

# IFRS in Brief

July 2005, **Issue 15**

This issue of *IFRS in Brief* covers the June 2005 meeting of the International Accounting Standards Board (IASB) and June 2005 amendments to the Constitution of the International Accounting Standards Commission Foundation (IASCF).

## Recent Publications

In June 2005, the IASB published the Exposure Draft of *Proposed Amendments to IFRS 3 Business Combinations*, the Exposure Draft of *Proposed Amendments to IAS 27 Consolidated and Separate Financial Statements*, and the Exposure Draft of *Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits*. These proposals will be discussed in forthcoming issues of *IFRS Briefing Sheet*.

## IASB Meeting

**Withdrawal of IFRIC 3 Emission Rights**  
The Board decided to withdraw IFRIC 3 with immediate effect. It made this decision after being briefed on possibilities considered by the International Financial Reporting

Interpretations Committee (IFRIC) to revise IFRIC 3 and related IASB standards. The IFRIC wished to revise IFRIC 3 in order to address concerns about accounting mismatches between accounting for the assets (emission right certificates), liabilities (obligations to deliver certificates for pollution) and deferred income (government grants).

As a result, the IFRIC will not pursue its planned amendment to IAS 38 *Intangible Assets* or the suggestion of the European Financial Reporting Advisory Group (EFRAG) to introduce a hedge accounting alternative.

The IASB plans to consider undertaking a more comprehensive approach to review the accounting for trade and cap emission right schemes in the near future. The Board's initial priority will be to revise IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. The exposure draft on revised IAS 20 is expected to be issued in 2006.

## Convergence with U.S. GAAP: Income Taxes

### Uncertain Tax Positions

The Board considered proposals in a draft U.S. Financial Accounting Standards Board (FASB) Staff Position (FSP) on uncertain tax positions. The FSP proposed that a tax deduction

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could be recognised only if there was a high probability of it being sustained if it was challenged by the taxing authorities. Under the FSP a deduction would be measured based on entity's best estimate of the likely settlement, if it was probable of being sustained. The IASB discussed whether the possibility of a challenge by a tax authority should be reflected in measuring tax obligations. This includes consideration of "detection risk" – the risk of being audited. The IASB was concerned that the proposals in the FSP could be inconsistent with its amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Board asked the staff to explore the issue of uncertain tax positions under IFRSs.

#### Disclosures

The Board considered the differences in disclosure requirements of IAS 12 *Income Taxes* and FASB statement SFAS 109 *Accounting for Income Taxes* and decided to make a number of amendments to IAS 12 to address some of these differences. In particular the Board decided to propose:

- to require disclosure of the tax impact of intercompany asset transfers (e.g., intercompany inventory sales) on the financial statements
- to delete the current requirement to disclose the nature of evidence supporting recognition of a deferred tax asset when its utilisation is dependent on future profits and the entity has suffered losses
- to require the disclosure of the fact that a company was not subject to income tax because its income was taxed directly on the owners (e.g., U.S. taxation of partnerships)
- to require reconciliation of the tax expense on accounting profit based on the tax rate in the parent company's jurisdiction, as opposed to the current requirement to

reconcile based on the average rate of relevant jurisdictions

- to require in individual company financial statements the disclosure of tax-related balances due to and from affiliates, if an entity is a member of a group that files a consolidated tax return
- to change the disclosure requirements relating to potential tax liabilities relating to unremitted foreign earnings when the liability has not been recognised.

#### Proposed Amendments to IFRS 6 and IFRS 1

The Board discussed the comment letters received on the Exposure Draft of *Proposed Amendments to IFRS 6 Exploration for and Evaluation of Mineral Resources and IFRS 1 First-time Adoption of International Financial Reporting Standards*. The Board decided to publish the amendments without change to the wording in the Exposure Draft. A summary of the proposals in the Exposure Draft is available in *IFRS Briefing Sheet – Publication of amendments to IFRS 6 Exploration for and Evaluation of Mineral Resources and IFRS 1 First-time Adoption of International Financial Reporting Standards*, Issue 23, published in May 2005.

#### IAS 32: Convertible Financial Instruments in a Foreign Currency

The Board tentatively decided to pursue a limited amendment to IAS 32 *Financial instruments: Disclosure and Presentation* to address an issue identified by IFRIC relating to classification as debt or equity of call options denominated in a fixed amount of a foreign currency. This issue commonly arises in connection with classification of the conversion feature of the foreign currency denominated convertible bond.

Under IAS 32 a contract settled by delivery of a fixed number of an

entity's own equity instruments in exchange for a *fixed* amount of cash is classified as an equity instrument. However, when a contract is settled by delivery of a fixed number of entity's own equity instruments in exchange for a *variable* amount of cash, it is classified as a financial liability.

At its April 2005 meeting the IFRIC discussed the classification of contracts settled by delivery of a fixed number of an entity's own equity instruments in exchange for a *fixed* amount of *foreign currency*. The IFRIC noted that application of hedge accounting guidance would view an obligation denominated in a foreign currency as a variable amount of cash. A majority of IFRIC members believed that call options denominated in a foreign currency therefore would be classified as financial liabilities.

At its June 2005 meeting the IFRIC decided to recommend that the IASB consider amending IAS 32 so that such call options are classified as equity. At this meeting the IASB agreed to explore the IFRIC's recommendation. While the Board appeared to plan further discussions, it seemed aware of and sensitive to the need for a resolution of this issue as soon as possible.

