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2006 Year-end IFRS update

Introduction

This publication provides a summary of the changes in International Financial Reporting Standards (IFRS) that entities need to apply in their 2006 year-end reports. The publication also provides a summary of those changes that will become effective in future periods, although entities are permitted, and in some cases encouraged, to apply them to earlier periods. These changes are presented in the following sections:

- Section 1:** New and amended standards and new interpretations that must be applied for financial years beginning on or after 1 January 2006
- Section 2:** New and amended standards and new interpretations issued, that are not yet effective, although entities may elect to apply these early
- Section 3:** Items not taken on to the International Financial Reporting Interpretations Committee (IFRIC) agenda, when the reason for the rejection provides some accounting guidance that assists with the interpretation and application of IFRS

Sections 1 and 2 provide an overview of the key requirements and changes of each new and amended standard issued by the International Accounting Standards Board (IASB or Board) and interpretations issued by the IFRIC. This overview is then followed by a summary of the transitional requirements and a brief discussion of the impacts that the change will have on the entity and/or its performance. References to other Ernst & Young publications that contain further details and discussion on this same topic have also been included, all of which can be downloaded from our website at www.ey.com/ifrs.

Section 3 provides a summary of the reasons published in the *IFRIC Update* why the IFRIC decided not to add an issue on to its agenda as the existing IFRS contained sufficient guidance to enable the transaction or arrangement to be accounted in an appropriate manner. While these updates do not have any authoritative status, they do provide a view about the application of the standards.

Our publication *International GAAP 2007* is a comprehensive analysis of all standards and interpretations, including all of those mentioned in this publication, and it provides examples that illustrate how the requirements are applied.

Our publication *Good Group (International) Limited*, an illustrative set of financial statements, incorporates all of the new disclosures that arise from these changes. It can also assist in understanding the impact on the financial statements.

This publication highlights only the key changes required for 2006 year-end reports and does not attempt to provide an in-depth analysis or discussion of how the standards and interpretations should be applied. Reference should be made to the text of the standards and interpretations before taking any decisions and actions.

The following table summarises the standards and interpretations with their effective dates, being financial years beginning on or after the date noted.

1. Applicable for December 2006 year-ends

Standard or Interpretation	Title	Effective date
IAS 1 and IAS 19	Amendment – Actuarial Gains and Losses, Group Plans and Disclosures	1 January 2006
IAS 21	Amendment – The Effects of Changes in Foreign Exchange Rates	1 January 2006
IAS 39	Amendment – Cash Flow Hedge Accounting of Forecast Intra-group Transactions	1 January 2006
IAS 39	Amendment – The Fair Value Option	1 January 2006
IAS 39 and IFRS 4	Amendment – Financial Guarantee Contracts	1 January 2006
IFRS 6	Exploration for and Evaluation of Mineral Resources	1 January 2006
IFRIC 4	Determining whether an Arrangement Contains a Lease	1 January 2006
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration, and Environmental Rehabilitation Funds	1 January 2006
IFRIC 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment	1 December 2005

2. Not effective for December 2006 year-ends, although they may be applied early

Standard or Interpretation	Title	Effective date
IFRS 7 (and IAS 32 and IAS 30)	Financial Instruments: Disclosures	1 January 2007
IAS 1	Amendment – Capital disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
IFRIC 7	Applying the Restatement Approach under IAS 29 <i>Financial Reporting in Hyperinflationary Economies</i>	1 March 2006
IFRIC 8	Scope of IFRS 2	1 May 2006
IFRIC 9	Reassessment of Embedded Derivatives	1 June 2006
IFRIC 10	Interim Financial Reporting and Impairment	1 November 2006
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions	1 March 2007
IFRIC 12	Service Concession Arrangements	1 January 2008

Other Exposure Drafts (ED) that have been issued and are still being discussed by the IASB that are not expected to be released as final standards and interpretations until later in 2007:

- ED of amendments to IAS 1 *A Revised Presentation*
- ED of amendments to IAS 23 *Borrowing Costs*
- ED of amendments to IAS 32 and IAS 1 *Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*
- IFRS 2 Amendment – *Vesting Conditions and Cancellations*
- ED of amendments to IFRS 3 *Business Combinations* and IAS 27 *Consolidations*
- ED of amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IFRIC D19 *IAS 19 The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements*
- IFRIC D20 *Customer Loyalty Programmes*.

Section 1: New standards and interpretations applicable for December 2006 year-ends

Amendment to IAS 19 Employee Benefits and IAS 1 Presentation of Financial Statements – Actuarial Gains and Losses, Group Plans and Disclosures

Key changes

Entities accounting for defined benefit plans now have the choice to recognise actuarial gains and losses outside of the profit or loss (ie, through equity), in addition to the previous options of recognising such gains and losses directly in profit or loss or using the corridor approach. When an entity adopts this new option, it must prepare a Statement of Recognised Income and Expense instead of a Statement of Changes in Equity. Changes in equity resulting from transactions with owners in their capacity as owners, all other movements in equity reserves and a reconciliation of retained earnings from the beginning of the period to the end of the period may only be presented in the notes.

