Exposure Draft

ED 165
August 2008

Improvements to Australian Accounting Standards

Prepared by the
Australian Accounting Standards Board

Australian Government
Australian Accounting Standards Board

Commenting on this Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 20 October 2008. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 7 November 2008. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Sent electronically through the 'Open for Comment' page on the IASB website (www.iasb.org)

A copy of all non-confidential submissions to the AASB will be placed on public record on the AASB website: www.aasb.gov.au and forwarded to the IASB.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this Exposure Draft are available by contacting:

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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards to be applied by:

(a) entities required by the *Corporations Act 2001* to prepare financial reports;

(b) all reporting entities engaged in the for-profit, not-for-profit or public sectors; and

(c) any other entity that prepares general purpose financial reports.

Australian Accounting Standards incorporate International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of the Standard in the Australian environment.

Australian Accounting Standards also include requirements that are specific to Australian entities. In most instances, these requirements are either restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues. In developing requirements for public sector entities, the AASB will consider the requirements of International Public Sector Accounting Standards (IPSAS), as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants.

Exposure Drafts

The use of an Exposure Draft (ED) is an essential piece of the due process that the AASB follows before making a new or amending an existing Australian Accounting Standard. The ED is designed to seek public comment on the AASB's proposals for a new Australian Accounting Standard or amendments to an existing Australian Accounting Standard.

Reasons for Issuing this Exposure Draft

The purpose of this ED is to invite comments from Australian constituents on the IASB's proposed amendments to IFRSs as part of its annual improvements project for 2008. The objective of the IASB's annual improvements project is to provide a streamlined process for dealing with a collection of miscellaneous, non-urgent but necessary minor amendments to IFRSs.

This proposed standard is contained in the Exposure Draft of Proposed *Improvements to IFRSs* that was issued by the IASB in August 2008. If these proposals are approved by the IASB, and subsequently by the AASB, they are expected to be applicable from the time the IASB amendments become effective.

Structure of this Exposure Draft

The AASB has decided to:

(a) reproduce the IASB Exposure Draft of Proposed *Improvements to IFRSs* without amendment as part of this ED;

(b) identify the Australian Standards affected by the proposals; and

(c) seek constituents' views on the proposals.

Main Features of this Exposure Draft

The IFRSs affected by the proposed amendments and consequential amendments to other IFRSs are listed in the introduction to the IASB's ED (see p 6).

The proposals in the ED, if adopted, would result in amendments to the following Australian Accounting Standards:

	Subject of the proposed amendment
AASB 2 *Share-based Payment*	Scope of AASB 2 and revised AASB 3
AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*	Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations
AASB 8 *Operating Segments*	Disclosure of information about segment assets
AASB 107 *Statement of Cash Flows*	Classification of expenditures on unrecognised assets
AASB 118 *Revenue*	Determining whether an entity is acting as a principal or as an agent
AASB 136 *Impairment of Assets*	Unit of accounting for goodwill impairment test
AASB 138 *Intangible Assets*	Additional consequential amendments arising from the revised AASB 3.
	Measuring the fair value of an intangible asset acquired in a business combination
AASB 139 *Financial Instruments: Recognition and Measurement*	Scope exemption of business combination contracts
	Application of the fair value option
	Cash flow hedge accounting
	Bifurcation of an embedded foreign currency derivative

The IASB proposes to include guidance in the Appendix to IAS 18 *Revenue* on determining whether an entity is acting as a principal or as an agent. The AASB is interested to learn whether the proposed guidance would be likely to have an impact on accounting for revenue by not-for-profit entities, particularly those in the public sector, and whether the proposed guidance might also be useful in the context of the Board's project on non-exchange revenue.

Application Date

It is proposed that two of the amendments in this Standard be applicable to annual reporting periods beginning on or after 1 July 2009 and that the remaining amendments be applicable to annual reporting periods beginning on or after 1 January 2010, with early adoption permitted.

Request for Comments

Comments are invited on any of the proposals in the ED, including the questions on the proposals as listed in the Invitation to Comment sections of the IASB ED.

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 20 October 2008. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 7 November 2008. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Specific Matters for Comment

In addition to responses to questions set out in the IASB's Exposure Draft the AASB would value comments on:

(a) whether the proposed guidance on determining whether an entity is acting as a principal or as an agent proposed to be included in AASB 118 has implications for not-for-profit entities, particularly those in the public sector, and whether it might be useful in the context of accounting for non-exchange revenue by not-for-profit entities;

(b) any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to not-for-profit entities; and

(c) whether the proposals are in the best interests of the Australian economy.

August 2008

EXPOSURE DRAFT OF PROPOSED

Improvements to IFRSs

Comments to be received by 7 November 2008

International
Accounting Standards
Board®

IMPROVEMENTS TO IFRSs

(Proposed amendments to International Financial Reporting Standards)

Comments to be received by 7 November 2008

Improvements to IFRSs (an exposure draft of proposed amendments to International Financial Reporting Standards) is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IFRSs. Comments on the exposure draft and the Basis for Conclusions should be submitted in writing so as to be received by **7 November 2008**. Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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International
Accounting Standards
Board®

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Improvements to IFRSs

Introduction

The International Accounting Standards Board has published this exposure draft of proposed amendments to International Financial Reporting Standards (IFRSs) as part of its annual improvements project.

The project provides a streamlined process for dealing efficiently with a collection of non-urgent but necessary amendments to IFRSs.

