



# On the Horizon for IFRS

April 7, 2008

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## IASB issues discussion paper on reducing complexity in reporting financial instruments

In its [Discussion Paper](#), *Reducing Complexity in Reporting Financial Instruments*, the IASB analyzes the main causes of complexity in reporting financial instruments. The paper discusses possible intermediate and long-term approaches to improving financial reporting and reducing complexity. The IASB would like to develop new standards that are principles-based and less complex than the current IFRSs. The Discussion Paper represents the first stage of the project to replace IAS 39, *Financial Instruments: Recognition and Measurement*.

The Discussion Paper includes three major sections:

1. *Problems related to measurement*: Financial instruments are currently measured in many different ways. This section discusses the complexity and associated problems created by these different measurements.
2. *Intermediate approaches to measurement and related problems*: This section discusses possible intermediate approaches as follows:

- ii. Amend the existing measurement requirements of IAS 39
  - iii. Replace the existing requirements with a fair value measurement principle and optional exceptions to fair value
  - iv. Simplify hedge accounting
3. *A long-term solution – a single measurement method for all types of financial instruments:* This section discusses a possible long-term solution of measuring all types of financial instruments the same way. Fair value appears to be the only measurement that provides relevant information for all types of financial instruments. There are concerns and issues associated with fair value that are also discussed in this section.

The comment period ends on September 19, 2008. See the [IFRIC project summary](#) for more information on this project.

The FASB has a similar project on its agenda and has recently issued an [Invitation to Comment](#), *Reducing Complexity in Reporting Financial Instruments*, which includes as an appendix the IASB's Discussion Paper. See the March 31, 2008 edition of *Current Accounting Issues Update* for a summary of the FASB's Invitation to Comment.

### IFRIC issues March 2008 meeting highlights

*All decisions reached at IFRIC meetings are tentative and may be changed or modified at future meetings. Committee decisions become final only after completion of a formal vote on an Interpretation or Draft Interpretation, which is confirmed by the IASB.*

The International Financial Reporting Interpretations Committee has issued the March 2008 [IFRIC Update](#), which summarizes the Committee's meeting in London on March 6, 2008. Highlights of the meeting are discussed below.

### IFRIC continues discussion of draft interpretation on real estate sales

In January 2008, IFRIC discussed comments received on draft interpretation D21, Real Estate Sales (D21) and requested that the staff prepare a flowchart illustrating the accounting for real estate agreements in accordance with IAS 11, Construction Contracts and IAS 18, Revenue.

At the March 2008 meeting, the staff presented a flowchart (see Section 2 of [Agenda Paper 3B](#)) that included two parts:

- Identification of the real estate sale
- Applicable standard and revenue recognition

#### Identification of the real estate sale

Part one illustrates the process for identifying whether a single agreement for the sale of real estate has one component or multiple components based on paragraph 13 of IAS 18 and paragraph BC31 of IFRIC 12, *Service Concession Arrangements*, which discusses separating a contract into a component for construction services within IAS 11 and a component for operating the asset constructed within IAS 18. If the contract contains multiple components, IAS 18 then requires the fair value of the consideration received or receivable to be allocated to each identified component. The staff proposed that in the Interpretation, instead of providing detailed guidance on multiple component sales, a reference would be made to existing guidance in IFRIC 12 and IFRIC 13, *Customer Loyalty Programmes*.

The Committee asked the staff to clarify, in the flowchart, whether the sale of land would be identified as a separate component within the scope of IAS 18 at the early stage of analyzing the transaction or included in the real estate sale component and treated as a separate component at a later stage.

### Applicable standard and revenue recognition

Part two of the flowchart addresses two issues:

- Whether to regard the real estate sale agreement (or component) as a construction contract within the scope of IAS 11 or an agreement for the sale of goods within the scope of IAS 18
- How to recognize revenue from the sale of real estate

IFRIC agreed that the first question in the flowchart should be whether the real estate agreement meets the definition of a construction contract. The Committee decided that draft guidance that helps to distinguish between construction and the custom assembly of goods from predefined vendor options is helpful and should be included in the Interpretation. Paragraph 9 of D21 includes the following distinction:

An agreement for the sale of real estate meets the definition of a construction contract when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not). In contrast, an agreement for the sale of real estate in which construction takes place independently of the sale agreement and buyers have only limited ability to influence the design of the real estate, e.g. to select a design from a range of options specified by the seller, or to specify only minor variations to the basic design, is a contract for the sale of goods (the completed real estate) within the scope of IAS 18.