New disclosures were also introduced, applicable to all entities with defined benefit plans, and include:

- a narrative description of the basis used to determine the overall expected rate of return on assets
- the amounts for the current period and previous four annual periods for each of the following:
 - the present value of the defined benefit obligation
 - the fair value of the plan assets
 - the surplus or deficit in the plan
 - experience adjustments on plan assets and liabilities
- the actual return on plan assets, and
- the best estimate of contributions expected to be paid to the plan during the next annual period.

Guidance has also been included for entities participating in a multi-employer plan when those entities prepare separate or individual financial statements. Where insufficient information exists and the plan has been accounted for as a defined contribution plan, and an agreement exists relating to how a surplus is shared, or a deficit is funded, the entity recognises an asset or liability arising from this contract.

Where a defined benefit plan exists for entities under common control, the cost recognised by the entity will be based on the contractual agreement for sharing costs, or on the actual contributions paid where there is no agreement.

Transition

When an entity elects to recognise actuarial gains and losses in full outside of the profit or loss, the change is applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

All entities will need to reassess the contractual arrangements for any group plans in which they participate, and consider the benefits associated with changing their accounting policy to recognise actuarial gains and losses outside of the profit or loss. The additional disclosures may require entities to set up new processes to capture the information needed.

The May 2006 edition of *Global EYE on IFRS* discusses further the choices available for accounting for actuarial gains and losses.

Amendment to IAS 21 *The effects of changes in foreign exchange rates*

Key changes

The amendment clarifies that monetary items (receivables or payables) between any subsidiary of a group and a foreign operation (rather than being restricted to arrangements between a parent and its subsidiary) may form part of the group's investment in that foreign operation (and therefore foreign exchange gains and losses are taken to equity on consolidation if settlement of the loan is neither planned nor likely to occur in the foreseeable future). It also allows monetary items that form part of a reporting entity's net investment in a foreign operation to be denominated in a currency other than the functional currency of either the parent or the operation itself.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

All foreign currency balances between foreign operations and/or entities in the group need to be reassessed to identify balances which may be considered part of the net investment. Additional foreign exchange differences may be taken directly to equity in the consolidated financial statements, thereby affecting reported performance in the year.

The January 2006 edition of *Global EYE on IFRS* discusses this amendment in detail and includes illustrative examples.

Amendments to IAS 39 *Financial Instruments: Recognition and Measurement*

The fair value option – key changes

This amendment restricts the use of the option to designate any financial asset or liability to be held at fair value through the profit or loss to the situations in which:

- it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities, or recognising the gains and losses on them on different bases ('accounting mismatch'),
- a group of financial assets and/or liabilities is managed and its performance is evaluated on a fair value basis, or
- it is a hybrid instrument (ie, a financial instrument with an embedded derivative), unless:
 - the embedded derivative does not significantly modify the cash flows otherwise required by the contract, or
 - with little or no analysis it would be concluded that the conditions necessary to separate an embedded derivative are not met.

Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* (continued)

The fair value option – transition

Items that were previously designated at fair value through profit or loss must be de-designated if these items do not meet these new criteria. After de-designation, if a financial asset or liability is to be measured at amortised cost, the date of de-designation is deemed to be the date of its initial recognition. Only instruments acquired after the amendment is effective may be added into this category.

The fair value option – impact

Entities must re-assess all instruments that were previously designated at fair value through profit or loss. They should also revisit their documented risk management policies and investment strategies as they relate to the management of their financial instruments, to ensure they are robust enough to allow assessment of items to which the option should be applied.

Cash flow hedge accounting of forecast intragroup transactions – key changes

The amendment allows a forecast intragroup transaction to be designated as the hedged item in a foreign currency cash flow hedge in the consolidated financial statements, provided that all three of the following criteria are met:

- the transaction is highly probable and meets all other IAS 39 hedge accounting criteria
- the transaction is denominated in a currency other than the functional currency of the entity entering into the transaction, and
- the foreign currency risk will affect the consolidated profit or loss (eg, when the transaction to purchase inventory is expected to be sold external to the group or is a depreciable asset).

Cash flow hedge accounting of forecast intragroup transactions – transition

Hedge accounting is available for all internal transactions entered into after the date of application of the amendment. For transactions prior to this date where the group had applied hedge accounting by linking the internal transaction to a specific external transaction, hedge accounting may still be applied if it would have met the requirements above, except that the external transaction is in the same functional currency of the entity entering into the transaction.