Structure of exposure draft

The exposure draft includes a chapter for each IFRS for which an amendment is proposed. Each chapter includes:

(a) an explanation of the proposed amendment;

(b) when necessary, any specific additional question unique to that proposed amendment;

(c) the paragraphs of the IFRS or implementation guidance that are affected by the proposed amendment;

(d) the proposed effective date of each proposed amendment; and

(e) the basis for the Board's conclusions in proposing the amendment.

Some proposed amendments involve consequential amendments to other IFRSs. Those consequential amendments are included in the chapter for the IFRS that sets out the proposed amendment.

Invitation to comment

The Board invites comments on the proposed amendments. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

(a) answer the question as stated;

(b) indicate the specific paragraph or paragraphs to which they relate;

(c) contain a clear rationale;

(d) describe any alternative the Board should consider.

Respondents need not comment on all of the questions. The Board is not requesting comments on matters in the IFRSs not addressed in the exposure draft.

The Board will consider all comments received in writing by 7 November 2008. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

General questions (applicable to all proposed amendments)

Question 1

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

Question 2

Do you agree with the proposed transition provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

Specific question

Question 3

The Board proposes to include in the Appendix of IAS 18 *Revenue* guidance on determining whether an entity is acting as a principal or as an agent. What indicators, if any, other than those considered by the Board should be included in the guidance proposed?

IFRSs addressed

The following table shows the topics addressed by these proposed amendments.

IFRS	**Subject of amendment**
IFRS 2 *Share-based Payment*	Scope of IFRS 2 and revised IFRS 3
IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*	Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations
IFRS 8 *Operating Segments*	Disclosure of information about segment assets
IAS 7 *Statement of Cash Flows*	Classification of expenditures on unrecognised assets
IAS 18 *Revenue*	Determining whether an entity is acting as a principal or as an agent
IAS 36 *Impairment of Assets*	Unit of accounting for goodwill impairment test
IAS 38 *Intangible Assets*	Additional consequential amendments arising from revised IFRS 3
	Measuring the fair value of an intangible asset acquired in a business combination
IAS 39 *Financial Instruments: Recognition and Measurement*	Scope exemption for business combination contracts
	Application of the fair value option
	Cash flow hedge accounting
	Bifurcation of an embedded foreign currency derivative

Approval by the Board of *Improvements to IFRSs* (proposed amendments to International Financial Reporting Standards)

Improvements to IFRSs (proposed amendments to eight International Financial Reporting Standards) was approved for publication by the thirteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

Proposed amendment to International Financial Reporting Standard 2 *Share-based Payment*

Introduction

The Board proposes the following amendment to IFRS 2 *Share-based Payment*.

Scope of IFRS 2 and revised IFRS 3

The Board proposes to amend paragraph 5 of IFRS 2 to confirm that the contribution of a business on formation of a joint venture and common control transactions are not within the scope of IFRS 2 even though they do not meet the definition of a business combination in IFRS 3 *Business Combinations* (as revised in 2008).

Proposed amendment to IFRS 2 *Share-based Payment*

Paragraphs 5 and 61 are amended (new text is underlined and deleted text is struck through).

Scope

5 As noted in paragraph 2, this IFRS ... However, an entity shall not apply this IFRS to transactions in which the entity acquires goods as part of the net assets acquired in a business combination ~~to which~~ as defined by IFRS 3 *Business Combinations* (as revised in 2008) ~~applies~~, in a combination of entities or businesses under common control as described in paragraphs B1–B4 of IFRS 3, or the contribution of a business on the formation of a joint venture as defined by IAS 31 *Interests in Joint Ventures*. Hence, equity instruments issued ... (and therefore within the scope of this IFRS).

Effective date

61 IFRS 3 (as revised in 2008) and *Improvements to IFRSs* issued in [date] amended paragraph 5. An entity shall apply those ~~that~~ amendments for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

Basis for Conclusions on proposed amendment to IFRS 2 *Share-based Payment*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Scope of IFRS 2 and revised IFRS 3

BC1 IFRS 3 *Business Combinations* (as revised in 2008) changed the definition of a business combination. The previous definition of a business combination was 'the bringing together of separate entities or businesses into one reporting entity'. The revised definition of a business combination is 'a transaction or other event in which an acquirer obtains control of one or more businesses'.

BC2 The Board was advised that the changes to that definition caused the accounting for the contribution of a business in exchange for shares issued on formation of a joint venture by the venturers to be within the scope of IFRS 2 *Share-based Payment*. The Board noted that common control transactions may also be within the scope of IFRS 2 depending on which level of the group reporting entity is assessing the combination.

BC3 The Board noted that during the development of revised IFRS 3 it did not discuss whether it intended IFRS 2 to apply to these types of transactions. The Board also noted that the reason for excluding common control transactions and the accounting by a joint venture upon its formation from the scope of revised IFRS 3 was to give the Board more time to consider the relevant accounting issues. When the Board issued revised IFRS 3, it did not intend to change existing practice by bringing such transactions within the scope of IFRS 2, which does not specifically address them.

BC4 Accordingly, the Board proposes to amend paragraph 5 of IFRS 2 to confirm that the contribution of a business on the formation of a joint venture and common control transactions are not within the scope of IFRS 2.

Proposed amendment to International Financial Reporting Standard 5 *Non-current Assets Held for Sale and Discontinued Operations*

Introduction

The Board proposes the following amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations

The Board proposes to amend IFRS 5 to clarify that IFRS 5 specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures in other IFRSs do not apply to such assets (or disposal groups) unless those IFRSs specifically require disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations.

Proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Paragraphs 5A and 44D are added.

