

# IFRS in Brief

October 2005, **Issue 17**

This issue of *IFRS in Brief* covers the September 2005 meeting of the International Accounting Standards Board (IASB) and the Draft Technical Correction 1 (DTC 1) Proposed Amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation*, issued on 30 September 2005.

**KPMG's monthly update on International Financial Reporting Standards (IFRSs)**

## **IASB Meeting**

At this meeting, the Board:

- reviewed its project timetable and decided to add projects on earnings per share, emission trading and fair value measurement
- decided to proceed with a limited scope project on equity instruments puttable at fair value
- decided not to proceed with a project on cross-currency convertible instruments
- discussed ongoing projects including revenue recognition, short-term convergence on income taxes, segment reporting, and consolidation.

## **Financial Instruments Puttable at Fair Value or Payable on Liquidation**

At this meeting, the Board discussed possible amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* that would result in equity classification of certain instruments puttable at the fair value of the residual interest in the issuer or payable on liquidation, including interests in partnerships and shares of limited-life entities.

The Board decided to continue work on developing an exception from liability classification for some of the instruments discussed, on the basis that they must be the most subordinated class of instruments of the issuer. The Board decided that this scope would exclude puttable minority interests, as they are not equity of the parent entity.

## **Revenue Recognition – Joint Project with the U.S. Financial Accounting Standards Board (FASB)**

At this meeting, the Board continued exploring a revenue recognition method that would:

- recognise revenue based on changes in assets and liabilities that are created by contracts with customers
- measure liabilities based on consideration paid or payable by the customers, rather than the amount that the entity would pay to transfer them to another entity.

The Board tentatively agreed to the following principles relating to this approach:

- Revenue would be recognised when each performance obligation is fulfilled.
- Separate performance obligations in revenue contracts would be identified based on their utility to a customer.
- A component of a contract has utility to a customer if it is sold separately by a vendor or it could be resold by the customer, or if it embodies an unconditional stand-ready performance obligation (e.g., a warranty or financial guarantee).
- Each performance obligation generally would be measured using a customer-based value, defined as the amount at which a component is or is capable of being sold.
- Fair value, rather than customer-based value, would be used to measure unconditional stand-ready obligations and liabilities that are required to be measured at fair value by another standard.

The Board asked the staff to explore the possibility of measuring performance obligations at fair value, rather than customer-based value, when there is an active market for these obligations.

#### **Cross-currency Convertible Instruments**

At this meeting, the Board decided not to pursue a limited amendment to IAS 32. The Board discussed a possible amendment that would have allowed obligations (written call options) to deliver a fixed amount of entity's own equity in exchange for a fixed amount of foreign currency to be classified as equity. The Board voted against proposing this amendment, and reaffirmed its view that such written call options should be classified as liabilities.

#### **Income Taxes – Short-term Convergence with U.S. GAAP**

At this meeting, the Board discussed the issues of uncertain tax positions and special deductions, working within the framework of its current exposure draft of amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Board tentatively decided that no probability recognition threshold would be applied to tax deductions, and that any uncertainty over filed tax positions should give rise to a stand-ready liability to pay additional tax, which would be measured at the expected value. This approach diverges from the draft U.S. FASB Staff Position on uncertain tax positions. The Boards plan to discuss this issue at their joint meeting in October 2005.

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

The Board discussed a number of issues relating to the pre-ballot version of the exposure draft on segment reporting. The IASB will propose replacing IAS 14 *Segment Reporting* with a standard based on the U.S. standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*. The Board decided that the scope of the proposed standard would include publicly-traded companies and fiduciary entities such as banks and insurance companies. The exposure draft is expected to be issued in the fourth quarter of 2005.

#### **Earnings per Share (EPS)**

The Board discussed a FASB Exposure Draft (ED) on earnings per share that is expected to be published in October 2005. The Board noted that certain proposed requirements in the proposed standard would diverge from IAS 33 *Earnings per Share*, particularly with respect to the treatment of convertible debt in calculating diluted EPS. The Board

plans to debate the proposals in the ED during the ED's comment period and then decide whether to propose them as amendments of IAS 33.

#### **Fair Value Measurements**

The Board decided to move forward with developing guidance on how to measure fair value. The Board decided to publish the final FASB standard on fair value measurements, which is expected to be issued in the fourth quarter of 2005, as an IFRS Exposure Draft, and identify any areas where IASB's views differ. After reviewing constituents' comments, the Board will decide whether to make any changes to the standard and will develop implementation guidance prior to publishing the final guidance. The document would focus on how, rather than when, to apply fair value measurement.

#### **Consolidation (including Special Purpose Entities)**

The Board discussed issues regarding potential voting rights in determining whether one entity controls another. The Board concluded that attribution of profits and losses should be based on present ownership interests, even if control is assessed based on potential voting rights. The Board also considered a difference in the timing of recognition of assets when options are held over the asset compared to when options are held over an entity that controls an asset. The Board plans to continue discussions in its future meetings.

#### **Emission Trading**

The Board decided to add to its active agenda a project on emission rights. The Board expects to address emission rights issues through amendments to existing standards rather than a new standard or interpretation. The Board decided first to develop a new version of IAS 20 *Accounting for Government Grants*

*and Disclosure of Government Assistance.* During the exposure period of the revised IAS 20, the Board plans to work on issues specific to emission trading schemes that would not have been addressed already in the revised IAS 20.

#### Other

The Board held an educational session with the International Valuation Standards Committee. The Board also continued its discussions of the following projects:

- the conceptual framework
- whether to require reporting of disaggregated information about changes in the fair values of financial instruments.

#### **Draft Technical Correction to IAS 21 *The Effects of Changes in Foreign Exchange Rates***

On 30 September 2005, the IASB published DTC 1 Proposed Amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation* (DTC).

The DTC clarifies that if a reporting entity *or any of its subsidiaries* has a receivable from or payable to a foreign operation that is not expected to be settled in the foreseeable future, then that monetary item is part of the reporting entity's net investment in that foreign operation. This also would apply to a receivable from an associate that is a foreign operation. However, a payable to an associate must not form part of the net investment in a foreign operation.

IAS 21 requires exchange differences arising on a monetary item that is part of net investment in a foreign operation to be recognised initially in a separate component of equity in the consolidated financial statements of the group, if that monetary item is denominated in the functional currency of either the reporting entity or the foreign operation. The DTC proposes to amend IAS 21 so that the monetary items considered to be part of the net investment in a foreign operation can be denominated in any currency. Exchange differences will continue to be classified in profit or

loss in the separate financial statements of the reporting entity.

If the DTC is adopted, then the amendments will be applied retrospectively with immediate effect. The IASB has requested comments on the proposed technical corrections by 31 October 2005.

#### **IASB Observer Notes**

IFRG has arranged to make available to KPMG 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.

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