Cash flow hedge accounting of forecast intragroup transactions – impact

Entities must assess their future intragroup transactions to determine if and when hedge accounting can be applied.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts*

Key changes

Financial guarantee contracts are accounted for as financial instruments by the issuer. Such contracts are recognised initially at fair value and subsequently carried at the higher of that initial value and the value that would be recognised if IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IAS 18 *Revenue* was applied. An issuer may explicitly state that it regards such contracts as insurance contracts, in which case the entity may choose to apply either IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 4 *Insurance Contracts* to such contracts. These elections are made on an individual contract basis and are irrevocable.

This requirement applies equally to the separate financial statements of entities within a group for guarantees provided on behalf of or to other group entities.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Such contracts may only be accounted for as insurance contracts if they were designated as such in the past.

Impact

Entities must evaluate all financial guarantee contracts they have issued, and determine their fair value for recognition in the financial statements.

When preparing separate financial statements of parents and subsidiaries in a group, careful analysis will be required of all arrangements to determine if any financial guarantees have been given, and an approach determined for measuring their fair value.

Ernst & Young's publication *Financial Guarantees – Amendments to IAS 39 and IFRS 4* provides further information about this amendment.

IFRS 6 Exploration for and Evaluation of Mineral Resources

Key requirements

IFRS 6 provides interim guidance for accounting for expenditures incurred in the exploration for and evaluation of mineral resources, while the IASB continues its project on extractive industries. It is limited to considering the nature of such costs that may be capitalised as assets and the facts and circumstances which indicate when such assets may be impaired and the level at which impairment is assessed.

The effect of IFRS 6 is to permit most entities to continue to use the accounting policies it previously applied to expenditure on exploration and evaluation activities within the boundaries specified.

Additional disclosures are also required that enable the users to understand the effect of the policies chosen.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

Entities with exploration and evaluation assets must assess whether their existing accounting policy for exploration and evaluation expenditure is in accordance with this Standard, and identify to which cash generating units any exploration and evaluation assets belong, for the purpose of impairment testing.

IFRIC 4 Determining whether an Arrangement contains a Lease

Key requirements

This Interpretation establishes criteria to be used to assess whether a lease is contained in an arrangement that is not in the legal form of a lease. Essentially, any arrangement that conveys the right to use a specific asset in return for payments will be considered a lease. The Interpretation includes criteria to help assess whether the contract, at the date of inception, relies on a specific asset or not, and whether the arrangement provides for the right to use the asset.

Determining whether there is a right to use the asset involves a consideration of the relationship between the contracted quantity of product/service and the asset's capacity, the pricing terms and the decision-making related to the operation of the asset concerned.

After a lease is identified, an assessment is undertaken to identify what type of lease it is—operating or finance—in order to determine the accounting and disclosures necessary.

IFRIC 4 Determining whether an Arrangement contains a Lease (continued)

Transition

When applying IFRIC 4 for the first time, entities may elect to apply it to arrangements existing at the beginning of the comparative period based on the facts and circumstances at that time, in order to assess whether there is a lease.

If an entity determines that a lease does exist after considering IFRIC 4, this will be accounted for as a change in accounting policy and it is applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

Entities will need to review all arrangements for the supply of goods and services to assess whether or not a lease exists, and establish processes for making this assessment when new contracts are entered into in the future. Judgement is required in assessing whether an arrangement contains a lease, which could apply to many common transactions such as take or pay contracts, outsourcing and infrastructure contracts. As a minimum, increased disclosure will be required when these are considered operating leases, and generating the information can be time consuming.

The September 2006 edition of *Global Eye on IFRS* discusses IFRIC 4 in further detail.

IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

Key requirements

IFRIC 5 sets out the accounting treatment for interests in funds established to finance the decommissioning or restoration of assets or environmental rehabilitation (decommissioning costs). The contributor to the fund must recognise a liability for its obligation to pay decommissioning costs, and separately recognise its interest in the fund, unless the contributor has legally transferred its obligation to the fund, with no recourse to the contributor.

The contributor recognises its interest in the fund:

- in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures*, if it controls, has significant influence over or jointly controls the interest, or if none of these exist,
- it recognises a right to receive reimbursement from the fund in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, in which case the reimbursement is recognised only when it is virtually certain that it will be received if the contributor settles the obligation. Changes in the carrying value of the reimbursement right are recognised in the profit or loss.

Contributors are required to disclose the nature of their interest in the fund and any restrictions on access to the assets in the fund. When reimbursement rights are recognised in accordance with IAS 37, the related disclosures required by that Standard must also be made.

IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (continued)

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

Entities will need to review the conditions of all such schemes to determine whether or not the liability is transferred to the scheme without recourse or whether it remains with the entity, and to identify precisely the impact of any decision-making given to the entity about how the funds are to be invested and/or managed.

IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

Key requirements

IFRIC 6 requires that liabilities relating to waste management in respect of sales of historical household equipment (as defined in the European Union (EU) Directive on Waste Electrical and Electronic Equipment) to be recognised when the entity participates in the market during the relevant measurement period. The measurement period is to be defined by each EU Member State, and will generally relate to the period in which such products are disposed of. An entity's liability will be assessed based on its market share during that period.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

Entities that sell household electrical equipment will need to review their national law that implements the EU Directive to understand how the measurement period will be applied to them and identify how they will be assessed for their share of the costs incurred for products disposed of during the measurement period. In many cases, significant uncertainty will exist and will require management to exercise judgment and establish systems in order to capture the data required to determine the liability.



