td>Equity category</td>
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<tr>
<td>Multi-category transaction section</td>
<td>Multi-category transaction section</td>
<td></td>
</tr>
<tr>
<td>Income tax section</td>
<td>Income tax section</td>
<td>Income tax section</td>
</tr>
<tr>
<td>Discontinued operation section</td>
<td>Discontinued operation section, net of tax</td>
<td>Discontinued operation section, net of tax</td>
</tr>
<tr>
<td>other comprehensive income, net of tax</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Definitions

• **Business section** comprises operating and investing activities
  – **Operating**: an activity that generates revenue through interrelated use of an entity’s net resources (day-to-day activities)
    – **Operating finance**: primarily related to operating activities and secondarily provides a source of long-term financing (e.g., pension plan and decommissioning obligation)
  – **Investing**: related to an asset or a liability that generates a return in the form of interest, royalties and dividends and that does not result in significant synergies
Definitions

• Financing section — items that are part of an entity’s activities to obtain or repay capital
  – Debt: activity related to
    – borrowing arrangements entered into for the purpose of obtaining or repaying capital or
    – transactions in an entity’s own equity that gives rise to a liability or an asset
  – Equity: as defined in IFRSs/US GAAP

Definitions

• Income tax section: current and deferred income tax assets and liabilities that are recognized in accordance with income tax standards
• Discontinued operation section: all assets and liabilities related to a discontinued operation as determined in IFRSs/US GAAP
• Multicategory transaction section: the net effects of an acquisition that results in the recognition of assets and liabilities in more than one section or category in the statement of financial position
Classification and Presentation

• Assets, liabilities, and equity; income and expense items; and cash flows are **classified in sections, categories, and subcategories:**
  – based on how those items relate to an entity’s activities at the reportable segment level (if > 1 reportable segment)

• Present **subtotals** and **headings** for each section, category and subcategory in each financial statement

Statement of Financial Position

• Assets and liabilities presented together in sections and categories
  – Classification in sections and categories is a means of disaggregation by **function**
  – Within sections and categories, disaggregate assets and liabilities with different **measurement bases**

• Present assets and liabilities in:
  – **Short- and long-term** subcategories
    OR
  – **In order of liquidity** (if more relevant)
Statement of Financial Position

- Display *total assets* and *total liabilities* at bottom of SFP
- Display *subtotals* for short-term and long-term assets and liabilities on SFP
- Eliminate concept of *cash equivalents* from IFRS and US GAAP
  - Classify cash balance in operating category
  - Classify former cash equivalents as short-term investments

Statement of Comprehensive Income

- Statement of comprehensive income in two parts
  - *Profit or loss/net income* (relevant subtotal)
  - *Other comprehensive income*
- Identify whether OCI items relate to operating, investing, or financing activities
- OCI items recycled from OCI section to other sections or categories
  - When and if required by IFRSs/US GAAP
Statement of Comprehensive Income

- **Disaggregation by function and nature** within each section and category
  - Disaggregation by function in the SCI (unless that is not useful) (e.g., selling goods, manufacturing, research & development, marketing)
  - Disaggregation by nature either in the SCI or in a note, grouped by function (e.g., materials, labor, transportation and energy costs for the manufacturing function)
    - If >1 reportable segment by-nature information disclosed in segment note, grouped by function [FASB only]

Statement of Cash Flows

- **Present all cash flows using a direct method**
  - Provide a meaningful depiction of how an entity generates and uses cash
  - Disaggregate and present gross cash receipts and gross payments related to
    - **Operating** activities: cash received from customers, cash paid for labor, cash paid for advertising, purchase of PP&E
    - **Investing** activities: cash received from dividends, purchase of fixed income securities
    - **Financing** activities: cash paid for interest, proceeds from issue of common stock
  - Consider timing differences between current period cash flows and related amounts recognized in the SCI
Statement of Cash Flows

Also on the statement of cash flows:

• A **reconciliation** of operating income to operating cash flows
  – Adjustments include: non-cash items (e.g. depreciation); changes in operating assets (e.g. inventories, receivables); and cash flows from purchase, sale, or settlement of operating items (e.g., capital expenditure)

• All relevant information about **non-cash activities**
  – e.g., non-cash acquisition of an asset and the conversion of debt to equity

Notes to financial statements

• An **analysis of changes** between the beginning and ending balances of line items that are important for understanding changes in an entity’s financial position

• Disclosure of all **remeasurements** in a single note

• FASB: additional **segment reporting** requirements
  – a measure of operating: profit or loss, assets, liabilities, and cash flows for each reportable segment
  – Reconcile total of each measure to corresponding consolidated total
Analysis of changes in assets and liabilities

- The following types of changes should be presented separately as part of the analysis:
  - cash changes
  - non-cash components that are recurring and routine (e.g., credit sales and interest expense)
  - non-cash components that are neither recurring nor routine (e.g., a business combination)
  - accounting allocations (e.g., depreciation expense)
  - accounting allowances or reserves (e.g., bad debt expense)
  - remeasurements (e.g., fair value changes and impairment losses)

<table>
<thead>
<tr>
<th>PP&amp;E Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning balance, January 1, 20X0</td>
</tr>
<tr>
<td>Capital expenditures</td>
</tr>
<tr>
<td>Capitalization of leased asset</td>
</tr>
<tr>
<td>Capitalization of remediation asset</td>
</tr>
<tr>
<td>Depreciation</td>
</tr>
<tr>
<td>Amounts reclassified to held for sale</td>
</tr>
<tr>
<td>Ending balance, December 31, 20X0</td>
</tr>
<tr>
<td>Capital expenditures</td>
</tr>
<tr>
<td>Cash received from sale of assets</td>
</tr>
<tr>
<td>Capitalization of remediation asset</td>
</tr>
<tr>
<td>Depreciation</td>
</tr>
<tr>
<td>Remeasurement - gain on sale of assets</td>
</tr>
<tr>
<td>Ending balance, December 31, 20X1</td>
</tr>
</tbody>
</table>
Remeasurement note

- Present separately the remeasurement component of income and expense items recognized in the SCI
- A remeasurement is an increase or decrease in the carrying amount of an asset or a liability that is the result of:
  - A change in (or transaction at) a current price or value (e.g., fair value change in a security, loss on sale of receivable)
  - A change in an estimate of a current price or value (e.g., impairment of goodwill)
  - A change in any estimate or method used to measure the carrying amount of an asset or liability (e.g., change in litigation accrual)

<table>
<thead>
<tr>
<th>Remeasurement note</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating: Gain on disposal of property, plant, and equipment</td>
<td>22,650</td>
<td>-</td>
</tr>
<tr>
<td>Gain on futures contracts (a)</td>
<td>5,821</td>
<td>5,390</td>
</tr>
<tr>
<td>Loss on sale of receivables</td>
<td>(4,987)</td>
<td>(2,025)</td>
</tr>
<tr>
<td>Change in estimate for bad debt expense</td>
<td>-</td>
<td>2,707</td>
</tr>
<tr>
<td>Loss on inventory</td>
<td>(29,000)</td>
<td>(9,500)</td>
</tr>
<tr>
<td>Impairment of goodwill</td>
<td>-</td>
<td>(35,033)</td>
</tr>
<tr>
<td>Change in estimated share-based compensation liability</td>
<td>(6,250)</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Change in litigation accrual</td>
<td>(1,998)</td>
<td>(1,850)</td>
</tr>
<tr>
<td>Investing: Fair value change of securities (b)</td>
<td>98,700</td>
<td>81,000</td>
</tr>
<tr>
<td>Fair value change of investment in company</td>
<td>7,500</td>
<td>3,250</td>
</tr>
<tr>
<td>Foreign currency translation adjustment on equity method investment</td>
<td>(2,160)</td>
<td>(2,000)</td>
</tr>
<tr>
<td>Other: Foreign currency translation adjustment - consolidated subsidiary</td>
<td>3,222</td>
<td>(2,295)</td>
</tr>
</tbody>
</table>

(a) Gains on futures contracts include realized gains included within costs of goods sold as well as unrealized amounts included in other comprehensive income.
(b) Fair value changes in securities include adjustments for dividends earned.
Differences between IASB & FASB EDs

- **Segment reporting**
  - FASB: disclose by-nature income and expense information for each reportable segment plus various operating measures
  - IASB: no new segment requirements (will review IFRS 8 in 2011)

- **Net debt information**
  - IASB: require items comprising net debt to be analyzed in a single note
  - FASB: no specific requirements for net debt information

- **Minimum line item requirements**
  - IASB: minimum line item requirements from IAS 1
  - FASB: no minimum line item requirements

Questions or comments?

Expressions of individual views by members of the IASB, FASB and their staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB and FASB on accounting matters are determined only after extensive due process and deliberation.
Implementation update: progress and plans

MICHAEL STEWART
Director of Implementation Activities
IASB
Implementation update
June 2010

Michael Stewart, Director of Implementation Activities

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

Agenda

- Overview of Interpretations Committee activity
- Annual Improvements
  - Committee’s involvement
  - Published May 2010
- IFRIC 19 Extinguishing Financial Liabilities with Equity
- Other amendments
- Current agenda topics
  - Production stripping
  - IFRS 2: Vesting/non-vesting conditions
  - Put options over non-controlling interests
- Other items under consideration
Overview of Interpretations Committee activity

<table>
<thead>
<tr>
<th>Issues considered</th>
<th>63</th>
</tr>
</thead>
<tbody>
<tr>
<td>Of which</td>
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<tr>
<td>Interpretations</td>
<td>1</td>
</tr>
<tr>
<td>Taken on formal agenda</td>
<td>3</td>
</tr>
<tr>
<td>Referred to Annual Improvements</td>
<td>21</td>
</tr>
<tr>
<td>Referred to Board</td>
<td>2</td>
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<tr>
<td>Other agenda decisions</td>
<td>28</td>
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<tr>
<td>Pending/WIP</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>63</td>
</tr>
</tbody>
</table>

Annual Improvements Committee’s involvement

- Additional role from January 2010
- Committee’s involvement
  - identifying and discussing new issues
  - deliberating comments received on exposure drafts
  - recommendations to the Board
- Board discusses recommendations
- Improvements to IFRSs issued by the Board
  - exposure drafts
  - final standards
Annual Improvements
Published May 2010

• 10 amendments to 6 standards and 1 interpretation
• Noteworthy amendments
  – IFRS 3
    – Measurement of non-controlling interests
    – Un-replaced and voluntarily replaced share-based payment awards
  – IFRS 7
    – Clarification on disclosures about the nature and extent of risks arising from financial instruments
  – IAS 34
    – Emphasis on general principles for disclosures in interim financial reports

IFRIC 19 Extinguishing Financial Liabilities with Equity

• Issue
  – How to measure the equity instruments issued to settle financial liability, fully or partially
• Main features of IFRIC 19
  – Consensus
    – part of consideration paid to extinguish financial liability
    – fair value measurement of equity instrument issued
    – difference with carrying amount of financial liability extinguished in profit or loss
  – Scope exclusions
  – Transition and effective date
    – annual periods beginning on or after 1 July 2010
    – retrospective application but only from beginning of earliest comparative period
Other amendments

- IAS 32 *Classification of Rights Issues*
  - financial instrument = equity instrument
    - when holder has right to acquire
      - fixed number of entity's own equity instruments
      - for fixed amount of cash, and
      - regardless of currency in which exercise price is denominated
    - if, and only if, offer is pro rata to all existing owners
  - applies retrospectively – annual periods commencing on or after 1 February 2010

Other amendments (continued)