Scope

5A This IFRS specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures in other IFRSs do not apply to such assets (or disposal groups) unless those IFRSs specifically require disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Additional disclosures about such assets (or disposal groups) may be necessary to comply with the general requirements of IAS 1.

Effective date

44D Paragraph 5A was added by *Improvements to IFRSs* issued in [date]. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted.

Basis for Conclusions on proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations

BC1 The Board identified a need to clarify the disclosure requirements for non-current assets (or disposal groups) classified as held for sale or discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Some believe that IFRS 5 and other IFRSs that specifically refer to non-current assets (or disposal groups) classified as held for sale or discontinued operations set out all the disclosures required in respect of those assets or operations. Others believe that all disclosures required by IFRSs whose scope does not specifically exclude non-current assets (or disposal groups) classified as held for sale or discontinued operations apply to such assets (or disposal groups).

BC2 The Board noted that paragraph 30 of IFRS 5 requires an entity to 'present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).' Paragraph BC17 of the Basis for Conclusions on IFRS 5 states that 'the Board concluded that providing information about assets and groups of assets and liabilities to be disposed of is of benefit to users of financial statements. Such information should assist users in assessing the timing, amount and uncertainty of future cash flows.'

BC3 The Board noted that some IFRSs other than IFRS 5 require specific disclosures for non-current assets (or disposal groups) classified as held for sale or discontinued operations. For instance, paragraph 68 of IAS 33 *Earnings per Share* requires an entity to disclose the amount per share for discontinued operations. The Board also noted that the requirements of IAS 1 *Presentation of Financial Statements* on fair presentation and materiality also apply to such assets (or disposal groups).

BC4 The Board also noted that when a disposal group includes assets and liabilities that are not within the scope of the measurement requirements of IFRS 5, disclosures about measurement of those assets and liabilities are normally provided in the other notes to the financial statements and do not need to be repeated, unless they better enable users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

BC5 The Board decided to clarify that IFRS 5 and other IFRSs that specifically refer to non-current assets (or disposal groups) classified as held for sale or discontinued operations set out all the disclosures required in respect of those assets or operations. Additional disclosures about such assets (or disposal groups) may be necessary to comply with the general requirements of IAS 1.

Proposed amendment to Basis for Conclusions on International Financial Reporting Standard 8 *Operating Segments*

Introduction

The Board proposes the following amendment to the Basis for Conclusions on IFRS 8 *Operating Segments*.

Disclosure of information about segment assets

The Board decided to amend the Basis for Conclusions accompanying IFRS 8 to clarify its view on the disclosure of segment assets. Paragraph BC35 sets out the reasons for the Board's decision to require a measure of segment profit or loss and segment assets to be disclosed regardless of whether those measures are reviewed by the chief operating decision maker. Some have read this paragraph as contradicting long-standing interpretations of SFAS 131 *Disclosures about Segments of an Enterprise and Related Information* published in the US and hence creating an unintended difference from US practice under SFAS 131.

Proposed amendment to Basis for Conclusions on IFRS 8 *Operating Segments*

In the Basis for Conclusions on IFRS 8, paragraph BC35 is amended (new text is underlined and deleted text is struck through) and a footnote is added at the end of paragraph BC35. Paragraph BC34 is not proposed for amendment but is included here for ease of reference.

Aspects of the management approach

Information about segment assets

BC34 Several respondents noted that, whilst a measure of segment profit or loss can be expected in every entity's internal reporting, a measure of segment assets is not always available, particularly in service industries or other industries with low utilisation of physical assets. Respondents suggested that in such circumstances a measure of segment assets should be disclosed only if those amounts were regularly provided to the chief operating decision maker.

BC35 ~~The Board noted that requiring disclosure of a measure of segment assets only when such a measure is reviewed by the chief operating decision maker would create divergence from SFAS 131. The Board also supported a minimum disclosure of segment profit or loss and segment assets. The Board therefore concluded that measures of segment profit or loss and total segment assets should be disclosed for all segments regardless of whether those measures are reviewed by the chief operating decision maker.~~ <u>The Board noted that paragraph 25 specifies how a segment amount that is required to be disclosed by paragraph 23 should be measured. Paragraph 25 states that 'only those assets and liabilities that are included in the measure of the segment's assets and segment's liabilities that are used by the chief operating decision maker shall be reported for that segment.' The measure for total segment assets would be nil when such information is not provided to the chief operating decision maker. Therefore, making no disclosure of segment assets would be in accordance with the IFRS in some cases. The Board also noted that the usefulness of segment asset disclosures in those situations would not be sufficient to justify the additional resources needed to track assets by segment for reporting purposes only.*</u>

* After IFRS 8 was issued the Board was informed that the reasons originally set out in paragraph BC35 contradict long-standing

interpretations published in the US for the application of SFAS 131 and create an unintended difference from practice in the US under SFAS 131. After reconsideration and discussion of the interaction between the disclosure and measurement requirements in the IFRS (paragraphs 23 and 25), the Board concluded that those reasons no longer reflected the Board's thinking. The Board therefore amended paragraph BC35 by *Improvements to IFRSs* issued in [date]. That conclusion is consistent with the wording of the IFRS and therefore no changes were made to the IFRS.

Basis for Conclusions on proposed amendment to Basis for Conclusions on IFRS 8 *Operating Segments*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Disclosures of information about segment assets

BC1 The Basis for Conclusions on IFRS 8 *Operating Segments* (paragraph BC35) sets out the reasons for the Board's decision to require a measure of segment profit or loss and segment assets to be disclosed regardless of whether those measures are reviewed by the chief operating decision maker. When the Board made this decision, it thought that this requirement would converge with US GAAP. However, after IFRS 8 was issued, the Board was made aware that such a requirement contradicts long-standing interpretations published in the US for the application of SFAS 131 and creates an unintended difference from practice in the US under SFAS 131.