Section 2: New standards and interpretations that have been issued, that are not required to be applied for December 2006 year-ends, although they may be applied early

IFRS 7 *Financial Instruments: Disclosures*

Effective for annual periods beginning on or after 1 January 2007.

Key requirements

IFRS 7 includes all of the disclosure requirements relating to financial instruments and will replace the disclosure section of IAS 32 *Financial Instruments: Disclosure and Presentation* and all of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*. IAS 32 will then contain only presentation requirements for financial instruments.

The most significant additional disclosure requirements of IFRS 7 (compared to IAS 32 and IAS 30) are as follows:

- Nature and extent of risks
 - qualitative risk disclosures are to include information on the processes that an entity uses to manage and measure its risks
 - quantitative data about the exposure to each type of risk (including credit risk, liquidity risk and market risk) arising from financial instruments
 - information about the credit quality of financial assets that are neither past due nor impaired
 - an analysis of financial assets that are past due or impaired, including a description of collateral held as security and its fair value
 - a market risk sensitivity analysis which includes the effect of a reasonably possible change in the risk variables, along with the methods and assumptions used in preparing the analysis.
- Other
 - a reconciliation of changes in the allowance for credit losses for each class of financial asset
 - enhanced income statement and balance sheet disclosures, including separate identification of net gains or losses and the amount of any impairment loss for each category of financial instrument
 - the criteria for determining when the carrying amount of an impaired financial asset is reduced directly and when an allowance account is used, and when to write off against the asset amounts charged to the allowance account
 - the gains or losses on the hedging instrument and on the hedged item attributable to the hedged risk of a fair value hedge
 - the ineffectiveness recognised in profit or loss arising from both cash flow hedges and hedges of net investments in foreign operations
 - profits or losses arising on initial recognition of financial instruments ('day 1' profits or losses) that are not recognised in the financial statements and a reconciliation of changes in this unrecognised balance during the period. The accounting policy for determining when unrecognised amounts are recognised in profit or loss must also be disclosed.

IFRS 7 *Financial Instruments: Disclosures* (continued)

Transition

The disclosures must be provided for all comparative periods presented.

Impact

Entities need to assess whether the processes and systems in place are capable of collecting this information and make any necessary changes. All documented policies should also be reassessed to determine that they are comprehensive and complete. As comparative information is required, entities should ensure that the information for 2006 is collected now.

Our publication *IFRS 7 Financial Instruments: Disclosures* provides a detailed comparison of the requirements of IFRS 7 with IAS 32 and IAS 30. The second edition of this publication (due out before the end of the year) will provide application guidance and illustrative examples of entities that have already applied IFRS 7.

The June 2006 edition of *Global EYE on IFRS* discusses how IFRS 7 affects entities outside of the financial institutions sector.

Amendment to IAS 1 *Presentation of Financial Statements – Capital disclosures*

Effective for annual periods beginning on or after 1 January 2007.

Key changes

This amendment to IAS 1 *Presentation of Financial Statements* requires entities to disclose information that enables readers to evaluate the entity's objectives, policies and processes for managing capital. The disclosures are based on information provided internally to key management personnel, and will include:

- the objectives, procedures and policies used to manage capital
- a description of what the entity manages as capital, the nature of any externally imposed capital requirements (if any) and how it meets its objectives for managing capital
- quantitative information about what the entity manages as capital and any changes from the prior period
- whether the entity complied with externally imposed capital requirements and the consequences of any non-compliance, (if applicable).

Transition

The disclosures must be provided for all comparative periods presented.

Impact

Entities will need to consider what information is currently used internally and how this is to be incorporated into the disclosures. Systems may need to be updated by some entities to ensure the quantitative information is collected on a timely basis.

IFRS 8 Operating Segments

Effective for annual periods beginning on or after 1 January 2009.

Key requirements

IFRS 8 was issued as part of the convergence project with the US Financial Accounting Standards Board. This new standard replaces IAS 14 *Segment Reporting* and adopts a management approach to segment reporting as required in the US Standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. This information may be different from that reported in the balance sheet and income statement and entities will need to provide explanations and reconciliations of the differences.

Additional disclosures required by IFRS 8 are:

- for all entities
 - information about products and services
 - information about geographical areas, and
 - information about major customers
- the factors used to identify an entity's reportable segments
- for each reportable segment, information is disclosed only if included in the results reported to the Chief Operating Decision Maker (CODM) or otherwise reported to the CODM. Items currently required by IAS 14 plus the following are to be considered:
 - interest revenue
 - interest expense
 - income tax expense or income
 - segment liabilities, if such information is reviewed by the CODM
- an explanation of the measurement basis used to determine the amounts disclosed
- a reconciliation between total reportable segment items with the amounts disclosed in the financial statements for revenues, profit or loss, assets, liabilities and other material items.