#### IAS 21 *The Effects of Changes in Foreign Exchange Rates – Net Investment in Foreign Operation*

IAS 21 requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised in a separate component of equity until disposal of the foreign operation. However, the wording of IAS 21 suggests that this approach applies only to monetary items that are denominated in the functional currency of either the reporting entity or the foreign operation.

The Board decided to propose amendments to IAS 21 to:

- eliminate the restriction on denomination of a monetary item and clarify that the net investment hedge approach also may apply to items denominated in a currency that is not the functional currency of either the reporting entity or the foreign operation
- clarify that the application of the net investment hedge approach is not restricted to transactions between the foreign operation and reporting entity but also extends to transactions between the foreign operation and any member of the consolidated group.

#### Segment Reporting – Convergence with U.S. GAAP

The Board decided not to include additional guidance on grouping of segments in the exposure draft on segment reporting that it expects to issue later in 2005. The IASB will propose replacing IAS 14 *Segment Reporting* with the comparable U.S. standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. The possible additional guidance considered by the IASB was issued by the Canadian Emerging Issues Committee (EIC), based on the Canadian standard, which is generally consistent with SFAS 131.

The Board decided not to include the guidance in EIC 115 *Segment Disclosures – Application of the Aggregation Criteria in CICA 1701*. The Board also decided to invite comments on whether the IASB should supplement the FASB's "pure" management approach for segment reporting by establishing requirements for measurement or presentation of any specific items.

#### Performance Reporting – Joint Project with U.S. FASB

The IASB staff updated the Board on the discussions at the June 2005 meeting of the Joint International Group (JIG). The JIG was established in 2004 by the IASB and FASB to assist the Boards and staff in identifying performance reporting issues and developing proposed solutions. Issues considered by the JIG at its June 2005 meeting included:

- update on progress of the first phase of the project, including whether comprehensive income should be presented in a single statement
- classification of line items within the statement of earnings and comprehensive income.

The IASB reaffirmed its previous decision made jointly with the FASB not to publish a discussion paper for the first phase (Segment A) of the project and instead to proceed directly to issuing an exposure draft. Segment A focuses on whether to require, rather than just encourage, presentation of a Statement of Comprehensive Income.

#### Conceptual Framework – Joint Project with the U.S. FASB

The Board continued to discuss issues related to qualitative characteristics of accounting information.

#### Revenue Recognition – Joint Project with the U.S. FASB

The IASB reviewed the objective, scope and progress of the project. The Boards decided to continue the joint project. The Boards also reaffirmed their previous decision that the framework for revenue recognition should be based on changes in assets and liabilities.

However, the Boards decided to explore an alternative approach to measurement of performance

obligations. Previously the Boards considered measuring such obligations at the amount that the entity would have to pay to transfer them to another entity. This raised the prospect of recognising day one gains for unfilled contracts based on pricing differences between wholesale and retail markets. The Boards were concerned that this approach may be difficult to apply in practice. A new approach will be explored under which the focus for measurement would be on the customer's perspective, i.e., obligations would be measured at the amount that a customer would pay the entity for fulfilling them.

#### Management Commentary

The Board reviewed a draft discussion paper *Preliminary Views on the Development of Standards and Guidance for Management Commentary*. The Board agreed to publish the discussion paper subject to resolution of minor comments and questions. The Board expects to publish the discussion paper in September 2005, with a six-month exposure period.

#### Technical Corrections Policy

The Board discussed a proposed policy for making technical corrections to the standards in cases when the wording in a standard does not reflect fully the intentions of the Board. Currently the Board does not have a procedure for making such corrections other than issuing a separate exposure draft. The new policy would require the Board to publish the proposed technical corrections on the IASB web site, generally with a comment period of 30 days. The Board asked the staff to develop a policy for distinguishing between the issues that should result in technical corrections and those that would be considered by the IFRIC. The Board will continue to discuss the proposed policy at a future meeting.

### **IASCF Constitutional Changes**

At their meeting on 21 June 2005 the Trustees of IASCF approved amendments to the organisation's Constitution, which governs the IASCF's operational arrangements. The changes are the outcome of the Constitution Review, which was initiated in November 2003.

The final amendments largely are consistent with the proposals published in November 2004 in IASCF consultation paper *Review of the Constitution – Proposals for Change*. They include:

- establishing a high-level advisory group to assist the Trustees in nominating and appointing individuals as Trustees
- expanding the number of Trustees from 19 to 22, to include representation from some large economies outside of Europe and North America
- emphasising the need for extensive consultation through formal and informal channels, beyond the current minimum due process requirements
- emphasising the IASCF's commitment to ensuring the IASB's independence, technical expertise, and diversity of perspectives and skills
- considering the special needs of small and medium-sized entities
- not introducing geographical criteria in the appointment of Board members.

The new Constitution took effect on 1 July 2005.

### **IASB Observer Notes**

KPMG has arranged to make available to our member firms' clients and contacts copies of the IASB Observer, a publication of European Research Associates Limited. The IASB Observer provides timely, detailed reporting of IASB meetings. Please talk to your usual local KPMG contact to receive this publication.

If you would like further information on any of the matters discussed in this issue of *IFRS in Brief*, please talk to your usual local KPMG contact or call any of our member firms' offices.

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