BC2 The Board reconsidered the reasons set out in paragraph BC35, and discussed the interaction between the disclosure and measurement requirements in the IFRS (paragraphs 23 and 25). In some industries with a low base of physical assets, a measure of segment assets is not always available or expected. The Board noted that there could be cases when making no disclosure of segment assets would be in accordance with the IFRS. In addition, the Board concluded that the usefulness of segment asset disclosures for those industries would not be sufficient to justify the additional resources needed to track assets by segment solely for reporting purposes.

BC3 The Board noted that the conclusions in paragraph BC2 above are consistent with the wording of the IFRS and therefore decided that no changes should be made to the IFRS. It further noted that paragraph BC35 as originally drafted no longer reflected the Board's thinking. Therefore, the Board decided to amend paragraph BC35.

Proposed amendment to International Accounting Standard 7 *Statement of Cash Flows*

Introduction

The Board proposes the following amendment to IAS 7 *Statement of Cash Flows*.

Classification of expenditures on unrecognised assets

In 2008 the International Financial Reporting Interpretations Committee (IFRIC) reported to the Board that practices differ for the classification of cash flows for expenditures incurred with the objective of generating future cash flows when those expenditures are not recognised as assets in accordance with IFRSs. Some entities classify such expenditures as cash flows from operating activities and others classify them as investing activities.

The Board proposes to amend IAS 7 to state explicitly that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activities.

Proposed amendment to IAS 7 *Statement of Cash Flows*

Paragraph 16 is amended (new text is underlined and deleted text is struck through) and paragraph 56 is added. Paragraph 6 is not proposed for amendment but is included here for ease of reference.

Definitions

6 **The following terms are used in this Standard with the meanings specified:**

...

Operating activities **are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.**

Investing activities **are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.**

Financing activities **are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.**

Presentation of a statement of cash flows

Investing activities

16 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources ~~intended to generate future income and cash flows~~ <u>that are initially recognised as assets in the statement of financial position</u>. Examples of cash flows arising from investing activities are:

(a) ...

Effective date

56 Paragraph 16 was amended by *Improvements to IFRSs* issued in [date]. An entity shall apply that amendment for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

Appendix to proposed amendment to IAS 7
Proposed amendment to Basis for Conclusions on IFRS 6 *Exploration for and Evaluation of Mineral Resources*

In the Basis for Conclusions on IFRS 6, paragraphs BC23A and BC23B are added. Paragraph BC23 is not proposed for amendment but is included here for ease of reference.

Temporary exemption from IAS 8 paragraphs 11 and 12

BC23 The Board acknowledges that it is difficult to make piecemeal changes to recognition and measurement practices at this time because many aspects of accounting for extractive activities are interrelated with aspects that will not be considered until the Board completes its comprehensive review of accounting for extractive activities. However, not imposing the requirements in the IFRS would detract from the relevance and reliability of an entity's financial statements to an unacceptable degree.

BC23A In 2008, as part of its annual improvements project, the Board considered the guidance on the treatment in IAS 7 *Statement of Cash Flows* of some types of expenditures incurred with the objective of generating future cash flows when those expenditures are not recognised as assets under IFRSs. Some entities classify such expenditures as cash flows from operating activities and others classify them as investing activities. Examples of such expenditures are those for exploration and evaluation activities, which can be recognised according to IFRS 6 as either an asset or an expense.

BC23B The Board noted that the exemption in IFRS 6 applies only to recognition and measurement of exploration and evaluation assets, not to the classification of related expenditures in the statement of cash flows. Consequently, the Board proposed an amendment to paragraph 16 of IAS 7 to state that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activities.

Basis for Conclusions on proposed amendment to IAS 7 *Statement of Cash Flows*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Classification of expenditures on unrecognised assets

BC1 This Basis for Conclusions summarises the Board's considerations in reaching its conclusions in proposing an amendment to IAS 7 *Statement of Cash Flows* in 2008. Individual Board members gave greater weight to some factors than to others.

BC2 In 2008 the International Financial Reporting Interpretations Committee (IFRIC) reported to the Board that practices differ for the classification of cash flows for expenditures incurred with the objective of generating future cash flows when those expenditures are not recognised as assets in accordance with IFRSs. Some entities classify such expenditures as cash flows from operating activities and others classify them as investing activities. Examples of such expenditures are those for exploration and evaluation activities, which IFRS 6 *Exploration for and Evaluation of Mineral Resources* permits to be recognised as either an asset or an expense depending on the entity's previous accounting policies for those expenditures. Expenditures on advertising and promotional activities, staff training, and research and development could also raise the same issue.

BC3 The IFRIC decided not to add this issue to its agenda but recommended that the Board amend IAS 7 to state explicitly that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activity.

BC4 In 2008, as part of its annual improvements project, the IASB considered the principles in IAS 7, specifically guidance on the treatment of such expenditures in the statement of cash flows. The Board noted that even though paragraphs 14 and 16 of IAS 7 appear to be clear that only expenditure that results in the recognition of an asset should be classified as cash flows from investing activities, the wording is not definitive in this respect. Some might misinterpret the reference in paragraph 11 of IAS 7 for an entity to assess classification by activity that is most appropriate to its business to imply that the assessment is an accounting policy choice.

BC5 Consequently, the Board decided to remove the potential misinterpretation by proposing an amendment to paragraph 16 of IAS 7 to state explicitly that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activities.