Transition

The disclosure must be provided for all comparative periods presented, unless the necessary information is not available and the cost to produce such information is excessive.

Impact

The information required to be disclosed will likely be readily available as it is already used internally. However, entities will need to put processes in place to reconcile this information to the balance sheet and income statement.

IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies

Effective for annual periods beginning on or after 1 March 2006.

Key requirements

IFRIC 7 requires entities to apply IAS 29 *Financial Reporting in Hyper-inflationary Economies* in the reporting period in which an entity first identifies the existence of hyperinflation in the economy of its functional currency as if the economy had always been hyperinflationary.

Therefore:

- non-monetary items measured at historical cost are restated to reflect the effect of inflation from the date the asset was acquired or liability was incurred until the closing date of the reporting period.
- non-monetary items measured at amounts current at dates other than acquisition, are restated to reflect the effect of inflation from the last remeasurement date until the closing date of the reporting period.
- deferred tax items in the opening balance sheet (of the reporting period and comparative period) are remeasured in accordance with IAS 12 *Income Taxes* after restatement of the non-monetary items, by applying the measuring unit current at the relevant opening balance sheet date. These remeasured deferred tax items are restated for the change in the measuring unit from the opening balance sheet date to the closing balance sheet date of the relevant period.

Impact

Application of this Interpretation will result in the restatement of the entity's comparative information under IAS 29 *Financial Reporting in Hyperinflationary Economies*. Systems and processes may need to be updated to ensure that the information is captured and correctly restated using the new measuring unit.

IFRIC 8 Scope of IFRS 2

Effective for annual periods beginning on or after 1 May 2006, early application is encouraged.

Key requirements

IFRIC 8 clarifies that IFRS 2 *Share-based Payment* will apply to any arrangement when equity instruments are granted or liabilities (based on a value of an entity's equity instrument) are incurred by an entity, when the identifiable consideration appears to be less than the fair value of the instruments given. It presumes that such cases are an indication that other consideration (ie, unidentifiable goods or services) has been or will be received. The unidentifiable goods or services concerned are to be measured at the grant date as the difference between the fair value of the share-based payment (equity given or liability incurred) and the fair value of any identifiable goods or services received.

For cash-settled transactions, the liability is to be remeasured at each reporting date until it is settled, in accordance with IFRS 2.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

IFRIC 8 Scope of IFRS 2 (continued)

Impact

Entities will need to re-assess all transactions in which shares have been issued (or liabilities incurred based on equity instruments) as consideration for goods and services received, although it is not expected to have wide application, as it was developed in response to the black economic empowerment schemes in South Africa.

IFRIC 9 Reassessment of Embedded Derivatives

Effective for annual periods beginning on or after 1 June 2006.

Key requirements

IFRIC 9 requires an entity to assess whether a contract contains an embedded derivative at the date an entity first becomes a party to the contract and prohibits reassessment unless there is a change to the contract that significantly modifies the cash flows.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

Some entities, when adopting IFRS for the first time, may have made assessments as at the date of transition as to whether or not embedded derivatives existed, rather than at the date of entering into the contract. This accounting now needs to be revised and may require access to information that is not readily available.

IFRIC 10 Interim Financial Reporting and Impairment

Effective for annual periods beginning on or after 1 November 2006.

Key requirements

IFRIC 10 addresses an inconsistency between IAS 34 *Interim Financial Reporting* and the impairment requirements relating to goodwill in IAS 36 *Impairment of Assets* and equity instruments classified as available for sale in IAS 39 *Financial Instruments: Recognition and Measurement*. The Interpretation states that the specific requirements of IAS 36 and IAS 39 take precedence over the general requirements of IAS 34 and, therefore, any impairment loss recognised for these assets in an interim period may not be reversed in subsequent interim periods.

Transition

For those entities that have produced interim financial statements since adopting the amended IAS 36 and IAS 39, and recognised impairment of goodwill or equity investments that had been reversed in the annual financial statements, the original impairment charge will need to be reinstated.

Impact

Entities reporting interim results may report different results than they would have, had they only reported on an annual basis.

Ernst & Young's *IFRS Alert* (Issue 3 July 2006) contains more detail about this Interpretation.

IFRIC 11 IFRS 2 – Group and Treasury Share Transactions

Effective for annual periods beginning on or after 1 March 2007, early application is permitted.

Key requirements

This Interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if:

- the entity chooses or is required to buy those equity instruments (eg, treasury shares) from another party, or
- the shareholder(s) of the entity provide the equity instruments needed.