- First-time adoption – relief from comparatives for certain financial instruments disclosures
  - March 2009’s Amendments to IFRS 7 *Improving Disclosures about Financial Instruments*
  - Limited amendment published in January 2010
    - no additional disclosures required on fair value measurement and liquidity risk for first-time adopters
    - same transition provisions for first-time adopters and current IFRS preparers
    - effective annual periods commencing on or after 1 July 2010
Current agenda topics: Production stripping

- Production stripping: removal of overburden/waste in the production phase of a surface mine
- Issue: how to account for stripping costs?
  - development phase – usually capitalised; little diversity
  - production phase – accounting diversity
- Interpretations Committee: tentative decisions
  - Stripping activity creates benefit → improved access to ore
  - Identify a stripping campaign – differs from routine stripping
  - Costs of stripping campaign must be **specifically associated** with the quantity of ore **directly benefiting** from the campaign
  - Benefit is realised when the ore is mined

Current agenda topics: Production stripping (2)

- Interpretations Committee: tentative decisions
  - current period: stripping costs included in current costs of production
  - future period(s): stripping costs accounted for as addition to / enhancement of an existing asset
    - component accounting → ‘stripping campaign component’
  - Measurement:
    - initial - accumulated costs of the stripping campaign
    - subsequent - stripping campaign component carried at cost less amounts amortised
  - Amortisation: over the reserves that directly benefit from the stripping campaign
Current agenda topics: IFRS 2: Vesting/non-vesting conditions

- Need for clearer definitions
- Proposals to distinguish more clearly between
  - service conditions, performance conditions, other vesting conditions
  - non-vesting conditions, contingent features
  - interaction between multiple vesting conditions, and impact on attribution period

- Next step
  - assess impact of proposed changes on current practice
  - clarification of proposed definitions
  - decision from Committee on how to proceed – interpretation or amendment

Current agenda topics: Put options over non-controlling interests

- Request
  - how to account for changes in carrying amount of “NCI put” liability in consolidated financial statements
  - limited to NCI puts after 2008 amendments to IFRS 3 and IAS 27

- Issue
  - potential conflict between IAS 32 / IAS 39 and guidance in IAS 27
    - IAS 32 / IAS 39 → subsequent changes in profit or loss
    - IAS 27: transactions with NCI → subsequent changes in equity

- Next steps
  - review of illustrative examples
  - define scope of project
Other items under consideration

- IAS 29 *Financial Reporting in Hyperinflationary Economies*
  - how to resume presenting IFRS financial statements after chronic hyperinflation
- IFRS 1 *First-time Adoption of International Financial Reporting Standards*
  - removing fixed date in exceptions
- IFRS 1 *First-time Adoption of International Financial Reporting Standards*
  - circumstances in which IFRS 1 applies more than once
- IAS 40 *Investment Property*
  - change from fair value to cost model
  - inconsistent guidance regarding classification and measurement of investment property management intends to sell

Questions or comments?

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Keynote speaker

FERNANDO RESTOY
Chairman
CESR’s
(Committee of European Securities Regulators)
Corporate Reporting Standing Committee
(CESR-Fin)
Technical break-out Sessions:

Conceptual Framework

WARREN MCGREGOR
Member
IASB

ALAN TEIXEIRA
Director of Technical Activities
IASB
Agenda

- Importance of a Conceptual Framework
- Current FASB and IASB Conceptual Frameworks
- Conceptual Framework Project
  - History of Project
  - Active Phases
  - Key decisions reached to date
- Next Steps
Importance of a Conceptual Framework

- Individual concepts held by each member
  - Agreement would require intersection of personal frameworks
  - Compounded by changes in board membership
  - Greater risk of
    - Transitory concepts & resulting standards
    - Different conclusions on identical issues
    - Ad hoc decisions leading to inconsistent standards

Examples

- Leases
  - What is an asset?
- Liabilities
  - Probability
- Financial Instruments
  - Measurement
Converged Frameworks

• Similar conclusions on accounting issues
• Converged and improved global accounting standards
• Differences in IASB & FASB frameworks:
  – FASB: ‘relevance’ is a recognition criterion
  – Role of “probable” in recognition (IASB) and definition (FASB)

Current FASB and IASB Frameworks

• Basic structure of both frameworks
  – Objective of financial reporting
  – Qualitative characteristics
  – Elements of financial statements
  – Recognition
  – Measurement
  – Display and disclosure
FASB

- Statement of Financial Accounting Concepts
- FASB currently has seven Concepts Statements
  - First six issued between 1978 and 1985
  - Last issued in 2000
  - Directed at financial reporting
  - Not authoritative

IASB

- Framework for the Preparation and Presentation of Financial Statements
  - Developed by IASC
  - Adopted by IASB in April 2001
  - Directed at financial statements
  - Authoritative via IAS 8
Joint Conceptual Framework Project

• Added to agenda in October 2004

• Objective:
  – To develop an improved and common conceptual framework that will provide a sound foundation for the development of accounting standards

Project Plan

• Eight phases:
  – Objective of financial reporting and qualitative characteristics of financial reporting information
  – Elements of financial statements and recognition
  – Measurement
  – Reporting entity
  – Presentation and disclosure, including reporting boundaries
  – Purpose and status in GAAP hierarchy
  – Applicability to the not-for-profit sector
  – Entire framework, remaining issues if any
Project Plan

• The project focus is on:
  – Omissions in the original frameworks
  – Concepts applicable to private sector business entities

• Not intended to be a fundamental rethink of the existing frameworks
Objective of Financial Reporting

- First phase to start
- Discussion Paper in July 2006
  - Received 179 comment letters
- Exposure Draft in May 2008
  - Received 142 comment letters

“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.”
Objective of Financial Reporting

- Primary users
  - Provide resources, but cannot demand information
  - Common information needs
Analyse the prospects for future net cash inflows
  - Buy, sell, hold
  - Efficient and effective use of resources

Main respondent concerns

- Identifying the users
- Stewardship
- Transparency versus stability
Qualitative Characteristics

• Relevance
  – Predictive Value
  – Confirmatory Value
  – Materiality, entity-specific

• Faithful representation (replaces reliability)
  – Completeness
  – Neutrality
  – Free from error
Qualitative Characteristics

• Enhancing Qualitative Characteristics
  – Comparability
  – Verifiability
  – Timeliness
  – Understandability

• Pervasive Constraint
  – Cost

Main respondent concerns

• Why is there a hierarchy?
• Why replace the term reliability?
Elements

- Identifying the components for presentation in the financial statements

- When does an element exist?
  - Physical
  - Based on contracts
  - Rights
    - Intangible assets
    - Goodwill
      - Non-contractual intangibles
      - Actual obligation gives rise to a future claim
Elements

- Other questions:
  - What about stocks and flows (changes in stocks)?
  - How many elements?

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

Elements

- Recognition/Derecognition
  - Currently recognition criteria in both frameworks
  - Revise the concepts for recognition
    - Eliminate differences
    - Provide a framework for resolving derecognition issues
  - Look at standards projects
    - Revenue Recognition
    - Financial Instruments
    - Leases
    - Consolidation
    - Insurance
Measurement

What is the most appropriate measurement attribute for a particular asset or liability?

- Financial instruments
- Investment properties
- Biological assets (e.g., agriculture)
Measurement

• Started in 2007
• New approach in November 2008:
  – Standards-level decisions in multiple-measurement environment
  – Qualitative characteristics and cost constraint are measurement selection factors
  – Value realisation connects relevance to the objective

International Financial Reporting Standards

Reporting Entity

IASC Foundation
The views expressed in this presentation are those of the presenter, not necessarily those of the IASC Foundation or the IASB
Reporting Entity

- No reporting entity concept to guide
  - Yet we report about it
- Objective of reporting entity phase:
  - To determine what constitutes a reporting entity for the purposes of financial reporting
- Published Discussion Paper in mid-2008
- Published Exposure Draft 11 Mar 2010
  - Comments by 16 July 2010

Reporting Entity

Consolidation and Control

- A parent and entities it controls
  - Most respondents agreed
- Control = Power + Benefits
- Risks and rewards alone not appropriate
  - Most respondents also agreed
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
Next steps

- Objective & QCs final chapters:
  - Q3 2010
- Reporting Entity phase
  - ED: 11 March 2010
  - Comments by 16 July 2010
- Measurement phase
  - DP 2010
- Elements

Questions or comments?

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Technical break-out Sessions:

Revenue recognition

PRABHAKAR KALAVACHERLA
Member
IASB

APRIL PITMAN
Technical Manager
IASB
IASC Foundation
The views expressed in this presentation are those of the presenter, not necessarily those of the IASC Foundation or the IASB


Revenue from contracts with customers

Agenda

• Why we’re doing the project
• Improvements to financial reporting
• Overview of proposed standard
• Main steps to apply proposed standard
• Onerous performance obligations
• Contract costs
• Disclosure
• Transition
• Who will be affected
• Feedback received on the discussion paper
• Project timeline

Why we’re doing the project

- IFRSs and US GAAP are different. Both need improvement:
  - US broad recognition concepts; numerous requirements by industry
  - IFRSs have two alternative standards; can be difficult to apply
- Objective - a single, principles-based revenue recognition standard for use across various industries and capital markets
  - replace IASs 18 & 11 and most of Topic 605 in FASB Accounting Standards Codification

Improvements to financial reporting

- Single model based on clear principles
- Will improve accounting for contracts with customers by:
  - providing a more robust framework for addressing issues as they arise
  - increasing comparability across industries and capital markets
  - providing enhanced disclosures
  - clarifying accounting for contract costs
Overview of proposed standard

Recognise revenue to depict the transfer of goods or services at an amount that reflects the amount of consideration received or expected to be received in exchange for those goods or services

- Revenue recognised when a good or service is transferred to a customer satisfying a performance obligation in the contract
- Amount of revenue is the amount of the transaction price allocated to the satisfied performance obligation

Main steps to apply proposed standard

**Step 1:** Identify the contract(s) with a customer

**Step 2:** Identify the separate performance obligations in the contract

**Step 3:** Determine the transaction price

**Step 4:** Allocate the transaction price to the separate performance obligations

**Step 5:** Recognise revenue when each performance obligation is satisfied
1 Identify the contract

- Most cases apply standard to a single contract
- Combine two or more contracts if prices are interdependent
- Segment a single contract into two or more contracts if some goods or services priced independently of other goods and services
- Account for a modification to a contract as a part of the original contract if price is interdependent with original contract. Otherwise accounted for as a separate contract.