BC6 The Board concluded that this proposal, if confirmed, would better align the classification of cash flows from investing activities in the statement of cash flows and the presentation of recognised assets in the statement of financial position, would reduce divergence in practice and, therefore, would result in financial statements that are easier for users to understand.

BC7 The Board also concluded that the Basis for Conclusions accompanying IFRS 6 should be amended to clarify the Board's view that the exemption in IFRS 6 applies only to recognition and measurement of exploration and evaluation assets, not to the classification of related expenditures in the statement of cash flows, for the same reasons set out above in paragraph BC6.

Proposed amendment to
Appendix of International Accounting Standard 18 *Revenue*

Introduction

The Board proposes the following amendment to the Appendix of IAS 18 *Revenue*.

Determining whether an entity is acting as a principal or as an agent

The Board proposes to amend the guidance accompanying IAS 18 to address the issue of determining whether an entity is acting as a principal or as an agent. Paragraph 8 of IAS 18 specifies the accounting for amounts collected on behalf of a principal. However, IAS 18 does not provide guidance on determining whether an entity is acting as a principal or as an agent.

Proposed amendment to Appendix of IAS 18 *Revenue*

In the Appendix of IAS 18, after example 20, a heading, a footnote and example 21 are added.

Recognition and measurement

21 *Determining whether an entity is acting as a principal or as an agent (2008 amendment)**

* In 2007 the IFRIC recommended that the Board include in this Appendix guidance on determining whether an entity is acting as a principal or as an agent in accordance with IAS 18. The IFRIC noted that this issue has widespread and practical relevance. The Board noted that paragraph 8 of IAS 18 specifies the accounting for amounts collected on behalf of a principal. However, the Board acknowledged that IAS 18 does not provide guidance on determining whether an entity is acting as a principal or as an agent. Example 21 was added by *Improvements to IFRSs* issued in [date].

Paragraph 8 states that 'in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.' Determining whether an entity is acting as a principal or as an agent depends on facts and circumstances and requires judgement. An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that, individually or in combination, indicate that an entity is acting as a principal include:

(a) the entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;

(b) the entity has inventory risk before or after the customer order, during shipping or on return;

(c) the entity has discretion in establishing prices, either directly or indirectly, for example by providing additional goods or services;

(d) the entity bears the customer's credit risk.

An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.

Basis for Conclusions on proposed amendment to Appendix of IAS 18 *Revenue*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Determining whether an entity is acting as a principal or as an agent

BC1 In 2007 the International Financial Reporting Interpretations Committee (IFRIC) received a request for guidance on determining whether an entity is acting as a principal or as an agent in accordance with IAS 18. Noting that this issue has widespread and practical relevance, the IFRIC recommended that the Board include such guidance in the Appendix of IAS 18 as a part of its annual improvements project.

BC2 The Board noted that paragraph 8 of IAS 18 specifies the accounting for amounts collected on behalf of a principal. However, the Board acknowledged that IAS 18 does not provide guidance on how to determine whether an entity is acting as a principal or as an agent.

BC3 The Board concluded that an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. The Board identified some features that, individually or in combination, indicate that this criterion is met. The Board concluded that an entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services.

Proposed amendment to International Accounting Standard 36 *Impairment of Assets*

Introduction

The Board proposes the following amendment to IAS 36 *Impairment of Assets*.

Unit of accounting for goodwill impairment

The Board proposes to amend IAS 36 to clarify whether the largest unit permitted by IAS 36 is the operating segment level as defined in paragraph 5 of IFRS 8 *Operating Segments* before or after the aggregation permitted by paragraph 12 of IFRS 8.

Proposed amendment to IAS 36 *Impairment of Assets*

Paragraph 80 is amended (new text is underlined and deleted text is struck through) and paragraph 140E is added.

Cash-generating units and goodwill

Recoverable amount and carrying amount of a cash-generating unit

Goodwill

Allocating goodwill to cash-generating units

80 **For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:**

(a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(b) not be larger than an operating segment ~~determined in accordance with~~ as defined by paragraph 5 of IFRS 8 ***Operating Segments*** **before aggregation.**

Transitional provisions and effective date

140E *Improvements to IFRSs* issued [date] amended paragraph 80(b). An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on proposed amendment to IAS 36 *Impairment of Assets*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Unit of accounting for goodwill impairment

BC1 Entities adopting IFRS 8 must reconsider the allocation of goodwill to cash-generating units because of the definition of operating segment introduced by IFRS 8. That definition affects the determination of the largest unit permitted by paragraph 80 for testing goodwill for impairment. In 2008 the Board was made aware that divergent views had developed regarding the largest unit permitted by IAS 36 for impairment testing of goodwill. One view is that the unit is the operating segment level as defined in paragraph 5 of IFRS 8 before the aggregation permitted by paragraph 12 of IFRS 8. The other view is that the unit is the operating segment level as defined in paragraph 5 of IFRS 8 after the aggregation permitted by paragraph 12 of IFRS 8.

BC2 The Board noted that the lowest level of the entity at which management monitors goodwill as required in paragraph 80(a) is the same as the lowest level of operating segments at which the chief operating decision maker regularly reviews operating results as defined in IFRS 8. The Board also noted that the linkage of the entity's goodwill monitoring level with the entity's internal reporting level is intentional, as previously described in paragraph BC140 of IAS 36.

BC3 The Board noted that aggregating operating segments for goodwill impairment testing into a unit larger than the level at which goodwill is monitored contradicts the rationale underlying IAS 36, as set out in paragraphs BC145–BC150 of IAS 36. In addition, meeting the aggregation criteria of similar economic characteristics permitted in IFRS 8 does not automatically result in groups of cash-generating units that are expected to benefit from the synergies of allocated goodwill. Similarly, the aggregated segments do not necessarily represent business operations that are economically interdependent or work in concert to recover the goodwill being assessed for impairment.