The Interpretation also extends to the way in which subsidiaries, in their separate financial statements, account for schemes when their employees receive rights to equity instruments of the parent. In particular, it prescribes that:

- When the parent grants rights to equity instruments to the employees, they will be accounted for as an equity-settled scheme (and as an equity contribution by the parent) when the parent accounts for it this way in the consolidated financial statements. When employees transfer between subsidiaries, each entity recognises compensation expense based on the proportion of the total vesting period for which the employee has worked for that subsidiary, measured at the fair value at the original grant date by the parent.
- When the subsidiary grants rights to equity instruments of its parent to its employees, it will be accounted for as a cash-settled scheme.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Impact

Entities have accounted for the above schemes in different ways. This Interpretation is likely to result in more schemes being accounted for as equity-settled schemes by subsidiaries.

All share-based payment schemes must be reassessed at the subsidiary level, and new processes may need to be implemented in order to enable an appropriate allocation of costs between subsidiaries to be made when employees transfer within the group or leave the group.

Ernst & Young's *IFRS Alert* (Issue 6 November 2006) contains more detail about this Interpretation.

IFRIC 12 Service Concession Arrangements

Effective for annual periods beginning on or after 1 January 2008.

Key requirements

The interpretation outlines an approach to account for contractual arrangements arising from entities providing public services. It provides that the operator should not account for the infrastructure as property, plant and equipment, but recognise a financial asset and/or an intangible asset. A financial asset is recognised to the extent that the operator has a contractual right to receive cash from the grantor or has a guarantee from the grantor. An intangible asset is recognised to the extent that the entity has a right to charge the public for use of the asset.

Transition

If changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Estimates and Errors*. However, if it is impracticable for an operator to apply this Interpretation retrospectively, it must:

- reclassify the relevant assets that existed at the start of the earliest period presented as financial assets and intangible assets
- use the previous carrying amounts of those financial and intangible assets (regardless of previous classifications) as their carrying amounts as at that date, and
- test financial and intangible assets recognised at that date for impairment. If this is impracticable, the amounts must be tested for impairment as at the start of the current period.

Impact

Entities with public-to-private service concessions will need to assess their existing contractual arrangements to identify the contracted cash flows that give rise to a financial asset and identify any intangible asset that may exist. Information systems may need to be established to enable appropriate accounting for each asset identified.



Section 3: Items not taken to the IFRIC agenda where the IFRIC has provided guidance as to the interpretation of IFRS

During 2006, the IFRIC considered a large number of items that it concluded should not be taken on to its agenda. Many items were not added to the agenda as they relate to the IASB's current projects or because the issue was of narrow application.

However, many items not taken on to the agenda as the IFRIC concluded that the appropriate accounting treatment could be determined directly from the existing IFRS. In certain other cases, the IFRIC concluded that clarification of the standard(s) concerned was required and referred the matter to the Board. When publishing its reasons for not taking these issues on to its agenda, the IFRIC either explained how the relevant standard(s) should be applied to the issue concerned, or the need for clarification by the Board, as the case may be.

Final date considered	Issue	Summary of reason for not adding to the IFRIC agenda
November 2006	IAS 1 - Whether the liability component of a convertible instrument should be classified as current or non-current	The IFRIC believes the requirements of IAS 1 and IAS 32 appear to be in conflict. It also noted that in practice, determining whether the liability component was classified as current or non-current focused on when the issuer was obliged to deliver cash or other assets. The Board subsequently agreed to amend IAS 1.
November 2006	IAS 11 - Allocation of profit in a single contract	The IFRIC believes that sufficient guidance exists in IAS 18 and IAS 11 and that it is reasonable that in a single contract, different profit margins may be determined for the different components of the contract.
March 2006	IAS 12 - Scope	The IFRIC believes that IAS 12 clearly applies to income taxes, while the scope of IAS 37 incorporates any other taxes. The IFRIC noted that IAS 12 implies that: <ul style="list-style-type: none"> (i) not all taxes are within the scope of IAS 12 (ii) taxes do not need to be based on a figure that is exactly equal to accounting profit to be within the scope of IAS 12 (iii) the term 'taxable profit' implies a notion of a net rather than a gross amount. The IFRIC noted that there are many taxes worldwide that would require further analysis; however, this could not be assessed in a reasonable period.
March 2006	IAS 17 - Leases of land that do not transfer Title to Lessee	The IFRIC noted that, as summarised in paragraph BC 8 of IAS 17, the Board had considered whether a long lease of land in which title would not transfer to the lessee would be a finance lease. However, this was rejected because "it would conflict with the criteria for lease classification in the Standard, which are based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee."