2 Identify performance obligations

A performance obligation is an enforceable promise in a contract with a customer to transfer a good or service to that customer

- Account for performance obligations separately if promised good or service is distinct
  - a good or service is distinct if an identical or similar good or service is sold separately
  - if not sold separately, goods and services are distinct if function and margin are distinct
2 Identify performance obligations

Specific implementation guidance

• principal versus agent considerations
• options to acquire additional goods and services (eg discount vouchers, customer loyalty points)
• rights of return
• licenses and rights to use
• product warranties and product liabilities

Implementation guidance - licenses

• Customer obtains control of the entire licensed IP (eg exclusive license for economic life)
  – sale of the IP, not a license
• Exclusive license, but customer does not obtain control of entire licensed IP
  – performance obligation to permit customer to use IP
  – revenue over time
• Non-exclusive license
  – performance obligation to transfer licenses
  – revenue when the customer is first able to use the license
Implementation guidance - warranties

• Cover for latent defects (‘quality assurance’ warranty)
  – not a performance obligation
  – requires evaluation of whether the performance obligation to transfer product is satisfied
  – revenue not recognised until the defective product or component is replaced

• Cover for faults post-delivery (‘insurance’ warranty)
  – is a performance obligation
  – revenue is recognised over the warranty period

3 Determine the transaction price

The transaction price is the amount of consideration the company expects to receive from the customer

• Uncertain consideration included in transaction price if:
  – experience of identical or similar contracts
  – expects circumstances will not change significantly

• Adjust consideration for collectibility
• Adjust consideration for the time value of money
• Measure non-cash at fair value
4 Allocate the transaction price

- Allocate transaction price to all separately identified performance obligations in proportion to standalone selling prices
- The standalone selling price of a good or service is the price at which the entity would sell that good or service if it was sold separately at contract inception
- Standalone selling prices estimated if not observable

5 Recognise revenue when each performance obligation is satisfied

- Revenue is recognised when a performance obligation is satisfied by transferring a good or service to the customer
- Good or service transferred when customer obtains control of it
  
  Control has transferred when the customer has the ability to direct the use of and receive the benefit from that good or service

- Transfer of control can be at a point in time or can be continuous
Onerous performance obligations

- Performance obligation onerous if direct costs to satisfy more than allocated transaction price
- Recognise a separate liability and corresponding contract loss
- Direct costs are all costs that relate directly to the contract or incurred only because of contract

Contract costs

- Costs may give rise to an asset recognised in accordance with other standards eg inventory
- Recognise contract fulfilment costs as asset if:
  - generate or enhance a resource used to satisfy performance obligations in the contract
  - relate directly to a contract (or anticipated contract) and
  - expected to recover under the contract
- Expense costs of obtaining a contract
Disclosure

Enhanced disclosures to help users understand the amount, timing and uncertainty of revenue and cash flows

- Information about contracts with customers
  - disaggregation of revenue
  - nature of performance obligations & additional information about onerous performance obligations
  - maturity analysis of remaining performance obligations in contracts with original duration of more than a year
  - reconciliation from opening to closing total contract balances
- Information about judgments and changes in judgments
  - timing of revenue recognition
  - determining and allocating the transaction price

Transition

- Full retrospective application
- Early adoption – tentative decisions:
  - permitted for first time adopters of IFRSs
  - not yet decided whether to permit for existing IFRS preparers
  - prohibited for US GAAP preparers
- Boards will consult publicly on transition and effective date for range of projects
Who will be affected recognition

- Revenue attributed to every distinct good or service, based on standalone selling price
  - telecommunications – ‘free’ handset will have attributable revenue
  - manufacturers – defer revenue for warranties
- Revenue recognised as good or service transfers to customer
  - construction contracts – percentage of completion
  - long-term contracts – greater unbundling
- Selling prices should be estimated, if not observable
  - software - removal of specific US guidance

Who will be affected measurement

- Probability-weighted estimate of contingent consideration included in the amount allocated if it can be reasonably estimated (ie if entity has relevant experience)
- Collectibility affects how much revenue is recognised when a good or service is transferred, not whether revenue is recognised
- Implicit financing effects (eg payment due significantly before or after transfer of goods or services) reported separately
Feedback received on the discussion paper

Feedback
• Clear definition & guidance required for control
• More guidance to identify separate performance obligations
• Address contract costs
• Product warranties – not all are performance obligations
• Guidance for intellectual property

Boards’ response
• Definition and indicators proposed
• Clarified not requiring completed contract method for all construction contracts
• Criteria proposed (‘distinct’)
• Guidance proposed
• Distinguish between product warranties that are a performance obligation & a failed sale
• Guidance proposed on licenses

Project timeline

June 2010
Exposure Draft
Targeted outreach

October 2010
Comment letters received
Public roundtables
Board Re-deliberations

2011
Final standard

Roundtables
London, US, Tokyo
Comment by October 2010

Contact information:
Henry Rees (Technical principal) hrees@iasb.org
April Pitman (Technical manager) apitman@iasb.org

Comment at www.iasb.org

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.
IASC Foundation
IFRS Conference
Wednesday 23 and Thursday 24 June 2010
Hilton London Metropole, United Kingdom

Technical break-out Sessions:

Financial instruments with characteristics of equity

JAN ENGSTRÖM
Member
IASB

JOANNA YEOH
Technical Manager
IASB
Review of financial instruments

- Classification & measurement
- Hedge accounting
- Impairment
- FI with characteristics of equity
- Derecognition
General consultation process

Discussion paper
Comment analysis
Exposure Draft
Comment analysis
Final standard
Effective date

9 – 15 months
9 – 15 months
12 – 18 months

Research
Standard setters, EFRAG, and others.

Additional input
Additional input

Feedback statement
2 year post implementation review


Project timeline

IASB did not deliberate the FASB PV and did not have a preliminary view

FASB Preliminary Views November 2007
IASB Discussion Paper February 2008
Exposure Draft
IFRS

The subsequent phases of the project are being undertaken jointly with the FASB

Input from constituents

Presentation outline

1. Project Objective
2. Developed settlement approach
3. Separation
4. Measurement
5. Other proposals
6. Next steps

- The following presentation is based on tentative decisions made by the Board up to this date.

What does the project achieve?

Distinction between equity and non-equity instruments by developing principles for equity classification

1. Convergence with US GAAP
2. Addresses known IFRS practice problems
3. Eliminates IAS 32 rules-based approach to some long-standing problematic issues
Which financial instruments?

- All financial instruments currently in IAS 32

Financial Instruments: Presentation

A difficult area

- Many approaches have been considered

Basic Ownership

Settlement-based (similar classification outcomes to IAS 32 for many instruments)

Claims

Mezzanine

Loss Absorption

Perpetual

Ownership Settlement

Reassessed Expected Outcomes
Settlement-based approach

- An entity is **required** to settle every instrument either in:
  - Cash or other assets (cash-settled), or
  - The issuer’s own equity instruments (equity-settled)

1. Decide if cash or equity settled

2. Apply relevant principles and criteria to determine classification

Cash-settled instruments

**Principle for equity classification :**

- The foundation of an entity’s capital structure, by providing protection for creditors
Cash-settled instruments

*Equity classification criteria:*

- If cash-settlement occurs because the entity
  - chooses or is required to distribute all of its assets
  - is required to redeem to allow existing shareholders to maintain control
  - is required to redeem when the holder ceases to participate in the entity's activities

Equity-settled instruments

*Principle for equity classification:*

- Expose the counterparty to value changes like those of the owners
- The holders may become an owner
**Equity-settled instruments**

*Equity classification criteria:*

- An exchange of a
  - Specified number of equity instruments issued must be fixed or vary only as an anti-dilution measure
  - Specified price must be in the functional currency of the reporting entity or shareholder
  - OR
  - for no further payment

---

**Classification approach**

- What is the form of settlement? (cash-settled)
- Meet the principle and criteria? (No)
- equity-settled
- Meet the principle and criteria? (Yes)
- Equity
- Yes
- Liability
- No
- No
Separated instruments

- Instruments with **liability and equity** components

- Examples:
  - Ordinary share with required dividend
    - Required dividend
    - Ordinary share
  - Bond convertible into a specified no. of shares
    - Bond
    - Conversion option

Initial measurement of equity instruments

- In general, use transaction price

- Except for
  - On exercise of equity-settled instruments: fair value
  - Separated components: residual after deducting the liability
### Subsequent measurement of equity instruments

<table>
<thead>
<tr>
<th>No redemption</th>
<th>Not remeasured</th>
</tr>
</thead>
<tbody>
<tr>
<td>Redemption required</td>
<td>Remeasured at current redemption value adjusted through equity</td>
</tr>
</tbody>
</table>

### Reassessment of classification

- At every reporting date
- If the entity has insufficient authorised shares to settle, than the instrument is classified as a liability until it is derecognised
Consolidation

• Carry over equity classification from the individual financial statements unless different terms and conditions require reclassification

Assessment of project objectives

1. Convergence with US GAAP
2. Addresses known IFRS practice problems
3. Eliminates IAS 32 rules-based approach to some long-standing problematic issues
Questions or comments?

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Instruments classified as equity

Cash-settled instruments
1. Perpetual share (ordinary and preferred)
2. Callable share
3. Share issued by limited life entity
4. Some co-operative shares
5. Some partnership interests

*classification assumes that the instruments do not include any other contractual obligations

Equity-settled instruments
1. Some forward contracts to issue shares
2. Some rights issues (including foreign currency rights issues)
3. Preferred shares mandatorily convertible into specified number of common shares
Instruments classified as liabilities

Cash-settled instruments
1. Cash-settled derivatives
2. Instrument that is mandatorily redeemable on a certain event

Equity-settled instruments
1. Equity-settled derivatives that do not meet specified for specified condition
2. Some convertible bonds convertible into a variable no. of shares
3. Equity-settled derivatives with settlement alternatives
Technical break-out Sessions:

Leases

PATRICIA MCCONNELL
Member
IASB

RACHEL KNUBLEY
Technical Principal
IASB
Why a lease project?

- Existing lease accounting doesn't meet users' needs
  - Accounting depends on classification
  - Users adjust financial statements to recognise assets and liabilities arising in operating leases
- Complexity
  - Difficult to define dividing line between finance and operating
What will proposals cover?

• Include:
  – Simplified accounting for short-term leases
    Lessee: recognise gross asset and liability
    Lessor: use accrual accounting
  – Long-term leases of land

• Exclude:
  – Contracts representing the purchase/sale of the underlying asset
  – Investment property (IAS 40) carried at FV
  – Leases of intangible or biological assets
  – Leases to explore for or use natural resources

Lessee right-of-use model

Lessee has acquired a right to use the underlying asset and is paying for that right with its rental payments

<table>
<thead>
<tr>
<th>All leases in scope</th>
</tr>
</thead>
<tbody>
<tr>
<td>B/S</td>
</tr>
<tr>
<td>• Right-of-use asset</td>
</tr>
<tr>
<td>• Obligation to pay rentals</td>
</tr>
<tr>
<td>P&amp;L</td>
</tr>
<tr>
<td>• Amortisation of right-of-use asset</td>
</tr>
<tr>
<td>• Interest expense</td>
</tr>
</tbody>
</table>
Lessee - Measurement

<table>
<thead>
<tr>
<th>Initial Measurement</th>
<th>Subsequent Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligation to pay rentals</td>
<td>PV of lease payments discounted using incremental borrowing rate</td>
</tr>
<tr>
<td>Right-of-use asset</td>
<td>Cost</td>
</tr>
</tbody>
</table>

Lessee - Options to extend

- Recognise obligation to pay rentals for the **longest possible lease term that is more likely than not to occur**
- Reassess at each reporting date
- Any change in obligation is an adjustment to the right-of-use asset

**Example**

- A machine is leased for 10 years
- Lease includes an option to extend for an additional 5 years
- Lessee must decide whether to recognise:
  - an obligation to pay 10 years of rentals
  - an obligation to pay 15 years of rentals
Lessee - Contingent rentals

- Include expected payments in obligation to pay rentals
- Reassess at each reporting date
- Recognise change in obligation:
  - arising from current or prior periods in profit or loss
  - all other changes as an adjustment to the right-of-use asset
- Residual value guarantees
  - treat the same as contingent rentals

Lessee - Presentation

- Statement of financial position
  - Obligation to pay rentals
  - Right-of-use asset within PP&E, separately from assets owned
- Statement of comprehensive income
  - Amortisation and interest expense presented separately
- Statement of cash flows – current format
  - Cash payments in financing activities
**Lessee - Transition**

- All leases except simple finance leases

<table>
<thead>
<tr>
<th>Obligation to pay rentals</th>
<th>= Right-of-use asset</th>
<th>= PV of lease payments</th>
</tr>
</thead>
</table>

- Adjust for prepaid or accrued rentals
- Review asset for impairment
- For simple finance leases, the measurement of the assets and liabilities would not be changed on transition or subsequently

---

**Lessor - Two models**

- **Performance Obligation**
  - Lease creates a new asset (receivable)
  - Records a performance obligation to permit lessee to use the asset
  - Underlying asset continues to be recognised

- **Partial Derecognition**
  - Lessor transfers and derecognises a portion of the leased asset
  - Recognises right to receive payment over lease term (receivable)
Lessor - Two models