BC4 Therefore, the Board decided to propose an amendment to paragraph 80(b) to state that the required unit for goodwill impairment in this standard is not larger than the operating segment level as defined in paragraph 5 of IFRS 8 before the permitted aggregation.

Proposed amendments to International Accounting Standard 38 *Intangible Assets*

Introduction

The Board proposes the following amendments to IAS 38 *Intangible Assets*.

Additional consequential amendments arising from revised IFRS 3

The Board proposes additional amendments to paragraphs 36 and 37 of IAS 38 to clarify the effect of its decisions in IFRS 3 *Business Combinations* (as revised in 2008) on the accounting for intangible assets acquired in a business combination.

Measuring the fair value of an intangible asset acquired in a business combination

The Board also proposes to clarify the description of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

Proposed amendments to IAS 38 *Intangible Assets*

Paragraphs 36, 37, 40, 41 and 130C are amended (new text is underlined and deleted text is struck through) and paragraph 130E is added.

Recognition and measurement

Acquisition as part of a business combination

Measuring the fair value of an intangible asset acquired in a business combination

36 An intangible asset acquired in a business combination might be separable, but only together with a related contract, identifiable ~~tangible or intangible~~ asset, or liability. ~~For example, a magazine's publishing title might not be able to be sold separately from a related subscriber database, or a trademark for natural spring water might relate to a particular spring and could not be sold separately from the spring.~~ In such cases, the acquirer recognises the intangible ~~group of~~ asset~~s as a single asset~~ separately from goodwill ~~if the individual fair values of the assets in the group are not reliably measurable~~. If an intangible asset is separable only with another intangible asset, the acquirer may recognise the group of intangible assets as a single asset.

37 ~~Similarly, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.~~ The acquirer may recognise~~s~~ as a single asset a group of complementary intangible assets ~~comprising a brand if the individual fair values of the complementary assets are not reliably measurable. If the individual fair values of the complementary assets are reliably measurable, an acquirer may recognise them as a single asset~~ provided the individual assets have similar useful lives. For example, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

40 If no active market exists for an intangible asset, its fair value is the amount that the entity would have paid for the asset, at the acquisition date, in an arm's length transaction between knowledgeable and willing parties, on the basis of the best information available. In determining this amount, an entity considers the outcome of recent transactions for similar assets. For example, an entity may apply multiples reflecting current market transactions to factors that drive the profitability of the asset (such as revenue and operating profit).

41 Entities that are ~~regularly~~ involved in the purchase and sale of ~~unique~~ intangible assets may have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in a business combination if their objective is to estimate fair value and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, for example ~~when appropriate~~:

(a) ~~applying multiples reflecting current market transactions to indicators that drive the profitability of the asset (such as revenue, market shares and operating profit) or to the royalty stream that could be obtained from licensing the intangible asset to~~ estimating the hypothetical costs the entity avoids by owning the intangible asset and not needing:

   (i) to license it from another party in an arm's length transaction (as in the 'relief from royalty' approach) or

   (ii) to recreate or replace it (as in the cost approach); ~~or~~ and

(b) discounting estimated future net cash flows from the asset.

Transitional provisions and effective date

130C IFRS 3 (as revised in 2008) amended paragraphs 12, 33–35, 68, 69, 94 and 130, deleted paragraphs 38 and 129 and added paragraph 115A. *Improvements to IFRSs*, issued in [date], amended paragraphs 36 and 37. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. Therefore, amounts recognised for intangible assets and goodwill in prior business combinations shall not be adjusted. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

130E *Improvements to IFRSs*, issued in [date], amended paragraphs 40 and 41. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Basis for Conclusions on proposed amendments to IAS 38 *Intangible Assets*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Additional consequential amendments arising from revised IFRS 3

BC1 When the Board developed IFRS 3 *Business Combinations* (as revised in 2008), it decided that if an intangible asset acquired in a business combination is separable or arises from contractual or other legal rights, sufficient information exists to measure the fair value of the asset reliably. The Board made related amendments to IAS 38 to reflect that decision. However, the Board has identified additional amendments to paragraphs 36 and 37 of IAS 38 that are needed to reflect clearly its decisions on the accounting for intangible assets acquired in a business combination. Those amendments would be effective at the same time as IFRS 3.

Measuring the fair value of an intangible asset acquired in a business combination

BC2 The Board was made aware that paragraph 41 of IAS 38 could be misinterpreted in practice and could lead entities to measure fair value inappropriately. To address this, the Board decided to amend paragraphs 40 and 41 of IAS 38 to clarify the description of valuation techniques commonly used to measure intangible assets at fair value when assets are not traded in an active market. The Board also decided that the amendments should be applied prospectively because retrospective application might require some entities to remeasure fair values associated with previous transactions. The Board does not think this is appropriate because the remeasurement might involve the use of hindsight in those circumstances.

Proposed amendments to International Accounting Standard 39 *Financial Instruments: Recognition and Measurement*

Introduction

The Board proposes the following amendments to IAS 39 *Financial Instruments: Recognition and Measurement.*

Scope exemption of business combination contracts

The Board proposes to clarify that the scope exemption in paragraph 2(g) applies only to binding (forward) contracts between an acquirer and a vendor in a business combination to buy an acquiree at a future date.