IFRIC discussed two views for accounting for real estate sale agreements that do not meet the definition of a construction contract when the seller transfers to the buyer control and the significant risks and rewards of ownership as

construction progresses (the criteria in paragraph 14(a) and (b) of IAS 18 for recognizing revenue):

- *View 1:* The sale agreement should be accounted for as a construction contract even though it does not meet the definition of a construction contract in IAS 11 (view taken in D21). Percentage of completion accounting would apply.
- *View 2:* The sale agreement should be accounted for as a continuous sale of goods within the scope of IAS 18. Percentage of completion accounting would still apply by analogy to IAS 11, because all the criteria for revenue recognition for the sale of goods in IAS 18 are met on a continuous basis.

The Committee generally supported View 2. Although View 1 and View 2 produce similar revenue recognition results, the segmenting and disclosure requirements for the real estate sale agreement under View 2 are determined by the provisions of IAS 18, which are less restrictive than IAS 11 (View 1). The staff will address whether additional disclosure requirements are warranted to close any gap between the IAS 18 and IAS 11 requirements.

The Committee asked the staff to clarify the term *continuous sale of goods* and to consider whether the continuous sale of goods might be indicative that the substance of the arrangement involves the rendering of services.

When the real estate sale agreement does not meet the definition of a construction contract and does not transfer control and the significant risks and rewards of ownership of the work in progress as construction progresses, the real estate sale is a sale of goods (completed real estate). Revenue is recognized when all the conditions in paragraph 14 of IAS 18 have been satisfied.

The staff will circulate a revised version of the flowchart and prepare a new draft of the Interpretation and the illustrative examples based on View 2.

See the [IFRIC project summary](#) for more information on this project.

### **IFRIC discusses draft interpretation on hedges of a net investment in a foreign operation**

At the March 2008 meeting, the IFRIC discussed hedge accounting, the application of different consolidation methods and recognition in earnings (recycling) of accumulated amounts recognized outside profit or loss on disposal of a foreign operation.

Pursuant to a request at the January 2008 meeting, the staff developed comprehensive examples on the effects of holding different hedging instruments by different entities within a group and of different methods of consolidation. Upon review and discussion of the examples, the IFRIC reached the following conclusions:

- The amount of the net investment to be hedged for the same risk cannot be duplicated. An entity cannot hedge the same risk more than once in financial statements that include the foreign operation. The net investment amount eligible to be hedged at each parent level depends on whether any lower level parent companies have already hedged the risk of the net assets of their foreign operations.
- A parent entity can hedge the risk of a net investment that it holds indirectly, because economic risk is not affected. The hedging instrument may be held by any entity within a group (other than the foreign operation being hedged).
- Where the hedging instrument is held or the method of consolidation that a group uses does not affect the assessment of the effectiveness of the hedge.

- When a hedged foreign operation is disposed of, the amount recycled to profit or loss from the group's foreign currency translation reserve (FCTR), would need to be identifiable in order to apply the recognition provisions for hedge accounting provisions in IAS 39, *Financial Instruments: Recognition and Measurement*.
- Under IAS 21, *The Effects of Changes in Foreign Exchange Rates*, when a foreign operation is disposed of, any related amount in the group's FCTR is included in profit or loss. The Committee indicated that although the amount determined by the direct method is the conceptually correct amount of FCTR for an individual foreign operation, IAS 21 does not require an entity to use this method or to make adjustments to produce the same result. The Committee agreed that the Interpretation should not prescribe either the direct method or the step-by-step method of consolidation; however, the determination of the amount recognized would depend on the method used.

The Committee asked the staff to recommend whether to include examples, and to draft the final interpretation.

See the [IFRIC project summary](#) for more information on this project.