- When to apply which model
  - June 2010 Board meeting

Lessor – measurement: two models

Performance obligation:
- Receivables
  - Initial measurement-PV of lease payments
  - Subsequent: amortised cost
- Performance obligation
  - Initial measurement: transaction price (= receivable)
  - Subsequent: over the lease term

Partial derecognition:
- Receivables –same as performance obligation approach
- Residual asset-allocated carrying value (except impairment)
Lessor – presentation: two models

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>Partial derecognition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statement of financial position</strong></td>
<td></td>
</tr>
<tr>
<td>Underlying asset</td>
<td>Lease receivable</td>
</tr>
<tr>
<td>X</td>
<td>X (separate from other receivables)</td>
</tr>
<tr>
<td>Receivable</td>
<td>PP&amp;E (by class):</td>
</tr>
<tr>
<td>X</td>
<td>Residual asset</td>
</tr>
<tr>
<td>Performance Obligation (X)</td>
<td>Owned assets</td>
</tr>
<tr>
<td>Net leasing asset / liability (X)</td>
<td></td>
</tr>
<tr>
<td>(gross with linked presentation)</td>
<td></td>
</tr>
<tr>
<td><strong>Statement of comprehensive income</strong></td>
<td></td>
</tr>
<tr>
<td>Lease income</td>
<td>Revenue</td>
</tr>
<tr>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>Cost of sales</td>
</tr>
<tr>
<td>X</td>
<td>(X) (gross or net depending on business model)</td>
</tr>
<tr>
<td>Depreciation (X)</td>
<td>Interest income</td>
</tr>
<tr>
<td>(separate presentation)</td>
<td></td>
</tr>
</tbody>
</table>

Options to extend– lessor

- Same as lessee accounting

- Performance obligation:
  - record any change as adjustment to right-of-use asset

- Partial derecognition:
  - treat as derecognition/re-recognition event for the residual asset
Contingent rentals – lessor

- Only include if reliably measurable
- Reassess at each reporting date and adjust receivable
- Performance obligation:
  - Record corresponding adjustment to P&L if related to a satisfied performance obligation
  - Adjust performance obligation if not yet satisfied
- Partial derecognition:
  - Recognise all corresponding changes in P&L

Lessor - Transition

- Performance obligation
  - All leases
  - Measure using original rate charged by the lessor

<table>
<thead>
<tr>
<th>Receivable</th>
<th>=</th>
<th>Performance obligation</th>
<th>=</th>
<th>PV of lease payments</th>
</tr>
</thead>
</table>

- Reinstate previously derecognised underlying assets
  - Depreciated cost or FV

- Partial derecognition
  - June 2010 Board Meeting
Disclosures
To enable users to evaluate the nature, amount, timing, and uncertainty of cash flows arising from lease contracts and how the entity manages those cash flows

Include:
- Nature of lease arrangements, including contingencies
- Short term leases
- Maturity analysis of contractual and total obligations (lessees) / receivables (lessors)
- Roll-forward of related assets and liabilities
- Incremental borrowing rate (lessees) / rate charged (lessors)
- Revenue recognition information (lessors)

Sale and leaseback

• Determine if underlying asset has been sold
  – transfers control and
  – all but a trivial amount of the risks and benefits
• If underlying asset sold
  – Record sale/purchase and lease
• If underlying asset not sold
  – Treat as financing
• Adjust assets, liabilities, gains and losses to reflect market rentals
Subleases

• Account for assets/liabilities in accordance with the related lessee and lessor models

• Performance obligation approach
  – Show the leased asset, lease receivable and performance obligation with “linked” presentation
  – Present separately the obligation to pay rentals to the head lessor

• Disclose the nature and amount of significant subleases

What next?

Discussion paper March 2009

Comment period & boards deliberations

Exposure Draft July 2010

Comment period & boards deliberations

Standard planned Q2 2011
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.
Technical break-out Sessions:

Emissions trading schemes

PHILIPPE DANJOU  
Member  
IASB

ALLISON McMANUS  
Technical Manager  
IASB
Agenda

1. Background and basics of emissions trading schemes
2. Adding the emissions trading schemes project to the agenda
   - Withdrawal of IFRIC 3
   - Divergent practice
   - Scope of the project
3. What are the main accounting issues?
4. Status of project
**Background**

- Environmental legislation resulting from concerns about climate change
- One example of legislation: Emissions trading schemes (ETS)
- Established as a means to implement the emission targets set as part of Kyoto protocol
- More and more jurisdictions are introducing some form of ETS

**Basics - how do emissions trading schemes work?**

- ETS implements broad emission targets by establishing an overall cap on emissions of entities subject to the scheme
- Overall cap is implemented differently depending on the type of scheme

**2 main types of schemes:**

- Cap & trade
- Baseline & credit

*schemes can be either statutory or non-statutory (voluntary)*
<table>
<thead>
<tr>
<th></th>
<th>Cap &amp; trade</th>
<th>Baseline &amp; credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall cap</strong> (emissions target)</td>
<td>Units of emissions (e.g., tonnes of CO₂) that may be released within commitment period</td>
<td>Baselines are assigned to individual emitters up to the overall cap. Credits issued only if emissions are below baseline at end of the year</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>Baselines are assigned to individual emitters up to the overall cap. 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>

### Example – for reference

<table>
<thead>
<tr>
<th></th>
<th>Cap &amp; trade</th>
<th>Baseline &amp; credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expected Emissions</strong></td>
<td>120 units during one year compliance period</td>
<td>120 units during one year compliance period</td>
</tr>
<tr>
<td><strong>Allocation of allowable emissions</strong></td>
<td>Polluter Co receives 100 allowances at the beginning of the period</td>
<td>Polluter Co receives baseline (at the beginning of the period) allowing 100 emissions</td>
</tr>
<tr>
<td><strong>Trading mechanism</strong></td>
<td>Polluter Co can trade all of its 100 allowances</td>
<td>Polluter Co can not trade its baseline</td>
</tr>
<tr>
<td><strong>Remittance obligation (at the end of the period)</strong></td>
<td>120 allowances in order to cover Polluter Co’s total emissions</td>
<td>20 credits in order to cover emissions in excess of baseline</td>
</tr>
</tbody>
</table>
Agenda

1. Background and basics of emissions trading schemes
2. Adding the emissions trading schemes project to the agenda
   - Withdrawal of IFRIC 3
   - Divergent practice
   - Scope of the project
3. What are the main accounting issues?
4. Status of project

Withdrawal of IFRIC 3

Proposal for European Union Emissions Trading Scheme (EU ETS) prompted IFRIC to develop an interpretation of how to account for emissions trading schemes.

IFRIC 3 was withdrawn in 2005
Noted in 2005 that market for allowances in EU were not developing as well as initially thought

IFRIC 3 issued in 2004 met with resistance

Divergent accounting practices
Divergent practice – 2 main approaches for initial recognition and measurement (cap & trade)

<table>
<thead>
<tr>
<th></th>
<th>Approach 1</th>
<th>Approach 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchased Allowances</td>
<td>Purchase price (i.e. Cost)</td>
<td>Purchase price (i.e. Cost)</td>
</tr>
<tr>
<td>Allocated Allowances</td>
<td>NIL</td>
<td>Market value</td>
</tr>
<tr>
<td>Government grant</td>
<td>N/A</td>
<td>Market value of allocated allowances received; amortised</td>
</tr>
<tr>
<td>Liability</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</td>
</tr>
</tbody>
</table>


Disclosure examples – initial recognition and measurement of allowances

**Approach 1**
GDF SUEZ Group - 2009 Annual Financial Statements
‘…emission [allowances] are classified as inventories, as they are consumed in the production process; emission [allowances] granted free of charge are recorded in the statement of financial position at a value of nil; emission [allowances] purchased on the market are recognized at acquisition cost.’ (page 41)

**Approach 2**
Repsol YPF, S.A. - 2009 Annual Financial Statements
‘Emission allowances are recognised as an intangible asset and are measured at acquisition cost. Allowances received for no consideration…are initially recognised at the market price…and a balancing item is recognised as a grant…’ (page 32)
**Adding ETS to the agenda and scope**

1. Need to eliminate divergent accounting practices
2. Requests from other national standard setters to add project to agenda
3. FASB and IASB decided to make ETS a joint project in 2007
4. Boards tentatively decided that scope of project will include rights and obligations arising under ETS

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**Agenda**

1. Background and basics of emissions trading schemes
2. Adding the emissions trading schemes project to the agenda
   - Withdrawal of IFRIC 3
   - Divergent practice
   - Scope of the project
3. **What are the main accounting issues?**
4. Status of project
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?
- What about **presentation** and disclosure issues?

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." [IASB Framework]
Are allowances in a cap and trade scheme assets?

**Resource?**
- Can sell allowances (generally no restrictions)  
  OR  
- Use allowances to offset emissions

**Control?**
- An entity can restrict access to its allowances

**Economic benefit?**
- Selling allowances or using them to offset emissions are benefits to the entity

What about a baseline? Is it an asset?

**Resource?**
- Allows an entity to emit up to baseline without additional cost

**Control?**
- Baselines are assigned to specific entities and therefore access to baseline is restricted

**Economic benefit?**
- If an entity emits it can do so up to baseline or can reduce emissions and sell credits
Allowances received for no monetary consideration – are they assets?

- Allocated allowances have the same characteristics as other allowances; only difference is that no monetary consideration is provided in exchange
- Conclusion should be the same on whether or not they meet the definition of an asset, but decisions on measurement may be different

Scheme administrator

No monetary consideration

Allocates Allowances

Entity

Similar to a government grant

Board has instructed staff not to use IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

How do you measure the assets?

Initial Measurement

- At fair value?
- At the amount paid to acquire the assets?
- What if they were obtained without monetary exchange?

Subsequent Measurement

- Remeasure at fair value?
- Amortised cost?
Obligations and 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.' [IASB Framework]

What are the obligations/liabilities?

• Most contentious issue
• Issue focuses on when a present obligation arises and when an entity can recognise a liability, initial focus: a cap and trade scheme
• In a cap and trade scheme, entities must return an allowance for every unit of emission (outflow)
• Entities are allocated allowances because they will be returned – does this create a present obligation?
• What are the obligations with a baseline and credit scheme? Are they different from a cap and trade scheme?
How do you measure the liabilities?

**Initial Measurement**
- At the measurement value of the related assets?
- At the estimated future settlement amount? Would that include considering the related assets on hand that will be used to settle the liability?
- A combination of the two?

**Subsequent Measurement**
- Any remeasurement?
- Should we consider the subsequent measurement of the related assets?

Presentation and disclosure issues

- Should the scheme assets and liabilities be presented on a gross or net basis?
- What are the other relevant financial disclosures related to emission trading schemes?
Agenda

1. Background and basics of emissions trading schemes
2. Adding the emissions trading schemes project to the agenda
   - Withdrawal of IFRIC 3
   - Divergent practice
   - Scope of the project
3. What are the main accounting issues?
4. Status of project

What is the status of the project?

- FASB/IASB joint project
- Project is in its early stages
- Many issues have yet to be discussed by the boards
- Staff research paper to be published in the next 3 to 4 months. Draft available on IASB website as May 2010 observer notes.
- Current target publication for ED: End of 2010(?)
Questions or comments?