Application of the fair value option

The Board proposes to clarify that the fair value option in paragraph 11A applies only to financial instruments within the scope of IAS 39 that contain embedded derivatives.

Cash flow hedge accounting

The Board proposes to clarify when gains and losses on hedging instruments should be reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1 *Presentation of Financial Statements* (as revised in 2007)) for cash flow hedges of a forecast transaction that subsequently results in the recognition of a financial instrument or for cash flow hedges of recognised financial instruments. The proposed amendments clarify that the gains or losses on the hedging instrument should be reclassified from equity to profit or loss as a reclassification adjustment in the period that the hedged forecast cash flows affect profit or loss.

Bifurcation of an embedded foreign currency derivative

The Board proposes to clarify what the 'economic environment' is in determining whether a currency is commonly used in contracts to buy or sell non-financial items and therefore is closely related to the host contract. The proposed amendment clarifies that contracts denominated in foreign currencies that have one or more of the characteristics of a functional currency (as set out in IAS 21 *The Effect of Changes in Foreign Exchange Rates*) are likely to be integral to the contractual arrangement and therefore closely related to the host contract and prohibited from being accounted for separately.

Proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement*

Paragraphs 2(g), 11A, 97 and 100 are amended (new text is underlined and deleted text is struck through) and paragraph 103H is added.

Scope

2 **This Standard shall be applied by all entities to all types of financial instruments except:**

(a) ...

(g) any forward contract~~s~~ that results from an agreement entered into before the acquisition date (ie before the date on which the acquirer obtains control of the acquiree) between an acquirer and a vendor, in a business combination, to buy or sell an acquiree at a future date and at a specified price (or on a specified price basis).

(h) ...

Embedded derivatives

11A **Notwithstanding paragraph 11, if a financial instrument ~~contract~~ within the scope of this Standard contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) financial instrument ~~contract~~ as a financial asset or financial liability at fair value through profit or loss unless:**

(a) ...

Hedging

Hedge accounting

Cash flow hedges

97 **If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognised in other comprehensive income in accordance with paragraph 95 shall be reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1 (as revised in 2007)) in the**

same period or periods during which the <u>hedged forecast cash flows</u> ~~asset acquired or liability assumed~~ affects profit or loss (such as in the periods that interest income or interest expense is recognised). However, if an entity expects that all or a portion of a loss recognised in other comprehensive income will not be recovered in one or more future periods, it shall reclassify into profit or loss <u>as a reclassification adjustment</u> the amount that is not expected to be recovered.

100 For cash flow hedges other than those covered by paragraphs 97 and 98, amounts that had been recognised in other comprehensive income shall be reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1 (revised 2007)) in the same period or periods during which the hedged forecast <u>cash flows</u> ~~transaction~~ affects profit or loss (for example, when a forecast sale occurs).

Effective date and transition

103H *Improvements to IFRSs* issued in [date] amended paragraphs 2(g), 11A, 97, 100 and AG33(d). An entity shall apply those amendments prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

In Appendix A *Application guidance*, paragraph AG33(d) is amended (new text is underlined and deleted text is struck through).

Embedded derivatives (paragraphs 10–13)

AG33 The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

...

(d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument ~~(such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency)~~ <u>is integral to the arrangement and hence</u> ~~is~~ closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

(i) the functional currency of any substantial party to that contract;

(ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or

(iii) a currency that has one or more of the characteristics of a functional currency, as set out in paragraph 9 of IAS 21, of a substantial party to the contract ~~is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade)~~.

Proposed amendment to guidance on implementing IAS 39 *Financial Instruments: Recognition and Measurement*

The answer to Question F.6.2 is amended (new text is underlined and deleted text is struck through).

F.6.2 Hedge accounting considerations when interest rate risk is managed on a net basis

Issue (j) – For cash flow hedges, if a derivative is used to manage a net exposure to interest rate risk and the derivative is designated as a cash flow hedge of forecast interest cash flows or portions of them on a gross basis, does the occurrence of the hedged forecast transaction give rise to an asset or liability that will result in a portion of the hedging gains and losses that were recognised in other comprehensive income remaining in equity?

No. In the hedging relationship described in Issue (c) above, the hedged item is a group of forecast transactions consisting of interest cash flows in specified future periods. The hedged forecast transactions do not result in the recognition of assets or liabilities and the effect of interest rate changes that are designated as being hedged is recognised in profit or loss in the period in which the forecast transactions occur. Although this is not relevant for the types of hedges described here, if instead the derivative is designated as a hedge of a forecast purchase of a financial asset or issue of a financial liability, the associated gains or losses that were recognised in other comprehensive income are reclassified from equity to profit or loss in the same period or periods during which the ~~asset acquired or liability incurred~~ <u>hedged forecast cash flows</u> affect~~s~~ profit or loss (such as in the periods that interest expenses are recognised). However, if an entity expects at any time that all or a portion of a net loss recognised in other comprehensive income will not be recovered in one or more future periods, it shall reclassify immediately from equity to profit or loss the amount that is not expected to be recovered.

Basis for Conclusions on proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Scope exemption of business combination contracts

BC1 The Board was advised that there was diversity in practice regarding the application of the exemption in paragraph 2(g) of IAS 39. Paragraph 2(g) applies to particular contracts arising from a business combination and results in those contracts not being accounted for as derivatives while, for example, necessary regulatory and legal processes are being completed.

BC2 Business combinations can be structured either as an acquisition of the net assets of an entity or as a purchase of controlling equity interests in the acquiree. The purpose of paragraph 2(g) is to ensure that the structure of an acquisition does not result in different accounting for the acquisition.