Final date considered	Issue	Summary of reason for not adding to the IFRIC agenda
July 2006	IAS 17 – Recognition of contingent rentals	The IFRIC noted that although IAS 17 is unclear on this issue, it has not led to contingent rentals being included in the total payment/receipts to be recognised on a straight line basis over the lease term. The IFRIC decided not to take the issue onto its agenda, but instead made a recommendation to the Board to amend IAS 17 to clarify this requirement. The Board subsequently agreed to amend IAS 17.
March 2006	IAS 27 – Separate financial statements issued before consolidated financial statements	The IFRIC noted that IAS 27 requires separate financial statements of a parent to identify the related consolidated financial statements, unless the exemption provided by paragraph 10 is applicable.
November 2006	IAS 32 – Changes in the contractual terms of an existing equity instrument resulting in it being reclassified to financial liability	The IFRIC noted that the change in terms result in derecognition of equity and that paragraph 33 of IAS 32 stated that no gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Therefore, the IFRIC believes that, at the time when the terms are changed, the difference between the carrying amount of the equity instrument and the fair value of the newly recognised financial liability should be recognised in equity.
November 2006	IAS 32 – Puts and forwards held by minority interests	Paragraph 23 of IAS 32 requires a parent to recognise a financial liability when it has an obligation to pay cash in the future to purchase the minority's shares, even if the payment of that cash is conditional on the option being exercised by the holder. After initial recognition, any liability to which IFRS 3 is not being applied must be accounted for under IAS 39. The parent then reclassifies the liability to equity if a put expires unexercised. The IFRIC agreed that there is likely to be divergence in practice in how the related equity is classified. However, it did not believe that it could reach a decision on this matter on a timely basis.
November 2006	IAS 32 – Classification of a financial instrument as a liability or equity	The IFRIC were asked to consider the role of contractual obligations and economic compulsion in the clarification of financial instruments. The Board discussed this matter at its June meeting and reported in the IASB Update that economic compulsion by itself would not result in a financial instrument being classified as a liability under IAS 32. Determining the classification required an assessment of the contractual arrangements both explicit and implicit, and could not be based on factors not within those contractual arrangements. The IFRIC decided not to add this item on to its agenda and requested the Board to provide clarity on this matter.

Final date considered	Issue	Summary of reason for not adding to the IFRIC agenda
November 2006	IAS 38 – The treatment of catalogues and other advertising costs	<p>This item is currently a project on the IFRIC's agenda. However, at its November meeting, in trying to determine the point at which advertising or promotional expenditure should be recognised as an expense, the IFRIC was unable to see which of the three recognition approaches below met the requirements of paragraphs 68-70 of IAS 38:</p> <ul style="list-style-type: none"> · when an obligation exists to pay for the advertising activity · when the advertising material is delivered to the entity · when the advertising material is delivered to the customer. <p>The IFRIC did agree that capitalising advertising costs and amortising them over the period in which sales are expected could not be supported by IAS 38. The IFRIC decided to recommend to the Board that IAS 38 be amended to clarify that advertising and promotional costs should be expensed when the advertising is undertaken.</p>
November 2006	IAS 39 – Valuation of electricity derivatives	<p>The IFRIC noted that the only exception in IAS 39 from the requirement to fair value derivatives after initial recognition is given in paragraph 46(c)–relating to unquoted equity instruments—and that it was not appropriate to extend this exemption to electricity derivatives. The IFRIC also noted that IAS 39 contains general principles on how to measure fair value. The IFRIC decided that more detailed guidance on this topic should not be developed, as the subject is too specific.</p>
May 2006	IFRS 2 – Scope of IFRS 2: Share plans with cash alternatives at the discretion of the entity	<p>The IFRIC noted that the definition of a share-based payment transaction does not require the exposure of the entity to be linked to movements in the share price of the entity. IFRS 2 explicitly contemplates transactions that provide a choice of settlement. Therefore, where any settlement does not vary with the share price, the plan is a share-based payment transaction in accordance with IFRS 2 since the consideration may be equity instruments of the entity. The IFRIC believed that even in extreme circumstances in which an entity was given a choice of settlement and the value of the shares that would be delivered is a fixed monetary amount, such share plans are still within the scope of IFRS 2.</p>

Final date considered	Issue	Summary of reason for not adding to the IFRIC agenda
May 2006	IFRS 2 - Share plans with cash alternatives at the discretion of employees: grant date and vesting periods	The IFRIC was asked to confirm the grant date and vesting date for plans in which employees were given a choice to have cash at one date or shares at a later date and, at the date of the transaction the formula for calculating the cash to be paid or shares to be delivered was known, but the exact amount of cash or number of shares was not known. The IFRIC noted that IFRS 2 clearly establishes that when a choice is given, a compound instrument has been issued, and the goods or services received in respect of each component are accounted for separately. Therefore, the vesting period of each component could be determined separately. Furthermore 'grant date' referred to the date when a shared understanding of terms and conditions was reached and did not require the exact amount of cash or number of shares to be known.
November 2006	IFRS 2 - Fair value measurement of post-vesting transfer restrictions	The IFRIC was requested to consider whether the value of shares issued to employees with post-vesting restrictions could be valued by looking only to an actual or synthetic market between the employee and the entity. The IFRIC noted that paragraph B3 of IFRS 2 requires consideration of actual or hypothetical transactions with all actual or potential market participants (not only employees) willing to invest in restricted shares that had been or might be offered to them.
March 2006	IFRS 3 - Whether a new entity that pays cash can be identified as the acquirer	The IFRIC believes that it is clear that IFRS 3.22 does not prohibit a newly formed entity that pays cash to effect a business combination from being identified as the acquirer.
March 2006	IFRS 3 - 'Transitory' Common Control	The IFRIC was asked to consider whether a re-organisation that involves forming a new entity to facilitate a sale of part of a group would be within IFRS 3 as control of the new entity would be transitory. The IFRIC noted that IFRS 3.22 states "when an entity is formed to effect a business combination, one of the combining entities that existed before the combination must be identified as the acquirer..." therefore the IFRIC concluded that whether or not the entities are under common control applies to the entities that existed before the combination, and excludes the newly formed entity.