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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.
Technical break-out Sessions:

Hedge Accounting

BOB GARNETT
Member
IASB
Introduction

• The Board intends to consider hedge accounting comprehensively
• Overall approach:
  – Use existing architecture
  – Address specific problem areas
  – Use clear and explicit principles
  – Identify any exceptions clearly
Hedge Accounting – broad direction

- Modify fair value hedge accounting
- Simplify cash flow hedge accounting mechanics
- Consider application to portfolio hedge accounting

This project will not look at hedge accounting for hedges of net investments in foreign operations

Components of the 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 – risk components

Fixed element

Variable element

Commodity bench mark

Financial and non-financial

Commodity bench mark
Hedged items – derivative as hedged item

- Debt holder
  - US$

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

- Interest rate swap
  - €

Issuer

Not allowed to be designated as a hedged item under IAS 39

Hedged items – groups and net positions

- **Issues:**
  - The profit or loss geography of gains and losses
  - The timing of recognition in profit or loss of gains and losses when the hedged items affect profit or loss in different reporting periods
  - Identifying when the group of items is no longer hedged
  - Intra group hedging activities
Hedging instruments – eligibility

• Issues:
  – Purchased options: time value of an option is treated as a separate held-for-trading instrument (or as ineffectiveness)
  – Cash instruments: the designation of non-derivative assets and liabilities is only allowed for a hedge of foreign currency risk
  – Risk components: arbitrary distinction between requirements for hedged items and hedging instruments

Hedge effectiveness

• Issues:
  – Requirements to perform quantitative tests are onerous
  – Arbitrary bright lines of 80-125%
  – Failing effectiveness has severe consequences
  – Conflicting guidance how to quantify effectiveness
Hedge accounting as a choice?

• Issues:
  – Onerous documentation
  – Free choice?
  – Implications for designation
  – Implications for dedesignating

Fair value hedge mechanics

• Issues
  – Different mechanics used for fair value and cash flow hedges increase complexity
  – Adjusting hedged item results in a measurement that is neither cost nor fair value
  – Cash Flow hedge accounting mechanics and OCI volatility
  – Presentation of hedging gains or losses
## Tentative approach to hedge accounting

<table>
<thead>
<tr>
<th>IAS 39</th>
<th><strong>Fair value hedge accounting</strong></th>
<th><strong>Cash flow hedge accounting</strong></th>
</tr>
</thead>
</table>

### Fair value hedge accounting
- Gains/losses on effective portion in OCI
- Any ineffectiveness recognised in P/L
- Hedged item is not remeasured
- Lower of test is not used for fair value hedges
- Items measured at amortised cost eligible as hedged items

### Cash flow hedge accounting mechanics

## Knock-on effects of other project phases

- **Embedded derivatives**
  - separate embedded derivative features that are available for designation as hedging instruments under IAS 39 disappear under IFRS 9 (for asset host contracts)

- **Impairment**
  - the proposed use of expected loss without an incurred loss threshold raises questions about requirements that hedged cash flows must be highly probable of occurring

- **Equity investments for which the OCI presentation was elected**
  - eligibility for designation as hedged items
Disclosures

- Presentation
  - Level of granularity
  - Balance sheet
  - OCI (recycling)

- Risk management strategy
  - Risks hedged (notional amounts and fair value movements)
  - Instruments used (fair value movements and effectiveness)
  - Hedging relationships

- Forecasting cash flows
  - Period of hedging
  - Rates and cash flows locked in

IFRS project vs FASB exposure draft

<table>
<thead>
<tr>
<th>IFRS hedge accounting project (comprehensive review)</th>
<th>FASB exposure draft (limited changes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Objective</td>
<td>• Eases qualitative testing for hedge effectiveness</td>
</tr>
<tr>
<td>• Hedged items eligibility</td>
<td>• Eliminates ‘lower of’ test by recognising all ineffectiveness in net income</td>
</tr>
<tr>
<td>• Hedging instrument eligibility</td>
<td>• Bifurcation by risk (benchmark interest rate risk, foreign currency and credit risk) allowed for financial items</td>
</tr>
<tr>
<td>• Effectiveness</td>
<td>• Only reassess if circumstances suggest a change</td>
</tr>
<tr>
<td>• Measurement of ineffectiveness</td>
<td>• Prohibits an entity from electing to dedesignate</td>
</tr>
<tr>
<td>• Hedge accounting as a choice</td>
<td></td>
</tr>
<tr>
<td>• Presentation and disclosure</td>
<td></td>
</tr>
<tr>
<td>• Fair value hedge accounting mechanics</td>
<td></td>
</tr>
<tr>
<td>• Knock-on effects of other projects</td>
<td></td>
</tr>
</tbody>
</table>
Next steps…

• Continue deliberations
• Exposure draft expected in Q3 2010
• Continued outreach
• IFRS in Q2 of 2011

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.
IASB update: 2011 and beyond

SIR DAVID TWEEDIE
Chairman
IASB
The views expressed in this presentation are those of the presenter, not necessarily those of the IFRS Foundation or the IASB.
Benefits capital markets…

- credibility of local market to foreign investors;
- greater cross-border investment;
- efficient capital allocation;
- comparability across political boundaries; and
- facilitates global education and training.

…and companies

- lower cost of capital;
- integrated IT systems;
- easier consolidation;
- ‘one set of books’;
- assist in raising capital overseas;
- understand financial statements of overseas suppliers, customers, subsidiaries.
Status of IFRS use around the world

- Since 2001, over 120 countries have required or permitted the use of IFRSs.
- Remaining major economies have time lines to converge with or adopt IFRSs in the near future.
- Next wave of new joiners in 2011/2012: Argentina, Canada, India, Mexico, South Korea, etc
- Japan: IFRS permitted for a number of international companies since 2010; decision about mandatory adoption around 2012.
Countries seeking convergence with the IASB or pursuing adoption of IFRSs, or require or permit IFRSs:

More than 100 countries require or permit the use of International Financial Reporting Standards (IFRSs), or are converging with the IASB’s standards.

**Fortune Global 500 (July 2009)**

<table>
<thead>
<tr>
<th>Fortune G500</th>
<th>Based on announced plans</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Which GAAP?</strong></td>
<td>2009</td>
</tr>
<tr>
<td>IFRSs and word-for-word IFRS equivalents</td>
<td>190</td>
</tr>
<tr>
<td>US GAAP</td>
<td>155</td>
</tr>
<tr>
<td>National GAAPs</td>
<td>155</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>500</td>
</tr>
</tbody>
</table>
Continuous progress
IFRS-US convergence efforts

<table>
<thead>
<tr>
<th>2001 – 04</th>
<th>Growing interest in IFRSs following US financial scandals</th>
<th>2002 - Norwalk agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>• remove differences</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• align agendas</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Short-term: remove major differences</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Medium-term: new joint standards where significant improvements required</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 2007 - MoU and SEC reconciliation requirement removal</td>
</tr>
</tbody>
</table>

- continued

<table>
<thead>
<tr>
<th>2008 - 09</th>
<th>Consideration US adoption and a date certain</th>
<th>Update of MoU with 2011 targets and SEC roadmap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov 2009</td>
<td>Renewed commitment to MoU – achieving 2011 target</td>
<td>• Joint statements by IASB-FASB and Trustee bodies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• monthly meetings and quarterly progress updates</td>
</tr>
<tr>
<td>June 2010</td>
<td>Statement on convergence work</td>
<td>Recognition of challenges regarding effective global stakeholder engagement on a large number of projects</td>
</tr>
<tr>
<td></td>
<td>➢ Prioritization of major convergence projects</td>
<td></td>
</tr>
<tr>
<td></td>
<td>➢ Target date for main projects remains June 2011</td>
<td></td>
</tr>
</tbody>
</table>
Support for a single set of standards
G20 Summit – 25 September 2009

- Redouble efforts to:
  - achieve a single set of high quality, global accounting standards within the context of their independent standard setting process
  - complete convergence project by June 2011.

- IASB’s institutional framework should further enhance the involvement of various stakeholders.

- G20 acknowledge that there could be differences between capital requirements and accounting rules:
  - to ensure comparability, the details of the leverage ratio will be harmonized internationally, fully adjusting for differences in accounting.

The importance of 2011

- IASB commitment remains
- A number of countries adopting or converging to IFRS around that time (2011/2012)
- G20 target date
- MoU target date

However:
Primary focus: achieve significant improvements to financial reporting without compromising due process
Managing transition

- Limited effective dates: New requirements take effect either 1 January or 1 July of any given year
  - projects completed in 2010 not before 1 January 2012
  - projects completed in 2011 not mandatory before 1 January 2013
  - some even later

- Enhanced stakeholder engagement
  - improved and additional outreach activities
  - additional steps to engage with investors
  - enhanced technical dialogue with prudential supervisors and market regulators

Improved and additional outreach methods

✔ Enhanced investor engagement (among others dedicated Investor Relations Manager)

✔ Enhanced outreach activities (project specific email alerts, podcasts of Board meetings, Feedback statements,..)

✔ Enhanced technical dialogue
  - in line with G20 recommendations: proposals take account of guiding principles of Basel Committee and Financial Crisis Advisory Group report
  - regular meetings with the Basel Committee
  - member of the Financial Stability Board
  - regular meetings with EFRAG
  - national standard-setters are partners in our work
  - participation in regional meetings of national standard-setters
Modified strategy and work plan

Target date for priority projects remains June 2011

- Prioritise major projects to permit sharper focus on those areas in most urgent need for improvement in both IFRS and US GAAP
- Phasing of publication of EDs and related consultations to enable broad-based, effective stakeholder participation
- Publication of separate consultation document seeking stakeholder input about effective dates and transition methods

The Major Projects

Crisis (MoU)
- Financial instruments
- Fair value measurement
- Consolidation
- Derecognition

Other (MoU)
- Revenue recognition
- Leases
- Post-retirement benefits
- Financial statement presentation
- Liability/Equity

Other (Non MoU)
- Insurance contracts
## The Major Projects

<table>
<thead>
<tr>
<th>Project</th>
<th>ED issued</th>
<th>Completion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derecognition</td>
<td>✔</td>
<td>Q3 2010</td>
</tr>
<tr>
<td>Consolidation</td>
<td>✔</td>
<td>Q4 2010</td>
</tr>
<tr>
<td>Financial statement presentation (OCI)</td>
<td>✔</td>
<td>Q4 2010</td>
</tr>
<tr>
<td>Liability/Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value measurement</td>
<td>✔</td>
<td>Q1 2011</td>
</tr>
<tr>
<td>Post-retirement benefits</td>
<td>✔</td>
<td>Q1 2011</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Project</th>
<th>ED issued</th>
<th>Completion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial instruments</td>
<td>Q3 &amp; Q4 2010</td>
<td>Q2 2011</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>✔</td>
<td>Q2 2011</td>
</tr>
<tr>
<td>Leases</td>
<td>Q3 2010</td>
<td>Q2 2011</td>
</tr>
<tr>
<td>Insurance</td>
<td>Q3 2010</td>
<td>Q2 2011</td>
</tr>
</tbody>
</table>
Modified strategy and work plan

IASB work plan

- Financial crisis projects (joint with FASB)
- Other projects
  - some are joint with FASB
  - others are IASB alone
- Conceptual Framework (joint with FASB)
### Financial crisis projects - Derecognition

<table>
<thead>
<tr>
<th>Project</th>
<th>Objective</th>
<th>Target dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derecognition</td>
<td>▪ Near-term priority: improving and converging US GAAP and IFRS disclosure requirements</td>
<td>Q3 2010: finalised improved disclosure requirements similar to US GAAP</td>
</tr>
<tr>
<td></td>
<td>▪ Additional research and post-implementation review of FASB amendments to assess future of the project (2012)</td>
<td></td>
</tr>
</tbody>
</table>

### Financial crisis projects – Consolidation

<table>
<thead>
<tr>
<th>Project</th>
<th>Objective</th>
<th>Target date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consolidation</td>
<td>▪ Boards agreed that standard should include common objectives and principles.</td>
<td>Full completion (IASB): Q4 2010</td>
</tr>
<tr>
<td></td>
<td>▪ IASB project in three parts</td>
<td></td>
</tr>
</tbody>
</table>
## – Consolidation continued