### **Agenda decisions**

*IFRIC agenda decisions are not Interpretations which are determined only after extensive deliberation and due process, including a formal vote. IFRIC Interpretations become final only when approved by the IASB.*

### **IAS 7, Statement of Cash Flows – Classification of expenditures**

The Committee was asked to provide guidance on the treatment of certain types of expenditures in the statement of cash flows. Some entities classify expenditures that are not recognized as assets under IFRSs as cash flows from operating activities while other entities classify these expenditures as

part of investing activities. The following are examples of expenditures that may or may not be recognized as an asset in the statement of financial position:

- Exploration and evaluation activities
- Advertising and promotional activities
- Staff training
- Research and development

The Committee decided to refer this issue to the IASB with a recommendation that the IASB amend IAS 7, *Cash Flow Statements*, to indicate that only an expenditure that results in a recognized asset would be classified as a cash flow from investing activities.

#### **Tentative agenda decisions**

After reviewing the following issues, the Committee tentatively decided not to add them to the agenda at this time. The issues will be reconsidered at the May 2008 meeting.

#### **IAS 19, Employee Benefits – Settlements**

The Committee was asked to clarify whether certain defined benefit plan payments are settlements as defined in IAS 19, *Employee Benefits*. The issue results from an existing plan giving its members the option to choose to receive a lump sum payment at retirement instead of ongoing payments. IFRIC indicated that events that are considered within the actuarial assumptions underlying the measurement of the defined benefit obligation are not accounted for as settlements in accordance with IAS 19. The Committee indicated that there was little diversity in practice on this issue.

#### **IAS 37, Provisions, Contingent Liabilities and Contingent Assets – Deposits on returnable containers**

The Committee was asked to provide guidance on whether the obligation to refund deposits on returnable containers should be accounted for in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*. Entities in certain industries distribute their products in returnable containers, collect a deposit for each container delivered and then have an obligation to refund the deposit when the containers are returned.

The Committee analyzed two circumstances: where the container is sold to the customer together with the product and is derecognized by the entity, and where the container remains the property of the entity that distributes the product.

- *If the containers are derecognized as part of the sale transaction (either completely at the time of the first sale or partially by depreciation over a number of sales), the obligation would be an exchange of cash (the deposit) for the containers (non-financial assets):* Because it involves the exchange of a non-financial item, it does not meet the definition of a financial instrument and accordingly, is not within the scope of IAS 39. The return of the containers is at the option of the customer. As part of the sale transaction, its cost should be recognized in accordance with paragraph 19 of IAS 18, *Revenue*.
- *If the containers are not derecognized as part of the sale transaction, then the customer's only asset is its right to the refund:* The obligation meets the definition of a financial instrument under IAS 32 *Financial Instruments: Presentation* and accordingly, is within the scope of paragraph 49 of IAS 39.

- The Committee indicated that divergence on this issue was unlikely to be significant.

#### **Work in progress**

It is the staff's expectation that the Committee will complete its discussions of draft interpretations D21 and D22 at the May 2008 meeting. In addition, an analysis of comments received on draft interpretation D23, *Non-cash Asset Distributions to Owners* and draft interpretation D24, *Customer Contributions* will be presented by the staff at the July 2008 meeting.

#### **Future Committee meeting**

The next Committee meeting is May 8-9, 2008.

#### **IASC Foundation appoints additional IFRIC members**

On April 3, 2008, the Trustees of the IASC Foundation issued a [press release](#) announcing the appointment of two additional members of the IFRIC pursuant to a November 2007 decision made by the Trustees to increase the size of the IFRIC in order to broaden its IFRS expertise.

The new members are:

- Margaret M. (Peggy) Smyth, Vice President, Controller, United Technologies Corp., United States
- Scott Taub, Managing Director, Financial Reporting Advisors, LLC, United States, and former Acting Chief Accountant and Deputy Chief Accountant, U.S. Securities and Exchange Commission

#### **IFRS reference materials**

##### **IASB projects, meetings, and effective dates**

See the [IASB website](#) for information on projects, meetings, and effective dates.

##### **Comparison between U.S. GAAP and IFRS**

The [comparison document](#) highlights the major areas of similarity and differences between U.S. GAAP and IFRS.