BC3 The Board decided that paragraph 2(g) should be restricted to forward financial instrument contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date and should not apply to currently exercisable option contracts that on exercise will result in control over an entity. This is because such option contracts are excluded from the scope of IAS 39 by paragraph 2(a).

BC4 IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) states that non-currently exercisable potential voting rights are not considered in determining control. As such, non-currently exercisable option contracts would not meet the definition of a business combination in IFRS 3.

BC5 Paragraph 2(g) refers specifically to contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date. Hence, the Board decided that the exemption in paragraph 2(g) should also not be applied to non-currently exercisable option contracts.

BC6 The concern that the structure of a business combination transaction may result in different accounting treatments without the exemption in paragraph 2(g) does not arise in the case of investments in associates because an investment in an associate does not represent an acquisition of the constituent assets of the investee. Hence, the Board concluded that paragraph 2(g) should not be applied by analogy to investments in associates and similar transactions.

Application of the fair value option

BC7 The Board was advised that there was diversity in practice regarding the application of the paragraph 11A of IAS 39, in particular whether the fair value option available in paragraph 11A can be applied to all contractual arrangements with embedded derivatives including those that contain host contracts outside the scope of IAS 39. The Board acknowledged that the wording of paragraph 11A was not clear.

BC8 During the development of the fair value option, the Board discussed the fair value option only in the context of financial instruments within the scope of IAS 39. Until *The Fair Value Option* was issued in June 2005 the option was restricted to financial assets and financial liabilities within the scope of the Standard. In amending the option, the Board did not intend to expand the class of assets and liabilities to which the option could be applied. The objective was to restrict an entity's ability to designate financial instruments as at fair value through profit or loss compared with the previously unrestricted version and not to widen the scope of the option to contracts not within the scope of IAS 39.

BC9 Accordingly, the Board decided to eliminate the diversity in practice by specifying that the fair value option in paragraph 11A applies only to financial instruments with embedded derivatives within the scope of IAS 39 (as was originally intended by the Board).

Cash flow hedge accounting

BC10 If a hedged forecast transaction results in the recognition of a financial asset or a financial liability, paragraph 97 of IAS 39 requires the associated gains or losses on hedging instruments to be reclassified from equity to profit or loss as a reclassification adjustment in the same period or periods during which the hedged item affects profit or loss (such as in the periods that interest income or interest expense is recognised).

BC11 The Board was informed that there was uncertainty about how paragraph 97 should be applied when the designated cash flow exposure being hedged differs from the financial instrument arising from the hedged forecast cash flows.

BC12 The example below illustrates the issue:

An entity applies the guidance in the answer to Question F.6.3 of the guidance on implementing IAS 39. On 1 January 20X0 the entity designates forecast cash flows for the risk of variability arising from changes in interest rates. Those forecast cash flows arise from the repricing of existing financial instruments and are scheduled for 1 April 20X0. The entity is exposed to variability in cash flows for the three-month period beginning on 1 April 20X0 due to changes in interest rate risk that occur from 1 January 20X0 to 31 March 20X0.

The occurrence of the forecast cash flows is deemed to be highly probable and all the other relevant hedge accounting criteria are met.

The financial instrument that results from the hedged forecast cash flows is a five-year interest-bearing instrument.

BC13 Paragraph 97 requires the gains or losses on the hedging instrument to be reclassified from equity to profit or loss as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affects profit or loss. The financial instrument that was recognised is a five-year instrument that will affect profit or loss for five years. The wording in paragraph 97 suggests that the gains or losses should be reclassified over five years, even though the cash flows designated as the hedged item were hedged for the effects of interest rate changes over only a three-month period.

BC14 The Board believes that the wording of paragraph 97 does not reflect the underlying rationale in hedge accounting, ie that the gains or losses on the hedging instrument should offset the gains or losses on the hedged item, and the offset should be reflected in profit or loss by way of reclassification adjustments.

BC15 The Board believes that in the example set out above the gains or losses should be reclassified over a period of three months beginning on 1 April 20X0, and not over a period of five years beginning on 1 April 20X0.

BC16 The Board decided to amend paragraph 97 of IAS 39 to clarify that the gains or losses on the hedged instrument should be reclassified from equity to profit or loss during the period that the hedged forecast cash flows affect profit or loss. The Board also decided that to avoid similar confusion paragraph 100 of IAS 39 should be amended to be consistent with paragraph 97.

Bifurcation of an embedded foreign currency derivative

BC17 The Board was advised that there was diversity in practice regarding the application of paragraph AG33(d), in particular what the ‘economic environment’ is in determining whether a currency is commonly used in contracts to buy or sell non-financial items.

BC18 Paragraph AG33(d) is intended to prohibit the separation of embedded foreign currency derivatives if they are integral to the contractual arrangement, ie they have been entered into for reasons that are clearly not based on achieving a desired accounting result or for speculative purposes.

BC19 The Board believes that contracts denominated in the following foreign currencies are likely to be integral to the contractual arrangement:

(a) the functional currency of any substantial party to that contract

(b) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions)

(c) a local currency of any substantial party to that contract

(d) a liquid international currency used by parties domiciled in small countries, as a convenient means of exchange

(e) a hard currency used by an entity operating in a hyperinflationary economy to protect against inflation

(f) a foreign currency commonly used in local business transactions—for example, when monetary amounts are viewed by the general population not in terms of the local currency but in terms of another related currency.

BC20 The Board noted that these currencies have one or more of the characteristics of a functional currency as set out in paragraph 9 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

BC21 Accordingly, the Board decided to amend paragraph AG33(d) to refer to the characteristics of a functional currency.