<table>
<thead>
<tr>
<th>Project part</th>
<th>Target dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Replacement of IAS 27</td>
<td>▪ Q3 2010: FASB round tables on IASB’s proposed standard</td>
</tr>
<tr>
<td></td>
<td>▪ Q4 2010: finalised IASB standard</td>
</tr>
<tr>
<td></td>
<td>▪ possible FASB ED on IASB standard?</td>
</tr>
<tr>
<td>Disclosures about unconsolidated SPEs/structured entities</td>
<td>Q4 2010: finalised IASB standard</td>
</tr>
<tr>
<td>Investment companies (part of Consolidation project)</td>
<td>▪ Q3 2010: ED</td>
</tr>
<tr>
<td></td>
<td>▪ Q1 2011</td>
</tr>
</tbody>
</table>

## Prioritised projects - other

<table>
<thead>
<tr>
<th>Project</th>
<th>Objective</th>
<th>Target dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentation of OCI</td>
<td>develop presentation standards that improve the reported items of OCI and allow easier comparability between US GAAP and IFRSs</td>
<td>Q4 2010: converged and improved standard</td>
</tr>
</tbody>
</table>
### Other joint projects

<table>
<thead>
<tr>
<th>Project</th>
<th>Status</th>
<th>Target dates</th>
</tr>
</thead>
</table>
| Financial statement presentation             | ▪ DP feedback indicated concerns that benefits could be outweighed by expected implementation costs.  
▪ Boards decided to engage in additional outreach activities and potentially reconsider proposals | ▪ Q3 2010: staff draft of proposed standard  
▪ Q4 2010: completion of outreach  
▪ Q1 2011: ED |

### Financial crisis projects - Other

<table>
<thead>
<tr>
<th>Project</th>
<th>Status</th>
<th>Target dates</th>
</tr>
</thead>
</table>
| Financial Instruments with characteristics of equity | Effects of proposal in draft ED being explored                          | ▪ Q1 2011: Joint ED (re-exposure)  
▪ Q3 2011: round tables  
▪ Q4 2011: issuance of improved and converged standards |
| Fair Value Measurement                       | develop a converged definition of fair value and common implementation guidance (incl for illiquid markets) | Q1 2011: target for final, converged standard |
### Other MoU projects

<table>
<thead>
<tr>
<th>Project</th>
<th>Status</th>
<th>Target dates</th>
</tr>
</thead>
</table>
| Post-employment benefits – Defined benefit plans | - ED issued in April 2010  
- Comments due 6 Sept 2010                                   | - Q1 2011: IFRS expected            |

### Prioritised projects – Financial Instruments

<table>
<thead>
<tr>
<th>Project</th>
<th>Objective</th>
<th>Target date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial instruments</td>
<td>Issuance of comprehensive improvements that foster international comparability of financial instruments</td>
<td>Full completion: Q2 2011</td>
</tr>
</tbody>
</table>

Differing development timetables and imperatives resulted in differing conclusions in a number of areas.

**Strategy to address differences:**
- Boards will publish each others proposals
- Joint consideration of feedback received
- FASB round-table meetings on their comprehensive proposals (IASB participation) - Q4 2010
- The Expert Advisory Panel is helping the boards to identify and resolve operational aspects of credit impairment models
## Prioritised projects - Financial Instruments

<table>
<thead>
<tr>
<th>Project part</th>
<th>Target date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedge accounting ED (Phase III)</td>
<td>ED: Q3 2010</td>
</tr>
<tr>
<td>Impairment (Phase II)</td>
<td>ED comments due 30 Jun 2010</td>
</tr>
<tr>
<td>Classification and measurement: financial liabilities</td>
<td>ED comments due 16 July 2010</td>
</tr>
</tbody>
</table>
| Asset and liability offsetting | ▪ Q4 2010: ED publication (IASB and FASB)  
▪ Q1 2011: round tables  
▪ Q2 2011: publication of standards – timing aligned with other changes to the FI standards |

### Objective:
- Responding to stakeholder concerns (BCBS and FSB and others) to address differences between IFRSs and US GAAP

## Prioritised projects - other

<table>
<thead>
<tr>
<th>Project</th>
<th>Objective</th>
<th>Target date</th>
</tr>
</thead>
</table>
| Revenue Recognition | development of a single, common standard for a wide range of industries and transaction types | ▪ Q4 2010: round tables  
▪ Q2 2011: joint standard |
| Leases | development of a joint lease standard that improves lease accounting and ensures that all lease contracts are recognised on the statement of financial position | ▪ Q3 2010: joint ED  
▪ Q4 2010: round tables  
▪ Q2 2011: joint standard |
### Other joint projects

<table>
<thead>
<tr>
<th>Project</th>
<th>Status</th>
<th>Target dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance</td>
<td>In 2009 the boards begin discussing the project jointly – agreed on joint approach in most areas</td>
<td>Q3 2010: IASB ED</td>
</tr>
<tr>
<td></td>
<td></td>
<td>July 2010: FASB decision about how to proceed with IASB proposals</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Q2 2011: final standard</td>
</tr>
<tr>
<td>Emission trading schemes</td>
<td>While understanding the growing importance of the project, the boards agreed that other MoU projects have a higher priority.</td>
<td>H2 2011: ED</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012: Converged standard</td>
</tr>
<tr>
<td>Income taxes</td>
<td>Significant negative comments on ED; Board considers limited scope ED</td>
<td>H2 2010: ED expected</td>
</tr>
<tr>
<td></td>
<td></td>
<td>H1 2011: IFRS expected</td>
</tr>
<tr>
<td>Joint ventures</td>
<td></td>
<td>Q3 2010: IFRS expected</td>
</tr>
</tbody>
</table>
### Other projects

| Annual improvements 2009-2011 | Q4 2010: ED planned  
|                             | Q2 2011: IFRS planned  |
| Extractive activities (oil and gas and mining) | Comments due 30 July 2010  
|                             | planned agenda decision  |
| Measurement of liabilities under IAS 37 | Q3 2010: deliberations on re-exposure draft (Jan 2010)  
| Management commentary | Q4 2010: Final ‘guidance’ document expected  
| Rate-regulated activities | Q3: decision on next steps  
| Effective date and transition | Q3: discussion document expected that will guide other final IFRSs |

### Conceptual Framework (joint with FASB)

#### Documents currently being developed:

| Phase A Objective and qualitative characteristics | Final chapter expected 3Q 2010  
| Phase B Elements and recognition | To be determined  
| Phase C Measurement | Discussion Paper planned 4Q 2010 or 1Q 2011  
| Phase D Reporting entity | ED was issued March 2010  
|                             | Comments due 15 July 2010  
|                             | Final chapter expected 4Q 2010 |
### Conceptual Framework (joint with FASB)

#### Potential future phases:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Description</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase E</td>
<td>Presentation and disclosure</td>
<td>Not yet active</td>
</tr>
<tr>
<td>Phase F</td>
<td>Purpose and status of framework</td>
<td>Not yet active</td>
</tr>
<tr>
<td>Phase G</td>
<td>Phase G Applicability to not-for-profit entities</td>
<td>Not yet active</td>
</tr>
</tbody>
</table>
Structure of IFRSs

A principle based standard

- No exceptions
- Core principles (objectives)
- No inconsistencies
- Tied to conceptual framework
- Judgement
- Minimum guidance
Rule-based Standards

- If don’t act with integrity
- If attack reasonable judgement in court
- If ask for voluminous interpretations
- If raw economic facts are unacceptable
- If regulators want one answer

So what will the future look like?

Principles  Rules
<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>IFRS in +120 countries and US convergence programme</td>
</tr>
<tr>
<td>2013</td>
<td>IFRS in +150 countries and US convergence programme</td>
</tr>
</tbody>
</table>

**Vision**

A single set of high quality global accounting standards
Questions or comments?

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Financial instruments: replacing IAS 39

STEPHEN COOPER  
Member  
IASB

SUE LLOYD  
Associate Director  
IASB
### Timetable

<table>
<thead>
<tr>
<th>Phases</th>
<th>Due process documents</th>
<th>Finalisation</th>
</tr>
</thead>
</table>
| 1. Classification and measurement | IFRS 9 published on 12 Nov 2009  
ED on financial liabilities published on 11 May 2010 | In time for year end financial statements  
2009 for financial assets  
During 2010 for financial liabilities |
| 2. Impairment methodology     | ED published in November 2009  
Comments due by 30 June 2010 | Expected during 2010                              |
| 3. Hedge accounting           | ED expected Q3 2010                                                                | Expected during H1 2011                            |

FASB ED covers all phases
Phase I: Classification and measurement

Overview of classification model - IFRS 9 for financial assets only

- **Entity's business model for managing**
- **Contractual cash flow characteristics**
- **Amortised cost (one impairment method)**
- **FVO for accounting mismatch (option)**
- **Reclassification required** when business model changes
- **All other instruments:**
  - Equities
  - Derivatives
  - Some hybrid contracts
  - ...
- **Fair Value (No impairment)**
- **Equities:**
  - OCI presentation available (alternative)
Overview of FASB proposal 
(financial assets and financial liabilities)

Entity's business model for managing +

Contractual cash flow characteristics

Can choose Fair Value through OCI (FV-OCI)

No recategorisation

Choice of amortised cost for own debt (mismatches) & some trade receivables/payables

Fair Value through Net Income (default measurement) (FV-NI)

All other instruments:
- Equities
- Derivatives
- Trading
- Some hybrid contracts
- Any instrument by default

Impact of FASB's FV-OCI classification on net income

If an entity meets the business strategy and contractual cash flow criteria they can irrevocably elect FV-OCI

Net Income = Interest income / expense + / - Credit impairment + / - FV changes due to hedged risks

- Any residual change in fair value goes to OCI
- Realised gains/losses are recycled
**FASB - Core deposits**

- Deposits
  - without a contractual maturity
  - considered to be a stable source of funds

  Measured as present value of average ‘core’ deposit liability

  Discount using

  - Difference between rate on next best alternative source of funding and all-in-cost-to-service rate
  - Over the implied maturity

**FASB - Amortised cost**

- Limited exceptions allow *election* of amortised cost

  - Financial liabilities
    - Meet FV-OCI criteria
  - Short-term trade receivables/payables
    - Liability at FV causes "accounting mismatch"
    - Meet FV-OCI criteria

  - Contractual linkage to a non-fair value asset
  - Issued by entity/operating segment with <50% assets at FV
FASB - Presentation in Statement of Financial Position

- FV-OCI and FV-NI items presented separately
- For FV-NI items only present fair value amounts and also amortised cost for own debt
- FV-OCI assets presented as follows:
  - Cost/Amortised cost XXX
  - Allowance for credit losses (XX)
  - Residual FV adjustment X
  - Fair value XXX
- FV-OCI liabilities as above but without impairment

Presentation in Statement of Financial Position - continued

- Capital could be presented as follows:
  - Common stock XXX
  - Retained earnings XXX
  - AOCI, excluding FV changes XXX
  - Equity excluding fair value changes YYY
  - Fair value changes for instruments (XX)
  - Total comprehensive equity ZZZ
Key differences between IASB and FASB

- FV-NI is the default under the FASB ED
- But generally impact on net income/P&L should be similar* for financial assets under the IFRS model and the FASB proposals