Final date considered	Issue	Summary of reason for not adding to the IFRIC agenda
January 2006	IFRS 6 - Application of the 'full-cost' method	The IFRIC noted it was clear that the scope of IFRS 6 consistently limited the relief from the hierarchy to policies applied to exploration activities and that there was no basis for interpreting IFRS 6 as granting any additional relief in areas outside its scope.
November 2006	IFRS 7 - Presentation of 'net finance costs' on the face of the income statement	The IFRIC confirmed its original analysis in October 2004 - that the presentation of 'net finance costs' was not allowed on the face of the income statement, unless finance costs and finance revenue are also disclosed on the face of the income statement - was still applicable and, therefore, did not add the item onto its agenda. The IFRIC also decided to recommend to the Board that paragraph IG13 of IFRS 7 be amended to avoid confusion. The Board subsequently agreed to amend IFRS 7.
November 2006	SIC 12 - Relinquishment of control	The IFRIC noted that under IAS 27, control has two components that must be considered (ie, the power to govern and the right to obtain benefits). The factors outlined in paragraph 10 of SIC-12 are only indicators and not necessarily conclusive. In the IFRIC's view, SIC-12 requires that the party with control over a special purpose entity (SPE) should be determined by exercising judgment after taking into account all relevant factors.

Tentative decisions

A number of items are still under discussion by the IFRIC; however, it has tentatively decided not to add the following items onto its agenda. It is expected that final decisions will be reached in upcoming meetings.

Last date considered	Issue	Tentative view
July 2006	IAS 39 - Indexation on Own EBITDA or Own Revenue	<p>IAS 39 excludes from the definition of a derivative those contracts whose value changes in response to a non-financial variable specific to a party to the contract.</p> <p>The IFRIC accepted that it is unclear whether revenue or EBITDA are financial or non-financial variables. However, its tentative view is not to take this issue onto its agenda as it would be unable to reach a consensus on a timely basis.</p> <p>The IFRIC also believes that the exclusion of non-financial variables within insurance contracts from the definition of a derivative in paragraph 9 of IAS 39 is not restricted to just insurance contracts as there is no explicit statement in IAS 39 that states this. Its tentative view is not to add this item onto its agenda.</p> <p>At the IFRIC's November 2006 meeting, in light of comment letters received, the IFRIC decided that further research should be undertaken before finalising its decision.</p>

Tentative decisions (continued)

Last date considered	Issue	Tentative view
November 2006	IAS 39 – Financial instruments puttable at an amount other than fair value	<p>The IFRIC was asked to consider two issues:</p> <ol style="list-style-type: none"> 1. should the accounting for a puttable instrument by the holder and the issuer be symmetrical? 2. when a subsidiary does not have equity instruments in issue, is its parent required to consolidate it under IAS 27 Consolidated and Separate Financial Statements and recognise goodwill under IFRS 3 Business Combinations? <p>On the first issue, the IFRIC noted that the issuer must apply IAS 32 while the holder must apply IAS 39. It was also noted that IAS 39 provides guidance on how the holder must identify and account for any embedded derivatives, and that this guidance applies regardless of whether the issuer separately accounts for any embedded derivatives. Given the guidance in IAS 39, the IFRIC tentatively decided not to add this item onto its agenda.</p> <p>In relation to the second issue, the IFRIC noted that the requirement to present consolidated financial statements under IAS 27 depends on the existence of control and not on the ownership of equity instruments. Its tentative decision, therefore, was not to add this item onto its agenda.</p>
November 2006	IAS 39 – Short trading	<p>Paragraph 38 of IAS 39 gives an exemption for “regular way purchases and sales of financial assets” from being accounted for as derivatives. The IFRIC was asked to consider whether a short sale can be accounted for using this special exemption. It was noted that a fixed price commitment between trade date and settlement date of a short sale contract satisfies the definition of a derivative and as such, the exemption, which permits the use of trade date or settlement date accounting, does not apply. Therefore, the IFRIC believed that IAS 39 required that a short sale should be accounted for as a derivative. Its tentative decision is not to add this item onto its agenda.</p>



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