<table>
<thead>
<tr>
<th>Topic</th>
<th>FASB ED</th>
<th>IASB Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and debt securities</td>
<td>May elect FV-OCI</td>
<td>Required to be at amortised cost (subject to FVO)</td>
</tr>
<tr>
<td>(assets) meeting criteria</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity investments</td>
<td>FV-NI</td>
<td>FV but, if not held for trading OCI election available</td>
</tr>
<tr>
<td>Financial liabilities</td>
<td>For financial institutions most at FV and many FV-NI (symmetrical model)</td>
<td>Retains IAS 39, except for presentation changes for FVO so most financial liabilities at amortised cost or bifurcated</td>
</tr>
<tr>
<td>Core deposits</td>
<td>‘Remeasurement value’</td>
<td>Redemption amount</td>
</tr>
</tbody>
</table>

* Differences will however arise due to differences in impairment proposals

International Financial Reporting Standards

Phase I: Classification and measurement (financial liabilities)
Financial liabilities – background

Feedback on ED:
- Financial liabilities “not broken”
- Financial liabilities less urgent
- Need to address ’own credit’

Excluded financial liabilities from the scope of IFRS 9 for 2009 year ends
To seek input on best way to address ’own credit’

Outreach activities
- Five alternative approaches to the own credit problem explored
- Staff and Board members met with:
  - Regulators
  - Preparers
  - Users (including a user survey)
  - Audit firms
  - Our RWG
- Focussed on practical issues in separating own credit and which solution would provide the most useful information
## Results of outreach

<table>
<thead>
<tr>
<th>Preparers</th>
<th>‘Own credit’ hard to separate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bifurcation of liabilities means don’t have to deal with complexity of identifying own credit</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Users</th>
<th>Liabilities viewed differently to assets – symmetry not useful</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>P&amp;L volatility from own credit not useful</td>
</tr>
<tr>
<td></td>
<td>Do not invent new measurement method: If remeasured prefer full fair value measurement on B/S</td>
</tr>
<tr>
<td></td>
<td>Bifurcation for liabilities helps address own credit concerns</td>
</tr>
</tbody>
</table>

| Overall                        | No consensus                                                  |

## Tentative decisions

**To address ‘own credit risk’**:

- Retain IAS 39 measurement requirements for financial liabilities:
  - held for trading ➔ fair value through P&L
  - hybrid liabilities ➔ bifurcation requirements in IAS 39
  - ‘vanilla’ liabilities ➔ amortised cost
  - maintain FVO (with current eligibility conditions)

- Separate out ‘own credit risk’ for FVO

- ‘Own credit risk’ portion would be separated in a manner similar to that used in IFRS 7 for disclosure (IFRS 7 B4)
FVO proposals

Profit or Loss (liabilities under FVO)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total change in FV</td>
<td>XX</td>
</tr>
<tr>
<td>Change in FV due to</td>
<td>(X)</td>
</tr>
<tr>
<td>‘own credit’</td>
<td></td>
</tr>
<tr>
<td>Profit for the year</td>
<td>XXX</td>
</tr>
</tbody>
</table>

Statement of Comprehensive Income (liabilities under FVO)

Other Comprehensive Income:

<table>
<thead>
<tr>
<th>Change in FV due to ‘own credit’*</th>
<th>X</th>
</tr>
</thead>
</table>

* Not recycled

Why this approach?

- Five alternatives explored during outreach. No consensus as to ‘best’ approach.
- Minimise disruption
  - Most entities bifurcate and will likely continue
  - Bifurcation method: IAS 39 similar outcomes to IFRS 9
- But addresses ‘own credit’
  - Separate ‘own credit’ only if use FVO
  - Have to do that today for disclosure purposes
Next steps

• Exposure draft: May 2010
• Comment Deadline: 16 July 2010
• Final Standard: 2010

FASB approach to own credit in ED

• For all financial liabilities at fair value recognise separately in net income (for FV-NI) or in OCI (for FV-OCI)
• Includes gains and losses only due to changes in credit standing – not due to the effect of changes in the price of credit.
Phase II: Impairment

IAS 39 replacement – phase II

- July 2009: IASB publishes RfI on the feasibility of the ECF approach.
- September 2009: Comment period ended for RfI.
- December 2009 - June 2010: EAP meetings and outreach.
- June 2010: Comment period for ED ends.
- End of 2010: IASB intends to issue final standard on impairment.

*separate project
Expert Advisory Panel

• What is it for?
  – To consider how to address operational challenges

• Who is on it?
  – Credit and risk experts from different regions and sectors

• How does it work?
  – Public meetings
  – Formed: Dec 2009   Ended: June 2010
  – EAP subgroups
    – Cash flow estimates
    – Effective interest method

Major operational issues – decoupling

Major operational issue #1:

• Allocation of initial expected losses (EL)
  – ED requires allocating the initial EL estimate over the expected life of the financial asset
  – Allocation mechanism: the (credit cost adjusted) effective interest rate (EIR)

• Potential simplification: ‘decoupling’ of interest and credit loss calculations
**Deriving expected cash flows**

Contractual CF

![Diagram showing expected cash flows]

- Expected CF1 (CU)
- Est. Loss (CU)
- Expected CF2 (CU)
- Est. Loss (CU)
- Expected CF3 (CU)
- Est. Loss (CU)
- Expected CF4 (CU)
- Est. Loss (CU)
- Expected CF5 (CU)

**EIR Expected**

---

**Organisational and IT structure**

Infrastructure separates accounting (interest rate) systems and credit risk systems

- Accounting Systems (interest rate)
- Credit risk systems

IASB Expected EIR
**Initial EL**

*Allocation of initial expected losses – ‘decoupling’*

Contractual CF (CU)  

Est. Loss (CU)  

EIR ‘Contractual’*  

Less: allocation of initial EL  

= Expected EIR  

*Similar to IAS 39, ie incl. adjustments for transaction costs, premium/discount etc.

**Different ways of decoupling**

- Use separate DCF calculation for the initial EL that is allocated over the life of the instrument by converting the PV of the EL into an annuity
- Disaggregating the calculation of allowance account into three building blocks: 
  - initial expected loss 
  - experience adjustment 
  - adjustment for changes in expectations for the remaining life of the instrument
Major operational issues – lifetime EL

Major operational issue #2:

• Estimating lifetime expected loss
  – Consider and use best available information
  – Based on historical information adjusted for management expectations of future conditions and likely changes in the portfolio
  – Basel II EL can be used as one possible starting point but would require adjustments
  – Reasonable estimates over 1 to 3 years, then revert to long term average loss rate

Open portfolios

Major operational issue outstanding:

• Application of impairment model to open portfolios
  – Significant operational challenges
  – ED would require carrying forward historical information from date of initial recognition (initial EL or EIR)
  – Most financial institutions only have forward looking information
  – Hard to differentiate whether the revision of expected loss relates to:
    – loans already in the portfolio (catch up adjustment)
    – new loans (initial EL recognised over life of instrument)
Open portfolios (cont’d)

Open portfolios vs closed portfolios

<table>
<thead>
<tr>
<th>Vintages</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.60%</td>
<td>2.30%</td>
<td>4.00%</td>
<td>2.30%</td>
<td>4.00%</td>
<td>5.90%</td>
<td>4.00%</td>
</tr>
<tr>
<td></td>
<td>3.70%</td>
<td>5.90%</td>
<td>10.60%</td>
<td>5.90%</td>
<td>10.60%</td>
<td>3.70%</td>
<td>10.60%</td>
</tr>
</tbody>
</table>

Risk system

IASB ED

Recognition of the initial expected loss

Over the life of the asset

Year 1  
Year 2  
Etc...

• reflects initial pricing decision
• avoids ‘front-loading’ of interest revenue

Immediately to profit or loss

Year 1  
Year 2  
Etc...

• ‘day 1’ loss  
• ‘back-loading’ profitability
Subsequent changes of estimates

**Over the life of the asset**
- Year 1
- Year 2
- Etc...
- • could result in a rate below risk free (even negative)
- • counter-intuitive: lower discount rate for a higher risk asset

**Immediately to profit or loss**
- Year 1
- Year 2
- Etc...
- • reflects change in credit quality
- • carrying amount is always the PV of the current ECF discounted at the (original) effective interest rate
- • change in estimates that reflect gains or losses are not allowed to be deferred (other IFRSs)

FASB ED - Impairment

- Applies to FV-OCI and trade receivables at amortised cost
- Estimate cash flows based on past and current conditions
- Losses do not need to be probable to be recognised
- Can evaluate on an individual or pool basis
- Treatment of initial expected future losses different to IASB
- Interest income calculated using effective interest rate unadjusted for losses but applied to carrying amount net of allowance for credit losses
- Allowance consists of credit impairments PLUS excess of interest received over interest income accrued
Introduction

• The Board is considering hedge accounting comprehensively

• Overall approach:
  – Use existing architecture
  – Address specific problem areas
  – Use clear and explicit principles
  – Identify any exceptions clearly
Hedge Accounting – broad direction

• Phased approach:
  – general hedge accounting first
    – modification of fair value hedge accounting
    – simplification of cash flow hedge accounting mechanics
  – against the background of the general approach consider:
    – portfolio hedge accounting

This project will not look at hedge accounting for hedges of net investments in foreign operations

Components of the hedge accounting model

- Objective
- Hedged items – eligibility
- Hedging instruments – eligibility
- Effectiveness – qualification
- Ineffectiveness – measurement
- Optionality of Hedge Accounting
- Presentation / disclosure
- Fair value hedge accounting mechanics
- Knock-on effects of other project phases

Hedge accounting (IAS 39)
Tentative approach to hedge accounting

- **IAS 39**
  - **Fair value hedge accounting**
  - **Cash flow hedge accounting**

Simplifications to existing hedge accounting requirements:

<table>
<thead>
<tr>
<th>Fair value hedge accounting mechanics</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Gains/losses on effective portion in OCI</td>
</tr>
<tr>
<td>• Any ineffectiveness recognised in P/L</td>
</tr>
<tr>
<td>• Hedged item is not remeasured</td>
</tr>
<tr>
<td>• Lower of test is <strong>not</strong> used for fair value hedges</td>
</tr>
<tr>
<td>• Items measured at amortised cost eligible as hedged items</td>
</tr>
</tbody>
</table>

Next steps…

- Continue deliberations
- Exposure draft expected in Q3 2010
- Continued outreach
- IFRS in Q2 of 2011
FASB ED - Hedge accounting

- Qualitative test to demonstrate that the hedging instrument would be *reasonably effective* in offsetting changes in the hedged item or forecasted transaction
- Bifurcation by risk (benchmark interest rate risk, foreign currency and credit risk) allowed for financial items
- All ineffectiveness associated with the hedged risk recognised in net income
- Only reassess if circumstances suggest a change
- Can only discontinue if criteria no longer met or instrument expires, is sold, terminated or exercised

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.
Panel discussion: replacing IAS 39

SYLVIE MATHERAT  
*Director, Financial Stability*  
*Banque de France*  
*Member*  
*Basel Committee (Chair Accounting Task Force)*

DENNIS JULLENS  
*European Head of Global Accounting and Valuation Group*  
*UBS Investment Bank*

CHARLOTTE JONES  
*CFO, EMEA*  
*Deutsche Bank AG*
Overview

Why replacing IAS 39 matters for prudential supervisors?

- Appropriateness of fair value in case of market dislocation?
- Effectiveness of the impairment model to absorb actual credit losses? - provisions too little too late –
- Neutrality of accounting standards has been challenged during the financial crisis + adverse effects of IASB/FASB divergences

Accounting standards can contribute to the resilience of the financial system

- useful to have increased synergy and consistency between accounting and prudential rules to strengthen the financial system
- Replacing IAS 39: opportunity for convergence with FASB
Overview

1) How accounting has impacted the financial stability

2) How to strengthen the financial system by improving accounting standard on financial instruments

3) Importance of the impairment model to mitigate pro-cyclicality: the BCBS approach

4) What has been achieved as of today

1) Accounting: impact on financial stability

Fair value measurement

- Mark to Market: quoted prices are relevant in case of efficient markets (level 1), but:
  - Issue in case of inactive or illiquid markets, distressed sales
- Use of quoted prices & other inputs (level 2)
- Mark-to-Model: instruments are measured through valuation models (level 3)
  - For levels 2 and 3, when markets are dislocated, issue about “uncertainty” in fair value measurements
- Fair value measurement of liabilities
  - Deterioration of own credit risk triggers recognition of gains
1) Accounting: impact on financial stability

Fair value measurement

Pro-cyclical effect

In Good Times
- Increase in liquidity - high market demand
- Increase in asset value
- Increase in balance sheet
- Macroeconomic impact - increase in leverage and creation of bubbles
- Increase unrealised gains in K
- Increase in asset value
- Increase in balance sheet

In Bad Times
- Decrease in liquidity - forced sales
- Downward pressure on K - deleveraging effect
- Decline in asset value
- Macroeconomic impact - forced deleveraging through recapitalisation - credit crunch
- Impact in balance sheet

Impairment model

- Main features of the incurred loss model
  - “Trigger event” mandatory to start building up provisions
  - Overstatement of interest income in the early life of the loans
  - Greater amount of provisions in economic downturn
    => pro-cyclical effect

- Consequences
  - Shortage of provisions to absorb credit losses in case of downturn
  - Loan losses have directly impacted the Income Statement => pro-cyclical effect
1) Accounting: impact on financial stability
Lack of Convergence

- Level playing field issue for the banking industry
  - Reclassification of financial instruments measured at fair value (FASB initiative, IASB followed under pressure in October 2008)
  - Accounting treatment of unrealised losses of Available for Sales instruments (differentiation of the credit risk component from other factors in US GAAPs approved in April 2009, not followed by IASB)

- Lack of consistency in applying accounting rules
  - Due to the complexity of the current accounting rules
  - Due to differences in interpretation: e.g. the incurred loss model – different interpretation between FASB and IASB and among countries applying IFRS

2) How to strengthen the financial system?

- Accounting standards should incorporate regulatory concerns => synergy between regulatory & accounting frameworks could contribute to Financial Stability

- **April 2009**
  - G20 London Summit
  - Declaration on strengthening the financial system
  - Objective: single set of high quality global accounting standards

- **August 2009**
  - Basel Committee
  - Setting up of a High Level Working Group (BCBS/FSB)
  - Guidelines on accounting for financial instruments
2) How to strengthen the financial system?
Response from the G-20

- London Summit focused on key accounting issues
  - Reduction of the complexity for financial instruments
    - to achieve clarity and consistency in the application of valuation standards internationally
  - Valuation of financial instruments:
    - Based on the liquidity & investors’ holding horizons => recognition of entities’ business models
    - Fair Value accounting framework confirmed, but no longer the sole measurement method. (full fair value method not encourage)
    - Recognition of valuation uncertainty
  - Loan Loss Provisioning
    - Use of broader range of credit information to design a new provisioning model
  - Off-balance sheet exposures
    - Recasting of the consolidation and derecognition standards
  - Involvement of regulators in standard setting process confirmed:
    - “within the framework of the independent accounting standards setting process, improve involvement of stakeholders, including prudential regulators and emerging markets, through the IASB’s constitutional review.”
How to strengthen the financial system?
BCBS response to G-20’s request

- The Guiding principles for the replacement of IAS 39 (IASB standard on financial instrument)
  - Importance of financial reporting for supervisors
  - Mixed attribute model based on the entity’s business model (fair value / amortised cost)
  - No expansion of fair value accounting through the Income Statement
  - Possible fair value adjustment in case of valuation uncertainty
  - No undue complexity, more transparency
  - Robust forward looking provisioning model for assets in the amortised cost category:
    - Building up of provisions with a life of the loan perspective by considering loss experience over full economic cycle(s)

3) Impairment - the GHOS’s request -

- Specific request of the GHOS
  - “it is essential that accounting standard setters & supervisors develop a truly robust provisioning approach based on expected losses.”

**January 2010**
- Group of Central Banks Governors and Heads of Supervision
- Request to build a robust Provisioning Approach in Accounting
- objective: to reinforce Basel Committee Reform package
3) Impairment - the GHOS’s request -

- Building on the Basel Committee's August 2009 Guiding Principles for the replacement of IAS 39, the BCBS should have a practical proposal of a sound EL provisioning approach to achieve the following key objectives:
  - Address the deficiencies of the incurred loss approach without expansion of fair value,
  - Promote forward looking provisioning => early identification and recognition of expected credit losses in a consistent and robust manner,
  - Address concerns about pro-cyclicality under the current incurred loss provisioning model,
  - Incorporate a broader range of credit information, both quantitative and qualitative,
  - Draw from banks' risk management and capital adequacy systems,
  - Be transparent and subject to appropriate internal and external validation by auditors, supervisors and other constituents.

3) Impairment - BCBS response to GHOS

- The starting point for the BCBS proposal is the IASB fixed rate model. This model is chosen because:
  - It is an expected cash flow model that allows an earlier recognition of expected credit losses and earlier building up of provisions
  - The need to eliminate the complexity associated with the IASB’s approach for floating rate financial instruments
- Adjustments are proposed to make the IASB model more operational while meeting the GHOS objectives. These adjustments relate to:
  - The determination of the expected credit loss rate (that influences the cash flow pattern)
  - The calculation of the Effective Interest Rate (EIR) and its possible revision in case of changes in estimates of expected credit losses (the revision of the EIR will limit the catch up adjustment compared with a fixed EIR).
3) Impairment - BCBS response to GHOS

What are the main features of the BCBS proposal?
- It builds on individual loan and portfolio characteristics that fit with the bank’s business model. Portfolios of loans are considered to have homogeneous characteristics.
- It assumes that banks continue to write new business (i.e., portfolios are open). This approach does not preclude the use of open portfolios based on homogenous credit characteristics or vintages.
- It calculates loss rates by drawing from risk management and capital systems. The loss rates that are calculated are based on objective quantitative and qualitative building blocks that are measurable and auditable.
- It allows for revision of the EIR for loan portfolios in response to material changes in loss expectations with subsequent changes in building up of provisions recognised over the residual life of the loan.

3) Impairment: BCBS response to GHOS

Recognition of interest income & building up of provisions
- Like the IASB proposal, interest income is recognised on the basis of the EIR.
- The BCBS proposal does not assume a perfect matching between the actual cash flows and the expected cash flows calculated from the application of the loss rate to the contractual cash flows.
- If estimates are correct, these possible differences between the actual and expected cash flows are essentially timing differences, which should be recognised in the provision account.
- The loan loss allowance account can never be negative.
3) Impairment: Phasing in of the BCBS approach

- Timing and manner of introduction of such an approach needs to be carefully thought through to take into account the economic cycle.

- When this approach is first introduced, the BCBS proposal recommends specific transition arrangements to ensure that the provisioning level is commensurate with the estimates of expected credit losses over the life of the banks’ loan portfolio.

4) What has been achieved as of today

- IFRS 9: new classification model of the IASB
  - Most of the supervisors’ requests have been met
    - Prominence given to the Business Model to classify financial instruments.
    - Expansion of the amortised cost category (removal of the tainting rules, broader range of eligible instruments including securitisation tranches).

- However some unsatisfactory answers
  - Fair Value category still a default category.
  - Category for strategic equity investment (fair value through OCI): prohibition of recycling the realised gains or losses could limit the use of this category.
  - Valuation uncertainty inherent in Fair Value measurement not tackled through accounting treatment.
4) What has been achieved as of today

- Many challenges ahead
  - The recent release of the FASB project puts at stake the convergence for financial instruments
    - Full fair value model
    - Expected loss model = front loading of provisions instead of building up provisions over the life of the instruments
    - Main concern about the prospect for a dual presentation of financial instruments (fair value, amortised cost) on the face of the balance sheet and the design of a Statement of Comprehensive Income gathering OCI with Net Income items.
  - Hedging (Phase 3) still to be discussed
  - Completion of IFRS 9 by June 2011 still an ambitious target.

Conclusion

- The overhaul of accounting standards to strengthen financial stability is not yet achieved and far from being implemented in a consistent way across the globe.
- But, prudential regulators still committed to providing inputs into the standard setting process of IAS 39 considering the importance of accounting standards for implementing prudential requirements in a consistent way (deletion of prudential filters)
Accounting for Financial Instruments
An Analyst View

London – June 2010

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IASB’s objectives with revamp of IAS 39

- Comparability and transparency
- Consistency in accounting for credit impairments
- Reduce complexity of financial instruments accounting

Classification and Measurement: Financial Assets

- Supportive of mixed measurement model
- Prefer business model over management intent
- Reclassification in case of business model change is sensible
- Dividing line between fair value and amortised cost appears at the right place
Classification and Measurement: Financial Liabilities

- Maintaining the current classification of financial liabilities
- Change is limited to financial liabilities with fair value option
- We support removing the impact of own credit from earnings

Amortized Cost and Impairments

- One impairment approach for all assets at amortized cost
- Support expected cash flow model as it is more forward looking
- The challenge is reliability given managerial discretion
Hedge accounting

- Hedge accounting is viewed as too complex and rule based
- Companies do not apply hedge accounting given hedge effectiveness rules
- As a result, accounting does not always reflect economic reality
- We believe the requirement for hedge accounting should be relaxed

Disclosure is not always the answer: Top 15 European Banks

Source: UBS - Number of pages 2008 Annual Reports based on company information
### Accounting for Financial Instruments: An Analyst View

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**UBS Investment Research: Global Equity Rating Allocations**

<table>
<thead>
<tr>
<th>UBS 12-Month Rating</th>
<th>Rating Category</th>
<th>Coverage</th>
<th>IB Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Buy</td>
<td>50%</td>
<td>35%</td>
</tr>
<tr>
<td>Neutral</td>
<td>Hold/Neutral</td>
<td>40%</td>
<td>33%</td>
</tr>
<tr>
<td>Sell</td>
<td>Sell</td>
<td>11%</td>
<td>24%</td>
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</table>

<table>
<thead>
<tr>
<th>UBS Short-Term Rating</th>
<th>Rating Category</th>
<th>Coverage</th>
<th>IB Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Buy</td>
<td>less than 1%</td>
<td>29%</td>
</tr>
<tr>
<td>Sell</td>
<td>Sell</td>
<td>less than 1%</td>
<td>0%</td>
</tr>
</tbody>
</table>

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

**Source:** UBS. Rating allocations are as of 31 March 2010.

**UBS Investment Research: Global Equity Rating Definitions**

<table>
<thead>
<tr>
<th>UBS 12-Month Rating</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Buy</td>
<td>FSR is &gt; 6% above the MRA.</td>
</tr>
<tr>
<td>Neutral</td>
<td>FSR is between -6% and 6% of the MRA.</td>
</tr>
<tr>
<td>Sell</td>
<td>FSR is &gt; 6% below the MRA.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>UBS Short-Term Rating</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.</td>
</tr>
<tr>
<td>Sell</td>
<td>Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.</td>
</tr>
</tbody>
</table>
Required Disclosures (continued)

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock’s price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

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IFRS 9 v IAS 39

**Advantages**
- Classification (of vanilla assets) determined by business model
- Increased comparability due to fewer measurement bases
- Single impairment model
- Solution to own credit issue
- Reduced complexity due to no bifurcation for instruments with financial asset hosts

**Disadvantages**
- Asymmetric model between assets and liabilities might be confusing
- Potentially more assets at fair value
- Limited convergence with US GAAP at present
Practical issues with implementation

- Incremental approach vs Big Bang conversion?
- When to adopt?
- Definition of business model
- Reclassification of AFS & HTM portfolios
- Reclassification / remeasurement of any reclassified assets
- Analysis of contractual cash flow features in loans
- Interpretations